

Big Shed Briefing

October 2013



SUMMARY

■ It has been a positive 2013 so far in the big shed logistics market. Take-up has totalled 13.1m sq ft and we expect year end take-up to outperform the 5 year average, topping 20m sq ft.

■ The North West and South East have been the best performers accounting for just over 50% of space transacted this year.

■ There has also been a considerable up-turn in occupiers opting for D&B solutions.

■ As can be seen in Graph 1 (page 2), the proportion of D&B has increased significantly, with a 55% increase in D&B year-on-year. We anticipate seeing

a further 10-15% increase in D&B this year with c.8m sq ft by the end of 2013.

■ This in turn has led to the return of the first speculative developments since the downturn.

■ IM Properties began on-site at Birch Coppice to provide 334,500 sq ft in two units. Lancashire County Developments at Lancashire Business Park are developing two adjoining sheds of 166,000 sq ft and Prologis have also announced they will spec build 310,000 sq ft at Dunstable and 225,000 sq ft at Ryton.

■ Demand is being driven by the value retailers, such as The Range, TJ Morris

and Aldi, whilst internet retailers and the large supermarkets are redefining their supply chains.

■ Investment wise, strong demand has driven yield compression of up to 100 bps and we expect further downward pressure on yields through the remainder of 2013.

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 “Demand is outstripping supply and the return of the spec shed signifies increasing developer confidence” Richard Sullivan, National Head of Industrial & Logistics

→ Take-up

■ Take-up to the end of Q3 2013 totalled 13.1m sq ft and represents a successful year to date, despite the continued lack of Grade A availability across the country.

■ 2013 is on course to surpass the year-on-year total and should beat the 5-year average annual take-up given a strong finish to the year.

■ Whilst funding and economic conditions remain uncertain we do expect to see an uptick in demand from more than just the largest retailers and 3PL's in the final quarter.

■ Take-up in the South East and London is 75% up on the whole of 2012 at 3.5m sq ft. North West has seen 2.8m sq ft transacted and the Midlands comes in at 3.6m sq ft.

■ Across the UK, developers and investors are seriously considering pushing the button on spec schemes in prime locations as pent up demand continues to be unable to be met by the current standing stock.

■ Take-up is still dominated by the 3PL's and largest retailers, with over 90% of all deals done this year being to businesses falling into one of these two categories.

■ Online sales currently account for just 11% of total sales in the UK and M&S and John Lewis' recent deals are good examples of how the UK's biggest retailers are gearing up to increase their online offering.

■ As highlighted in Savills recent report "E-tailing and the impact on distribution

warehouses" this domination will continue, with Savills predicting that 50 million sq ft of space will be taken by retailers alone in the next five years as the full force of internet retailing is felt.

■ M&S are currently reducing their number of warehouses from over 100 properties to just three mega-sheds. They have moved their website in-house, it was previously outsourced to Amazon, and now offer next day delivery. These changes have resulted in a 30% increase in online sales demonstrating the growth that's still in online retail sales.

Availability

■ Availability across all size bands and across all regions has become severely restricted for Grade A space in prime locations.

■ The North West has just 5% vacancy rate and just one Grade A development with Units 1 and 2 at Lancashire Business Park set to be completed by late summer. In terms of good quality second-hand space there is choice but not lots of it. Comet's 471,698 sq ft former unit, XL on Statham Lane, is currently the largest available space.

■ The South East has seen plenty of activity with the recent deals to Parcelforce and strong interest in the remaining Grade A units in the sub 200,000 sq ft range.

■ Yorkshire has slightly more units than the South East and North West which are the regions suffering the

most chronic shortages. Yorkshire could accommodate occupiers looking for greater than 200,000 sq ft in and Grade A units are available at LPP Sheffield, Sherburn 330, SIRFT and Victor and Valiant in Doncaster.

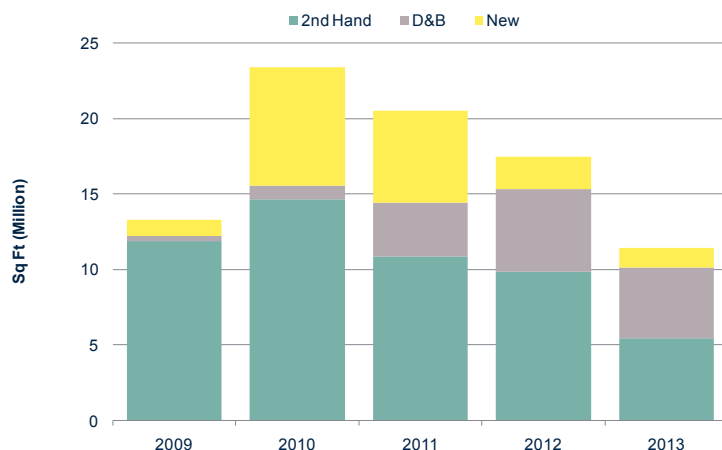
■ Space now coming to the market is letting extremely quickly with Parcelforce's letting in Beckton, of the former LOCOG unit, an excellent example.

