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Logistics

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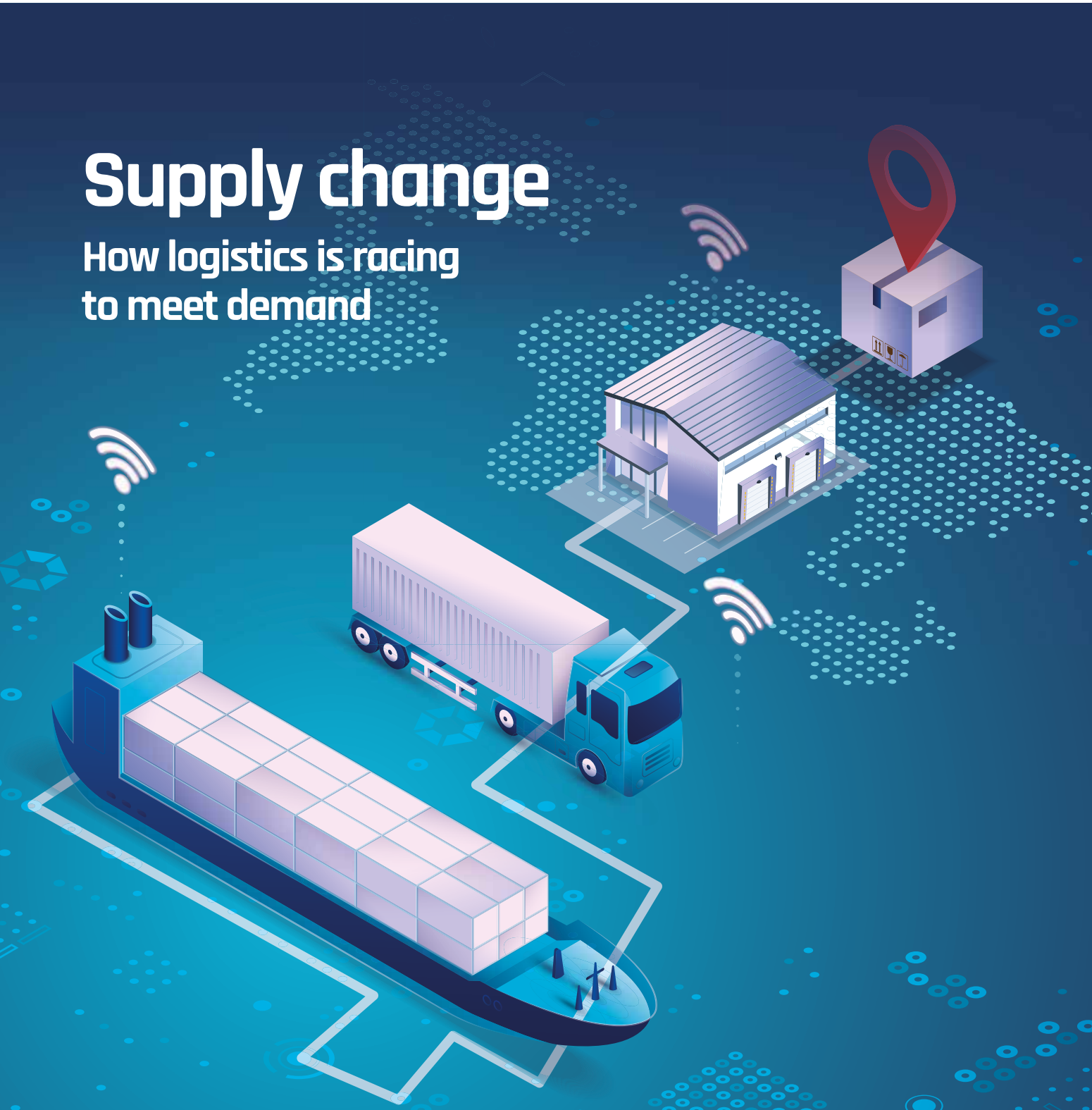
Supply change

How logistics is racing to meet demand



KEYNOTE INTERVIEW

Logistics' trans-Europe express gathers speed

E-commerce and supply chain transformation, coupled with investor demand, are creating a truly pan-European industrial and logistics market, says Panattoni CEO & co-owner Europe, Robert Dobrzycki

While European logistics real estate markets have garnered avid investor interest in recent years, much developer and investor activity has been focused in a few prime markets. But occupier trends that have intensified during the pandemic – notably, the need to provide e-commerce delivery centers close to populations and onshoring bringing increased production activity back to parts of Europe – are now creating conditions in which it is both necessary and desirable to create truly pan-European development platforms that are able to fulfill investors' desire to build large, diversified portfolios across the continent.

