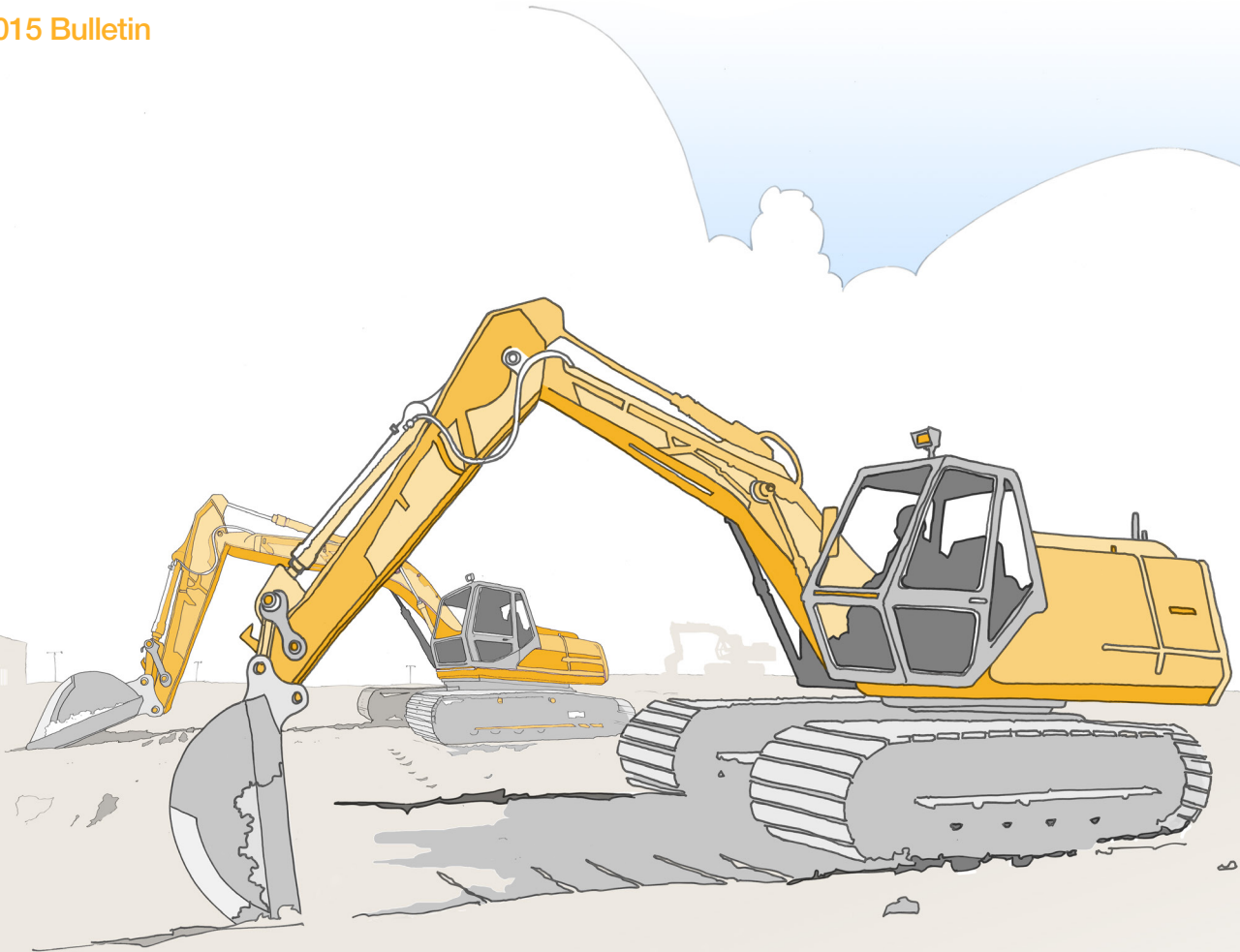


PRIME LOGISTICS

The definitive guide to the UK's
distribution property market

Q2 2015 Bulletin



QUARTERLY SUMMARY

- Largest quarterly volume of development underway since Q1 2007
- 50% of all development starts were speculative
- Following an exceptional Q1, take-up falls 31% to 9.2m sq ft
- Overall availability rate falls further, but new supply bottoms-out
- Rents remain static as we await evidence from latest phase of speculative builds
- Fierce competition on prime investment deals sets new yield benchmarks



GERALDEVE

What has happened to the speculative space completing development since 2014?

