Benefiting from structural shifts in the economic landscape: *European Industrial & Logistics*

August 2020

- Industrial and logistics (I&L) combines large-scale logistics as well as light industrial properties and comprises extensive properties.
- I&L occupational demand is driven by global trends such as e-commerce and the digital transformation of manufacturing.
- The main locations for I&L are metropolitan regions, complemented by dedicated areas for logistics or modern production, especially in Germany, France, the United Kingdom and Benelux.
- The logistics sector is a liquid investment market but has experienced significant yield compression in recent years.
- Light industrial has emerged as an upcoming attractive investment opportunity achieving above-average returns, especially for business parks and light manufacturing property.
- Combining logistics and light industrial within an investment portfolio creates a solid foundation of market liquidity and yield prospects, based on a well-diversified number of occupiers from different industries.

Industrial and logistics – benefiting from economic dynamics

Industrial and logistics (I&L hereafter) are a major pillar of the economy as well as the basis for the supply of goods to companies and households. In this report, I&L property is defined as comprising big-box logistics and light industrial real estate. I&L is the answer to a range of recent and continuing economic trends that are contributing to expanding demand for industrial and storage capacities in Europe. Firstly, the share of e-commerce is steadily accelerating, with a projected growth rate of 6.8% p.a. until 2024.[1)] E-commerce, in combination with the trend of urban expansion[2)] and growing demand for timely deliveries, is increasing the need for urban logistics – the second factor. Thirdly, the new industrial revolution (so-called Industry 4.0) is pushing frontiers in the digital transformation of manufacturing/production and related industries as well as value creation processes. Last, but not least, de-globalisation is bringing back supply and demand chains to the European market.

Besides its future-orientation, the stock of industrial property is huge. The share of I&L in commercial real estate in Europe is estimated as at least 30%.[3)] Data from Germany and the United Kingdom provides evidence that most of this value has not been realized from an investor's perspective so far – which is especially true for light industrial property.

Defining I&L property

I&L property is divided into two major sectors: logistics and light industrial real estate.

Logistics property

For storing, picking and distributing goods, space and infrastructure are needed. Logistics property – usually at least 10,000 m² in size – fulfills this need and allows for round-the-clock operations. Location wise, logistics property requires good transport connections, ideally by road, rail, water and air. It is not only found in metropolitan areas but, as logistic hubs, can also be concentrated in more remote areas with proper access to transportation routes.

Light industrial property

Light industrial is the general term for mixed-used commercial property that is in or near metropolitan areas with good transport connections. These properties typically have a medium-sized multi-tenant structure although they can also include large single company occupiers. Due to the necessity to serve multiple tenants, they exhibit a high degree of flexibility in terms of use and occupiers, which is a unique selling point. Light industrial property can be classified into the following categories:

1) Warehouse property
Warehouse property offers simple storage facilities up to 10,000 m². The size distinguishes it from logistics property.

2) Business parks
Business parks are centrally managed. They are composed either of a group of separate buildings or connected rental units. Business parks can be of all sizes and commonly provide a 20-50% office share. Typical tenants are companies involved in the light manufacturing and warehousing/logistics sector.

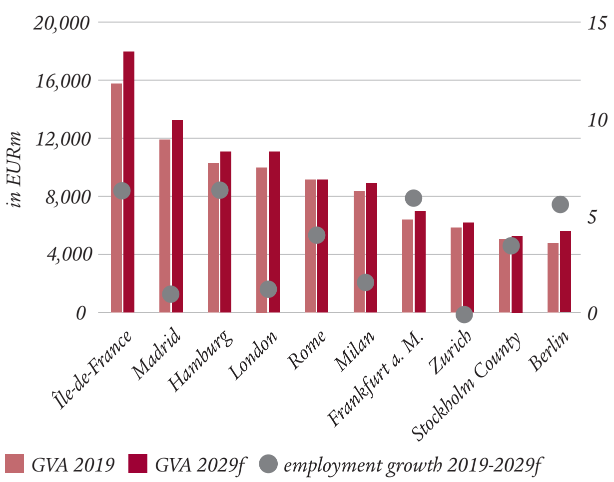
3) Light manufacturing property
These assets comprise individual objects which are utilized for diverse manufacturing purposes as well as alternative uses like storage, research, service, wholesale, and retail trading. They possess a flexible and reversible utilization structure.

4) Conversion property
Conversion properties are usually transformed and revitalized former production plants or industrial areas with potential for further densification.

Relevant European regions for I&L property
A straightforward way to identify regions of importance to the logistics and light industrial sector is an analysis of respective current and future gross value added (GVA) and associated positive employment growth in relevant industries.

Logistics economics
For the logistics sector, economic data on GVA and employment in the "transportation and storage" sector yields the top ten logistics regions in Europe.

