The Flight to Functionality and Quality: Modern Logistics Assets Poised to Outperform

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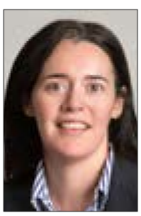

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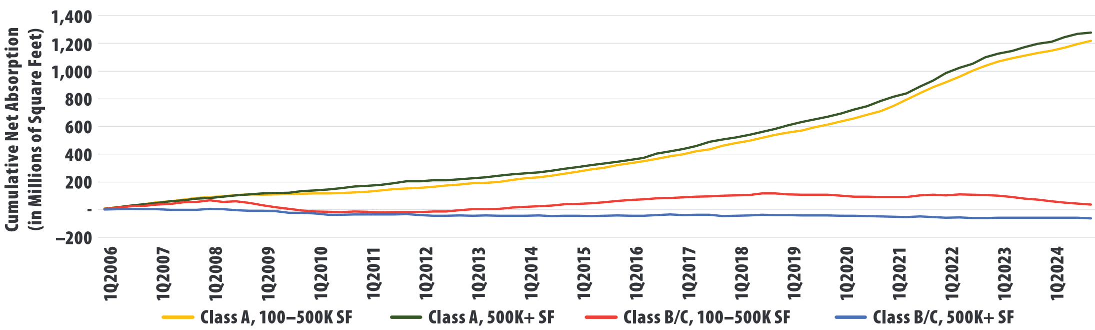
After a decade of exceptional growth, industrial real estate markets across the US and Europe have experienced a near-term slowdown in tenant demand, driven by macroeconomic and policy uncertainty. Tighter financial conditions and evolving trade dynamics have led to a more measured pace of leasing activity. Though we are observing strong tenant interest, prevailing global uncertainty is prolonging decision-making—potentially indicating pent-up demand and the likelihood of accelerated leasing activity once conditions stabilize. Vacancy rates have edged higher, particularly in markets that have experienced significant speculative deliveries over the past two years. However, the softness appears cyclical rather than structural. Occupiers remain focused on modern, high-quality space, and demand continues to bifurcate between modern logistics facilities and older, functionally obsolete stock.

At the same time, the development pipeline is contracting sharply. Higher borrowing costs and construction inflation have made new projects difficult to underwrite on a historical land-cost basis, with completions projected to decline by 74% in the US and 27% in Europe from recent peaks. This pullback sets the stage for a tighter market as long-term demand drivers—e-commerce penetration, supply chain digitization, and onshoring/nearshoring—maintain positive momentum. Historical precedent supports this thesis: in prior downturns, modern logistics assets delivered 150–175 basis points of unleveraged return outperformance compared with older stock during the initial recovery. Against this backdrop, institutional-quality Class A industrial properties appear well positioned to lead performance in the next phase of the cycle.

Demand Bifurcation and Modern Specifications

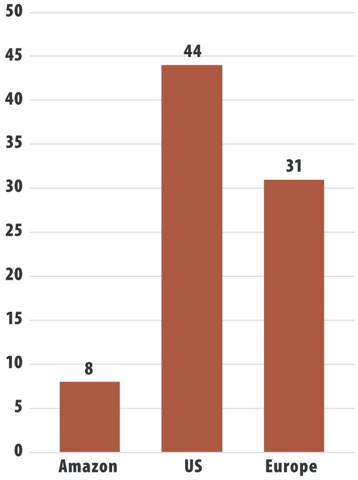
Demand tailwinds for modern, Class A industrial space have been strong globally over the past few cycles. In the US, going back to 2006, Class A net absorption has totaled more than 2.5 billion square feet, while Classes B and C net absorption has been –38 million square feet over the same period (Exhibit 1). Though this is largely driven by the fact that new supply is concentrated in Class A products, this isn't the entire story; total Classes B and C space has increased by 173 million square feet over this period while occupied Classes B and C space declined.

