GVA

Industrial Intelligence

Autumn 2017

175 acre Peddimore site, Birmingham. GVA are retained by Birmingham City Council to seek a development partner for this prime warehousing and industrial site.

An APLEONA company

The Range, Central Park, Bristol. GVA acted for developer Delta Properties.

H1 2017 big shed deals

Property	Occupier	Sq ft	Date
Central Park, Bristol	Amazon	1,200,000 (33.5 acres)	Jun 17
Tamworth 594	XPO Logistics	645,000	Apr 17
Eurocentral, North Lanarkshire	Lidl	624,000	Feb 17
Fort Dunlop, Birmingham	Jaguar Land Rover	550,000	Apr 17
Lyons Park, Coventry	Amazon	434,000	Feb 17
Apex Park, Daventry	Gardman Limited	413,700	Feb 17
Thornhill Road, Swindon	Honda	402,000	Jun 17
M58 Distribution Centre, Skelmersdale	Accrol Papers	368,000	Mar 17
Logistics North	Amazon	357,000	Jan 17
Birch Coppice, Tamworth	Beko Plc	346,000	Jun 17

UK Occupier overview

Take-up of modern distribution units over 100,000 sq ft amounted to 11.0 million sq ft during the first half of 2017, just below the five-year average of 11.3 million sq ft.

Unsurprisingly take-up was down during H1 2017 on the record breaking levels of 2016, Amazon's highly acquisitive year. Even so, the internet retailer still took 2.3 million sq ft in five deals including the largest of 1.2 million sq ft at Central Park in Bristol. Take-up by all **retail** occupiers accounted for 48%, compared to over 60% last year.

The **manufacturing** sector increased its share of take-up to 28%, compared to 17% during 2016. The automotive sector was particularly active with deals to Michelin, Aston Martin and the 550,000 sq ft headline deal to Jaguar Land Rover at the Tyre Fort in Birmingham. **Third party logistics** companies also took a larger share of take-up than last year at 23%. While the deals in this sector tend to be less than 200,000 sq ft, the stand out deal was 645,000 sq ft to XPO Logistics in Tamworth.

There were a similar number of deals over 100,000 sq ft between the three main sectors of retail, manufacturing and third party logistics and the average size overall was 253,000 sq ft. However this varies significantly between the sectors. Some very large Amazon deals increased the average size of internet retail deals to 420,000 sq ft, compared to non-internet retailing at 270,000 sq ft. The average size of manufacturing deals is 220,000 sq ft and third party logistics is 194,000 sq ft.

The **Midlands has increased its dominance** compared to last year accounting for almost half of all take-up, focussed on the 'Golden Triangle'. Other regions to take a significant share of take-up were the South West (Bristol and Swindon - 15%), the North West (14%), including two more deals at Logistics North in Bolton and London and the South East (11%).

In the latest RICS Commercial Property Market Survey, while overall sentiment turned slightly more cautious for all property sectors, industrial fared better than offices and retail with 'reasonable demand growth, declining leasable space and rents rising at a solid pace.'

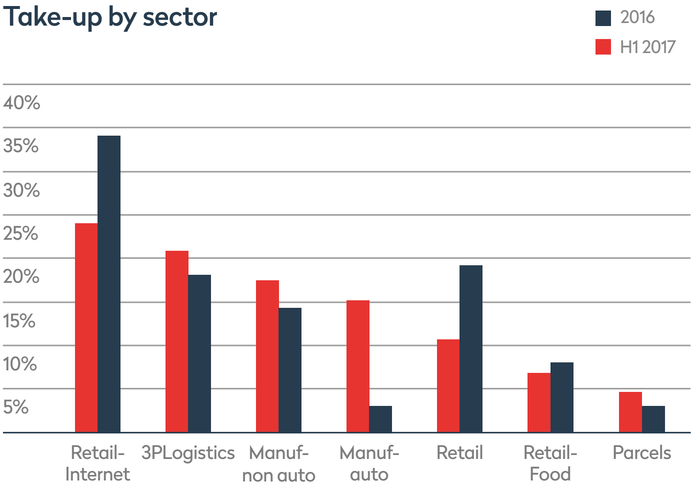
Existing supply remains constrained but has increased over the past year as 2016 saw the highest level of speculative completions in the current cycle and a number of second-hand modern units returned to the market. This has meant that availability levels have increased from their cyclical low last year to a current level which equates to 1.3 years' supply based on annual average take-up.

