PRIME LOGISTICS

The definitive guide to the UK's distribution property market

Q3 2012 Bulletin

Q3 2012 OVERVIEW

- The supply of new or refurbished stock falls further
- Investor interest in logistics remains strong, but only for core prime assets
- A quiet summer for industrial property as we see a double-dip in occupational demand and weak levels of investment
- The quarterly volume of development completions rises, although continues to be solely build-to-suits

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PRIME LOGISTICS – Q3 2012 IN PERSPECTIVE

It was a quiet summer for the industrial property occupier market as only 6.35 million sq ft of space completed within 54 transactions during Q3. This low volume of space represents a 14% reduction on the Q2 figure and a 44% reduction on the figure a year earlier. It also represents the lowest single quarterly figure since Q2 2009. As depicted in the chart, demand on a less volatile four-quarter rolling basis also continued its downward trajectory in Q3 and, somewhat in sync with the double-dip in the economy overall, is seemingly experiencing a second period of contraction of its own. The decline in the average size of transactions also continued throughout 2012 and the Q3 four-quarter rolling average transaction size was a very low 117,000 sq ft, the lowest since 2005.

New or refurbished properties continued to dominate take-up volumes during Q3, accounting for 51% of the total. Secondhand properties accounted for 49% of all take-up during the quarter, with secondhand lettings accounting for 34%. It seems that the long-running feature of the industrial market – the scarce supply of good quality stock – has pushed occupier appetite towards secondhand space. Several long term available refurbished or good quality secondary buildings were let during Q3 as occupiers committed to the best quality available space open to them before supply is exhausted.

As shown in the table opposite, the automotive sector has proved particularly active in this regard, leasing almost a million sq ft during Q3. Several large automotive companies such as Jaguar Land Rover, Nissan and BMW are commiting to production in the UK and are investing in their facilities. This has led to a growth in demand for industrial property from both these companies and their dependent supply chains. However, satisfying such future demand may prove difficult. The lack of good quality available space and the restricted nature of lending for companies down the supply chain to invest in new facilities could stifle future growth. In the absence of long leases (suppliers to the automotive sector are generally contract-driven and therefore require shorter lease terms) and strong covenants, lenders are unlikely to provide finance on such terms.

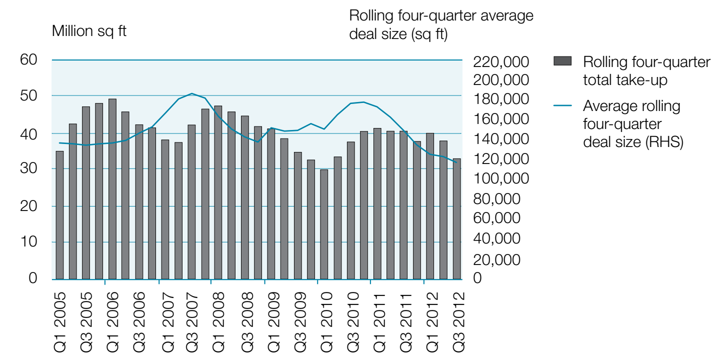
Whilst demand has been sluggish over summer, we believe that there are several reasons to expect that demand will improve in 2013. The UK economy is anticipated to experience a gradual recovery over the coming quarters and there are large and credible requirements for space in the market which could bolster take-up levels next year. Amazon, for instance, riding the wave of changing shopping patterns, has four requirements for space of 1 million sq ft each. It is thought that such demand will make this mini cycle shorter and shallower than the previous period of contraction and that we begin to see improvement in take-up volumes as we enter 2013.

The total volume of available buildings stood at just under 100 million sq ft at the end of September– marking the second consecutive quarterly decline. Of this, only 14 million sq ft could be classified as new or refurbished supply and even less as prime new build, well-located space. However, the volume of poor quality secondary and tertiary available stock remains elevated and there are several available buildings of poor quality which have been longstanding features of the market. Around 20% of all available secondhand stock has been on the market for more than three years, the outlook for which could be either demolition or change of use. Perhaps indicative of this, there was around 2.5 million sq ft of space withdrawn from the market in Q3, the majority of which was earmarked for demolition.

Conversely, the supply of land marketed for development has increased for two consecutive quarters and is at its highest level for over a year. We expect this to continue to rise as land owners attempt to capitalise on the increased levels of demand for purpose-built space on well-located sites with planning consent. The larger industrial developers, already sitting on large land banks with planning consent, remain land hungry. Prologis has been notable in this regard during Q3, buying a 32 acre site in Dunstable capable of accomodating two warehouses over 300,000 sq ft.