Figure 1: Top 10 regions in transportation and storage



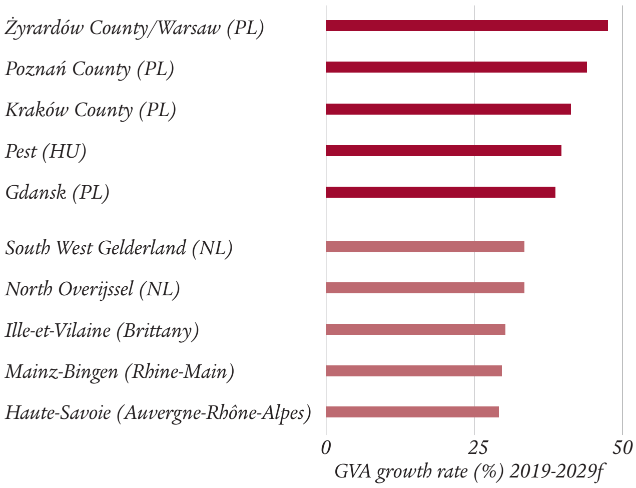
Source: Oxford Economics

With a GVA of EUR 15.7 bn in 2019 and a growth rate of 15% to 2029, Île-de-France is the largest "transportation and storage" region. The average 2019 GVA figure for the top ten is EUR 8.7 bn, the associated GVA growth rate is 0.9% p.a. Despite low projected future employment growth, Madrid generates the second highest GVA in transportation and storage, with EUR 12 bn in 2019 and +10% growth to 2029. Its accessibility by water, road, rail and air makes Hamburg (2019: EUR 10.1 bn) Northern Europe's prime logistics location, ranked third.[4)]

Ports are an important interface in the supply chain between sea and land transportation and play a significant part in logistics and freight distribution. Rotterdam (2018: 442 million tons), Antwerp (212 mt), and Hamburg (118 mt) are the leading European ports by freight and container volumes handled.[5)]

Focusing on the regions that are expected to exhibit highest GVA growth in transportation and storage inevitably leads to Eastern Europe. The average annual growth rate among the top five fastest-growing East European regions in transportation and storage is 4.2%. Their peers in the West (top fastest-growing regions) have an average annual growth rate of 3.1%.

Figure 2: Top growth regions in transportation and storage – by Eastern and Western Europe



Source: Oxford Economics

The impact of selected megatrends on transport modes
Urban logistics and the associated last-mile delivery is a battle won on the road[6)] and in areas with high population density.[7)] Capitals and their surrounding areas in particular, such as Paris, London, and Berlin, meet both criteria.[8)]

Business Park in Berlin | ®BEOS AG

An increase in e-commerce is creating greater demand for freight transport, such as air cargo, in Europe.[9] Charles de Gaulle (Paris) and Frankfurt am Main airports are Europe's leading cargo airports, each having handled 2.1m metric tons in 2019. Unexpectedly perhaps, Luxembourg features among the top European cargo airports after handling 893,000 tons of freight in 2019.[10]

De-globalisation is boosting demand for faster and resilient transportation infrastructure.[11] Europe has one of the densest networks of road, rail, and inland connections in the world. The transportation network density is particularly high in Central Europe and Benelux as well as around capitals and areas of intensive economic activity.[12]

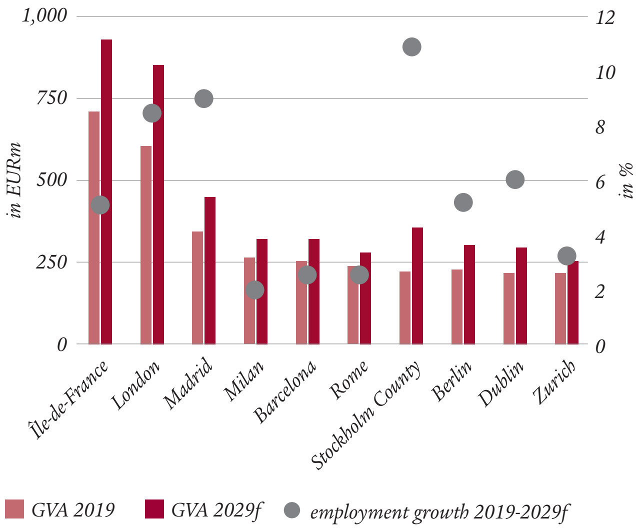
Light industrial economics

When assessing light industrial property, an understanding of their tenant-structure and distribution is useful. Firstly, the tenancy profile includes occupiers of all sizes from large corporations to small and medium-sized enterprises (SMEs).[13] There are 1.7 million SMEs in Europe[14], with Germany (388,000), the United Kingdom (202,000), Italy (182,000), Spain (125,000) and Benelux (89,000) hosting the highest numbers.[15] Secondly, light industrial occupiers are primarily operating in the following six industries:[16]

- Manufacturing
- Wholesale & retail trade
- Information & communication
- Transport & storage
- Professional, scientific & technical activities
- Public administration & defence

Therefore, filtering regions respective to their GVA and employment in these six industries can effectively identify regions that are particularly important for light industrial real estate. The result is a top ten list, led by Île-de-France and with Zurich at the bottom.[17]

