Big Shed Briefing

April 2016

The Big 555 in Sherburn in Elmet where Logicor have leased the largest available warehouse in the UK, totalling 556,126 sq ft, to L&G Homes.

SUMMARY

■ 2016 has started brightly with first quarter take-up above the long term average and the previous quarter reaching 7.1m sq ft. Whilst a number of deals over 500,000 sq ft have helped pull the figures up it is encouraging to note that there has been above average demand in the smaller size ranges.

■ Regionally, the South West had its best quarter ever with 2.1m sq ft transacted, more than 2014 and 2015 combined. The South East however had a highly anomalous quarter with just one transaction recorded against a long term average 1.2m sq ft for a typical Q1.

■ Total supply stands at 33.1m sq ft across the country of which 9.8m sq ft is classified as grade A, down a further 5% from the same time last year.

■ We expect supply to rise in the coming quarters as 7.1m sq ft of stock is due to be delivered to the market speculatively in 2016, two thirds of which is located in The North West and The West Midlands.

■ The investment market saw deal counts remain constant and investment volumes increase from the same period in 2015, reaching £683m for the first quarter. Overall, the industrial sector has been the only market to see investment volumes increase in 2016 which bodes well given the investor caution surrounding the upcoming EU referendum.

"The first quarter of 2016 has seen robust occupational demand. Whilst a number of large deals have helped the figures it is encouraging to see above average deal volume in the smaller size ranges, where 71% of speculative completions are due in 2016" Kevin Mofid, Head of Industrial & Logistics Research

Availability

■ Since the beginning of 2016 an additional 31 units totalling 5.3m sq ft have come to the market across the country, of which 1.9m sq ft is classified as new speculative development. Excluding build to suit, take up of existing units in the first quarter reached 2.7m sq ft meaning total supply fell by 900,000 sq ft. Total supply now stands at 33.1m sq ft.

■ At a regional level, the East Midlands saw 1m sq ft of speculative units come to the market accounting for 55% of all of the speculative completions so far in 2016. In the North West an additional 1.2m sq ft of warehouse space came to the market, all classified as grade B and C.

■ Of the core logistics regions Savills monitor the highest supply is in the North West which has 40 units on the market totaling 6.87m sq ft, of which 82% are either grade B or C. The West Midlands has just 2.8m sq ft on the market, down from close to 4m sq ft in 2014.

■ Even with an increase of speculative development the supply of grade A warehousing continues to fall and now stands at just 9.8m sq ft, down by 4.9%. At a size level the recent letting of The Big 555 in Sherburn in Elmnet to L&G Homes now means that the largest units on the market are the former Matalan unit in Skelmersdale , which totals 391,000 sq ft, and the former Primark unit at Magna Park Lutterworth. This Grade B unit totals 411,613 sq ft and will be available for occupation in the autumn.

Take-up

■ 2016 has started brightly in the big shed occupational market, with any fears of a Brexit inspired slow down seemingly unfounded. Take-up reached 7.1m sq ft, which is both an increase on the last quarter of 19.5% and 26% higher than the long term first quarter average of 5.7m sq ft.

■ The market has however benefitted from two key factors, the large amount of build to suit (BTS) deals and the strong level of take-up for units between 100,000 and 200,000 sq ft. In the first quarter there have already been four deals over 500,0000 sq ft, compared to eight for 2014 in its entirety. This has ensured that BTS deals accounted for 59% of the market in Q1 2016. As graph three demonstrates however, take up for smaller units is above the long term average too, demonstrating robust occupier demand across varying size ranges.

■ The picture at a regional level warrants further investigation as the spread of take-up has not been uniform. The deal allowing The Range to take 1.2m sq ft, combined with a further three deals ensured that the South West had its best quarter ever and meant that 2016 so far has seen more take-up than 2014 & 2015 combined. Against a long term average Q1 take-up of 1.2m sq ft across five transactions, The South East had a highly anomalous quarter with just one deal completing where DHL took 130,000 sq ft in Bedford. We do expect that the remainder of the year will return to average take-up levels as a number of large requirements find home and units under offer complete.

■ In our last edition we identified how the occupier market has, in the last five years, become more diverse with take-up being derived to a wider range of companies rather than being dominated by the supermarkets. However, given the amount of warehouse space that Amazon and other pure play retailers are now committing to the market could come to be dominated by online retailers increasing as their proportion of the market, which rose from 14% in 2015 to 27% in Q1 2016.

