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## Sustainability in logistics real estate: the current situation

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The first association that most people make with logistics is transport and trucking. These words carry a somewhat more negative than positive connotation in relationship to the concept of sustainability. Warehousing is another key component of logistics and is just as much linked to the concept of logistics sustainability. This article examines the European logistics real estate market and sustainability in a broader context and strives to establish a cornerstone for future logistics real estate developments that will fully integrate the concept of sustainability.



In the real estate business, warehouses and distribution centres constitute the focal points of the logistics real estate specialty market. These structures are used for the storage, transfer and handling of goods.

Some characteristics of this type of building structure are:

- size (from 5.000 to 50.000/75.000 m<sup>2</sup>)
- clearance standard of 10-12 meters, silo construction up to 30/40 meters
- an average of approximately 1 dock per 1,000 m<sup>2</sup> warehouse floor
- approximately 5% of warehouse surface as office area of standard level
- fire protection with certified sprinkler system and fire compartmentalization up to 10,000 to 20,000 m<sup>2</sup>
- high load capacity and flatness of building floor
- dock and loading facilities for in- and outbound logistics.

Notwithstanding the building characteristics, the location of the building in relationship to the transportation corridors, staff and multimodal infrastructure is an essential consideration.

### Investment market logistic real estate

The investment market for logistic real estate has developed over the last 10 to 15 years in the Netherlands and other major European cities. In the past, these buildings were typically on the balance sheet of the user companies themselves. These types of building structures were rarely held by institutional investors inasmuch as it was more or less an unknown market. Additionally, potential investors initially had great difficulty accepting the high risk levels that were a result of the large investment amounts in combination with a concentrated and unilaterally highly interpreted risk: one building at one location with one tenant who operates within a specific market. Through a combination of factors this market has changed:

- The trend (need) of companies to focus on core business competencies, thus the outsourcing of transportation and warehousing, has rapidly developed from a competitive advantage to a negative discriminator.
- The positive side of the relative high risk was that the corresponding returns were above benchmark returns compared to other real estate sectors. The investment market appreciated the higher associated returns especially in light of an era of high investment capital availability.
- The first serious player and pioneer in the European market in terms of investment and development of logistics buildings, ProLogis, made a successful leap from the well established US market to Europe in the second half of the 90's. ProLogis set the standard for future players and substantiated that this could be a profitable market.

Subsequent to the entry of ProLogis into the European market, the European logistics real estate sector has slowly but steadily developed over the last fifteen years into a respectable market and investment opportunity. The investment market in The Netherlands is around one billion Euros per year although 2009 marked a decline as a result of the financial crisis.

## Sustainability

Sustainability is a concept within this segment that was initially used by developers primarily for commercial reasons. Sustainable investment and sustainable logistics buildings were presented as distinctive elements; however, developers only incorporated those sustainable investments that would eventually pay off for them.

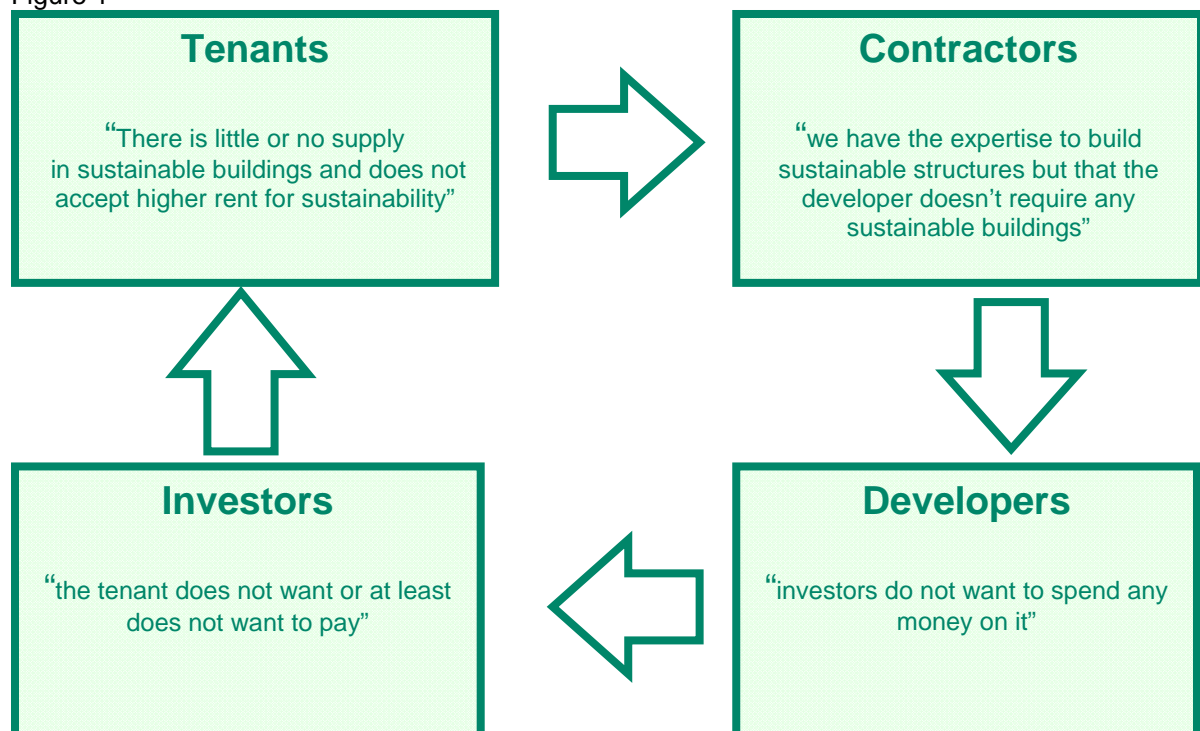
The fact that the tenant also received a financial benefit was a nice side effect. The focus was to get the potential tenant interested in the building. These kinds of measures included:

