The UK Big Box Industrial and Logistics Market

July 2014

Introduction and Overview

Welcome to our latest update on the UK ‘big box’ industrial and logistics market.

This report provides a comprehensive round-up of market demand and supply, based on our tracking of Grade A quality distribution units of 100,000 sq ft and over.* It also comments on investment activity and yields.

The **key messages** from our latest numbers are:

Occupier demand fell back in the first half of 2014 compared with the second half of 2013.

- 6.4 million sq ft was taken up in H1 2014, 23% lower than H2 2013 (8.3 million sq ft).
- Of the total amount of Grade A floorspace taken up in H1 2014 around 3.6 million sq ft comprised new floorspace with the remaining 2.8 million sq ft consisting of good quality second-hand space.

Grade A availability continued to fall.

- Total Grade A availability was 2% lower at the end of June 2014 compared with the end of December 2013.
- Compared with the average annual take-up rate over the last five years (2009-2013) there is currently less than one year of supply in the market, based on immediately available Grade A supply and speculative development.
- At the end of June 2014 there was 6.0 million sq ft of new floorspace available, including eight units speculatively under construction totalling 1.2 million sq ft.
- The overall level of availability at the end of June 2014 represented a vacancy rate of around 7% nationally compared with our estimate of the Grade A stock.

Retailers were the most active source of demand in H1 2014.

- Retailers accounted for 50% (3.2 million sq ft) of all Grade A take-up in H1 2014, compared with 43% during 2013.
- Logistics companies accounted for 21% of total demand in H1 2014 and manufacturers accounted for 13% of total demand. The remaining 16% was taken by ‘other’ types of companies.

Rental growth expected

- Whilst headline rents remained broadly unchanged over the first half of 2014, net effective rents continued to harden as tenant incentives diminished.
- With a lack of available prime space the market is becoming more landlord favourable.
- Quoting rents in core regions saw notable growth in H1 2014

Prime distribution yields continued to sharpen in the first half of 2014.

- At the end of June 2014 prime distribution yields** stood at 4.75% in London and 5.25% in the South East. Regional prime yields stood at 5.75%.
- There is evidence of lower yields for exceptional covenants on longer leases.

*Take-up includes build to suit (BTS) units when planning permission has been secured.

**Assuming a 15-year lease with open market rent reviews.

Economic Context

The latest indicators suggest that the momentum that the UK economy started to gather last year is continuing and recent growth forecasts for 2014 have been revised upwards; the HM Treasury's latest average of 'new' GDP forecasts for 2014 is now at 3.0% compared with 2.7% at the start of this year.

UK GDP rose by 0.8% in the first quarter of 2014, its fifth consecutive increase. Service industries (+0.9%) contributed most to this growth, but manufacturing rose more sharply (+1.4%); however its contribution to the overall economy is much smaller. The automotive sector has been one of the strongest growing components of manufacturing, with separate data from the SMMT showing year-to-date output growth of 3.5%, despite a dip in May.

This pick-up in activity has had a positive impact on labour market conditions, which have been improving over the past couple of years. The latest data (three months to April) show a large increase in employment and a large fall in unemployment compared with the previous three months.

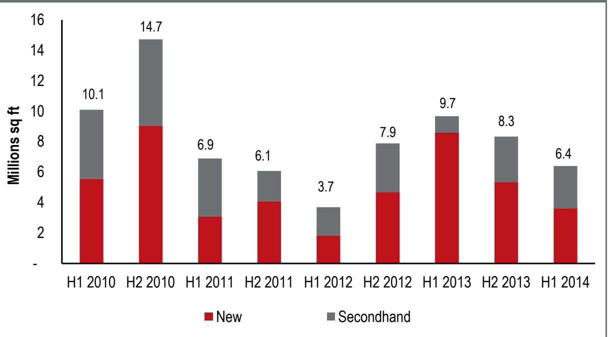
The growth of employment has supported retail sales, which since the turn of 2013 have seen a sharp increase in growth in volume terms. In the three months to May 2013 retail sales volumes, excluding spending on automotive fuel, rose 5.5% compared with a year ago, assisted by a World Cup boost. Online sales, ex. automotive fuel, rose 15.1% in the year to May, bringing the share of total sales accounted for by online sales to 11.4% compared with 10.3% in May 2013.

The upturn in the economy, and consequent reduction in spare capacity, have brought the prospect of an interest rate rise nearer, as highlighted in the minutes from the latest Bank of England Monetary Policy Committee Meeting (June), despite consumer price inflation of just 1.5%.