Exhibit 1: Industrial Absorption by Class and Building Size



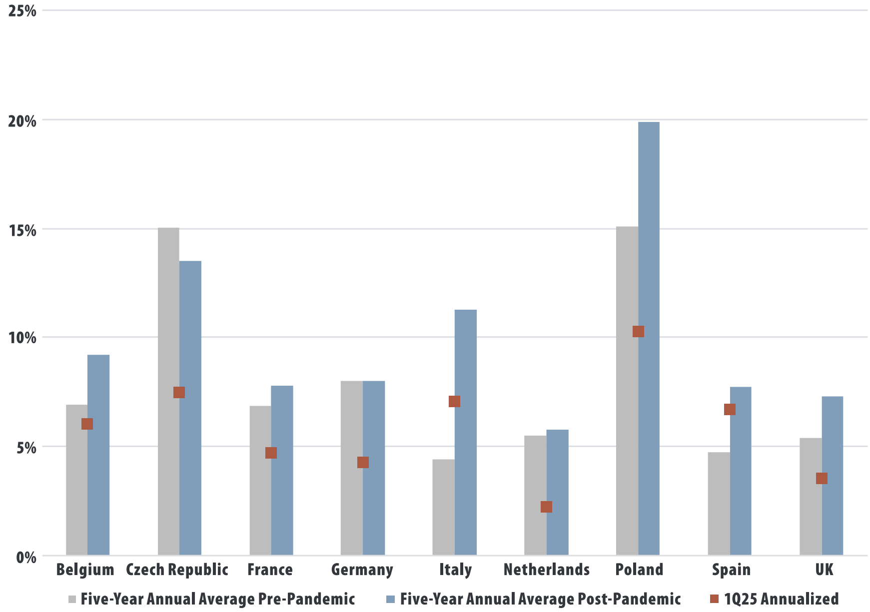
Sources: CoStar, Affinius Capital Research
Note: Industrial properties in top 30 markets over 100,000 square feet

Exhibit 2: Age of Industrial Portfolio—Amazon Versus Global Markets



Source: CoStar
Notes: Only industrial properties over 100,000 square feet. Average age is based on the most recent of year built or year renovated for each property.

Exhibit 3: European Logistics Take-Up (% Stock)



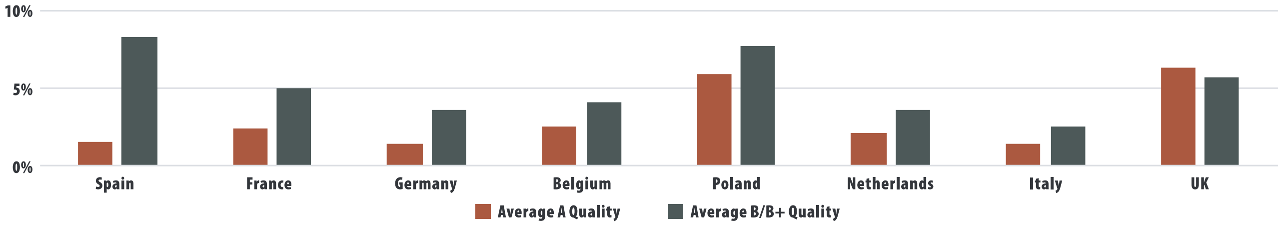
Source: CBRE; 1Q2025

Some of the most active and fastest-growing users over this period, including e-commerce retailers and third-party logistics providers, have demonstrated a clear preference for new, modern facilities. This is driven by multiple factors:

- **Efficiency:** Modern industrial assets are purpose-built to accommodate high-cubic-volume, tech-enabled fulfillment operations. E-commerce tenants prioritize features such as 36- to 44-foot (11- to 15-meter) clear heights to allow for multilevel racking systems, larger building footprints and deeper truck courts to handle greater throughput, and higher dock door counts to support the cadence of same-day or next-day delivery. Older facilities, with their lower ceiling heights, limited maneuverability, and insufficient loading capacity, often fall short of these operational needs.
- **Robotics and Last-Mile Delivery:** Newer buildings are more likely to include upgraded electrical infrastructure to support automation, robotics, and temperature-controlled storage. Many also offer generous trailer and van parking—critical in an era of last-mile logistics and rising fleet-management complexity.
- **Labor Accessibility:** Industrial tenants increasingly factor in labor availability, seeking facilities near population centers, particularly for high-turnover warehouse and fulfillment roles. Amenities at modern logistics facilities are increasingly a differentiator for attracting talent and improving productivity.
- **Responsible Investing Mandates:** Institutional tenants with environmental, social, and governance (ESG) mandates are more inclined to lease space in buildings that meet current environmental standards. Modern facilities typically offer renewable energy solutions, wellness amenities, energy-efficient lighting, insulation, and HVAC systems and are more likely to achieve LEED or other green building certifications. This not only helps tenants reduce operating expenses but also supports corporate sustainability targets and regulatory compliance.

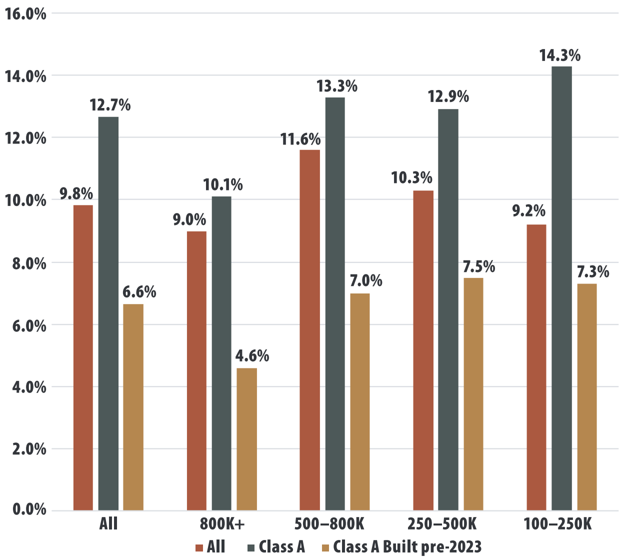
These tenant preferences are evident when comparing the composition of Amazon's logistics portfolio against the broader industrial stock across the US and Europe. The average building vintage in Amazon's network is 2017—less than a decade old—highlighting the company's emphasis on modern, purpose-built facilities designed for high-throughput e-commerce operations. By contrast, the average vintage of US industrial inventory stands at 1981, with the European stock similarly aged at 1994 (Exhibit 2).

Exhibit 4: REIT Industrial Vacancy by Quality



Sources: Company disclosures, Green Street; February 2025

Exhibit 5: Industrial Vacancy Rates by Building Size and Class, Top 42 US Markets



Sources: CoStar, Affinius Capital Research

Decelerating Industrial Demand Amid Uncertainty

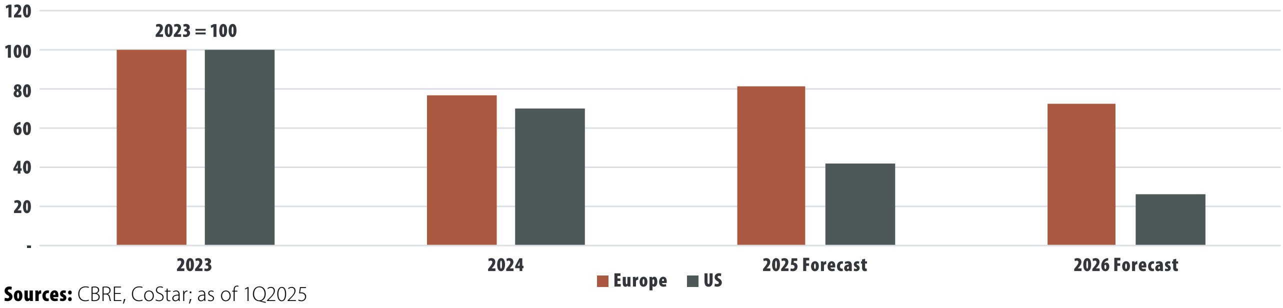
Tenant demand has moderated since 2024, driven by the stabilization of e-commerce growth in some markets and rising economic and policy uncertainty. For example, in Europe, industrial take-up averaged 5% of total stock in the 12 months to 1Q2025, below the 10% of the past five years (Exhibit 3). A key consequence of this slowdown is a growing bifurcation in demand between higher- and lower-quality assets as occupiers become increasingly selective.