Reduced institutional funding risk and the industry's ability to provide design and build solutions more quickly has meant the level of **speculative completions has fallen** from 2016 levels. This is set out in more detail in the next section.

Prime distribution rents across the 13 locations we monitor have increased by an average of 7% over the 12 months to September. An average of eight months' rent free on a ten year term means the average of all prime net effective rents has increased by 6%. This compares to average distribution **rental growth** of 3.7% (on the IPD monthly index) and we forecast growth of around 3% pa this year and next.

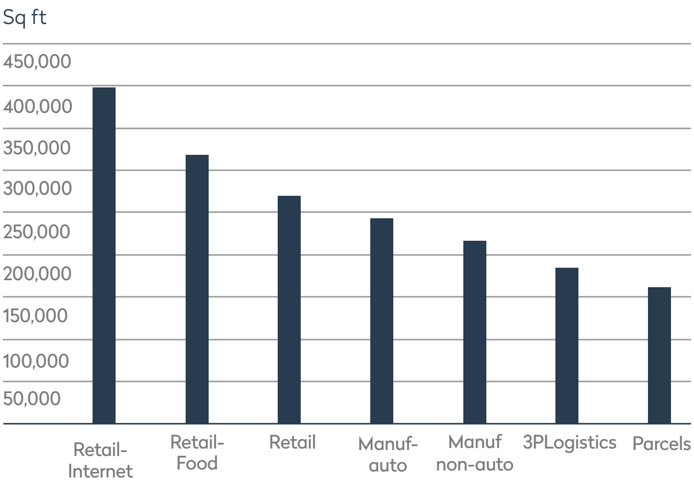
While there remains an underlying level of uncertainty caused by Brexit, general demand levels for big sheds remain robust with a number of enquiries for existing units, design and build and land acquisition, particularly from discount retailers and ecommerce. Levels of take-up are expected to be stronger for the second half of the year, with some very large requirements expected to sign.

Take-up by sector



Source: GVA

Average deal size by sector – 2016/17



Source: GVA

Island Road, Reading. A development by Peel Logistics and Rockspring.

Key speculative buildings available (over 300,000 sq ft)

Property	Developer	Sq ft
M6DC, Kingswood Lakeside, Cannock	Exeter Property Group/Graftongate	375,465
Imperial Park, Siskin Parkway, Coventry	Peel/M&G	346,900
Angle 340, Andover	Anglesea/Goodman	336,800
DC1, Welham Green, Hatfield	Segro	332,000
Prologis London Gateway, Stanford-Le-Hope	Prologis	316,561
Mountpark, Bardon	Mountpark	314,500

Key speculative buildings under construction

Property	Developer	Sq ft	Completion
Altitude, Milton Keynes	IDI Gazeley	574,000	Dec 2017
Nickel 28, South Normanton	Richardsons Capital	261,000	Apr 2018
Zorro, Ashby Park, Ashby-de-la-Zouch	Canmoor	234,700	Dec2017
Prologis Park, Birmingham Interchange	Prologis	233,000	Feb 2018
Unit 1 Symmetry Park, Swindon	DB Symmetry	217,000	Dec 2017
Prologis Park, Fradley, Lichfield	Prologis	213,500	Mar 2018
Conneqt Alpha, Kingswood Lakeside, Cannock	Opus Land	154,000	Jun 2018

Big shed speculative development remains active but falls from peak

Reduced institutional funding risk and the industry's ability to provide design and build solutions more quickly has meant the level of speculative completions has fallen.

