EMEA Industrial

Logistics real estate is being reshaped by worldwide growth in e-commerce

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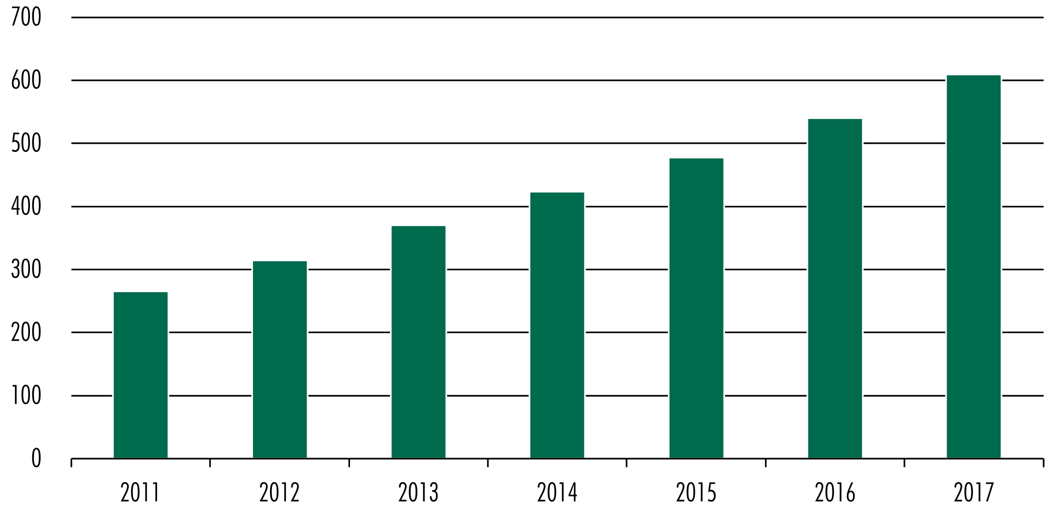
The worldwide growth in e-commerce continues unabated with increasing effects for the European retail and logistics markets. Business-to-consumer (B2C) sales in Europe have been growing at an annual rate of about 15% and are expected to exceed € 500 billion in 2016, according to research by the Ecommerce Foundation. The UK leads Europe in the growth of online retail; it was responsible for 30% of all European B2C online sales last year. Other markets are growing, however, and their expansion has begun to reshape the logistics sector on the continent profoundly.

- Across Europe, logistics operations' costs have increased to 40-50% of total e-commerce retail costs—pushing retailers and logistics providers to economize.
- Mergers and acquisitions, consolidations and new development are all increasing in response to the rising volume and expense.
- Take-up of logistics space in European markets is accelerating, due in large part to strong growth in the size of the facilities involved.
- XXL warehouses are simultaneously meeting the logistics needs of e-commerce retailers and the transactional needs of institutional investors.
- "Final mile" facilities are on the rise as well, encircling major cities and XXL hubs to provide quick delivery to demanding customers.

Figure 1: European Business-to-Consumer e-Commerce Turnover



Source: E-commerce Foundation, 2015.

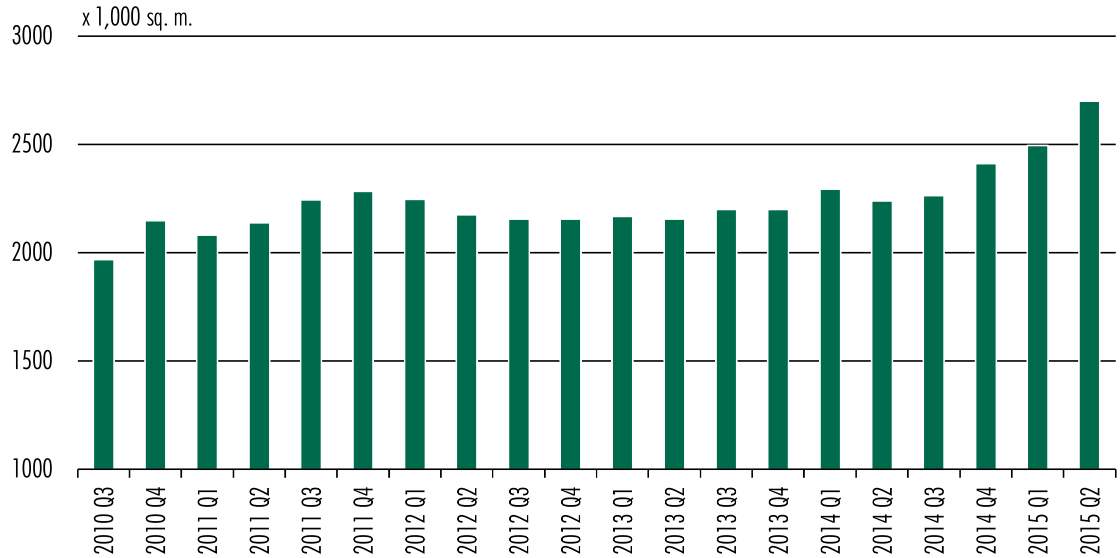
While e-commerce is making the number of parcels shipped around Europe grow rapidly, the average value per parcel is falling—at an estimated rate of 15% per year.[1] This implies that logistics operations' share of e-commerce retail costs is increasing—up to 40% or 50% of total costs, by some measures. As a result, the pressure on retailers and their logistics service providers (3PLs) to economize is high. In a search for economies of scale, a wave of mergers and acquisitions is currently sweeping through the logistics sector, with headlining announcements from FedEx and TNT, XPO and ND Logistics and XPO and Con-Way, and DSV and UTi.

