

# European Logistics & Industrial Markets

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Improving macroeconomics and changes in supply chain management will support occupier demand for logistics facilities over the medium-term.

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Occupier markets are recovering with demand levels increasing and availability falling.

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Prime logistics assets offer investors good defensive attributes in the short-term and are underpinned by robust fundamentals in the long-term. Industrial estates which are well located in strong industrial areas also offer good performance potential.

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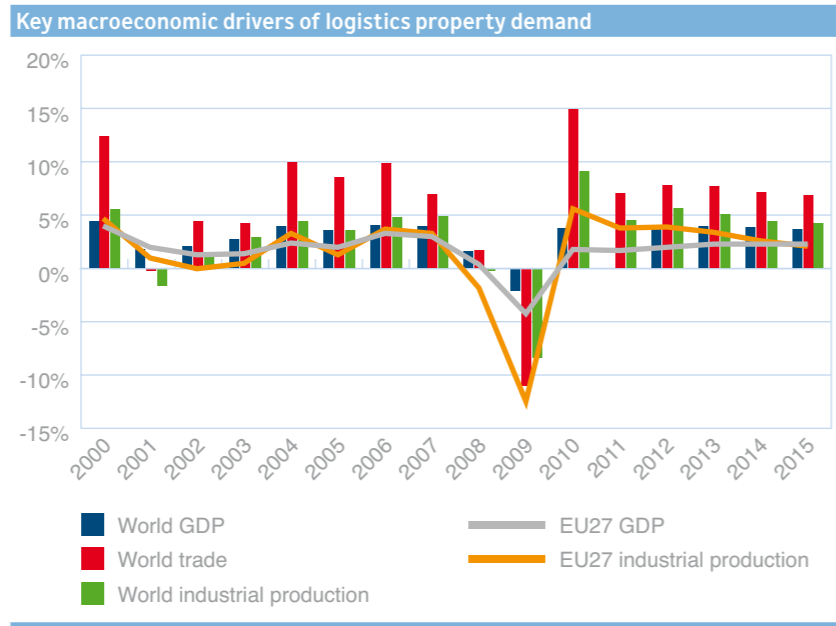


### Market drivers

Across Europe, the storage and distribution activities associated with logistics and supply chain management are the principal drivers of industrial property demand. For this reason, within the industrial sector, the logistics segment attracts most attention from developers and investors, although the importance of industrial units and estates should not be overlooked.

The demand for logistics facilities (warehouses) derives from virtually every spectrum of economic activity, whereas demand for other industrial uses is more related to production and assembly, with large-scale manufacturing often taking place in specialist factories, which are usually owner occupied. That said, manufacturing activities generate demand for warehouses and requirements related to manufacturing and production remain a significant source of industrial property demand. This is particularly the case in low cost countries, notably in Central and Eastern Europe, but is also more generally true, especially as manufacturing is growing strongly.

The demand for logistics and industrial premises collapsed across Europe in 2009 following the sharp decline in manufacturing output and world trade in the wake of the credit crunch. By late-2009, however, the global and European recovery were established, assisted by concerted injections of liquidity and fiscal stimulus across the major economies. During 2010 global GDP revived strongly, world trade gathered momentum and manufacturing output turned around. In Europe, Germany, in particular, experienced a strong rebound in economic activity, led by exports from its large manufacturing sector.



Source: Oxford Economics

Across Europe, occupier demand for logistics and industrial premises started to recover last year.

Whilst European domestic demand remains more subdued, the economic recovery has continued into 2011. Business confidence across Europe is also increasing, particularly in the export-orientated sectors.

Forecasts suggest a steady improvement in real economic activity across Europe and demand prospects are now more positive than they have been for the past couple of years. With domestic demand reacting to fiscal tightening, much of the contribution to growth is expected to come from net exports and manufacturing sectors.

The recovery in world trade and output is reflected in traffic volumes at Europe's major ports and airports. Over 2010 as a whole, Rotterdam and Antwerp container volumes (TEUs) increased by 14.4% and 15.9% respectively, while in the first nine months of 2010 Hamburg

reported an increase of 10.7%. Air cargo through the major airports has also been increasing.

Aside from the more positive growth outlook, changes in the way companies organise their logistics and supply chains will continue to be an important driver of property demand. Logistics and supply chain management are increasingly recognised by businesses as being critical to their competitive advantage. As a result, companies are continually reassessing their supply chains to improve their performance and reduce costs, and the development of efficient warehouse networks is a key component of this.

