Industrial Intelligence

Autumn 2018

SPECIAL HIGHLIGHT FOR AUTUMN 2018:

PLACES THAT WORK

Mountpark, Southampton

Welcome to the latest edition of Industrial Intelligence, our biannual review of the Industrial and distribution markets.

James Attfield
Senior Director

Winds of change

Since our last publication, we have seen significant changes which affect our market. Whilst there is still no resolution in place, the level of uncertainty in the economy has intensified as we near the Brexit deadline. We expect the outcome of the negotiations to be a variation of the Chequers deal, although there will be many who wait with bated breath.

Across the economy there were some reasons for positivity, with employment still robust, the Markit/CIPS Purchasing Managers Index remaining above the crucial 50 no-change threshold and the service and manufacturing sectors continuing to expand (albeit at a slower pace than during the last year). However, there have also been some bad news stories with the high street seeing signs of pain, most notably with House of Fraser.

The increasing share of internet retail has led to increased investment and occupier demand for distribution and the structural changes in the retail market have so far been positive for the sector. This year we have seen a record level of take-up by retailers in the big shed market, with a fairly even split between ecommerce, pure play retailers and third party logistics, many serving retail contracts.

Sheds and beds

The affordability of housing remains an issue in the UK and this is particularly true in London. While attempting to solve this issue over the past decade, building tens of thousands of homes in the capital, we have potentially created another with the loss of significant amounts of smaller scale and often low-cost industrial space.

As a business, we have been trying to address these problems. Our collaboration with a coalition of regeneration experts on **'Places that work'**, identifies the opportunity to deliver 20% additional light industrial employment capacity alongside new housing development in London, not only underpinning feasibility but creating more diverse places with a range of economic activities – something we have called the 'New London Mix'.

The desire for more creative problem solving has been apparent, with the report stoking significant interest not only from local authorities but funds, investors and large scale occupiers.

The report outlines the policy reforms needed, challenges the institutional barriers and provides new recommendations in the approach to policy, funding and facilitation of schemes; positioning ourselves at the forefront and helping London solve one of its most significant problems.

This need not apply only to London either, many of the fundamentals apply to some of the UK's largest cities, and we are already working with some of our clients to see how this can be rolled out.

Looking forward

There are significant challenges to the industrial sector as the looming Brexit deadline approaches but with the structural changes in the retail sector and the need to find innovative solutions to land constraints in London there are also significant opportunities.

Creating places that work

Martyn Saunders, Director of Regeneration and Spatial Planning at GVA summarises the recent publication 'Places that Work', a collaboration between GVA and a coalition of regeneration experts. The report outlines plans for a 'New London Mix' of housing and commercial space, which could support growth and increase current light industrial floorspace supply by up to 20%.

Against a backdrop of global economic and technological change, London needs to accommodate a growing population and foster a more inclusive, innovative and resilient economy. But the capital's diverse portfolio of flexible commercial, light industrial, retail, lower value office, creative and hybrid workshop space is being eroded by redevelopment, both for housing and large scale industrial buildings while demand for such space is growing.

Draft New London Plan policy has stepped up protection for industrial land and proposes a sharper focus on mixed-use as a way of accommodating both commercial and residential needs. But much new mixed-use development provides a ground floor occupied by generic convenience stores, coffee shops or is never fitted out and is eventually flipped to poorly designed residential.

There will always be industrial activities that should not be mixed with housing and will need land that is protected from co-location. But mixing flexible commercial and light-industrial spaces within residential led developments can work well in other industrial areas, high streets and high roads, town centres, and other regeneration schemes. We call this way of developing the 'New London Mix', and call for it to become a crucial pillar for London's growth policy, alongside retaining and intensifying protected industrial land.

Places That Work also demonstrates that there are many areas in London where such a mixed approach is viable now or could be viable with relatively modest changes in market conditions or funding availability. And this is not a niche opportunity.

We estimate demand from an expanding urban service sector and from displaced businesses to exceed four million square metres – equivalent to all employment space in the Upper Lea Valley and Old Kent Road combined. And there is a growing and serious interest across the private, public and housing association sectors in taking the next steps required to move from the one or two exceptional examples that already exist to making them mainstream.

