RESEARCH

2011
EUROPEAN LOGISTICS & INDUSTRIAL
Market report

Knight Frank

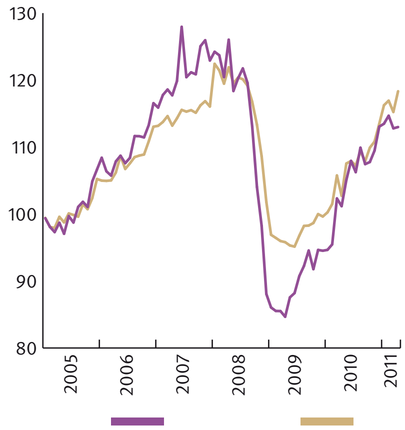
HIGHLIGHTS

- Prime logistics rents have stabilised in most European markets, after widespread falls were recorded during the economic downturn. Prime rents have remained essentially flat in most major markets in the first half of 2011, though modest rental growth has been observed in some locations in countries where occupier demand has been boosted by increased industrial activity, such as Germany and Russia.
- Speculative development remains at a very low level across Europe. The lack of recent construction completions has led to growing shortages of high quality space in many key locations, helping to bring down vacancy rates.
- Investment volumes in the sector have increased since 2009, partly due to a number of large portfolio deals. Investor interest remains focused mainly on prime assets in core Western European markets such as the UK and Germany, although there are also signs of increased activity in Central and Eastern Europe.

Figure 1

European Union industrial activity indicators

Index, 2005=100



Source: Eurostat

Figure 2

Prime logistics rents – change from end 2009 to June 2011

%

Source: Knight Frank

Changes calculated in local currency terms

Market overview

European economic conditions improved gradually during 2010 and into the first half of 2011, led primarily by growth in Germany, whose large industrial sector has benefitted from a revival in international trade, leading to increased global demand for its goods and greater manufacturing and export activity. Industrial turnover and retail sales have improved since 2009, and increased levels of cargo traffic through the continent's major ports have been recorded, helping to drive growth in the demand for logistics and industrial property.

A strengthening in the take-up of industrial and logistics space has been observed over the last year, albeit occupational activity remains fairly modest in many European markets. Combined with an abrupt slowing of development completions, the increased take-up has helped to bring down vacancy rates in most locations, though the availability of secondary space remains high. There is a growing stock of older vacant properties that are obsolete to the current needs of many logistics operators, who demand modern, flexible and sustainable facilities with large floor areas, high ceilings and numerous loading docks to enable the efficient throughput of goods.

Construction activity remains limited by developers' caution and ongoing restrictions on bank finance. Speculative development activity, which has come virtually to a halt across Europe in the last two years, remains at a very low level, although there is evidence that developers are now beginning to build new speculative schemes of modest sizes in some undersupplied locations. For the immediate future, however, it is likely that the majority of new developments will continue to be built-to-suit projects.

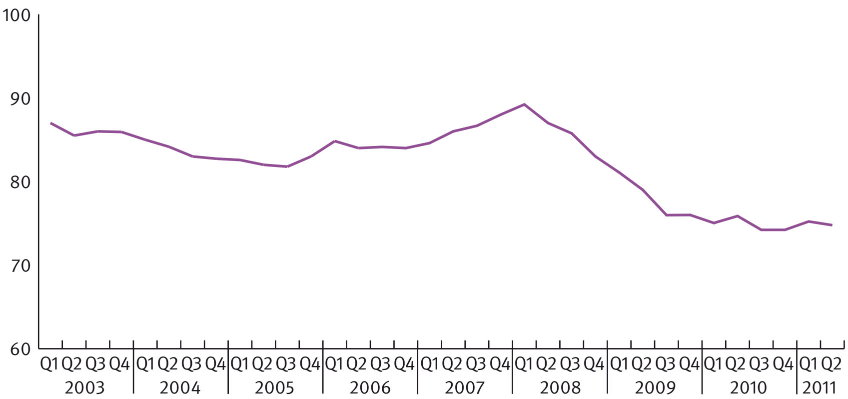
The balance between supply and demand, which has been heavily in the favour of occupiers in the last two years, is now shifting. Tenants, who have been able to negotiate reduced rents and increased incentives during the recession, are finding that the strength of their position is being gradually eroded, as the availability of prime space diminishes.

