Logistics matters:
The BNP Paribas Real Estate Logistics Index
in conjunction with IPD
November 2011
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1 INTRODUCTION

1.1 BACKGROUND

BNP Paribas Real Estate are market leaders in all aspects of property advice relating to the industrial and logistics sector. Across the country we have expert teams covering agency, investment, lease advisory, business rates, planning, valuation, corporate real estate, building consultancy and research.

For many years we have noticed that across the property industry the terms industrial, standard industrial, logistics and distribution are used almost interchangeably when talking about either large warehouses or smaller units on industrial estates.

The aim of this report is to bring clarity and transparency to the Industrial sector as a whole by creating a bespoke sample from the IPD All Industrial universe that draws out information on the logistics sector across the country.

Building on the successful BNP Paribas Real Estate Logistics Matters Research series, this research, in partnership with IPD, uses the same definition for logistics as our previous work: units let to a single occupier over 50,000 sq ft in size.

In order to create this sample BNP Paribas Real Estate took the pre-existing IPD Distribution Warehouses sample and then identified units that matched the size threshold from the remainder of Standard Industrial. BNP Paribas Real Estate were also able to use their extensive knowledge of the logistics sector to identify tenants, and therefore units, that were also being used for a logistics-related purpose.

This created a bespoke sample of properties that is a closer match to what is happening in the world of operational logistics.

Throughout the report we refer to ‘Logistics’, ‘All Industrial’ and ‘Standard Industrial’:
- Logistics is the BNPPRE sample;
- All Industrial is the entire industrial sector group;
- Standard Industrial is the remainder of assets in All Industrial when the assets chosen for the Logistics sample are removed.

The main aim of this report is to look at how these Logistics assets behave, relative to the remaining Standard Industrial units.

As Figure 1 demonstrates, Logistics began to separate itself in terms of asset performance in the early 1990s. This is in line with the evolution of operational logistics and supply chain management and the creation of national and regional distribution centres. An index with a booming performance in the early 1990s and a stable performance above that of the Standard Industrial units develops. This index reaches a higher peak in 2006 and over the course of the last four years has set itself apart from Standard Industrial assets; Logistics is certainly an index that is deserving of further examination.

Our report comprises two main sections:
- a logistics market update covering supply, demand and forecasts for 2012;
- performance analysis of logistics and industrial assets both at a national level and across regions for the following periods: 2010, H1 2011 and over the long term.
1.2 IPD OVERVIEW

IPD is a global information business dedicated to the objective measurement of commercial real estate performance. As the world’s number one provider of real estate performance analysis for funds, investors, managers and occupiers, IPD offers a full range of services including research, reporting, benchmarking, conferences and indices. Operating in over 20 countries, including many European countries, the US, Canada, Australia, New Zealand and Japan, its indices are the basis for the developing commercial property derivatives market, and the most authoritative measures of real estate returns worldwide.

Within the UK, IPD’s suite of performance indices is accepted as representing the performance of the UK property market. The 2010 IPD UK Annual Index represents information collected from 283 funds投资ing in property which held a combined total of over 11,276 assets valued at over £134 billion – equivalent to 58% of the UK investment market. The Index tracks the performance of UK property all the way back to 1981.

1.3 REFERENCE SAMPLE AND TERMS

‘Total return’ is the overall level of return derived from property. This can be split into income return – the money investors receive from rent (net of costs) – and capital growth – the change in the capital value of the property. Income return might be compared to the dividend on a company’s share; capital growth could be compared to the change in price of the share.

The capital value of a property is affected by two factors: rental levels and yield levels, meaning that capital growth can further be split out into two drivers.

- ‘Rental value growth’ is the change in the level of rent that a valuer estimates a property might achieve were it to be let on the open market. If a valuer thinks that open market rental values have risen from say £40 psf to £50 psf, rental value growth would be 25%, and capital values would increase by this amount, all other factors remaining the same.

- ‘Yield impact’ quantifies the impact on capital values of a change in yields. If yields rise, capital values fall; conversely, if yields fall, capital values rise. A positive yield impact of say 10% would indicate that yields had fallen by such an amount as to increase capital values by 10%. Likewise, a negative yield impact of say -15% would show that a rise in yields had caused capital values to fall by 15%.

- ‘Residual’ is caused primarily in markets where rental values of an asset are falling, but the underlying tenant’s lease structure prevents these falls from being fully realised in the final capital growth movement.

The bulk of the report is focused on industrial assets within the IPD Annual Index and is based on a sample size of 2,942 properties as at December 2010 with a combined value of £19.6 billion.

Table 1: Sample size, end 2010

<table>
<thead>
<tr>
<th></th>
<th>Capital value (Emillion)</th>
<th>Number of properties</th>
<th>% of total UK IPD industrial assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Logistics</td>
<td>5,322</td>
<td>527</td>
<td>27.2</td>
</tr>
<tr>
<td>Standard</td>
<td>14,236</td>
<td>2,415</td>
<td>72.8</td>
</tr>
<tr>
<td>Industrial</td>
<td>19,558</td>
<td>2,942</td>
<td>100</td>
</tr>
</tbody>
</table>

The H1 2011 analysis in section 3.1 of the report is based on the IPD UK Quarterly Index to end June 2011. The results from this index take into account the first two quarters’ performance of 2011 and comprised 2,299 industrial properties with a combined value of £17.3 billion.