Key supply chain changes include the continuing centralisation of retail distribution, the reconfiguration of inbound supply chains, the growth of dedicated e-fulfilment operations and the growth of 'reverse logistics', which requires facilities to handle returns, packaging and waste. In addition, mergers and acquisitions between companies typically lead

to the re-alignment of supply chains and warehouse networks.

Looking forward, whilst economic risks remain, we believe that the latest evidence paints a relatively optimistic macroeconomic picture, which, along with the reassessment of supply chains, will continue to drive occupier demand for modern, well-located facilities. In our opinion, the fundamentals underpinning logistics property demand are strong and these should support robust property performance over the long-term.

### Property market dynamics

Whilst economies generally have been improving, occupier demand across Europe is recovering at different speeds. In the UK, the take-up of new warehouse floorspace (units of 10,000m<sup>2</sup> and over) in 2010 doubled compared with 2009, whilst in Germany, the take-up of logistics property (in units of 5,000m<sup>2</sup> and over) increased by around 40% in the major conurbations. In France, take-up over 2010 was only marginally higher than 2009, although activity in the Ile-de-France region increased more significantly. In Central and Eastern Europe, take-up increased by 49% in Poland, by 106% in the Czech Republic and by around 86% in Romania.

While take-up generally rose last year this was from a very low base as for many countries 2009 had seen the lowest level of take-up for many years. In addition, some of the demand last year was undoubtedly driven by opportunistic deals, with occupiers taking advantage of very competitive terms to acquire new facilities, or to renegotiate leases on existing ones. That said, the overall picture is, nonetheless, one of a real pick-up in occupier demand.

On the supply side, the recession caused a near moratorium on speculative development. With capital values declining and debt in short supply, major developers focused on de-leveraging and leasing their vacant portfolios. Where new facilities were developed this was almost exclusively on a build to suit basis.

As the availability of new logistics space has gradually diminished, due to the combination of take-up and very limited replenishment, overall levels of vacancy appear to have stabilised. Comprehensive vacancy rates are difficult to estimate across Europe's industrial markets because in many locations the built stock is simply unknown. However, for markets where we know the logistics stock, vacancy rates for new and modern quality space universally fell over 2010.

Whilst patterns vary between countries and markets, much of the second-hand warehouse availability in many countries is poor quality, and unsuited to efficient logistics operations and, therefore, not competitive with new supply. In the UK, for example, our analysis suggests that only around a quarter of the available second-hand stock at the end of 2010 provided the specification occupiers seek in large facilities, namely good height and column grid layout, dock level and ground level access, sufficient yard depth and appropriate office space.

The balance between demand and supply has strongly favoured occupiers over the past two years. As a result, headline rents have generally fallen and tenants have additionally been able to secure significant inducements, such as extended rent free periods and capitals contributions.

Looking forward, we expect:

- market demand and supply to become more balanced and shortages of new and good quality stock will emerge in some locations this year.
- developers to continue to focus on build to suit developments, although some may promote speculative developments in well established core logistics markets, especially on sites where they have already secured sizeable pre-lets.
- rental levels on existing schemes to stabilise and inducements to reduce.
- a two-tier rental market will emerge with rents on build to suit facilities being typically higher than those prevailing on existing developments, reflecting build costs and development values.

Country	Location	Property	Type	Tenant	Developer/owner	Size (m <sup>2</sup> )
Poland	Swarzedz (Poznan)	LCP Logistics Facility, Swarzedz	New lease	AB Foods	London and Cambridge Properties	26,178
Hungary	Székesfehérvár	Stand alone unit	Lease extension	DHL	Aviva	25,000
Romania	Ploiesti	Ploiesti West Park	Pre-let	Toro	Alinso Group	15,000
Czech Republic	Prague	Tulipán Park Hostovice	New lease	Schachermayer	Standard Life	5,609
Romania	Timisoara	Incontro Park Timisoara	New lease	Starfoods	Catalyst Capital	5,170

Source: King Sturge

**Occupier market snapshots**

In the **UK**, the take-up of new logistics facilities (units of 10,000m<sup>2</sup> and over) doubled in 2010 compared with 2009, with 1.3 million m<sup>2</sup> taken-up. With 52% of this total involving existing speculatively-developed space, and no new development delivered, available new supply fell to 1.2 million m<sup>2</sup> by the year end, down 36% on end-2009. The availability of good quality second-hand space stood at 1.3m<sup>2</sup> at end-2010. The increase in take-up last year reflected a revival in demand from retailers, which accounted for 74% of floorspace taken-up. About a quarter of retailer take-up was for internet fulfilment facilities, a driver that seems likely to continue. In January 2011 Amazon agreed terms on a new build to suit facility of c. 92,000m<sup>2</sup> in Scotland.