Demand has outpaced supply for industrial space across most European and US markets for much of the past decade, pushing vacancy rates in 2022 to record lows of 2.2% and 3.8%, respectively. Over the past few years, given elevated construction deliveries on both sides of the Atlantic Ocean, vacancy rates have risen. However, in some markets, there is a significant spread in vacancy rates between class and vintage.

- The spread in vacancy rates between A and B/B+ industrial properties is most pronounced in Spain (680 basis points), driven by a limited investable universe and a surge in new A grade supply in 2023, which led tenants to favor modern, ESG-compliant spaces (Exhibit 4).
- The UK, in contrast, shows a negative spread because of an oversupply of high-quality stock during the pandemic, which was spurred by high development margins and a spike in e-commerce penetration rates (38% over 2020–2021 compared with 26% as of April 2025), according to the Office for National Statistics.
- The US has a similar differentiation at the market level. Nationally, across the top 42 markets, Class A vacancy rates currently sit above overall rates across various size classifications. The elevated Class A vacancy is largely attributable to a wave of speculative development delivered over the past 24 months amid heightened macroeconomic uncertainty. When isolating Class A products completed prior to 2023—assets that have longer leasing horizons—the picture changes materially; among Class A products delivered pre-2023, which have had more time to lease up, vacancy rates are well below market averages, particularly for larger buildings (Exhibit 5).

We expect that recent demand softness may continue over the next couple of quarters, particularly in the US. Policy-driven uncertainty—including the trajectory of interest rates and evolving trade and tariff regimes—has contributed to a more cautious posture among occupiers. In particular, sectors tied to discretionary consumer spending and global trade have moderated expansion plans in the face of tightening financial conditions and geopolitical ambiguity. These dynamics

Exhibit 6: Europe and US Industrial Completions, Benchmarked to 2023



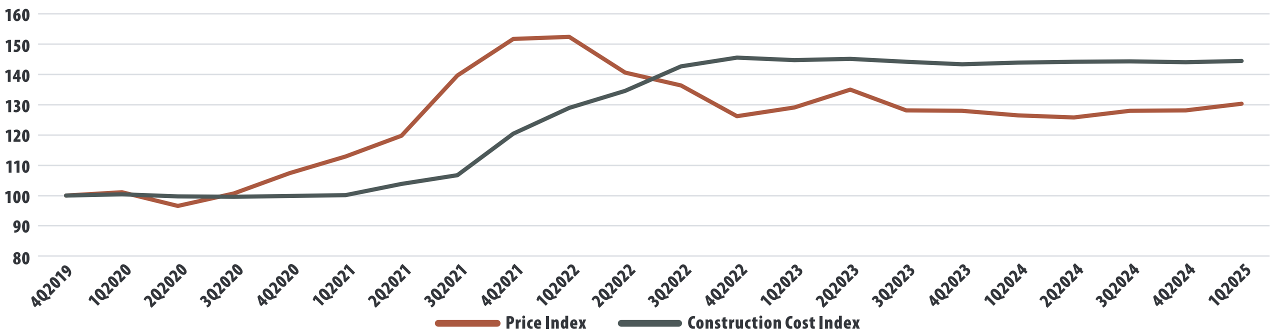
Sources: CBRE, CoStar; as of 1Q2025

Exhibit 7: Large Industrial Markets With the Sharpest Drops in Projected Industrial Completions (2026 Versus 2023)

