DTZ Research

PROPERTY TIMES

Good start to the year

Europe Industrial & Logistics Q1 2015

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Contents

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- The European economy is back on track with the latest figures showing positive GDP growth for majority of countries, with the exception of Italy. Industrial production nevertheless remains muted overall in Europe with less than a 2% increase in 2014 (compared to 7% growth in China and 4% in US).

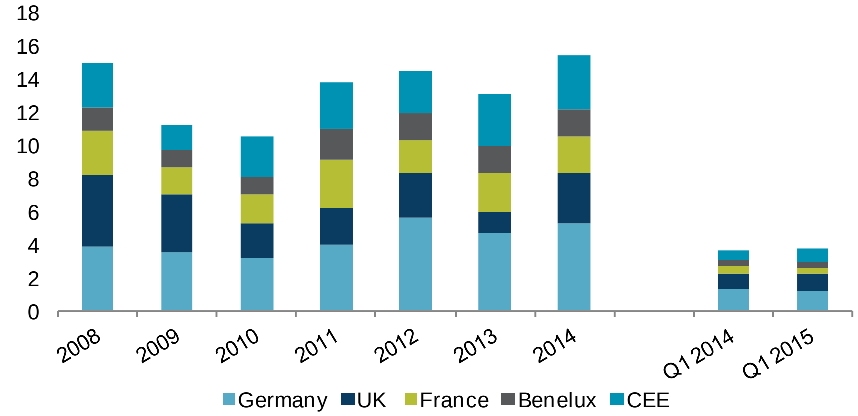
- Demand for logistics space is mainly driven by retailers and industrial companies, especially in the core three European markets (UK, France and Germany). Around 3.8m sq m of industrial space was transacted in the main European markets covered in our study, which represents a 6% increase on a y-o-y basis (Figure 1). Location-wise, in Q1 2015 Germany attracted some 35% of total occupier activity. Amongst other countries of interest to occupiers the CEE region had a strong start to the year with more than 800,000 sq m of logistics space leased, up by 32% in comparison with Q1 2014.

- After several years of downward pressure, rental values remained stable overall with some increases in some of the CEE markets. In the long-term, the prime industrial rental values are expected to enter into an upward cycle. We forecast these to increase by an average of 1.6% per annum over the next five years.

- About EUR 4.2bn were invested in the industrial sector in Europe, a volume in line with the one recorded in Q1 2014. Country-wise, the UK is the main European investment hotspot with EUR 1.3bn of inflows. The largest transaction of the quarter was signed in Italy with the acquisition of a EUR 323m portfolio by CERBERUS CAPITAL MANAGEMENT. Continuing the 2014 trend the international and US-based investors showed a strong interest towards the European industrial market with almost EUR 1bn of the inflows in Europe coming from them.

Figure 1

Logistics space take-up – Main European markets, million sq m



Source: DTZ Research

Economic climate

Positive GDP growth recorded in the majority of countries for the first time since the crisis

The worldwide economy is definitely gaining momentum, with a GDP above the 2% mark for the second year in a row in 2014. Despite bearish results in Japan, Asia Pacific is leading the way with 4.7% GDP growth in 2014 (5.3% in India and 7.4% in China). The US economy also showed strong recovery signs with GDP growth expected to reach the 3% mark from 2015 (Figure 2).

Even if the picture is less positive, the European economy is now back on track after five years of struggle. With the exception of Italy (-0.4% in 2014), all the main European countries registered positive GDP growth in 2014 and for the first time since 2008. The UK and the CEE countries were the most dynamic with GDP rising by 3.1% and 3% over the year respectively.

These two locations are expected to lead the way in the coming years with an average GDP growth of 3.2% p.a. for CEE and 2.6% p.a. for the UK until 2018. By contrast, GDP recovery is expected to be subdued in France with a forecasted 1.3% growth per annum over the same period.

European industrial production to remain subdued

Europe confirms itself as a place of final consumption rather than production. Industrial production was muted in 2014 and no rebound is expected in the medium-term (Figure 3). Even Germany, the European leader, accounted for an unexpected decrease at the start of the year. Nevertheless, Eurozone April Markit PMI index for manufacturing industry posted a 13-month high giving a glimmer of hope for the continent.