9.2
MILLION SQ FT
Q2 2015
OCCUPATIONAL TAKE-UP
DOWN 31% ON Q1

Let



59%

Available



41%

Q2 2015 – A QUARTERLY REVIEW

TAKE-UP

It was always going to be hard to top the volume of space transacted in Q1, which turned out to be the strongest quarter on record. And with 9.2 million sq ft agreed, take-up fell 31% to just below the long term average of 9.3 million sq ft. With this said, the overall volume of space taken-up in the first half of 2015 still exceeded the first half of 2014.

The dynamics of occupier demand changed during Q2, with an increased focus on smaller secondhand buildings. This meant that the number of deals agreed remained above average as an increased number of buildings between 50 -100,000 sq ft in size were occupied. This size bracket accounted for 46% of total demand, which is an unusual finding, and one driven largely by occupier demand for flexible space to service new operations and expansionary activities.

There were still large deals agreed however, and the North West was home to two of the biggest ones with **Exertis** pre-letting 543,620 sq ft in Burnley and **B&M Bargains** taking 460,882 sq ft in Middlewich. Other notable deals include **Clipper Logistics** (for Zara) taking 341,025 sq ft in Northampton and **CDS Superstores** (The Range) letting 256,640 in Barnsley.

NEW SUPPLY BOTTOMS-OUT

Following several secondhand lettings, the overall availability rate fell further in Q2, from 8.2% to 7.8%. The availability rate of new or refurbished space remained stable at 2.1% however as the space that was taken was replenished with speculative developments. It is likely that we have now seen the nadir in terms of available new/refurbished space, especially as the speculative space starting construction begins to enter our supply figures.

The low level of availability continues to force occupiers with large requirements to design-and-build solutions. It has also encouraged the further increase in speculative development we have seen this quarter as several developers started speculative build programmes.

The amount of new speculatively-built space entering our supply figures has up until now been relatively modest. As depicted above, over half of all completed developments have let. However, as 50% of all starts were speculative in Q2, much depends on the level of occupier interest in these schemes. Given that developers have by and large focused on established locations, we expect high levels of interest.

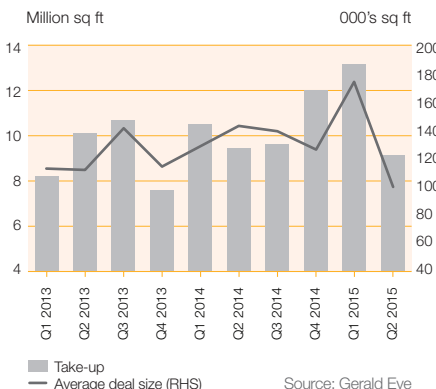
SPEC DEVELOPMENT INTENSIFIES

50% of all development starts were speculative in Q2. 18 buildings commenced construction, totalling 2.9 million sq ft, more than double the amount of speculative space started in Q1. Development was spread across 11 regions and several different developers, and, the average size of property started was 165,000 sq ft. When added to the 2.9 million sq ft of purpose-built space which got underway, the quarterly total of just over 5.7 million sq ft is the largest volume of space to start construction in one quarter since Q1 2007.

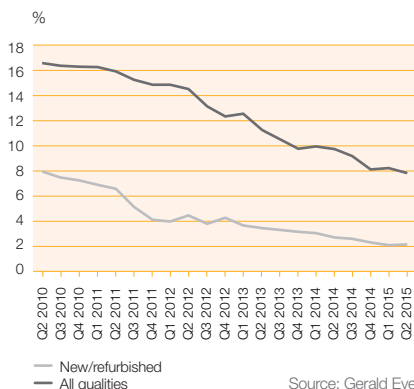
Conversely, 5.7 million sq ft of space completed development in Q2, the largest volume to complete in a single quarter since Q4 2007. 81% of this space was purpose-built, as amongst others, Sainsbury's completed on its warehouses in Daventry and Basingstoke.