Europe			US	
1	France	–48%	Los Angeles/Inland Empire	–74%
2	Czech Republic	–43%	Seattle	–71%
3	UK	–40%	New York/Northern New Jersey	–70%
4	Netherlands	–36%	Columbus, OH	–69%
5	Germany	–22%	Phoenix	–67%

Sources: CBRE, CoStar; as of 1Q2025

Exhibit 8: US Industrial Price Versus Construction Cost Indices



Sources: Green Street, FRED St. Louis, Affinius Capital Research

are likely to keep leasing velocity below prior-cycle peaks in the quarters ahead. In Europe, although tenant interest remains strong, ongoing global uncertainty is extending decision-making timelines—suggesting latent demand and the potential for a surge in leasing activity once market conditions stabilize.

However, we view this as a cyclical pause rather than a structural inflection. The long-term demand backdrop for industrial real estate remains robust. Secular forces—including the continued penetration of e-commerce, the digitization of supply chains, and the strategic imperative for onshoring and nearshoring in a fracturing global economy—should support sustained absorption.[1] Increased defense spending in Europe is also expected to positively impact logistics demand. In our view, these tailwinds will continue to underpin the outperformance potential of institutional-quality industrial assets over the coming decade.

Supply Headwinds Subsiding

The last few years have seen record construction deliveries in both the US and Europe in response to historically high demand following supply chain

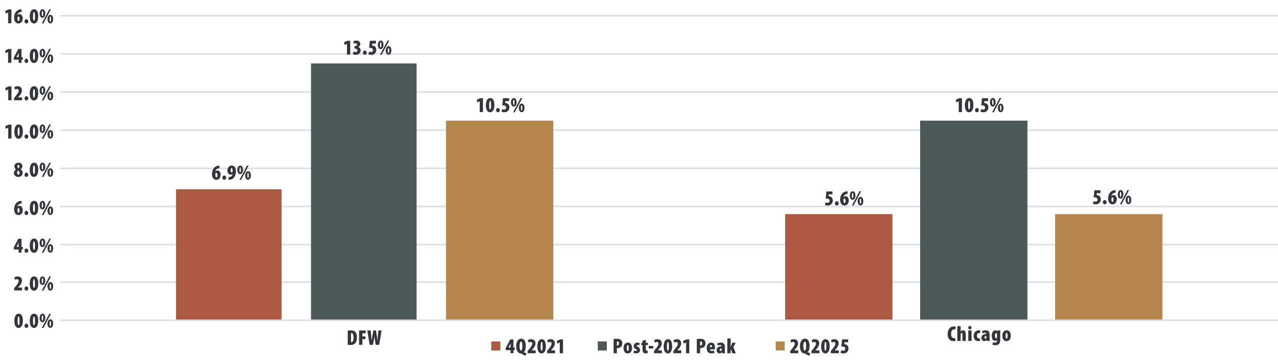
1. See our Global Markets article from the Winter 2025 *PREA Quarterly* on how US reindustrialization is driving demand.

Exhibit 9: US Modern Logistics Outperformance Following Construction Declines

Cycle	Decline in Completions	Average Annual Return—Industrial <10 Years Old	Average Annual Return—Industrial >10 Years Old	Annual Outperformance—Modern Products
Dot-com Bust	**–56%**	10.0%	8.3%	**1.75%**
Global Financial Crisis	**–84%**	12.2%	10.5%	**1.68%**
Current Cycle	**–72%**			**?**

Sources: CoStar, NCREIF, Affinius Capital Research

Exhibit 10: Dallas–Fort Worth and Chicago Vacancy Rates for Properties Over One Million Square Feet



Sources: CoStar, NCREIF, Affinius Capital Research

recalibrations and accelerated shifts to e-commerce during the pandemic. However, more recently there has been a notable slowdown in construction activity, reflecting more cautious market sentiment, and penciling new developments has been difficult since 2022, given rising borrowing rates and elevated construction costs. Forecasts indicate a sharp decline in new deliveries—down 27% in Europe and 74% in the US—by 2026 compared with recent peaks (Exhibit 6).