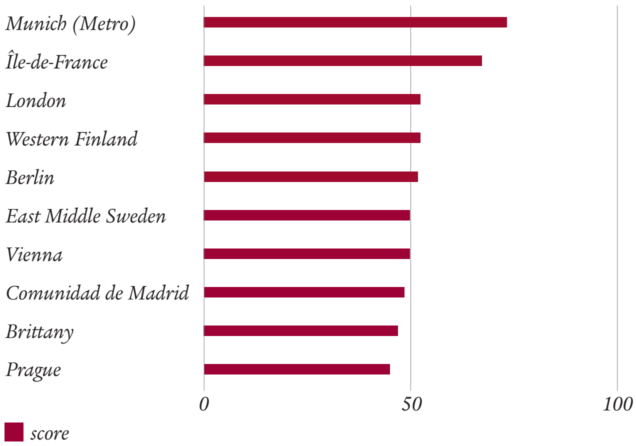
Figure 3: Top 10 most important light industrial regions



Source: Oxford Economics

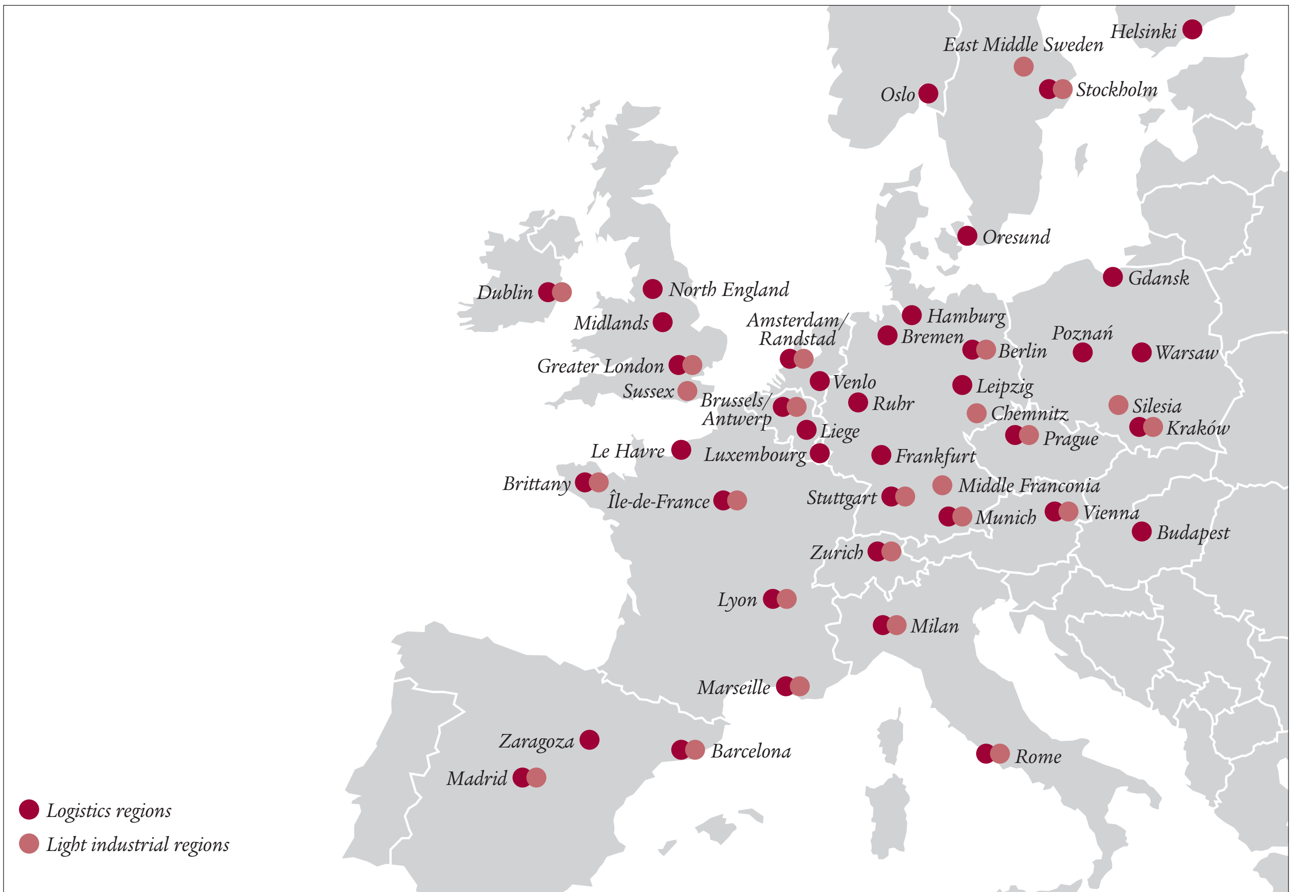
Since light industrial occupiers are also engaging in new forms of manufacturing known as "Industry 4.0", information on top Industry 4.0 regions should be included in any comprehensive analysis. A recent study identifies the current top twenty current Industry 4.0 centres in Europe and their potential in terms of technological advantages. The leading regions are spread over ten different countries but are dominated by Germany, France, and the United Kingdom, which account for 58% of the total. The regions with the strongest Industry 4.0 potential are Munich (Metro), Île-de-France, and London.[18)]

Figure 4: Top 10 regions with strongest Industry 4.0 potential



Source: Balland and Boschma (2019)

Figure 5: Top regions for I&L property in Europe



Source: Swiss Life Economic Research

To conclude, Swiss Life Asset Managers identifies leading I&L regions in Europe using a range of relevant metrics. These include current and future GVA and employment in relevant industries, population density, adaptability to economic dynamics, infrastructure access and quality as well as the potential for Industry 4.0. The findings are illustrated in Figure 5.