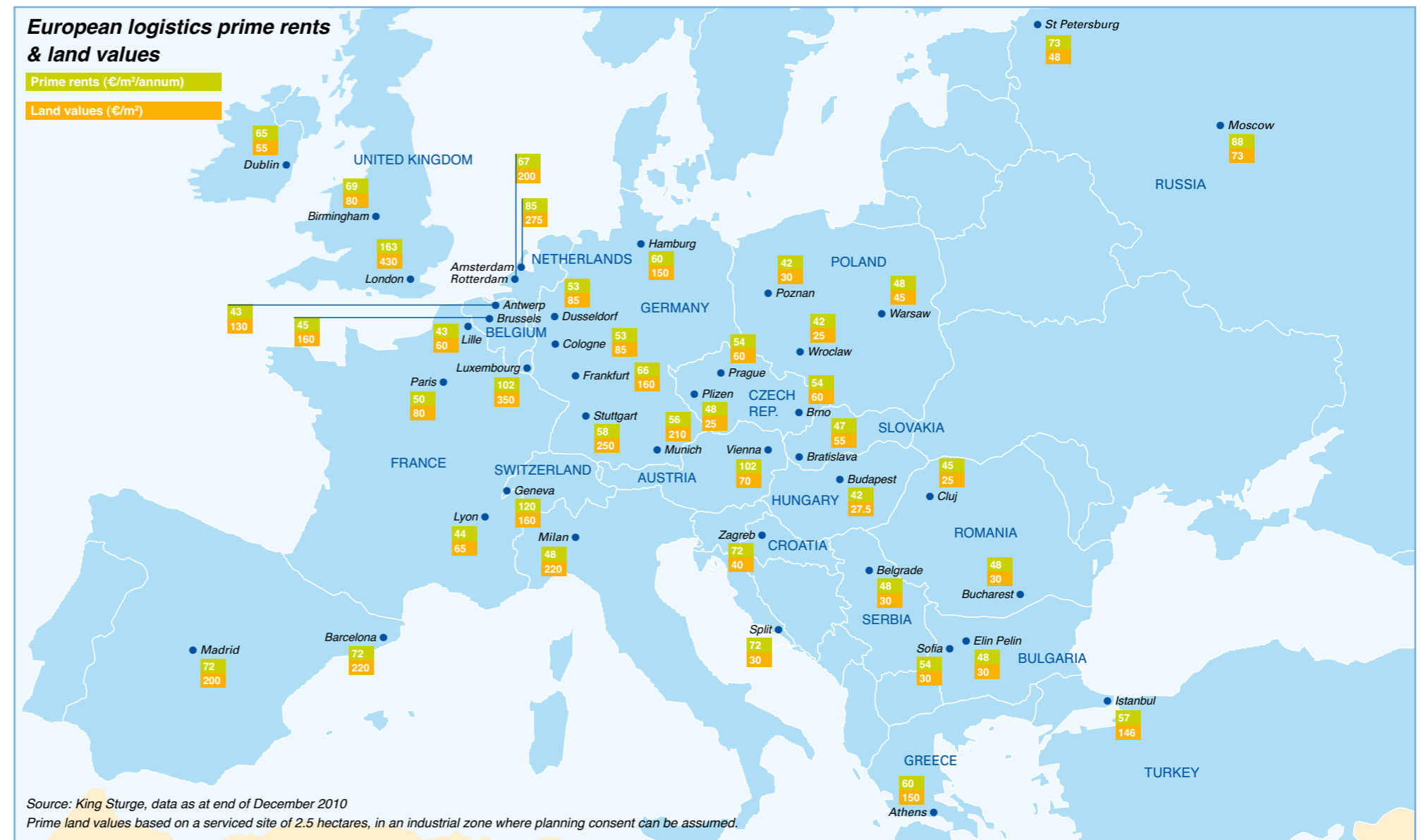
The **German** logistics market saw a resurgence in occupier activity, with the take-up of large facilities (5,000m<sup>2</sup> and over) in the five major conurbations 40% higher than in 2009. Hamburg, in particular, saw a strong rebound in demand, with take-up, up around 60%. With no sizeable speculative development, availability levels fell. Speculative industrial development is likely to remain very subdued in the short-term. In general, very few new projects are being brought forward without being pre-leased or pre-sold.