Whilst anecdotally there are concerns of the development market overreacting to the supply shortage and creating an oversupply, when compared to the four quarter period prior to Q2 2008, where 62% of the space completing development was speculative, only 18% of the previous four quarters completions is categorised as speculative. And around half of these buildings have been subsequently let.

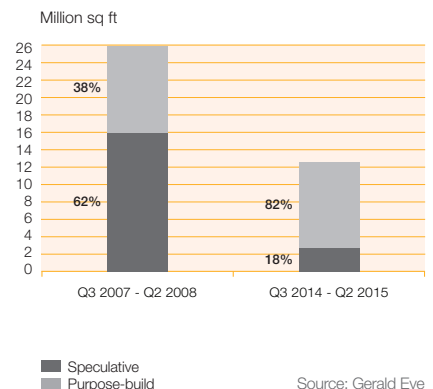
Quarterly take-up and average deal size



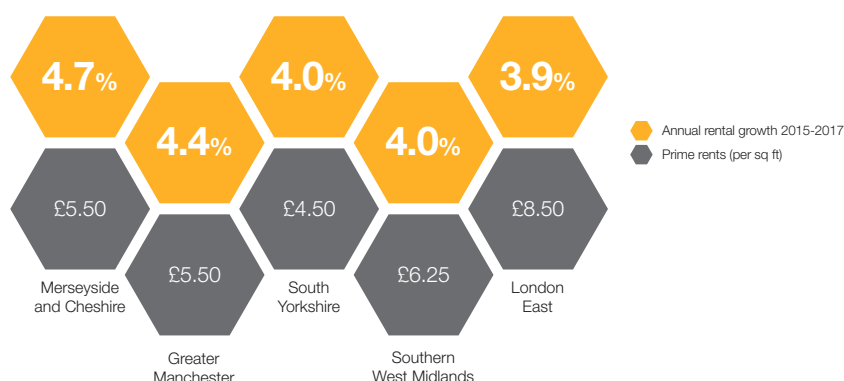
Quarterly availability rates



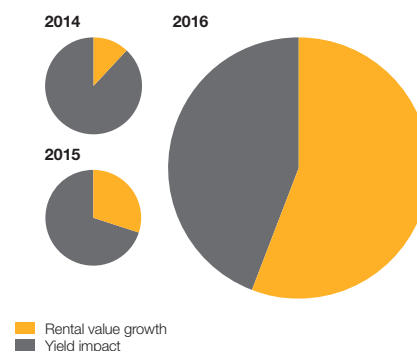
Development completions by type



Top 5 forecast prime rental growth hotspots



Growing importance of rental growth to warehouse capital values



AWAIT EVIDENCE OF FURTHER RENTAL GROWTH

Following the growth in prime headline rents we recorded in 30 out of our 51 locations during Q1, prime rents largely remained stable in Q2. Demand remains strong and supply very limited, and indeed negotiations are being undertaken at a higher level than our recorded rents, but there is not yet the evidence to justify further growth this quarter.

There are now several speculative schemes underway which have ambitions for a high rental profile, but we wait with interest to see at what level these schemes are agreed at. As prime rents are by and large back to the levels being achieved in 2007, we are likely to see average rents increase past previous peaks as deals are agreed on the current wave of speculative space.

In growth terms, our rental growth forecasts have highlighted certain locations in the North West as having the best prospects for rental growth over the next few years, with over 4% growth expected. Other locations, such as the Southern West Midlands and certain regions in London, which may have already witnessed significant improvement in prime rents, are also expected to continue to post strong levels of rental growth.

NEW YIELD BENCHMARKS

Investor confidence in the sector is as high as ever with buyers continuing to be attracted to the fundamentals of record low availability rates, rental growth and the return of speculative development. The few prime opportunities available have been subject to fierce competition and, in the process, new benchmark yields have once again been set. The momentum of the current market is such that these benchmarks are unlikely to last long given the number of long income deals under offer at prices reflecting yields below 4.2%.