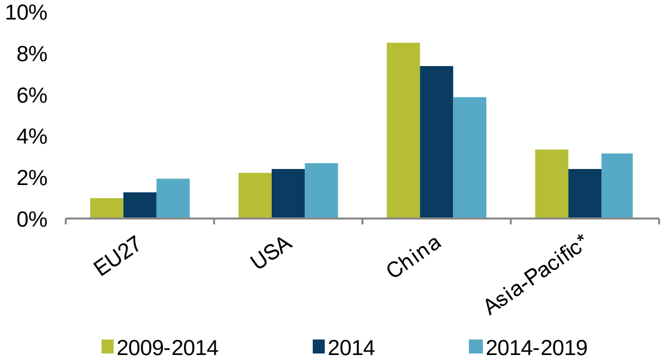
Foreign exchanges down

Surprisingly, the weak Euro, the low inflation and the improving global economy did not contribute to more international trade for Eurozone countries.

The Euro area is still struggling to gain market share in international trade. Exports went down by a record 6.9% in Q4 2014 in comparison with the previous quarter (and -9.6% in comparison with Q4 2013). This was the third decreasing quarter in a row (Figure 4). This sharp slowdown could be partly explained by a lower demand coming from the oil producing countries weakened by the severe fall in oil prices registered in the second half of 2014.

Figure 2

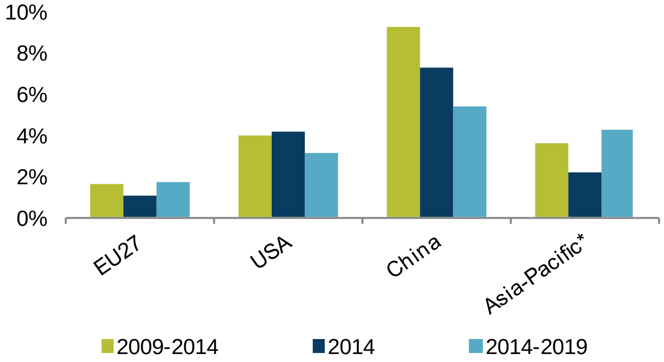
Annual GDP growth



Source: Oxford Economics **China excluded*

Figure 3

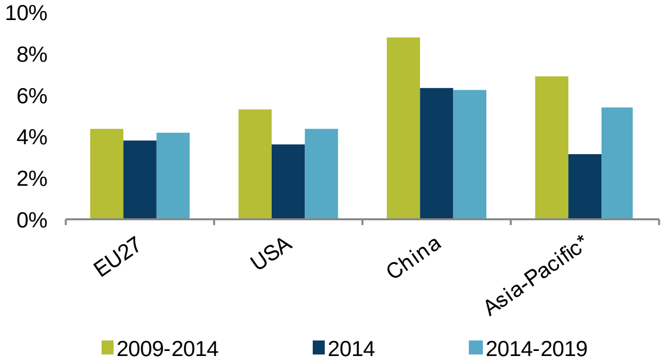
Industrial production growth



Source: Oxford Economics **China excluded*

Figure 4

Cross border trade growth



Source: Oxford Economics **China excluded*

Occupier market

A build-to-suit market

Around 3.8m sq m of industrial space was leased in the main European markets covered in our study, which is a 6% increase from last year. The European industrial market remained in line with the record levels of last year with the quarterly volumes back to the pre-crisis levels (Figure 5).

In Q1 2015, Germany was the driver of the occupier activity in Europe with 1.2m sq m leased. Nevertheless this is an 8% decrease from Q1 2014, but up by 9% in comparison to the average Q1 figures from 2010.

The CEE region had a good start to the year as well with more than 800,000 sq m leased, up by 32% in comparison with Q1 2014. The Polish market was particularly dynamic with 560,000 sq m of logistics space transacted.

Retailers and industrial companies were the drivers of the European industrial market in Q1 2015, while 3PL occupiers remained cautious .

