A Bright Future Beckons For European Logistics Real Estate Market

December 2024

Summary

The European logistics real estate market, supported by robust market fundamentals, remains a bright spot in the sluggish European commercial real estate market. Remarkable rental growth in this sector has outpaced other key real estate areas, driven by strong demand, limited new supply, and a historically low vacancy rate below the 5% shortage threshold. Logistics has emerged as the most sought-after asset type, leading the recovery in investment activities with its share of total investment rising steadily to 20% in the first half of 2024. The sector holds promising prospects with sustained demand and rental growth. Investment has also shown signs of recovery, along with the ECB's initiation of a rate-easing cycle and a broader economic resurgence.

Long-term structural trends, including the expansion of e-commerce, nearshoring, and green transitions, are poised to bolster demand across manufacturers, logistics operators, distributors, and retailers, providing robust tailwinds for the logistics sector. Furthermore, as EU environmental regulations tighten, demand for prime modern assets, distinguished by strategic locations, energy efficiency, and ESG compliance, is set to further escalate.

A solid market foundation, combined with stabilized yields and significant growth potential driven by secular tailwinds, offers a unique and compelling opportunity for investors to secure prime assets, which are poised for long-term stability and growth in the burgeoning European logistics real estate market.

European Logistics Total Stock and Vacancy rate Q2 2024

Source: CBRE, CGLIM Research

1. Logistics Real Estate Market Overview

Despite economic fluctuations, the logistics real estate market remains the best-performing sector in the European commercial real estate(CRE) market, demonstrating resilience with a robust market foundation.

Over the past five years, the logistics sector has recorded significant rent growth, outpacing other commercial real estate (CRE) sectors in the EU. This trend is expected to continue, driven by tight supply-demand dynamics across the European market. The vacancy rate has steadily declined alongside growing demand and persistent space scarcity, reached 4.8% in Q2 2024, significantly below the ten-year average of 8.02% from 2009 to 2019. Though logistics leasing activity moderated to 11.4 million sqm in H1 2024, it remains at a sustainable level that matches the 2019 figures following the pandemic surge. Q2 2024 showed signs of recovery, with demand increasing by 17% q-o-q and 4% y-o-y. The occupier industry has become more diversified, including third-party logistics operators, retailers, e-commerce businesses, and manufacturers. Moreover, the logistics sector has emerged as a highly sought-after asset type among investors, with its share of total investment in the EU CRE market increasing from 10% in 2014 to 20% in H1 2024. New development remains constrained due to current land and space scarcity, tight financial conditions, stricter land policies, and increased sustainability regulations. This thinning pipeline is expected to sustain low vacancy rates and support rental growth, especially in traditional key markets.

Looking ahead, the logistics market is poised for continued growth, propelled by long-term secular tailwinds. As online sales expand across European markets, transforming consumers' lifestyles and shopping habits, logistics has become indispensable infrastructure. Furthermore, amid persistent geopolitical tensions and emerging trade protectionism, manufacturers are shifting toward nearshoring and reshoring strategies, boosting the demand for logistics space. Concurrently, Europe's commitment to its green transition, aiming for a net-zero target by 2025 and revitalizing its manufacturing sector, further supports this trend. Sectors such as renewable energy, including solar power, electric vehicles, and battery storage, are expected to develop rapidly, further bolstering demand in logistics real estate market.

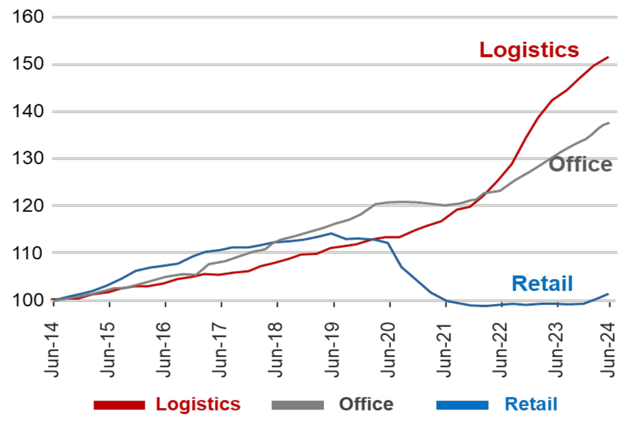
2. Resilient Performance amid Volatility

