INTRODUCTION

MSCI and BNP Paribas have continued their collaboration in property market research to produce the fifth annual UK Logistics Investment Report. Logistics properties are an important and distinct investment sector within the wider property investment universe, with performance driven by a complex set of factors including the changing demands of retailers and growing online sales, a re-organisation of supermarket supply chains and an expanding automotive sector. The Logistics sector is also characterised by large average lot sizes and benefits from excellent transport connectivity.

The logistics market has developed alongside changing consumer and retailer trends, particularly following the growth in internet-based retail. Logistics are larger, more modern and better connected than traditional industrial or warehouse properties. As a result, they tend to achieve higher rents and stronger yields for investors.

This report is divided into two sections. The occupier market and the transaction and investment market sections are based on BNP Paribas’ analysis of recent UK transactions which closed over the last year. The investment performance section focuses on Logistics assets within the IPD UK Quarterly Property Index. As of the end of June 2015, the IPD Index sample based on 646 properties with a combined value of £10.0 billion. Logistics properties in this sample had an average floor-space of 17,700 square metres compared to 9,500 square metres for standard industrial.

SAMPLE SIZE

The logistics property sample is based on the exposure of the measured investment funds contributing to the IPD UK Quarterly Property Index as of the end of June 2015. Logistics are a distinct market segment within the broader industrial sector allowing comparison with other property sectors and property types.

Logistics properties within the broader IPD universe are defined as large warehouse buildings designed specifically for the distribution industry, built post-1975 with a floor-space in excess of 5,000 square metres and single let. Additionally, logistics assets must be located within easy access of key transport centres such as major national roads, airports, ports and rail links.
EXECUTIVE SUMMARY