- increase the isolation level of the building
- install skylights / light caps and energy-efficient lighting fitting
- install gray water system construction (toilet flushing with rainwater)
- equip the roof with a high reflectivity level.

Of course there is nothing wrong with these measures, but there was clearly not a sustainability vision in the developer- and investment market. The market in this area looked like a 'closed loop' (Figure 1) when it came to sustainability:

- The investor indicates that the tenant doesn't want or at least doesn't want to pay.
- The developer indicates that investors do not want to spend any money on it.
- The contractor indicates that he has the expertise to build sustainable structures but that the developer does not require any sustainable buildings.
- The tenant indicates that there is little or no supply in sustainable buildings and does not accept higher rent for sustainability.

Figure 1



It seems that in the last two years this market is slowly turning and becoming more serious. The trendsetter is not the investor or developer, but instead for the most part the tenant / user of the building. Corporations are opting for sustainability at a company level based on an intrinsic choice and are leading through operational choices to include real estate.

## Sustainable measures

Another reason for this turnaround is the future assessment model like GreenCalc and Breeam in Europe and LEED in the US. These methods compare buildings qualitatively on sustainability. A characteristic that is crucial in the world of real estate and real estate valuation.

An important development in this area is the recently introduced international benchmark; the Environmental Real Estate Index, where institutional investors can compare the environmental score of individual investment properties with specific targets in this field.

This brings us ultimately to the question: what does sustainable actually mean in the context of logistics and logistics real estate? And how will this develop?

What is sustainability in the context of logistics real estate? Sustainability measures can be divided into:

### 1. Relating to materials

The material is directly related to resource use (emissions from extraction, production and transportation of construction (bottom) parts). It also considers post construction emissions into the soil and air and the use of infinite raw materials (sustainable produced wood) and residues (granulated material/concrete and steel brace/steel) in the production of new building components. In the long-term, the concepts of re-usability/recyclability will increasingly become important, such as design buildings (or parts thereof) whereas for example the frame after fifteen years is re-usable.

### 2. Relating to energy efficiency

This measure receives the most attention. The main energy users in a distribution centre are:

- heating
- lighting
- handling equipment such as trucks or conveyors.

The sustainability measures are herein focused on:

- increasing the insulation of the building
- energy-efficient lighting with light sensors and motion detection, heat cold storage (underground geothermal energy) with pipe systems to large depths in the soil.

Additionally, large roofs of distribution centres are examined to ascertain whether they are applicable for solar panels.

It is anticipated that developments will accelerate at a faster pace. Investors will have to ensure that sustainability is a key component of their portfolio in the future. The ongoing change to a pull market (request of tenants) versus push market (investors offer it) is essential for a real breakthrough.

In the Netherlands there is currently about 6 million m<sup>2</sup> of unoccupied space in buildings. According to the tenants, the leading reasons for this are: too low building clearance or restricted flatness and floor load. Therefore tenants prefer qualitatively better buildings. In about ten or fifteen years, the logistics properties that are now built will become vacant if no clear choice for sustainability has been made. Despite temporary effects like the current financial crisis, the undercurrent of sustainability efforts is clear and irreversible. Moreover one can be certain that energy sources will become scarce and costly.

It remains to be seen whether investors will see this as only a financial hurdle consideration in the short term or whether they will have the insight to place this requirement in the forefront and invest in the logistics real estate market?

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