However, there are some persistent institutional barriers across London that prevent such solutions from progressing. To overcome these, new approaches and tools are needed – not just in policy terms but in the funding and institutions required to deal with widespread market failure. The scale of change is significant, but there is precedent: from small beginnings, housing associations now house more than one in ten Londoners, and are major players in growing the city.

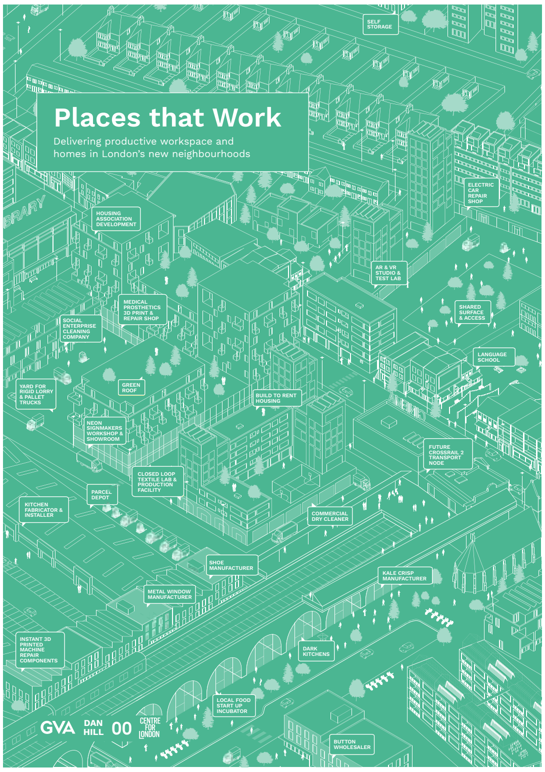
Places that Work sets out the scale of the challenge and opportunity London faces, and calls for a new approach to delivering New London Mix as the next generation of mixed use development in London's key areas of change.

15,000,000 sq m
existing industrial floorspace in London

3,500,000 sq m
opportunity space is 20% of existing industrial floorspace

Places that work makes several key recommendations to the government and private sector:

- Establishing a significant London-wide Commercial Space Investment Fund that accelerates and supports the provision of new forms of mixed residential and productive employment and industrial development.
- Establishing area-based Local Economic Growth Companies to purchase, hold and manage new commercial space from an early stage in the development cycle with a focus in Opportunity Areas where there is potential for the New London Mix at scale.
- Developing enhanced and updated planning policies, area frameworks and development management approaches and good practice guidance at both a regional and local level to support effective delivery of mixed productive employment and residential schemes.
- Delivering five trailblazing projects by 2022 that demonstrate a range of conditions, typologies and delivery routes, exploring social impact and diverse investment opportunities supported by a longitudinal research programme.
- Supporting wider and deeper understanding of the agenda set out in Places That Work and other associated projects through conferences, publications, design competitions, exhibitions, training and other channels.



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Scale of opportunity

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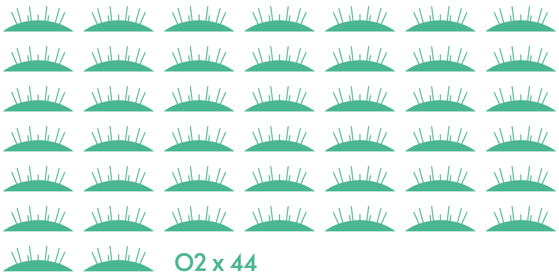
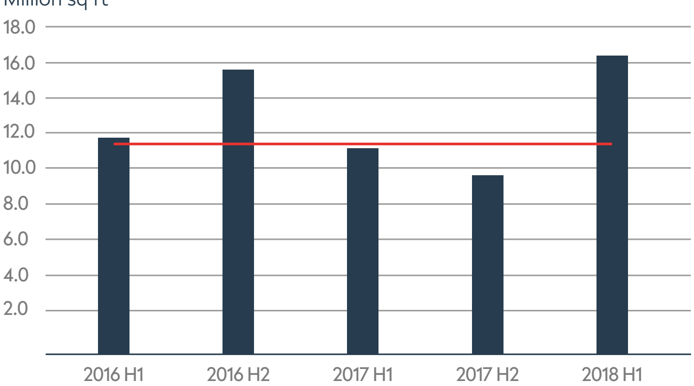