Occupier activity in **France** remained fairly stable in 2010. Around, 1.5 million m<sup>2</sup> was transacted during the year, a 3% increase on 2009. However, take-up remained below the 2001-2008 average of c. 2 million m<sup>2</sup> per annum. Whilst the Ile-de-France and Rhône corridor experienced strong growth, most provincial areas remained weak. The vacant stock remains relatively high in France at 3.9 million m<sup>2</sup>, 80% of

which is new or recently developed stock. The virtual standstill in new development is likely to lead to a decrease in vacancy rates in the short to medium term.

The **Benelux countries**, particularly the Netherlands and Belgium, have traditionally attracted significant demand for large-scale logistics facilities, particularly around their major ports (Rotterdam and Antwerp) and airports (Schiphol and Brussels). However, these markets were hit hard by the collapse in world trade in 2009. Even though trade returned to growth in 2010, demand has remained suppressed compared with pre-recession levels. Overall availability continued to trend upwards in both Belgium and the Netherlands last year, but available new and good quality modern logistics stock fell, largely because no new speculative development was delivered. In Amsterdam and Rotterdam the available units are usually of lesser quality or in secondary locations. The availability of large modern logistics facilities in the Greater Brussels area also remains limited with the majority of vacant supply here failing to meet current occupier requirements.

Occupier demand in **Poland** picked up in 2010, with some 1.46 million m<sup>2</sup> of modern warehouse space leased compared with 982,000m<sup>2</sup> in 2009. Around a third of floorspace leased last year involved lease extensions and renegotiations. Warsaw and Upper Silesia recorded the largest volume of transactions. The national vacancy rate decreased over 2010 to 15.5% at the end of the year, compared with 18.2% at end-2009. The vacancy rate for the top nine logistic regions was slightly lower, at 13.9%. The highest vacancy rate was recorded in Warsaw Zone 3 (30 - 50 km from the City Centre), with the lowest vacancy rates recorded



in Pomerania (5.1%), Warsaw 1 (up to 10km from the City Centre, 10.1%), and Wielkopolska (9.5%). New supply delivered in 2010 totalled around 254,600m<sup>2</sup>, 75% down on 2009.

A total of 785,000m<sup>2</sup> of modern logistics and warehouse space was leased in the **Czech Republic** in 2010, more than double that in 2009 (381,000m<sup>2</sup>). Prague accounted for 41% of take-up, Pilsen, 27% and Northern Moravia, 15%. In 2010, only 150,000m<sup>2</sup> of new development was delivered, a 5-year low, and there was no significant speculative

development. Nationally, the vacancy rate for class A warehouse and industrial space fell to 10.4% by the end of 2010, compared with 17.6% at the end of 2009. The lowest vacancy rates are currently in Eastern Bohemia (0%), North Bohemia (5%) and South Moravia (6.5%) whilst the highest rates are in South Bohemia (18.5%), North Moravia (14%) and Prague (13%). We expect demand to remain robust this year.

The **Hungarian** industrial market received a boost from strong growth in the German manufacturing sector in 2010. Around 210,000m<sup>2</sup> of

speculative space was taken-up in the greater Budapest area. The vacancy rate for modern Grade A space in greater Budapest declined from 22.0% at the end of 2009 to 19.5% at the end of 2010. At the end of 2010, no speculative developments were under construction, and it is not expected that any such developments will start in the first half of 2011.

In **Slovakia**, the take-up of industrial space totalled around 100,000m<sup>2</sup> in 2010, but new development came to a virtual standstill. As a result, the national vacancy rate remained low,

at just 3% at end-2010. A number of new logistics projects are due to be delivered in 2011. Subject to a high proportion being pre-leased, 80,000m<sup>2</sup> to 100,000 m<sup>2</sup> is expected to be completed, with the cities of Senec and Kosice accounting for most of this. However, with demand likely to hold firm, we do not anticipate an increase in vacancy levels.