<u>1) Substantial rental growth in European logistics market over the decade</u>

Over the past decade, the European logistics real estate sector has seen a remarkable 51% increase in rents, with the fastest growth occurring during the pandemic, significantly outperforming key sectors such as office and retail. In contrast,

the office sector saw a 38% rise in rents over the same period. Meanwhile, retail rents, dampened by the pandemic, have returned to pre-pandemic levels, as seen in 2014. The retail market in France and Germany recorded a 25% decrease in rent compared to 2014 levels. However, intensifying supply-demand dynamics have driven rental growth in the logistics sector. The CEE region leads, with average rent growth of 58% over the decade, followed by Germany and France, where rents surged by 53% and 47%, respectively. The Netherlands, Spain, and Italy also recorded increases between 30% and 40%. Looking ahead, rental growth in the European logistics market is set to continue its upward trajectory after a record 2023, outpacing other sectors in the coming years. Given the constraints on new supply due to tight financial conditions and stricter sustainability policies, rental rates for modern assets in the prime location with marked supply-demand disparities are projected to escalate further.

Exhibit 1: Rent Index for the European Real Estate Market (% 2014 Q2=100)



Source: Cushman, CGLIM Research

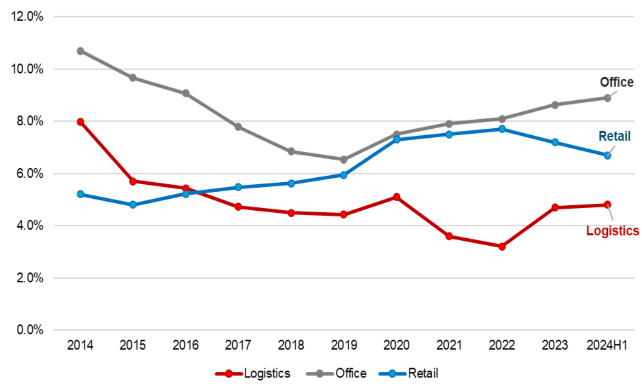
2) Narrowing vacancy rates in the logistics sector contrast with widening trends in other sectors

The office market is contending with structurally higher vacancy rates due to a mix of factors. Beyond the short-term demand reduction caused by the pandemic and economic fluctuations, shifts towards hybrid and remote working models suggest a new normal of diminished corporate demand. Sustainability and energy regulations have become a tightening ratchet on the office sector, given the quality and age of the current office stock. The office vacancy rate has followed an upward trajectory, reaching an average of 8.9% across European markets in Q2 2024, a rise of 2.4% compared to 2019.

The retail real estate market has gradually improved, reached an average vacancy rate of 6.7% by Q2 2024, driven by robust real wage growth, declining inflation, and the recovery of international tourism. However, the vacancy rate presents a mixed and polarized picture among different sub-categories. Retail warehouses and retail parks have outperformed, with vacancy rates reaching 3.8% across Europe. These types of assets offering essentials such as food, DIY products, and furnishings, have been less impacted by economic downturns and e-commerce expansion. Retail parks are also designed with an experience-oriented approach, serving as showrooms where customers can browse and test products, and doubling as last-mile distribution centers for delivery or self-pickup. In contrast, shopping centers have struggled with increasing vacancies. Retail brands, especially in fast fashion and electronics, face challenges adapting to evolving consumer demands, compounded by competition from online shopping and smaller retail formats. The vacancy rate in shopping malls has climbed from 3% in 2005 to over 13.8% in Q2 2024, with Germany, the Netherlands, Spain, and the UK experiencing rates above 15%.

In contrast, the vacancy rate in the logistics market has steadily decreased, plummeting from double-digit rates in 2012 to a historic low of around 3% in 2022, thanks to the e-commerce boom during the pandemic and the ongoing nearshoring trend. Despite the influx of new supply over the past three years and the normalization of demand, the tight supply-demand dynamics have only eased slightly, with the vacancy rate edging up to an average of 4.8% across the European market in Q2 2024.