These 3PLs are also consolidating their warehouse operations in pursuit of greater economies of scale, which is resulting in a strong growth in the size of occupier transactions. These transactions are increasingly linked to e-commerce operations. It is difficult to present clear numbers here, as many logistics operations have a mixed-use character, delivering to both traditional sales channels and for e-commerce. Indicative numbers from CBRE Research nonetheless reveal that in the core markets of Europe, about one-third of the current take-up of industrial space has a link with e-commerce, and this share is expected to grow.

Europe saw an uptick in the take-up of logistics space in Q4 2014, and this growth has continued throughout 2015. The Irish and Netherlands markets, for example, are well on their way to a record year. E-commerce growth is playing an important role, but it is worth to point out that a substantial portion of the growth is attributable not to a larger number of transactions, but to strong growth in the average size of the distribution facilities involved.

[1] Source: Van Riet Group / Shopping Tomorrow.

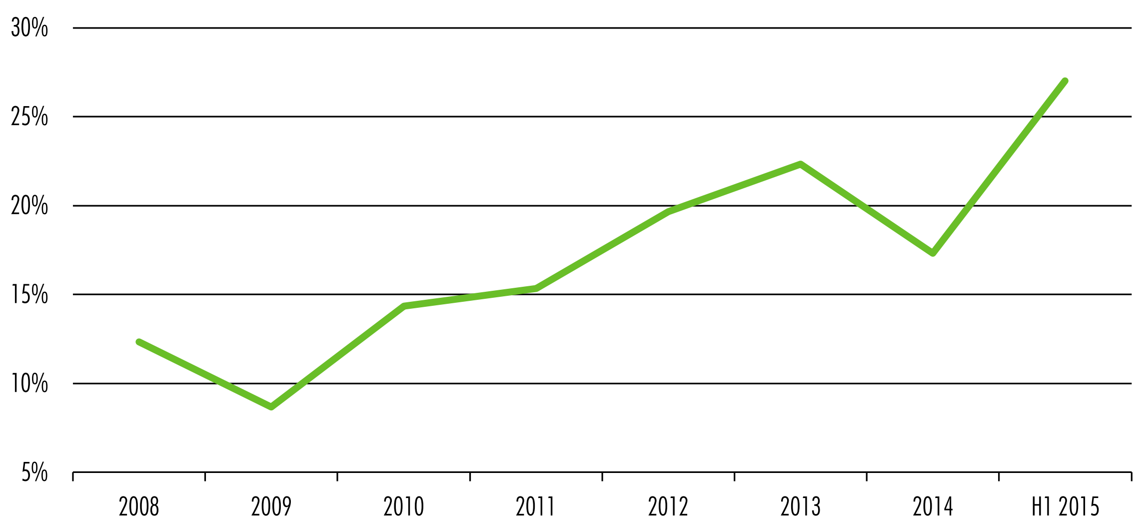
Figure 2: Take-up of Logistics Space in 28 European Key Hubs (rolling 4-quarter average)



Source: CBRE Research, 2015.

Figure 3 displays data from the UK, France and the Netherlands—three of Europe's key logistics markets. It shows a bumpy but visible increase in XXL warehouses' share of the total logistics take-up. XXL warehouses are defined here as modern distribution centres with a footprint of at least 50,000 sq. m. Other typical characteristics include a free height of at least 10m, 1 loading dock per 1,000 sq. m., and large premises to ensure efficient truck manoeuvring and parking space for the warehouse staff. In fact, a floor space ratio of no more than 40% is optimal, resulting in the need for very large plots of land. In the first half of 2015, more than a quarter of the logistics space taken up in these three markets concerned space in XXL warehouses.

