The Opportunity in European Logistics

LOGISTICS LEANS IN

August 2021
Vanessa Muscarà
Head of Research & Strategy
LOGISTICS LEANS IN

OPPORTUNITIES FOR THE CHANGING LANDSCAPE OF EUROPEAN WAREHOUSING

- Covid-19 impact: shifting drivers away from GDP to online retail sales and lack of ‘modern’ stock
- Successful assets to comprise technologies that optimize supply chains and enhance wellbeing
- Logistics retains defensive characteristics; healthy demand and tenants that generally pay on time
- Opportunities exist across the risk spectrum e.g. reposition obsolete stock to sell to core investors

Econometric models have traditionally employed macro-economic variables, namely GDP, to forecast logistics performance. In 2020, accelerated online sales highlighted the already rising ‘disconnect’ between logistics market trends and economic growth, with European take up levels reaching record high volumes (+11 million sqm), whilst GDP in select European economies reached up to double-digit negative figures\(^1\). This growing negative correlation suggests it is time to search beyond GDP for factors impacting future logistics performance (see figure 1).

**Figure 1: Index of logistics take up vs EU GDP (Index 2007 = 100)**

![Graph showing the index of logistics take up vs EU GDP from 2007 to 2020](image)

Source: PMA Q1 2021, Europa Capital Q2 2021

The virus outbreak in 2020 highlighted the importance of supply chain resilience, prompting calls for holding more inventory or reshoring production. But thanks to technology, market players are enhancing the productivity and use of logistics facilities, which in turn is impacting the design of industrial buildings. Going forward, more profound changes are expected in the European logistics sector including ESG policies to optimize energy usage and the adoption of WELL certifications to attract and retain talent\(^2\).

This study reviews the evolving meaning of ‘modern’ logistics stock, away from standard ‘sheds’ to highly specified automated assets. In particular, the study reviews the implications of these evolving trends on core and value add investment strategies.

The study concludes that compared to other commercial sectors, logistics properties are likely to retain the classic characteristics that institutional investors consistently pursue; healthy demand from occupiers that sign

---

\(^1\) Source: PMA Q2 2021  
\(^2\) Founded in 2013, WELL is the leading certification for advancing health and well-being in buildings globally
relatively longer leases, in turn underpinning steady cash flows. In addition, the pandemic has highlighted the opportunity to upgrade stock by implementing supply chain efficiencies through better data analytics as well as environments that focus on people’s health and wellbeing.

DEMAND

The acceleration of ecommerce

Select global regions are expected to reach online penetration rates above 30% by 2025 (see figure 2), suggesting that demand for logistics assets will continue to reach new record levels over the forecast horizon. This notion is further supported by Prologis’ estimate that every 1% of additional online sales in the US will require an additional two million sqm of logistics space, largely due to online retailers offering more product variety and needing more stock buffers. A similar exercise applied to major Eurozone markets shows that the majority of logistics space will be required in Germany (+10 million sqm) followed by the UK over the next decade (+8 million sqm), in line with forecast online penetration rates.

Figure 2: Online spending, select global regions (% total retail sales)

In the next section, we review the characteristics of new stock at a time when technology advancements and certifications are shaping the design of industrial buildings.

SUPPLY

Logistics - the shed gets a makeover

Today, ‘modern’ logistics real estate of the type typically held by institutions, is broadly comprised of two main groups: regional logistics warehouses above 10,000sqm and urban last-mile assets below 10,000sqm. The purpose of both is to keep goods in motion; the former between regions and the latter from the edge of cities directly to the consumer. The destination of goods determines an asset’s location and occupier type, namely logistics operators or distributors of manufacturers, online or omni-channel retailers among others. But with

---

3 Source: “Accelerated retail evolution could bolster demand for well-located logistics space”, Prologis June 2020
4 Source: “Higher online share to boost logistics demand by 15%” Capital Economics, November 2020
online retail sales in 2020 accelerating up to three years ahead of schedule, landlords will need to provide more automation to achieve scalability, precision, and efficiency to handle the growing volume of product demanded through ecommerce.