Exhibit 2: Vacancy Rates for Key Sectors in the European Real Estate Market

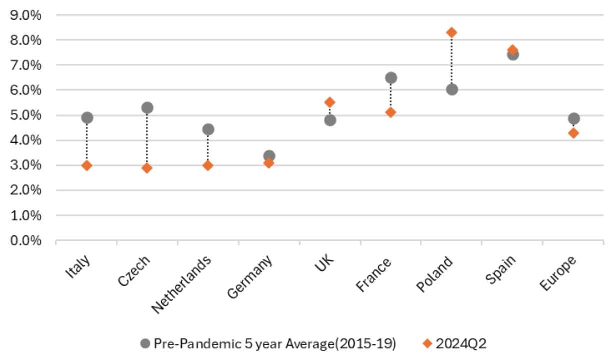


Source: MSCI, CBRE, CGLIM Research

Most European countries exhibit low availability due to persistent challenges of land scarcity and limited space, particularly in Italy, the Czech Republic, the Netherlands, and Germany, where vacancy rates remained at a historic lows around

3% in Q2 2024. Furthermore, the CEE region has experienced substantial growth in the logistics market thanks to its strategic geographical location and the ongoing reorganization of global supply chains. Hungary's total stock surged by 114%, from 2.4 million sqm in Q4 2020 to 5.1 million sqm in Q2 2024, while Poland's stock grew by 67%, from 20 million sqm to 33.5 million sqm in the same period. Despite the influx of new supply, vacancy rates in both markets have remained relatively healthy, with Hungary recording 8.5% and Poland 8.3% in Q2 2024. Additionally, other traditional markets, such as France's logistics market, have also seen rapid growth in total stock over the past decade, while its vacancy rate remains at a healthy level of 5.1% in Q2 2024.

Exhibit 3: Logistics Market Vacancy Rates (%) Across European and Selected Countries

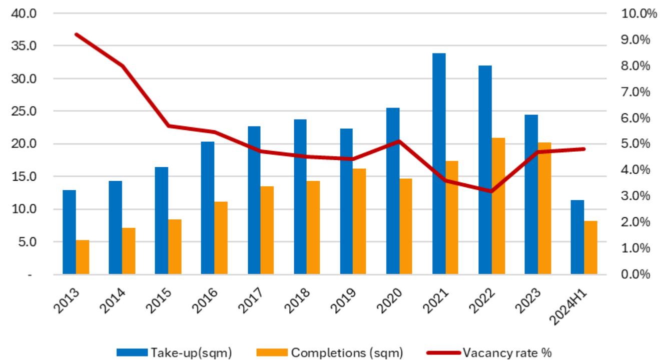


Source: CBRE, CGLIM Research

3) Robust leasing activity in the European logistics market

Leasing activity in the European logistics sector has shown robust performance over the past decade, with annual gross take-up doubling from 12 million sqm in 2013 to approximately 24.5 million sqm by 2023. Despite fluctuating economic conditions, leasing activity in 2023 was 16% higher than the pre-pandemic five-year average of 21.1 million sqm. Resilient demand continued into Q2 2024, with gross take-up recording 6.2 million sqm across 11 key European markets. This pushed the 2024 H1 total to 11.4 million sqm, returning to a sustainable level after the booming years, while remaining 8% higher than the five-year average from 2015-2019.

Exhibit 4: European Logistics Market Take-up, Completions (Million sqm) and Vacancy (%)



Source: JLL, CGLIM Research

4) 3PLs, manufacturers, and retailers are key demand sources in the European logistics market

In the European logistics market, third-party logistics operators (3PLs) represent the largest source of demand and have expanded their share over the past five years. They play a crucial role in providing distribution services for a diverse range of customers, including manufacturers and retailers. The share of demand from 3PLs has increased from 34.1% in 2019 to 45% of total take-up in H1 2024.