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2 MARKET COMMENTARY

In this section we provide a market update based upon the data we collect on a quarterly basis. All figures refer to new and second hand property over 50,000 sq ft.

2.1 SUPPLY

Our statistics for the supply of warehousing in the UK Logistics market would seem to paint a fairly healthy picture for the occupier with 147million sq ft of property on the market. However, delving deeper into the statistics shows a worrying polarisation of the market, both in terms of the availability of new space and the size of space on the market.

At a regional level the majority of space on the market is contained in the core logistics regions of the Midlands, the South East, Yorkshire and the Humber and the North West which account for 73% of all available space. Of these core regions the Midlands accounts for 16% of the stock equating to 23.8 million sq ft. As in 2010 Yorkshire and the Humber accounts for the highest proportion of stock with 28.7 million sq ft of property on the market or 20% of all stock.

The level of new stock on the market continues to decrease with just 23.5 million sq ft of new property on the market, a decrease of 20% year on year. The level of second hand stock now accounts for 82% of the total supply, up from 75% at the same time last year.

With every quarter that passes the disparity between new and second hand property continues to grow. In the Midlands for example second hand property accounts for 74% of all supply whereas in the South East this figure rises to 85%.

Figure 2: Total nationwide supply by region

![Pie chart showing supply by region](image)

Figure 3: Grade of supply by region (million sq ft)

![Bar chart showing new vs second hand supply](image)

Figure 4: Total supply by quarter (million sq ft)

![Bar chart showing quarter wise supply](image)
Examinaing supply by size band also paints an interesting picture and the data supports the views of our Industrial Agency teams who are starting to report pockets of under supply in certain markets and certain size bands. The Midlands for example has 3.7 million sq ft of units on the market over 250,000 sq ft down from a peak of 5 million sq ft in 2009. The South East on the other hand has 4.4 million sq ft of units over 250,000 sq ft which equates to 16% of all supply.

By taking current supply levels and an annualised take up rate we are able to produce years of supply figures that again demonstrate that in some markets the availability of stock is becoming a critical issue. Nationwide for both new and second hand property there is currently 4.5 years of supply, for new stock alone this falls to 1.9 years. However, for new units in the Midlands this figure falls to 1.4 years where as Yorkshire has 3.6 years of supply for new stock, the highest figure for any of the core regions.

2.2 TAKE UP

Take up for 2011 (to the end of Q3) has totalled 24.95 million sq ft, which is 200,000 sq ft less than the same three quarters in 2010. However take up for Q3 2011 has totalled 10.39 million sq ft, which is the highest quarterly take up since Q3 2009. Based upon active requirements and buildings which are known to be under offer we expect that take up for 2011 should pass the 30 million sq ft mark, which will be an increase on the 29.86 million sq ft achieved in 2010.

The key trend for 2011 has been the emergence of the design and build market in the large unit market, driven by the lack of supply of large modern units. In Q3 alone 3.17 million sq ft of take up was in this category, a third of all take up in that quarter, with 2.5 million sq ft of this take up being in the Midlands and the South East. Examples of design and build deals include Peugeot taking 300,000sq ft in Coventry and Brakes taking a 207,000 chilled warehouse unit in Reading.

Take up for second hand units in 2011 has significantly outweighed that of new units, driven by the lack of new stock on the market, along with the fact that many of the second hand units are fully fitted out to a high standard. Indeed to date in 2011 take up for new units has accounted for 32% of all units transacted compared with 41% in 2010 and 44% in 2009.

At a regional level the proportion of take up in the midlands has decreased, which in part can be attributed to the decreasing supply levels of prime stock. For example in 2010 almost third of all take up was centred on the Midlands, in 2011 this has fallen to 26%.
In 2010 we reported that 46% of all deals fell into the 50-100,000 sq ft size band. Of the 188 deals completed to date in 2011 54% now falls into this category. In terms of the volume of space taken 38% of space taken falls into the 100-250,000 sq ft size band. The volume of deals below 100,000 sq ft has ensured that the average deal size has fallen from 160,000 sq ft in 2010 to 132,000 sq ft in 2011.

Once again the bulk of large deals has involved retailers, specifically the food and grocery sector. However, 2011 has seen the emergence of units being taken specifically by online retailers or for the internet retailing division of ‘traditional’ retailers.

Key deals for 2011 to date include Amazon taking 700,000 sq ft in Rugby, Waitrose investing in a 360,000 sq ft unit in Chorley and Tesco recently winning planning permission for a 900,000 sq ft unit in Reading.

2.3 OUTLOOK

For 2012 we expect the polarisation of supply to continue as the last remaining large units in the Midlands and South East are taken. Thus the proportion of second hand supply in these markets will therefore continue to rise.

As retailers are taking more new and design and build units we expect more good quality second hand units to return to the market as companies rework their supply chains. There will also potentially be a raft of good quality units returning to the market as 5 year breaks or lease expiries are reached following on from the record take up levels of 2007.