With the UK economy gathering strength, we would expect to see corporate occupier demand for big box warehouses rise over the next year or so, but, as we report below, take-up in the first half of this year was 23% lower on H2 2013. We would be surprised if this dip is not reversed in the second half of this year.

Occupier Take-up & Demand

Take-up (Grade A units ≥ 100,000 sq ft)

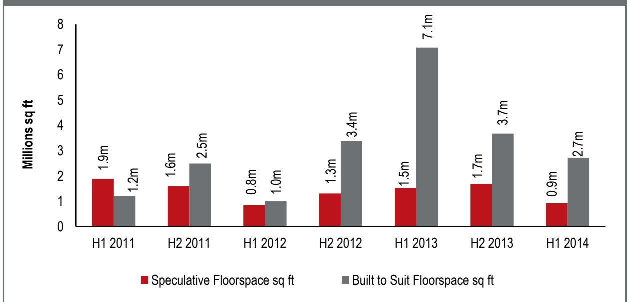


Source: JLL, take-up refers to millions sq ft

Occupier take-up of Grade A logistics floorspace in the first half of 2014 totalled 6.4 million sq ft, 23% lower than H2 2013 (8.3 million sq ft). Over the past five years, we have seen a fairly close correlation between the annual take-up of logistics space and annual UK GDP growth. However, take-up over a short period (three to six months) is often quite volatile, with fluctuations usually due to one or two big transactions, or the absence of these. The first quarter of 2014 saw a number of large retailer transactions including Waitrose taking almost 940,000 sq ft at Magna Park Milton Keynes, however take-up softened in the second quarter. This is likely to be largely attributable to a shortage of good quality available supply and the length of time companies typically take to source and agree terms on new built to suit (BTS) facilities.

Approximately 3.6 million sq ft of space taken up in H1 2014 comprised new units with the remaining 2.8 million sq ft consisting of good quality second hand units. With the lack of immediately available speculatively built units in the market, the majority of new space taken up comprised BTS space which has been a continuing trend over the past two years. Around three quarters of all new space taken up in H1 was in BTS units.

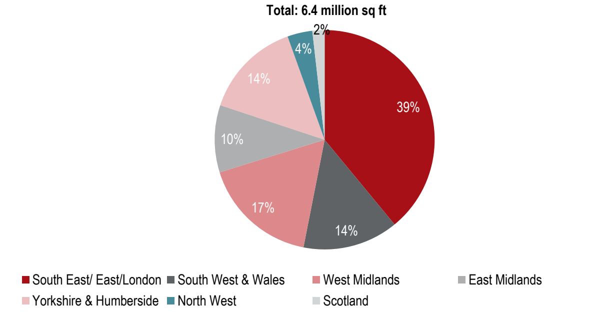
Take-up of new Floorspace – Speculative vs Built to Suit



Source: JLL, take-up refers to millions sq ft

Regionally, the Greater South East (South East, East and London) accounted for the largest share of take-up in H1 2014, at 39% of the total Grade A floorspace transacted. The West Midlands accounted for a 17% share. The South West & Wales combined and Yorkshire & Humberside each accounted for a 14% share of total demand.

Take-up of Grade A floorspace by Region – H1 2014



Source: JLL

Key Deals in H1 2014

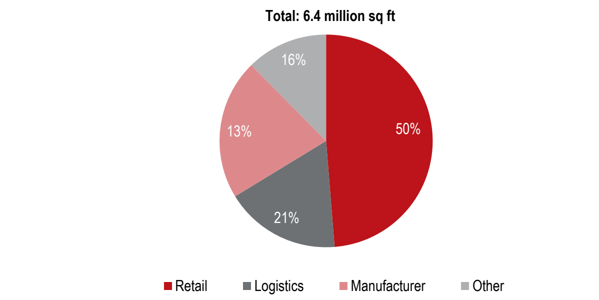
Location	Occupier	Size (sq ft)
• Magna Park Milton Keynes	Waitrose	938,449
• Central Park, Bristol	Farm Foods	175,000
• Birch Coppice, Tamworth	DAU Draexlmaier Automotive	168,900
• Black Swan, Northampton	The White Company	189,663
• LPP Sheffield	Great Bear	412,519

Retailers accounted for the largest share of demand in H1 2014 (50%). Logistics companies accounted for 21% of demand and manufacturing companies accounted for 13%. 'Other' companies recorded 16% of total take-up in H1.

