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Logistics real estate: Infrastructure of a shifting economy

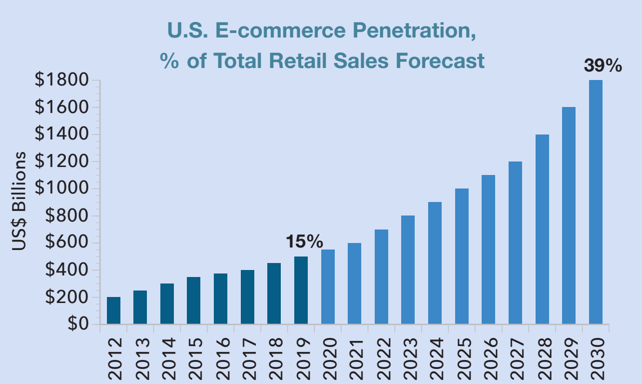
With consumers forced to stay home, e-commerce has seen an acceleration in sales, placing a strain on inventory levels and supply chains. This catalytic shift in consumer behavior is driving logistics real estate to serve as the infrastructure to answer that demand.

Infrastructure of a Shifting Economy

The global pandemic is sparking vast changes among the logistics real estate space, requiring companies to adjust to fluctuations in demand, supply and labor availability. The long-term effects are projected to boost demand for logistics real estate in three ways:

1. Acceleration of E-commerce

- As a result of the pandemic, quarantines are creating new online consumers and driving demand for goods bought online, fueling the need for distribution facilities at a rate much higher than the current cycle.[1]
- E-commerce sales represented 15 percent of total retail sales in 2019, and it is expected to jump to 39 percent by 2030.[1]



Source: CBRE U.S. MarketFlash, Post-Coronavirus Industrial Real Estate, March 23, 2020

- These changes drove record increases in online purchases over the course of a few days.[2]
  - ◊ Online grocery in the U.S. saw a +100 percent boost in daily online sales.[2]
  - ◊ Overall e-commerce in the U.S. increased by 25 percent, largely propelled by grocery.[2]
  - ◊ Grocery delivery app downloads hit record levels, and worldwide online searches for "grocery delivery" increased by 450 percent versus last March.[3]

2. Supply Chain Diversification

- Demand for U.S. East Coast and inland port locations should increase as companies diversify their supply chains, largely due to U.S.-imposed tariffs and the pandemic disrupting their reliance on China.[1]
- The rapid shift in consumer behavior toward e-commerce has put pressure on supply chains to adapt — for every dollar of sales an e-commerce retailer realizes, it needs three times the level of supply chains compared to other forms of commerce.[4]

3. Inventory Controls

- Companies and suppliers may decide to increase their inventory levels in the long term to ensure they are adequately able to meet demand for business continuity purposes, thus increasing the demand for warehouse space.[1]

1 CBRE U.S. MarketFlash, Post-Coronavirus Industrial Real Estate, March 23, 2020
2 Growth from March 13 – 15 compared to baseline period of March 1 – 11, 2020. Adobe Analytics Digital Economy Index 2020
3 Apptopia, Google Trends as of March 17, 2020
4 eCommerce Drives Industrial Real Estate Boom, PYMNTS, April 2, 2020
5 CBRE U.S. Industrial & Logistics Figures Q4 2019
6 CBRE Industrial & Logistics 2020 U.S. Real Estate Market Outlook
7 CBRE Research
8 U.S. Census Bureau
9 CBRE Research: Same-Day Speed
10 Coronavirus and Supply Chain: Implications for the Industrial Market, CBRE, March 6, 2020
11 Coronavirus Impact on the Property Markets: Focus on U.S. & Canada, Cushman & Wakefield Research
12 Elion is registered as an investment adviser with the SEC under the Investment Advisers Act of 1940 (the "Advisers Act").
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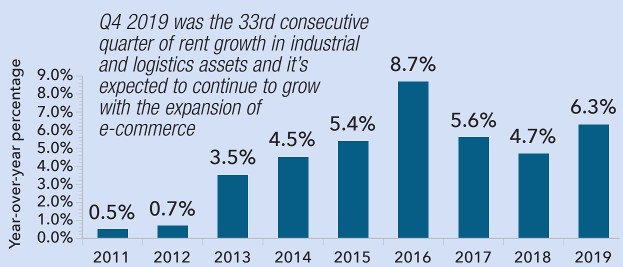
Strong Real Estate Fundamentals Pre-Crisis

Fundamentals in the logistics real estate sector were strong heading into the crisis, with solid occupancy levels and consumer preferences driving demand for infill locations.

