RESEARCH

LOGISTICS & INDUSTRIAL

OCCUPIER & INVESTMENT MARKET COMMENTARY **H1 2015**

Economic overview

While the UK economy strengthened during the second quarter, with quarterly GDP growth estimated at 0.7% (up from 0.4% in Q1) a key feature in recent months that is uncharted waters, at least since the 1960s, is zero inflation. This will have implications for the UK industrial property market, particularly for rental growth in real terms.

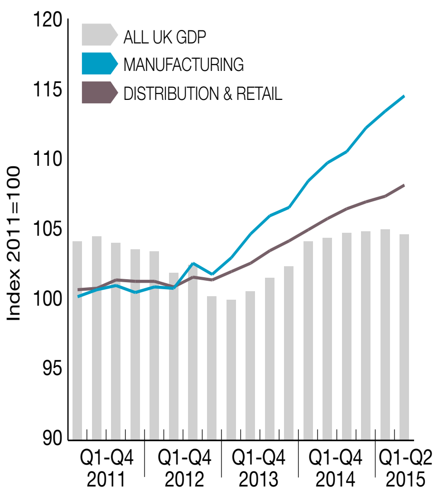
With regard to the two main sectors driving underlying occupier demand, manufacturing output remains flat, whereas UK Distribution and Retail is one of the strongest performing sub-sectors, recording annual growth of 4.5% in Q2 2015 (Figure 1).

Occupier market

Demand for units above 50,000 sq ft eased off during the first six months of 2015, with a total of 16.8 million sq ft acquired for occupation in H1. This is 27% down on H2 2014 and 10% below the five-year bi-annual average (Figure 2).

FIGURE 1

UK Economic output indices



Source: ONS

However, this follows an exceptionally strong H2 2014, particularly in the Midlands where take-up had dominated activity. While the Midlands continued to dominate activity in the first half of the year, albeit at a much reduced level, the North West saw a significant recovery with just over 3 million sq ft of space taken in H1 2015, accounting for 18% of total take-up in the first half of the year. Two of the largest leasing deals in the North West region came from B&M, who took 343,312 sq ft at the Onyx350 building in Runcorn and secured 436,115 sq ft at the 'Midpoint 460' unit in Middlewich in Cheshire by way of a sub-lease from the main tenant Tesco.

The Midlands also continued to dominate the pre-commitment activity with 1.45 million sq ft, which accounted for 45% of the total in the first half of the year.

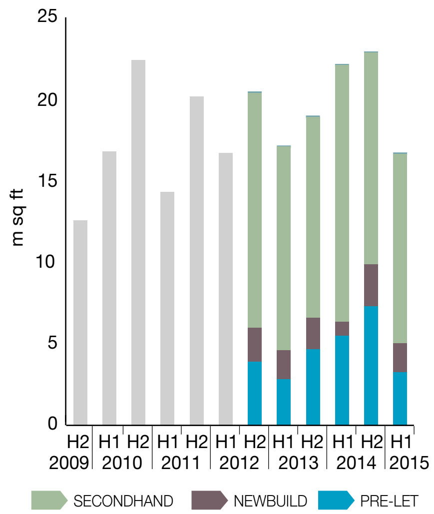
Supply shortages continue to leave occupiers with a lack of choice. In the big-shed market, new-build supply of units above 100,000 sq ft currently stands at 8.4 million sq ft, down 70% from its peak in Q1 2008 (Figure 3). In the Midlands current availability is equivalent to just 6 months' supply. With around 4.6m sq ft of speculative space planned or under construction across 27 buildings for delivery in 2015/16, this takes the overall supply - including existing space - to around 12 months. However, over 2m sq ft of the space available or planned is also under offer, which indicates a continued shortage of supply.

Given the lack of available industrial space we anticipate further rental growth across the regions in the UK over the next 12 months. We expect to see substantially more speculative development delivered to the market over the coming years. The rate of rental growth will eventually slow as new speculative development comes through and supply increases.

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

FIGURE 2

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

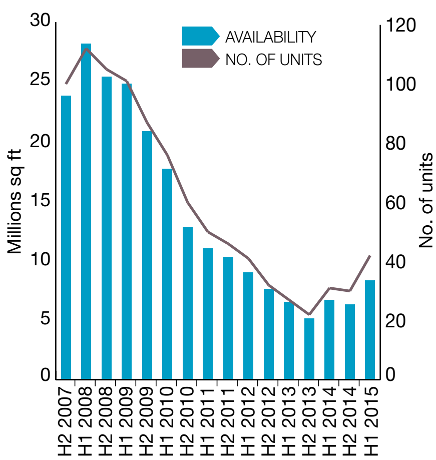


Source: Knight Frank Research

FIGURE 3

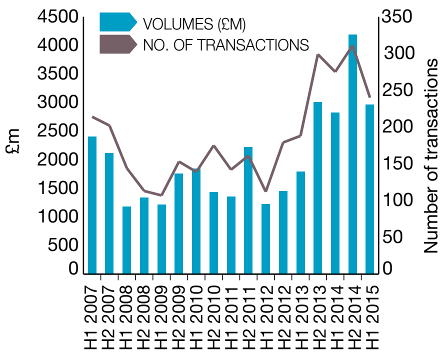
New sheds available (100,000 sq ft+)

