RESEARCH

Knight Frank

LOGISTICS & INDUSTRIAL

OCCUPIER & INVESTMENT MARKET COMMENTARY **H2 2017**

Economic overview

The UK economy grew by 0.5% in Q4, marking the strongest quarterly growth in 2017. This brought annual growth to 1.8% in 2017, which was marginally lower than the 1.9% GDP growth seen in 2016. (Figure 1).

The boost to the economy at the end of the year was driven by the dominant service sector and increased production output – particularly from strong growth in manufacturing. Consumer focused services, however, showed slower growth, as did construction.

The manufacturing sector has benefited from strong global growth and a weaker pound since the Brexit vote in 2016, which has helped boost exports and UK manufacturing. However, despite stronger than expected growth in the final quarter of 2017, there remains uncertainty in the wider economy and the underlying picture is one of slower and uneven economic growth in 2018.

Occupier market

During the second half of 2017, a total of 10.8m sq ft of logistic and industrial units above 50,000 sq ft was acquired for occupation. This brings annual take-up for 2017 to 27.3m, which is 28% below the level of take-up seen in 2016 (Figure 2).

The occupational market continues to benefit from the structural shift towards e-commerce and on-line retailing, which now accounts for 18% of all retail sales in the UK (Figure 3).

However, the more recent acceleration in manufacturing output growth is supporting traditional occupiers and this is reflected in the changing mix of occupiers taking space. In West Yorkshire, for example, occupier demand has derived mainly from the traditional manufacturing and distribution sectors, with little activity in the second half of 2017 from the online retail sector.

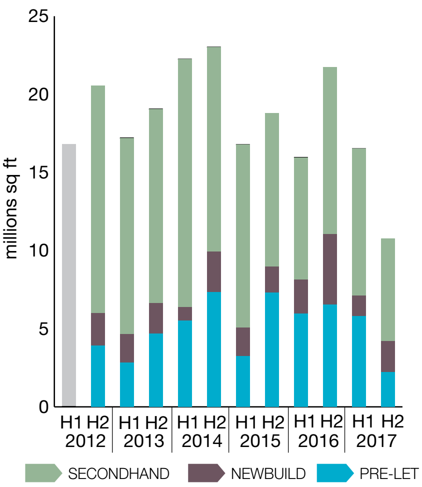
At regional level, the Midlands continues to dominate the market, with 42% of total take-up coming from this area, followed by London and the South East, which accounted for a further 19% of total take-up during H2 2017.

Lack of supply is limiting take-up. In the Big Shed market new build supply of units above 100,000 sq ft stood at 10.5m sq ft at the end of December 2017 compared with a peak of 28m in Q1 2008. (Figure 4). Developers are responding to the shortfall with a new wave of speculative development. However, there is a shortage in the sub 100,000 sq ft band in the Midlands and in London conurbations the pressure on land suitable for industrial development continues to increase as the need to build more homes grows.

The outlook for 2018 in the context of slower uneven economic growth is mitigated by supply shortages. Longer term occupier requirements will be driven by the increasing shift to automation with artificial intelligence and the need for sites / buildings that can accommodate higher power requirements and autonomous vehicles.

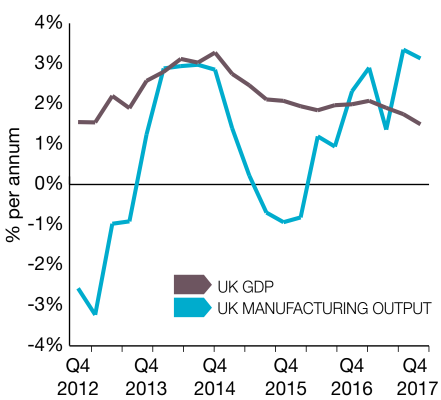
For more detailed commentary on the occupier markets, please refer to our regional LOGIC reports.

FIGURE 2
UK Logistics take-up
(50,000 sq ft plus)



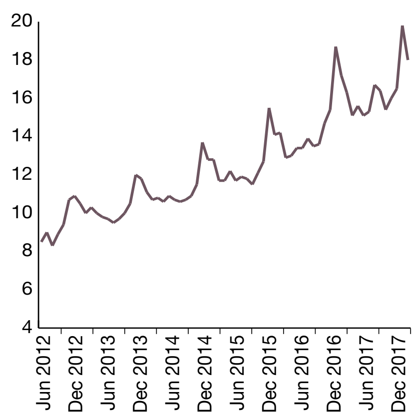
Source: Knight Frank Research

FIGURE 1
UK GDP and manufacturing output
[c.o.p. 1 year]



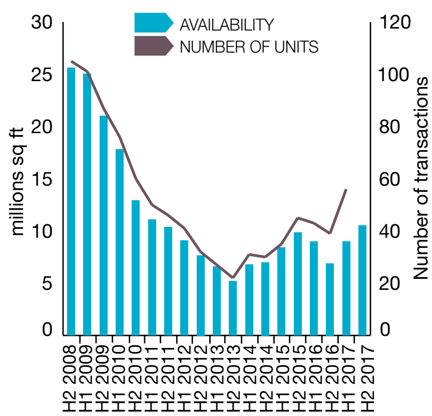
Source: ONS

FIGURE 3
Internet sales as a percentage of total retail sales (%)



