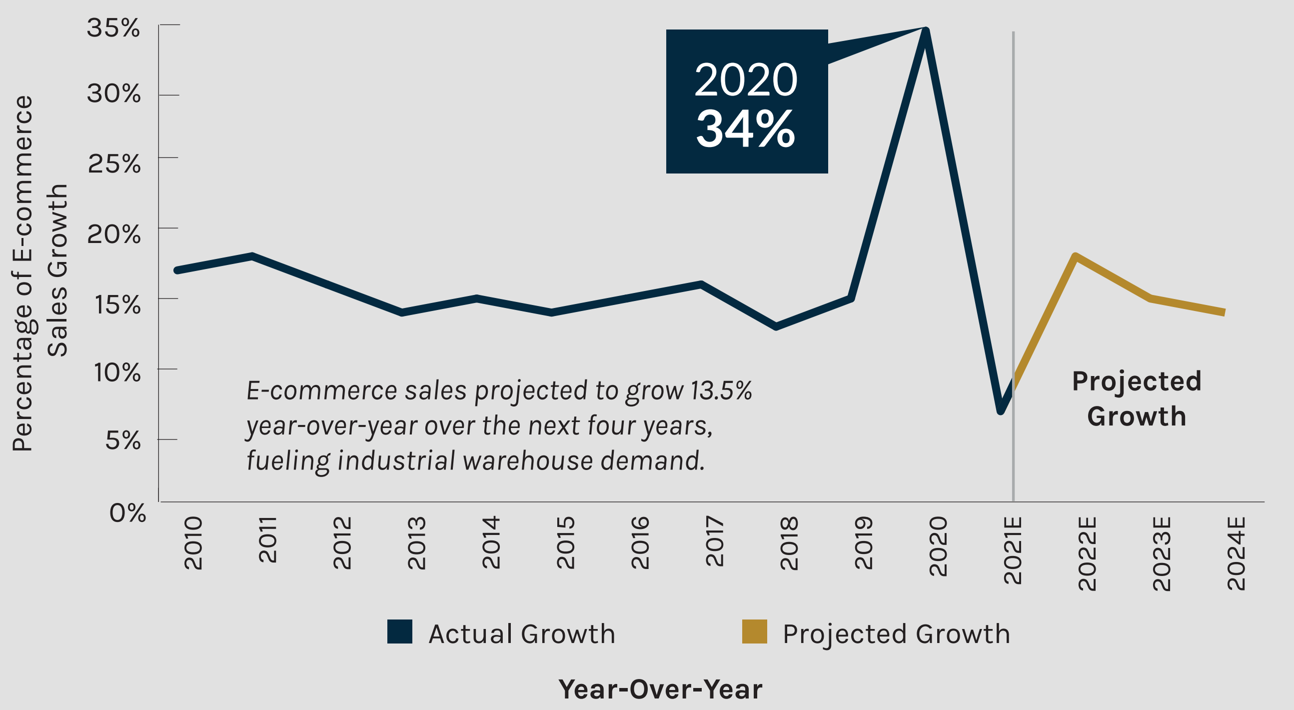
Market Insights

What Does the Acceleration of E-commerce Mean for Investors in Industrial Warehouses?

As COVID-19 disrupted the lives of millions of people in 2020, all sectors of commercial real estate felt the effects from changes in consumer behavior, although one-sector in-particular stood out — industrial real estate.

With consumers staying home, online sales skyrocketed, increasing more than 34% year-over-year, which is more than double the 15% year-over-year growth in 2019.[1] This acceleration of e-commerce has in-turn propelled demand from retailers for even more industrial warehouse space.[1] The question the real estate industry is now facing is if the exceptional e-commerce growth of 2020 will be ongoing, what impact will it have on the future demand for warehouses and how can investors capitalize on this trend? We believe consumers will continue making more online purchases long after the pandemic subsides, thanks in-part to the convenience and flexibility e-commerce provides.

Growth of E-commerce Sales[1]



What Does the Acceleration of E-commerce Mean... (Continued)

With this change in behavior, many businesses are reinventing their logistics supply chains — including the need for more warehouse space — to accommodate the added inventory needed to fulfill an integrated shopping experience that includes online and brick-and-mortar retail (omnichannel). Industry sources estimate that e-commerce demand requires up to three times[2] more industrial warehouse space than traditional brick-and-mortar sales to fulfill orders. The sustained tenant demand due to the rapid expansion of e-commerce has caused both increased property valuations and rent growth within the sector and the tailwinds fueling warehouse demand are unlikely to weaken anytime soon.

E-Commerce Has Historically Driven Unparalleled Warehouse Demand

As e-commerce adoption began to gain traction in the early 2000s, many retailers (principally Amazon) shifted from pricing competition to delivery time competition, betting that speed to the consumer's doorstep would prove a competitive advantage — which it did. As the last economic cycle (2008-2020) matured, Amazon's growth trajectory in the industrial space moved from large-scale distribution centers to focus on the need for last-mile warehouses. These smaller warehouses close to dense population centers allowed Amazon to provide same- or next-day delivery to more U.S. consumers.