Real Estate Markets
Solid economic fundamentals and a positive outlook for I&L create real estate markets investment opportunity. Logistics is a well-known, established sector whereas light industrial is more nascent. Overall, I&L investment volumes are rising steadily – from EUR 12.7 bn in 2011 to EUR 36.4 bn in 2019. The United Kingdom, France, and Germany attract the most interest, accounting for over 50% total European capital flows. Together with the Netherlands, they hold a 69% share of total volumes.

Table 1: Top I&L regions by average 5-year investment volume

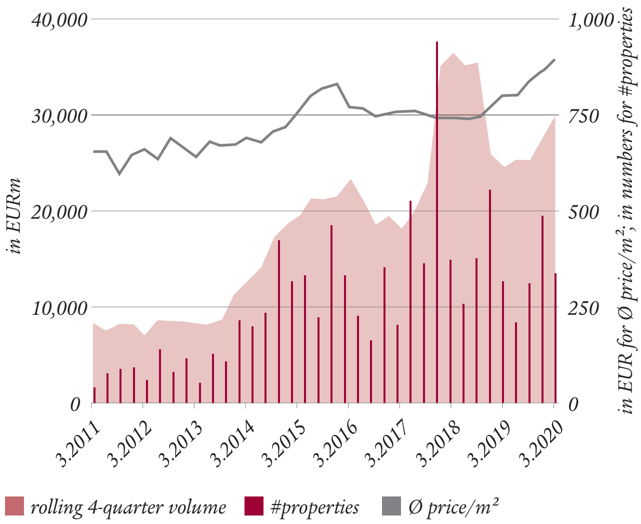
Region	*Ø 5-yr volume in EURm*
Amsterdam/Randstad	1,490
Paris	1,450
London (Metro)	1,388
Rhine-Ruhr	1,030
Frankfurt/Rhine-Main	523

Source: RCA

In the top regions, I&L property has proven relatively resilient to the corona crisis. Although H1 2020 investment volumes at a European level (EUR 13.8 bn) are 6% lower than the volumes achieved in the comparative period of 2019, volumes in the top five regions (EUR 2.6 bn) in H1 2020 are 6% above their equivalent in H1 2019.

European logistics real estate market
In 2019, European logistics transaction volumes amounted to EUR 27.7 bn (+7% to 2018; +230% to 2011).[19] Logistics thus constitutes more than two-thirds of the I&L property market in 2019. After years of stability, prices per m² are rising again (2019: +12% to 2018; +34% to 2011). The spike in transaction volumes in 2017 was due to an exceptionally large portfolio deal that was spread over multiple regions across Europe.[20]

Figure 6: Transaction volumes and average price/m² paid in the European logistics property market

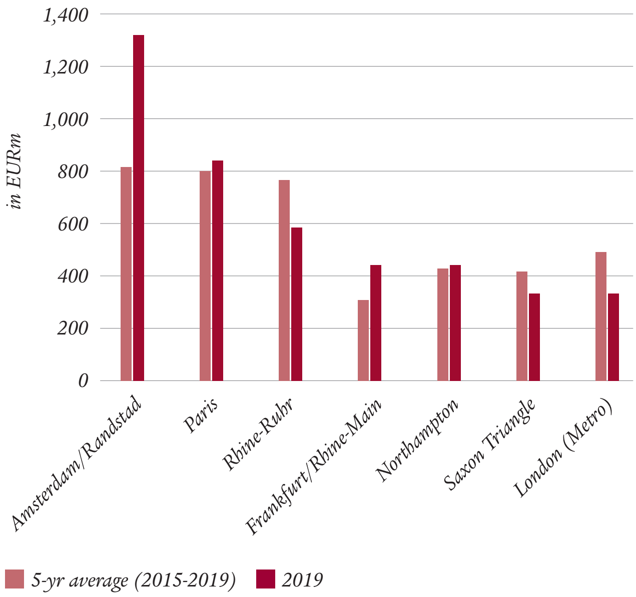


Source: RCA

The number of properties sold per annum is increasing – despite the normal quarterly volatility. The data also shows that the floorspace sold is correlated with the number of properties sold. Between Q1 2011 and Q1 2020, floorspace rose by 110% to 9.511 million m² and the number of properties sold by 180% to 339.