Persistent Rent Growth in Infill Locations

- Q4 2019 represented the 33rd consecutive quarter of rent growth in the U.S., with average net asking rent rising to $7.63 per square foot, an increase of 5.1 percent year-over-year.[5]
- Rising rents were forecasted to be partly driven by infill industrial space in supply-constrained markets as e-commerce companies race to offer same-day delivery to customers.[6]
  - ◊ Warehouses of less than 120,000 square feet have seen rents rise by 30 percent in the past five years.

Industrial Annualized Rent Growth



Source: JLL, "United States Industrial Outlook – Q4 2019"

Historically Low Vacancy Rates

- The overall vacancy rate remained unchanged from Q3 to Q4 2019 at 4.4 percent, with a marginal 20 basis point increase year-over-year.[5]
- With extremely low vacancy rates and limited space options in several markets, higher than normal renewal rates were projected for 2020.[6]

Population Growth

- Estimated U.S. population growth of 2.5 million per year equates to +100 million to 125 million square feet of new warehouse demand per year.[7]
- Over the next five years, the U.S. population is expected to increase by 12.5 million, further driving consumption and thus leading to additional demand for warehouse space.[7,8]

Efficiency in Middle- & Last-Mile Distribution

- Distribution and fulfillment supply chains are being transformed to accommodate short delivery promises, forcing supply chain models to become more efficient nationwide.[9]
- Light-industrial properties, typically smaller than 200,000 square feet and often located in or adjacent to infill urban markets, have been identified as the solution to the "last-mile" needs driven by e-commerce.[9]

Built to Weather the Storm

Logistics is better positioned than other real estate sectors due to the potential boost to long-term demand from e-commerce and supplier inventory needs.

Trajectory Remains Robust

- Compared to other real estate asset classes, industrial leases are longer-term and are less likely to respond to short-term disruptions, decreasing the likelihood that warehousing lessees vacate industrial properties because of the spread of the virus.[10]
- Though the industrial-logistics sector is expected to emerge from the crisis better-positioned than other asset classes,[11] we believe rental rates and property valuations may decline slightly in submarkets where increased vacancy rates could apply downward pressure.
  - ◊ However, the accelerating shift to e-commerce amid the crisis is likely to induce longer-lasting changes in consumer behavior benefiting the asset class for the long term. For every $1 billion of online sales, 1.2 million square feet in warehouse space is needed to fulfill orders.[11]
  - ◊ The economy is expected to rebound relatively quickly compared to other post-crisis recoveries, with projected growth of 5.8 percent in 2021, assuming the pandemic fades in the second half of 2020.[11]

Opportunity in High-Barrier, High-Growth Markets

- Some states are seeing a bigger overall e-commerce boost with online sales lifting 20 percent or more since the crisis.[2]
- Near-term stress combined with the long-term strength of the asset class may present investment opportunity.[11]
- Elion's logistics investment strategy focuses on high-barrier-to-entry, high-growth urban markets. To learn more about specific identified investment opportunities or to download the full report visit https://elionpartners.com/news/logistics-real-estate-infrastructure-of-a-shifting-economy.

ABOUT ELION PARTNERS

Elion Partners is a logistics-focused real estate investment firm and registered investment adviser.[12] As a vertically integrated platform, Elion is both a fiduciary and operator, managing more than $1.5 billion in real estate assets through closed-end funds and permanent capital investment vehicles. As long-term stewards of capital, principals of Elion invest personally in each of the firm's funds to ensure alignment of interests and transparency with its capital partners.

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