Shot in the arm for industrial

COVID-19 hit the global economy hard in 2020 with real estate not immune. But certain sectors such as industrial have been resilient and even benefited during and coming out of this downswing.

Importantly, the health pandemic has accelerated trends that were already well established in the pre-COVID environment.

For industrial, the adjustment in online spending which was taking place in the pre-COVID environment has been brought forward given consumers have been forced to adjust their spending habits almost overnight.

Online sales have also been boosted by increased working from home (easier to buy goods online and receive deliveries at home), strong detached housing markets (which typically boosts spending via wealth impacts and desire to renovate an appreciating asset) and a shift away from services consumption, at least temporarily.

We expect some of these shifts to unwind as economies continue to open but that overall sales are likely to grow over the medium term given the ease and convenience of online shopping.

For example, Green Street is currently projecting that US online sales will grow to 30% of total sales by 2030 from around 15% in 2020.

Demographics drivers also at play

We see solid online sales projections as related to demographics and in particular the bulge in the millennials population in key developed markets over the past decade.

As this tech-savvy group (currently aged between 26-40 years) progresses with their careers and moves into larger living spaces to start families and accommodate remote working trends, online sales are expected to rise at a stronger pace than overall spending.

The boost to online sales is underpinning demand for large distribution centres and smaller infill facilities across markets.

Many occupiers are responding to the shift in consumer preferences by expanding their overall requirements and moving into modern facilities to improve their supply chains and delivery times to consumers.

Large distribution centres have continued to be in strong demand from large global operators and investors.

At the same time, demand for last mile facilities has been accelerated by COVID-19 disruptions due to requirements for getting goods quickly to consumers, including food and other essentials.

Global economic momentum

The cyclical recovery in global trade and manufacturing is adding to industrial demand, particularly in and around major ports and transport hubs.

The sector may also benefit from rising inventories if retailers and wholesalers replenish stocks and shift from 'just-in-time' inventory management to a 'just-in-case' approach.

Medium term increased re-shoring or near-shoring of production may provide further demand as importers and governments look to shore up their supply chains.

Accelerating capital shifts

Globally, we continue to see cross border capital shifting into the industrial sector (alongside residential) at the expense of retail with COVID-19 accelerating the shift (Chart 1).

Investment appetite for the sector remains significant given the headwinds facing other traditional sectors such as retail and secondary office exposure given working from home shifts.

As with leasing activity, a volatile macroeconomic backdrop and pandemic were not enough to deter investment activity. Globally, transaction activity totalled US$169 billion for 2020 just -1% below prior year levels. This compares to a fall of -25% in aggregate across all other sectors.

Transactions have remained strong this year as investors look to increase their exposure to the sector with investment volumes in the year to May marginally higher than the same period of 2020.

Paying for growth

Over the past decade, the industrial sector has developed into a fully-fledged core asset class.

Pricing has rerated accordingly with cap rates below CBD offices in certain markets, such as the US and UK, which we believe reflects solid fundamentals and rental growth potential relative to other sectors.

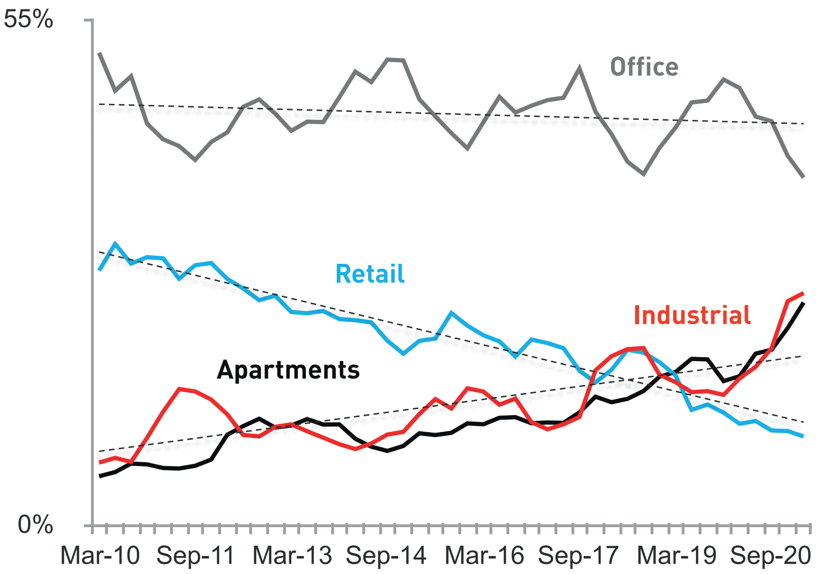
Early movers in the sector are generally comfortable with their existing industrial portfolios and are either looking to take more risk via development or partnering with their existing operator partners.

Others that have long being focused on core office and retail strategies have a lower exposure to industrial and, alongside those with core-only strategies, may be looking to increase their exposure.

We believe demand for industrial exposure is likely to remain strong over the medium-term supporting development activity and exit strategies.

Chart 1: Global cross border transactional activity*

Annual % of total by sector



Source: RCA, as at June 2021. *excluding development sites

Macquarie Asset Management's Real Estate Business

Our real estate investments have long been focused on sectors such as industrial which we believe have been supported through cycles by structural tailwinds such as demographics, urbanisation, and technology.

We have based our investments on these thematics for the best part of a decade now, including by partnering with strong logistics management teams and developing businesses to take advantage of these trends.

In the US, we continues to grow our logistics platform, Logistics Property Co (LPC), which is focused on investing in high quality, modern logistics development opportunities in major industrial markets across North America.

'Traditional industrial demand drivers such as GDP remain positive and have been boosted by structural changes such as e-commerce penetration rates, supply chain reconfiguration, onshoring, and inventory management resulting in a strong rental growth outlook' according to Eric Wurtzebach, Americas Head of Real Estate.

Other investments in the Americas region include establishing one of the largest portfolios of industrial real estate in Mexico.

'We continue to target acquisitions of prime industrial properties and selective developments located in key distribution markets and manufacturing hubs across Mexico to cater for growing local online demand and increased re-shoring of production as US importers look to diversify their supply chains' says FIBRA Macquarie México's CEO Juan Monroy.

In Europe, investments continue to be focused on both develop-to-core strategies and income strategies, including via our UK development platform PLP.

'The last mile facilities subsector has begun to be better differentiated from bulk storage, in both design and rental pricing, as supply chains continue adapting to a new model to accommodate e-commerce growth' according to Dana Gibson, co-head of real estate in Europe.

MACQUARIE