EUROMARKET

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CAN EUROPE'S LOGISTICS PROPERTY SECTOR DELIVER?

As European property markets sought to recover from the financial and economic turmoil, it would be fair to say that most of the investment activity over the past two years has focused primarily on core office and retail assets in the most liquid markets. The level of investment in the industrial sector may have faltered over that period, but interest did not entirely disappear, with clear signals that investors are turning once again towards this vital sector.

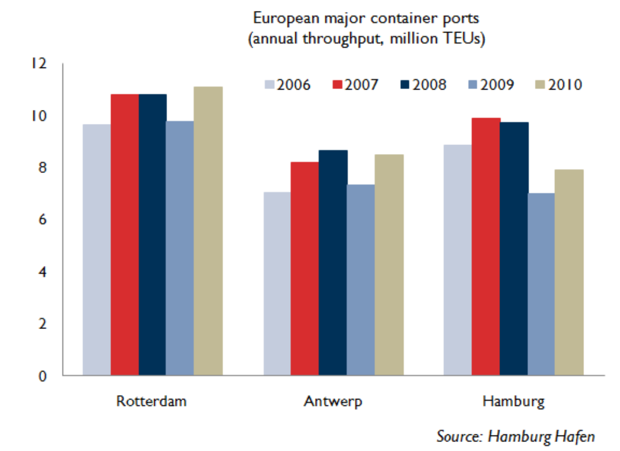
Growing Appeal

Structural changes in Europe have supported the growth of industrial property catering for logistics operations, which has attracted buyers looking for available modern investment-grade product. One important change has been the enlargement and integration of the European Union, which has provided access to a much bigger consumer base and with it a wider geographic coverage[1].

National and pan-European distribution networks have evolved, along with greater outsourcing to third-party providers by companies seeking efficiencies in their supply-chains. These companies, along with retailers, now provide a strong tenant base. As distances and complexity in serving the region have increased, so too has the requirement for efficient methods of storing and distributing goods.

Given their location and well-developed transport infrastructure, the Netherlands, along with Belgium and France have captured a high percentage of this activity, hence this is where many logistics properties have tended to be located. The role of Germany at the centre of an expanded European Union, should also see its status improve as we proceed through the decade.

While intra-EU trade is significant, the shift of manufacturing to a global platform has also meant more cargoes are passing through European airports and sea ports. These gateways have seen rising demand for efficient warehousing to support the movement of freight. In particular, the reliance on the sea to transport large volumes of cargo in containers has resulted in activity being concentrated at a number of strategic ports, especially those along the Le Havre-Hamburg range. There is high demand for efficient logistics facilities surrounding these key transport nodes, as well as along the major transport networks radiating away from them.

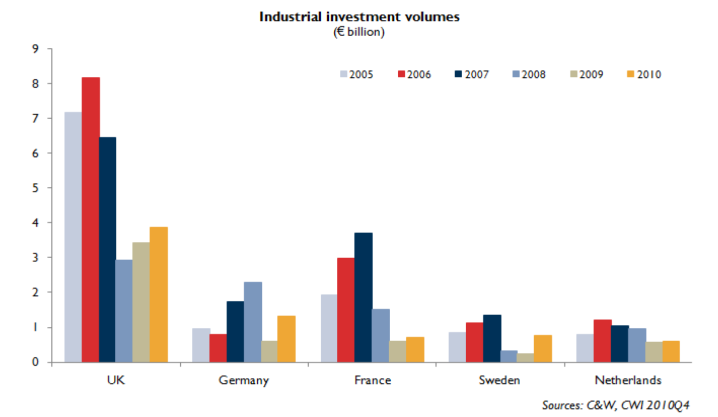


The three leading sea ports in Europe, Rotterdam, Antwerp and Hamburg saw an uplift in container volumes in 2010, each posting growth comfortably above 10%. While these robust levels of activity were for the most part stimulated by the rebound in world trade and manufacturing output, growth in volumes is forecast to continue to trend upwards, particularlyas more cargoes are containerised.

On the move again

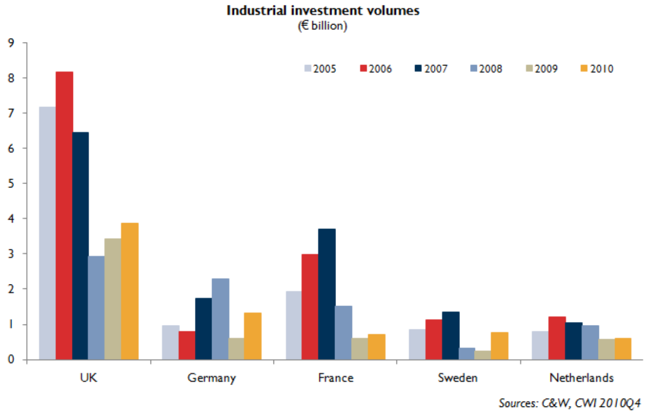
Following a muted performance in 2009, European industrial occupier markets began to see more activity in 2010 and are expected to benefit from ongoing economic recovery. However, austerity measures being implemented by countries may continue to suppress some activity, at least over the first half of 2011.

