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# Big Shed Briefing

October 2016

Dunstable 360 where Prologis, advised by Savills, has leased 358,068 sq ft to Amazon

## SUMMARY

■ Demand in the UK logistics sector remains strong. By the end of the third quarter of 2016 more warehouse space has been transacted than by the year end of 2015, accounting for 26.2m sq ft.

■ Whilst a number of large deals have undoubtably pushed these figures on there remains a significant amount of churn in the market as Savills tracked information on 39 separate deals, 70% higher than an average third quarter.

■ Strong levels of take-up and decreasing levels of speculative development have seen total supply fall by 22% year on year to reach 26.4m sq ft.

■ The make-up of existing supply has altered through 2016 as speculatively completed units enter our supply database, with 60% of the market made up of grade B & C units, compared to 72% of the market just one year ago.

■ The investment market remains buoyant with £661m invested in the third quarter of 2016. With above average levels of transactions there is encouraging liquidity in the market given financial market volatility post Brexit.

■ Looking forward, the upcoming busy period for retailers will be a leading indicator as to whether the occupational market will continue its strong performance into 2017.

"Strong levels of take-up are ensuring that supply levels continue to fall and the current level of speculative development is not replenishing stock at a fast enough pace to satisfy demand " Kevin Mofid, Head of Industrial & Logistics Research

## Take-up

■ The third quarter of 2016 has proven to be an exceptional quarter with 10.45m sq ft of warehouse space transacted. This is 4.7m sq ft above the long term average of 5.7m sq ft and a huge 166% up on the same quarter in 2015. This also means that by the end of the third quarter of 2016 take-up has exceeded all of 2015.

■ The strong levels of take-up were helped by two 1m sq ft + deals to Amazon including 2.2m sq ft over four floors of rentalised space at London Distribution Park in Tilbury. Whilst the floor print of this building is ~550,000 sq ft we have included as 2.2m sq ft as it is understood that rent is being paid on all floors. Moreover the concrete mezzanine floors are structural to the building and not considered occupiers fit out.

■ It should also be noted that Savills has tracked information on 39 separate transactions which is 70% above the average amount for a third quarter. Indeed so far in 2016 there have 104 deals over 100,000 sq ft compared to just 82 for the same period last year.

■ At a regional level the North West accounted for 21% of take-up across eight transactions all in the 100,000 - 200,000 sq ft category.

■ As the supply of grade A units has increased as speculative units reach practical completion it is encouraging to note that 19% of deals in the third quarter were for speculatively constructed units. Also, whilst Build to suit units are becoming increasingly prevalent it should also be noted that 29% of deals were for second hand units.

## Availability

■ The previously described strong levels of take-up, combined with a slowing pace of speculative delivery in 2016 has resulted in the supply of units over 100,000 sq ft declining sharply and now stands at 26.4m sq ft, down 22% from the third quarter of last year.

■ As speculatively constructed schemes have reached completion and entered our supply statistics the balance of available supply has also changed at a Nationwide level. Since October 2015 the proportion of grade B & C stock on the market has fallen from 72% of total supply to just 60%, meaning that the remaining 40% is either speculatively constructed or grade A second hand.

■ However, the balance of supply by size range has not altered. Indeed of the 158 units Savills are currently tracking only 21% are above 200,000 sq ft. The two largest grade A units on the market are both 2nd hand and both in the East Midlands, Quantum at Magna Park Lutterworth (411,613 sq ft) and DC372 at Prologis Park Pineham (374,132 sq ft). The largest speculatively constructed unit on the market is 360 at Logistics North in Bolton which achieved practical completion this quarter.

■ Regionally the North West retains its position as having the largest amount of supply, with 33 units on the market totalling 5.5m sq ft. However, the level of grade C stock remains high, accounting for for 38% of supply. We expect this to remain high as there has been very little occupier demand for grade C units in 2016.

■ The UK average vacancy rate has also fallen to 6.2% due to the strong levels of take-up and lack of supply coming forward.

## Development Pipeline

■ Since the result of the vote for the UK to leave the European Union there has been only one announcement of new speculative development. Exeter Property Group and Graftongate have started construction of a 372,000 sq ft unit in Cannock in the West Midlands.

■ Not only is this the only announcement this quarter, it is also the largest unit speculatively developed in this cycle, eclipsing the 358,000 sq ft developed by Prologis in Dunstable and the 357,000 sq ft recently delivered at Logistics North in Bolton.