The prime yield compression of the last 12 months has forced an increasing number of institutional investors to expand their requirements, thereby causing a further convergence of the yield spread between prime and secondary. There has also been a noticeable yield shift in sub £10 million pricing, as this asset type begins to gain interest from institutions that can no longer compete in the more aggressive pricing of the £10-50 million bracket, which has been dominated by **Tritax Big Box REIT** and **Standard Life** during Q2.

As average prime yields are at or within a whisker of the lows achieved in the last cycle, it will prove critical to investors throughout the rest of 2015 to pinpoint areas and opportunities where above average rental growth is expected.

OUTLOOK

Although take-up showed a 31% quarterly fall on the exceptional volume of space transacted during Q1, at 22.4 million sq ft, more space has transacted during 2015 that at the same point in 2014. Given the number of large requirements for space in the market and the fact that around 7 million sq ft of space is currently under offer and the occupational market outlook is positive.

We expect that developers will continue to develop to meet this demand and that investors will remain keen to purchase such space whilst the market fundamentals are favourable. This will continue to push rents on, and as depicted, given recent yield compression, rental growth will become an increasingly important driver of capital growth over the next few years. Choosing the area of strongest expected rental growth is key and we expect renewed interest in locations in the North West, the Southern West Midlands and East and West London.

There are of course risks to this positive outlook. An increase in interest rates or bond yields for instance would ultimately have a negative effect on industrial property capital values. The prospect of an EU referendum could also create investor uncertainty as we approach 2017, especially if the 'out' campaigners start to gain ground. But, for now, these risks are in the background and most of the identified risks are on the upside.

Key logistics investment transactions Q2 2015

Property	Purchaser	Vendor	Price (£m)	Size (sq ft)	Yield (%)	Tenant
MP3, Magna Park, Milton Keynes	Standard Life Pooled PPF	IDI Gazeley	85.7	638,000	4.2	John Lewis
Capitol Park, Goole	Tritax Big Box REIT Plc	Sterling Capital	47.1	701,979	5.7	Tesco Plc
Prologis Park Sideway, Stoke-on-Trent	Tritax Big Box REIT Plc	Prologis	43.4	526,409	5.5	Dunelm
Isis Reach, Belvedere	Standard Life	Deutsche Asset & Wealth	41.0	316,190	5.0	Office Depot
Flex Meadow, Harlow	Tritax Big Box REIT Plc	LondonMetric	37.2	267,989	5.0	Brakes
Heywood Distribution Park, Manchester	Tritax Big Box REIT Plc	Chubb PF	34.1	381,096	5.3	Argos
Lymedale Business Park, Newcastle-Under-Lyme	Tritax Big Box REIT Plc	Deutsche Asset & Wealth	30.1	396,937	5.9	New Look
Westwood Park, Wigan	Tritax Big Box REIT Plc	Nice-Pak International	28.6	399,492	6.4	Nice-Pak

In general, Q2 has been a very positive quarter, with resilient levels of occupier demand, a development market doing its best to fill the supply gap and new record yields being set in the investment market. Even commercial property lending has reached a six year high according to the latest De Montfort report. We think that developers will remain targeted and selective in their decisions and realise that the development response should be commensurate with the strength of the occupier market as opposed to the amount of money currently targeting the sector.

GERALD EVE IN THE MARKET

Gerald Eve is well-established in the logistics property market and covers the full range of property services, from national occupational and investment agency through to lease consultancy and valuation. Our specialists have been involved in several high profile transactions during the quarter. Please contact them directly for more information.



George Underwood

advised Standard Life on the £85.7 million forward funding of the 638,000 sq ft John Lewis III shed at Magna Park, Milton Keynes.

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Richard Ludlow

advised Peugeot on the disposal of the final part of the 625,000 sq ft sq ft distribution centre, Coventry DC, by letting 141,000 sq ft to Voith.

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Sven Macaulay

advised Yodel on the purchase of 7 Nettlehill Road, a 96,933 sq ft warehouse on Houstoun Industrial Estate, one of the largest industrial deals agreed in Scotland this year.

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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. All previous editions can be downloaded from our website.

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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