Alongside Waitrose taking almost 940,000 sq ft at Magna Park, Milton Keynes a number of other retailers were also active in H1. In particular Asda took three units in the first half of this year all of which were in the Greater South East; two in London and one in Dartford. Two of these units will be used to fulfil online orders.

E-tailing continues to grow strongly and this is driving demand for new facilities from both retailers and parcel delivery companies. In the first half of this year, both UK Mail and Yodel took units in the Midlands.

Take-up of Grade A floorspace by Sector – H1 2014



Source: JLL

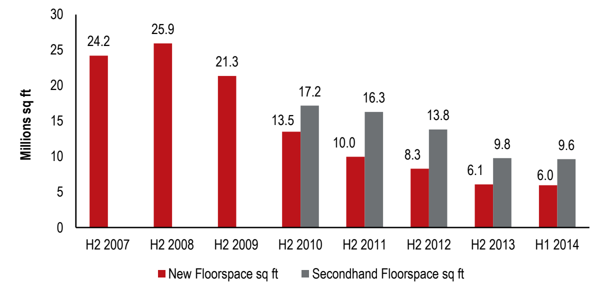
As the economy is predicted to grow strongly this year, we expect to see a stronger level of take-up in the second half of the year. Indeed there are currently a number of units under offer or in solicitor's hands and we continue to track a large volume of active requirements.

Available Supply

At the end of June 2014, Grade A availability stood at around 15.6 million sq ft, of which 6.0 million sq ft was in existing speculatively developed new space including eight units speculatively under construction totalling 1.2 million sq ft. The remaining 9.6 million sq ft comprised good quality second-hand space.

At the end of June 2014 total Grade A availability was around 2% lower than at the end of 2013; both new and second hand space were down by 2%. New supply was 79% below the pre-recession peak.

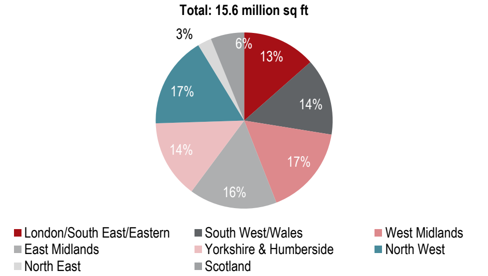
Supply (Grade A units ≥100,000 sq ft)



Source: JLL. Secondhand statistics not collected prior to 2010.

The overall level of availability represented a national vacancy rate of around 7% compared with our estimates of the total Grade A stock. The East Midlands, Greater South East and North East all have vacancy rates below the national average.

Supply of Grade A floorspace by Region – June 2014



Source: JLL

Key New Available Units at the end of June 2014

Region	Unit/Scheme	Size (sq ft)
Eastern	Basildon Gateway	107,355
South West	Crossflow	338,000
West Midlands	Prologis Park Ryton	226,760
East Midlands	Brackmills 110	112,500
Yorkshire & Humber	Wakefield Eurohub	190,000
North West	Lancashire Business Park	168,392
North East	Drum One	263,382
Scotland	Titan, Eurocentral	122,200
Eastern	Prologis Park Dunstable	310,000

Nationally, there is currently only one new unit immediately available which is able to offer more than 500,000 sq ft – namely LPP Corby which provides 525,000 sq ft.

2013 saw the return of big box speculative development following the recession and with supply continuing on a downward trend and strong business confidence, this year has seen a further pick-up in speculative development. At the end of June 2014 there were eight big box units speculatively under construction nationally totalling 1.2 million sq ft. Three of these were under construction in the Midlands and five in the Greater South East. Earlier this year, DAU Draexlmaier Automotive leased IM Properties Birch Coppice speculative unit before practical completion. This highlights the strong demand for new well specified units in key strategic locations. We expect to see further speculative development starts this year.

Rents

Headline prime distribution rents in the major markets that we monitor remained broadly unchanged in the first half of 2014. However, net effective rents continued to harden as the incentives available to tenants fell further.

Talking Point. What's in a cliché? One size doesn't fit all

It is one of the most overused expressions by market commentators and it is self-evidently true, but the cliché 'one size doesn't fit all' applies more clearly to warehouse property demand now than perhaps ever before.

Of course, it has always been the case that warehouse occupiers require different types of facilities, reflecting the different roles that warehouses perform in the supply chain. But with the growth of online and multi-channel retail, we are seeing growing demand for facilities that are fundamentally different from the first generation of big box warehouses, which are now 20 to 25 years old.

