PRIME LOGISTICS

The definitive guide to the UK's distribution property market
Q4 2018 Bulletin

International Property Consultants

GERALDEVE

WHAT TO EXPECT IN 2019

Should we experience a disorderly Brexit, we would expect some major short term disruption to both the economy and equity markets. Commercial real estate is not going to avoid these negative impacts, but the logistics sector is far less vulnerable than both the office and retail sectors.

2018 turned out to be the second-highest year on our record for occupier take-up of logistics space, with the total volume of space occupied less than 1% below 2016. The industrial sector has actually managed to flourish against the unusual economic and political environment it has found itself in. Whilst hard to unpick the reasoning behind each deal, we have seen a few instances of occupiers, particularly those related to the pharmaceutical or food industries, taking short term space, with very short lease breaks, on the face of it to house additional inventory in case of a no-deal Brexit.

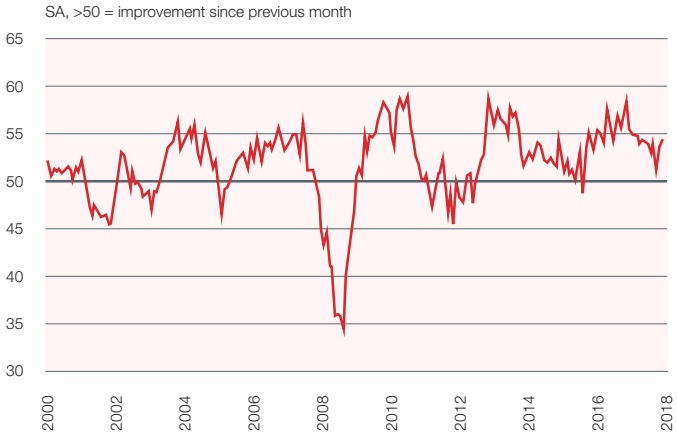
High frequency data, such as the IHS Markit/CIPS Purchasing Managers' Index rose to a six month high in December 2018, driven by a solid increase in stocks of purchases, which in turn is reflective of Brexit preparations by manufacturers and their clients. Indeed, there are various requirements for logistics space in the market, citing the potential need for additional space due to Brexit uncertainty. However, the majority of these requirements are waiting for further clarity before committing. This could provide a short term boost to occupier demand in 2019, although the broader negative impact on the economy is likely to make this bounce in occupier activity short-lived.

Allied to this is demand from online retailers and those retailers which are rationalising their high street store portfolios and investing in their distribution networks. This could help to keep overall occupier demand elevated at a time of great uncertainty for the wider economy. This demand could soon soak-up the recently-completed speculative space delivered to the market, which in turn could continue to drive positive rental growth, albeit not at the same rate of growth seen over the last few years.

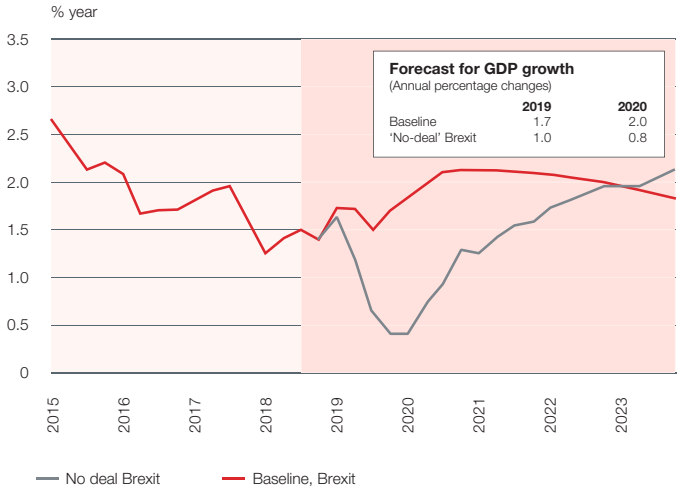
Many investors realise that this is one of the few sectors that has the real possibility of meaningful income return and rental growth. The best quality logistics properties still offer the opportunity to attract very strong tenants on long, often index-linked leases. These 'long and strong' opportunities have the greatest depth of interest as some investors seek to reduce their risk exposure in the late run cycle.