GVA has monitored more than one hundred big shed speculative schemes (over 100,000 sq ft) in the current development cycle (2014 to 2018), totalling 21 million sq ft.

From a very low level of activity the amount of completed space grew rapidly from 2015 to a peak in the first half of 2016 - five million sq ft (see chart). This slowed to 3.3 million sq ft during the first half of this year. We expect completions to fall further to 2.3 million sq ft over the second half of 2017 and to 1.6 million sq ft during H1 2018.

Of all completions, 45% of space has been transacted and 55% is still available. The average void period following completion on schemes where deals have been concluded is 6 months, which varies between 10.1 months in the South East and 2.5 months in Yorkshire and Humberside, although this figure relates to just two developments in iPort, Doncaster.

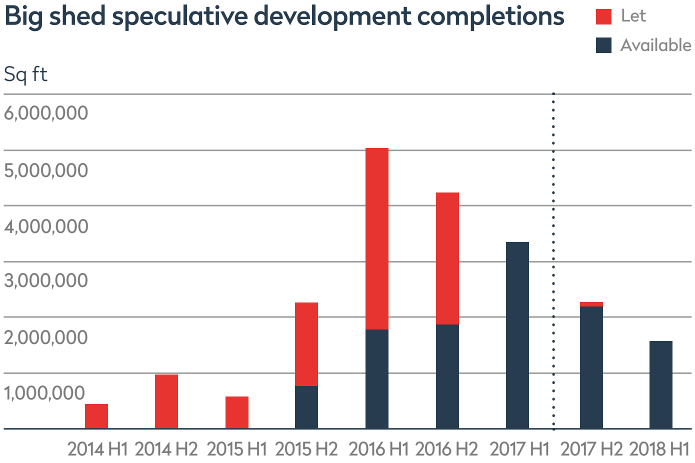
Speculative activity during this development cycle has been mainly concentrated in core locations. This is emphasised by the dominance of the Midlands, which accounts for over half of all completions. A quarter of activity has been in the South East and 16% in the North West, while there has been much less speculative activity elsewhere (see chart). The average size of speculative units has been a cautious 183,000 sq ft, as the larger units have tended to be design and build.

This is highlighted by the ONS warehouse construction orders, which records the value of all development at the start of construction and is a proxy for development activity. Compared to the speculative development cycle this shows less of a dip in recent activity as it includes all schemes including design and build. The rolling annual total is 15% below the peak in Q3 2015 but is still double the level since the low point at the beginning of 2013.

In terms of developers, Prologis has constructed by far the largest amount of speculative development at 3.6 million sq ft. Goodman has developed around half this amount and Mountpark has also been involved in 1.1 million sq ft of space. Developers that have constructed over 500,000 sq ft of speculative space include Stoford, IM Properties, Graftongate, Exeter Property Group, Wilson Bowden, Roxhill and Verdion.

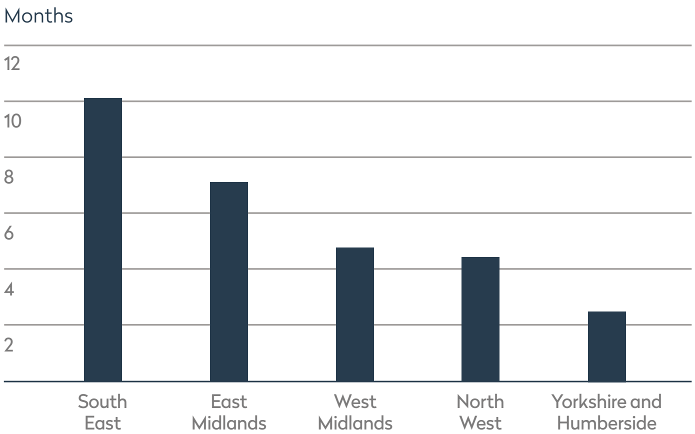
Demand for development sites is still strong in the main from both developers and many investors. Robust capital value and rental value growth continues to keep development viability healthy. While double digit annual growth in building costs has off-set residual value in recent years, costs have levelled off over the past year (BCIS industrial tender price index). According to the Construction Products Association, industrial construction output is forecast to fall over the next two years, before picking up again in 2019.

