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Long-term demand drivers behind logistics real estate

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The logistics sector has come out of the Covid-19 recession more sought-after than ever. As shown in figure 1, in 2020, it was the only real estate sector in Europe with rising investment volumes (11% YOY). The sector's strength throughout the crisis follows half a decade of increasing liquidity and institutionalization. According to INREV fund-level return data, logistics has posted a five-year annualized return of 14.3% (figure 2). This outperformed all other sectors, including residential (12.9%) and office (6.9%). As a result of these strengths, prime yields have compressed to historic lows. In Germany, for example, prime yields more than halved to 3.25% over a decade, not far above German prime CBD office yields at 2.55%.¹

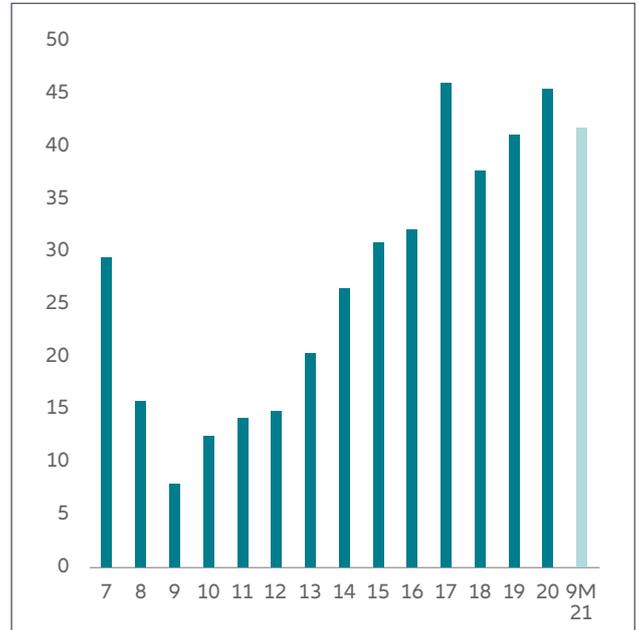
Investors continue to have a bullish outlook on the logistics sector. However, very tight pricing suggests that further yield compression is unlikely. Instead, future performance will have to be driven by rental growth. It is therefore more important than ever to understand logistics' long-term demand drivers.

¹ CBRE, July 2021



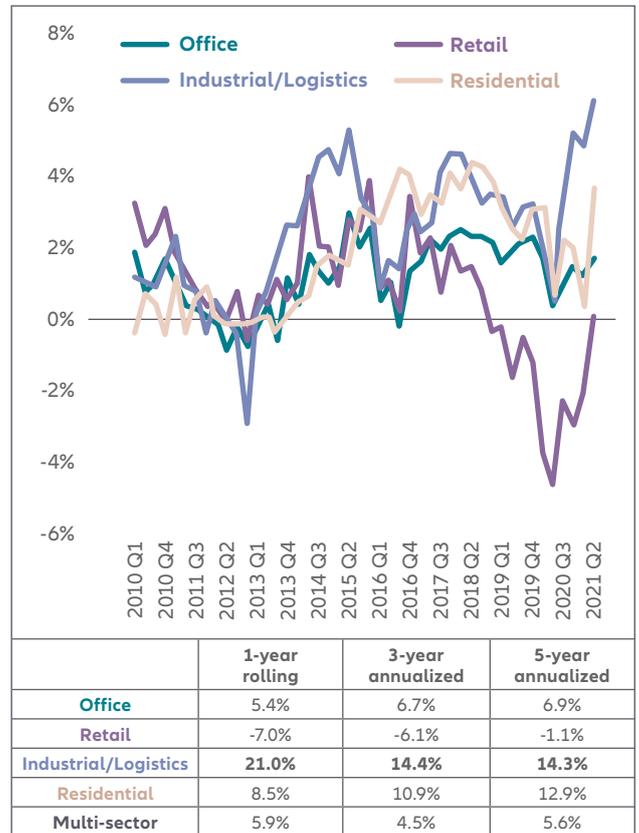
Credit: VGP

Figure 1. Europe industrial investment volume (bn EUR)



Source: RCA, Q3 2021

Figure 2. INREV fund-level returns



Source: INREV, Q3 2021

Changing sources of logistics demand

Logistics space demand has shifted from manufacturing and trade to retail consumption. This is a result of a combination of changing demographics and e-commerce.²

Millennials and Generation Z, the digital native generations, have entered prime consumption ages. Continued growth of urban populations has also been a catalyst for higher consumption and e-commerce adoption. As households move from rural to urban areas, their income levels and consumption expenditures rise. Moreover, they gain greater access to digital resources.