In **Romania**, industrial take-up in 2010 totalled around 130,000m<sup>2</sup>, up from 70,000m<sup>2</sup> in 2009. Take-up increased for both logistics

and production space. Bucharest accounted for about a quarter of all industrial take-up last year, with most demand being for logistics space. Demand for production space tends to be stronger outside Bucharest, where property and labour costs are cheaper. At the end of 2010, the vacancy rate in Bucharest stood at around 15%, but we expect this to reduce over 2011 with no significant developments expected to be delivered. Beyond Bucharest there are a number of emerging production and logistics hubs, mostly to the west of the capital, and often based around large manufacturing plants: examples include Pitesti (Renault), Craiova (Ford), Cluj (Nokia) and Ploiesti (Unilever and P&G). Poor infrastructure remains an issue especially away from Bucharest.

In **Croatia**, the logistics and warehouse sector is at a relatively early stage of development and there is a limited stock of modern facilities. However, the market has seen some significant developments including the Zagreb Logistics Park, the first phase of which has been delivered, with phase II of the project under construction. In addition, Immorent, part of Erste Bank Group, is promoting the 66,000m<sup>2</sup> Logistic Centre Jastrebarsko, 25 km from Zagreb, close to Jastrebarsko toll station on the A1 motorway connecting Zagreb with Rijeka and Dalmatia, an area that is now widely

recognised as a significant hub for logistics and wholesale occupiers. These and other new developments should mitigate the lack of modern facilities over the next few years.

The **Serbian logistics market** is currently undeveloped with only a few new facilities, most of which are owner occupied. The total stock of modern warehousing in the greater Belgrade area is less than 90,000m<sup>2</sup>. Most distribution warehouses and light industrial properties are located around important transport hubs and corridors, notably around the Nikola Tesla Airport, along the E70 motorway, and in the Port of Belgrade. Outside Belgrade, industrial and technology parks have been developed in the major regional cities, such as Novi Sad, Indjija, Vršac in the north and Niš in the south. The market was very subdued in 2010, however, as the economy recovers, requirements for distribution warehouses are likely to expand, re-igniting developer and investor interest. Currently, the vacancy rate is close to zero and rents are relatively high compared with other Eastern European countries.

**Bulgaria's** industrial sector suffers from a lack of international, high quality, logistics parks with the market being dominated by owner-occupied stock. Very little speculative product has been developed.

Infrastructure is also poor and needs improvement before Bulgaria can take full advantage of its strategic position linking Greece and Turkey with the rest of Europe. Occupier activity was subdued over 2010, although activity started to pick up in the latter part of the year. Sofia remains the focus of recent property activity. The overall vacancy rate in Sofia gradually decreased over 2010 with almost no new speculative developments coming to the market. Whilst overall, the Bulgarian property market is oversupplied, the industrial sector has scope for growth in the medium and long-term.

The bulk of **Turkey's logistics market** is focused on Istanbul and its wider area, including Gebze on the Asian side of the Bosphorus and Hadimkoy on the European side. However, the prospect for growth in other key cities, especially those with a significant port facility, such as Izmir, cannot be overlooked. Whilst the sector has developed over the past five years, the supply of modern institutionally investable logistics stock remains limited, although a number of projects are now nearing completion such as Access Turkey's Logipark at Tuzla. Occupier activity in Istanbul was subdued in 2009, picked up slightly in 2010 and is now moving ahead more rapidly. Lack of available modern stock of the right specification, however, hampers progression. Land prices at \$200 or more per m<sup>2</sup> also mean that speculative development is constrained. Whilst Istanbul benefits from its strategic location, improving infrastructure, a large population and improving macroeconomic base, development is constrained by its hilly topography and pattern of land ownership. Other cities are generally less well served by infrastructure, but do not suffer from Istanbul's topographical constraints. Whilst rents are significantly less than



Ploiesti West Park, Ploiesti, Romania

in Istanbul, so are build costs. In addition, land prices are a fraction of Istanbul levels and the availability of sites is greater. Given its economic size, its strategic location and its growth prospects, Turkey offers strong logistics potential in the medium to long-term.

### Investment markets

Investor demand in the industrial sector picked up considerably in 2010 compared with 2009. According to RCA, some €10.7bn was transacted in the industrial market across Europe in 2010, 55% up on 2009, but still well below the 2007 peak when just under €29bn was invested in industrial property. The industrial sector accounted for roughly 12% of total commercial property investment in 2010, which is in line with previous years.