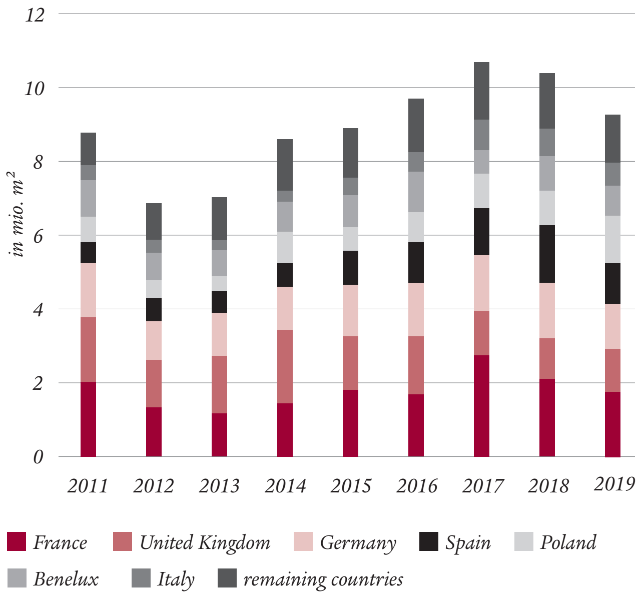
More than 50% of the investment volumes in 2019 were accounted for by the United Kingdom (19%), France (19%), and Germany (17%). However, regional rankings differed from this high level trend. Amsterdam/Randstad in the Netherlands was the leading logistics investment market with investments of EUR 1.3 bn in 2019. It accounts for a one third share of the Dutch logistics market (2019: EUR 3.4 bn). The second and third largest regional investment markets in 2019 were Paris (EUR 0.8 bn) and Rhine-Ruhr (EUR 0.6 bn). These markets both account for a much lower share of their domestic investment markets (France: EUR 5.1 bn; Germany: EUR 4.7 bn), equivalent to 16% and 12%, respectively. This reflects their markets being less clustered and offering greater regional diversification.[21]

Figure 7: Greatest regional transaction volumes in the logistics market



Source: RCA

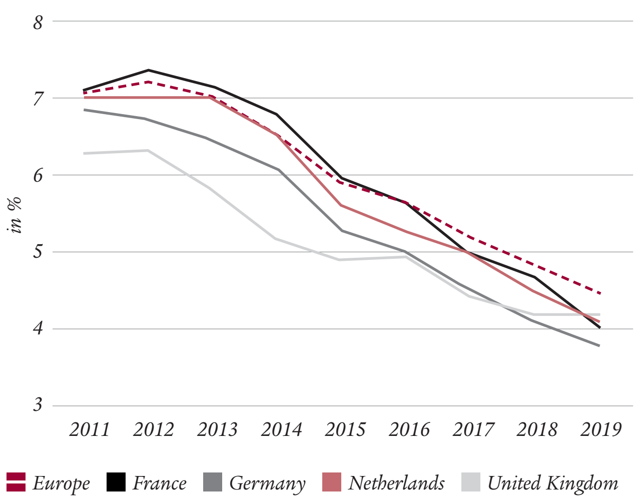
Figure 9: Take-up volume in the European logistics market



Source: PMA

Increasing investor demand is causing price appreciation and yield compression. In 2019, average prime yields in major European markets decreased by 30 bps to 4.5%. Nonetheless, yields are still relatively high compared to other sectors, for example they are almost 100 bps above prime office yields.[22] Values have fallen below 4% in Germany whilst in the Netherlands and France they are still above the 4.0% threshold. In the United Kingdom, yields remained stable 2019 at 4.2%.

Figure 8: Net prime yields in the European logistics market



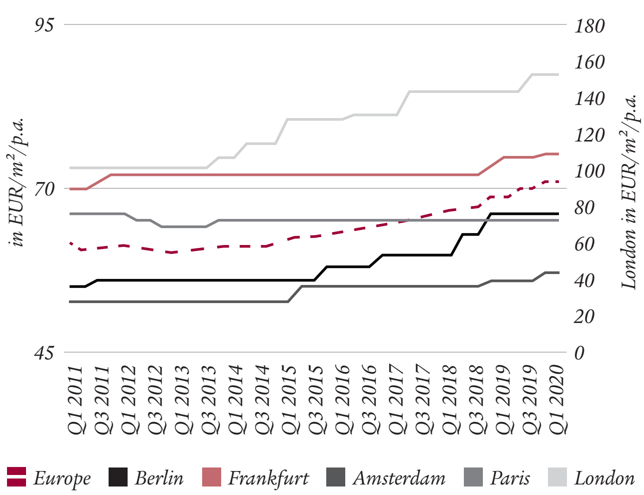
Source: PMA

The growing economic importance of logistics and inherent occupier demand for suitable property is reflected in letting activity. Indeed, it is the healthy occupier market that is driving the investment market.

Strong demand for logistics space has led to rising take-up volumes over the past decade. Since 2018 though, take-up in the core markets declined because of the low level of space availability, especially in major Western markets. Thus, demand has shifted to secondary markets. There has also been greater occupational demand for Eastern European locations due to space and cheap labour availability. Take-up volumes in Poland have risen as a result (+33% to 2018; +15% p.a. on 3-year average).