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Q What investor-level trends are fueling greater geographic diversification across European logistics markets?

There is a huge shift of capital from other asset classes to logistics because of the well-established structural trends that favor the sector.

However, compared to the amount of capital allocated, the total stock and value of industrial property is still small relative to other real estate sectors. There is much more demand from investors than there is product available, therefore yields are continuing to compress across European markets.

The historically high capital values we see today are nevertheless still justifiable, because it is becoming ever more difficult for developers to buy land, get a permit to build and supply new logistics facilities in desirable locations.

Frequently, logistics is not perceived as a desirable use for municipal authorities in high-consumption areas, and populations in those areas do not want warehouses as neighbors. Scarcity supports values for logistics property, while also offering investors the likelihood of

further yield compression in the long run because of excellent prospects for rental growth.

Meanwhile, the difficulty and expense of accessing the logistics market at scale is transforming the way in which investors are working with developers to deploy their capital. Instead of buying standing product, they are trying to cut themselves a slice of development profit by backing developers.

Because building volume through development on a deal-by-deal basis is difficult, investors are funding large-scale pan-European construction platforms. That is part of the reason why Panattoni has been expanding its geographic reach, to be able to do that faster and better across more European markets.

Add to that the fact that large pan-European logistics portfolios are extremely liquid, and it explains why the region's logistics market is becoming much more programmatic, volume-oriented and pan-European.

Q Do some European locations still offer comparatively attractive entry yields?

Demand from occupiers and capital providers still does not match completely, which creates buying and development opportunities.

Demand fundamentals in western Poland and eastern Spain are better than in western France or eastern Germany, but that is not yet reflected in investor demand or in yields. Investors, in their high-level analysis, reason that France represents a better capital markets outlook, and much more liquidity, than Spain.

The same applies for Germany versus Poland. The demand from logistics occupiers in western Poland and eastern Spain is very strong; however, while their popularity with investors has yet to catch up, the yield gap between those locations and those that are favored by investors is wider than it should be. In fact, a warehouse in western Poland should be perceived as more attractive than one in eastern Germany, because it is still serving German demand from a location on the other side of the border, where labor is more cost-efficient.

Meanwhile, there is huge demand for logistics space in France, but it is very difficult to build it. It is much easier to develop on the Spanish side of the border in areas that are still serving France. There is more land available in Poland and Spain, increasing the risk to standing assets of competition from new development, and that plays a role in shaping investors' perceptions of value in those locations.

Of course, it is more attractive to hold assets in a supply-limited location. However, it will not be long before land is scarce everywhere, and the volume of money coming into the logistics market is so high that the yield gap we still see today will soon close.

Q How are supply chain trends opening up new markets for industrial development?

In the past, companies were chasing efficiency, which led them to site their production platforms in low-cost global locations. Occupiers are increasingly taking the view that long supply chains are risky, so they are shortening and diversifying their supply chains and seeking to bring them closer to the end consumer, even though that generates higher costs.

When the first lockdowns closed borders, businesses created temporary country-by-country supply chains to ensure continuity of supply. Those are

Transforming old assets to service a strategic market

In November 2021, Panattoni made its first acquisition in France, a 150-acre former automobile spare part production and storage site on the outskirts of the city of Beauvais located 47 miles north of Paris. Together with remediation and brownfield specialist ADM, the developer will tear down the old facility and build in its place a 485,000-square-foot, state-of-the-art logistics center.

