RESEARCH

LOGISTICS & INDUSTRIAL

OCCUPIER & INVESTMENT MARKET COMMENTARY **H1 2014**

Economic overview

The upward trajectory of the UK economy continues apace. Latest official figures reveal that the economy expanded by 0.8% in Q2 2014, marking a sixth successive quarter of robust growth and taking output back to its pre-recession level. In July, the IMF also revised its forecast for UK GDP growth to 3.2% in 2014, the strongest of all the G7 nations.

With relevance to logistics occupiers, UK Distribution & Retail has been one of the strongest performing sub-sectors of the economy, recording year-on-year growth of 4.9% in Q2 2014, compared with 3.1% for the UK economy as a whole (Figure 1). Encouragingly, UK manufacturing is also now recording consistent growth, although the recent strengthening of sterling does pose something of a threat to UK exports.

Occupier market

Reflecting improving confidence in the occupier market, total UK-wide take-up in units above 50,000 sq ft was a commendable 22.2m sq ft in H1 2014, up 17% on H2 2013 and 22% above the five-year bi-annual average (Figure 2). Build to suit deals amounted to 5.0m sq ft in H1, the highest level seen since the before the downturn, and indicative of the critical shortage of existing new-build supply.

The Midlands was the main focus of pre-commitment activity in H1 followed by the wider South East region, with 3.0m sq ft and 1.3m sq ft sq ft respectively. H1's two largest deals by some distance were Primark's pre-let of A14 Centre, in Thrapston, East Midlands (1.06m sq ft) and Waitrose's pre-let at Magna Park, Milton Keynes (936,000 sq ft).

The shortage of good quality standing stock has become an enduring theme which now stretches the length and breadth of the UK. However, the situation is most acute in the wider South East and Midlands regions, the latter of which has only six months' worth of supply now available following a stellar 6.6m sq ft of take-up in H1.

Developers are now responding to the situation. New-build availability in the big-shed market recently increased for the first time in five years, following the commencement of a number of speculative schemes in H1 (Figure 3), while speculative development of units in excess of 50,000 sq ft increased by 80% during the period to stand at 1.53m sq ft across 10 schemes.

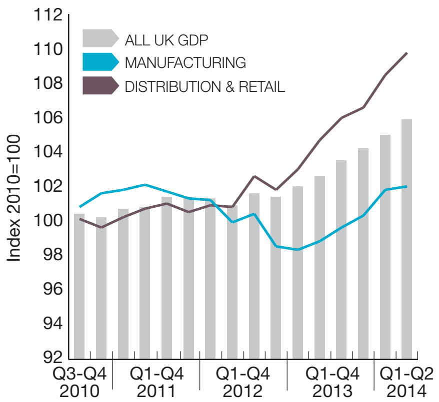
All of these developments are located the wider South East and Midlands regions, with additional schemes likely to go on site shortly, such as two Prologis schemes at Grange Park, Northampton and Heathrow, West London. Developers remain much more reticent to progress schemes speculatively elsewhere in the UK's other regions, where sites continue to be primarily marketed for design and build solutions.

The restricted choice of accommodation in the market means that landlords now have the upper hand. Incentive packages have moved in sharply across all regions and this has subsequently been followed by a lengthening of lease terms, effectively narrowing the level of flexibility standing stock typically offers compared with design and build solutions.

The next step for the market is headline rental growth. We have already seen rents reach new highs for particular unit sizes in the tightest markets during H1 and we expect this to become more widespread over the coming 12 months. In turn, evidence of rental growth will give the green light for developers to bring further speculative development forward, albeit the focus is likely to remain in the South East and Midlands over the next 12 months.

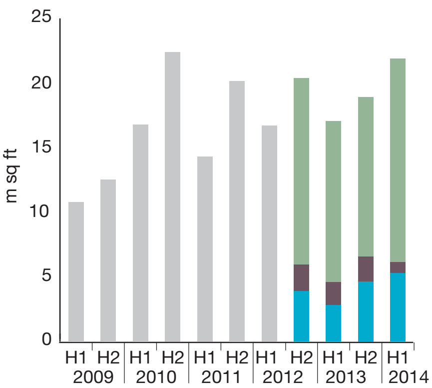
Please refer to our regional LOGIC reports for more detailed commentary.

FIGURE 1
UK economic output



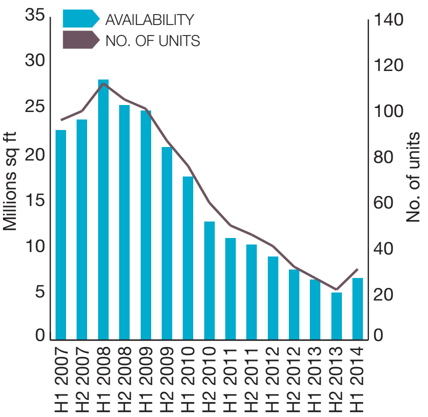
Source: ONS

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



Source: Knight Frank Research

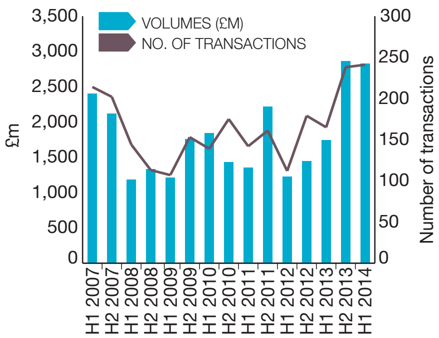
FIGURE 3
New sheds available (100,000 sq ft+)
Includes speculative development