Rolling four quarter total take-up and average deal size

Source: Gerald Eve



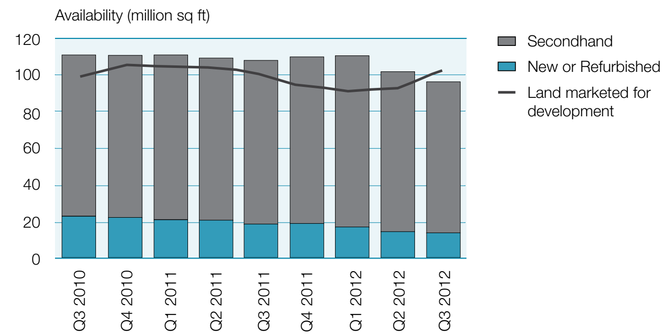
Automotive occupational transactions – Q3 2012

Source: Gerald Eve

Address	Town	GE Region	Occupier	Event	Size (sq ft)
Rivet	Coventry	Southern West Midlands	Lear Seating	Letting	225,000
The Fort, DC3	Birmingham	Southern West Midlands	Jaguar Land Rover plc	Letting	166,052
Apex Park	Daventry	Southern East Midlands	Hankook Tyres	Letting	150,653
Orton 130, Bakewell Road	Peterborough	Cambridgeshire	Perkins Engines Company	Letting	130,888
Eurocentral	Bellshill	Scottish Central Belt	Stapletons Tyre Services	Letting	71,000
Castlewood Business Park	Nottingham	Northern East Midlands	Meridian Lightweight Technologies	Pre-let	60,000
Omega Park	Didcot	Oxfordshire	Pirelli Motorsport Services	Letting	55,000
Stratus, Swan Lane	Wigan	Greater Manchester	Eagle Specialist Vehicles	Letting	51,880

UK industrial availability by quality and supply of land marketed as available

Source: Gerald Eve



Development completions during Q3 totaled 2.64 million sq ft – the largest quarterly volume for over a year and more than double the volume of completions during Q2. However, all completions were purpose-built and we have yet to see a return to speculative development to bolster the waning available supply. Large completions during the quarter include the Co-Op's 435,750 sq ft distribution warehouse in Avonmouth and Moog's 209,000 sq ft warehouse on the i54 Business Park in Wolverhampton.

The shortage of good quality supply has continued to place upward pressure on prime rents in certain geographical pockets of the country. Early on in the quarter, the pre-let by dnata of 141,500 sq ft of 'airside' space at Heathrow, understood to have been agreed on a ten year lease at a rent of £16 per sq ft, marked a record high for the location. The chances of future rental growth are strengthened by such deals as design-and-build schemes are fast becoming the only choice for occupiers not willing to compromise on location or quality. Headline rents for design and build schemes are, on balance, higher and fewer incentives are likely to be offered to tenants.

There is also upward pressure on rents from the fact that certain industrial developers are offering pre-lets for short lease terms. This has proved popular with companies such as Jaguar Land Rover and could put upward pressure on prime rental levels through the (anticipated) premium on rents for the occupier's flexibility and to offset the developers' risk. This could also put added pressure on the landlords of competing secondhand buildings to differentiate their product, which could in turn exacerbate the negative rental growth on secondary buildings and further polarise the market between prime and non-prime properties.

The investment market was sluggish over the summer and, as depicted opposite, only five logistics deals over £10m completed during Q3. Blackstone were notably absent from the large deals during the quarter, with the limelight instead taken by Standard Life who, looking to satisfy a new requirement for higher-yielding logistics, completed three acquisitions. Elsewhere, the off-market sale of the M&S RDC at Castle Donington to a Swiss Trust for £76m (equating to 5.25% for 24 years with geared uplifts) represented the second largest ever deal (after the Tesco RDC at Reading) and the sharpest yield paid in the logistic sector since 2008.

