

PRIME LOGISTICS

The definitive guide to the UK's
distribution property market

Spring 2011 Bulletin



GERALDEVE

PRIME LOGISTICS – THE MARKET IN PERSPECTIVE

Following 2009, the year we would all prefer to forget, headline figures for 2010 have highlighted a marked improvement in the big shed occupier market. The signs of encouragement we reported on in our last Prime Logistics bulletin were realised in the second half of 2010, with around 20 million sq ft of space taken-up during Q3 and Q4 across the 24 Gerald Eve key distribution regions. Total take-up in Q4 2010, of around 10 million sq ft, was the highest quarterly volume recorded in our regions since Q4 2007.

So what drove this increase in take-up? Well, in short, it was occupiers in the retail sector who were the most acquisitive during 2010. Collectively, the sector took up 15.7 million sq ft of space during 2010; the largest amount of annual take-up in the sector for a decade. Of this 15.7 million sq ft, around 4.7 million sq ft of space was pre-let – emphasising how the spike in take-up of new (mostly speculatively-developed) stock has eroded the amount of new or refurbished space available.

Following the poor levels of take-up from the manufacturing sector during 2009 (when it more than halved compared to 2008 volumes) occupier activity from this sector returned to average annual levels of activity during 2010, recording take-up of around 7.5 million sq ft in our regions. In line with the growth in output from the manufacturing sector itself, the letting activity from the sector was weighted towards the second half of 2010, both in terms of the size of space taken and the number of transactions completed. Q3 in particular demonstrated above-average levels of occupier commitment with around 2.3 million sq ft of take-up from 16 deals.

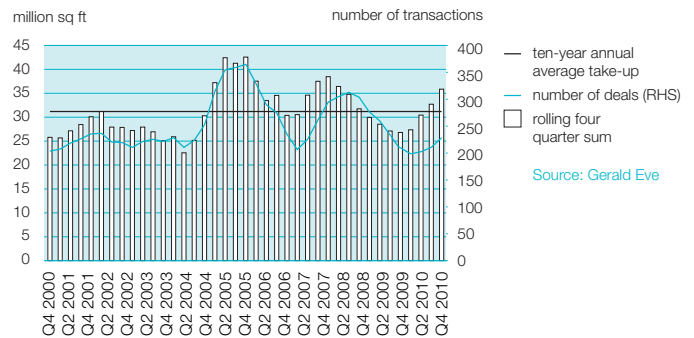
Although good quality space has continued to attract interest from occupiers, the significant overhang of secondhand stock remains. As companies consolidated operations and focused on driving maximum efficiencies from their properties, the amount of secondhand stock marketed as being available doubled between Q4 2007 and Q4 2010 and now stands at 90 million sq ft for our regions. Across the country, both rents and market incentives remained stable during the second half of 2010, although were still being negotiated at highly competitive levels. In particular, the demand-supply imbalance for secondhand stock continued to attract a high level of incentives.

This imbalance was exacerbated by low levels of development in 2010. Only 5 million sq ft of developments completed in the year (of which only a negligible 160,000 sq ft was speculative), which marks the lowest level in over a decade. 2011 is expected to be similarly subdued in terms of development, with purpose-builds again driving headline figures. The issues for the market during 2011 will be the availability and location of suitable land to house these projects and the amount of unwanted secondhand space that will be returned to the market from the occupiers of these schemes.

So, what do we expect for 2011 and to what extent will weak development activity and a fragile economy hinder performance? Well, there are large requirements for space in the market which will help maintain headline take-up figures in 2011; however, the economic headwinds are strong. Household finances are now faced with negative real wage growth and growing unemployment and we maintain our cautious outlook for consumer spending in 2011. The rise in VAT and the anticipated effects of the Government's Comprehensive Spending Review will undoubtedly have a dampening impact on consumer sentiment during 2011, and will ultimately constrain demand for warehouse space from the retail sector.

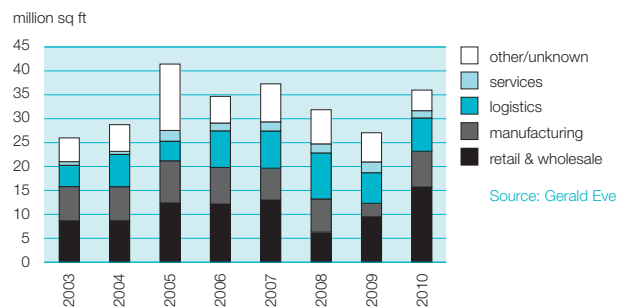
So, whilst this is the most positive bulletin we have released for two years, there are strong economic pressures expected for the first half of 2011 which will undoubtedly suppress performance. We will continue to monitor the market and hopefully report back with further positive news in our autumn bulletin.