18M SQ FT OF BIG BOX LOGISTICS TRANSACTED IN 2015

DESIGN & BUILD = 83% OF GRADE A

THE NORTH WEST ACCOUNTED FOR 23% OF THE SQ FT VOLUME COMPARED TO AVERAGE OF 16%

ONLY 11 BUILDINGS GREATER THAN 300,000 SQ FT AVAILABLE NATIONALLY

4.5M SQ FT OF SPECULATIVE DEVELOPMENT UNDERWAY

5.6M SQ FT COMPLETED

RENTAL GROWTH OF 4.6% SINCE JUNE 2013

£2.6BN DEPLOYED INTO SECTOR THUS FAR IN 2015, 87% UP ON THE LONG TERM AVERAGE

AVERAGE YIELD ON LOT SIZES OF £20M OR GREATER PLUMMETING 112BPS TO 5.38%

2015 RECORD YIELD L&G’S PURCHASE OF WAITROSE UNIT AT 4.17% (NIY)

FORECASTING ANNUAL GROWTH OF 2.6% PA FOR THE NEXT FIVE YEARS

ONLINE SHOPPING MARKETS TO DOUBLE TO £645BN BY 2018

850 ACRES OF INDUSTRIAL LAND TO BE LOST TO RESIDENTIAL IN LONDON ALONE

NORTHERN IRELAND 52.3%

SCOTLAND 41.8%

NORTH WEST 34.5%

NORTH EAST 34.8%

DETAILED BY SIZE

Wales 33.8%

SOUTH WEST 20.2%

SOUTH EAST 20.2%

EAST ANGLIA 35.7%

LONDON 31.8%

OUTER SOUTH EAST 35.6%

EAST MIDLANDS 34.4%

WEST MIDLANDS 34.3%

Wales 33.8%

SOUTH WEST 20.2%

SOUTH EAST 20.2%

EAST ANGLIA 35.7%

LONDON 31.8%

OUTER SOUTH EAST 35.6%

EAST MIDLANDS 34.4%

WEST MIDLANDS 34.3%

Wales 33.8%

SOUTH WEST 20.2%

SOUTH EAST 20.2%

EAST ANGLIA 35.7%

LONDON 31.8%

OUTER SOUTH EAST 35.6%

EAST MIDLANDS 34.4%

WEST MIDLANDS 34.3%

Wales 33.8%

SOUTH WEST 20.2%

SOUTH EAST 20.2%

EAST ANGLIA 35.7%

LONDON 31.8%

OUTER SOUTH EAST 35.6%

EAST MIDLANDS 34.4%

WEST MIDLANDS 34.3%

Wales 33.8%

SOUTH WEST 20.2%

SOUTH EAST 20.2%

EAST ANGLIA 35.7%

LONDON 31.8%

OUTER SOUTH EAST 35.6%

EAST MIDLANDS 34.4%

WEST MIDLANDS 34.3%

Wales 33.8%

SOUTH WEST 20.2%

SOUTH EAST 20.2%

EAST ANGLIA 35.7%

LONDON 31.8%

OUTER SOUTH EAST 35.6%

EAST MIDLANDS 34.4%

WEST MIDLANDS 34.3%
It’s fair to say that the Big Shed Logistics market has continued to mature since the inaugural edition of the UK Logistics Investment Report back in 2010. The sector has evolved from a subsector of the industrial category and now a distinct sector of the market in its own right, with a unique risk/return profile.

THE NEXT 12 MONTHS
By the time we re-convene for the next BNP Paribas Logistics Index in 2016, several events might have impacted the logistics sector and here we will take a look at some of the more probable scenarios for the next 12 months.

1) Economic rents - There is a school of thought that the ‘economic rent’ will begin to play more of a role over the next 12 months, as demand continues to outweigh supply, particularly in the South East and for units on the edge or inside of the M25. Rental growth will persist and BNP Paribas RE Research is forecasting annual growth of 2.6% p.a for the next 5 years. So will we see logistics rents catch up with retail warehouse rents?

2) Demand - Recent research from OC&C Strategy Consultants, PayPal and Google is suggesting that the four largest online shopping markets in the world (US, China, UK and Germany) will double to £645 billion by 2018, whilst forecasts from the ONS suggest that online retail will grow a further 8% to account for 20% of total retail sales within the next 5 years. When you consider that currently online accounts for just 12% of total retail spend and the consequences that has had on the logistics sector thus far, and there’s a further 8% growth to come in the next 5 years, then the significance of this growth becomes apparent. Another component of demand will come from the UK’s automotive industry. A recent report by the Society of Motor Manufacturers concluded that annual car production will break the current record of 1.92m cars, set back in 1972. The sector’s success is largely due to the premium brands of Jaguar Land Rover (JLR), Aston Martin, Bentley and Rolls-Royce and their popularity in the world’s developing economies, particularly China. An increase in production to predicted levels would also have an accompanying effect on the supply chain its associated demand for space.

3) Supply – Developers have responded to the lack of supply, but more stock needs to come to the market to keep up with demand. Additionally, land that has been given over to industrial uses must be protected to support further growth of the industry and wider UK economy. In particular there needs to be a debate around future employment land versus residential. In London this is particularly acute, with 850 acres of industrial land to be lost to residential, which is seen as a higher value use. With much of the political debate centred on building new homes, with the government promising to add 1m new homes by 2020, then the fear is the UK Logistics industry could fail to keep up with future demand without the will of the politicians and planners.

4) Investors – There is an already established core of experienced Pan-European logistics investors, with significant platforms, such as SEGRO, Prologis, Logicor and Tritax Big Box. However, with investors continual desire for yield in a low income environment we anticipate further new entrants to the sector. Patrizia recently announced its intention of a pan-European logistics business and we don’t think they will be the last to enter the market. Strong relationships with occupiers and a client/service provider relationship will become essential as the logistics sector matures.

The fear is the UK Logistics industry could fail to keep up with future demand without the will of the politicians and planners.

Robert Taylor
BNP Paribas Real Estate
TAKE-UP
At the end of September, just over 18m sq ft of Big Box Logistics (100,000 sq ft +) had been transacted across the UK and represents the strongest 9-month period behind only 2008 and 2014. This is despite the much touted lack of supply hindering volumes, with Design and Build (D&B) picking up a lot of the slack.

As usual it is the Midlands that leads the way in terms of demand, with a touch over 5m sq ft transacted to date. The UK’s logistics heartlands on average accounts for around one-third of occupational demand on an annual basis, but so far this year that figure has dropped slightly to 29%.

