THE MARKET AWAKENS

Reading Industrial Market January 2015

Haslams commented on the industrial market for Reading UK CIC at the end of 2013 in which we highlighted a number of trends. The market has now moved on, but is it changing direction?

- **Acute lack of supply across all size ranges**
- **Development pursued as demand increases**
- **Significant increase in take up**
- **Freehold units continue to be attractive**
- **Industrial property investment remains in favour**
- **Retailers and E-tailers expected to form a large part of demand going forward**

Lack of Supply

There was limited supply in the market in 2013 and the situation has not improved. Figure one shows the reduction in supply across all size ranges since 2010. In particular there is an acute lack of supply of units over 15,000 sq ft

Previously due to uncertainty in the general economy, occupiers had resisted the need to relocate or expand. These occupiers are now entering the market to find very limited choice. There were just over 537,000 sq ft of transactions in 2014, a 107% increase on 2013.

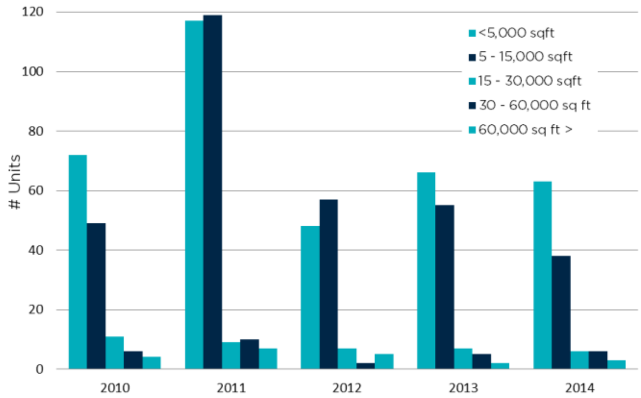

Figure 1: Supply levels 2010 - 2014

The result has been noticeable rent rises and falling incentives. Landlords are also now able to insist on longer leases. As a result we envisage that £10 per sq ft plus will become the tone for the region. However, it will take the development of new stock to break through this historic ceiling. Until then occupiers will need to compromise and expect to be in competition.

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Trade

In 2013, we referred to the potential for the trade counter market to become saturated. This view needs to be fine-tuned. Landlords of those properties in which trade occupiers have been "making do" due to the lack of proper trade alternatives should be wary as going forward these properties will be vacated for more favourable, probably new units.

Trade occupiers continue to seek out prominent units and are no longer content to lease an industrial unit tucked at the back of an industrial estate. There is now evidence that they will pay a premium for quality units in prominent locations of the right size. This is partly as a result of their business models being based on annual rents, and therefore building any size of unit does not automatically attract a high rent per sq ft.

In Reading we have seen a number of well positioned estates such as IPIF's Hyperion Way take advantage of this situation by repositioning the estate and achieving decent rental growth. Whereas other, less well located, estates have lost trade occupiers. Potentially, the larger industrial development sites will comprise an element of trade/road side development resulting in more trade occupiers relocating in the town and new ones gaining a foothold in better locations than their direct competitors. We anticipate USS's trade focused development of Reading Trade Park on the A33 to be at the forefront of this market.

Take Up

There remains a decent occupier demand for freehold units. Surprisingly though this is not only the case for smaller units, but also mid box units of up to 100,000 sq ft. We expect this trend to continue in 2015 but with more emphasis on smaller units as SMEs become more comfortable with general economic conditions.

This year's take up of 537,000 sq ft is significantly higher than the 5 year average take up for the Greater Reading area of 350,000 sq ft. In addition to this year's staggering level of demand we are aware that there is over 180,000 sq ft of space currently under offer. See Figure 2.

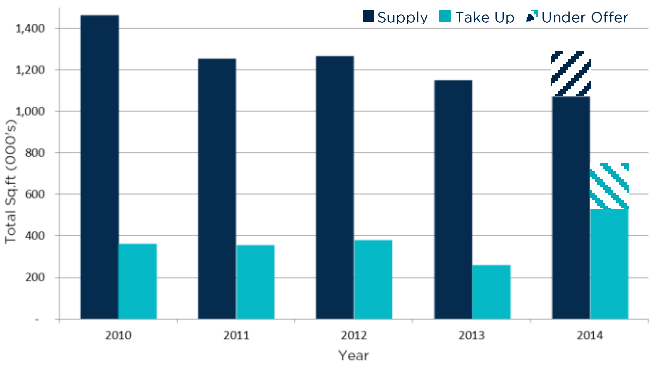

Figure 2: Supply and Demand 2010 - 2014

The level of transactions in 2013 was lower than the long term average at only 260,000 sq ft, and this increase from last year is a sign of improving demand. Interestingly the total square footage of transactions this year includes approximately one quarter of sales. See Figure 3.