However, it is possible that the yield spread between core and core-plus, having shrunk over the last couple of years, could begin to widen again. Core-plus assets could underperform against core counterparts as investors apply a greater risk premium to shorter leases and older properties.

UK Manufacturing PMI
Source: IHS Markit/CIPS



Impact of scenarios on GDP growth
Source: Oxford Economics



Forecast for GDP growth
(Annual percentage changes)

	2019	2020
Baseline	1.7	2.0
'No-deal' Brexit	1.0	0.8

Q4 2018 HIGHLIGHTS

50.5
MILLION SQ FT
SPACE TAKEN UP DURING
2018
2ND LARGEST ON RECORD

3.6%
PRIME RENTAL GROWTH IN 2018

22bps
FALL IN UK AVERAGE PRIME YIELDS IN 2018

12.2
MILLION SQ FT
Q4 2018 TAKE-UP

POSITIVE
PRIME RENTAL GROWTH IN
23 (OUT OF 51)
GERALD EVE CENTRES IN Q4

2018 TAKE–UP OF BIG SHEDS 100,000 SQ FT+

40%

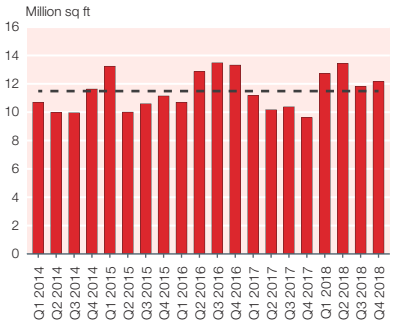
SPECULATIVE DEVELOPMENT COMPLETIONS

4.2
MILLION SQ FT

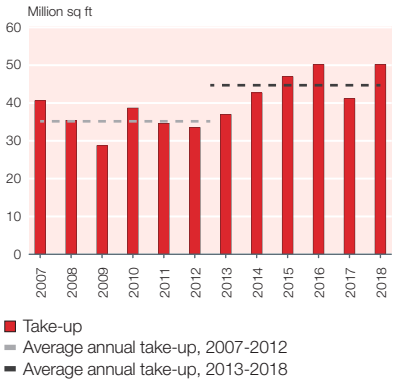
LARGEST QUARTER SINCE Q4 2007

GERALDEVE

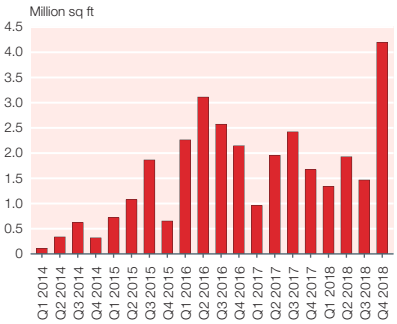
UK quarterly take-up and five year average, Q1 2014-Q4 2018
Source: Gerald Eve



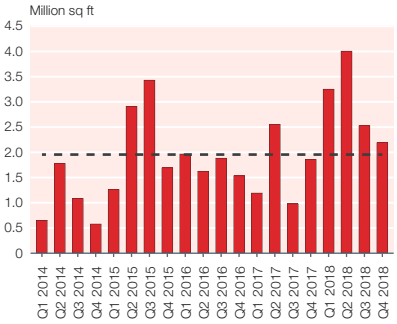
Annual take-up and six year averages, 2007-2018
Source: Gerald Eve



Speculative development completions, Q1 2014-Q4 2018
Source: Gerald Eve



Speculative development starts by type, Q1 2014-Q4 2018
Source: Gerald Eve



STRONG END TO THE YEAR FOR THE OCCUPIER MARKET

Almost 12.2 m sq ft of space was taken-up in the last quarter of 2018, representing a 2% quarterly increase on Q3 and was 18% up on the 10 year quarterly average. Activity in large sheds drove this increase, with over 77% of the space taken-up in Q4 involving buildings measuring over 100,000 sq ft in size. The average building size taken-up in Q4 was 174,000 sq ft – far in excess of the 146,000 sq ft five year average deal size.