Big shed speculative development completions



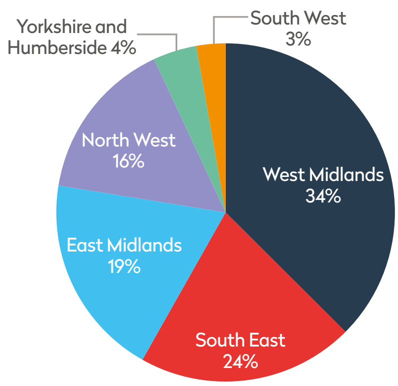
Source: GVA

Average void post PC on deals done



Source: GVA

Speculative big shed completions in the current cycle (2014–2018)



Source: GVA

Distribution comparables

Date	Location	Area (sq ft)	Unexpired term (years)	Rent (£psf)	Tent/Purchaser	Price	NIY
Jun-17	BIRMINGHAM, Hams Hall, Coleshill	783,000	16	£6.50	Sainsburys/ Foreign Investor	£100,000,000	4.77%
Jun-17	PETERBOROUGH, Kingston Park	736,000	12.5	£6.90	Debenhams/ Foreign Investor	£86,400,000	5.80%
Jun-17	BIRMINGHAM, Birch Coppice Business Park	700,000	21	£7.40	Ocado/ Tritax Big Box REIT	£92,330,000	5.25%
Jun-17	CREWE, Radway Green	254,000	19.5	£11.82	BAE/ Foreign Investor	£56,000,000	5.00%
Jun-17	PLYMOUTH, Breakwater Industrial Estate	200,000	15.0	£6.05	Royal Mail Group/ Plymouth City Council	£19,250,000	5.90%
May-17	HAYES, Dawley Park	140,000	7.5	£10.05	Lufthansa Technik/ Valor Real Estate Partners	£27,300,000	5.05%
May-17	AVONMOUTH, Central Park	160,000	20	£8.22	DHL/ BlackRock	£28,100,000	4.37%
May-17	DONCASTER, Trax Park	262,000	15	£4.77	Unilever/ Tritax Big Box REIT	£20,900,000	5.61%
Mar-17	DUNFERMLINE, Sandpiper Lane	1,020,000	14.5	£3.19	Amazon/ Rasmala Plc	£61,000,000	5.50%
Mar-17	AVONMOUTH, Accolade Park	872,000	17.0	£4.87	Accolade Wines/ Foreign Investors	£62,000,000	6.50%

Multi-let comparables

Date	Location	Area (sq ft)	Unexpired term (years)	Rent (£psf)	Tent/Purchaser	Price	NIY
Jul-17	DEESIDE, Deeside Industrial Park Estate	871,143	7.4	£3.85	Columbia Threadneedle	£40,780,000	6.86%
Jul-17	WELWYN GARDEN CITY, City Park Industrial Estate	202,336	6.25	£7.81	Legal & General	£27,000,000	5.42%
Jun-17	WALTHAMSTOW, Uplands Business Park	290,000	3.1	£5.70	BlackRock	£50,600,000	3.10%
Jun-17	MITCHAM, Wates Way Industrial Estate	131,875	6.2	£6.59	Capital Industrial	£20,000,000	3.80%
Jun-17	MIDDLETON, Stakehill Industrial Estate	679,845	5.4	£4.77	UBS	£46,850,000	6.38%

National investment overview

We continue to see **strong investor demand** for both prime and secondary industrial property. The level of demand continues an upward trend when compared with the other commercial property sectors. Transactional volumes for the UK commercial property investment market decreased from £71bn in 2015 to £51bn in 2016, however the weighting for industrial property has increased from 8% in 2015 to 11.7% in 2016. For the first six months of 2017, that share stands at 13.6% (£3.7bn), of which £2.7bn was in the distribution sector.