■ Stock that has stood empty since prior to the downturn has let recently. Examples include The Duke in Staffordshire recently let to Clipper to fulfill a Super Group contract, The Campbell Centre in Stoke that let to WRS and the Blue Planet letting to JCB.

■ Although there has been a significant rise in D&B, at the other end of the market some occupiers need open ready space and are unwilling to pay the premiums attached to pre-lets.

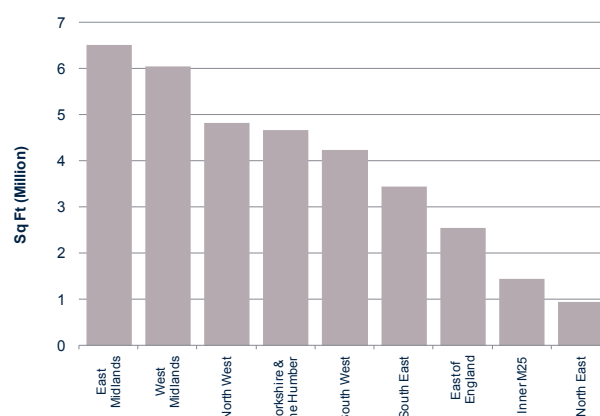
■ Therefore whilst we expect to see D&B take-up increase, the second-hand market will continue to play a pivotal role and good quality second hand space in prime locations will continue to shift in a very short time, as has been seen over the last 12-18 months.

GRAPH 1
Take-up to end Q3 2013



Graph source: Savills

GRAPH 2
Current availability



Graph source: Savills

Investment

■ Current sentiment for the industrial sector is extremely good with strong demand across the entire quality spectrum for both multi let estates and single let warehouses. Trading volumes throughout Q1 2013 were relatively low at approximately £320m due to supply constraints with little stock being traded as investors sought to retain industrial ownerships.

■ Q2 saw an increase with around £600m traded including Prologis' acquisition of a £247m portfolio from London Metric.

■ Strong demand against constrained supply has created robust market pricing, yield compression and delivering outperformance for the sector. Distribution warehousing is the top performing IPD sub-sector based on total returns so far in 2013.

■ Against an improving occupational story the sector is considered defensive offering relatively high income returns, low obsolescence, above average lease lengths without the rental volatility suffered by offices and retail.

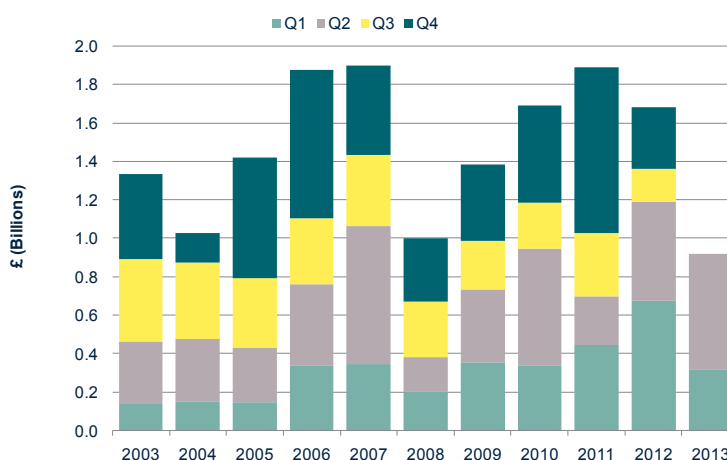
■ The sector is seeing increasing overseas interest as "Logistics" becomes established as a recognised global asset class driven by growing awareness of defensive characteristics and favourable risk adjusted returns.

■ Blackstone continue to be the leading overseas investor into UK logistics accounting for circa 20% of all acquisitions in 2012. Also, interest from Middle East (Gatehouse, 90 North), Russia (Delin Capital), North America (Chambers Street, Cabot) and Asia (EPF). Overseas capital is also becoming indirectly exposed to the sector via investments in Prologis (Norges – circa £2bn) and Gazeley (Brookfield – circa £370m).