Amazon continued to be acquisitive in Q4, committing to a two million sq ft purpose-built multi-storey facility in County Durham, and taking a 502,000 sq ft secondhand building at Barlborough Links in Chesterfield. In line with the findings of high frequency stock purchasing survey data, increased take-up by manufacturers also helped drive Q4 volumes. There were 21 individual deals agreed by occupiers in the sector, totalling over 3.1 million sq ft – more than double the amount of space taken by manufacturers in Q3.

SECOND-HIGHEST YEAR FOR OCCUPIER DEMAND ON RECORD

The advance of online retail has had a profound effect on demand for logistics property, and the volumes of space now being taken-up are on average a lot higher than 10 years ago. We recorded over 50.5 million sq ft of occupational take-up in 2018, up 18% on 2017, and, less than 1% below the record breaking level of take-up recorded in 2016.

The average transacted building size in 2018 was 167,300 sq ft, the second largest on record, and reflective of several large-scale pre-lets and development sales agreed by the likes of Amazon, B&M Bargains, Lidl and Wayfair. Retail and wholesale occupiers, seeking very large bespoke facilities, were therefore crucial to demand in 2018 and accounted for almost 40% of space taken-up in 2018.

LARGEST QUARTER FOR SPEC DEVELOPMENTS COMPLETIONS FOR OVER 10 YEARS

Around 6 million sq ft of logistics development space completed in Q4 2018, on both a purpose-built and speculative basis. This is the largest volume of space to have completed in one quarter since Q3 2017. 70% of this total, or 4.2 million sq ft, was speculative. This was the largest volume of space to have completed speculatively in one three month period since Q4 2007 and reflects developers' increased appetite for speculative development.

Regionally, these speculative completions were centred on the Southern West Midlands, Merseyside & Cheshire and Greater Manchester in Q4. Whilst levels are elevated, when put in a longer historical context, the total volume of space completing development speculatively during the whole of 2018 was 9 million sq ft – around half what was developed speculatively during 2007.

HOWEVER, THE RATE OF SPEC DEVELOPMENT STARTS SLOWED IN Q4 2018

Around 2.2 million sq ft got underway speculatively during Q4, across 15 individual buildings, which represents a 13% decrease on the 2.5 million sq ft of space which got underway speculatively during Q3 2018. Whilst the overall volume of speculative development starts tailed-off towards the end of 2018, there is still strong appetite from developers and investors for further development.

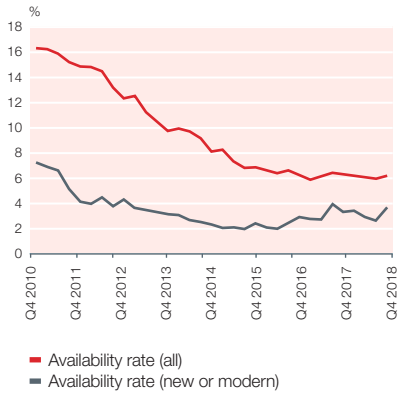
Developers remain confident in the underlying strength of the occupier markets, and we recorded speculative activity across a broad range of developers in Q4. Some investors, keen to increase their exposure to the logistics sector, but maybe finding direct acquisitions of buildings too expensive, are opting instead to provide capital support to developers. We have seen several tie-ups of established developers and new capital, such as Chancerygate and Hines UK, and, Goya and Hillview, which removes some of the developer risk and is likely to support further spec development.