Whilst the market witnessed a short pause both before and immediately after the referendum, the industrial sector responded well as the dynamics continue to match investor requirements; namely long dated, secure income and a robust growth story. Consequently there is strong demand in a market with a limited level of supply.

The **distribution** sub-sector remains highly competitive and as the knowledge of this sector has increased, a wider pool of investors has formed. Once dominated by UK institutional investors, purchasers have more recently included private UK and overseas buyers, sovereign wealth funds and local authorities. Whereas the traditional UK institutional investors remain the dominant players within the £10m – £40m lot sizes, the pool of investors for the £50m+ investments is drastically reduced and it is principally led by Tritax Big Box REIT and overseas mandates. Developers are benefiting from forward selling pre-let deals with the yield discount between standing investments and pre-lets being minimal.

The **multi-let industrial** arena continues to see strong investor demand, mainly driven and supported by a limited supply of stock. Development constraints, difficulties in funding developments without pre-lets and the loss of some estates to alternative uses in recent years have meant that existing properties command high occupational take-up, driving rental growth performance. In addition, the relative unsophistication of an industrial unit means that refurbishment and obsolescence costs are also much lower than offices, which limits landlords' downside risk.

Multi-let estates tend to attract a different type of investor to distribution property as they require a focused management approach and a good understanding of location and occupational dynamics. UK institutions and property companies remain the dominant players in the sector, particularly for larger estates of £10 million and above, given their experience and historic specialism supported by strong asset management capabilities. The sub £5 million bracket is mainly dominated by private UK nationals and small property companies.

There is now a **wider pool of investors** competing across the industrial sector. The shift in trend from opportunity to wealth protection due to global political and economic uncertainty has stimulated demand and Sterling's depreciation makes for a compelling story for overseas investors. The appetite for the sector remains unrelenting and as such we believe pricing will hold firm in the next 12 months.