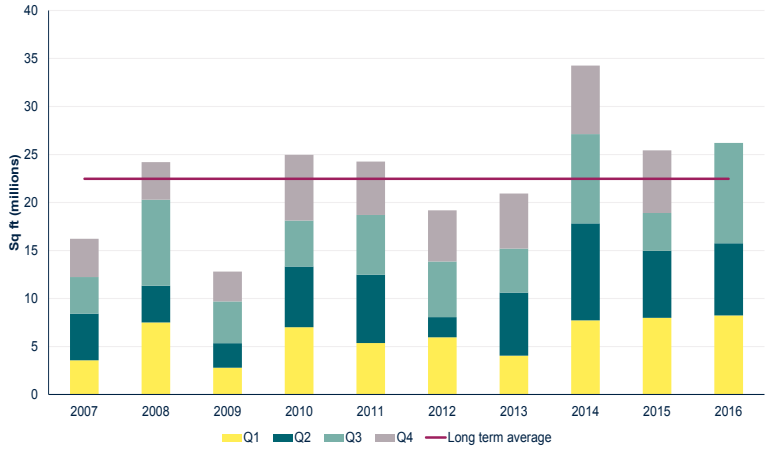
■ There are now just 20 units due for completion in the remainder of 2016 and into 2017 which total 3.8m sq ft.

■ Of those units 71% are in the 100,000 - 200,000 sq ft category, with the average size being 179,207 sq ft.

■ At a regional level the speculative schemes are located across all core regions aside from Yorkshire where there are no new units due for delivery. The West Midlands accounts for 37% of the speculative space due for delivery followed by The North West, which accounts for 23%. London and the South East combined account for just 16% of the space due for delivery.

GRAPH 1

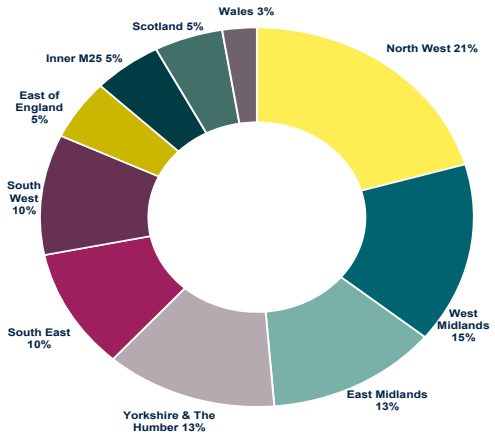
### Take-up exceeds 2015 already




Graph source: Savills

GRAPH 2

### Q3 take-up by region (deal count)




Graph source: Savills

## Investment

■ Given the volatility and uncertainty in many financial markets in the aftermath of the outcome of the EU referendum it is encouraging to observe that investment volumes for single let logistics units have reached £661m in the third quarter of 2016, with over 40 units transacted. This is a slight increase on the £642m transacted in the same quarter of 2015, but up a 25% increase on Q2 2016.

■ Just six deals account for over half of the capital deployed in the quarter. These include Legal & General committing £150m to the forward funding of the previously mentioned Amazon warehouse at the Port of Tilbury and Tritax Big Box REIT forward funding Bericote to construct a 543,692 sq ft unit at Four Ashes near Wolverhampton for £56.3m.

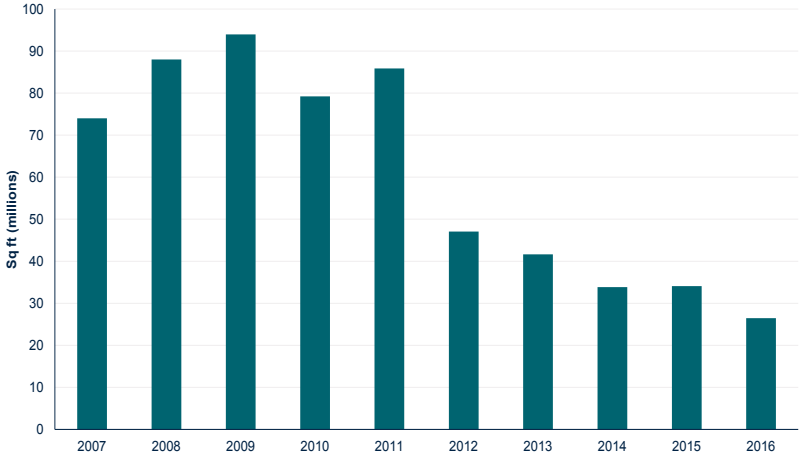
■ The aftermath of the Brexit vote also saw a flurry of activity as some of the UK's largest open ended unit trusts suffered redemptions and sought to raise capital through property sales. In the industrial sector, Logicor acquired BT, Magna Park, the Morrisons Unit in Swan Valley, Northampton along with seven industrial estates in a £135m acquisition. More recently Tritax have secured contracts to acquire a number of logistics units from M&G and TH Real Estate.

■ We have observed an above average Number of transactions this quarter, with a further 41 transactions making up the remaining investment volume , demonstrating an encouraging level of market liquidity post Brexit. The depth of investor interest on 'institutional' lot sizes has improved following positive post referendum total returns forecasts for industrial and logistics. We are also witnessing increasing levels of activity and demand from local authorities seeking revenue "creation".

■ The Savills prime yield for distribution warehouses is currently 5% having moved out 25bps in the third quarter. There is however a growing evidence base that suggests the fourth quarter could see a downward pressure on pricing.