DEVELOPMENT ACTIVITY YET TO MAKE AN IMPACT ON OVERALL AVAILABILITY

Despite the significant increase in speculative development completions, the year ended as it began, with an overall availability rate of 6.2%. Over 6 million sq ft of speculatively developed space was let throughout the course of 2018, albeit not at the same frenzied pace as in 2016, where a lot of space was let under construction. This, when combined with the fall in secondhand availability, has kept availability rates flat and low.

However, whilst the overall rate of availability seems to have bottomed-out, this development activity has meant that the quality of the available supply has started to improve. We are reporting an elevated amount of space actively being marketed during construction and a better quality of available logistics accommodation to choose from. Currently there is over 7.5 million sq ft under construction and available, which, given the static levels of secondhand availability, has improved the overall quality of market supply.

Availability rate, by quality of building, 2010-2018
Source: Gerald Eve

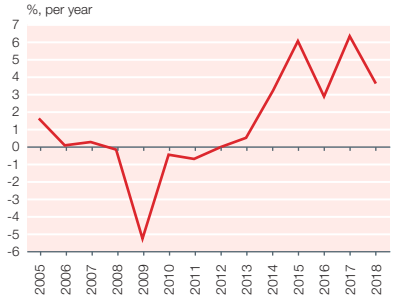


CONTINUED POSITIVE PRIME RENTAL GROWTH

We recorded widespread UK rental growth in Q4 2018, with increases in prime rents in 23 of our 51 centres and an overall quarterly rental growth rate of 1.6%. In line with our forecasts made at the start of the year, UK prime logistics rents increased by an average 3.6% during 2018. Whilst down on the 6.4% recorded in 2017, prime rents in several markets are well in advance of previous highs.

Landlords are going to want to hold out for the best possible terms on the improved quality of available space, which in turn is likely to keep upward pressure on rents. However, it is worth bearing in mind that occupiers may struggle to afford ever-rising rents, which could increasingly become an issue in the medium term, especially if Brexit-related issues affect underlying business conditions and cash flows.

Prime headline rental growth, 2005-2018
Source: Gerald Eve



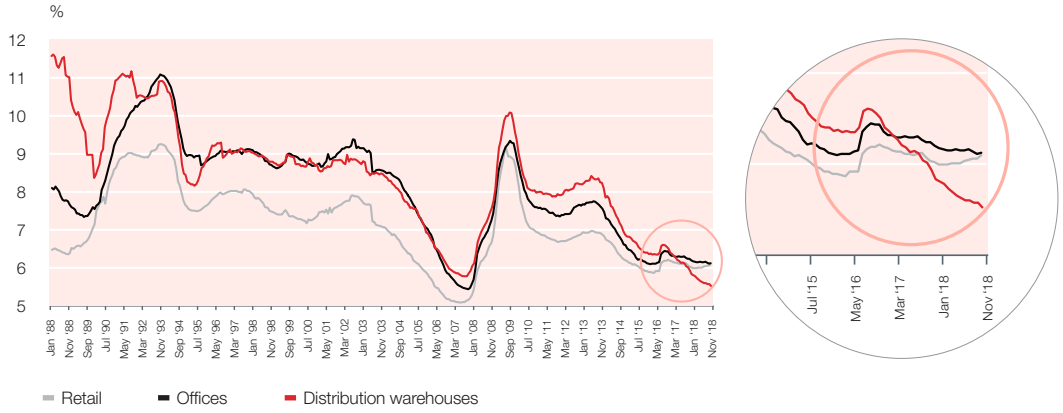
INDUSTRIAL IS THE STANDOUT PERFORMER

For the UK commercial property investor, industrial property is the standout performer and investor competition continues to keep prices high. Industrial property compares favourably against all other commercial property asset classes and we continue to see competitive bidding on the limited amount of stock that has traded, particularly in London.

This in turn has driven down yields to record lows and nationally, according to MSCI, Industrial property is now recording a lower average equivalent yield than both Offices and Retail, the first time in MSCI history that we have seen this difference in asset class performance.