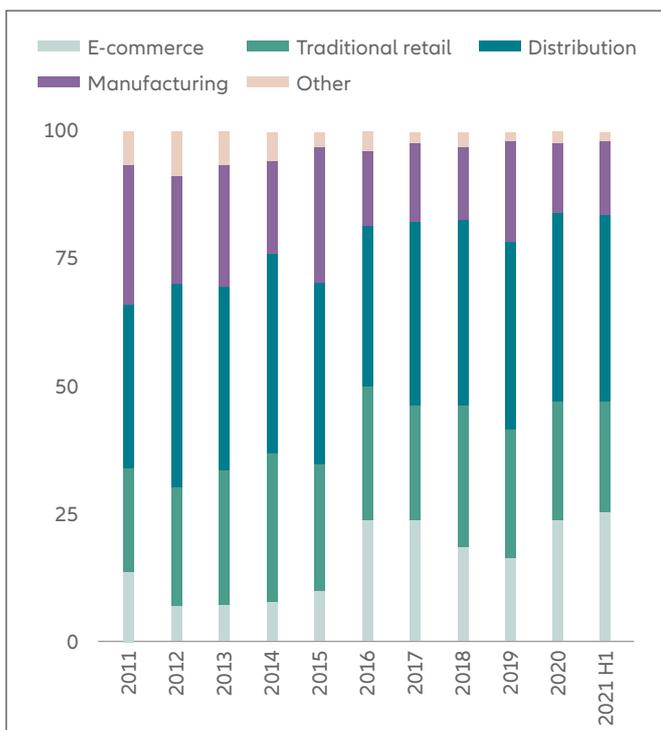
The rise of e-commerce has required more complex global supply chains. Logistics now has more diverse space requirements than before. New necessities include e-

fulfillment centers and parcel hubs, as well as sorting and delivery centers of varied sizes and locations. Alongside increased sophistication, logistics space requirements have also risen. Facilities must be able to handle a greater product variety, easy returns, higher sales volatility and lower space efficiency of parcel shipping.

The prominence of retail is evident in Europe leasing figures. The share of retail take-up (as an aggregate of traditional retailers and e-commerce) has risen significantly since 2016 and makes up around half of overall logistics demand (figure 3). The pandemic has proved this relationship even stronger. Despite significant downturn in industrial production and international trade, logistics take-up in Europe increased concurrently with the fast rebound of retail sales driven by lockdowns and pent-up demand (figure 4).

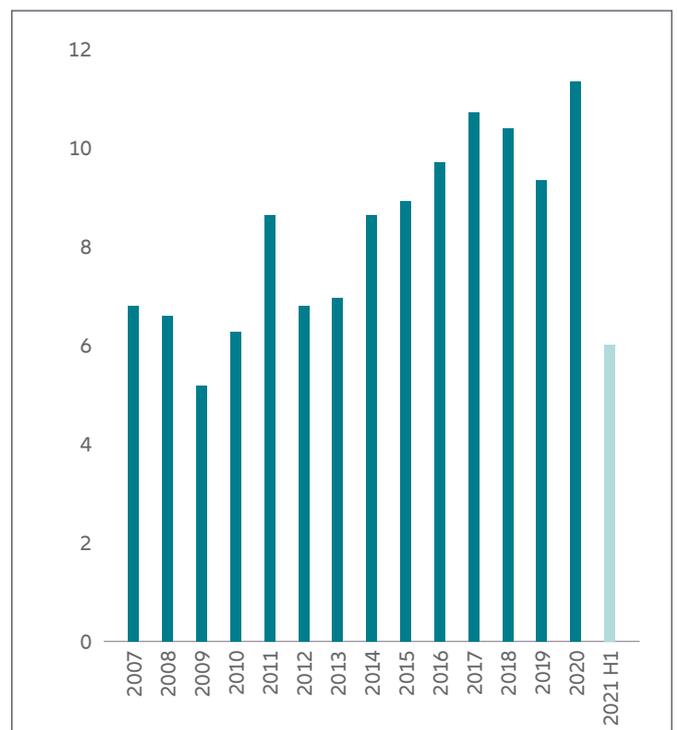
² Prologis finds higher correlation between retail sales and logistics demand in U.S. (net absorption) than do traditional sectors

