PRIME LOGISTICS

The definitive guide to the UK's distribution property market

Q4 2013 Bulletin

Q4 2013 OVERVIEW

- 2013 was a good year for the industrial leasing market as annual take-up rose 11%
- The 7.4 million sq ft transacted in Q4 did however represent a quarterly fall of 30%
- Nearly all deals over 500,000 sq ft agreed in 2013 were pre-lets
- 8.5 million sq ft under offer suggests a strong start to 2014
- Further speculative development planned in the South East for early 2014
- Increasing weight of money in the investment market has led to further yield compression

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Q4 2013 – A QUARTERLY REVIEW

2013 was a good year for industrial property. Annual take-up for the year was 37.3 million sq ft, which marked an 11% improvement on 2012 and the highest annual volume since 2010. This is despite the fact that only 7.4 million sq ft transacted in Q4, which was the lowest quarterly volume of space taken-up during 2013.

During 2013, take-up was strongest in established locations such as the Southern West Midlands and Merseyside and Cheshire but it was also the strong annual growth seen in markets such as London East, the Scottish Central Belt and Humberside which helped drive the annual total.

The shortage of new space on the market continued to drive occupiers to build bespoke properties. At the end of 2013, only 3.2% of all available new or refurbished stock was being marketed as available. Whilst only 33% of annual take-up involved pre-lets or pre-sales, with the exception of Marks & Spencer leasing the speculatively-built 647,000 sq ft building at SIRFT in Sheffield, all deals over 500,000 sq ft in size were either pre-lets/sales during 2013. Those occupiers with large requirements for space had little choice but to build it for themselves. Throughout 2013, the industrial property market continued to do its best to react to the evolving property needs of retailers given the step-change in consumer shopping patterns. Increased demand from internet retailers, such as Amazon taking 161,134 sq ft in Hemel Hempstead, as well as parcel delivery and logistics companies taking space to service internet retail contracts, has meant that the desire of logistics and home delivery companies to strategically position themselves around major population centres has certainly helped to drive demand during 2013.

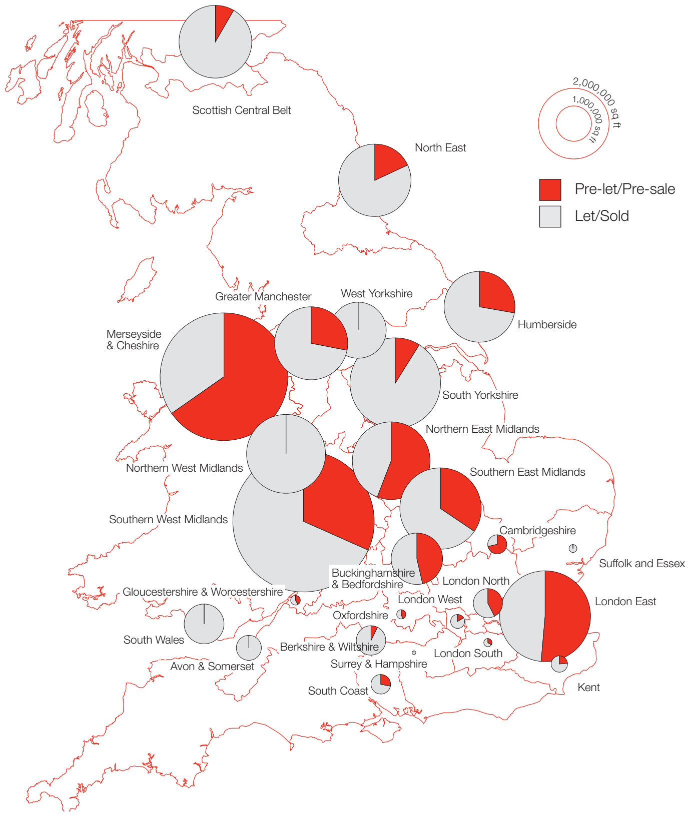
We expect that this will continue – with smaller satellite hubs around major conurbations to service the online grocery or general home delivery market – but what retailers need is flexibility when it comes to their property network. The peaks in consumer demand at different times of the year together with the desire of retailers to quickly expand or contract the amount of floorspace they occupy has meant that flexible lease structures are desired. The 'common user' facility due to be built in 2014 at the London Gateway scheme is an interesting idea. As retailers continue to take a fresh look at their stock-keeping and supply networks, the concept of a shared facility could provide some of the flexibility modern retailer businesses demand from their property networks. To this end, Prologis are expected to speculatively develop a 400,000 sq ft chilled London 'food hub' at the scheme, which will only be open to occupiers who use the park.