Occupier market at a glance

Figure 1

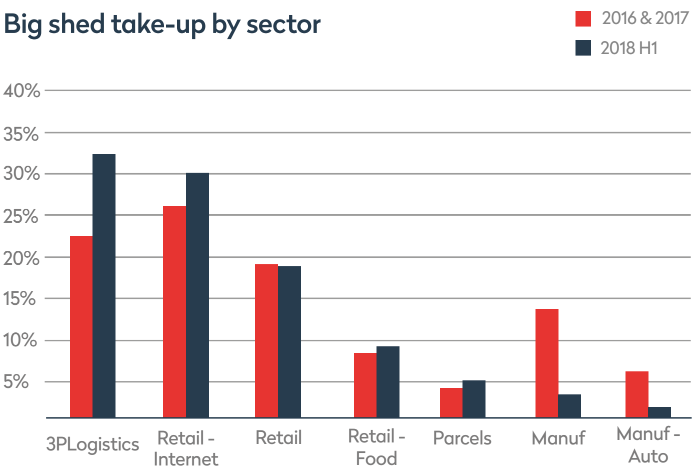
Big shed take-up (over 100,000 sq ft)



Source: GVA

Figure 2

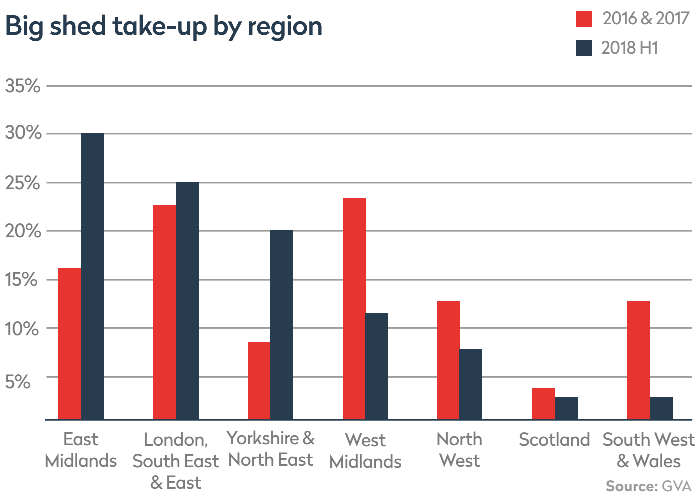