Anecdotal evidence suggests that some developers are now ready to consider developing new units speculatively based upon the occupational demand and the lack of supply we are seeing in certain markets. However the prevailing economic concerns are still hampering the return of large scale speculative development.

In relation to take up there is nothing to suggest that 2012 will see any increase on 2011. The recent raft of deals in the automotive sector will see the emergence of the automotive supply chain as an additional occupational sector, especially in the Midlands.

Large 3PLs are also starting to examine their property requirements and starting to look at strategic sites instead of being led by individual contracts. This trend could see a number of requirements come to the market around the 1 million sq ft mark.

We have also seen strong demand for cross docked units, in particular in the 50-100,000 sq ft size band around conurbations. This is being driven by the increase in online shopping and the requirements to have a faster through put of stock.

The waste and recycling industry also still has requirements for large buildings and sites. 2011 has seen a number of bottle necks reduce the amount of deals seen. However, the requirement the new facilities has not decreased, indeed a recent research report by the Associate Parliamentary Sustainable Resource Group concluded that £8 billion of investment is required to meet the landfill diversion targets.
3 PERFORMANCE

In this section we analyse the performance of the BNP Paribas Real Estate Logistics Index and compare performance measures with the remaining Standard Industrial properties as defined in section 1.1 and in the following subsections:

- Performance comparison for H1 2011
- Annual performance over 2010
- Historic performance between 1981-2010 (at a regional level there are some exceptions where data does not go back to 1981, such as Wales)

3.1 PERFORMANCE COMPARISON IN H1 2011

During the first half of 2011 commercial property’s investment performance remained very similar to that of the second half of 2010 with weak performance in both quarters, delivering total returns of 2.3% q/q and 2.0% q/q, respectively. Rental growth was low and yield impact did little to improve capital values by contributing less in Q2 than in Q1 on All Property. In terms of capital growth, Industrial was the worst hit of the main property sectors, recording 0.1% q/q for both quarters. This was mainly due to the continued trend of negative rental value growth. Q2 2011 was the 12th consecutive quarter of falling rents. Yield impact added a positive contribution to capital values, albeit small at 0.4% q/q for both Q1 and Q2.

Figure 11 shows the performance of Logistics and Standard Industrial. All Industrial is also shown for overall performance during H1 2011.

- At the national level, total returns between the two segments have converged compared to previous quarters with Standard Industrial and Logistics both delivering 3.6% h/h in H1 2011.
- However, in five out of the nine major UK regions, Logistics outperformed Standard Industrial.
- Performance in Scotland differentiated the most where total returns were 170 basis points lower for Logistics, at 2.9% h/h, compared to 4.6% h/h for Standard Industrial.
- Wales was the only region to experience a negative total return during H1 2011 for either industrial sub-category, with Welsh Standard Industrial total returns at -0.3% h/h.
- In Standard Industrial, Scotland delivered the highest total return, at 4.6% h/h, followed by London & South East, at 3.8% h/h.
Table 2: Capital growth and Rental value growth comparison (% h/h), H1 2011

<table>
<thead>
<tr>
<th></th>
<th>Logistics</th>
<th>Standard Industrial</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>CG</td>
<td>RVG</td>
</tr>
<tr>
<td>London &amp; SE</td>
<td>0.7</td>
<td>-0.2</td>
</tr>
<tr>
<td>South West</td>
<td>-0.4</td>
<td>-2.7</td>
</tr>
<tr>
<td>Eastern</td>
<td>0.5</td>
<td>-0.6</td>
</tr>
<tr>
<td>East Midlands</td>
<td>0.5</td>
<td>0.3</td>
</tr>
<tr>
<td>West Midlands</td>
<td>-0.7</td>
<td>-0.1</td>
</tr>
<tr>
<td>Yorkshire &amp; Humber</td>
<td>-0.9</td>
<td>-1.1</td>
</tr>
<tr>
<td>North West</td>
<td>-0.2</td>
<td>-0.7</td>
</tr>
<tr>
<td>Scotland</td>
<td>-1.1</td>
<td>-0.9</td>
</tr>
<tr>
<td>Wales</td>
<td>-2.6</td>
<td>-3.0</td>
</tr>
<tr>
<td>All Sectors</td>
<td>0.2</td>
<td>-0.4</td>
</tr>
</tbody>
</table>

During the first part of the year, capital growth and rental value growth were amongst the main differentiators in the sector’s performance, so further analysis is worthwhile at a regional level (see Table 2).

On capital growth:

- As anticipated, performance of the industrial segments remained fairly flat; overall logistics posted a slight increase of 0.2% h/h while standard industrial 0.3% h/h.
- Logistics saw positive capital value growth in three regions: London and the South East (0.7% h/h), Eastern and East Midlands with 0.5% h/h respectively.
- Standard Industrial capital value growth was also positive in three regions: Scotland (1.1% h/h), Eastern (0.4% h/h) and South West (0.1% h/h).
- Wales was the worst performing region for both segments; logistics at -2.6% h/h while standard industrial saw values fall by -3.9% h/h.