Prime logistics rents, which came under significant downward pressure across Europe during 2008-09, now appear to have stabilised in most markets, with a few exceptions such as Ireland and Spain, where occupier activity remains affected by continued economic uncertainty. In contrast, pockets of rental growth have been seen in countries including Russia, where there has been a sharp contraction in available supply, and Germany and Sweden, where occupier demand has been boosted by increased industrial activity.

Figure 3

European weighted average prime logistics rent

€ per sq m per annum



Source: Knight Frank

Based on an average of prime rents in 17 key logistics markets, weighted by size and market maturity

European logistics map

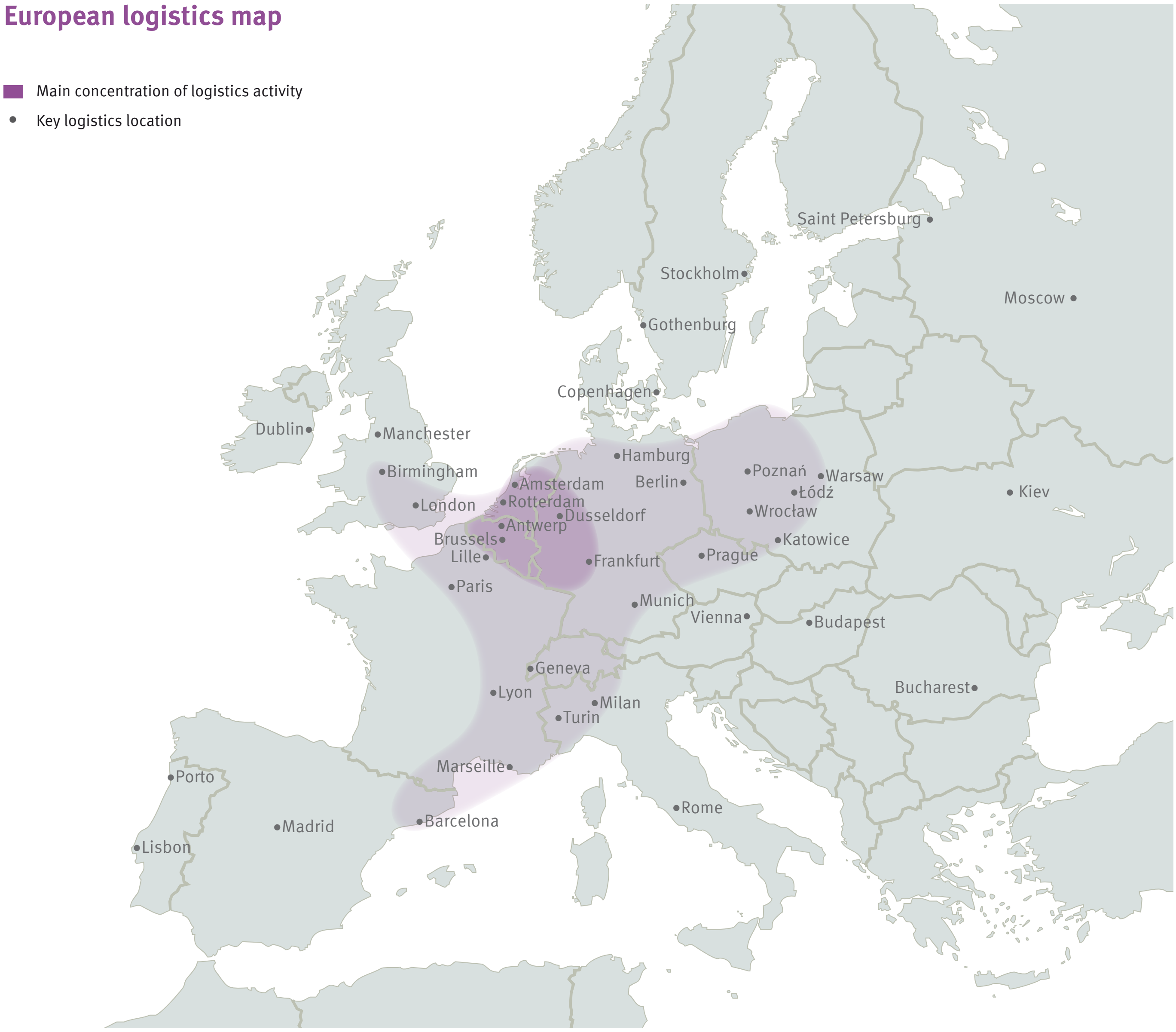


Table 1
Cargo traffic handled by busiest seaports

Seaport	Country	Total cargo handled 2010 (million tonnes)	% Change 2009-2010
Rotterdam	Netherlands	429.9	+11.1
Antwerp	Belgium	178.2	+12.9
Hamburg	Germany	121.2	+9.8
Amsterdam	Netherlands	90.6	+4.3
Marseille	France	86.0	+3.4
Algeciras	Spain	70.6	+1.0