Big shed take-up by sector



Source: GVA

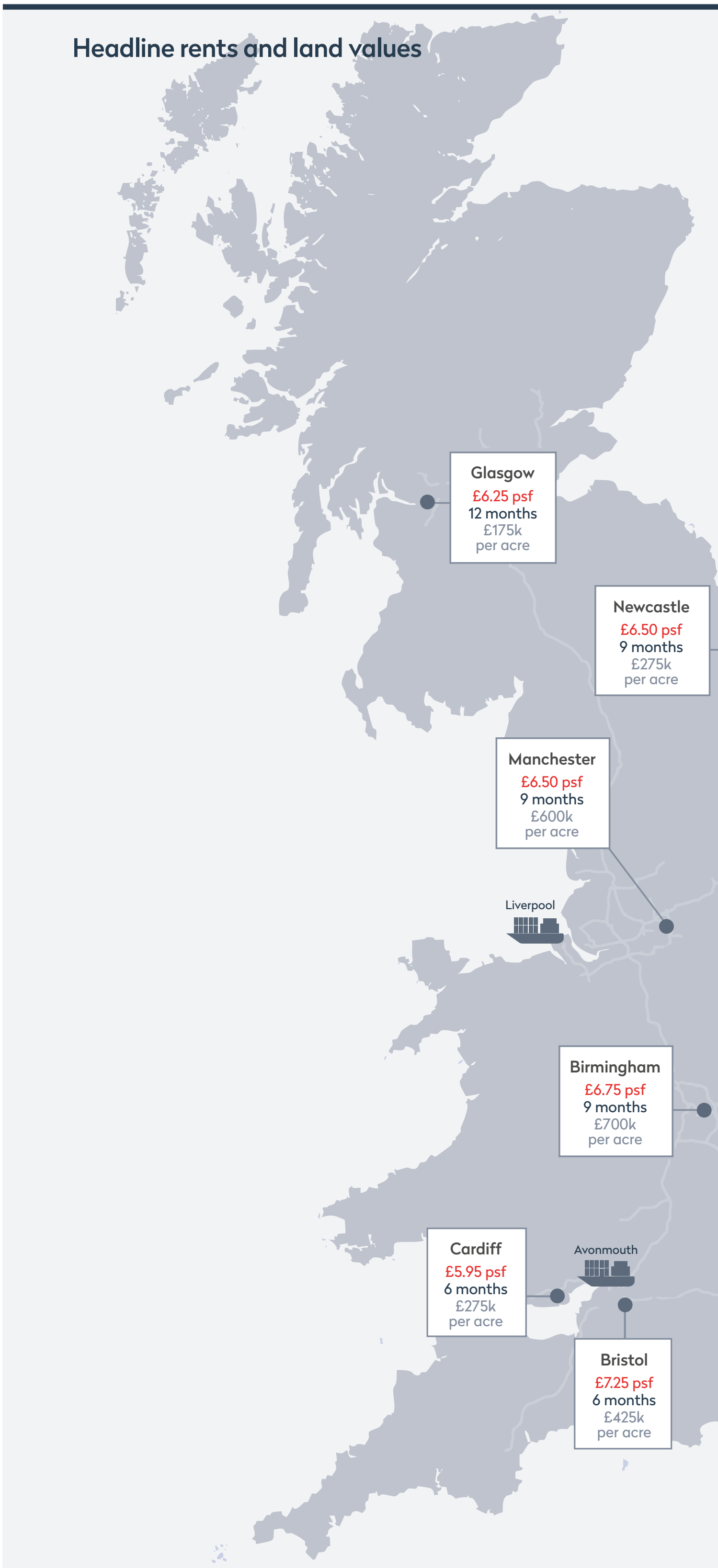
Figure 3

Big shed take-up by region



Source: GVA

Headline rents and land values



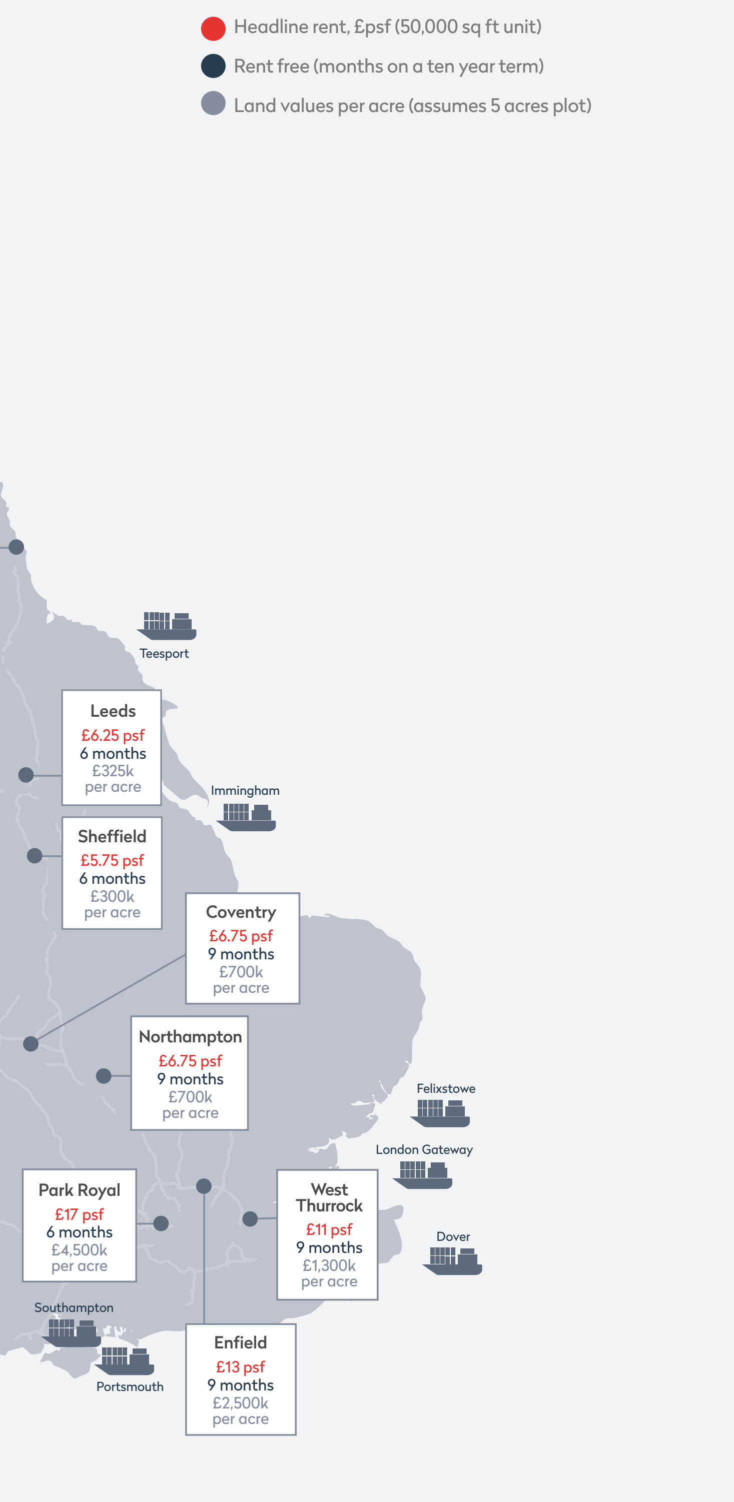
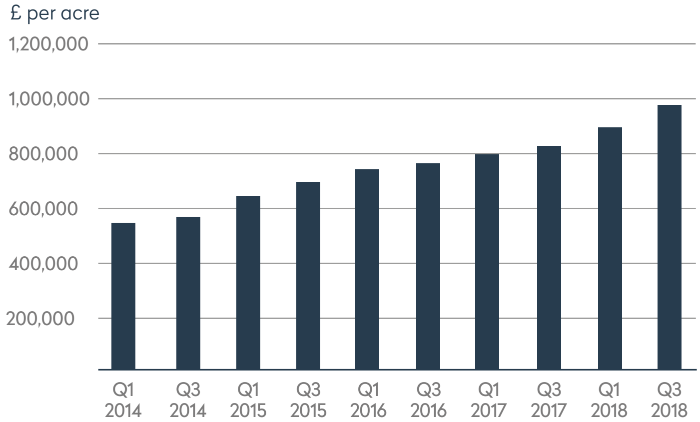


Figure 4

Average industrial land values (13 locations, 5 acre plot)



Source: GVA

Figure 5

Availability of big sheds (over 100,000 sq ft)

