Newsletter (11) - Logistics Real Estate

(1) Introduction

In this week's edition of our newsletter, we explore industrial real estate amid the shifting market conditions. With changing demand dynamics and a significant decline in new construction starts, investors are facing an increasingly attractive buying environment. In the following sections, we examine evolving occupier specifications, the faltering pipeline of new supply, and pricing arbitrage through portfolio investment strategies.

(2) Changing Occupier Specifications

In recent years, demand for industrial real estate has become more multifaceted. Nevertheless, e-commerce remains the primary demand driver, with expectations of further penetration reinforcing its long-term growth trajectory. To illustrate, across mainland Europe, CBRE projects e-commerce penetration to increase by 5% by 2030, while in the UK, it is expected to rise by 6% by 2027. Beyond increased penetration, consumers expect faster delivery times for their orders. As a result, primarily big-box and last-mile logistics facilities remain in demand.

Consequently, e-commerce tenants are increasingly favoring larger, centralized distribution hubs over multiple smaller warehouses. By consolidating into a single facility, tenants can deliver to an entire country, improving supply chain efficiency and reducing bottleneck risks. At the same time, as customers are becoming more time-sensitive, urban and infill warehouses close to major population centers are increasingly favored to accelerate delivery. In urban logistics, connectivity is the single most important factor for asset demand, with tenants requiring strong access to national (inbound goods) and local road networks (outbound deliveries). While leasing peaked during COVID, current demand is primarily driven by third-party logistics (3PL) providers and large retailers like Amazon. These tenants are increasingly prioritizing modern, high-specification facilities in a flight-to-quality trend, including high dock-door ratios, cross-loading, and efficient site coverage. Furthermore, new leases are now predominantly signed in assets that meet zero-carbon certifications such as BREEAM and LEED and allow for automation, AI, and data integration to optimize supply chains and reduce operating costs. Industrial properties that align with these evolving tenant requirements will be best positioned to attract high-credit tenants seeking to rationalize their portfolios.

Beyond e-commerce, several global trends are driving demand for logistics. The AI boom has spurred large demand for data centers (for more details, see our last RE newsletter). Additionally, vulnerabilities in globalized supply chains, exposed during COVID, and recent tariffs introduced by the Trump Administration are incentivizing companies to relocate production facilities to the U.S. This is expected to give rise to demand for light-and-heavy industrial assets located in stronger western economies. However, the extent to which these policies will influence manufacturers to commit to long-term leases remains uncertain and will only become clearer in the coming months. Finally, governments are demanding more warehouse space driven by higher stockpiling of military and medical supplies. This trend is primarily driven by rising defense spending and increased caution regarding pandemics (e.g., Monkeypox). Hence, while evolving trends within e-commerce are impacting occupier requirements, further global megatrends including data centers, onshoring and government stockpiling are all presenting opportunities for developers to capitalize on.

(3) Supply Dynamics

As occupier specifications have changed, demand for industrial assets has become largely bifurcated. Concurrently, supply of industrial assets has undergone structural shifts of its own. The zero-interest rate environment of 2020 and 2021 drove large speculative construction, with completed projects only now coming into the market. As such, UK logistics availability in 2023 was 2.5 times higher than in 2021. However, macroeconomic pressures, such as rising interest rates and building costs, have led to developers avoiding speculative construction to de-risk leasing uncertainty. Similarly, lenders have reduced leverage for speculative developments and now require pre-lease agreements, often as triple-net, to ensure predictable cash flows and protection against operating costs. As a result, developers are increasingly focusing on build-to-suit (BTS) projects, thereby constructing assets that meet the design specifications desired by pre-leased tenants. This dynamic has led to a decline in new construction, with Blackstone's Kathleen McCarthy arguing that new construction starts are down by two-thirds since 2021.