The level of occupational demand for space is driving prime rents in Europe. London has the most expensive logistics space at 152.0 EUR/m²/p.a. in Q1 2020, compared to the European average of 70.6 EUR/m²/p.a.

Figure 10: Prime rents in the European logistics market



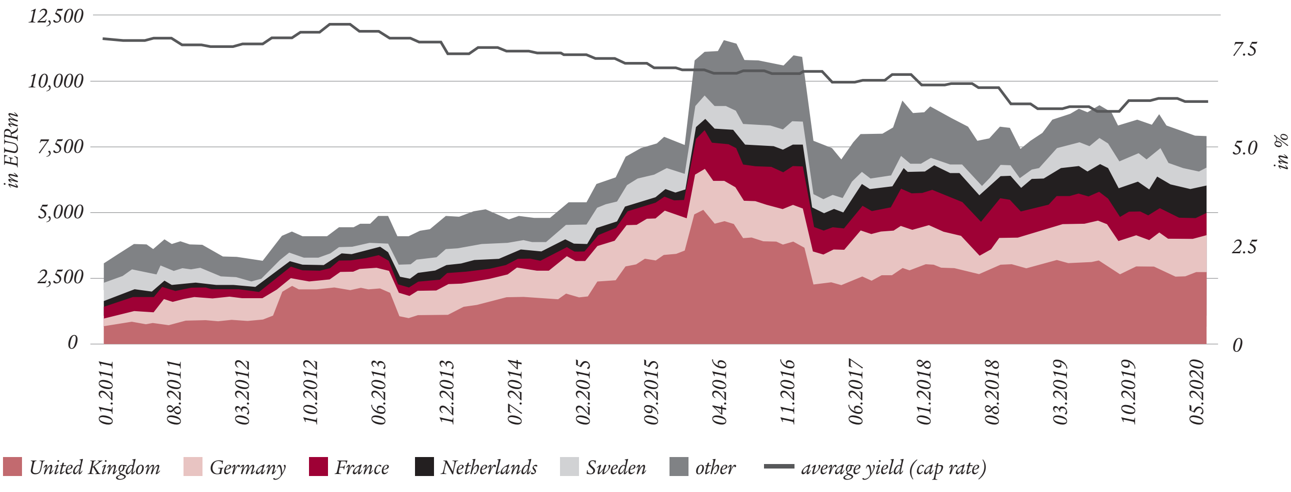
Source: PMA

Logistics Property in Hanover | ®BEOS AG

European light industrial real estate market

Provision of light industrial real estate has been increasing. This is attributable to its contemporary nature and proximity to metropolitan areas as well as its flexibility, multi-use and multi-tenanted structure. These characteristics also mean the sector offers risk diversification. That said, data availability for light industrial property is scarce. At a European level some data on flex[23] and warehouse property (<10,000 m²) is available. Although the overall market for light industrial property is therefore underestimated, the available data provides an understanding of market developments.[24]

Figure 11: Rolling 12-month investment volume and yield of light industrial property



Source: RCA; data includes flex and warehouse (<10,000 m²)

Since 2011, transaction volumes have more than doubled from EUR 3.5 bn to EUR 8.7 bn in 2019. Investment weightings between flex and warehouse property have remained relatively stable at 60% and 40%, respectively. The popularity of the sector among investors is increasing but it is a small niche market. There are two main reasons for this. Firstly, its full investment potential has not yet been unlocked because light industrial property is often owned by SMEs who are only gradually becoming aware of the benefits of selling their property. Secondly, the asset management of light industrial property requires specialist knowledge that few investors possess.[25)]

A total of EUR 65 bn was invested into flex and warehouses (<10,000 m²) since 2011. The largest volumes were directed towards the United Kingdom (36%) and Germany (17%), followed by France (11%) and the Netherlands (9%). On a regional level, investment is distributed in a similar manner to the I&L sectors previously considered.

Table 2: Top investment regions for flex property

Region	*2019 volume in EURm*	*Ø 5-yr volume in EURm*
Amsterdam/Randstad	576	523
Paris	326	273
London (Metro)	241	511
Rhine-Ruhr	176	113
Frankfurt/Rhine-Main	113	176

Source: RCA

Table 3: Top investment regions for warehouse (<10,000 m²) property

Region	*2019 volume in EURm*	*Ø 5-yr volume in EURm*
London (Metro)	379	331
Amsterdam/Randstad	344	240
Birmingham	115	95
Manchester (Metro)	88	65
Paris	87	100