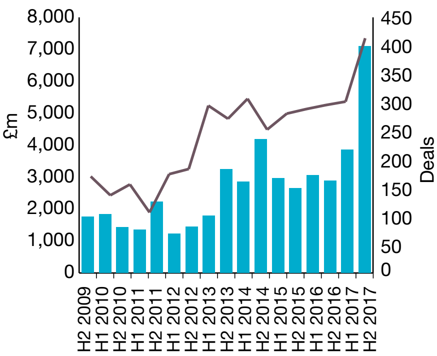
Source: ONS

FIGURE 4
New sheds available
(100,000 sq ft plus)



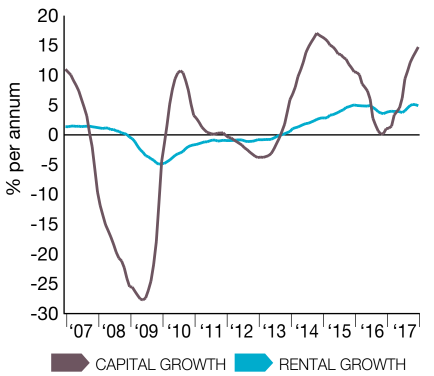
Source: Knight Frank Research

FIGURE 5
Industrial investment transactions



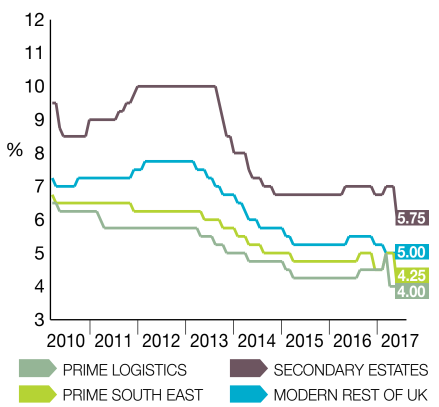
Source: Property Data / Knight Frank

FIGURE 6
Industrial sector performance



Source: IPD/Knight Frank

FIGURE 7
Single-let and multi-let warehouse yields



Source: Knight Frank

Investment market

Investment in UK industrial property continued to trend higher during 2017. The volume of investment transactions exceeded £7bn in the second half of the year, bringing the annual total for 2017 to almost £11bn, an increase of 80% on 2016 levels. (Figure 5). The industrial sector's share of total commercial property transactions also rose and now accounts for 17% of all commercial property transactions.

Key investment deals during the second half of the year include Royal London Pension Fund's acquisition of the Birches for £65.0m (NIY 4.66%), Legal & General Property's purchase of Kingsland Business Park for £70.0m (NIY 5.90%) and Tritax Big Box REIT's acquisition of Prologis Park Sideway for £78.5m (NIY 5.13%).

Overseas investors have continued to increase their holding of UK industrial property. Their share of industrial purchases increased to 44% in 2017, and they were also the largest net buyers during H2 2017, partly as a result of a single large portfolio acquired by China Investment Corp for £2.4bn. UK institutions were the second largest group of investors accounting for 21% of the total in 2017.

Industrial capital values are now rising at an annual rate of 15% and the sector's annual rental value growth is 4.9% (Figure 6). In terms of the wider market, industrials continue to outperform the other two core sectors, achieving an annual total return of 21% in December 2017 , with London and the South East leading the way.

Competition for stock has continued to put downward pressure on yields. The IPD All Industrial Equivalent Yield stood at 5.8% at the end of December 2017, 63 bps down since the start of the year. With 10-year gilts also now down to 1.19%, the gilt yield gap for the industrial sector is 461 basis points.

While yields on the best long-let prime stock have reached very low levels, with single-let distribution yields at 4.00%, it is the higher-yielding secondary estates and distribution facilities that have seen the greatest yield compression in recent months, in part reflecting the lack of prime stock available to purchase. (Figure 7).

Selected warehouse / logistics transactions in H2 2017

Property	Vendor/Purchaser	Price	NIY	Date
The Birches, East Grinstead	BP Pension Fund/Royal London Pension Fund	£65.0m	4.66%	Dec-17
Kingsland Business Park, Basingstoke	SEGRO Plc/Legal & General Property	£70.0m	5.90%	Nov-17
Prologis Park Sideway, Stoke-on-Trent	Prologis UK Ltd/Tritax Big Box REIT Plc	£78.5m	5.13%	Oct-17
DIRFT Logistics Park, Daventry	London Metric Property Plc/ Tritax Big Box REIT Plc	£48.8m	5.00%	Oct-17
Wilstead Industrial Park, Bedford	Private Investor/Canmoor Asset Management Welland PUT	£29.2m	6.75%	Aug-17
City Park Watchmead, Welwyn Garden Centre	Aviva Investors/Lega & General Property	£27.0m	5.42%	Jul-17

Source: Knight Frank Research

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