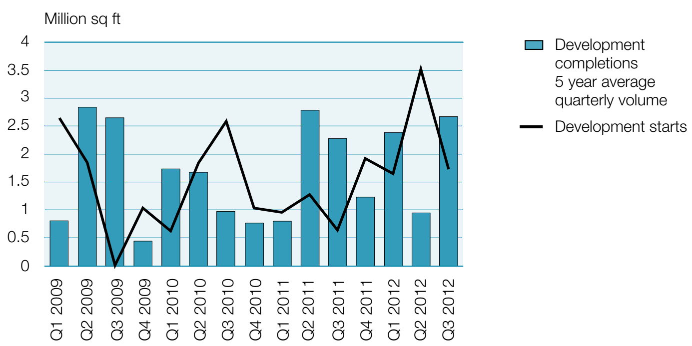
Whilst quarterly total investment volumes were down, there is a healthy level of demand for the best logistics assets. Opportunities which display one or more compromised fundamentals are continuing to struggle however, as the majority of investors are risk-averse and lending remains extremely restricted. Whilst demand for the best prime stock remains buoyant and the lack of supply of suitable opportunities is sufficient to maintain existing yield levels, spending pressure is not yet significant enough to set new benchmarks, aside from one-off deals involving the very best-in-class assets such as the M&S unit.

The prospective sale of the John Lewis RDC on Magna Park Milton Keynes is an interesting case study and highlights current investor attitudes to the sector. Whilst it may arguably be one of the best logistics units in the UK, the Crown struggled to generate interest from their summer marketing campaign due to a combination of lot size (£66m), aggressive pricing (6.00%) and income length (15 years).

Whilst our capital growth expectations for 2012 are negative across all property sectors, we expect that 2013 will bring with it some positive capital return contribution for industrial property, with the pattern continuing through to 2016. It is anticipated that the combination of the limited supply of quality industrial stock together with low levels of development will keep the prospect of falling capital values in check in the medium term. We anticipate a gradual improvement in industrial property performance, as depicted in the opposite chart, delivering the highest average annual returns of all property sectors over the five-year period.

The next full update will be released in February 2013 and will contain individual market reports and detailed analysis for all of our 26 regions. The full update will also include an annual review of 2012 performance and will replace the quarterly update for Q4 2012.

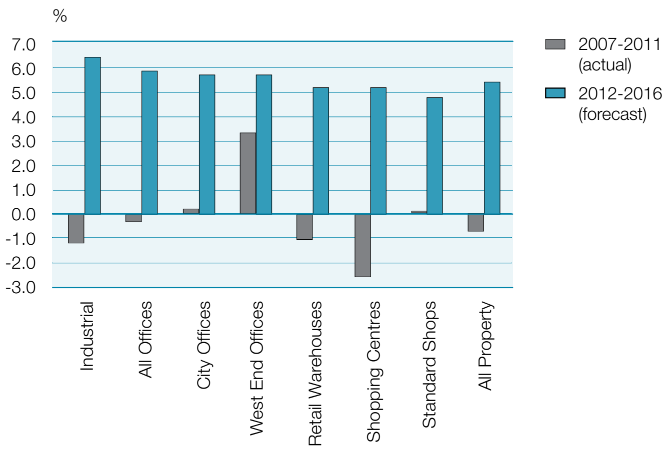
Quarterly development starts and completions
Source: Gerald Eve



Key logistics investment transactions, Q3 2012
Source: Gerald Eve

Property	Tenant	Purchaser	Vendor	Price (£m)	Size (sq ft)	Net Initial Yield (%)
M&S, East Midlands Distribution Centre, Leicestershire	Marks & Spencer Plc	Swiss Trust	Zenprop & Credo	76.0	902,575	5.25
Palletforce, Centrum West Business Park, Burton-upon-Trent	Palletforce	Standard Life	Goodman	20.8	379,482	8.75
Plot 9000, Frobisher Way, Hatfield	Home Delivery Network Ltd	Standard Life	Yodel (S&L)	19.5	170,751	7.48
Yodel Sort Centre, Wednesbury, West Midlands	Home Delivery Network Ltd	Standard Life	Yodel (S&L)	11.5	200,264	8.26
M&S, Dartford Tunnel Distribution Centre, West Thurrock	Marks & Spencer Plc	Lothbury Thrust	Private investors	18.9	250,277	7.40

IPD total return forecasts, by sector
Source: Gerald Eve, IPD



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GERALD EVE IN THE MARKET

As detailed below, we have specialists covering the full range of property services and have been involved in several high-profile recent transactions. For more information on the transactions listed below or on the services we offer, please see the contacts section below.

George Underwood
advised NFU Mutual on the £17m acquisition of the 263,000 sq ft Next distribution centre in Doncaster.

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Mark Trowell
advised AG Barr on their new 265,000 sq ft premises at Magna Park, Milton Keynes.

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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 research report gives detailed analysis and statistics for 26 key distribution areas – from take-up, stock and development statistics to drivers of occupier demand, growth forecasts and regional outlooks.

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