Source: Port authorities

Table 2
Cargo traffic handled by busiest airports

Airport	Country	Total cargo handled 2010 (tonnes)	% Change 2009-2010
Paris Charles de Gaulle	France	2,399,067	+16.8
Frankfurt	Germany	2,275,106	+20.5
London Heathrow	UK	1,551,405	+15.0
Amsterdam Schiphol	Netherlands	1,538,135	+16.8
Luxembourg Findel	Luxembourg	705,370	+12.2
Cologne-Bonn	Germany	656,000	+16.7

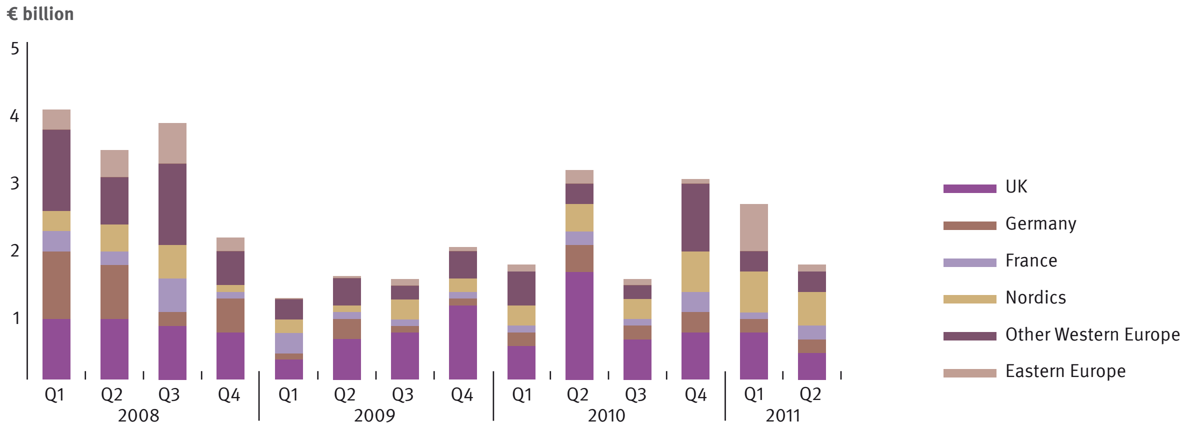
Source: Airports Council International/Airport authorities

Figure 4
Prime logistics yields

Graph shows the high and low points of prime yields in the last five years

Source: Knight Frank

Figure 5
Industrial investment volumes



Source: Knight Frank/Real Capital Analytics

Investment market

According to Real Capital Analytics data, around €10.2 billion was invested in European industrial and logistics property during 2010. This represented a significant 46% increase on the previous year's total, albeit 2009 had seen a particularly weak performance across all property sectors. Investment volumes in H1 2011 were broadly in line with 2010, with just under €5 billion invested in the sector, though there was some slowing of activity in Q2.

Between them, the UK and Germany accounted for nearly half of the total European transaction volume for 2010. Major deals in these markets included Hansteen's acquisition of a 34-property German industrial portfolio from HBI Holding and HBI Delta for an effective acquisition cost of c.€330 million, and SEGRO's purchase of BAA's 50% share in The Airport Property Partnership, a joint venture with Aviva which owns 18 warehouse properties near Heathrow, Stansted, Edinburgh and Gatwick airports in the UK, for £237 million (c.€287 million).

The UK and Germany continued to see significant levels of activity in H1 2011, while transaction volumes in the Central and Eastern European region increased strongly, boosted by two notable deals. AEW Europe and Tristan Capital Partners entered into an 80:20 joint venture with VGP Parks, for a logistics portfolio centred on Prague, in a deal worth c.€300 million, while CA Immo's acquisition of the €1.5 billion Europolis portfolio, with properties across the CEE area, included a logistics element estimated to be worth 23% of the total value.

As in most property sectors, investors remain risk-averse and focused on prime assets. Many investors will currently only consider acquiring fully occupied logistics properties on the best estates let to strong covenants. Where such properties are let on secure long term leases, logistics assets can provide relatively low risk, bond-like characteristics. Demand for secondary stock remains limited, and the availability of debt for such assets is highly restricted.