Investor interest was strongest in the UK, France and Germany, which together accounted for just over 65% of the total 2010 volume. The largest UK industrial transaction during 2010 was the 50/50 joint acquisition by Segro and Aviva Investors of 18 industrial warehouses around Heathrow, Stansted, Edinburgh and Gatwick airports for c. €552 million. The largest transaction on the continent was Hansteen's acquisition in April of the HBI light industrial portfolio in Germany for €330 million.

Investor demand has remained focused on prime, long let assets with strong covenants. However, there remains good investor demand for good secondary assets in sustainable locations, although the availability of debt remains a severe constraint on activity. Poorer quality secondary assets have attracted little interest.

Reflecting investor demand, prime logistics industrial yields saw

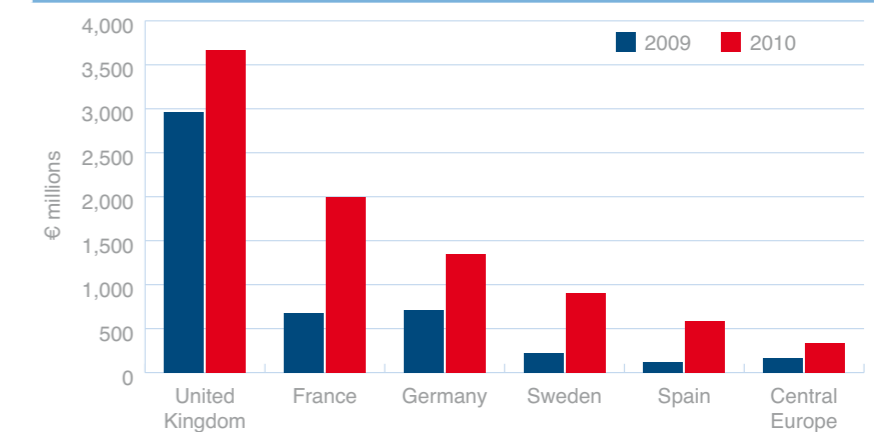
considerable compression over the year. The most significant downward yield shifts were recorded in the core Western European markets of the UK, France and Germany.

In Central Europe, prime yields saw some downward movement in the second half of 2010. For example prime logistics yields in Warsaw, Prague and Bratislava fell by 25, 50 and 75 basis points respectively over the year to stand at 8.25% at the year-end. Over the year the gap between prime yields and poorer quality secondary yields increased significantly as demand for

secondary assets increased more slowly than for prime assets.

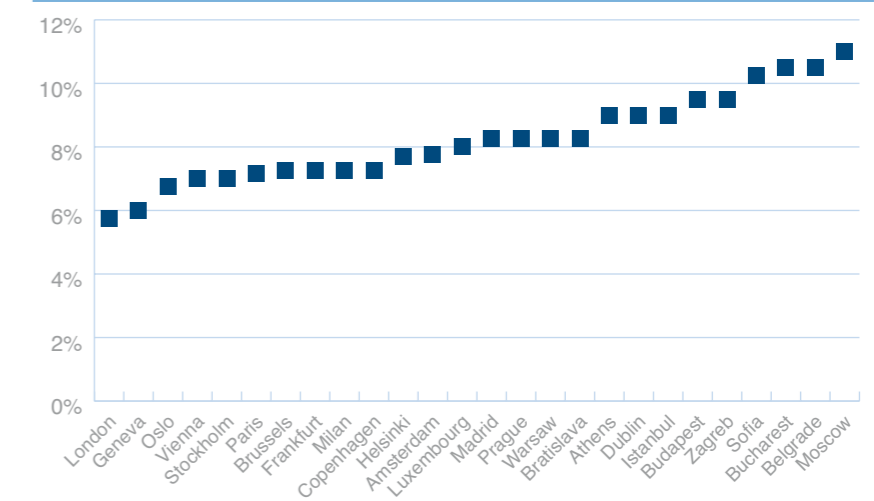
Looking forward, we expect prime industrial yields to remain fairly stable in the short-term in most Western European markets. Whilst the industrial sector did not experience the same level of yield compression as offices and retail during 2010, it also saw a less severe yield correction during the downturn, highlighting its less volatile nature and defensive qualities. Certain CEE markets could see further downward yield movement, given the strong levels of investor demand and lower perceptions of risk.

### Largest European industrial investment markets 2010 & Central Europe



Source: Real Capital Analytics

### Prime logistics yields as at end of December 2010



Source: King Sturge

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