Rolling four quarter total take-up and number of deals, Q4 2000 – Q4 2010



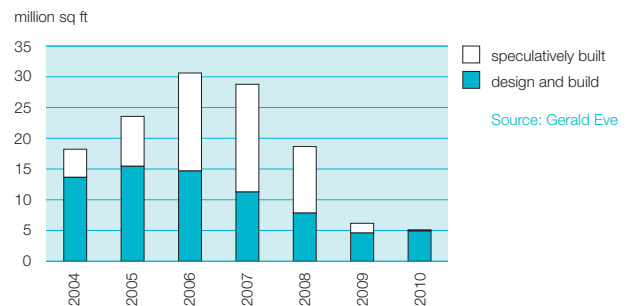
This chart shows the cumulative total take-up for the previous four-quarter period. The average four-quarter total take-up since Q4 2000 is around 31 million sq ft. The four-quarter total to Q4 2010, 36 million sq ft, was the highest rolling figure since Q3 2008 and rounded off a year of successive quarterly improvements in take-up.

Annual total take-up by sector, 2003 - 2010



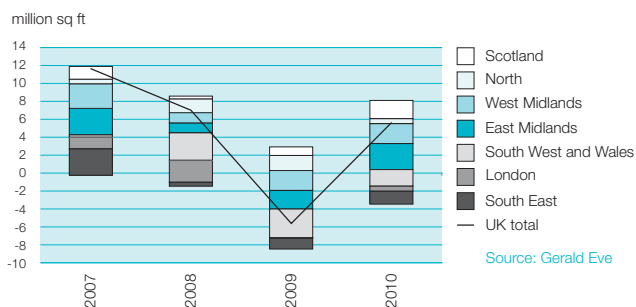
On an annual basis, 2010 take-up showed an increase of 33% on the total for 2009, recording the strongest annual figure since 2007. The retail and wholesale sectors were the key drivers of activity during 2010 and accounted for 44% (15.7 million sq ft) of all take-up over 50,000 sq ft within the 24 Gerald Eve regions. This 15.7 million sq ft was made up of only 65 deals (creating an above-average deal size of 242,000 sq ft) and is indicative of the sector's desire for large sheds.

Development completions by type, 2004 - 2010



Only 5 million sq ft of warehousing space developments completed in 2010 – the lowest level for at least a decade. Given the speed with which large sheds can be built, developers have sought to secure tenants on institutionally-acceptable pre-lets or sales rather than build speculatively and have focused on getting well located sites in advanced stages of preparation for potential occupiers. There are parts of the country; particularly prime areas in London and the South East, which are beginning to look more attractive to developers and institutional investors, especially against the backdrop of the recent strong demand for big box sheds.

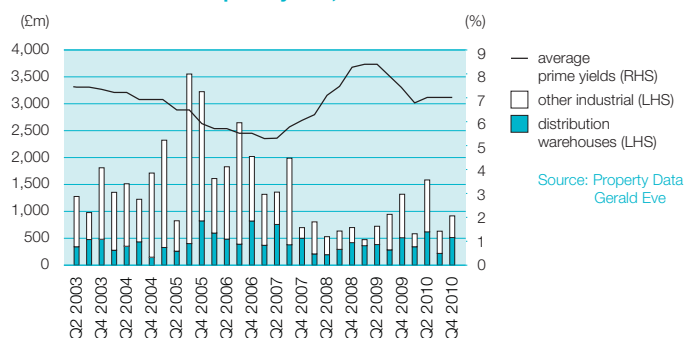
Annual net absorption* by broad geographic region, 2007 – 2010



* For this calculation, we have assumed that all available space is 'vacant' on the premise that space that is marketed as being available is underused and likely to be vacated.