The overall picture in Europe is mixed—although completions in France have dropped sharply by 48%, Poland has seen only a 10% decrease. Exhibit 7 highlights major global logistics markets projected to have significant declines in new construction over the next couple of years. Given that borrowing costs remain elevated and that construction cost increases have outpaced industrial pricing since 2019 (Exhibit 8), construction starts are likely to remain muted. Note that Europe has not experienced the same intensity of cost pressures as observed in the US. As a result of supply reductions, modern supply is likely to fall short of evolving demand. More than 60% of Europe's warehouse stock is more than a decade old, meaning much of it fails to meet current energy performance and ESG standards. Consequently, we anticipate intensified competition for compliant, high-quality space.

Total Return Tailwinds for Class A Logistics

Historically, sharp declines in industrial construction created conditions leading to the outperformance of modern logistics facilities in subsequent years. Using the US as an example, in the two previous major market downturns, industrial development activity declined substantially. During the dot-com bust, industrial construction completions fell by 56%, and during the global financial crisis, they fell even more, by 84%. Although unleveraged industrial property returns were healthy overall during the initial three-year recovery following both downturns, as shown in Exhibit 9, industrial buildings that were less than ten years old had annual unleveraged total return outperformance of 175 and 168 bps, respectively.

This finding is consistent with Green Street's *European Industrial Outlook* (January 2025), which projects that in Europe, A-quality assets will outperform B-quality assets in like-for-like net rental income growth starting in 2025,

as market demand normalizes. The report predicts the performance gap to be most significant in markets where the supply of A-quality assets is relatively limited.

Representative Case Study: DFW and Chicago Bulk Industrial

Since 2021, both the Chicago and the Dallas–Fort Worth (DFW) industrial markets experienced large increases in new deliveries of buildings of over one million square feet:

- At the end of 2021, the DFW market had 70 industrial buildings of over one million square feet but has since delivered 28 new buildings of this size, a 40% increase in the total inventory.
- Chicago experienced a similar increase, going from 72 buildings of over one million square feet to 85 over the same period, an 18% increase.

As a result of new supply, both markets saw a pronounced increase in the vacancy rate for these large facilities, as shown in Exhibit 10. However, given that new supply has tapered off, these elevated vacancy rates have reversed fairly quickly. Chicago's vacancy rate for properties of over one million square feet has reverted back to 5.6%, and DFW has seen a significant reduction from the peak in 1Q2024. Given that each market has only one property of this size currently under construction, vacancy rates are likely to drop further as space is absorbed.

Conclusion

While industrial markets are navigating a period of near-term recalibration, the broader trajectory remains favorable, particularly for high-quality, modern logistics assets. Tenant requirements are becoming increasingly sophisticated, placing a premium on buildings that offer scale, functionality, and compliance with evolving ESG standards. As leasing decisions become more discerning, well-located Class A facilities are capturing a disproportionate share of demand, while older stock faces rising obsolescence risk.

On the supply side, the development cycle is slowing materially across the US and Europe, constrained by elevated costs of capital and construction materials. This pullback is setting the stage for a more favorable balance between supply and demand over the medium term. Combined with durable secular tailwinds—such as continued growth in omnichannel retail, reshoring strategies, and the reconfiguration of global supply chains—these dynamics suggest that modern industrial assets are poised not just to recover but to outperform. For investors focused on long-term, income-driven strategies, Class A logistics remains a compelling opportunity within the real estate landscape. ■

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