Figure 3. Europe logistics take-up by tenant type



Source: PMA, 2021

Figure 4. Europe logistics take-up* (m sqm)



Source: PMA, 2021
*Aggregate of 26 city markets

Acceleration of e-commerce

Covid-19 hastened 10 years' e-commerce adoption into just a few months.³ Global e-commerce sales by the end of 2020 reached USD 2.4 trillion, marking a 140% increase in five years whilst global online penetration rose from 8% in 2015 to 18% in 2020.⁴

Even though some of the boost is expected to be transitory, changes in consumer preferences will be lasting. The pandemic marked a tipping point in Europe e-commerce adoption (14%) which has typically lagged U.S. (c.20%) and Asia Pacific (South Korea >35%; China >25%).⁵

Lockdowns expanded online penetration of new product categories, such as online groceries and home improvement products. The pandemic also forced adoption by older age cohorts: 70% of 'Baby Boomers' who bought groceries online in France from mid-March to mid-April 2020 were first-time buyers.⁶

Across Europe, divergent e-commerce penetration offers many different opportunities (figure 5). Nowhere is close to full e-commerce penetration, and so everywhere will need more logistics space. CBRE estimates that online spending in Europe will require 20.17 million sqm of additional space by 2025.⁷ For comparison, global e-commerce is forecast to need an extra 138 million sqm to satisfy annual e-commerce sales of USD 3.9 trillion. Countries with lagging penetration will grow faster going forward. Early adopters such as the UK and the Netherlands will be more prepared to adopt innovative solutions such as instant grocery delivery.

³ McKinsey, *How COVID-19 is changing consumer behavior – now and forever*, 2021

⁴ CBRE, *Global E-commerce Outlook 2021*, 2021

⁵ Europe refers to simple average of nine countries covered by CBRE forecasts

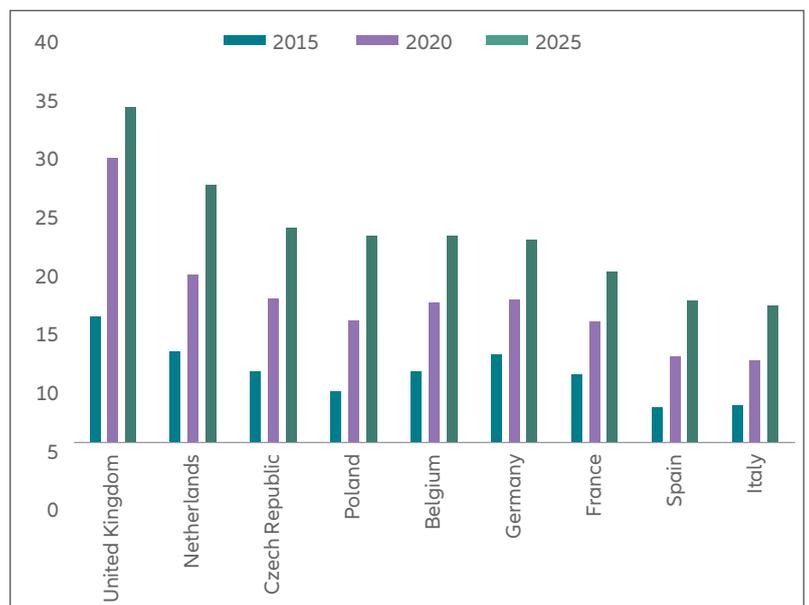
⁶ Statista, *E-commerce and corona: first-time online buyers France 2020, 2021* (<https://www.statista.com/statistics/1111384/online-grocery-shopping-coronavirus-generations-population-france/>)

⁷ Estimate for ten major European markets CBRE tracks. CBRE forecasts USD 1bn incremental e-commerce sales to create 92,903 sqm of additional logistics space