The growth of multi-channel retail is driving demand for a range of distinct types of warehouses, including mega e-fulfilment centres, central parcel hubs, local parcel delivery centres, returns processing centres and dedicated warehouses to fulfil online grocery orders. Although the UK is one of the most mature online retail markets in the world, this market is predicted to grow strongly, so the demand for these types of facilities will continue to increase over the coming years. For example, IMRG and Metapack have recently raised their 2014 forecasts for parcel volume growth from UK e-retailers from 12.5% to 16% to 19%, with parcel deliveries expected to hit 940 million parcels to UK and non-UK consumers.

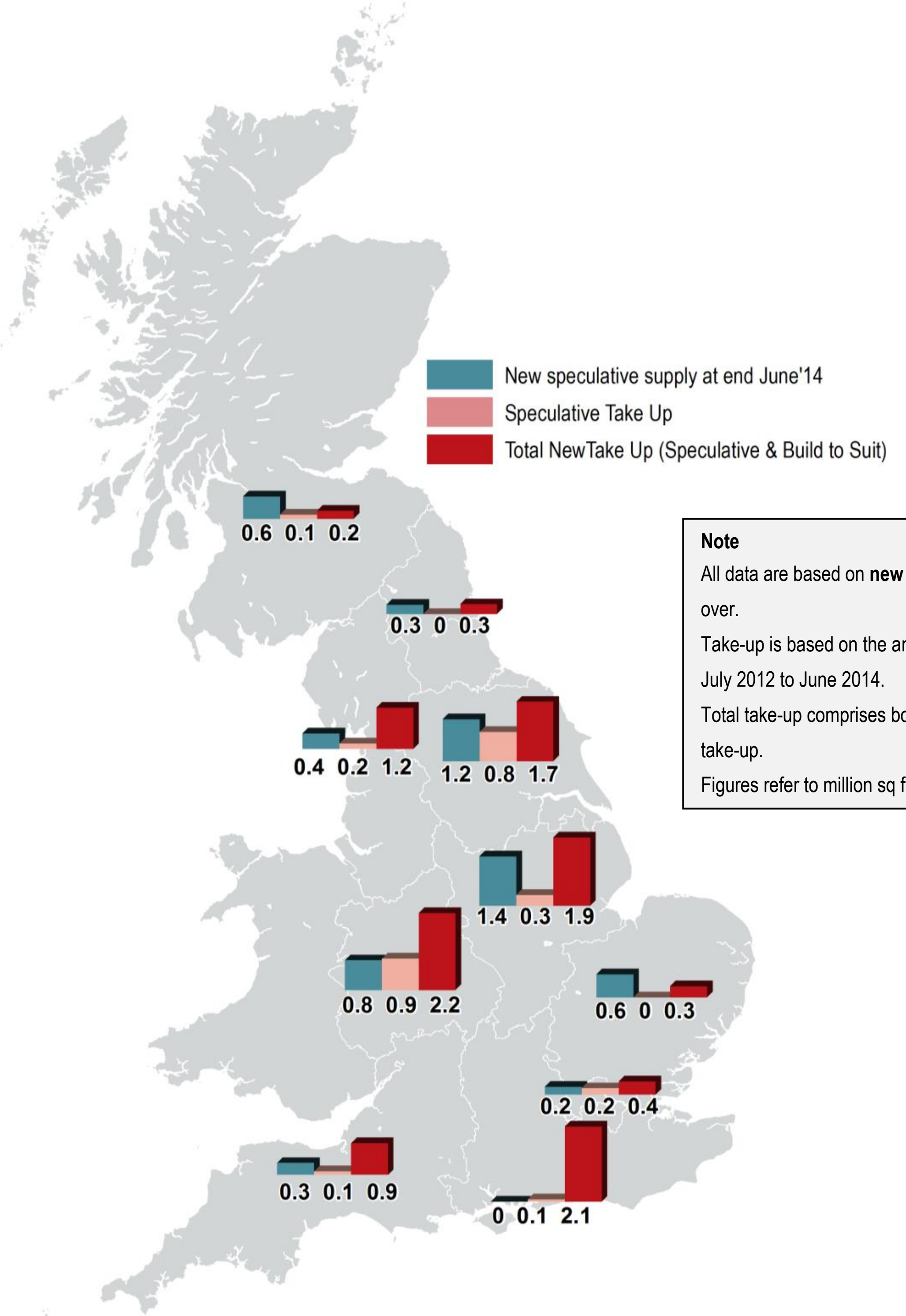
Another area where we predict increasing demand is for multi-user (and multi-purpose) warehouse facilities operated by third party logistics providers.