In terms of significant transactions in the UK, NEXT PLC signed over 65,300 sq m of logistics space, DUNELM over 48,900 sq m in “Prologis Park” Stoke-on-Trent. In France, BUT leased 60,000 sq m and LIDL 40,800 sq m. With the e-retail boom, all these companies redefined their supply chain and favoured build-to-suit solutions rather than moving into an existing building that won’t fully meet their needs.

New upward cycle in rental values

After a bearish period, industrial rental values are stabilising in the majority of European markets. An increase of 5% was recorded in the CEE markets such as Bucharest and Budapest. The current average European industrial rental values are €68/ sq m/yr, and €56 if the UK is excluded.

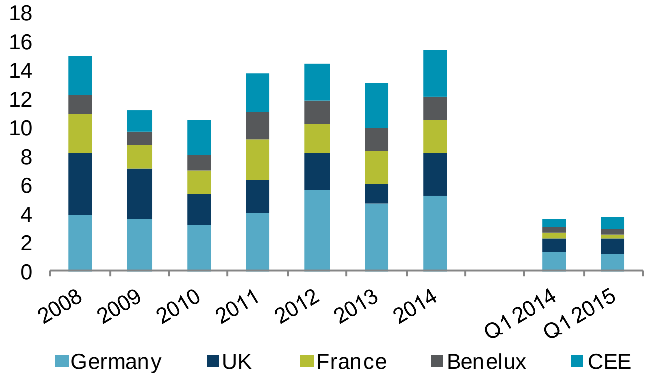
Our forecasts suggest that 2015 will be the starting point of a new upward cycle in rental values across Europe. Rents are expected to grow by an average of 1.6% per annum until 2019. The UK market currently is the most expensive in Europe with rental values of €203/sq m/yr in London (Heathrow) and €90/sq m/yr in Birmingham with rents forecasted to increase by an annual pace of above 2%. After several years of shortage in grade A supply, transactions on both speculative and build-to-suit buildings should fuel the market.

By contrast, rents in the French and German markets are not expected to register any significant change in the short term (Figure 6). Although French rental values remain amongst the lowest at the European level, ranging between €41 in the regional markets and €52 in the Greater Paris Region.

Figure 5

Logistics space take-up – Main European markets

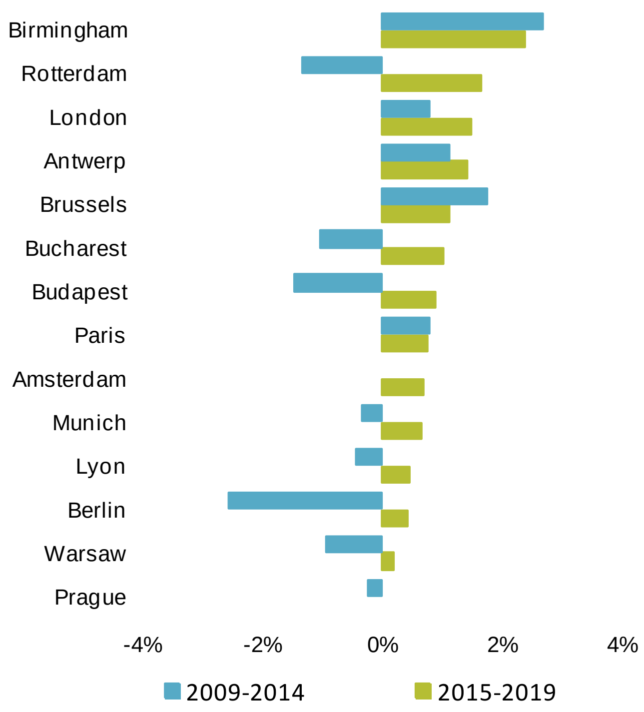
Million sq m



Source: DTZ Research

Figure 6

Industrial rental values growth



Source: DTZ Research

Investment market

Good start to the year

The European industrial investment market posted a dynamic start to the year with a EUR 4.2bn investment volume in Q1 2015, a figure similar to the one registered in Q1 2014. This performance is remarkable given the fact that 2014 was a decade record year for the European industrial market with EUR 21.7bn of investment.