The opportunity for occupiers to purchase units is eroding as rents rise and yields fall to historically low levels. As a result, investment values versus vacant procession values will drift further apart.

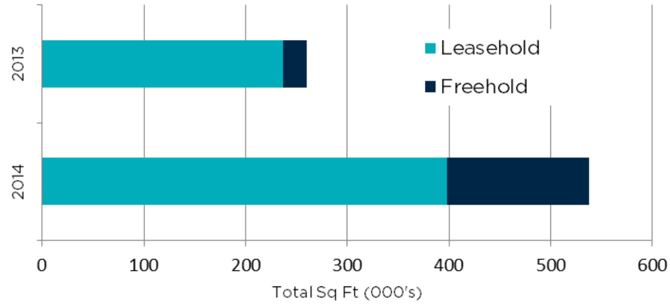

Figure 3: Take up levels – 2013 & 2014

Development

As predicted, a number of development sites are being worked up for development. These include two sites in south Reading. Reading Gateway (20 acres) which was purchased in the 3rd quarter of the year by Kier Property and the Island Road site (12 acres) purchased just before by Evander Properties for the development of 240,000 sq ft. Whether these sites will be speculatively developed is yet to be seen, not because the market is not ready but they may end up being entirely pre-leased given the pent up demand. An early sign of this is the completion of SEGRO's parcel delivery centre for Geopost UK a subsidiary of French postal service La Poste on Imperial Way, south Reading.

The biggest threat to industrial development is the pressure from other commercial uses. At present from a land value perspective industrial development is competitive against other uses but, as has historically been the case, this situation will change at some point, although we are predicting much of the same for 2015.

The only speculative development in the region for 6 years called Access 12, Theale is now 35% let which includes the letting of Unit A1 to Glendening Signs at the start of 2014 for around £9.50 per sq ft.

Access 12, Theale

Investment

The purchase of Worton Grange at Junction 11 M4 for £57.75m (6.2%) by UBS Triton from SWIP at the start of the year stole the headlines but there have been some other interesting sales this year. Two multi-let industrial estates also sold; Heron Industrial Estate, sold by Picton to Threadneedle for £3.6m (7.9% NIY) and Deacon Way was sold by Aberdeen for £5.85m (7.32% NIY) to Canmoor. These transactions were ahead of quoting terms which was unsurprising given the strength of the general investment market. The threat of a rise in interest rates at some point in 2015 and the general election may have an impact on the investment market, but we believe the weight of cash and positive city sentiment for commercial property investment will maintain yields at current levels particularly with forecasted rental growth.

HSS leased 47,000 sq ft at Worton Grange just after the estate was purchased by USS. The estate is now fully let.

Retailers and E-tailers

With the exception of Geopost mentioned above, we are yet to see the full effect on the industrial market of the retailers and e-tailers change in distribution methods. This is partly as a result of the limited supply of opportunities in the region, but also because the majority of retailers and e-tailers are yet to properly decide which direction they will go in.

Retailers turn to the Dark side with the predicted growth in the number of the dark store warehouses in the UK.

The ability to sell goods via the internet is no longer a USP as everyone is doing it. What is now crucial is how quickly those goods can be delivered. Furthermore, the ability to return goods - the level of which was originally underestimated - is now a major influence on the supply chain model. These factors have spawned a number of new concepts including the last mile delivery centre, regional distribution centres, dark stores, dot com warehouses and click and collect facilities.

No one is still sure how all this will affect the industrial market, but one thing for certain is that it will have a large impact one way or another. As one of the most affluent regions in the UK the retailers and e-tailers must be particularly focused on how homes and business in this region can be delivered to effectively.

The Reading industrial market experienced unprecedented levels of activity during 2014. We predict a similar story in 2015. Our advice is therefore for developers to build, occupiers to move quickly and investors to factor in rental growth.

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