Of the other regions, it is the North West that has led the way, driven by a flurry of deals along the M62 corridor from Liverpool to Rochdale. The region has seen its transactional volumes increase significantly, with more space transacted year-to-date than in the whole of 2014 and has thus far accounted for 23% of the volume of deals done across the UK, compared to an average of c.16%.

Key deals in the North West have seen discount retailer Poundland agree to a 20-year lease on 335,275 sq ft, at a site off the M6 near to Wigan, which Standard Life have agreed to forward fund for £30m. XPO Logistics on behalf of Missguided, the online fashion retailer, have also undertaken their own design and build programme, at Evander’s Trafford Park in Manchester.

In addition to over 1.8m sq ft of new or D&B space being taken, it is the second-hand market that has led the way, with more space transacted year-to-date than in the whole of 2014 and has thus far accounted for 23% of the volume of deals done across the UK, compared to an average of c.16%.

Across the other regions it’s Yorkshire that has seen the majority of the demand, with 20% of deal volumes being focussed in the area. Poundland and TK Maxx have accounted for over 1.1m sq ft, with another eleven deals completed across the region.

FIGURE 1: LOGISTICS TAKE-UP
Source: BNPPRE research
* End Sept 2015

SUPPLY
Supply, or lack of it, has been one of the main talking points in the UK logistics market for some time now. But perversely the much touted lack of supply has not resulted in the grinding slowdown in take-up volumes that some of the more bearish commentators may have suggested, but this is only half the story.

The buoyant level of demand has thus far been kept afloat partly by the huge level of Design and Build (D&B) that has taken place in the market over the last two years. The largest deals, that have helped keep volumes at above average levels, can be attributed to D&B, with 55% of all space let this year being D&B product and for Grade A space this rockets to 83%, highlighting the dearth of new, Grade A supply on the market.

With limited supply of built stock due to strong levels of demand, coupled with historically low levels of development, from 2010 right up until mid-2013, there is currently just one building over 500,000 sq ft available, LogiCor’s Sherburn550 up in Yorkshire and only eleven buildings of greater than 300,000 sq ft are available nationally.

But there are some relatively simple reasons why the developers are holding back from speculatively building this type of very large shed. One reason is that requirements in the larger size brackets, above 400,000 sq ft, tend to be much more bespoke and a standard institutional ‘Big Box’ does not often fit the criteria.

Additionally they tend to be for much larger occupiers who have carefully planned out their future supply chain requirements and can afford to wait c.9-12 months for construction to complete, rather than retro-fit a unit that may never fully meet their operational requirements.
Finally, from a developer or investor's point of view, there is simply no need to take the risk. On average, 78% of all deals done since the start of 2014 was for space between 50,000-249,999 sq ft, with nearly 300 deals completed in this size bracket, compared to 56 of 250,000 sq ft or greater, and half of these were D&B.

During the last development boom prior to the 2009 crash, a number of investors and developers piled into the sector, flooding the market with product that in some instances took many years to shift. Keen to avoid the mistakes of the past, developers have been a lot more cautious in this cycle. Development has been focussed solely on the 'prime' pitch locations of the South East, Midlands and North West, as well as some well-located sites in South Yorkshire, where there is recognised strong demand.

But we are seeing a supply response from developers, both in terms of speculative development and the ‘readying’ of their land banks to take the larger D&B requirements.

There is currently 4.5m sq ft of speculative development underway across the country, with a further 5.6m sq ft completed so far this year, a clear response to the supply shortage. But it is still almost a third less than the 14.5m sq ft that was developed in 2007, although for the reasons stated above it’s hard to imagine development ever getting back to that level.

### RENTS

Perhaps the biggest issue on the UK logistics agenda currently is that of rental growth, after years of muted increases, rental growth is now firmly back on the agenda with investors keen to take advantage of the current market.