Credit: VGP

Figure 5. Europe e-commerce penetration



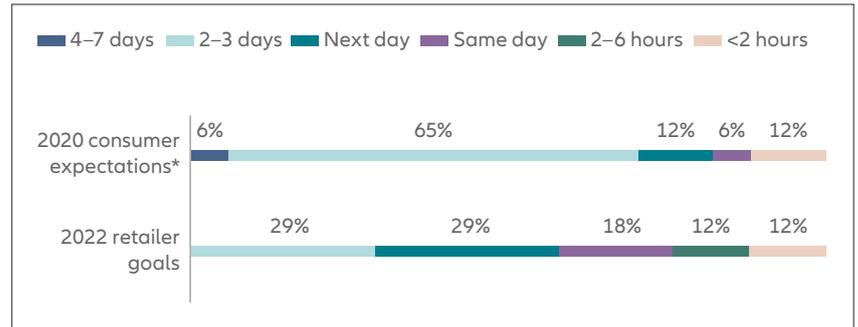
Source: CBRE, 2021

Increased importance of urban locations

Demand for urban logistics space will rise as delivery times continue to compress. Fast and reliable delivery provides a significant competitive advantage to retailers.⁸

A survey published in March 2021 shows that retailers have ambitious delivery targets for the near future exceeding what consumers are currently asking for (figure 6). Improvements in delivery speed will require significant supply chain investment towards end-consumers.

Figure 6. Delivery speed: consumer expectations and retailer goals



Source: McKinsey, *Retail speaks. Seven imperatives for the industry*, 2021
 *Figures may not sum to 100%, because of rounding

⁸ PWC consumer survey published in June 2021 finds fast and reliable delivery ranked as the most important attribute of online shopping globally (41% of respondents)



Credit: AEW / Mateja Lux

Amazon as a catalyst

Amazon’s rapid delivery standards have changed consumer expectations. From 2000 to 2015, the company’s free-delivery time declined from more than eight days to around two days.⁹

Amazon offers fast shipping as a product by itself. Amazon Prime reached 200 million members globally in 2020, double the customer base it had in 2017. The service has continually improved, now offering One-Day, Same-Day and even two-hour delivery on groceries in some locations. Excellent delivery times are matched by wide geographical reach. For example, in Germany in 2020, Amazon was offering same-day delivery in the 20 largest cities. By comparison, an average large retailer covers only two.¹⁰

⁹ McKinsey, *Retail optimization*, 2020

¹⁰ McKinsey, *Retail optimization*, 2020

Amazon maintains and enhances its competitiveness via investment into dense logistics networks. These require specialized warehouses and high emphasis on last-mile logistics. Figures 7 and 8 highlight how large fulfillment centers are supported by many smaller facilities in more urban locations.

Figure 7. Amazon Fulfillment Centers



Figure 8. Amazon Sortation Centers, Delivery Stations and Prime Now Hubs



Source: MWPVL International (Retrieved 29 November 2021 from www.mwpvl.com/html/amazon_maps.html)

A societal focus on sustainability and new technologies will reinforce the trend towards urban logistics. An MIT study found that adding an urban fulfillment center cut transportation emissions in half compared to out-of-town distribution.¹¹ Moreover, cities offer wider opportunities for the use of electric vehicles, autonomous vehicles, drones and green delivery options such as bike couriers.

¹¹ MIT Real Estate Innovation Lab, *Retail Carbon Footprints: Measuring Impacts from Real Estate and Technology*, 2020