Strong demand, together with the ongoing falls in overall availability we have seen in the market throughout 2013 has made this a critical time for industrial property developers. Developers are all too aware of the shortage of space and lack of suitable options for the modern logistics occupier, but both they and their financiers have been hesitant to begin speculative development programs. That said, IM Properties and Prologis have begun speculative schemes in established logistics locations and there is another half a million sq ft of speculative space expected to start in early 2014.

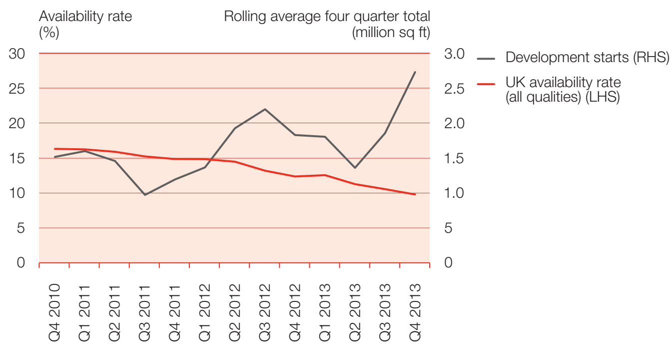
We do not believe however that the floodgates will open to mass speculative development. Despite total availability volumes falling 7% in Q4 to the lowest on our records, funders of such projects are yet to fully buy in to the viability of such schemes, especially outside of core locations, preferring instead to finance strategic land acquisitions. Well-located land with the potential for appropriate planning permission remains in high demand as developers aim to align their land banks to capitalise on future occupier activity. In this regard, we have noticed an increase in the number of schemes granted planning permission in Q4 as developers ready sites for future demand.

With that said, Q4 was a busy quarter for the development market as 3.9 million sq ft started construction, the largest quarterly volume of space starting construction since Q1 2008. It was developments for retailers and wholesalers which accounted for the largest volume of starts of the quarter as Sainsbury's began their 950,000 sq ft scheme in Daventry, Lidl started construction of their 450,000 sq ft warehouse in Nursling and Travis Perkins their 630,000 sq ft scheme in Warrington. Other notable development starts were accounted for by the manufacturing sector as Hitachi got underway on their 460,000 sq ft train production plant in Newton Aycliffe and Aero Engine Controls on their 278,818 sq ft manufacturing and technology facility in Birmingham.

2013 regional take-up by type of transaction
Source: Gerald Eve



Development starts and availability rate
Source: Gerald Eve



There was 2.4 million sq ft of completed development in Q4 2013, almost double the volume of space completed in Q3. Large schemes reaching completion include Asda's 616,000 sq ft warehouse in Avonmouth and B&M Bargains 500,220 sq ft warehouse in Liverpool. Other notable development completions were more manufacturing than logistics, and include SITA UK completing their 139,328 sq ft materials recycling facility in Avonmouth and Network Rail their 192,385 sq ft rail operating centre in Crawley.

This development activity has gone some way to provide the investment market with much-needed product. Investor interest in industrial property has intensified as the year progressed throughout 2013, and prime yields moved in across all of our regions throughout the year as bidding on assets became increasingly competitive. The weight of money targeting the sector continued to increase due to the good level of income yield on offer relative to other sectors and the improving occupational market. More investors cottoned on to the supply/demand imbalance in the sector and saw the benefits that multi-channel retail could bring to the logistics market. Confidence bred confidence as 2013 went on.

This culminated in a new low yield of 4.68% being set in Q4 as Middle Eastern investor Iken Trust purchased the Goodman-developed 112,200 sq ft warehouse occupied by Kent County Council at Aylesford Commercial Park for £12.8 million. Whilst an exceptional deal in many ways given that it is extremely rare to see this combination of long income, local government tenant, South East location and an up-and-built (rather than funding) opportunity, it still represents the lowest initial yield for several years.