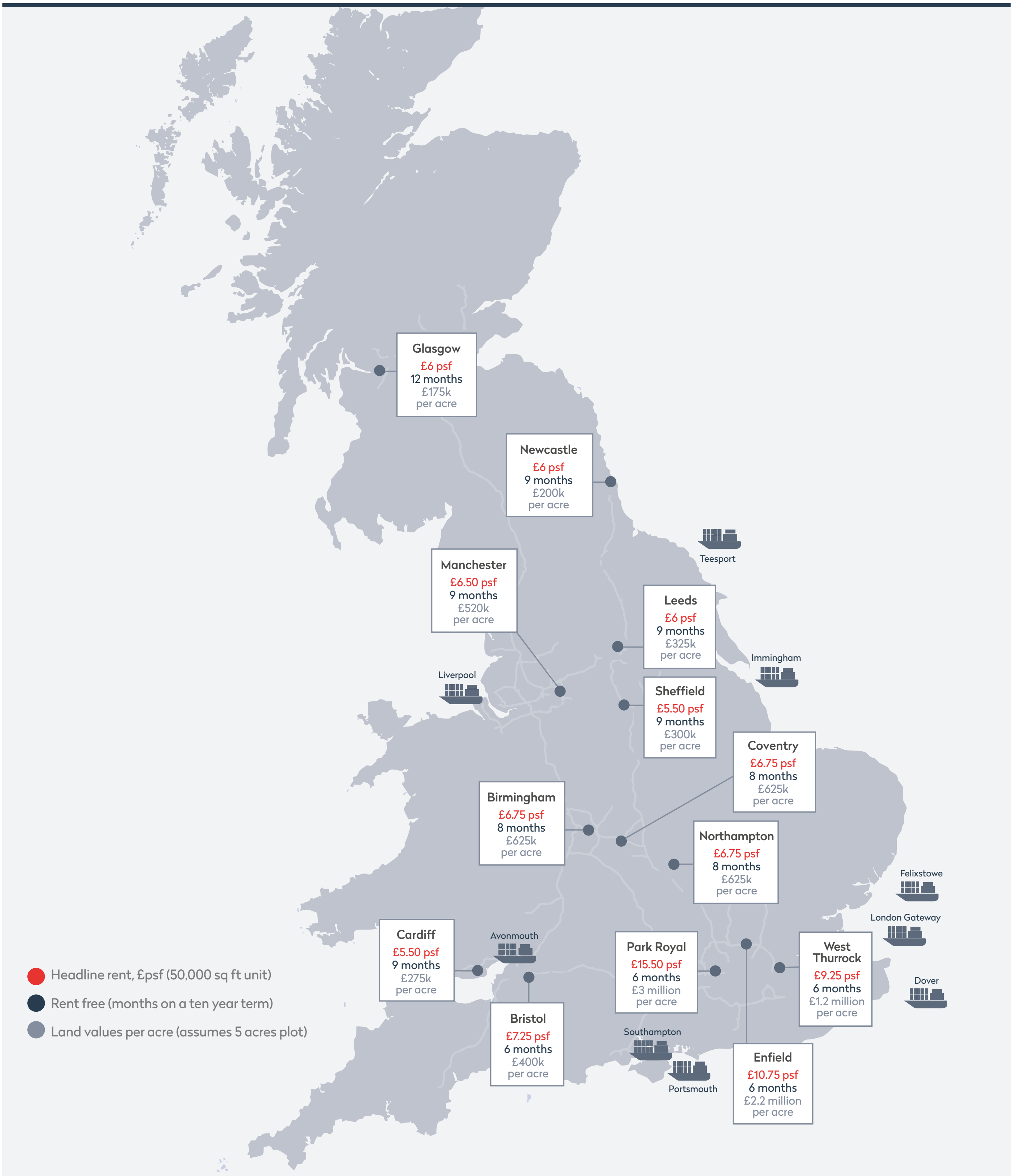
Following last year's EU referendum, average industrial property **capital values** were relatively unaffected compared to other sectors, falling by just 1%. Strong growth in capital values has since rebounded to the levels seen before the referendum, achieving growth of 6.6% over the 12 months to Q2 2017 and resulting in a positive total return of 13.2% (IPD Quarterly Index).

Looking forward there is a range of uncertainties including a potential rise in interest rates and the emergence of the Brexit deal. However, the weight of money and relative scarcity of supply of industrial property will continue to support yield levels, particularly for quality defensive stock and long dated income. We expect strong capital value growth of around 8% for 2017 before reducing to a more modest 3% in 2018. With an income return of around 5%, this equates to a total return of over 13% and 8% respectively.

Horizon 38, North Bristol. 326,000 sq ft phase A of the mixed use development by St Francis and iSec.

197,000 sq ft Alchem1, a speculative unit in Crick, Rugby. GVA are letting agents on behalf of Legal and General

Headline rents and land values



Island Road, Reading. A development by Peel Logistics and Rockspring.

Should you wish to discuss any details within this report please get in touch.

David Willmer
Senior Director
0121 609 8302
david.willmer@gva.co.uk

Nick Collins
Senior Director
020 7911 2112
nick.collins@gva.co.uk

Andrew Pexton
Director
0161 956 4207
andrew.pexton@gva.co.uk

Rob Oliver
Director
0113 280 8034
rob.oliver@gva.co.uk

Mark Beaumont
Senior Director, Investment
020 7911 2183
mark.beaumont@gva.co.uk

Nick Roberts
Director, Investment
020 7911 2178
nick.roberts@gva.co.uk

Giles Tebbitts
Research
020 7911 2670
giles.tebbitts@gva.co.uk

Visit us online
gva.co.uk/research

GVA Offices

Birmingham
Bristol
Cardiff
Dublin
Edinburgh
Glasgow
Leeds
Liverpool
London
Manchester
Newcastle

Follow us online