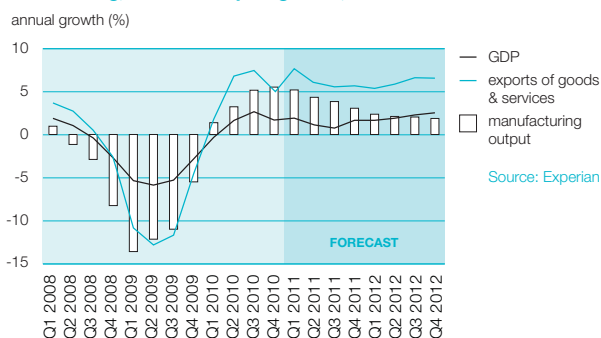
The chart above demonstrates the true effects development completions, take-up and changes in availability levels have had on the overall occupancy of logistics space. If, on aggregate, more space is returned to the market than occupied in a given year, then the corresponding net absorption figure is negative. This was certainly the case during 2009, with the West of England and the East Midlands in particular suffering negative net absorption. However, for our 24 regions during 2010, net absorption turned positive and the actual physical occupation of space increased by just over 4 million sq ft, with the Midlands showing the most positive change in absorption levels.

Investment volume and prime yields, Q2 2003 – Q4 2010



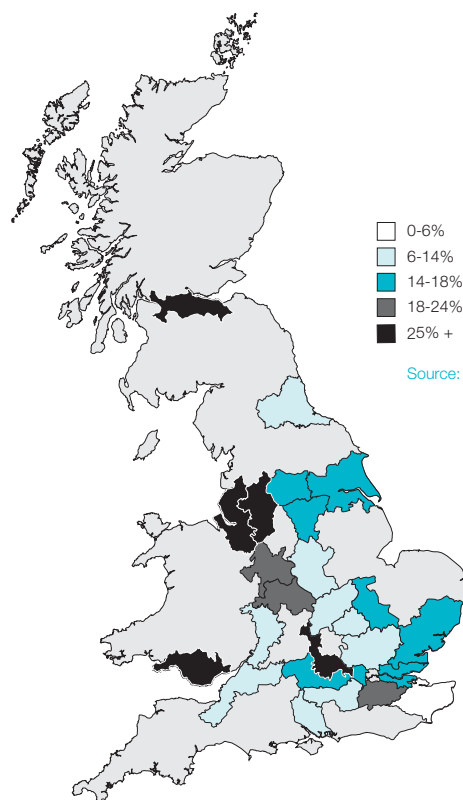
Following the yield compression of the second half of 2009 and early 2010, prime logistics yields essentially remained stable for the second half of 2010. Investor demand remained risk-averse, with the funds' money focused on best-in-class assets. Whilst institutions continued to have cash to spend for the best product during Q4, there was not the same pressure for them to invest as was the case during the final quarter of 2009.

Manufacturing, GDP and export growth, Q1 2008 – Q4 2012



The manufacturing sector witnessed an impressive turnaround of fortunes during the second half of 2010. The sector has good momentum behind it and business surveys indicate that sentiment is high, although future quarterly growth rates are expected to be less impressive during 2011, especially for those regions with a heavy exposure to public sector cuts. While weak domestic demand is expected to persist, the outlook for trade remains favourable, with relatively healthy growth rates in exports anticipated.

Availability rate by region, Q4 2010



The total availability rate for Gerald Eve's regions at the end of Q4 2010 was 16.8%, a slight increase on the 16.4% rate in Q3 2010, although a reduction from the 17.2% we saw in Q4 2009. The majority of the space released to the market during the second half of 2010 was secondhand, with around 6 million sq ft of such space added to the market during H2 2010. Regionally, the rate of increase in secondhand space being returned to the market slowed in South Wales during H2 2010, although the overall rate remains high. Conversely, Greater Manchester witnessed an increase in the availability rate and now has a rate of around 27%, which was driven by the return of unwanted stock following large scale consolidations. Total availability is expected to remain elevated as tenant demand focuses on good quality space and the release of unwanted regional distribution space is returned to the market as a result of the recent pre-lets on large national distribution centres by major retailers.

We will keep you updated on the state of the big sheds markets by releasing a Prime Logistics bulletin every half year and a full update with individual market reports and detailed analysis every two years. If you have any queries or comments, please don't hesitate to contact us.

Next full update: Autumn 2012
Next bulletin: Autumn 2011

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Prime Logistics is the definitive guide to the UK's distribution property market. Dealing with logistics units of 50,000 sq ft and above, this biennial research report gives detailed analysis and statistics for 24 key distribution areas – from take-up, stock and development statistics to drivers of occupier demand, growth forecasts and regional outlooks.

Prime Logistics is a short summary and is not intended to be definitive advice. No responsibility can be accepted for loss or damage caused by any reliance on it.

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