In North America, market players are already seeking ways to improve efficiencies in the supply chain. In 2018, Prologis opened a ‘Lab’ in San Francisco (a 13,000 sqft warehouse), to experiment with Internet of Things systems, loading and sorting equipment, warehousing optimization tools and more. More recently a smaller ‘Lab’ was opened in Amsterdam focusing on creating ‘digital twins’ to track the movement of goods and Building Information Models of existing facilities.5

In summary, logistics assets were previously considered standard boxes with little variation between building specifications. Going forward, ‘modern’ stock with automated components will be far more bespoke.

**Net zero carbon logistics**

There is a growing industry consensus that sustainable practices are not a trend, but a responsibility. As we prepare for the transition to Net Zero Carbon (NZC) by 2050, logistics assets do not set out to perform well, having generated meaningful ‘embodied’ carbon at the construction phase through the erection of their steel frames.6 Moreover, modern assets with automated components also need higher power supply, further contributing to emissions throughout the operating lifecycle.

Carbon offsetting solutions include achieving certification such as BREEAM which has made a name for itself in logistics, not only due to being internationally recognized, but also because it puts a strong emphasis on green infrastructure surrounding buildings. Emissions can also be partly offset by integrating renewable energy sources, such as solar panels on roofs to create electric grids, which lowers total occupation costs.

**Health & wellbeing**

Perhaps the most radical aspect of innovation efforts in the logistics sector is the growing number of assets adhering to WELL standards (up to 26% of logistics completions since 2018 in the Netherlands).7 The WELL Building Standard is a performance-based system to measure, certify and monitor features of the built environment that impact human health and well-being, including air, water, nourishment, light, fitness, comfort, and mind.

The standard is usually associated with office buildings, where it is used to attract tenants with highly paid “knowledge workers”. The adaption of WELL in logistics properties highlights the difficulty in attracting and retaining warehouse employees.

**WHERE ARE THE INVESTMENT OPPORTUNITIES?**

**Core strategies**

Evidence from the UK suggests that lease lengths are shortening across all traditional real estate sectors except in the case of purpose-built logistics stock. For example, an MSCI study released earlier this year highlighted that some 60% of rental income in the UK Quarterly Property Index is currently tied to leases that either expire or have a break clause in the next five years. Similarly, among high street units and shopping centers, average lease

---

5 A digital twin is a virtual representation of a real-time digital counterpart of a physical object or process

6 Net Zero Carbon is when carbon emitted as a result of all activities associated with development, ownership and servicing of a building are zero or negative. Source: Better Building Partnership, Net Zero Carbon Framework, May 2021

7 Source: PMA, WELL Project Directory 2021
lengths in 2020 continued to drop to record lows; 5.8 years, down from 6.8 years in 2018\(^8\). That’s not to say that this trend spells the end of retail and office steady cash flows. Instead, income streams will more likely be linked to a landlord’s ability to look forward and imagine how these spaces can be used differently.

Conversely, core investors seeking secure income today, can find comfort in the typical lease lengths signed by European logistics operators, particularly new purpose-built stock (see figure 3). Research indicates that the UK leads the ranking (13 years), followed by Finland (12 years), Poland, Sweden and Germany (10 years).

**Figure 3: European purpose-built logistics lease lengths (years)**

![Figure 3: European purpose-built logistics lease lengths (years)](image)

Source: Savills Q1 2020

Lastly, logistics net operating income was impacted relatively less throughout the pandemic with occupier’s ability to pay rent never falling below 90% unlike other sectors (see figure 4).

**Figure 4: Rent collection since start of the pandemic by sector**

![Figure 4: Rent collection since start of the pandemic by sector](image)

Source: INREV Covid-19 Sentiment Survey 2021

This evidence further reinforces the long-term defensive characteristics of the logistics sector versus All Property, with annualized returns over the last 20 years driven by income (5.7%) rather than capital growth (2.0%) (See figure 5).