Put simply, rents have been on the rise due to the combined factors of the supply/demand imbalance already discussed. Prime rents on new product such as CP52 in the Midlands are now quoting at £6.50 per sq ft, up 13% on the £5.75 per sq ft that was being quoted 18-24 months ago for prime space, quite a jump considering prime rents have been hovering around £5.50 since 1996 in the Midlands. In real terms, i.e. if you were to strip inflation out, then prime rents in the Midlands currently stand 27% down on the £5.50 per sq ft that was being achieved twenty years ago, demonstrating that there is scope for further increases.

In the South East, new schemes are quoting £9.50, again up significantly on quoting rents of £8-£8.25, just eighteen months ago, although not nominally higher than the rental levels of twenty years ago, when prime rents in Slough were £8 per sq ft.

Latest data from the BNP Paribas Logistics Index, in conjunction with MSCI, shows rental value growth of 4.6% since June 2013, compared to rental growth for offices of 13.6% and an ‘All Property’ figure of 5.7%, with only the retail sector producing weaker rental growth than Logistics. Therefore, despite the recent upswing in rents in the sector, there is still more to come particularly if the supply/demand imbalance continues and especially when you consider that the BNP Paribas Logistics Index suggests that rents on average are still 3.8% below their June 2008 peak.

---

Robert Taylor  
BNP Paribas Real Estate
INVESTMENT

The logistics investment market has seen £2.6bn deployed into the sector thus far in 2015, which is up 87% on the long term average (2005-14) for the first 9 months of the year.

Investors are actively trying to deploy capital into the sector, convinced by the occupational demand story, which in turn has been driven largely by the by technology and changing consumer habits.

Whilst lot sizes fail to match those available in both the office and retail sector, this has not deterred the institutional investors who are seeking secure long-dated income, as well as looking to capitalise on the rental growth story.

Whilst volumes to date this year have failed to match those seen last year, when £3.5bn was deployed by the end of September 2014, pricing has continued to improve as yields compressed further. We have seen fifteen deals completed this year at sub 5.2% net initial yield (NIY) with the average yield on lot sizes of £20m or greater plummeting 112 bps to 5.38%.

With so much capital targeting the sector, aggressive bidding has been taking place on stock when brought to the market, hence why we have seen this level of yield compression/price growth.

Institutional investors are attracted to the sector by the long-dated and stable income, as well as looking to capitalise on the rental growth story.

Hugh White
BNP Paribas Real Estate

FIGURE 2: INVESTMENT VOLUMES
Source: BNPPRE research, Property Data, Real Capital Analytics

Standard Life’s 4.2% (NIY) forward funding deal of a new 638,000 sq ft John Lewis distribution centre set a new benchmark for ‘Big Sheds’ earlier in the year, but L&G’s purchase of a Waitrose unit in Chorley, Lancashire at 4.17% (NIY) has since broken that barrier and demonstrates how pricing has sharpened through 2015.

Moving forward we anticipate certain institutional investors to look more towards forward funding schemes, to take advantage of the development yield discount over the current open market yields, but demand will not ebb away as investors seek to take up defensive positions against the anticipated fall in capital growth from 2017 onwards.
UK Logistics provided investors with a total return of 19.6% in the 12-months to June 2015.

Table 1 shows a breakdown of the capital value and number of properties for Logistics, All Industrial and All Property assets in the IPD UK Quarterly Property Index.

<table>
<thead>
<tr>
<th></th>
<th>Capital Value (£MILLION)</th>
<th>Number of Properties</th>
<th>% of Total UK by CV</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK Logistics</td>
<td>10,016</td>
<td>646</td>
<td>6.9</td>
</tr>
<tr>
<td>UK All Industrial</td>
<td>26,943</td>
<td>2,655</td>
<td>18.5</td>
</tr>
<tr>
<td>UK All Property</td>
<td>145,365</td>
<td>9,618</td>
<td>100</td>
</tr>
</tbody>
</table>

Logistics assets, given the modern construction and key location bias, are of a larger average lot size, at £15.5 million, compared to standard industrial assets with an average value of £8.4 million. As a result of these larger lot sizes, logistics attract a more specialist base of private investors than standard industrials given the significant financial commitment required. Historically, this has meant that logistics properties tend to be held by some of the larger investors, particularly institutions, although there is a growing number of REITs and investments made through specialist property companies and sovereign investment funds.