On rental value growth:

- Overall performance was negative with logistics averaging -0.4% h/h while standard industrial posted -0.5% h/h.
- All regions had negative rental value growth bar logistics in East Midlands with 0.3% h/h and standard industrial in Scotland with 0.9% h/h.
- Logistics rental value growth was particularly weak in Wales with -3.0% h/h and South West with -2.7%.
- Standard Industrial rental value growth was weak in East Midlands with -1.7% h/h and Wales with -1.6% h/h.
3.2 PERFORMANCE IN 2010

Table 3: All UK total return comparison (% y/y), 2010

<table>
<thead>
<tr>
<th></th>
<th>Logistics</th>
<th>Standard Industrial</th>
<th>All Industrial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total return</td>
<td>10.8</td>
<td>10.8</td>
<td>10.8</td>
</tr>
<tr>
<td>Income return</td>
<td>7.4</td>
<td>7.2</td>
<td>7.2</td>
</tr>
<tr>
<td>Capital growth</td>
<td>3.2</td>
<td>3.4</td>
<td>3.3</td>
</tr>
</tbody>
</table>

Source: IPD Annual Index

Table 3 shows the components of total return for Logistics, Standard Industrial and All Industrial.

- For the year to 2010 the total returns were the same for both Standard Industrial and Logistics at 10.8% y/y.
- Total return was positive for both industrial segments at the end of 2010, while only Logistics posted positive performance in 2009.
- Meanwhile income return remained at similar levels: 7.4% y/y for Logistics and 7.2% y/y for Standard Industrial.
- Unlike in previous years, 2010 saw a convergence in performance between industrial segments. Compared to 2009, All Industrial saw an improvement in capital growth. There was little difference in the capital growth component between industrial segments but it was slightly higher for Standard Industrial at 3.4% y/y, compared to 3.2% y/y in Logistics.

The performance of industrial assets by region shown in Figure 12 indicates that 2010 was another good year for the Logistics sector. It outperformed Standard Industrial in all bar two regions: Yorkshire & Humber and Scotland. The Logistics total return was above 10% y/y in six out of nine regions; the highest performance was in the South West at 12.4% y/y, followed by London & the South East at 11.8% y/y and the Eastern region at 11.3% y/y. Standard Industrial showed similar patterns to Logistics. The highest performing region was London & the South East at 11.6% y/y followed by the South West at 10.8% y/y and Scotland at 10.6% y/y. The largest outperformance between the two segments in one region was seen in Yorkshire & Humber where Standard Industrial returned 10.3% y/y, 379 bps higher than the Logistics total return.

Table 4: Capital growth and Rental value growth comparison (% y/y), 2010

<table>
<thead>
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</tr>
<tr>
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<tr>
<td>North West</td>
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</tr>
<tr>
<td>Scotland</td>
<td>1.1</td>
<td>-1.2</td>
</tr>
<tr>
<td>Wales</td>
<td>2.3</td>
<td>-0.9</td>
</tr>
<tr>
<td>All Sectors</td>
<td>3.2</td>
<td>-1.3</td>
</tr>
</tbody>
</table>
Logistics capital growth was positive in all regions bar Yorkshire & Humber with -0.5% y/y and North West with -0.3% y/y. The best locations being London and the South East with 4.4% y/y and Eastern with 3.2% y/y, while the weakest were North West with 0.7% y/y and Wales with 1.1% y/y.

Logistics outperformed Standard Industrial in five regions with the largest differences seen in South West (+173 bps) and Wales (+122 bps). On the other side, Standard Industrial’s largest outperformance was in Yorkshire & Humber (+297 bps) and Scotland (+196 bps).

Figure 13 illustrates that in the Logistics sector, yields expanded only in the Yorkshire & Humber region, detracting 1.1% y/y from capital values. All other regions in this sector saw contracting yields, boosting capital values; in four regions yield impact added over 5.0% y/y.

The largest movement in the Logistics sector was in the West Midlands where yield impact reached 6.1% y/y, followed by the South West with 5.9% y/y. In the Standard industrial sector the largest yield movement was found in London & the South East with 6.7% y/y, followed by the West Midlands with 5.7% y/y and the Eastern region with 5.4% y/y. All Standard Industrial were more volatile than all Logistics in 2010.

Over the year the largest difference in terms of yield movement between the two segments was recorded in Yorkshire & Humber where yield impact in Logistics was 586 bps lower than Standard Industrial – followed by the North West with 339 bps. In Wales and the East Midlands yield impact in Standard Industrial was lower than Logistics by 255 bps and 233 bps, respectively.

Overall, yield impact was stronger for Standard Industrial, with 5.6% y/y compared to 4.5% y/y for Logistics.

Income return remained the strong driver of positive returns, as shown in Figure 14, and it was similar in Logistics across all regions, at 7.0% y/y or above. The lowest income return was for Yorkshire & Humber which also recorded the lowest capital growth. Together these weaker components of total return ensured that the region was the lowest performing in the Logistics segment in 2010.