One example of this is the Common User Facility at London Gateway which is due to start construction in Summer 2014. These types of facilities are not necessarily different from 'standard' warehouses but certainly can be. For example, Uniserve recently secured planning consent for a 500,000 sq ft, 40m high building at Felixstowe, which it intends to build out with three to four mezzanine floors to undertake a range of contract-led activities including wine bottling, clothing and e-fulfilment.

So a cliché it may be, but 'one size doesn't fit all' is certainly apposite. But, to use another cliché, for warehouse developers and investors, 'the devil is in the detail'!

Supply and Take-up of new floorspace in the Big Box Logistics market at June 2014

- This map compares new existing speculatively developed supply with recent take-up.
- At the end of June 2014 the immediate availability of new space was below the annual average level of take-up recorded over the past two years in a number of regions nationally.
- In the South East there was no new speculative floorspace available at the end of June 2014.



Note
All data are based on **new** units of 100,000 sq ft and over.
Take-up is based on the annual average of the two years, July 2012 to June 2014.
Total take-up comprises both speculative and build to suit take-up.
Figures refer to million sq ft.

Source: JLL

Investment Market

Investors continue to target the UK logistics market this year following a strong 2013. Investors interest remains strongly focused on prime distribution assets, but with a lack of prime product in the market investors are also targeting good quality secondary stock.

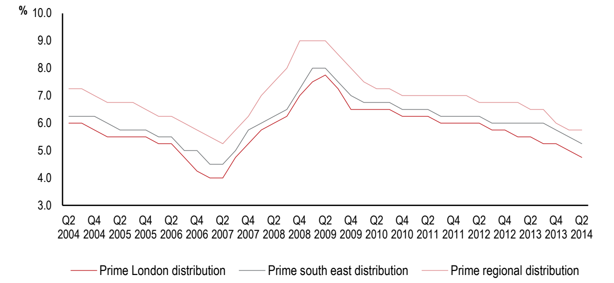
As was the case last year, domestic and international buyers are targeting the UK Industrial logistics market and as the year progresses and momentum picks up, transactions that completed 12-18 months ago are now starting to look relatively cheap.

Key Investment Deals in H1 2014

Scheme/Unit	Size (sq ft)	Yield	Price
Magna Park, Milton Keynes (Waitrose)	938,449	4.64%	£114m
Derby Commercial Park (K&N and Heineken)	632,000	5.75%	£57.1m
Next in Doncaster	755,052	6.07%	£60m
Tesco in Bolton	275,155	7.24%	£16.09m

With a high level of interest in the market and a severe shortage of stock, yields have further sharpened. Prime yields in London, assuming 15-year income, stood at 4.75% at the end of June 2014 having moved in 50bps since the end of 2013. Prime distribution yields in the South East stood at 5.25% at the end of June 2014, 50 bps lower than at the end of 2013; and prime regional distribution yields stood at 5.75% at the end of June 2014, 25bps lower than the end of 2013. Prime distribution yields have been on a downward trend over the past couple of years.

London, South East & Regional Prime Distribution Yields



Source: JLL
*Assuming a 15-year lease with open market rent reviews.

As investor demand is not expected to weaken in the near future there is potential for yields to sharpen further in the second half of this year. With a continued shortage of prime product in the market we expect investors to further target the secondary market and as a result we expect to see secondary yields sharpen further and the arbitrage between prime and secondary to narrow.

Conclusions

- Total occupier demand in H1 2014 was 23% down on H2 2013, partly attributable to a continuing lack of immediately available supply in the market.
- Despite a slowdown in take-up and a pick-up in speculative development, Grade A available supply continued to diminish. In the six months to the end of June 2014 Grade A availability fell by 2%.
- Overall prime headline rents in the major markets remained broadly unchanged over the first half of 2014.
- Prime logistics yields in London, the South East and the regions sharpened over the first half of this year. There continues to be a strong level of interest in the UK distribution market from both domestic and international investors.

Market Outlook

- With a number of active requirements in the market we expect to see a healthy level of demand recorded in the second half of 2014.
- With a shortage of immediately available stock in the market we expect to see occupiers continuing to sign for new BTS units.
- We expect to see further announcements of big box speculative development this year in key strategic markets where there is a lack of supply.
- Our model-based forecasts suggest that distribution rents overall will grow modestly over the medium-term, but in selective locations we now think there is stronger potential for growth given very limited supply.
- Investors will remain focussed on acquiring prime product in prime locations. There will also be strong interest in secondary stock in good locations due to a lack of available prime product.
- We expect there is further potential for yields to sharpen this year as the investment market remains strong and there is a lack of prime product available.

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