Source: RCA

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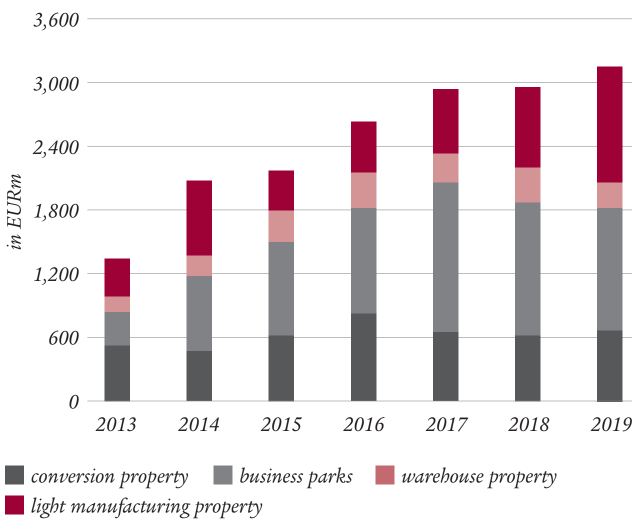
As investor demand causes capital growth and yield compression, the average yield (cap rate) for light industrial property declined from 7.9% in Q1 2011 to 6.3% in Q1 2020 on a European basis. The yield of warehouses (<10,000 m²) is 10 bps higher than for flex, according to RCA. In a popular market like London, yields even went as low as 4% in 2020.[26)]

An analysis of the German light industrial market provides a more illuminating understanding of the sector because of better data granularity for both the investment and the occupational market. The German market is also a proxy for the significant unrealised potential of light industrial property in Europe.

The overall market value of German light industrial property is over EUR 560 bn, of which approximately EUR 280 bn is investment-grade. Only a fraction of this volume is invested stock – the majority is still owner-occupied by SMEs. Yet more SMEs are bringing their assets to the market[27)] and so the sector is becoming more accessible to investors. Out of these EUR 280 bn of investment-grade stock, only EUR 17 bn has been circulating in the investment market since 2013. As a result, there remains a huge unmet investment potential in the German market alone. The same is likely to be true for other European markets, too.[28)]

Figure 12: Investment volumes in the German light industrial market

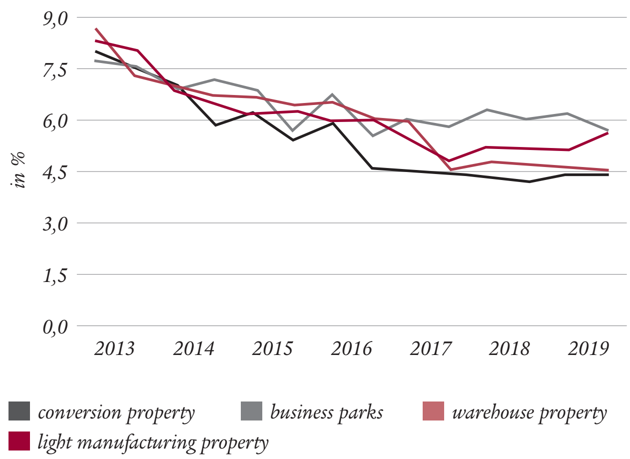


Source: Initiative Unternehmensimmobilien

Transaction volume totaled over EUR 3 bn in 2019. This suggests, on a European level, the light industrial market is much larger than the data implies. According to RCA, investment volumes for flex and warehouse (<10,000 m²) stock in Germany in 2019 was EUR 1.6 bn.

German light industrial data also sheds light on the heterogeneous prime yield levels and developments in light industrial property.

Figure 13: Prime yields (gross) in the German light industrial market

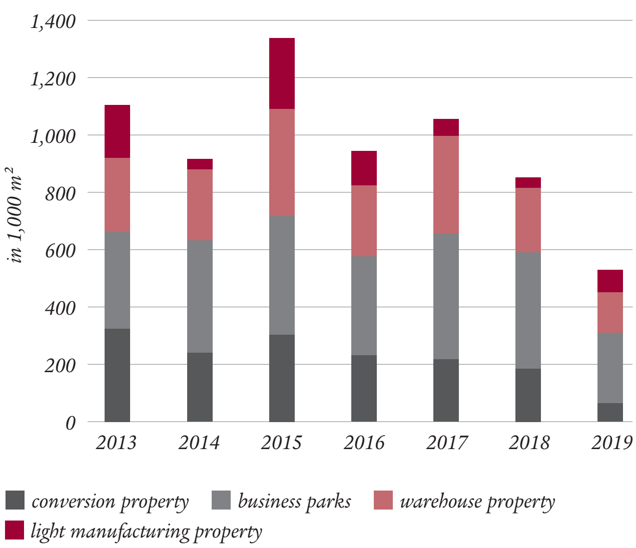


Source: Initiative Unternehmensimmobilien

Highest prime yields are recorded in business parks and light manufacturing property (both 5.6% as of 2019). Yields for warehouse and conversion property were more than 100 bps lower at 4.5%. Prime yields of conversion and warehouse property have stabilized. For business parks, prime yields are compressing from a high level.

High demand for space combined with limited availability and insufficient completions to cater for demand are leading to falling take-up. In 2019, take-up in Germany was 38% below the previous year.