Apart from in the Yorkshire & Humber region, yield movements were positive in 2010, boosting capital growth. However, the other main driver of capital values, rental value growth, had a negative effect on performance across eight of the nine regions. The largest falls in rental values were seen in the South West and Yorkshire & Humber at -2.4% y/y and -2.2% y/y, respectively. The lowest rental value declines were in Wales – 0.9% y/y – followed by London & the South East with -1.0% y/y. The North West was the only region to record positive rental value growth, albeit marginal at 0.1% y/y.

Yorkshire & Humber region saw the second highest rental value falls of -2.2% y/y in 2010 (-3.1% y/y for the 3-year average) and experienced the largest positive residual at 2.9% y/y. The large residual is due to the abundance of over-rented assets, however, in the event of losing a tenant, an asset becomes rack-rented and the benefit of the top-slice income is lost. By comparison a relatively small residual of 0.2% y/y was seen in London & The South East, where falls in rental values were not as pronounced and consequently the risk of income loss due to the loss of a tenant was not so marked.
3.3 PERFORMANCE BY AGE-BAND

Figure 15 compares the performance of Logistic assets by age-band. Four segments have been chosen, each being 10 years in duration. The first band is from 1970 to 1979 and it is also the most volatile. In 1988, Logistics in this age-band posted the highest total return of 42.2% y/y, and then fell to a record low of -26.5% in 2008. The trend was similar for the other age-bands. Assets built between 1980 and 1989 were also quite volatile and in 1993 recorded a total return of 36.2% y/y, mainly due to a high yield impact of 31.3%. Assets in the other two bands (1990–1999 and 2000–2010) performed better than older assets because they have different physical characteristics which comply with international standards and best match tenants demand. However, over the last eight years the performance of Logistics by age-band has been very similar, and not necessarily related to the age of the building. In 2008 the crisis hit the Logistics segment hard and total return performance was negative in all four age-bands, ranging from -21% to -26.5% y/y. In 2010, the highest return of 11.6% y/y was posted by assets built between 1990 and 1999.

Equivalent yields, have always been lower for assets built between 2000 and 2010 and progressively increase in each band. This has been quite consistent since 2003, the first year in which data are available for all the four bands. At the end of 2010, equivalent yield for assets in 2000–2010 band was 8.3%, while it was 10.2% for assets in 1970–1979 band. The investors’ risk perception has changed quite a lot compared with the market peak of 2006 when equivalent yield was 5.5% for 2000–2010 and was 6.6% for 1970–1979.

In terms of rental value growth, only the 2000–2010 band showed positive figures with 0.1% y/y in 2010, while the other bands were still in negative territory, ranging from -0.6% y/y to -8.0% y/y. Over the last three years (2007–2010), the band 2000–2010 posted the smallest fall in rental value growth, at -1.0% y/y. This became progressively worse depending on the asset’s age, reaching -4.0% y/y for the 1970–1979 age-band. At the market peak in 2006, rental value growth was negative only in 1980–1989 band with -0.7% but it was higher in 1970–1979 band with 4.7% than in 2000–2010 band with 2.3%.
3.4 PERFORMANCE BY AGE-BAND: LATEST TRENDS

The most telling contemporary trend in the age-band analysis is seen in the equivalent yield series. Investors will always weigh up the balance between income return offered by an asset and its potential future growth. All this should be captured in the equivalent yield and thus the equivalent yield is the clearest indicator of an investor’s interpretation of an asset’s risk, i.e. the higher the yield the higher the risk. Older logistics stock has always been given a larger risk premium compared to their more modern counterparts, with 1970-1979 stock averaging a 150bp spread over the 2000-2010 stock over the last five years. Towards the end of the boom period, in 2007, the spread of yields from the modern stock to the oldest category, 1970-1979, compressed to just 30bp, in the aftermath of strong buying activity for older, secondary property. During the subsequent crash, investor appetite for such properties evaporated and the average equivalent yield for the 1970s stock soared to 11.3% in 2009, at a time when the average equivalent yield for all logistics was 8.6%. Interestingly, the 1990s and 1980s stock managed to hold its ground between 2008 and 2010. Stock that achieves strong income returns and offers value-add potential, through refurbishment or more extensive development, has remained in investor’s plans, despite the general trend of risk-aversion keeping all logistics yields elevated from the 2006 trough.

Looking at the 2010 data, the 1990s and 1980s stock produced the strongest income returns at 8.8% y/y and 8.4% y/y, respectively. This was superior to the average income return for the segment at 7.4% y/y. In addition to this, yield impact for the 1990s and 1980s stock in 2010 was 2.9% y/y and 2.2% y/y, respectively. This was better than the yield impact observed in 2010 for the stock built over the last decade, at 0.6% y/y, and is predominantly attributed to investors’ increased comfort with taking on assets that are older and outside the usual definition of prime.