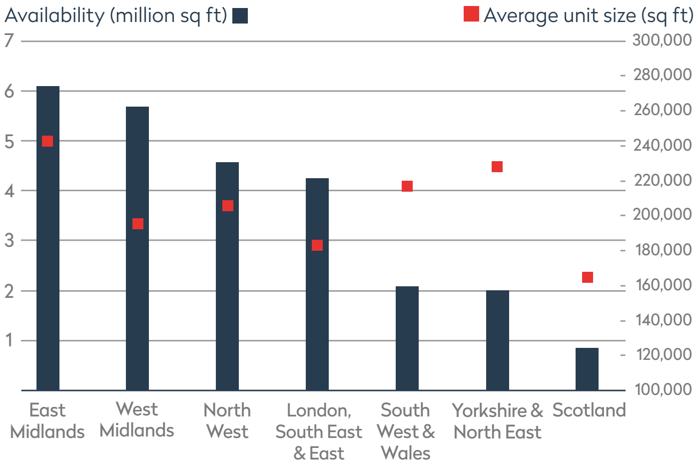
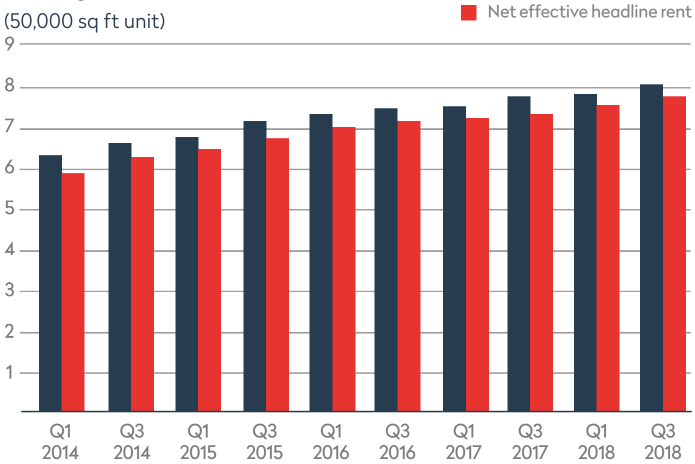


Figure 6

Average headline rents



Occupier Market

Record take-up for retailers

There has been an exceptional level of activity in the big shed market during the first half of 2018, particularly in the first quarter. Take-up of new / modern warehouses over 100,000 sq ft totalled 16.1 million sq ft for H1, a third up on the five year six monthly average of 11.3 million sq ft.

Demand has been dominated by the retail sector with ecommerce (30%), non-internet retail (28%) and third party logistics (32%) all contributing significant shares of activity. Demand from manufacturing occupiers fell however following strong activity in 2016 and 2017.

The first half of the year saw a return to activity from Amazon, the largest single occupier. B&M joins the ecommerce giant with deals of over a million sq ft. There were also a handful of deals over 500,000 sq ft, including Aldi, Lidl as well as 3PLs XPO and Clipper Logistics.

Over 2.5 million sq ft of deals were agreed at East Midlands Gateway, Castle Donnington. With further substantial deals the East Midlands accounted for 30% of space taken during H1. In the South East (26%) there was a high concentration of retailer deals north of the M25 in Hatfield, Dunstable and Bedford. There was also a return to strong activity in Yorkshire (10%) where logistics companies were the dominant occupier and the North East (10%) where there was a 1.5 million sq ft deal at Symmetry Park, Donnington.

The large number of deals over 500,000 sq ft during H1 (see table) is emphasised by the average deal size of 307,000 sq ft. This compares to 220,000 sq ft over the previous two years. The largest average deal size by sector was ecommerce (500,000 sq ft) and unsurprisingly by region was the East Midlands (400,000 sq ft).

In terms of supply, current availability of modern big sheds amounts to 25.3 million sq ft, approximately 14 months' supply based on past take-up rates. This compares to 24.3 million sq ft recorded at the end of 2017. With a large number of speculative completions in the pipeline as well as modern second hand sheds returning to the market, we expect supply levels to gradually increase. However with robust occupier demand we anticipate supply will continue to remain relatively constrained.

The land constraints in the South East mean that increases in land values have been by far the strongest, particularly in West London where values have soared by around 50% over the past year. Elsewhere we have witnessed strong growth of around 10% in the golden triangle and M25 locations such as Enfield and West Thurrock, whereas in the north and Scotland prices have remained stable.

Upward pressure continues on prime rents as the average net effective rate for the 13 locations we monitor has increased by 3.3% over the past 12 months to September. Rental growth has been strongest in the South East and Yorkshire & North East. We expect a continuation of low vacancy rates and relatively strong rental growth of around 4% pa for all industrial in 2018, moderating to just over 3% next year.

With a healthy level of properties under offer and requirements we expect occupier demand to remain strong. The looming Brexit deadline presents significant challenges to the sector including agreement on the movement of goods, the costs of tariffs and the availability of labour but the structural changes in the retail sector continue to support significant further growth in the sector.