Despite this, BTS industrial assets continue to receive relatively favorable financing terms compared to more distressed asset classes. This is primarily due to the asset class's strong fundamentals in an otherwise difficult market. Unlike office buildings, which require large ongoing CapEx (often rising faster than rents), industrial properties have lower physical depreciation since they are built with durable materials and prioritize functionality over looks. Additionally, construction costs are lower than those of office buildings, reducing exposure to construction price volatility during development. Another factor in industrial real estate's resilience in the current market is the stability of its lease structures. While retail and office landlords have seen lease terms shortened in recent years, industrial properties still secure long-term agreements often averaging 20 years with CPI indexed rent adjustments. This creates a predictable income stream, making industrial assets easier to underwrite in the current real estate market.

(4) Portfolio Acquisitions

With shifting demand and a weakening construction pipeline, the largest real estate private equity investors have increasingly focused on portfolio acquisitions over individual assets. With speculative development slowing and demand shifting toward BTS, long-term leased assets, investors are adjusting their investment strategies to focus on scale, stability, and pricing inefficiencies. In this environment, portfolio acquisitions have become an attractive way to deploy large funds efficiently while mitigating asset-level risk (across both markets and tenants).

Portfolio acquisitions give investors immediate exposure to multiple assets, lowering idiosyncratic risk as well as underwriting and transaction costs. For example, when Oxford Properties, the investment arm of OMERS, wanted to expand into U.S. industrial, it purchased a 149-property portfolio (14.5 million sq.ft.) from KKR for $2.8bn. For the strongest investors, large access to leasing and transaction comparables allows them to accurately assess where true market pricing lies. While portfolio acquisitions often command a premium, mega-funds use data and pricing arbitrage to uncover undervalued assets within these portfolios. By applying mark-to-market cap rates, they identify mispriced properties and embedded discounts, effectively turning a seemingly premium-priced acquisition into a value-add play. Under current market conditions with many sellers facing distress or seeking to exit locked-up investments, these strategies are creating attractive buying opportunities. Consequently, according to Savills, European total logistics investment volumes in 2024 reached €37.9

billion, an increase of 14% compared to 2023. This increase in logistics acquisitions reflects the shift to a resilient asset class in an otherwise uncertain investment market.

(5) Aggregation

Once acquired, individual assets or portfolios are often aggregated into larger platforms, creating diversified and stable income-producing vehicles. Here, platform structures allow cross-collateralization in financing, where pooled assets serve as security for debt, improving borrowing terms and increasing value. An example of this strategy was Blackstone's €21bn recapitalization of Mileway in 2022, its European last-mile logistics platform. The transaction allowed existing LPs to cash-out while enabling Blackstone to retain control of the portfolio for an extended period, further trying to increase value. This aggregation strategy is particularly common in multi-let industrial portfolios, where properties are subdivided into multiple units leased to different tenants. Multi-let industrial assets typically achieve higher yields, as smaller spaces are leased at a higher price per square foot, reflecting added leasing and operational complexity. Managing multi-let portfolios is highly management-intensive as it requires far more lease negotiations, credit monitoring, and maintenance expenses. Given this, successful platform aggregation relies on an efficient operating structure, which in turn creates multiple levers for value creation, including raising occupancy rates, increasing rents on short-term leases, and conducting manage-to-green conversions. For example, M7 Real Estate, a specialist in multi-let industrial, has recently raised several rental rates by 40%+ in just a few years, despite difficult market conditions. This performance led Oxford Properties to sell a 50% stake in M7 Real Estate to AustralianSuper for €840mn.

At exit, this platform structure often commands a premium over its individual assets. By bundling properties into an institutional-grade income product, PE firms can target a wider buyer pool, including REITs, pension funds, and sovereign wealth funds, leading to a higher valuation at sale. In summary, industrial platforms aggregated to scale can generate core/core+ income streams and achieve exit valuations at a premium to individual asset values, presenting an interesting value-add play for patient investors to continue capitalizing on.

(6) Conclusion

In conclusion, industrial real estate is being reshaped by shifting demand patterns, a constrained supply pipeline, and a changing investment environment. As speculative development slows, investors are deploying capital into portfolio acquisitions and platform aggregation to create value. With market conditions creating pricing inefficiencies, investors who can be granular and patient will be best positioned to generate outsized returns.