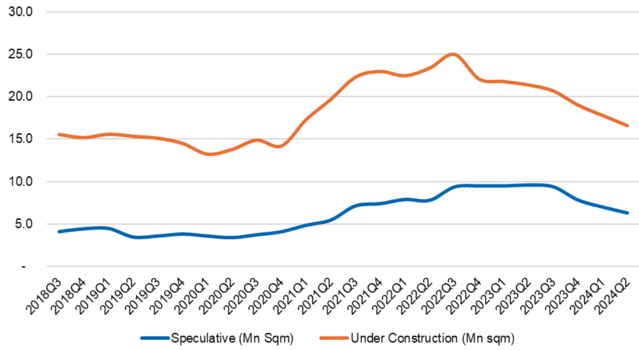
Manufacturing companies have emerged as the second most active tenant type, fueled by the nearshoring/reshoring trend amid heightened geopolitical tensions and trade protectionism. Demand from manufacturers continues to grow, contributing 20% of gross take-up in the first half of 2024. Leading sub-sectors include electric vehicles, battery production, and pharmaceuticals. Supported by policies that favor renewable energy production and the long-term warehousing needs of the manufacturing sector, demand for logistics space is expected to grow steadily in the coming years. Retail remains a key occupier, though its demand has moderated after previous booming years, now capturing 23% of the total take-up in H1 2024. Alongside the main types of occupiers, the tenants of logistics space are also becoming more diverse, including industries like telecoms, biotech, pharmaceuticals, IT, R&D and Media, suggesting a healthy market development.

The European logistics market is experiencing a shift in tenant demands, influenced by evolving trends in sustainability, e-commerce, and renewable energy manufacturing. Following the 2022 energy crisis and stricter EU environmental regulations, tenants are increasingly prioritizing energy-efficient spaces. Additionally, there is a growing adoption of new supply chain management technologies, automation facilities, and advanced production machinery, fostering a preference for long-term leases that ensure operational continuity in high-tech equipped warehouses. Many properties are now being customized with features like solar panel-ready roofs, enhanced roof load capacities, flexible column spacing, and seamless flat floors designed for specific loading requirements. This trend towards modern spaces is expected to sustain rental growth for prime assets and widen the rent gap with older stock.

5) Constrained new supply across European logistics markets

New construction is declining across the European logistics market, amid tightening financial conditions, elevated interest rates, stricter land policy and rising construction costs. Developers have adopted cautious approaches, including postponing new construction, transforming active pipelines to 'Shell & Core' status, and shifting to build-to-suit (BTS) models for the purpose of enhanced adaptability, timing flexibility, and cost savings. Additionally, against the backdrop of the EU's "Net-Zero 2050" and "no-net-land take by 2050" targets, many countries have adopted stricter environmental and planning policies to support green transition and sustainability, exacerbating land scarcity and complicating new logistics developments. In H1 2024, construction fell by 24% y-o-y to 16.6 million sqm, with speculative development dropping to 6.3 million sqm—the lowest level since 2021. The scarcity of land and available space, along with constrained new supply, are expected to maintain low vacancy rates and drive rental growth in the coming years.

Exhibit 5: European Logistics Market Under Construction (Million sqm)

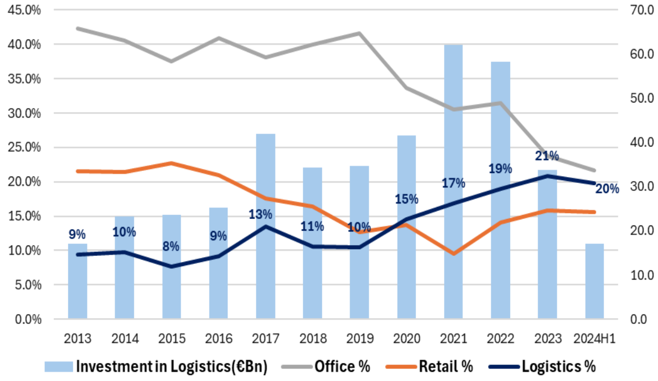


Source: JLL, CGLIM Research

6) Logistics has emerged as one of the most sought-after asset types among investors.