Nevertheless, the industrial sector remains a specialists' playground attracting only 8% of the total European investment inflows in Q1 2015 (Figure 7).

In terms of locations, the UK is the main investment hotspot with an average market share of 41% over the past decade. Although, this market share shrank to 30% in Q1 2015 with EUR1.3bn invested, the UK kept its leading position (Figure 8).

By contrast, investment activity was subdued in Germany and France - the other two main European markets - with EUR 657m and EUR 118m of inflows in Q1 2015 respectively.

Southern Europe continued to enjoy increasing market activity with EUR 617m already invested in industrial assets in Q1 2015. This is a remarkable performance for this region having recorded an annual investment volume of EUR 357m on average over the past five years. Nevertheless, this performance is mainly driven by one deal inked in Italy. The UNICREDIT bank sold a EUR 323m portfolio of foreclosed industrial assets to CERBERUS CAPITAL MANAGEMENT, a US-based private equity firm.

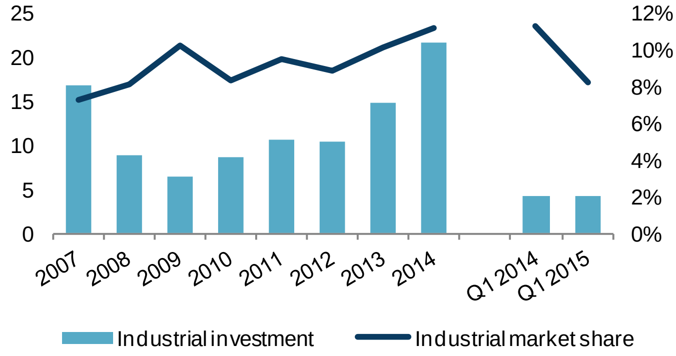
Big players back on the industrial market

International investors were almost absent from the European industrial market during the crisis peak with only EUR 568m invested in 2009. Since then, they have increased their presence year after year. In 2014, their asset acquisitions reached a record level of EUR 5.8bn. The 2015 started in the same vein with almost EUR 1bn of inflows coming from outside Europe.

Nevertheless, the industrial market remains a specialist area with domestic investors dominating the market. In Q1 2015 they accounted for around 75% of the total investment volume (EUR 2.6bn out of EUR 4.2bn (Figure 9).

Figure 7

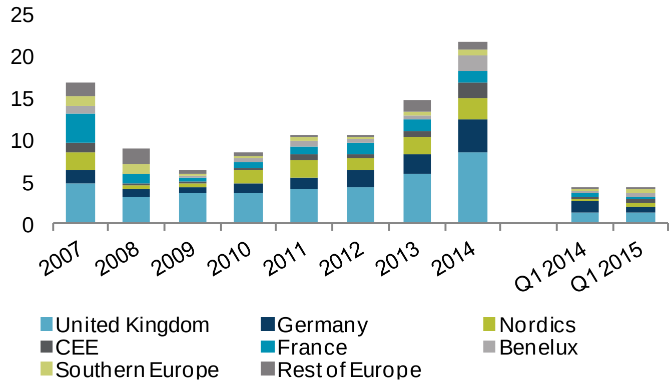
European industrial investment market, €m



Source: DTZ Research

Figure 8

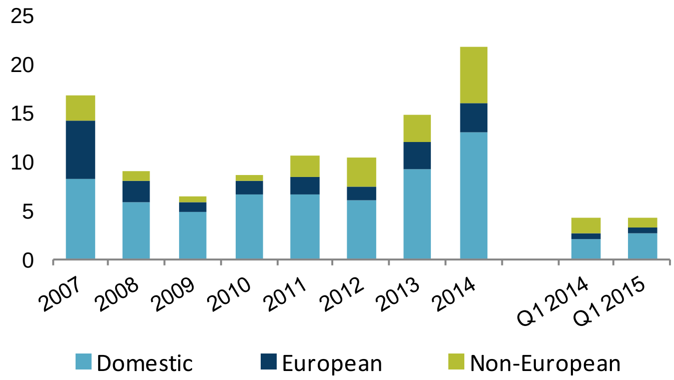
European industrial investment market, €m