\(^8\) Source: Savills Q4 2020
Figure 5: Total returns (%): European All Property vs Logistics (20 years annualised)

<table>
<thead>
<tr>
<th></th>
<th>Total Return (%)</th>
<th>Capital growth (%)</th>
<th>Distributed income</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Property</td>
<td>5.3</td>
<td>1.6</td>
<td>3.7</td>
</tr>
<tr>
<td>Logistics</td>
<td>7.7</td>
<td>2.0</td>
<td>5.7</td>
</tr>
</tbody>
</table>

Source: INREV 2021

Looking ahead, structural headwinds in the retail and office sectors mean that rental growth prospects are poor outside of the logistics sector. The logistics sector is therefore more likely to provide both defensive and outperforming qualities to core portfolios.

**Value Add strategies**

The supply response of the logistics sector is often considered a downside risk given the simple and fast construction cycles and low upfront investment. However, when comparing forecast online sales versus modern stock per capita in the US versus European regions, the provision of net new modern stock is justified (see figure 6).

Indeed at 2.5 sqm per household, modern logistics stock in the US is more than double the provision in select major European economies albeit projected online penetration rates in the US are far lower than in the EU or the UK (see figure 2), suggesting there is ample scope to meet the supply gap.

**Figure 6: Modern logistics stock per capita**

Source: Prologis 2021

And while evidence of rising construction material inflation in select European markets will likely chip away at the profitability of development in the short term, this is most likely to have been driven by the restarting of delayed office projects in 2020⁹. Beyond 2021, structural factors impacting office and retail demand, is likely to leave few sectors outside of logistics that will be driving commercial construction.

---

⁹ In the UK, construction output prices reached 2.2% y-o-y in Q1 2020, up from a record low of -0.3% in 2020. Source: ONS
Addressing human needs

The total logistics workforce in the European Union is 3.3 million and an average European facility employs over 100 people per 10,000 sqm of floor space\(^\text{10}\). Nevertheless, the difficulty in attracting and retaining talent is highlighted in CBRE’s European logistics occupier survey (see figure 7).

In 2019, Prologis developed ‘Four Tactics’ to support logistics real estate owners to attract, train, and retain labour, including improving the work environment, much like office environments. As discussed earlier, WELL certifications go some way into achieving this objective with one project in France currently experimenting with providing childcare services\(^\text{11}\).

**Figure 7: Which of the following external factors represent the three greatest challenges for your company’s future operations?**

<table>
<thead>
<tr>
<th>Factor</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost escalation</td>
<td>40.0%</td>
</tr>
<tr>
<td>Labour shortages</td>
<td>35.0%</td>
</tr>
<tr>
<td>Covid-19</td>
<td>30.0%</td>
</tr>
<tr>
<td>Economic uncertainty / Currency fluctuations</td>
<td>25.0%</td>
</tr>
<tr>
<td>Changing or softening consumer demand</td>
<td>20.0%</td>
</tr>
<tr>
<td>Tighter regulation or legislation</td>
<td>15.0%</td>
</tr>
<tr>
<td>Competition from ecommerce retail platforms</td>
<td>10.0%</td>
</tr>
<tr>
<td>Competition from emerging markets</td>
<td>5.0%</td>
</tr>
<tr>
<td>Fuel prices / Transport costs</td>
<td>0.0%</td>
</tr>
<tr>
<td>Environmental concerns</td>
<td>0.0%</td>
</tr>
<tr>
<td>Geopolitical issues</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

Source: European Logistics Occupier Survey, CBRE Q1 2021

**ESG Strategies – carrot or stick?**

Environmental concerns among logistics occupiers currently play a limited role in driving decision-making (see figure 7). A more recent global survey however, exposed a further nuance to the argument, highlighting that 40% of European occupiers consider energy efficiency solutions offering cost savings would escalate their sustainability agenda\(^\text{12}\).