Investment in the European commercial real estate (CRE) market rebounded in H1 2024, reaching €86.5 billion, marking a 10% y-o-y growth. The logistics sector continues to lead, attracting €17.1 billion (up 7% y-o-y) and accounting for 20% of the total volume, reflecting strong market fundamentals and investor confidence. In contrast, both the office and retail sectors grew modestly, by 1% y-o-y. Although the office sector contributed the largest volume at €18.7 billion, its market share decreased from 40% in 2014 to 21.6% in H1 2024. The retail sector maintained a steady 15% of total volume at €13.5 billion. Reflecting broader European trends, investment in logistics assets has recovered across key markets. In Germany, logistics investment surged 52% y-o-y to €2.9 billion, representing 21% of the total CRE volume. The French logistics sector also showed robust growth, with investment surging 75% y-o-y to €1.5 billion, boosting its market share from 15% pre-2021 to 34% in H1 2024.

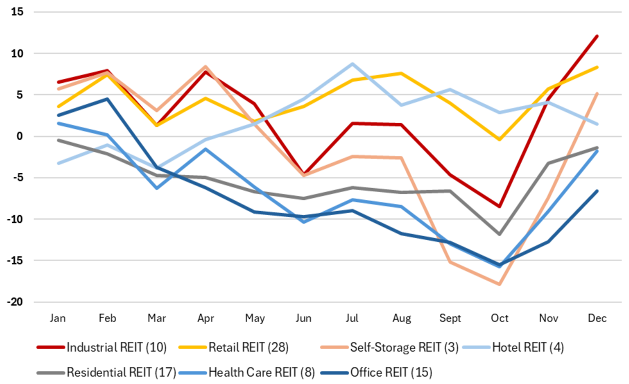
Exhibit 6: European Real Estate Investment by Sectors, % of Total Volume



Source: CBRE, CGLIM Research

As the ECB concluded its rate-hiking cycle in October 2023, European listed REITs experienced a strong resurgence, with logistics REITs leading the recovery, posting total returns of 12% by end-2023. Prime yields for European logistics assets have also stabilized since early 2024. A revival in investment activity is expected in the coming years, driven by the ECB's rate cuts starting in June and a broader economic recovery.

Exhibit 7: European Listed REIT performance by Sectors, 2023 Cumulative Total Returns (%)



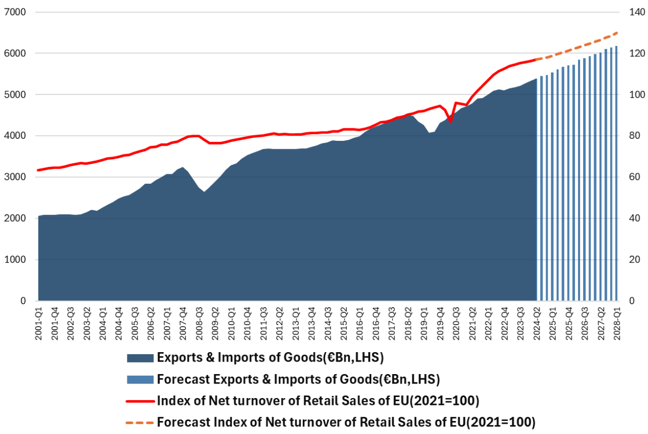
Source: CBRE, CGLIM Research

3. The logistics market embarks on an era of sustained growth, fueled by multiple long-term trends

1) Retail sales and E-commerce expansion

European retail sales have exhibited consistent growth over the past two decades, with the net turnover index reaching 116.8 in Q2 2024 (2021=100), according to Eurostat. Post-pandemic, European trade in goods has resumed a steady growth path, supported by a strong wage growth, stabilized inflation, and improved purchasing power. Looking ahead, European retail sales are projected to grow at a 2% CAGR over the next five years. This recovery is expected to drive demand for logistics space.