■ An ongoing trend amongst UK based investors is acquiring units let on shorter leases (sub 10 years) at higher yields (7.5%+) where there is potential for the tenant to remain in occupation beyond the term of the existing lease.

■ Yields have compressed by between 25-100 bps with the

GRAPH 3
Total big shed investment volumes



Graph source: Savills; Property Data

greatest movement shown by short income investments. These were considered relatively cheap to acquire and confidence in their ability to be re-gear or re-let has risen. Consequently yields have moved in from 9% net initial yield (NIY) 2 years ago to sub 8% for the best stock.

■ Distribution offering "middle dated" income typically of around 10 years has also experienced yield compression of circa 50 bps to now stand at around 7% to 7.5%.

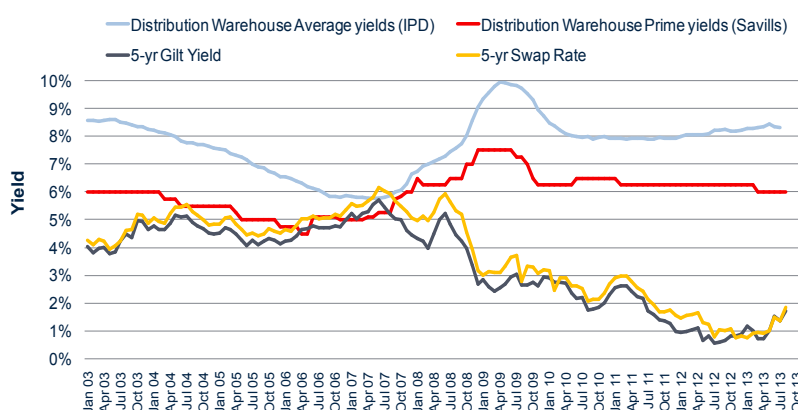
■ The availability of long dated income of 15 years plus is becoming rare, which reflects a lack of recent speculative development and reluctance from occupiers to commit to such lengthy terms. This market has been driven by prelets to occupiers such as The Co-op, Marks & Spencer,

John Lewis, Brake Bros and Travis Perkins.

■ Long dated income is extremely sought after from UK institutions, private and overseas investors, attracting yields of between 5.5% to 6.5% with premium prices achieved for index linked leases.

■ Moving forwards, we expect continued inward pressure on yields for the remainder of 2013 as significant capital seeks exposure to the sector, far outweighing the availability of suitable product.

GRAPH 4
Prime yields starting to move in?



Graph source: Savills; IPD; Bank of England

OUTLOOK

Improving market conditions and the next phase of online retail growth will see increased demand for prime logistics space

■ Demand over the next 12-18 months will remain strong for prime logistics space, with the biggest online retailers continuing to fuel the demand. Rents will rise and yields will fall for the best space.

■ The problem as alluded to earlier is that at the moment there is not enough high quality warehousing to satisfy the demand and so retailers are holding off on taking space and in some cases looking to acquire on a D&B basis.

■ Despite this lack of currently available Grade A space, we anticipate that take-up this year will beat the 5-year average take-up, which sits at c. 20m sq ft and will be up 10% year-on-year. Moving forwards from Q4 2013 and into H1 2014 we expect to see less recessionary conditions with returning consumer confidence ensuring the retailers come back to the market to satisfy growing demand.

Key Occupier Data

Grade A / new supply (over 100,000 sq ft):

17.3m sq ft

Take-up end-September 2013:

13.1m sq ft

Five year average annual take-up:

20.7m sq ft

Top rent achieved 2013:

£9.32 per sq ft - DX Network Services Limited at Units 2, 3 & 4, Colnbrook Freight Centre (100,000 sq ft+) second hand building Heathrow

Key Investment Data

Big shed prime yields:

Long term (c. 15 years) 6%

Medium term (c. 10 years) 7%

Short term (c. 5 years) 7.75%

2013 Key deals:

311,282 sq ft at Merlin 310, Trafford Park purchased by Henderson for £19.7m (7.10% NIY) from Aviva and let to TDG (UK) Ltd, lease expiry October 2017.

656,603 sq ft at Argos Distribution Centre, Bedford purchased by London Metric for £40.0m (7.00% NIY) from a private investor and let to Argos, lease expiry December 2022.

1.1m sq ft at Units 2 & 3, Brookfields Park, Manvers Way, near Rotherham purchased by Legal & General for £86.68m (5.5% NIY) from Tritax and let to Next Group Plc for 25 years from purchase completion.

668,918 sq ft at Magna Park, Milton Keynes purchased by Aviva for £76.5m (4.85% NIY) from Gazeley and pre-let to John Lewis for 30 years from practical completion.

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