FIGURE 3: UK LOGISTICS EVOLUTION
Source: MSCI
INVESTMENT PERFORMANCE
The last year marked a significant turning point for the broader UK commercial property market, as sustained growth for both capital and rents spread nationwide. Total returns for the UK market hit their highest level since 2005 and rents grew for all key property sectors as occupational confidence returned. International investment into UK real estate has increased significantly in recent years, focused primarily on prime London assets. However, the UK leasing structure and lack of trading barriers has helped the popularity of UK real estate in broad national terms. Logistics has followed this trend, with the sector witnessing a growing appeal from international investors. Broadly positive economic news further boosted sentiment towards investment real estate as the expectations of future rental value growth spur on investors to bid higher and on riskier income streams.

TABLE 2: UK LOGISTICS PERFORMANCE SUMMARY
JUNE 2014 - JUNE 2015, % YEAR-ON-YEAR
Source: MSCI

<table>
<thead>
<tr>
<th>Metric</th>
<th>June 2014 - June 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total return</td>
<td>19.6%</td>
</tr>
<tr>
<td>Income return</td>
<td>+ 6.0%</td>
</tr>
<tr>
<td>Capital growth</td>
<td>+ 12.9%</td>
</tr>
<tr>
<td>Cross product *</td>
<td>+ 0.7%</td>
</tr>
<tr>
<td>Rental value growth</td>
<td>+ 3.4%</td>
</tr>
<tr>
<td>Yield impact</td>
<td>+ 10.4%</td>
</tr>
<tr>
<td>Residual **</td>
<td>- 0.6%</td>
</tr>
</tbody>
</table>

Overall for 12-months to the end of June 2015, total returns from UK investment real estate hit 15.6% year-on-year outpacing both UK equities (FTSE 100) which returned a negative -0.2% for the 12-month period and UK government bonds (JP Morgan UK 8-10 year) which returned 6.9%. Property Equities, with a return of 15.4%, were marginally outperformed by direct real estate as analysts took an optimistic view on future rental expectations as the economy, and particularly as the retail sector improves.

UK Logistics provided investors with a total return of 19.6% in the 12-months to June 2015, marginally below the 21.8% returned in the 12-months previous. The fallback in returns can largely be explained by the fact that this sector of the market was amongst the earliest to show signs of recovery with gains in capital value emerging earlier than in the broader property market. Overall, the UK property market provided investors with a total return of 15.6% between June 2014 and June 2015. With the expectation of all other industrials, total returns fell marginally for all investment property sectors compared to the 12-month between June 2013 and June 2014, as the rate of yield compression slows and the market stabilises after a tumultuous recovery over the last three years.

For the 12-month period in this analysis, the office sector led the way with a total return of 20.7%, followed by other industrial on 20.7%, marginally ahead of the logistics return of 19.6%, and retail on 11.1% y/y. This stabilisation in returns from UK logistics property as the recovery matures is illustrated by the quarterly investment performance trends as shown in Figure 4.
PERFORMANCE BY SECTOR

Relative performance of the UK property market is illustrated by Figure 5. Retail has continued to lag market performance in 2015 with a total return of 11.1% over the last 12-months as concern as to future trade and weak rental performance weighed on returns. However, the UK retail market remains highly polarised, with certain locations, like central London, producing amongst the highest returns of any property type and sector. The office sector has continued to perform strongly with occupier demand boosting rental values as the recovery of the services sector gathers pace, especially in London and the South East. The industrial segment (excluding logistics) followed with a similarly strong return to offices as re-pricing through yield compression boosted total returns through value appreciation.

Whereas UK logistics lagged in terms of total return performance between June 2014 and June 2015, the key market indicators for this property type were firmly positive. Investor confidence was strong as a significant positive yield impact drove values higher contributing 10.4% to 12-month total returns and compressing yields further over the course of the year. Logistics and all other industrials recorded the greatest shift in investor attitudes towards any property type, with retail only recording a yield impact of 5.5% as occupier concerns weigh and confidence remained on edge. Offices remained a steady performer for investors, with a positive yield impact of 9.4% continuing to edge yields lower nationally.