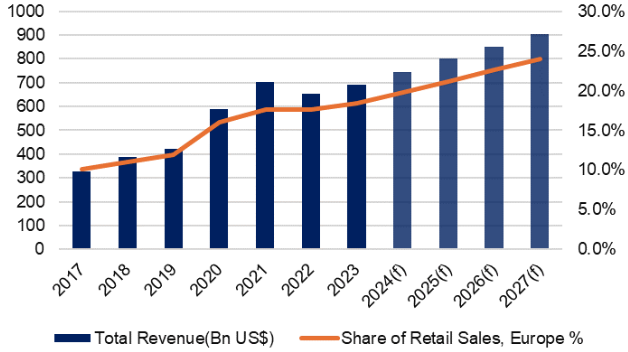
Exhibit 8: European Retail Sales Index (2021=100) and Trade in goods (€ Billion)



Source: Eurostat, Oxford Economics, CGLIM Research

Moreover, the structural shift in consumer online shopping habits is expected to continue driving demand in the logistics market. E-commerce revenue in Europe surged by 66% during the pandemic, rising from USD $422 billion in 2019 to USD $702 billion in 2021. Although growth slowed in 2022 due to inflation and the return to physical stores post-lockdowns, the market rebounded quickly, with 2023 revenue recovering to USD $690 billion. Driven by ongoing digital adoption and consumption recovery, supported by strong wage growth, e-commerce sales are forecast to grow at a 6.6% CAGR through 2027, reaching USD $902 billion. E-commerce's share of retail sales is also expanding, increasing from 10% in 2017 to 18% in 2023, with expectations to reach 24% by 2027. E-commerce penetration is projected to grow across European countries, with Italy seeing the highest increase, from 14.5% in 2023 to 24.5% in 2027. Other key markets, including Germany, Spain, and France, are expected to see growth of 7% to 8.2% over the next five years, reaching penetration rates between 23% and 28%.

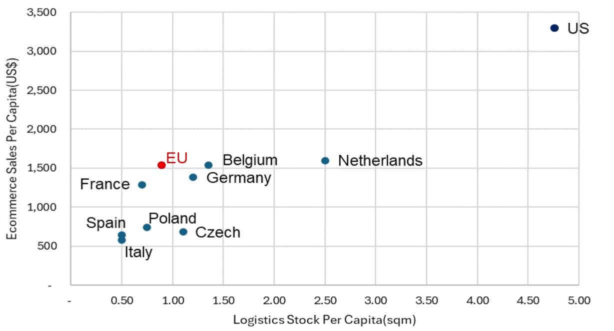
Exhibit 9: E-Commerce Total Revenue (US$ Bn), Share of Total Retail Sales in Europe



Source: ECDB as of Apr 2024, IMF, CGLIM Research

In 2023, per capita e-commerce sales in the U.S. reached $3,500, supported by a logistics stock of 4.76 sqm per capita. In contrast, Europe, still in the early stages of online shopping, recorded per capita e-commerce sales of $1,500 with a logistics stock of just 0.9 sqm per capita. Anticipated growth in e-commerce revenue and market penetration is expected to sustain demand in the European logistics sector over the medium to long term. Furthermore, as customers request for faster delivery times, more retailers are offering two-day or same-day shipping. This shift is leading to higher inventory levels across supply chain networks and driving demand for logistics spaces. The expansion of e-commerce will also boost demand from related sectors such as third-party logistics (3PL), wholesalers, B2B trade, packaging, and grocery.

Exhibit 10: 2023 E-commerce Sales (US$) vs Logistics Stock (sqm), Per Capita

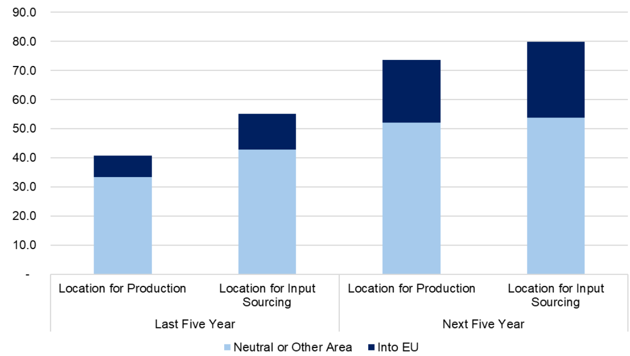


Source:U.S.Department of Commerce, Statisa, IMF, CGLIM Research

2) Nearshoring and reshoring trends provide tailwinds for logistics market growth