However, the post-purchase capital expenditure of a value-add strategy would almost be a requirement to counteract a loss of value through declining rental values. In 2010, estimated rental values increased slightly for the 2000-2010 category at 0.1% y/y, whereas the 1990s stock saw rents fall by 0.6% y/y and 1980s stock saw rents drop by 2.3% y/y. Stock built between 1970 and 1979 saw rents drop off by 8% y/y, the only category to see rental falls quicken compared to 2009. Demand and supply fundamentals are clearly weighted in newer stock’s favour, resulting in the different rental growth trends observed. Investors, as always, had to trade-off the benefits of high income returns with the risk of rental value losses. As 2010 proved, older stock can offer competitive returns but as the 1970-1979 stock data showed, there is a limit to how far investors and occupiers were prepared to go.
4 LONG-TERM PERFORMANCE

4.1 NATIONAL LEVEL

The international economic crisis has had a detrimental effect on the real estate industry over the last three years. The All Property return delivered -2.5% y/y during this period. At a sector level, All Industrial recorded a total return of -3.1% over three years, worse than Retail at -2.0% y/y, but slightly better than the Office sector at -3.2% y/y. The total return of -1.8% y/y for Logistics over the same period, indicates the resilience displayed by this type of asset during the course of the downturn.

Looking at the long term annualised total returns over the history of the index, the Logistics sector has tended to provide investors with stronger returns than the Standard Industrial sector. The largest outperformance by the Logistics sector comes over the last three years, where the total return of -1.8% y/y, whilst negative, was 177 basis points higher than the -3.6% y/y provided by Standard Industrial. The largest total returns came from investing over the full period of the 30-year Index; where Logistics was the top performer with a total return to investors of 11.0%, whilst Standard Industrial returned 10.6%.

Figure 17 looks at the annual total return provided by the industrial segments under analysis over the full history of the IPD Annual Index. During the boom period of the late 1980s the Logistics sector was very much in its infancy and as such, total returns were seen to be very similar to that of the Standard Industrial assets. During this early period, the industrial sector saw a gradual increase in the outsourcing of manufacturing to cheaper locations such as Asia and Central Europe, thus increasing the need for warehousing and distribution space as more and more products were sourced from abroad. The general movement in the UK economy from being production-based to service-based also contributed to the initial rise in demand for Logistics assets in the UK.

At the peak of the cycle in 1988 there was a difference of only 10 basis points between the Logistics assets total return peak at 39.2% y/y and 39.3% y/y in the Standard Industrial. It was not until 1990 that a clear distinction between these asset classes emerged.

The Logistics assets bottomed out at a positive 0.8% y/y in 1990, but the Standard Industrial units fell into negative territory at -3.9% y/y, a gulf of over 460 basis points. As the investment market once again saw value in the property industry, the weakened pound encouraging foreign investors in particular into the UK market, valuers were quick to react to the fresh demand and prices rebounded in the early 1990s. This was particularly pronounced in the Logistics sector where total returns reached 13.6% y/y in 1991, outperforming the Standard Industrial total return of 8.6% y/y by nearly 500 basis points.

Table 5: Annualised total return comparison (%)

<table>
<thead>
<tr>
<th></th>
<th>3 years</th>
<th>5 years</th>
<th>10 years</th>
<th>20 years</th>
<th>30 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Logistics</td>
<td>-1.8</td>
<td>1.1</td>
<td>6.8</td>
<td>9.5</td>
<td>11.0</td>
</tr>
<tr>
<td>Standard Industrial</td>
<td>-3.6</td>
<td>0.5</td>
<td>6.6</td>
<td>9.1</td>
<td>10.6</td>
</tr>
<tr>
<td>All Industrial</td>
<td>-3.1</td>
<td>0.6</td>
<td>6.7</td>
<td>9.1</td>
<td>10.6</td>
</tr>
</tbody>
</table>

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The largest boom for the Logistics sector came in 1993, with the emergence of many high profile deals occurring during the sector’s infancy; the previously deeply fragmented sector began a consolidation spree in the wake of the economic recession and the total return recorded reached its second highest point in the IPD Index, at 31.8% y/y. This was almost entirely driven by favourable movements in yields adding to capital values. Even more remarkable was the difference between this and the Standard Industrial return of 19.8%, a disparity of over 12 percentage points.

However, the latter half of the 1990s was not quite as prosperous and in the period 1995–2000 Logistics provided investors with total returns below that of the Standard Industrial sector. This does, however, illustrate how the behaviour of logistics assets differs from that of more standard industrial units: rental value growth was not seen to be as strong and yield movements did not add as much to capital values as in the Standard Industrial segment. This was most evident in 1998–1999 when the Logistics assets’ total return was 475 bps below the Standard Industrial return.

The convergence of total returns of the Logistics and Standard Industrial seen from 2001 is indicative of the way in which the entire UK real estate market was driven by the increased availability of cheap credit during the boom and adversely affected during the credit crunch; all of the main sectors were hit similarly and there was a general convergence of total returns across sectors. In 2008, the total returns for the Retail, Office and Industrial sectors was -22.6% y/y, -22.4% y/y and -21.2% y/y, respectively; the Logistics annual total return was the same as the All Industrial at -21.2% y/y. Again in 2010, total return was the same for the industrial segments.

However, we have seen Logistics prove more resilient than Standard Industrial as it has emerged quicker from the recession over the last three years.