Horizon 38, North Bristol. A development by MSF Filton, a joint venture between St Francis Group and iSec. 115,000 sq ft unit G2 recently let to Apec.

Key Availability Q3 2018

Scheme	Town	Sq ft
Cross Point Business Park	Coventry	685,000
Altitude	Milton Keynes	574,000
Panattoni Park, Eastwood	Nottingham	550,270
Wolverhampton 450, Gravelley Way	Wolverhampton	448,123
Unit 5320 Quantum, Magna Park	Lutterworth	411,613
Cribbs Causeway Centre	Bristol	384,000
Dallam Point	Warrington	379,900
Wellington Parkway, Magna Park	Lutterworth	377,000
Central Park	Rugby	376,869
M6DC, Kingswood Lakeside	Cannock	375,465

A selection of key big shed deals - H1 2018

Property	Occupier	Sq ft	Date
Symmetry Park, Darlington	Retailer	1,500,000	Jun-18
East Midlands Gateway	Amazon	1,300,000	Feb-18
Hardwick Hill at Elstow, Bedford	B&M	980,000	Apr-18
Hardwick Hill at Elstow, Bedford	Aldi	700,000	Apr-18
East Midlands Gateway	XPO (Nestle)	650,000	Feb-18
Sheffield 615	Clipper Logistics (Pretty Little Thing)	615,000	Apr-18
Dunstable	Lidl	600,000	Jan-18
East Midlands Gateway	Shop Direct	500,000	Jun-18
Tectonic 500, Barlborough Links	Amazon	500,000	May-18
East Midland Airport	UPS	435,000	Feb-18

Investment Market

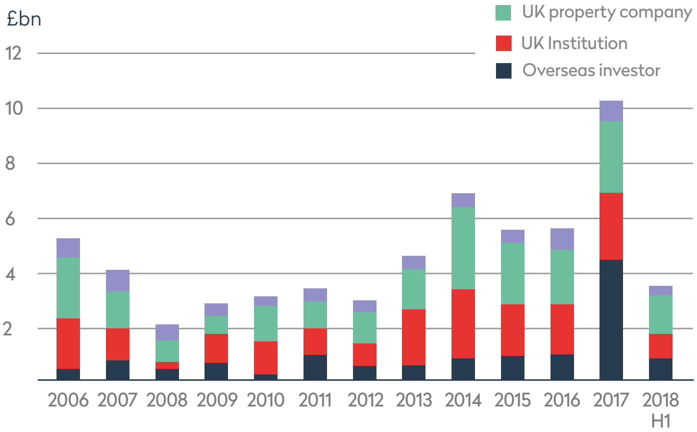
Volumes down but strong demand remains

In broad terms, the investment market dynamics have not differed since last year for the industrial sector. There remains a compelling story for industrial investment which is largely driven by strong occupier demand, a lack of available standing stock and limitations to speculative development particularly when considering multi-let property. Although volumes for the first half of 2018 are down on 2017's record year, volumes stood at £3.6bn against a half year average over the last 10 years of £2.4bn.

The industrial sector enjoyed a 14% share of all commercial property investment volumes. Although this is down on last year's spectacular year (17% of volumes) it compares strongly to an average of the previous five years of around 10%.

At the start of the year we saw activity from some vendors taking advantage of keen pricing levels in order to exit assets, mainly UK institutional investors. However, that particular sentiment was not universally felt by all. As such, the UK institutional investors were the dominant purchaser type in the first half of the year and together with UK property companies, accounting for around two thirds of the volume of activity.

Industrial investment volumes



Source: GVA

Although there have been fewer deals than in recent years the market has witnessed some sizeable transactions so far this year. Overseas investors have accounted for a large proportion of such deals, around 20% of the total volume for the first half of the year. Some examples include Blackstone and M7's purchase of the Powerhouse portfolio consisting of 40 light industrial units for £320m and Westbrook Partners' acquiring the Martinbridge Industrial Estate in Enfield for £53.8m. Mansford's Sterling Portfolio for £162m followed the acquisition late last year of Dominvs Group's entire commercial portfolio (largely industrial) for £100m. There have been some new entrants to the market, notably Singapore's Ascendas REIT, which purchased the Owl Portfolio from Oxenwood Real Estate/Catalina Holdings for a total consideration of £205m in July.