Persistent geopolitical instability, including the Russia-Ukraine conflict and tensions in the Middle East and Red Sea, continues to pose risks to supply chain security. In response, more companies are adopting nearshoring strategies, relocating production closer to end customers or key markets. This shift aims to enhance supply chain resilience, reduce transportation costs and lead times, and mitigate potential disruptions from distant supply sources. A recent ECB survey of large EU firms also confirmed this trend. 74% of firms plan to adopt nearshoring, diversification, and friend-shoring strategies over the next five years, up from 41% in the past five years. Similarly, the share of firms adopting these strategies for input sourcing has increased from 55% to 80%.

Exhibit 11: Firms Adapt Nearshoring, Diversifying and Friend-Shoring Strategy, EU 2023



Source: ECB Survey 2023, CGLIM Research

Among the acceleration of reshoring and nearshoring activities, European logistics market has witnessed a surge of demand from the manufacturing sector, which emerged to be a key type of occupiers, accounting for 20% of the total takeup in 2024 H1. The CEE regions, benefiting from their central geographic location, proximity to major markets, strong infrastructure, and comparatively lower labor and rental costs, have seen the fastest demand growth from manufacturers, with a 22% y-o-y increase in 2023.

Companies adopting nearshoring strategies typically exhibit greater stability and often commit to long-term contracts. Establishing fixed production lines or automated distribution/sortation systems requires substantial investment and is normally difficult to relocate. Moreover, these investments constitute strategic decisions, closely aligned with long-term corporate goals and consider key factors such as local market demand, proximity to the regional value chain, and potential policy incentives. Once made, such decisions are not easily reversible. This shift in operational needs has not only spurred the growth of Industrial Outdoor Storage (IOS) but also driven the evolution of logistics spaces, which are increasingly designed to be larger, offer greater clear heights, and provide flexibility to accommodate advanced automation facilities. Overall, nearshoring is poised to drive demand in the logistics market over the medium to long term.

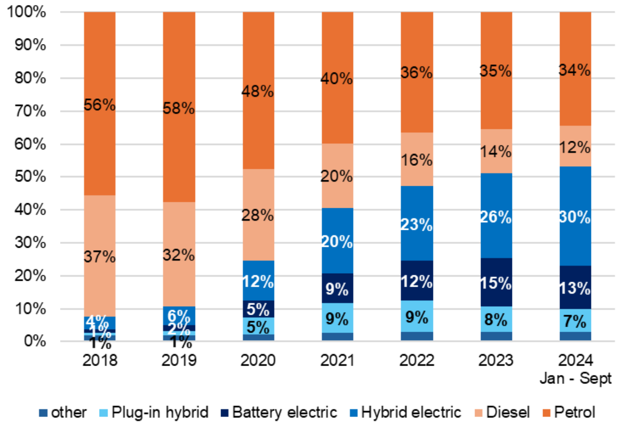
3) EU's green transition boost renewable-related industries and fuels demand for logistics space

Both existing buildings and new constructions are facing increasingly stringent environmental and energy standards. Currently, Europe's built environment accounts for 36% of CO2 emissions. The EU aims to reduce emissions from buildings by 60% by 2030, employing a phased approach to achieve its net-zero target. In 2024, EU updated the Energy Performance of Buildings Directive (EPBD) mandating all new constructions from 2030 to be 'zero-emission' and 'solar ready' for hosting rooftop solar facilities. Additionally, the EPBD has set Minimum Energy Performance Standards (MEPS) for non-residential buildings and enhanced requirements for recharging infrastructure and pre-cabling in new buildings. In response, European countries have tightened environmental policies. Germany, for instance, has updated its Renewable Energy Sources Act and Climate Action 2030 to promote renewable energy and cap building emissions, including introducing a carbon price on emissions. France has adopted the Environmental Regulation 2020 and 'Net Zero Artificialization 2050' (NZA), targeting reductions in building emissions and urban land use. Meanwhile, the Netherlands has enforced stricter nitrogen emission policies for new constructions, and Poland has strengthened building regulations and zoning policies.

