RESEARCH

Knight Frank

LOGISTICS & INDUSTRIAL

OCCUPIER & INVESTMENT MARKET COMMENTARY **H1 2018**

Economic overview

The UK economy grew by 0.4% in Q2 2018, representing a 0.2% acceleration from the first quarter of the year, and a 1.3% increase from the same quarter last year. Growth was principally driven by services and construction, which was partly offset by a decline in manufacturing and energy supply.

Services sector output increased at a rate of 0.5% in Q2 2018, faster than the previous quarter (0.3%) and an improvement from this time last year (0.3%). This is the largest quarterly services growth since Q4 2016. Manufacturing output however fell by -0.8% in Q2. Even so, considered over a 12 month period, manufacturing output shows an increase of 1.4%.

Importantly, employment levels in the UK remain high. The UK unemployment rate stood at 4.0% in Q2 2018, 0.2 percent points lower than in the first quarter this year. This is the lowest since the winter of 1975.

Occupier market

In the first six months of 2018, a total of 17m sq ft of logistic and industrial space was acquired by occupiers. Notably, this represents the strongest start to a year since 2014. At a market level, the Midlands continued to dominate occupier activity, with the region accounting for 43% of take-up across the UK.

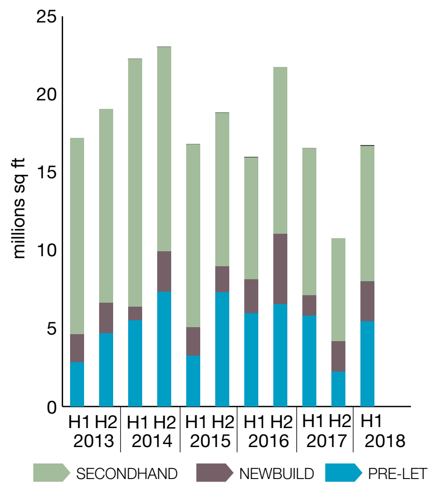
The proliferation of distribution channels related to online retailing remained a major feature of the UK market. On-line accounted for 17% of retail sales in June 2018 as the structural shift in consumer spending preferences continued at pace. (Figure 3). Customer experience is fundamental to a retailer's success in capturing market share in this changing environment. This need continues to support demand for both large scale fulfilment centres and urban logistics centres that are able to accommodate 'quick time' delivery.

On the supply side, new development, both underway and recently completed, has meant that availability has begun to edge upward. In the big shed market, new build supply of units above 100,000 sq ft stood at 10.6m sq ft at the end of June 2018 (Figure 4). Although this total represents a 20% increase when compared to the same point in 2017, the H1 2018 total remained 7% below the 10-year average. Significantly, industrial developers continue to see strong competition from the residential sector. Industrial land in London in particular is under significant strain given the high demand for housing and the higher land values that residential development commands. This means that the pace of new industrial supply coming to market will continue to be restrained, thus adding upward pressure to rents.

The outlook for the second half of 2018 is largely positive. Demand for good quality industrial and distribution remains strong, principally underpinned by the ubiquitous growth of online retailing. Brexit, of course, remains a disruptive influence albeit, business confidence at the mid-year juncture remained above that recorded before the EU referendum in June 2016. Furthermore, the weakened exchange rate of Sterling, a product of the ongoing EU stalemate, continues to aid UK exports.

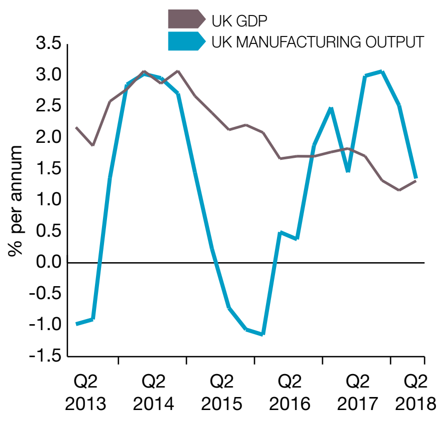
For more detailed commentary on the occupier markets, please refer to our regional LOGIC reports.