Prime logistics yields, which moved out sharply during the market downturn, have hardened in the last two years in most European markets. After peaking in mid-2009, for example, prime yields have moved down by 50 basis points in the major German markets and by 75 basis points in Paris, taking prime yields in these locations to c.7.00%. However, there has been less evidence of yield compression in markets where the economic and investment environment remains weaker, such as Spain and Ireland.

Over the rest of the year, prime yields should remain broadly stable, or come under moderate downward pressure. In light of the limited demand for secondary assets, the gap between prime and secondary yields may continue to widen. There appears to be scope for yields in some Central and Eastern Europe markets to move inwards, closer to Western European levels.

Occupier market snapshots

Demand for warehouse properties in the Netherlands remains fairly subdued, remaining strongest around key logistics locations such as **Amsterdam**'s Schiphol Airport and the Port of **Rotterdam**. There has been a general trend for occupiers to relocate to newer properties, leaving high levels of vacancy among older secondary stock.

Following a relatively subdued 2010, strong take-up was recorded in the Belgian market during Q1 2011. The majority of logistics occupiers are located in the **Brussels-Antwerp** axis, although a lack of available industrial land in this area has prompted some developers to seek opportunities further south in locations between Brussels, **Charleroi** and **Mons**. Prime rents in Brussels have remained stable over the last year, at €55 per sq m per annum for semi-industrial warehouses and €45 per sq m per annum for logistics properties.

Occupier demand in the **Bucharest** market is currently focused on relatively small spaces of 1,000-10,000 sq m. Developers continue to be cautious, generally building only at the request of tenants, though there are speculative projects due to deliver new space to the Romanian market during 2011 outside of Bucharest, at **Ploiesti** and **Timisoara**.

Demand for space in **Dublin** remains subdued, although there has been an improvement in activity since the start of 2011. Most recent lettings have been for short lease lengths, typically two years, with very few long term leases being signed. With limited recent development activity, most of the existing supply comprises older buildings built in the 1980-90s.

The improvement in the German economy has helped to boost demand for industrial and logistics space in the country. There have, however, been relatively few built-to-suit developments, largely because many occupiers have sought to take space in second hand properties on short lease lengths. Speculative development activity ground to a halt in the last two years, but recent months have seen major developers such as SEGRO and Gazeley either commence or announce plans to construct new

Figure 6
Prime logistics rents
€ per sq m per annum

Source: Knight Frank

speculative space, albeit on a relatively small scale. Prime rents are currently €72 per sq m per annum in **Frankfurt** and €78 per sq m per annum in **Munich**.

Headline rents in the UK market have remained broadly stable over the last year, although competitive terms and incentives remain on offer from landlords. Improved take-up levels in 2010 have led to shortages of large-scale distribution units in many of the most sought-after locations, particularly near to major transport links in and around Greater **London**. While speculative development remains limited, there are signs that developers are acquiring prime sites in anticipation of a strengthening of the market.

The take-up of logistics space in Spain was weak during 2010, reaching 243,000 sq m in **Madrid**, 44% below the previous year's total. Prime rents have continued to fall, softening to €72 per sq m per annum in Madrid, more than 25% below the peak of 2007, but appear to now be stabilising at this level.

There has been a sharp decline in the amount of warehouse space available in the **Moscow** market, as a result of a combination of improved demand and reduced development completions. The vacancy rate, which reached 12% at the end of 2009, stood at 4.5% in Q1 2011. While increased activity from developers is now being observed, take-up levels are likely to outstrip the level of new supply coming to the market over the rest of the year, putting continued downward pressure on vacancy rates and fuelling rental growth.

Despite improved take-up and a stalling of development activity, availability levels remain high in many parts of the French market. Recent activity has been strongest in the Ile de France area, around **Paris**, while demand has generally been weaker in regional markets.

Vacancy rates have been falling in **Prague** and other major Czech markets, such as **Brno**, where availability is now very low. There are significant amounts of new space under construction in the Czech market, almost all of which is pre-leased.

Development activity in Poland slowed considerably in 2010, with new completions in the country's eight largest markets reaching only around 15% of the previous year's total. However, construction activity has since increased, mostly in built-to-suit projects. Despite the low level of recent completions, vacancy rates remain elevated in many Polish markets, including **Warsaw**, and rental growth may be constrained until more of the available space is filled.

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