The volume of distribution warehouses transacted during Q4 decreased again to £811 million, with a large proportion of this figure made up of two large portfolios. REITs were a dominant purchaser in Q4. Ascendas REIT, Tritax Big Box REIT, UKCP REIT, Warehouse REIT and Urban Logistics REIT were all acquisitive in the last quarter of the year.

Retail, Office and Distribution Warehouse equivalent yields, Jan 1988 - Dec 2018
Sources: MSCI, Gerald Eve



GERALDEVE

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.

Mark Trowell
advised ATCO Power Generation on the sale of the 42 acre Barking Power Station site to the City of London Corporation at the end of 2018.

Mobile +44 (0)7768 987508

Josh Pater
advised a multi-national food production company on the acquisition of Unit K, Springhead Park, Northfleet, a modern 141,000 sq ft facility.

Mobile +44 (0)7782 271355

Nick Ogden
advised on the sale of a UPS parcel hub in Kentish Town for £61 million.

Mobile +44 (0)78 2510 6681

INDUSTRIAL & LOGISTICS CONTACTS

Agency

London
Mark Trowell
Tel. +44 (0)20 7333 6323
mtrowell@geraldeve.com

David Moule
Tel. +44 (0)20 7333 6231
dmoule@geraldeve.com

Josh Pater
Tel. +44 (0)20 3486 3473
jpater@geraldeve.com

Midlands
Jon Ryan-Gill
Tel. +44 (0)121 616 4803
jryan-gill@geraldeve.com

North West
Jason Print
Tel. +44 (0)161 259 0475
jprint@geraldeve.com

South West & Wales
Richard Gatehouse
Tel. +44 (0)29 2038 1863
rgatehouse@geraldeve.com

Scotland
Sven Macaulay
Tel. +44 (0)141 227 2364
smacaulay@geraldeve.com

Investment
John Rodgers
Tel. +44 (0)20 3486 3467
jrodgers@geraldeve.com

Nick Ogden
Tel. +44 (0)20 3486 3469
nogden@geraldeve.com

Lease Consultancy
Chris Long
Tel. +44 (0)20 7333 6444
clong@geraldeve.com

Ian Gascoigne
Tel. +44 (0)121 616 4812
igascoigne@geraldeve.com

Rating
Keith Norman
Tel. +44 (0)20 7333 6346
knorman@geraldeve.com

Valuation
Richard Glenwright
Tel. +44 (0)20 7333 6342
rglenwright@geraldeve.com

Research
Steve Sharman
Tel. +44 (0)20 7333 6271
ssharman@geraldeve.com

Sophie Jones
Tel. +44 (0)20 3486 3784
sjones@geraldeve.com

OFFICES

London (West End)
72 Welbeck Street
London W1G 0AY
Tel. +44 (0)20 7493 3338

London (City)
46 Bow Lane
London EC4M 9DL
Tel. +44 (0)20 7489 8900

Birmingham
Bank House,
8 Cherry Street
Birmingham B2 5AL
Tel. +44 (0)121 616 4800

Cardiff
32 Windsor Place
Cardiff CF10 3BZ
Tel. +44 (0)29 2038 8044

Glasgow
140 West George Street
Glasgow G2 2HG
Tel. +44 (0)141 221 6397

Leeds
1 York Place
Leeds LS1 2DR
Tel. +44 (0)113 204 8419

Manchester
No1 Marsden Street
Manchester M2 1HW
Tel. +44 (0)161 259 0450

Milton Keynes
Avebury House
201-249 Avebury Boulevard
Milton Keynes MK9 1AU
Tel. +44 (0)1908 685950

West Malling
35 Kings Hill Avenue
West Malling
Kent ME19 4DN
Tel. +44 (0)1732 229423

EG AWARDS 2017 WINNER NATIONAL ADVISER OF THE YEAR

2017 Property Awards Winner

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.

United States and European Alliances

Gerald Eve has an international alliance with Lee & Associates who have offices in 56 US and Canadian cities and a number of Europe alliance partners in 25 cities across 16 European countries.