GRAPH 3

### Nationwide supply continues decline




Graph source: Savills

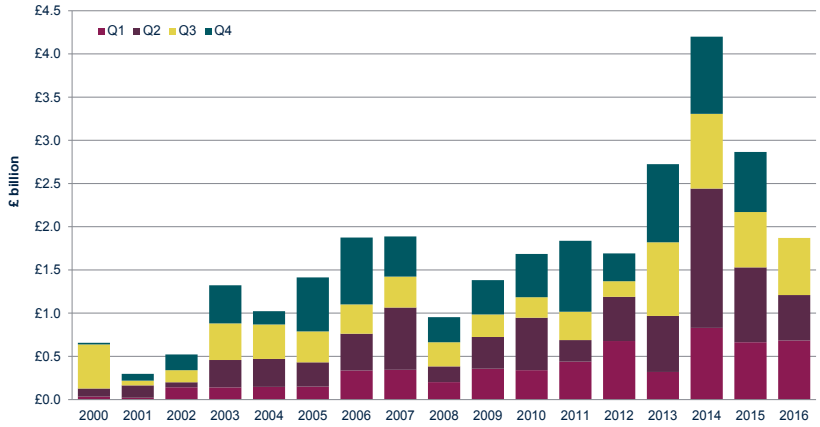
GRAPH 4

### Speculative delivery by region and size Q416 - Q317


Graph source: Savills

GRAPH 5

### Distribution warehouse investment volumes




Graph source: Savills/ Property Data

# OUTLOOK

## Attention turns to Christmas trading figures and the health of the retail market

- Savills released a standalone paper covering the potential impact Brexit on the UK logistics market in July which we will be updating in the fourth quarter of this year.

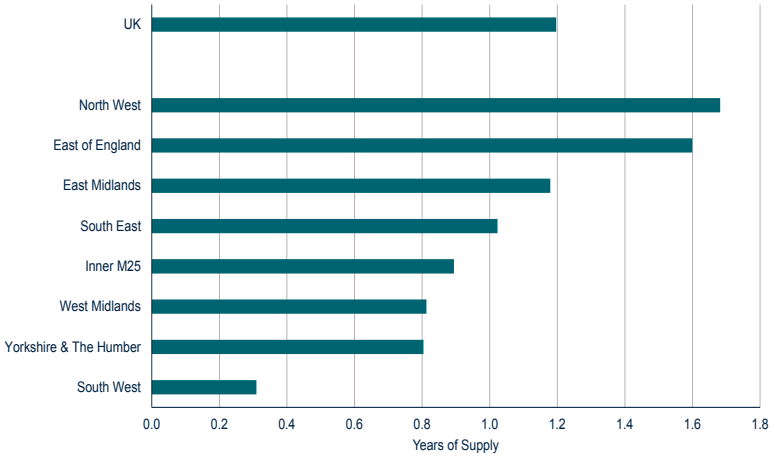
- However, our initial conclusions were that occupier take-up would remain robust in the short term and supply would fall have largely played out, with only one speculative scheme coming forward since the result of the vote.

- Data from the OECD shows household expenditure accounted for 65% of UK GDP in 2015. Over the last ten years the retail sector, in all its forms, has accounted for 43% of all the warehouse space transacted, therefore the fortunes of both sectors are clearly intertwined.

- Back Friday, on 25th November 2016, will be an important pre Christmas barometer of retail health. Assuming retailers have a strong Black Friday and subsequent Christmas we envisage occupier demand remaining robust into the early part of 2017 when the negotiations regarding Article 50 will come to the fore.

GRAPH 6

## Regional years of supply




Graph source: Savills

## Key Occupier Data (100,00 sq ft and above)

**Current Grade A / new supply**
10.7m sq ft

**Average annual take-up:**
22.8m sq ft

**2016/17 speculative development completions:**
3.8m sq ft (20 schemes)

UK Vacancy rate:
6.2%

## Key Requirements

| Occupier | Region | Size |
|---|---|---|
| **Lidl** | North West | 30-40 Acres |
| **Wayfair** | North West | 300-400,000 sq ft |
| **Makita** | Midlands/SE | 300,000 sq ft |
| **Co-op** | South Mids | 500,000 sq ft |
| **Wilkinson** | South East | 450,000 sq ft |

## Please contact us for further information


**Richard Sullivan**
National Head of Industrial
+44 (0)20 7409 8125
rsullivan@savills.com

**Toby Green**
Director - South East
+44 (0)20 7409 9903
tgreen@savills.com

**Ranjit Gill**
Director - Birmingham
+44 (0)21 634 8402
rsgill@savills.com

**Jon Atherton**
Director - Manchester
+44 (0)161 277 7207
jatherton@savills.com

**Dave Robinson**
Director - Leeds
+44 (0)113 220 1218
darobinson@savills.com

**Rob Cleeves**
Director - Bristol
+44 (0)1179 102 227
rcleeves@savills.com

**William Rose**
Director - Peterborough
+44 (0)1733 201 391
wrose@savills.com

**James Williams**
Director - UK Investment
+44 (0)20 7409 8785
jebwilliams@savills.com

**Simon Collett**
Building Consultancy
+44 (0)20 7409 5951
scollett@savills.com

**Kevin Mofid**
Research
+44 (0)20 3618 3612
kmofid@savills.com