Figure 6 shows the key drivers of performance in 12-months to June 2015 for the UK market by sector and property type, with yield impact representing investor sentiment and rental value growth a proxy for occupier sentiment.

Since mid-2013 the logistics sector has comfortably outperformed the all property benchmark.

Colm Lauder
MSCI

Logistics performed in-line with distribution warehouses which recorded a marginally weaker return of 19.2%, with rental growth of 2.9% in-line with the 3.1% growth for logistics. Distribution warehouses are categorised as smaller units than logistics with gross floor area of between 1,000 and 5,000 square metres versus a minimum of 5,000 square metres for logistics. Additionally, logistics are located within easy access of key transport points such as railways, airport and motorways. However, the demand for larger logistics style units has only marginally outpaced distribution warehouses from an occupier perspective, with three year annualised rental growth of 1.2% for logistics compared to 1.1% for distribution warehouses. This highlights the fact that both property types have performed well owing to a recovery in demand as the shift to online retailing makes such a facility a requirement for a broad range of retailers. Such requirements are now crucial to the probability of many retailers distribution and supply chain network.
PERFORMANCE BY REGION
The economic strength of London has had a significant impact on investment property performance in both the capital and surrounding areas, both from an occupier and investor perspective. The dominance of London, in terms of GDP and property investment activity, has boosted the performance of the South East. In effect this has buffered the South East from much of the sustained declines suffered other parts of the UK market post-2010 when London was already recovering. This had presented a significant performance spread between the South East of England and the rest of the UK when national markets remained fragile.

However, as the wider market recovers, more regional locations have dominated investor returns, as sharp re-pricing takes place in markets that had remained subdued for sustained periods. This has provided a short-term boost to total returns as capital value growth combines with stronger levels of income return. Income, as a percentage of total return, tends to be higher in regional and secondary markets than in London and the South East.

Regional markets outperformed throughout the 12 months to the end of June 2015, overtaking both outer London and the South East in terms of total return, as illustrated in Figure 7. Logistics in the North West and Eastern England led performance with a return of 22.2% and 21.8%, respectively, while Scottish and Welsh properties provided more modest levels of total return at 15.8% and 15.2%, respectively.

Improving investor sentiment (as expressed by yield impact) toward logistics assets, especially for regional assets, was the key determinant of performance over the last year. On a national level this was expressed by the strong positive yield impact which boosted returns by 10.4% y/y, but on a regional level, fast recovering markets gained the most, as yields compressed across the country. The change in equivalent yields for each of the regional logistics markets is illustrated by Figure 8 with Yorkshire & Humberside recording the largest pricing shift as equivalent yields fell from 7.8% to 6.5% in the space of 12-months. London and the South East recorded the lowest levels of yield compression over the year, with an end-June yield of 5.9%. This location has witnessed significant yield compression in 2013 and 2014 recovering earlier than many regional markets.

The divergence in yield compression between London and the South East, and for weaker locations such as Wales and Scotland remained clearly evident in 2015 with equivalent yield spreads of more than 300 basis points available across the UK market between the strongest and weakest market. Much of this spread can be explained by the perception of occupier strength around London given the sustained economic recovery in the capital. Longer-term demographic trends in London are also of great appeal to investors and occupiers, given the significant growth witnessed, and further expected, in the younger age bands compared to the rest of the UK. However, fast recovering regional markets have recorded the largest positive yield impact movements, such as the East Midlands at 12.0%. Investors are now heading further beyond the South East in search of higher yields in markets where assets remain significantly discounted compared to their previous peak.

FIGURE 7: TOTAL RETURNS BY REGION
JUNE 2014 – JUNE 2015, % YEAR-ON-YEAR
Source: MSCI

FIGURE 8: EQUIVALENT YIELD COMPRESSION
JUNE 2014 TO JUNE 2015, %
Source: MSCI

- Total return (% year-on-year)
- 12-month yield compression, %
- Equivalent yield jun-15, %
- Equivalent yield jun-14, %
The pace at which yields are strengthening across the UK market was also evident by examining initial yield trends as illustrated by Figure 9. This shows that all key regional markets recorded a tightening in initial yields over the last 12-months, reflecting confidence in the future rental growth potential of prime regional logistics assets.