Among investors, the requirement to comply with government-imposed standards such as NZC is likely to encourage a significant increase in compliance-led portfolio exposures. While the goal is not mandatory until 2050, many leading institutional investors, REITs and fund managers have committed to earlier targets\(^\text{13}\).

---

\(^\text{10}\) Source: Eurostat, Prologis Research. Total reflects NACE sector "warehousing and support activities for transportation"  
\(^\text{12}\) “The future of global logistics real estate – Demand, decarbonization, digitization, design”. A survey conducted in April 2021, comprising 720 logistics experts in 43 global countries. Source: JLL  
\(^\text{13}\) 87 Global Asset Managers (with $37 trillion of assets) have signed up to the Net Zero Asset Managers Initiative and, in the UK, 37 fund managers are BBP Climate Commitment Signatories.
Overall, we view this as a value-add opportunity to retrofit existing assets with carbon offsetting solutions such as solar panels or green certifications to create NZC products that appeal to institutions.

CONCLUSION

The systemic shock brought about by Covid-19 has resulted in a weakening relationship of future logistics trends to the health of the economy. Going forward, the performance of the sector is expected to be more driven by tenant solutions that enhance supply chain resilience to meet sudden surges in demand, as was the case in 2020. Moreover, the shortening of lease lengths across traditional real estate sectors, further supports the view that landlords can no longer afford to take on a passive management role. In the case of the logistics sector, value creation is no longer just about the location of an asset, but also about the landlord’s ability to provide a comprehensive solution to ‘customers’.

Looking ahead, automation, energy efficiency solutions and wellbeing certifications are likely to impact the asset’s income in terms of rental tone and lifecycle duration. Thus, we see this as an opportunity for value-add investors to repurpose obsolete stock with solutions that include access to technologies, access to a network of different locations and help with attracting and retaining employers. Once stabilized, core investors can expect to benefit from income streams underpinned by relatively longer leases compared to those traditionally seen in the office and retail sectors.

-----------------------------------------------------------------------------------------------------------------------------

CASE STUDY

Project Axis: Dutch and German Logistics Portfolio

In July 2021, Europa Capital completed the sale of a Dutch and German portfolio of urban logistics and warehouse assets to Strategic Industrial Real Estate, Arrow Capital Partners’ platform backed by Cerberus.

The 38-asset portfolio, is concentrated in key logistics and urban markets along major transport corridors in The Netherlands and Germany. In total, it provides c.360,000 sqm of accommodation, and is let to a diverse range of e-commerce and 3PL occupiers including Lekkerland, Deutsche Post Immobilien (DHL), Dutch Organic International Trade B.V., Fahrrad XXL Feld GmbH, CWS boco Deutschland GmbH.

The assets, which have been amassed since August 2018 were originally acquired by Europa Capital on a transaction by transaction basis on behalf of three different value add investment strategies covering urban logistics in Germany and The Netherlands and warehousing in Germany. The strategies were based on the premise of improving the occupancy and rental profile by letting vacant space and restructuring or extending leases.
This landmark sale represents one of the largest ever for Europa Capital and is the culmination of three successful investment strategies and multiple asset purchases. It also demonstrates Europa Capital’s track record of identifying and aggregating good quality assets in structurally supported sectors before crystallising strong returns on behalf of our investors through disposal.

Vanessa Muscarà | Head of Research & Strategy

Vanessa joined Europa Capital as Head of Research & Strategy in September 2020. She is responsible for providing expert guidance to support Europa’s tactical and strategic business support needs. Before joining Europa Capital, Vanessa held research roles at M&G Real Estate & LaSalle Investment Management. She received an MSc in Property Development & Planning from University College London and an MEng in European Civil Engineering from the University of Warwick. Vanessa demonstrates commitment to the research community in her roles as Past Chair of the Society of Property Researchers (SPR) and member of the Urban Land Institute (ULI) Smart Urban Growth group, Urban Regeneration Council, Women Leadership Initiative and Europe Awards for Excellence jury.
Important Information

The preliminary information presented herein is provided for discussion purposes only and is being furnished on a confidential basis by Europa Capital Partners LLP (authorised and regulated by the Financial Conduct Authority (“FCA”), registration number 518295) (this entity and its affiliates being, “Europa Capital”), to a limited number of sophisticated investors. This document should not be treated as constituting a financial promotion for the purposes of the FCA’s Handbook of rules and guidance.