Development Pipeline

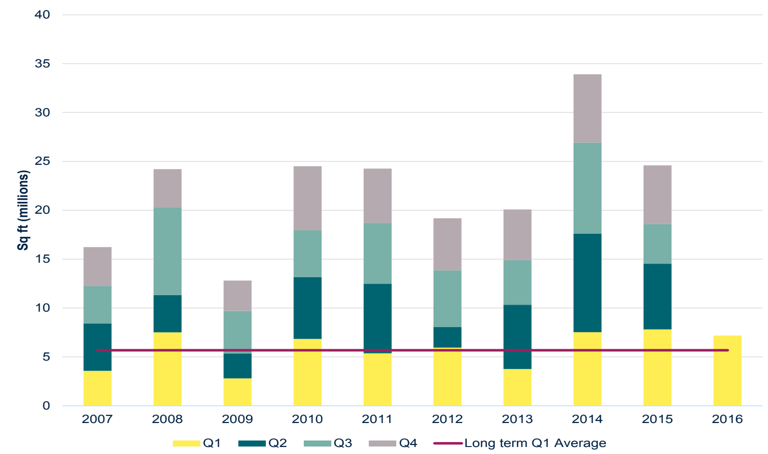
■ Since the start of the year there have been five speculative development announcements totalling 1.1m sq ft. The largest being Prime Omega in Warrington at 356,192 sq ft.

■ Taking into account speculative units previously announced Savills is tracking 7.1m sq ft of space across 38 units for delivery in 2016. Of those units 71% are between 100,000 & 200,000 sq ft and 13% are above 300,000 sq ft, the largest being 358,068 sq ft at Prologis Park Dunstable.

■ As graph four demonstrates, the development pipeline varies across regions with 36% of the stock under construction located in the West Midlands and a further 30% in the North West.

GRAPH 1

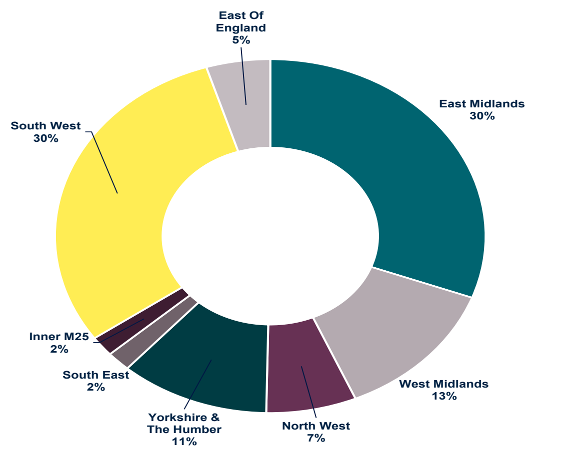
First quarter take-up above average



Graph source: Savills

GRAPH 2

Q1 take-up by region



Graph source: Savills

Investment

■ With many markets seeing investors take a cautious approach it bodes well for the rest of 2016 to report that investment volumes in the wider industrial sector increased on both an annual and quarter basis, the only sub sector to do so. Total investment reached £1.8bn, up 27% on the last quarter and 39% on the same period in 2015.

■ Looking at distribution warehouses in isolation also demonstrates a robust level of demand with total investment volumes reaching £683m, way above the long term average of £343m for a first quarter.

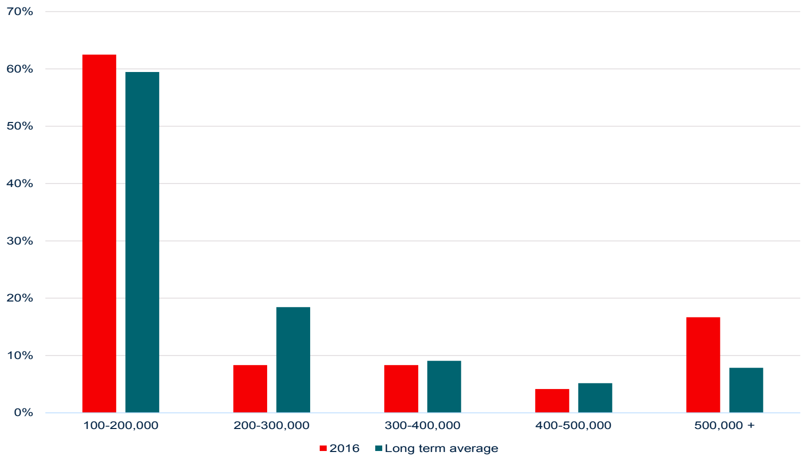
■ Whilst the deal count remained reasonably constant compared to the same period last year, and actually increased, 42 compared with 44, investment volumes were boosted by the £200m sale of the Phoenix Portfolio by IM Properties to the Malaysia's Employees Provident Fund.

■ With many global markets, for assets aside from real estate, now increasingly volatile we are starting to see a more diverse investor base for prime assets in the UK logistics market. Indeed, overseas investors accounted for 45% of all transactions in the first quarter of 2016, compared to just 17% in 2015. Increasingly logistics is being seen as a mature and global asset class and we expect overseas investor interest to increase.

■ The Savills prime yield for distribution warehouses is currently 4.75% having moved out 25bps in 2016. Investor sentiment to the sector remains strong but we are seeing investors become more discerning and targeting investments of scale or the most liquid of stock.