Industrial rents are typically less volatile compared to offices, hence the level of decline has not been as severe during the downturn. Prime rents are now assumed to have reached the bottom of the cycle, with some markets already seeing small increases where supply constraints have started to impact (+1% in Oslo, +3.4% in London Heathrow, +3.5% in Lyon yoy). A restricted supply pipeline, with almost all speculative development curtailed and levels of existing new stock reducing should further stimulate modest rental growth in sought after facilities.

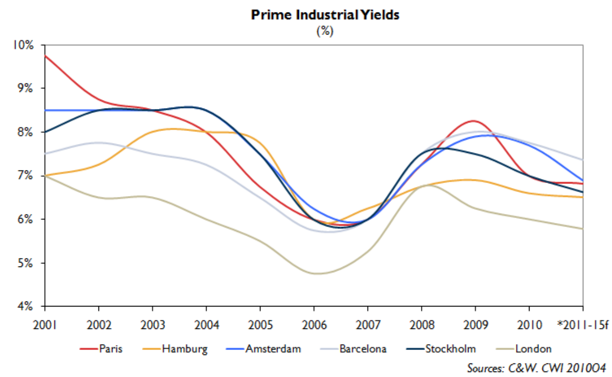


[1] The population of the Euro area (17 countries) and the Eurozone (27 countries) are estimated at close to 331M and 501M inhabitants respectively – source Eurostat.

Industrial investment in 2010 focused on the more liquid European markets. The UK, France and Germany saw a combined investment volume amounting to €5.9 billion in 2010, compared to €12 billion at the peak in 2006/2007. Sweden and the Netherlands also saw a return of investor interest, bringing investment to €7.3 billion, resulting in a 34% annual uplift for industrial product in the five countries. The prospects for 2011 remain positive with industrial assets now back on investors' radar. Volumes are unlikely to rise dramatically however as aggressive pricing now prevalent in core Europe and limited availability of suitable investment products are likely to constrain the amount of investment activity over the year.

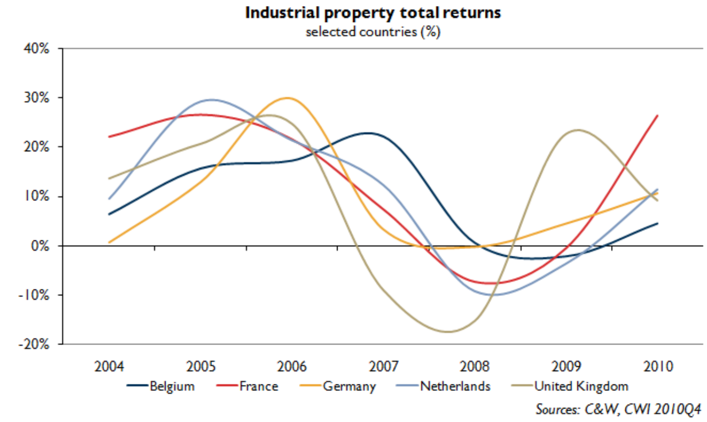


The outward shift in yields seen in 2007-8 has reversed in the main industrial markets. Prime yields continued to compress in 2010, however, the pace of correction slowed in the second half of the year. The most substantial falls to date have occurred in the UK (-100bps for prime London Heathrow assets), France (-125bps on average) and the Nordics (-50bps for Stockholm) where investors have been active. UK yields corrected first and fastest in the recovery, but have now stabilised. Further compression in European industrial yields is forecast to be at a more moderate rate. Individual markets, such as Amsterdam, Rotterdam and Antwerp are forecast to outperform the Western Europe average for industrial total returns to 2015, each being strong hubs for logistics activity.



The recent economic jitters have intensified the focus placed on getting logistics operations right. Companies found during the downturn, often to their detriment, that inefficient storage and distribution networks could be a breakpoint for their businesses.

In the economic recovery period and beyond, effective logistics operations will become increasingly important, with a corresponding boost in demand for good-quality industrial facilities catering for these operations.



Going forward, logistics operations will increasingly take place within a region where further enlargement and integration of the European Union will provide access to even more consumers, as retailers continue to roll-out their offerings. Transport networks are expanding both at point of entry and across Europe. For instance, the new port developments of London Gateway in the south-east of England and JadeWeserPort in northern Germany will provide additional strategic gateways to increasing volumes of containerised cargo.

Logistics operations will, by necessity, evolve in order to accommodate such developments. This will present more opportunities as well as challenges to occupiers of logistics space seeking to maximize operational efficiency, as well as for developers and investors in providing modern investment-grade facilities. The merger of ProLogis and AMB Property Corporation, two major industrial property developers, supports this trend.

The fundamentals will still need to be applied for successful investments in this sector, namely well-located modern stock, within easy reach of key transport nodes and routes, serving large consumer bases, with access to adequate pools of labour. Assets such as these coming to the market should ensure modern large industrial properties continue to be on the wish lists of investors.

[2] Concerns over : the sovereign debt of peripheral European markets, the potential impact of faster than expected inflation on the real economy notably households' spending, the Japanese earth quake and tsunami and the implied supply chain disruptions.

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