4.2 THE REGIONAL PATTERN

Figure 18 compares three-year annualised total returns for Logistics and Standard Industrial at a regional level. Due to the strong negative performance in 2008, total returns for each region were negative for this annualised period.

- Logistics suffered less than Standard Industrial in every region.
- The largest outperformance by the Logistics sector was seen in Wales with a three-year annualised total return of -0.3% y/y compared to -6.0% y/y recorded by Standard Industrial.
- Logistics in the East Midlands region also fared better than Standard Industrial with a difference of 440 basis points.
- In the Eastern, Scotland, Yorkshire & Humber and London & the South East regions total returns were at a similar level for both Standard Industrial and Logistics.
Figure 19 looks at the relative performance of Logistics assets by region compared to the All UK Logistics over the last three years. It shows which components of total return led to the over/under performance within a specific region, relative to all UK Logistics. Yield impact and rental value growth are the main drivers in determining the performance of each region has come from over the three year time period.

- Yorkshire & Humber delivered the lowest relative total return with -2.6%, while Scotland and Wales delivered the highest relative total returns with 1.7% and 1.6%, respectively.
- The underperformance of the Yorkshire & Humber region was due to low relative yield impact of -2.4% coupled with negative rental value growth of -0.9% and negative relative income return of -0.7%.
- In the North West, low relative yield impact at -1.1% (second lowest after Yorkshire & Humber), and negative rental value growth of -0.9% contributed to a negative relative total return of -0.4% y/y. This was slightly better performance than the Eastern region where the relative total return was -0.5% y/y.
- Logistics in Scotland have benefitted from both more favourable rental movements over the last three years and a less severe expansion of yields relative to the national average, ensuring it was the best performing region over this time period. Rental value growth contributed 1.3% y/y and yield impact 0.4% y/y to this relative outperformance.
- In Wales despite the negative rental value growth of -0.9%, the yield impact positively contributed to the good performance of the region.

Figure 20 takes a longer view and looks at the regional performance of Logistics compared to Standard Industrial over the last 10 years. This time period incorporates the full cycle experienced over the last 10 years since 2000.

- The highest total returns over the 10-year period were seen in Scotland and Wales, for both Logistics and Standard Industrial. Logistics in Scotland delivered the highest return, at 8.8%, which was 181 basis points above the 10-year annualised All Logistics figure of 6.8% y/y.
- The lowest 10-year performance was seen in the North West for both Logistics and Standard Industrial, at 6.2% y/y and 5.5% y/y respectively.
- The largest outperformance between the two segments was seen in the West Midlands where Logistics delivered 7.0% y/y, 115 basis points higher than in Standard Industrial.
- Logistics in the Eastern region also performed much better relative to Standard Industrials in the same region; 7.3% versus 6.4%.
- Conversely, Logistics in London & South East and Yorkshire & Humber underperformed Standard Industrial in the same region Logistics assets providing ten-year returns lower than that of the returns seen in the Standard Industrial assets.
As in Figure 19, Figure 21 analyses which performance components of Logistics affected their total return in each region relative to UK Logistics.

- Once again Scotland saw the largest outperformance with a positive relative contribution to total return of 1.7%. This was owing to strong rental value growth and income return at 0.5% and 0.6%, respectively, whilst yield impact also provided a boost at 0.7%.
- Wales followed Scotland with the second best relative total return performance, at 0.9%. Income return provided 0.7% of the contribution and relative capital growth was also positive.
- The north West and Yorkshire & Humber posted the worst performance amongst all regions both with relative total returns of -0.5%. This was due to the negative rental value growth in both regions of -0.6% and -0.3% respectively. Moreover these two regions also had the lowest relative contribution from yield impact, at -0.8% and -1.0% respectively.
- London & the South East's relative total return was slightly negative at -0.1% y/y – the result of negative relative income return and yield impact.

Table 6 looks at the rental and capital value growth of Logistics over different time periods.