The demand for distribution assets also remains strong, largely driven by strong investor appetite for income and perceived to be defensive stock. Tritax Big Box REIT remains the dominant player in the larger scale transactions, investing £226m in four Big Box assets. Howden's I & II in Raunds for £103.7m and Eddie Stobart in Corby for £81.8m are two of the highlighted deals illustrating the scale of investment for single assets. Tritax has also more recently acquired the £121m Link 66 building in Darlington.

The pre-let funding market for bigger sized units remains a favourable way for investors to acquire prime industrial units and developers continue to enjoy the demand from the end user. This is not a dynamic mirrored in the multi-let market as development constraints are more complex and pre-lettings are generally rarer. We would not anticipate this changing over the next 12 months.

Looking forward, there continues to be a downward pressure on yields and we anticipate demand remaining strong despite wider economic uncertainty as we approach the Brexit date of 29th March 2019. The average equivalent yield for all industrial property according to the MSCI index fell 13 basis points during Q2 to 5.42%, which compares to 5.98% a year ago, demonstrating the keen demand for this sector. We expect to see a continuation of both yield compression driven by rental growth forecasts and the logical business case that industrial property is the key sector to support so much UK business enterprise.

Single-let deals

Date	Property	Area (sq ft)	Unexpired term (years)	Rent (£psf)	Tenant	Price	NIY
Jul-18	LEEDS, Logic Leeds	361,000	15	£5.15	Premier Farnell	£38,700,000	4.50%
Jun-18	DARLINGTON, Link 66	1,500,000	20	N/A	Retailer	£120,700,000	5.00%
May-18	DARTFORD, Capacity	92,000	25	£9.50	Berendsen	£21,500,000	3.87%
Apr-18	DONCASTER, South Elmsall	288,000	3	£3.46	Superdrug	£15,000,000	6.20%
Mar-18	HATFIELD, Hatfield Business Park	77,226	9.4	£10.18	Royal Mail Group	£17,500,000	4.20%
Mar-18	RAUNDS, Warth Park	245,497	2	£5.50	Exertis (UK) Ltd	£21,607,000	5.85%
Mar-18	BASILDON, DC1 & DC2 Prologis Park	134,183	10	£7.14	Swan Commercial Services and Korda Development	£20,750,000	4.30%
Feb-17	CORBY, Midlands Logistics Park	844,000	20	N/A	Eddie Stobart	£81,800,000	5.00%

Multi-let deals

Date	Location	Area (sq ft)	Unexpired term (years)	Rent (£psf)	Purchaser	Price	NIY
Jul-18	Edisons, Dartford	133,688	8.4	£7.90	Valor	£22,750,000	4.35%
Jun-18	Zenith, Basildon	197,476	8.75	£7.53	Orchard Street IM	£36,190,000	3.85%
May-18	Flyers Way, Westerham Kent	49,144	6.33	£7.47	Aberdeen Standard	£7,160,000	4.80%
May-18	The Gate Centre, Brentford	82,419	7.9	£13.99	M&G Real Estate	£37,200,000	2.90%
May-18	Orbital One, Dartford	67,018	6.24	£8.46	M&G	£12,800,000	4.15%
Apr-18	Doranda Way, West Bromwich	152,311	4.1	£5.40	HSBC Pension Fund	£14,945,000	5.17%
Feb-18	Martinbridge Trading Estate, Enfield	280,015	9.16	£6.35	Westbrook	£53,750,000	3.10%
Feb-18	Mill River Trading Estate, Enfield	93,786	3.91	£8.20	Capital Industrial	£18,100,000	3.98%

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

James Attfield
Senior Director
020 7911 2275
james.attfield@gva.co.uk

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

John Barker
Director
020 7911 2121
john.barker@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

GVA
65 Gresham Street, London EC2V 7NQ

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