This document is confidential and may not be copied or distributed by the recipient (except to the recipient’s professional advisers who must be informed of, and agree to, its confidentiality) without the prior written permission of Europa Capital. The recipient and its professional advisers, by accepting delivery of this document, agree to keep confidential all matters contained herein and to return this document promptly upon request.

The information contained herein may not be relied on in any manner as legal, tax or investment advice. This document should not be treated as constituting an inducement of representation in connection with any offer or invitation, nor shall it, or any part of it, form the basis of, or be relied upon in any way in connection with, any contract relating to any Europa Capital managed investment fund, managed account or other similar vehicle sponsored by Europa Capital.

Information in this document has been derived from sources that have not been independently verified and no representation is made that such information is accurate or complete. Except where otherwise indicated herein, the information provided herein is based on matters as they exist as of the date of preparation and not as of any future date, and will not be updated or otherwise revised to reflect information that subsequently becomes available.

This document may also contain projections with respect to general economic conditions. They have been prepared based on Europa Capital’s current view in relation to future events and various estimations and assumptions made by Europa Capital, including estimations and assumptions about events that have not yet occurred, any of which may prove to be incorrect. While the projections are based on assumptions that Europa Capital believes are reasonable under the circumstances, they are subject to uncertainties, changes (including changes in economic, operational, political and legal circumstances) and other risks, all of which are beyond Europa Capital’s control. No reliance should be placed on the information or opinions contained in this document or their accuracy or completeness. No representative, warranty or undertaking, express or implied, is given as to the accuracy or completeness of the information or opinions contained in this document by Europa Capital or by their respective directors, officers, partners, members, shareholders, employees, affiliates or agents and no liability is accepted by any of the foregoing for the accuracy or completeness of any such information or opinions.

This document is intended only for and will be distributed only to persons resident in jurisdictions where such distribution or availability would not be contrary to applicable laws or regulations.

This document is being communicated in the UK by Europa Capital LLP, which is authorised and regulated by the FCA, only to persons who (i) fall within Article 14 (“Investment Professionals”) of the UK Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (as amended) (the “CIS Order”), (ii) fall within Article 22 (“High net worth companies, unincorporated associations etc.”) of the CIS Order, (iii) fall within one or more of the categories of persons referred to in COBS 4.12 of the FCA’s Handbook of rules and guidance, or (iv) are persons to whom this communication may otherwise be lawfully communicated (the persons referred to in (i) – (iv) being referred to collectively as “Relevant Persons”). This document must not be acted on or relied on by persons who are not Relevant Persons.

Past, targeted or projected performance is no indication of future performance. In addition, any forward looking assumptions contained in this document are subject to known and unknown risks and uncertainties which may cause actual results to be materially different from those contemplated by such assumptions. This document may also contain projections with respect to general economic conditions. They have been prepared based on Europa Capital’s current view in relation to future events and various estimations and assumptions made by Europa Capital, including estimations and assumptions about events that have not yet occurred, any of which may prove to be incorrect.

The investment opportunity and securities described herein have not been approved by any securities regulatory authority of any state or by the US Securities and Exchange Commission, nor has any such authority or commission passed on the accuracy or adequacy of this document. Any representation to the contrary is unlawful. This document does not constitute an offer to sell securities or the solicitation of an offer to purchase securities. All offers and sales of interests in the investment opportunity in the US will be made exclusively by means of a confidential private placement memorandum and shall be conducted through MEC Global Partners LLC, 28 State Street, 10th Floor, Boston, MA 02109; member FINRA/SIPC.