KEYNOTE INTERVIEW

Sovereign wealth funds lean into industrial

Demand for US logistics will remain strong long into the future, says Logistics Property Company's Jim Martell and Brent Steele

The US has long been a magnet for sovereign wealth funds, given the country's long-term stability and efficient financial market systems that allow outside governments to diversify risk while building and preserving capital.

Chicago-based Logistics Property Company was founded in 2018 with Macquarie Asset Management, the asset management division of Australia's Macquarie Group, a diversified financial services group.

Since then, it has raised close to $3 billion from six of the world's largest investors because of their appetite for US logistics, according to Jim Martell, CEO of Logistics Property Company, and Brent Steele, its chief investment officer.

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Q What factors influence international investors when selecting real estate investments, particularly in the US?

Brent Steele: When Jim and his leadership team partnered with Macquarie Group to establish Logistics Property Company, they identified the evolution in institutional real estate investing as global capital increasingly looked to find and partner with best-in class operators directly.

International capital has always been attracted to office properties and more of the main real estate asset classes. Industrial was one of them, but it previously fell down the line as a priority for global capital. All of that began to shift from 2015-20.

Jim and Macquarie Group have effectively combined operational experience with strategic insights into tenant needs and competitive advantages, creating a robust platform that manages global capital and engages investors.

Between existing and under-development investments, the company manages over 27 million square feet across 67 industrial properties.

Jim Martell: What is very important for these international investors is also the tax structure. So many of them are limited to being 49 percent holders of properties.

Take Australia, for instance: the combination of multiple funds in Australia cannot be more than 49 percent for tax purposes, based on US withholdings and other tax structuring.

They also want to do that through a real estate investment trust (REIT) set-up for tax purposes. Our model was created to accommodate those two challenges: the 49-percent limitation and a REIT-ownership format, all to be as tax efficient as possible.

We really focus on communication and transparency. Investors join us on a weekly call to go through what we are doing and why, which helps them understand our organization, our strategy and our perspective. But equally important for us is getting their perspective.

We get a take on what is happening globally and in their backyard that might be influencing their decisions and what they are looking for. That gives us a clear line of communication with them, and I think they have come to appreciate that level of communication and transparency.

Q What are the benefits to focusing on industrial, compared with other property types?

JM: When you look at all the different products, from office to retail to housing and so forth, industrial probably is the simplest product from the standpoint of buying the land, building it, getting it leased and selling it.

Industrial by itself is a very short cycle, which can be 12 to 18 months. Because of the short cycle, outside influences have less chance of impacting the outcome compared with an office or multifamily building that might take five to seven years to go through the gestation process of development and lease-up.

As for the product itself, demand for industrial and logistics property has been steadily rising. The acceleration of demand is driven by two things.

One is the growth of GDP, which is so highly correlated with the sector. As a country's GDP increases, so does the need for warehouses and manufacturing facilities, leading to increased investment in industrial real estate. A growing economy requires more space to produce, store and ship goods.

Second, as we moved from storefront brick-and-mortar retail and got into e-commerce, especially in the period immediately following the covid-19 shutdowns, that accelerated probably 10 years' worth of demand for industrial real estate in very short order. That took off in 2020, and 2022 was probably the year we saw the most development and rent growth in the US industrial and logistics sector.

Q Is that growth trend expected to continue in 2025?