Figure 14: German light industrial property take-up



Source: Initiative Unternehmensimmobilien

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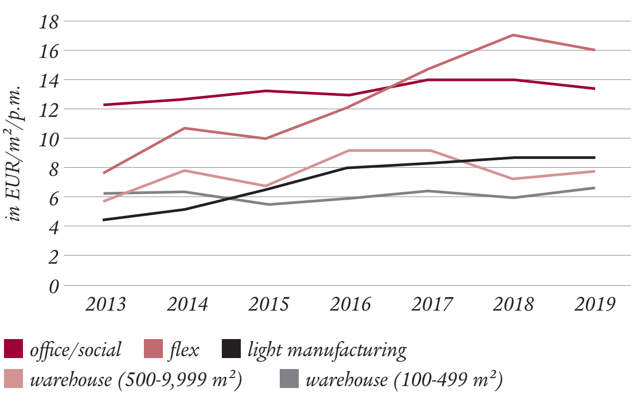
Similar patterns emerge for other European areas such as the Paris region and Denmark, where take-up volumes and vacancy rates are declining.[29)] Growing rental levels reflect that it is insufficient supply, rather than demand, that is constraining take-up.

Figure 15: Prime rents for German light industrial property



Source: Initiative Unternehmensimmobilien

Rents have risen by 54% since 2013 in Germany on average. Rents for flex space more than doubled and represent the most expensive space among light industrial property (2019: 16.30 EUR/m²/p.m.). It is likely that relatively expensive space has reached its peak.

Summary

The combination of logistics and light industrial property offers investors access to a well-diversified market across sectors, use types, and regions. The market that is benefiting from current and future economic dynamics and that is seeing rising occupier and investor demand. The logistics market provides investors with the ability to engage in a highly liquid and sizeable sector, although it has low yield levels in the core markets. Light industrial property is an emerging sector with significant future investment potential that needs to be unlocked. As light industrial and logistics owner-occupiers are selling their real estate, investment opportunities are multiplying. Light industrial is a specialist real estate class: only a minority of investors can unlock its competitive advantages and capture superior yields. A portfolio with a balanced asset allocation of I&L property, focusing on core European countries such as the United Kingdom, France, Germany, and the Netherlands as well as key metropolitan areas and capitals, allows for yield advantages with simultaneous diversification benefits.

[1] *Statista*
[2] *McKinsey&Company 2018*
[3] *ECB Monthly Bulletin, February 2010*
[4] *Logistik-Initiative Hamburg*
[5] *Eurostat, Maritime ports freight and passenger statistics, March 2020*
[6] *European Commission (2012): Study on Urban Freight Transport*
[7] *Dablanc et al. (2016): Observatory of Strategic Developments Impacting Urban Logistics*
[8] *McKeen and Miller (2020): Classification of Regions of Europe and the Mediterranean Region by Road Density; Eurostat, News April 2020, How closely do people live together in your region?*
[9] *Saraceno and Cerniglia (eds), A European Public Investment Outlook, Cambridge, UK: Open Book Publishers, 2020; European Investment Bank, Stories, Does This Change Everything? Air travel and coronavirus, April 2020; Europe Air Cargo Market to 2027 - Regional Analysis and Forecasts by Type, Service, and End User*
[10] *International Airport Review, Article, January 2020; Cargo Trends, News, February 2020*
[11] *Dowell and Victoria-Jaramillo (2017), The Evolving Role of Transportation in Economic Development*
[12] *Eurostat, Inland transport infrastructure at regional level, April 2020; European Commission, Trans-European Transport Network (TEN-T)*
[13] *Initiative Unternehmensimmobilien market report H2 2019*
[14] *Excluding micro-enterprises with less than ten employees; Statista, November 2019*
[15] *German Economic Institute (2017)*
[16] *Swiss Life Asset Managers*
[17] *GVA is the sum of the respective GVA-values of the six industries defined earlier. Île-de-France comprises the regions FR101, FR105, FR106; London: UKI31-UKI34, UKI41-UKI45*
[18] *Balland and Boschma (2019)*
[19] *Real Capital Analytics (RCA). We define logistics property as warehouses with an area of 10.000 m² and more*
[20] *Blackstone, Press Release, June 2017*
[21] *RCA*
[22] *Property Market Analysis (PMA)*
[23] *RCA definition of "flex": Industrial properties that are flexible in that they can be used for industrial or office activities. These properties are often used as research labs, tech/telecom facilities, and other mixed office-light industrial uses.*
[24] *In this section the use of the term "light industrial property" refers to flex and warehouse property*
[25] *Initiative Unternehmensimmobilien market report H2 2019*
[26] *RCA*
[27] *Initiative Unternehmensimmobilien market report H2 2019; JLL, Press Release, May 2019*
[28] *JLL, Press Release, May 2019*

Gudrun Rolle
gudrun.rolle@swisslife-am.com

Andri Eglitis
andri.eglitis@swisslife-am.com

Francesca Boucard
francesca.boucard@swisslife.ch

Do you have any questions?
Please send an email to: info@swisslife-am.com.
For more information visit our website at: www.swisslife-am.com/research

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