The project will be built in line with the principles of the Afilog charter for environmental commitments, of which Panattoni is a founding signatory, and is targeting a 'very good' BREEAM accreditation. It is also committed to conserving and improving the biodiversity of several acres of natural wooded land in the area. The deal comes on the heels of Panattoni's first hire in the country, Salvi Cals as managing director, along with five other employees in its newly opened Paris office.

New hub: an artist's rendering of the completed Beauvais logistics facility

very inefficient, so they are unlikely to persist as the pandemic becomes less of an issue. However, as long as covid and geopolitical factors continue to cause supply chain uncertainty, we will continue to see companies setting up multiple facilities in Europe, where once they would have operated out of fewer buildings or located them elsewhere.

We are seeing that trend in Western Europe, but it is Central and Eastern Europe that has been the chief beneficiary. The most visible consequence of that trend for the industrial market is that production facilities are being opened in Europe, instead of in Asia, to serve Western European demand. For example, electric vehicles destined for German and French buyers are being built in the central and Eastern part of the continent.

Demand in southeastern Europe has grown substantially. Labor is in short supply in Western Poland and the Czech Republic. Developers are unlikely to cross into Ukraine because of tensions on the Russian border, so the locations most likely to benefit are Hungary, Slovakia and Poland, which are already established markets for Panattoni, and also Romania, Serbia, Slovenia and Croatia. Increased production will drive more economic activity in those areas, so local consumption will grow as well, creating more warehouse demand.

For developers, those markets were difficult to enter because the volume in each of those small countries was not sufficient to justify setting up a local development operation. However, with volumes growing significantly, it is more practical for a pan-European developer to serve those local markets. That is definitely an expansion path for us going forwards. There is still a very substantial economic development gap to be closed between those markets and Western Europe.

Q Are those locations also attracting more attention from investors?

Occupiers may want space in a location, but without investor demand the market is not a good prospect for developers like us. It differs from country to country, but we have seen growing investor appetite for southern and eastern Europe since the pandemic, which encourages us to go there. Investors who are looking for a bit more yield, for higher returns, cannot find that in Western European markets.

There is much more potential upside in Eastern Europe. Volumes are lower but growing, and we have seen some global investors who specifically want to be in Southern and Eastern European logistics markets because there is much less competition, a bit more yield, and they still believe in the market dynamics.

Q Panattoni is also seeking to expand into more national markets in Western Europe. What is driving that?

Tenant demand, which is mostly for e-commerce fulfillment in areas of high consumption, is the main driver. At the same time, investors want pan-European coverage, exposure and access to product.

In the past, we felt that within Western Europe, France and Italy were a bit less dynamic and more mature than some other markets. However, e-commerce growth has made those markets a more attractive prospect for developers. Creating product in France is tougher than in most other European countries.

"We will continue to see companies setting up multiple facilities in Europe"

Greenfield development is limited and getting permits is difficult. We plan to progress mainly through a brownfield strategy, buying older facilities, remodeling and repositioning, demolishing, and constructing modern buildings. We have secured a site north of Paris and we are hoping to acquire a second one soon. A few other acquisitions are on target for the first quarter of 2022.

In Italy, we have established a team and will probably close on two sites in the north of the country in early 2022. The fundamentals there are similar to other Western European markets, with the large e-commerce customers that we serve elsewhere also expanding there. We are also looking at Sweden. Our end-user clients want to be there because it has quite a large consumer market to serve. Property there is expensive, but it is also a very liquid market.

Q What are the main challenges facing European logistics developers?

At the moment, the challenges are on the supply side: land acquisition and construction costs. Supply chain issues meant that building costs have risen substantially over recent months. It is not the level of cost that presents a problem. Because there is high demand from tenants, they will pay more rent. It is the unpredictability of cost. Sharp increases halfway through a project can be difficult to absorb. There is no magic way of dealing with it. You just have to watch costs closely and have a strong relationship with your contractor and your capital provider so that the risk is shared.

The yield compression we are seeing at the moment creates a natural hedge for construction cost increases and they are also likely to be offset by rental growth. When building programs have long lead times, if you cannot lock in your construction costs, you should not be locking in your final investment yield either. ■