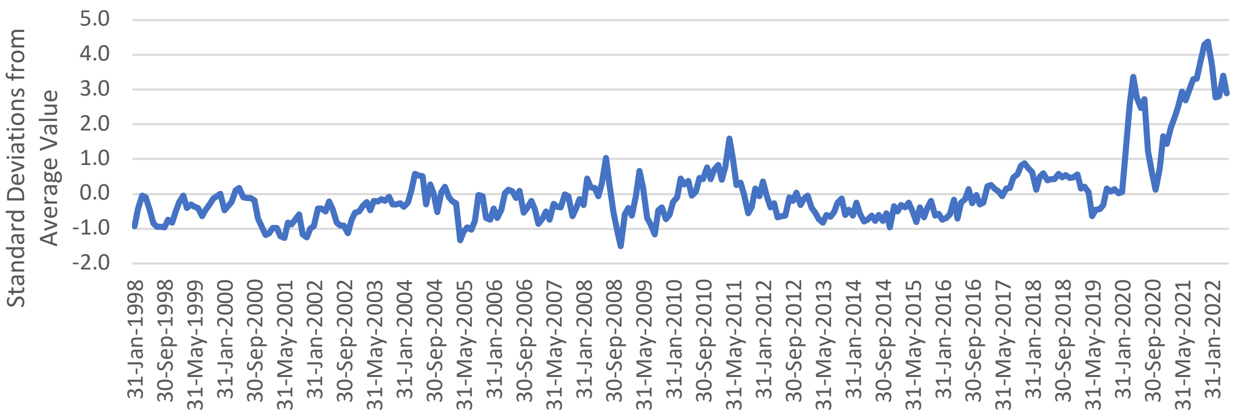
Investment to help solve the problem of our time: building resilient supply chains

The best investment theses for real estate are almost always underpinned by their relevance to solving the greatest social and economic problems of the day. Among the most pressing of issues currently is the rebuilding and reconfiguring of global supply chains and better ensuring their future resilience. The provision of logistics real estate is a part of the solving of this problem – but likely not just any logistics real estate assets will be fit for purpose. Rather, the solution lies with the delivery of state-of-the-art stock with the highest ESG credentials, in the best submarkets and allowing for the most efficient distribution of goods. They must be highly responsive to occupier needs.

Figure 1: Global Supply Chain Pressure Index



Source: Federal Reserve Bank of New York, Global Supply Chain Pressure Index https://www.newyorkfed.org/research/gscpi.html accessed 7 June 2022 data as of May 2022

Early in the pandemic we made a case for modern logistics based not only on its long-term structural drivers but also the acute and urgent need of these facilities to accommodate a massively expanded E-commerce capability given the urgency of home delivery of goods to maximise social distancing policies. Indeed, what followed through 2020 and 2021 was a considerable acceleration of E-Commerce volumes globally and this boosted absorption and substantially pushed up the rental and capital values of logistics assets.

Notwithstanding the "re-opening" of many societies from lockdowns and various restrictions in the past several months as vaccination rates increased and new variants proved to be relatively less deadly, E-Commerce is here to stay. Although we anticipate a relative deceleration in the rate of E-Commerce growth in the next few years, this is still positive growth and furthermore comes off a much expanded base and this will continue to support occupational demand in the sector. The latest forecasts from Euromonitor (May 2022) expect E-Commerce penetration ratios this year to have reached over 40% in South Korea and just over 30% in China: both are world leaders on this indicator. CBRE forecasts U.S. online sales will grow by $330 billion between 2020 to 2025, based on the same data. This would see e-commerce penetration reach 26% of all U.S. retail sales from ~20% today.

At this point in time, the more important driver of logistics demand may well be the building or reconfiguring of more resilient supply chains. Clearly the "just-in-time" model of supply-chain management has had its heyday and too many frictions have made the quick and nimble production, assembly and distribution of goods susceptible to disruption. Ominous signs of disruption have been emerging for several years: trade wars and other geo-political conflicts have been heightened rather than lessened in the past decade while climate change and its related weather volatility and intensity of storms is also increasingly challenging this model. The ship stuck in the Suez Canal – one of the world's busiest trading routes – for six days last year which backed up shipping being but one reminder how a combination of bad weather (in that case a sandstorm) and potentially human error as well, can snarl shipping so suddenly and dramatically. Demographic challenges and especially the shortage of skilled workers in fulfillment centers or driving trucks have also arisen in major labor markets.

The pandemic itself also challenged supply chains, and especially the scale and scope of the 'post-pandemic' reopening of many economies and this has contributed to high headline inflation as well as frustrated consumers. For most of 2022 thus far, this has coincided with two other events which have acted to stress even further, our global supply chains. The Russian invasion of Ukraine has sent global energy and fuel prices to much higher levels and whereas transport and fuel costs were deflationary in most economies in much of 2020, they have currently reversed course and have pushed inflation to multi-decade highs in many major economies. Second, whereas much of the world has opened and emerged from pandemic-related lockdowns and resumed somewhat normal consumption, China in recent months has faced one of the most stringent lockdowns since the very start of the pandemic. Several of its major factory and port cities were locked down for several weeks and this too contributed to supply chain issues as they serve as major production sites and export centers to the rest of the world, as well as sites of sizable local consumption.

How to measure the intensity of these shocks and stressors on global supply chains and consider where and how modern logistics facilities are most needed and best configured? The New York Fed has created a new index at the start of this year which is an aggregate of several existing series and has the goal of developing a measure of global supply chain pressures that could be used to gauge the importance of supply constraints with respect to economic outcomes. Known as the GSCPI (Global Supply Chain Pressure Index) it goes back to 1997 and incorporates the Baltic Dry Index and Harper Index (of shipping costs) along with airfreight cost indices from the U.S. Bureau of Labor Statistics and several supply-chain-related components from the Purchasing Managers' Index (PMI) survey of manufacturers across seven key and inter-connected economies: China, the Eurozone, Japan, South Korea, Taiwan, the UK and U.S. The results seen at Figure 1 above show that between May of 2021 and May of this year, the index has hovered at roughly between three and four standard deviations above its long-term average. This is a period of heightened shock which is so much greater than at any other point in at least the past quarter century for which we have this data.

It is incumbent upon real estate investors to try and help alleviate the global supply chain problem. Although the GSCPI is not forecast into the future, we believe that it will remain under stress for a few more years to come. Yet at the same time, retailers and E-commerce players are restocking inventory and aspire to stock excess inventory close to centers of major consumption, through a so-called "just-in-case" supply chain model. This has the potential to absorb large quantities of logistics space globally and specifically of modern, state-of-the-art facilities which are well-located for efficient distribution and with the highest ESG standards.

Shane Taylor
Americas and APAC Head of Research, CBRE Investment Management

CBRE Investment Management