Concurrently, tenants are increasingly prioritizing sustainability and energy accessibility in logistics spaces, especially in light of recent volatile and high energy costs. Tenants with advanced automated production or sophisticated distribution systems often require reliable, high-capacity energy sources to ensure operational continuity. Additionally, tenants' adoption of electrifying fleets is expected to increase demand for logistics properties with onsite power supplies or charging stations. Developers have also started equipping new assets with features to meet tenants' ESG compliance needs, such as low-water maintenance systems, external wall heat insulation, passive solar designs to minimize heat transfer, and fiber-reinforced concrete to lower carbon emissions. The acceleration of nearshoring and e-commerce is anticipated to offer opportunities in the market and boost demand for modern logistics spaces.

Furthermore, driven by supportive green transition policies, the green-energy industry is booming. For instance, the EU has set an ambitious goal to increase the share of renewable energy in total energy consumption to at least 42.5% by 2030, effectively doubling the current share. Additionally, the EU plans to ban the sale of non-renewable energy vehicles starting in 2035. Moreover, customers are also shifting toward electric vehicles, with the market share of new car registrations in the EU expanding from below 10% in 2018 to over 50% during the first three quarters of 2024. Both the regulations and market trends have provided tailwinds for the renewable energy industries, particularly manufacturers in sectors like solar power, battery storage, and electric vehicles, which are expected to fuel demand for industrial and logistics space in the future.

Exhibit 12: EU New Car Registration by Power Source (%)

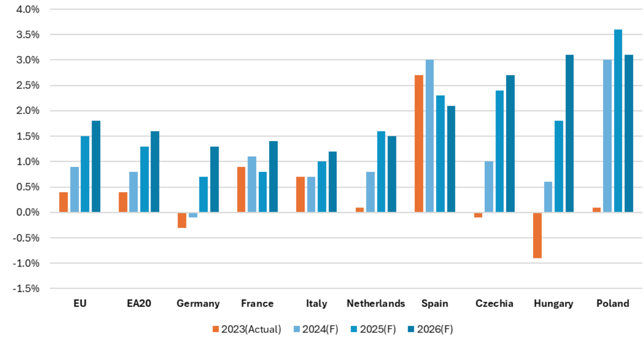


Source: European ACEA , CGLIM Research

4) Macroeconomic recovery is expected to support the European real estate market revival

The European economy maintained its momentum in Q2 2024, growing by 0.3% q-o-q and 0.8% y-o-y, with most countries reporting positive GDP growth in H1 2024. Inflation reached 2.4% in August, projected to average 2.6% for 2024 before easing to 2.4% in 2025. The labor market remains robust, with the EU unemployment rate reaching a historic low of 5.9% in August. In most European countries, robust wage growth has outpaced inflation, with real wages rising by 4.3% across the EU in Q2. Real disposable income per capita grew by 0.6% q-o-q in Q2 2024 and is expected to continue expanding, supporting the recovery in private consumption and GDP growth in the coming years. Looking ahead, the EU economy is projected to grow by 0.9% in 2024 and accelerate to 1.5% in 2025. The broader economic recovery is expected to drive demand and investment in the real estate market.

Exhibit 13: Real GDP Growth Rate and Forecast (%), EU and Selected Member States, 2023 – 2026



Source: European Commission, CGLIM Research

4. Bright Outlook

Looking ahead, the European logistics market holds promising prospects. The sector has demonstrated resilience amid the challenging period, underscored by tight supply-demand dynamics, limited new developments, and steady rental growth. The ECB's transition to a rate-easing cycle has supported gradual yield stabilization, signaling a key turning point in real estate valuations. Solid market fundamentals, coupled with yield stabilization and the potential for high growth driven by secular tailwinds, present a unique and appealing entry point in the logistics sector. For investors with in-depth market insights and regional expertise, this phase presents a golden opportunity to acquire premium assets that promise long-term stable growth.

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