<table>
<thead>
<tr>
<th>Region</th>
<th>2010</th>
<th>3 year</th>
<th>5 year</th>
<th>10 year</th>
<th>20 year</th>
<th>RVG</th>
<th>CVG</th>
<th>RVG</th>
<th>CVG</th>
<th>RVG</th>
<th>CVG</th>
<th>RVG</th>
<th>CVG</th>
</tr>
</thead>
<tbody>
<tr>
<td>London and the South East</td>
<td>-1.0</td>
<td>4.4</td>
<td>-1.5</td>
<td>-8.7</td>
<td>-0.2</td>
<td>0.3</td>
<td>-0.1</td>
<td>0.0</td>
<td>1.6</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>South West</td>
<td>-2.4</td>
<td>4.6</td>
<td>-2.8</td>
<td>-8.2</td>
<td>-1.9</td>
<td>-5.1</td>
<td>-0.7</td>
<td>-0.3</td>
<td>-0.9</td>
<td>1.2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Eastern</td>
<td>-2.0</td>
<td>3.6</td>
<td>-2.8</td>
<td>-9.1</td>
<td>-1.3</td>
<td>-6.0</td>
<td>0.5</td>
<td>0.3</td>
<td>0.0</td>
<td>1.7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>East Midlands</td>
<td>-1.1</td>
<td>3.3</td>
<td>-1.9</td>
<td>-8.0</td>
<td>-0.6</td>
<td>-5.1</td>
<td>-0.2</td>
<td>-0.3</td>
<td>-1.0</td>
<td>1.6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>West Midlands</td>
<td>-1.6</td>
<td>2.9</td>
<td>-3.0</td>
<td>-8.1</td>
<td>-1.7</td>
<td>-5.7</td>
<td>0.3</td>
<td>0.1</td>
<td>0.0</td>
<td>1.6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yorkshire &amp; Humber</td>
<td>-2.2</td>
<td>-0.5</td>
<td>-3.1</td>
<td>-10.4</td>
<td>-1.3</td>
<td>-6.3</td>
<td>-0.2</td>
<td>-0.6</td>
<td>-0.7</td>
<td>0.8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>North West</td>
<td>0.1</td>
<td>-0.3</td>
<td>-3.2</td>
<td>-9.4</td>
<td>-1.8</td>
<td>-6.3</td>
<td>-0.5</td>
<td>-1.0</td>
<td>-0.1</td>
<td>1.3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scotland</td>
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<td>1.1</td>
<td>-1.0</td>
<td>-7.6</td>
<td>0.0</td>
<td>-4.6</td>
<td>0.6</td>
<td>1.0</td>
<td>1.7</td>
<td>3.1</td>
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<td></td>
</tr>
<tr>
<td>Wales</td>
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<td>-3.2</td>
<td>-7.6</td>
<td>-1.1</td>
<td>-5.3</td>
<td>0.0</td>
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<td>-1.0</td>
<td>-0.1</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>All Logistics</td>
<td>-1.3</td>
<td>3.2</td>
<td>-2.3</td>
<td>-8.6</td>
<td>-0.9</td>
<td>-5.3</td>
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<td>-0.2</td>
<td>-0.4</td>
<td>1.6</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: IPD Annual Index

Rental value growth in 2010 was positive only in the North West region in 2010, at 0.1% y/y, while it ranged from -0.9% y/y in Wales to -2.4% y/y in the South West. The three and five-year rental value growth figures were negative in all regions (in Scotland it was 0% for the five-year annualised). Only over ten years were there signs of small positive rental growth for more regions.

Capital value growth was positive in seven out of nine regions in 2010 but negative in all regions over three and five years. However, all regions had a positive capital growth over 20 years, with the highest recorded by Scotland Logistics, at 3.1%.
4.3 INVESTMENT

Figure 22 illustrates investment flows for industrial assets that were part of the IPD Annual Index between 1981 and 2010.

- There was a huge amount of investment in Logistics relative to the capital size of the sector during the late 1980s; spending peaked at 32% in 1989.
- Spending continued at levels far above that of the Standard Industrial assets throughout the 1990s.
- Investment activity was low in logistics in 2008 and 2009; as a result net investment as a % of total capital value was in negative territory. On the other side, it was positive in Standard Industrial in 2009 at 0.8%.
- Net investment as a % of total capital value was in positive territory in 2010 for both Logistics and Standard Industrials.

Figure 22: Historic net investment as a % of total capital value, 1981-2010

Source: IPD Annual Index
5 CONCLUSION

The aim of this report has been to utilise the expert knowledge of BNP Paribas Real Estate to construct a sample of properties to reflect what is actually happening in operational logistics and the supply chain. It is our view that this sample highlights the differences between Logistics and Standard Industrial properties, whilst in 2011 total returns have converged the differences at a regional level between capital and rental growth for example are stark.

The key conclusions from the index in 2011 are:

• For H1 2011 total returns for both Logistics and Industrial have converged at 3.6%
• In H1 2011 Logistics has achieved 0.2% Capital Growth compared with 0.3% in Industrial. However in terms of rental value growth Logistics has outperformed Industrial with -0.4% rental growth compared to -0.5% for Industrial.
• In terms of total returns for 2011, Logistics has outperformed Industrial in 5 of the 9 regions covered, including the South east, the East Midlands and the North West.
• Of the core Logistics regions Yorkshire achieved the lowest total return of 2.5% for H1 2011. This correlates with the amount of vacant stock on the market in Yorkshire of 28.7 million sq ft.
• At a regional level the only region to achieve any rental growth for Logistics was the East Midlands at 0.3%. Once more this correlates with the occupational market which saw a third of all take up in the Midlands in 2010 and the subsequent squeeze on supply.
• In 2010, logistics investment activity (net investment) was most positive in the North West with £127 million followed by East Midlands with £102 million and London and the South east with £98 million. On the other side, investor’s interest was very low in other regions like West Midlands (-£40 million) or South West with -£6 million. The first half of 2011 confirmed that London and the South east was the most active region with £49 million while East Midlands was lowest at -£14 million.
• On logistics performance, assets within the 1990-1999 age-band delivered the highest total return in 2010 with 11.6% y/y, driven by a strong capital growth of 8.8% y/y.
• For 2010 modern logistics stock constructed from the year 2000 performed better than all other age bands in terms of rental growth and capital growth.