Source: Knight Frank Research

FIGURE 4

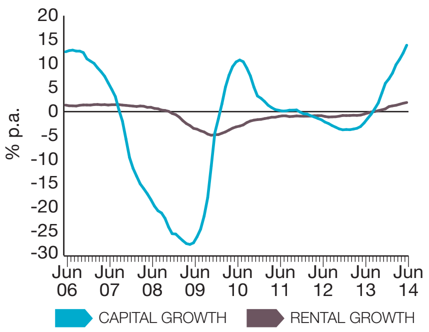
Industrial investment transactions



Source: Property Data / Knight Frank Research

FIGURE 5

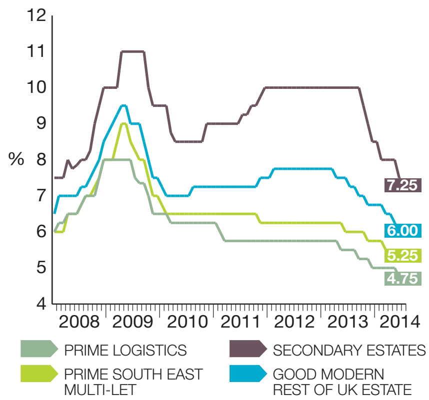
Industrial sector performance



Source: IPD

FIGURE 6

Warehouse and industrial yields



Source: Knight Frank Research

Investment market

Investment appetite for UK Industrial has been clearly reflected in transaction volumes, with over £2.8bn of industrial assets changing hands during H1 2014 - this is only slightly below the near-record total of H2 2013 and 57% above the total for the same period last year (Figure 4). Despite there being something of a 'summer lull' in activity, a fresh wave of deals is expected later in 2014 when more stock becomes available.

The market is dominated by UK institutions, with overseas investors often finding themselves out-competed on price despite strong interest for single-let assets. Within the spectrum of commercial property, the investment case for UK industrial is compelling given its prospects for rental growth – linked to a lack of good quality supply – and the underlying structural rise in occupier demand from e-commerce.

Positive sentiment towards Industrial is also reflected in recent performance. According to IPD, Industrial total returns have climbed to a 20-year high of 22.3% over the past 12 months, underpinned by strong capital growth and the long-awaited return of rental growth (Figure 5). IPF's latest consensus forecast also shows that Industrial is tipped to be the lead performing UK sector over the medium term, with average annual total returns of 9.3% p.a. to 2018, compared with 8.3% for All Property.

Prices have continued to increase, reflecting the sheer weight of money in the market and competition for limited product. Yields for single-let distribution and multi-let estates hardened further during H1, with prices for 20-year income (with fixed RPI uplifts) reaching 4.75% (Figure 6). Solid occupier market fundamentals have also driven strong demand for good quality secondary product and shorter income stock, causing prices in this segment of the market to rise sharply over the past 12 months.

The steady rise in values has seen increasing instances of profit-taking activity, and we expect this to feature even more prominently in H2 2014. A number of H1's deals involved assets that were re-sold for a significant profit within as little as 12 months from their initial purchase.

In search of greater value and investment opportunity, competition has also moved on to include joint venture funding with developers for new-build, typically multi-let schemes. With clear evidence of rental growth in the offing, this is expected to gather pace over the next 12 months as development becomes increasingly viable.

Selected warehouse / logistics transactions in H1 2014

Property	Vendor/Purchaser	Price	NIY	Date
Worton Grange Industrial Estate, Reading	Scottish Widows / UBS Triton Property Fund	£57.8m	6.18%	Feb-14
Magna Park, Milton Keynes	Gazeley / L&G Property	£114.1m	4.64%	May-14
Clifton Moor Industrial Estate, York	Cornerstone Real Estate / IPIF	£40.8m	6.20%	May-14
Deeside Industrial Park East, Deeside	Centurion Properties / SWIP Property Trust	£33.9m	8.00%	May-14
Morrisons RDC, Sittingbourne, Kent	Morrisons / Tritax Big Box REIT Plc	£98.7m	5.17%	Jun-14
Premier Park, Trafford Park, Greater Manchester	Harbert European RE Fund / Lothbury IM	£19.3m	5.60%	Jun-14

Source: Knight Frank Research

Newmark Knight Frank Global

www.KnightFrank.com

COMMERCIAL RESEARCH
Oliver du Sautoy, Associate
+44 20 7861 1592
oliver.dusautoy@knightfrank.com

VALUATIONS
Giles Coward, Partner
+44 20 7861 1679
giles.coward@knightfrank.com

AGENCY
Charles Binks, Partner, Head of Logistics
+44 20 7861 1146
charles.binks@knightfrank.com

CAPITAL MARKETS
Johnny Hawkins, Partner
+44 20 7861 1519
johnny.hawkins@knightfrank.com