GRAPH 3

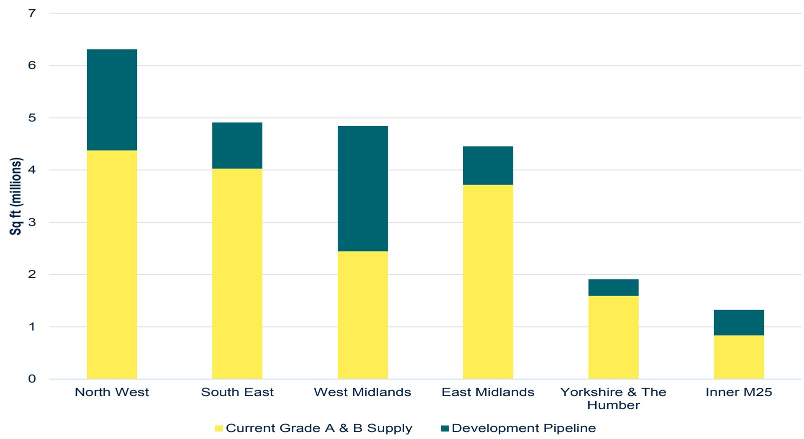
Proportion of take-up by size range



Graph source: Savills

GRAPH 4

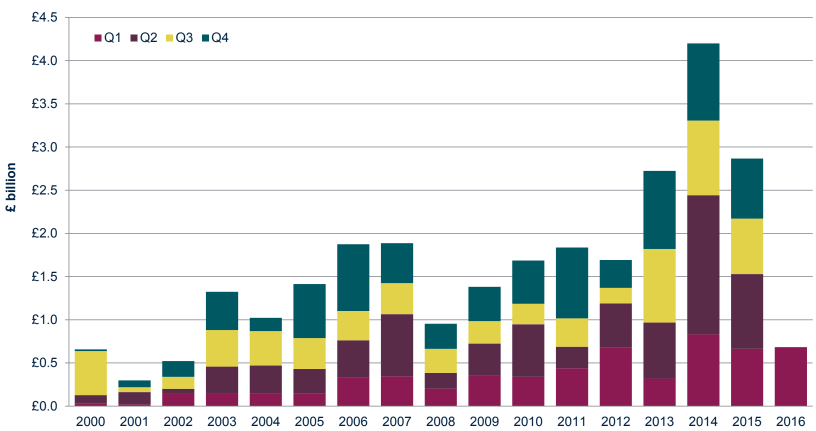
Current supply and development pipeline



Graph source: Savills

GRAPH 5

Distribution Warehouse Investment volumes



Graph source: Savills/ Property Data

OUTLOOK

Robust take-up levels across the country, and lack of large unit supply, will see a net absorption of existing speculative supply....

■ With the first quarter of 2016 seeing above average take-up levels and occupier requirement levels remain robust we expect that 2016 will be another strong year. Crucially, deal count in the smaller size ranges is strong which, in the past, has been necessary for take -up levels to out-perform long term averages.

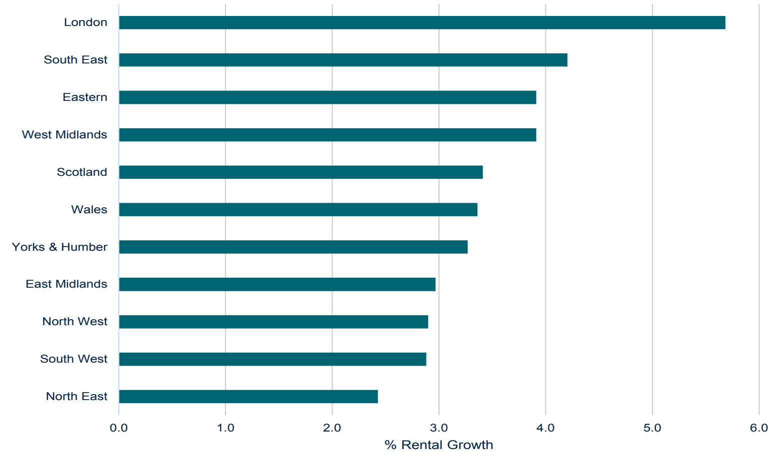
■ The balance between constrained supply and strong occupier demand has seen rents rise in many markets. Rental growth forecasts from RealFor suggest an average of 4% growth for UK industrials, ranging from 5.7% in London to 2.4% in the North East.

■ Whilst speculative announcements have slowed we expect to see more schemes announced later in the year as developers wait for recently completed schemes to confirm tenants.

■ In our last edition we suggested a "new normal" for investment volumes will be £2.5-3bn per year. Q1 volumes put the sector in good stead to reach that target along with the fact that the sector remains largely insulated from the potential implications of the outcome of the upcoming EU referendum.

GRAPH 6

2016 rental growth forecasts by region



Graph source: RealFor

Key Occupier Data

Current Grade A / new supply (over 100,000 sq ft):
9.8m sq ft, down 4.9% year/year

Average annual take-up:
22.2m sq ft

Remaining 2016 speculative development completions:
6.9m sq ft (37 schemes)

Vacancy rate: 7.83%

Key Investment Data

Big Shed Prime Yields
Long term income: 4.75%
Medium term income: 5.25%
Short term income: 5.75%

Investment Volumes
2015: £2.86bn
Q1 2015: £664m
Q1 2016: £683m
Q1 long term average: £343m

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