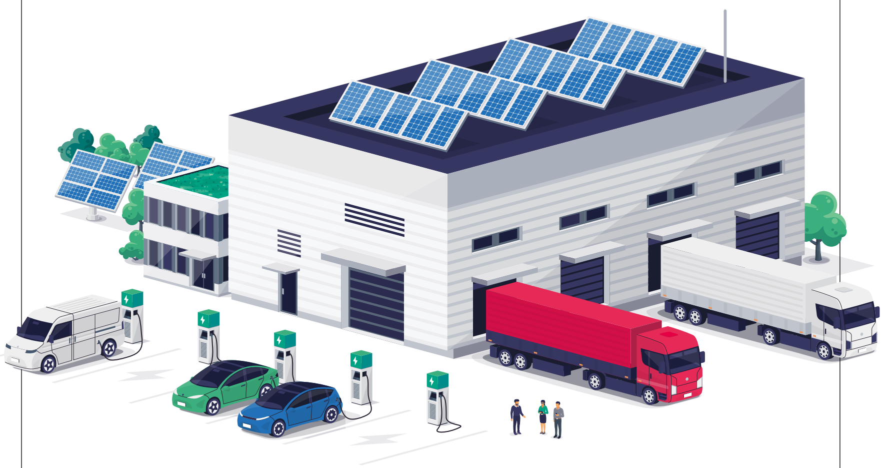
JM: We are seeing construction decline significantly. Rent growth has slowed a bit. When you go back to industrial asking rents in 2015 to what it is now, in many cases, it has doubled or tripled – even though the marginal growth over time has slowed down since then.

In many cases, the US industrial markets got down to vacancy rates that were 2 to 4 percent. Now, across the country, we are in the 7 to 7.5 percent

Q How can managers address the environmental and sustainability concerns that many institutional investors have across their portfolios?

JM: We have ramped up our focus on environmental and sustainability initiatives and hit a milestone recently with the number of our projects that are LEED Certified, both Silver and Gold. We are constructing our buildings with state-of-the-art engineering and design to limit the amount of steel and concrete we are using, especially in our floors.

In addition, we are working to design and construct our structures to add solar panels. We have worked very hard on all that, and it is meeting our investors' expectations.



range – still below historical averages and below vacancy rates for other property types today, but higher than it was a few years ago.

As interest rates increased, the yield on cost obviously had to increase, and companies were more cautious. Also, the cost for a company to move its warehouse and outfit it with new equipment and machinery has become extremely expensive.

Therefore, big corporations put a hold on a good number of the new facilities, given the financial impact of opening new warehouses amid climbing interest rates, geopolitical uncertainty and the looming cloud of a potential recessionary period in 2023 and much of 2024.

Industrial supply had been growing based on e-commerce demand and it has slowed down now because of higher interest rates and occupiers being more expeditious.

BS: If you look at the gross leasing numbers over that same time period, they are still strong. It is the net absorption we are talking about falling off, simply because we did have a lot of supply that came in. That demand was not necessarily keeping up with the robust amount of new supply that was coming online.

But at an absolute leasing level, industrial leases are still taking place, and there is still a lot of gross leasing. So, as that supply is delivered and is absorbed with not much in the pipeline behind it – as construction starts have slowed significantly in the past year – you see some attractive fundamentals ahead if you are an owner-operator of US logistics.

Q Are institutional investors reallocating capital toward industrial?

BS: Historically, in an institutional portfolio allocation between the main product types, logistics would be somewhere in the mid-teens and you would see a huge load up of office space. Those two have switched as office properties have become distressed in many cities. It is all about capital efficiency.

Suburban offices, in certain cases, and even low-rise buildings in urban core locations are no longer the highest and best use for these commercial spaces.

If you look at the rent you can generate in those markets, and the demand drivers given their proximity to consumers, they are now being repositioned into logistics facilities, small-bay warehouses and last-mile shipping. An empty office building does not produce returns and does not create jobs, so investors are starting to look at the other property types.

And then there are the demands of capital just to keep running that type of building, office versus logistics facilities.

Logistics has very good retention, or even if you need to re-let, you are talking about a couple dollars in tenant improvements per square foot, compared to much higher costs to operate, lease-up and fit-out office space. Plus, the operating model for industrial logistics allows you to pass through many expenses to your tenancy.

In addition to the continued interest from global equity capital, debt financing for US logistics remains readily available from banks, life insurance companies, private mortgage lenders and securitized structures. And this, despite the absence of government-sponsored programs that are available to the multifamily sector.

People are driven by data, and they understand there are opportunities based on the capital efficiency and the utilization of these big institutional portfolios. As a result, we have seen a much bigger increase in target allocations within global capital for logistics space and industrial properties. ■

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