Source: DTZ Research

Figure 9

European industrial investment market, €m



Source: DTZ Research

Yields

Yields stabilising in the core markets but more compression forecasted in the peripheral markets

Given the strong appetite shown by investors, both domestic and foreign, and the lack of opportunities available on the market, prices are increasing. Prime yields went down by an average of 15 bps over the course of Q1 2015. Nevertheless, yields are stabilising in many core markets like France, Germany and Belgium. By contrast, yield compression is still ongoing in the peripheral markets such as Barcelona (7.75% down by 25bps in Q1 2015) or Prague (7.00%, -50 bps over the quarter).

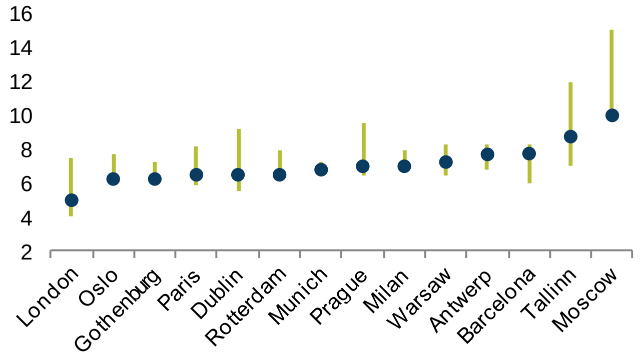
We believe that further yield compression is possible in some European markets. Several markets are still above their historical low, for example London Heathrow was at 5% at the end of Q1 2015 versus 4% reached in mid-2007 (Figure 10).

Moving forward, our forecasts suggest that the current cycle is coming to its end with yields expecting to stabilise in the core European markets. Peripheral ones, in Southern Europe and CEE in particular, are expected to lag by few quarters and to stabilise only in 2017.

Figure 10

European prime industrial yields

(Q1 2015 = dot, Q1 2005 to Q4 2014 = line)



Source: DTZ Research

Definitions

Classification
Warehouses are classified according to their technical characteristics (hardness at ground level, unimpeded height, etc.), their accessibility (distance from the motorway, not being shut into an urban area), and their capacity for growth (adaptation to present and future ICPE standards and to the constraints of insurers).

New building
A building that has never been used. Also called "first-hand" in contrast with "second-hand" buildings

Non-speculative building
A building for which all the steps preliminary to launching the project have been taken (purchase of the land, preparatory studies, obtaining of the building permit, etc.), while actual construction will only begin once a user has committed to all or part of the project.

Old or second-hand building
A building that has already been occupied by a user. Also called "second-hand" buildings in contrast with "first-hand" or new buildings.

Operating licences
Licences required to operate a warehouse building. There are around a hundred different kinds, the most frequent being numbered as follows: 1510 (Covered warehouses), 1530 (Wood and/or paper stocks), 2662 (Honeycombed Plastics storage), 2663 (Storage of manufactured plastics, tires), 1412 (Container storage of flammable gases or aerosols), and 1432 (Container storage of inflammable liquids).

Owner-occupier project
A building whose occupier is the owner

Speculative building
A building whose construction is begun without previous sale or letting to one or several users.

Take-up
The total deals, whether rentals or sales, carried out by users, including pre-let, turnkey rentals, and owner-occupier projects.

Turn-key transaction
A building whose construction begins after a definite commitment from an occupier/tenant, even if a developer's project existed previously without construction having begun. These operations are included in take-up only when the preconditions (such as permits and financing) have been fulfilled.

Warehouse
A building for stocking, distribution, or light assembly. Such premises are ranked in different categories: Class A for a highly functional or "new generation" warehouse, Class B for a building up to the standards of a modern warehouse, and Class C which includes all other warehouse buildings. Classification is done according to a number of criteria, such as the building's construction date, ceiling height, manoeuvring area, hardness of the floor, etc.

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