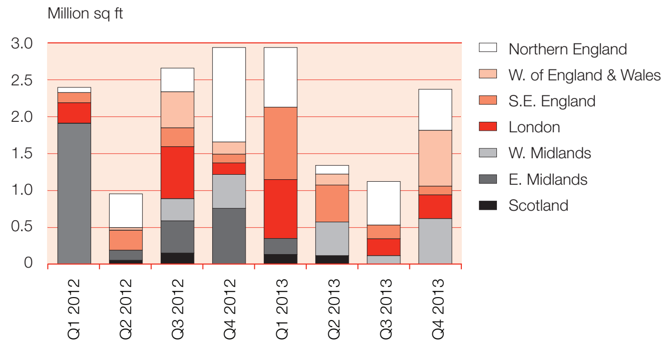
The potential for investors to access strong covenants at an attractive yield level in a market where rents are low and which many expect to enjoy strong growth in demand given the change in economic expectations has meant that industrial property has featured prominently in investment plans during 2013. During Q4, even those more secondary properties or properties offered with shorter income went for over the asking price.

Looking to 2014, the occupational drivers discussed earlier are expected to continue to feed through into the investment market. As more buildings are developed, either speculatively or on a design-and-build basis, this will provide the market with more prime stock on which to trade. But this will not be enough to satisfy the appetite of investors. We expect that banks will begin to increase their lending as we go into 2014, so we could see more leveraged buying, which will thereby increase the pool of investors targeting the sector. Combine with this those investors priced out of prime properties and there will soon be a very large pool of willing and able investors. We believe that this pool will begin to target secondary and there will be a widespread loosening of fund criteria for industrial due to the lack of prime product. We expect that best in class yields will largely remain stable during 2014, bar a few exceptional deals, but that the yield gap between prime and secondary will narrow as focus is switched to more secondary assets.

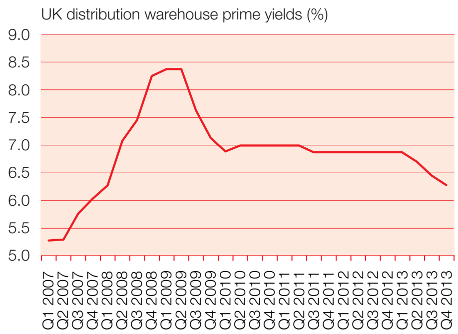
We remain positive about the current market conditions. With leading indicators suggesting that we are finally emerging from a period of very low economic growth (retail sales and manufacturing output are both showing sustained signs of improvement), we expect 2014 to be another good year for industrial. Occupationally, we envisage an increase in demand as prospective occupiers regain confidence in their own businesses, but at the same time expect the supply shortage to inhibit overall volumes. We expect developers to continue to prepare themselves for this increase in demand by speculatively buying land, the competition for which will force values for strategically-located sites to rise and we envisage more speculative developments to begin construction in core locations as the year goes on.

All in all, leading indicators suggest vast improvement and the market is enjoying renewed impetus given the changing shopping patterns of the consumer. We are forecasting more steady growth during 2014, which we believe will be a year that the sector really begins to gather steam.

Development completions by broad region
Source: Gerald Eve



Gerald Eve average UK distribution prime yields
Source: Gerald Eve



Our predictions for 2014

- A 5-7% increase in annual take-up
- Investment in multi-channel retail operations will continue to benefit industrial property. We expect this to take the form of an increased number of smaller satellite hubs around major conurbations. Design innovation and lease flexibility will be key to meeting the changing needs of retailers' supply chains.
- Attempts to redress the supply shortage will begin with more strategic speculative development starts, although developers will focus on their land banks first and foremost.
- Availability of built stock will continue to fall and the number of pre-lets will continue to rise.
- Large scale schemes such as the Thames Gateway will attract further tenants given the supply shortage.
- The weight of money targeting the sector will continue to increase, with perhaps more leveraged investors, but the lack of suitable stock and the anticipated loosening of fund criteria for industrial will switch attention to secondary assets.

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GERALD EVE IN THE MARKET

Over the last three years, we have advised on over **4 million sq ft** of industrial property – either leasing, marketing, buying or selling big sheds. We are very well established in the sector and have specialists covering the full range of property services, from agency to lease consultancy to valuation. Our specialists have been involved in several high-profile transactions during Q4. Please contact them for more information.

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voted CoStar 2013 'Deal Maker of the Year' for West Midlands Industrial and advised Prologis on the sale to UK Mail of 22 acres at Prologis Park Ryton to accommodate a 225,000 sq ft cross-dock mail facility.
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BEST SUPPORTING ROLE
WINNER 2013

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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