### QUARTERLY MARKET TRENDS

In the last four quarters, the UK market recovery has broadened geographically, while key markets such as London have recorded some stabilisation in pricing and moderation in returns. The last 12-months was also marked by a number of notable investment transactions in the UK logistics market, particularly in the regions, as investors search for yield takes them outside of London and the South East.

Performance highlights for the quarter end June 2015 include:

- UK all property total returns ended 2014 strongly with a return of 4.4% quarter-on-quarter in the third quarter, and 4.1% in the fourth quarter;
- Performance had been impressive throughout 2014, peaking with a return of 4.7% in the second quarter of the year;
- 2015 started at more modest pace, with a total return for UK All Property of 2.9% in the first quarter which grew to 3.5% in the second quarter;
- Logistics followed a similar pattern, as a quarterly return of 3.1% in Q1 grew to 4.1% by the end of Q2 in June 2015. The quarterly total return trend for the last 12-months is illustrated by Figure 10.
THE LONGER-TERM VIEW

Taking a longer term view can show how these investment trends have changed and how real estate cycles influence performance. Over the last 14 years, investment performance of the logistics property sector has been closely linked to the broader UK commercial property cycle, with yield expansion, rather than rental value declines, the main cause of the crash in performance between 2007 and 2009. More recently, the growing level of rental performance has buoyed the logistics sector helping it outperform the wider UK market. The drivers of total return for the logistics sector between June 2001 and June 2015 are displayed in Figure 11 below.

The dominance of yield impact as the key driver during certain parts of the market cycle is further evidence of the speculative, investor driven, nature of the logistics investment market while the emergence of rental value growth is closely linked occupier confidence.

Income is the key driver of long-term performance. Capital value growth, as affected by yield movement and rental value growth, will have little impact on long-term investment performance when total returns are only marginally in-excess of income returns. This highlights the importance of the quality of an income stream and the strength of income returns.

The logistic sector has recorded an average income return of 6.7% per annum over the last 14.5 years, above the 6.6% of all other industrial. This is despite the fact that the income qualities of logistics versus the broader industrial sector would be generally judged to be more secure and reliable.

In Figure 12 (overleaf), total returns have been indexed to a base of 100 as at December 2000 for logistics versus the wider property market. It is notable, that since mid-2013 both the logistics sector and the other industrial sector have comfortably outperformed the all property benchmark, largely due to the weaker performing retail sector dragging the market average lower. Over the last three years, the logistics sector has returned an average return of 15.7% per annum, compared to 14.7% for all other industrial and representing a significant outperformance of the UK market, with All Property returning an average of 12.1%.

FIGURE 11: DRIVERS OF TOTAL RETURN 2001-2015, % QUARTER-ON-QUARTER

Source: MSCI
With investors continual desire for yield in a low income environment, we anticipate further new entrants to the sector.

Hugh White
BNP Paribas Real Estate
REFERENCE 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 rate of income return is the rent actually paid by a tenant over 12 months, divided by the capital employed in the property. The income measure is net of any revenue expenditure incurred by the landlord, including incentives.

Capital growth is the change in the capital value of a property over 12 months net of capital expenditure, expressed as a percentage of the capital employed over the year. The capital value of a property is in the view of the valuer, the price the property would achieve on the open market. On a rack-rented or reversionary property capital growth is roughly equal to the product of Rental Growth and the Yield Impact.

The equivalent yield is the rate at which the prospective rental income over the entire length of a lease is discounted to equate with the current capital value.

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 growth is the change in the level of rent that a valuer estimates a property might achieve were it let on the open market. If a valuer thinks that open market rental values have risen from say £40 per square foot to £50 per square foot, 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%.

Over-renting occurs when the open market rental value falls below the rent actually paid by the incumbent tenant.

A reversionary property is one where the open market rental value exceeds the rent paid; a rack-rented property is where the two are equal.