Includes speculative development



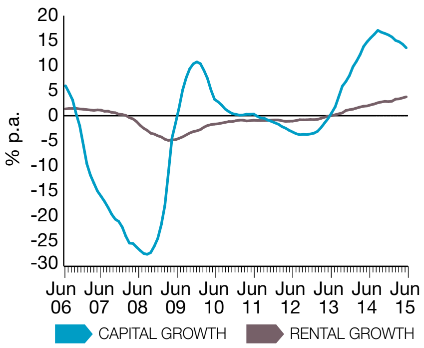
Source: Knight Frank Research

FIGURE 4
Industrial investment transactions



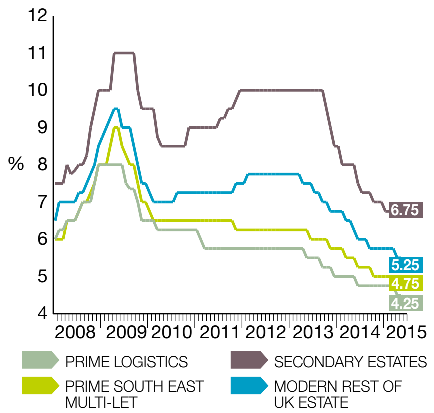
Source: Property Data / Knight Frank Research

FIGURE 5
Industrial sector performance



Source: IPD

FIGURE 6
Single-let and multi-let warehouse yields



Source: Knight Frank Research

Investment market

Following record activity in the second half of 2014, the UK industrial investment market was relatively subdued in H1 2015. According to Property Data, just under £3.0bn of industrial assets changed hands during the first half of 2015, compared with the record £4.2bn achieved in H2 2014. This was 5% up on the corresponding period in 2014, when £2.8bn was transacted (Figure 4).

Property companies were the most active investors during the first half of 2015, followed by UK institutions and overseas investors. Apart from Blackstone's acquisition of a £388m portfolio of Logistics Assets from Anglesea Capital and Oaktree Capital Management, the majority of transactions were completed by domestic investors. The most active of these investors was The Tritax Big Box REIT, who acquired a total of £320 million across seven deals. We expect substantially more speculative development to be delivered to the market over the coming years.

However, H1's subdued level of turnover largely reflects a lack of suitable buying opportunities in the market, rather than investor demand which remains strong for prime properties, underpinned by improving occupier fundamentals.

Investors are benefitting from accelerated rental growth. The IPD Monthly Index shows that in the year to June 2015, industrial rents increased by 3.8%, which is the highest rate of rental growth since May 2001, and with CPI inflation back to zero in June this represents real rental growth for investors. Capital growth while still strong has eased somewhat to 13.6% (Figure 5).

Strong investor sentiment has led to further yield compression, and with rental growth now a realistic prospect, yield polarisation between prime and secondary assets is narrowing. In the six months to June 2015, single-let distribution yields compressed by 50bps to 4.25%, while yields for prime multi-let and secondary estates compressed by 25bps to 4.75% and 75%, respectively (Figure 6).

Selected warehouse / logistics transactions in H1 2015

Property	Vendor/Purchaser	Price	NIY	Date
Biggleswade Retail Park, Biggleswade	LXB Retail Properties Plc / Aberdeen UK Retail Parks	£115.8m	4.75%	Apr-15
Magna Park MP3, Milton Keynes	IDI Gazeley / Standard Life Pooled PFF	£85.7m	4.20%	Mar-15
Goresbrook Park, Dagenham	Landid Property Ltd & Sheikh Family Office / London Metric Property Plc	£56.5m	5.10%	Jan-15
ProLogis Park Sideway, Stoke-on-trent	ProLogis UK Ltd & Wittington Investments / Tritax Big Box REIT Plc	£43.4m	5.47%	Jun-15
Estuary Business Park, Liverpool	B&M Retail Ltd / Cordea Savills PanEuro PF	£41.5m	5.20%	Mar-15
Markham Vale, Chesterfield	Henry Boot Developments / M&G Real Estate	£36m	6.00%	Jun-15

Source: Knight Frank Research

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