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



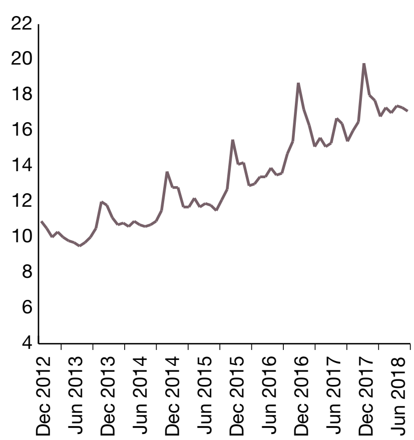
Source: Knight Frank Research

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



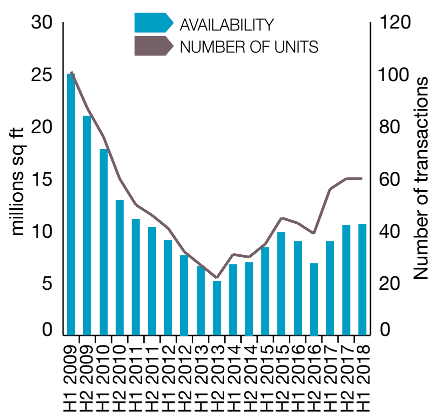
Source: ONS

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



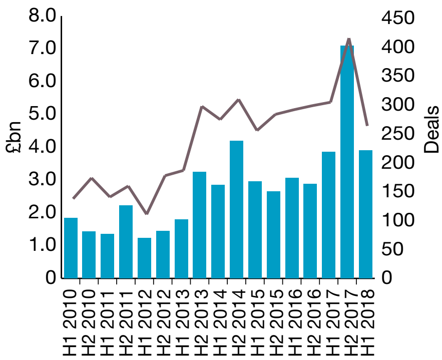
Source: ONS

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



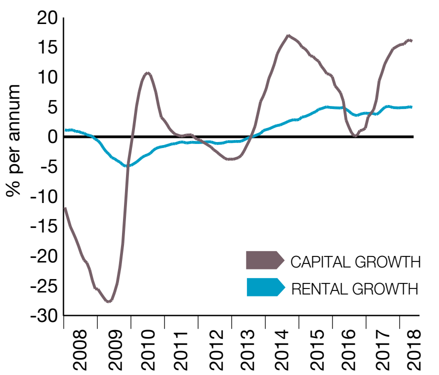
Source: Knight Frank Research

FIGURE 5
Industrial investment transactions



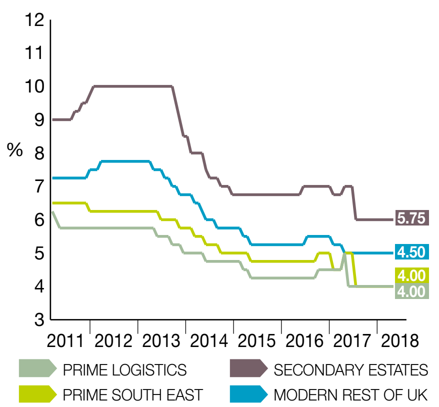
Source: Property Data / Knight Frank

FIGURE 6
Industrial sector performance



Source: IPD/Knight Frank

FIGURE 7
Single-let and multi-let warehouse yields



Source: Knight Frank

Investment market

Industrial property continues to carry favour with investors. Industrial property accounted for 17% of all commercial property transactions in 2017, with this investor demand carried through into H1 2018 where the sector accounted for 14% of deals. Investment volumes during the period reached £3.7bn, 33% above the 10-year average (Figure 5).

Blackstone and M7 Real Estate's purchase of the Powerhouse portfolio for £320m was the largest transaction to complete in H1. The portfolio comprises 4.5m sq ft of light industrial space across 40 properties located mostly in the North West and the Midlands along the M6 corridor. Other key investment deals exceeding £100m include Legal & General Property's purchase of Woodside Industrial Estate for £182m (NIY 5.02%) and Tritax Big Box REIT's agreement to forward fund the development of a logistics fulfilment centre at Link 66 in Darlington for £120.7m (NIY 5%).

Despite the largest transaction of the year being to a US fund, domestic money accounted for the majority of capital spent in H1. UK investors accounted for 69% of investment volumes in the first half of 2018. Significantly, UK buyers were responsible for four of seven transactions over £100m. Overseas buyers remain active however, spending £900m across 25 deals in H1.

Over H1 2018, capital value growth reached 6.8%, up some way from the 5.4% recorded at the mid-point of 2017. Rental value growth has remained relatively consistent registering a 2.5% uplift in the first six months of 2018.

Sustained demand for investment opportunities has continued to put downward pressure on yields. The IPD All Industrial Equivalent Yield fell to 5.5% in June, a dip of 30bps since January. Over the same period, 10-year gilts moved in to 1.42%, meaning a yield gap of 400+ bps has been maintained.

Yields on the best long-let prime stock remained at a record low in H1 with single-let, distribution yields at 4.00%. Yields on modern regional estates moved in to 4.5% during 2018 reflecting a shift of 50bps since the turn of the year. (Figure 7).

Selected warehouse / logistics transactions in H1 2018

Property	Purchaser	Vendor	Price	NIY
Powerhouse Portfolio	Blackstone Real Estate	InfraRed Capital Partners	£320.0m	6.3%
Woodside Industrial Est	Legal & General UK PF	Harbert European RE Fund	£182.0m	5.0%
Sterling Industrial	Westbrook Partners	Mansford LLP	£162.0m	6.8%
Magnus Portfolio	M7 Real Estate/	Helical Plc	£150.0m	6.4%
Link 66, Darlington	Tritax Big Box REIT Plc	DB Symmetry	£121.0m	5.0%

Source: Knight Frank Research

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