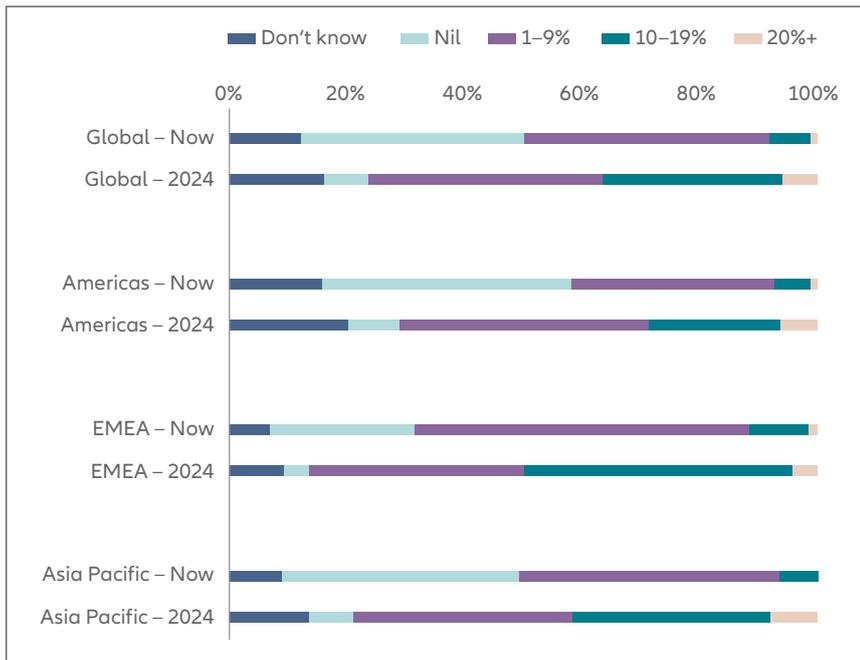
Dense European cities have scarce available land and many zoning restrictions, and so will require innovative approaches to logistics. There are a few viable solutions to accommodate more industrial space within densely populated cities. Multi-storey warehousing, already used in Asia, may become more popular in Europe if the necessity for last-mile facilities and land values remain high enough. New vertical last-mile logistics hubs include G Park London Docklands and Paris Air2 Logistique. Alternatively, mixed-use buildings with logistics included may provide a compromise that opens up new locations.

Focus on ESG performance

Strong demand for ESG performance will lead to green building rental premiums. This is especially true in Europe: the region has stringent regulations, higher consumer sensitivity and ambitious corporate sustainability targets. 76% of logistics experts in Europe identify a ‘focus on environmental solutions’ as a significant supply chain trend. This compares to 51% in the Americas and 59% in Asia Pacific.¹² In Europe, 56% of experts see a 1-9% rent premium for green buildings now with a significant expansion by 2024. Europe’s eco-friendly warehouses are setting new standards from design to construction and operations. Many new developments are designed to be

¹² JLL, *The Future of Global Logistics Real Estate*, 2021

Figure 9. How much of a rental premium for green warehouses?



Source: JLL, *The Future of Global Logistics Real Estate*, 2021

carbon neutral with renewable energy sources such as solar panels and onsite wind turbines. Further innovative solutions include using rainwater to irrigate green spaces and clean interiors are also being tested.

Future-proofing assets with regards to ESG will require a holistic approach. Other parts of the supply chain will have to be transformed to make them more sustainable. For example, delivery vehicles are expected to electrify rapidly as more low-emissions zones are introduced in Europe. Similarly, there are efforts to decarbonize freight transport by using hydrogen as a fuel. In Germany, the government is supporting a company called Clean Logistics that converts heavy diesel trucks to hybrid hydrogen power. Warehouses will need to accommodate new requirements that come with these changes. For example, charging points for electric vehicles or easy access to hydrogen filling stations could become essential.

Shifting needs in supply chains

Covid-19 disruption has demonstrated the vulnerabilities of global supply chains. The automobile sector alone is forecast to lose USD 210 billion of revenues due to semiconductor shortages.¹³ A McKinsey study has shown there have been more frequent and severe supply shocks in recent years: disruptions lasting a month or more now occur every 3.7 years on average. As a result, companies may lose more than 40% of a year's profits every decade.¹⁴

¹³ AlixPartners, *Shortages related to semiconductors to cost the auto industry \$210 billion in revenues this year, says new AlixPartners forecast*, 23 September 2021 (<https://www.alixpartners.com/media-center/press-releases/press-release-shortages-related-to-semiconductors-to-cost-the-auto-industry-210-billion-in-revenues-this-year-says-new-alixpartners-forecast/>)

¹⁴ McKinsey, *Risk, resilience, and rebalancing in global value chains*, 2020

Companies are expected to improve resilience by increasing inventories and re-shoring/near-shoring. In Europe, Green Street estimates a modest change away from Just-in-Time would require 5-10% more industrial space.¹⁵ Some early examples of supply chain diversification are evident in semiconductor manufacturing in Europe. If there is an increase in re-shoring/near-shoring, Central and Eastern European countries will benefit significantly. This trend could extend wider in Europe if automation accelerates; this would mitigate the challenges of higher wages and tight labor supply.

¹⁵ Green Street, *Industrial: Supply Chain Disruption Beneficiary*, 18 November 2021



Credit: PicMyPlace

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