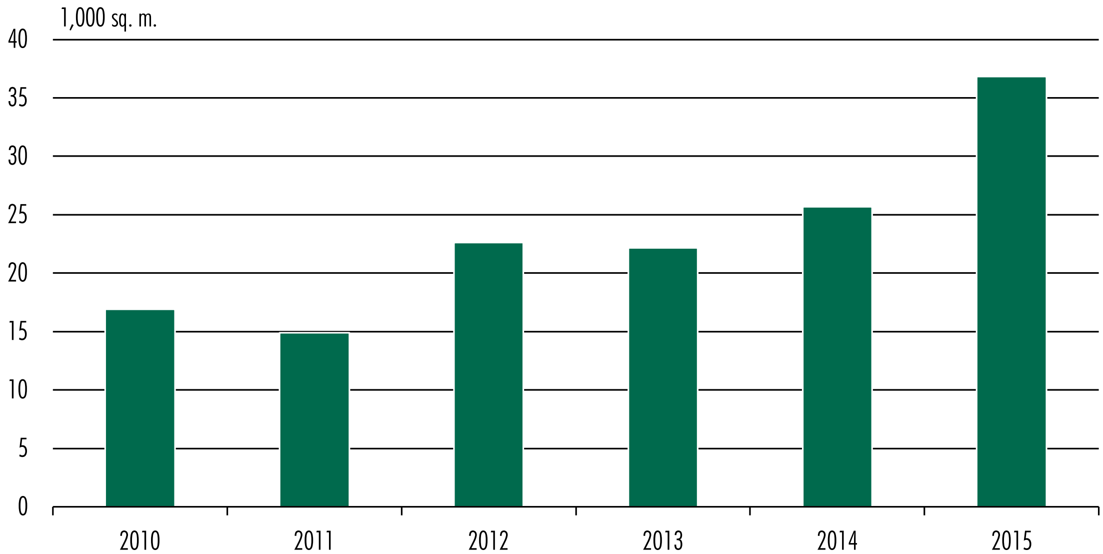
Figure 3: XXL Warehouses' Share of Total Logistics Take-up in the UK, France and the Netherlands



Source: CBRE Research, 2015.

The upturn in demand and size requirements is leading to an increasing scarcity of suitable accommodation in the most desired logistics hubs. In turn, this is prompting growth in new development. Construction activity in Europe has picked up considerably in recent quarters, providing pressure relief for some markets—particularly in continental Europe. However, new development has also started to act as a trigger for occupier demand in itself, as rents for new property are often lower than those being paid for existing accommodations. This is further supporting the shift towards XXL warehouses.

Figure 4: Average Size of Logistics Development Starts in the Netherlands



Source: CBRE Research, 2015.

The offering of new development schemes at competitive rent levels is being made possible in part by the continuing appreciation of logistics real estate, delivering correspondingly declining yield levels. This implies that investors targeting these assets are prepared to settle for lower rents, while still being able to make the required initial return.

Investor appetite remains strong, but scale and size are a decisive factor in the industrial segment of the market. For institutional capital targeting European logistics real estate, transaction size or 'ticket size' is an important factor, with the sweet spot of transaction volume currently between EUR 75m and EUR 150m. For traditional assets, this volume is difficult to achieve in a single-asset transaction, which partly explains the growing demand for portfolios. XXL warehouses are also able to feed this segment of the market; investors find them very desirable as a consequence. New developments are often targeted in an early stage, and forward funding schemes have started to become more common.

Although e-commerce is certainly not solely responsible for the scaling up of the logistics markets—the rationalization of traditional retail supply chains is also playing a role—this article aims to show that it has had a marked impact indeed, effectively shaping both the occupier and investment markets for logistics real estate in Europe.

As a final note, it is worth mentioning another development that is taking shape: the rise of the final mile hub. Increasingly demanding consumers require an increasingly customized delivery. Delivery within tight timeframes throughout the day has become the new norm, and returns management is also a strong factor in play. As these customers are increasingly living in cities, central XXL warehouse hubs are increasingly being supported by rings of final mile facilities surrounding each of the big cities in Europe. In the wake of occupier demand, this asset type has now also been discovered by (institutional) investors.

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