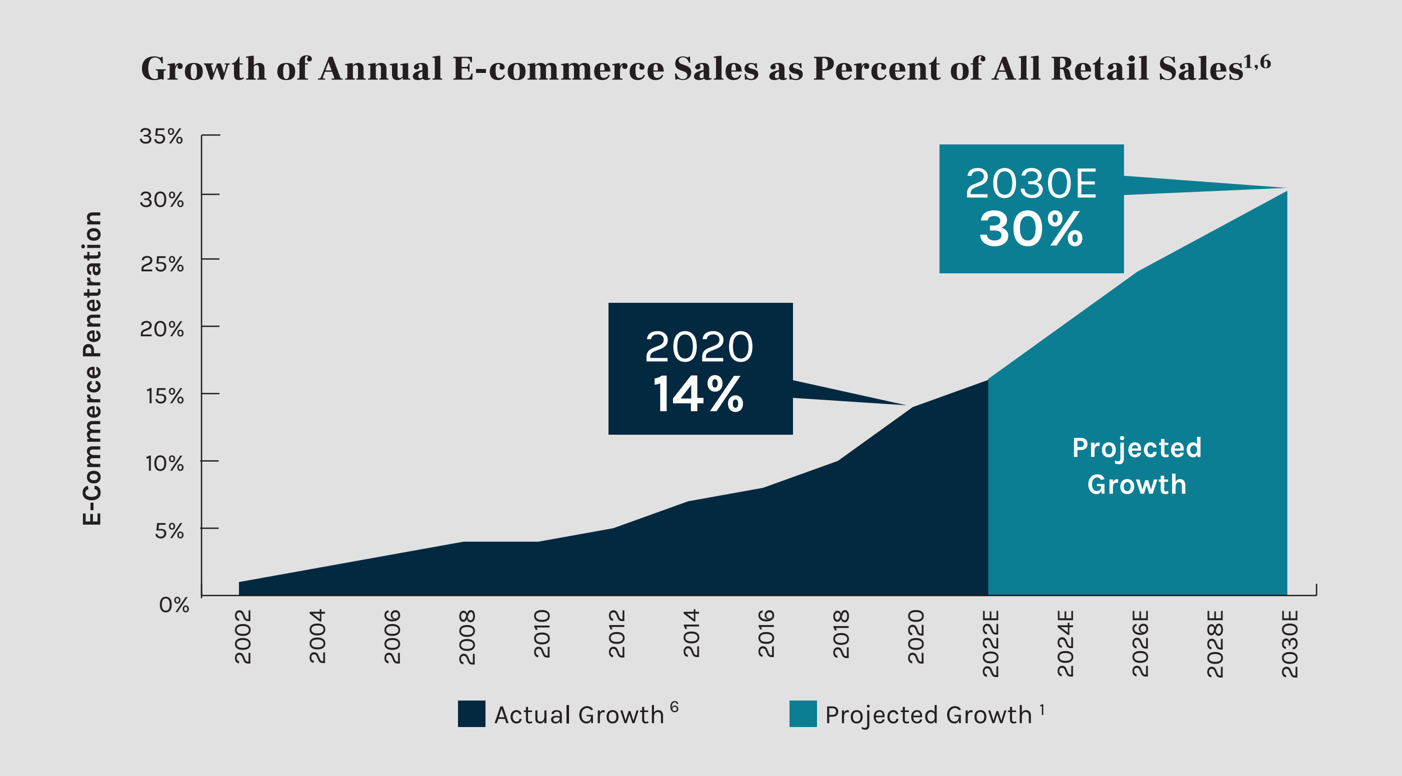
> *"It's impossible to imagine a future 10 years from now where a customer comes up and says, I just wish you'd deliver a little more slowly."*
>
> **— Jeff Bezos, CEO of Amazon**

To keep up with Amazon, many other retailers focused on developing a last-mile segment of the supply chain during this time, as well. Between 2016 and early 2020, both e-commerce and brick-and-mortar retailers began to invest heavily in omnichannel strategies. Retailers also focused on speed-to-consumer strategies to compete more effectively as e-commerce became more broadly accepted by consumers, driving demand of last-mile warehouse space.

The uptick in e-commerce activity has sparked a substantial increase in product returns, with around 30% of products purchased online being returned.[3] As retailers continue to chase online customers, they are also investing in warehouse space that can efficiently handle reverse logistics (or the supply chain of processing returned merchandise) — which requires up to 20% more warehouse space and a completely different infrastructure where last-mile warehouses can accept, sort and either dispose, recycle or refurbish the returned product.[4] Many retailers who are unable or unlikely to build out an in-house logistics network to service returns, may outsource this process to third-party logistics (3PL) firms. 3PLs specialize in the midstream distribution of products to consumers and reverse logistics service, becoming the top user of large bulk industrial warehouses (warehouses that are more than 100,000 square feet and located on or near major interstates or airports) — and particularly older and unrenovated warehouses such as Class B or C properties.[5]

E-commerce Growth Explodes in 2020 and Looks to Extend Well into the Future

2020 spurred consumers into adopting e-commerce as physical storefronts were forced to shutter for extended periods. During the year, e-commerce sales as a percent of total retail sales experienced unprecedented growth, leaping from 11.0% as a share of total retail sales in 2019 to 14.0% in 2020.[6] E-commerce accounted for an average of 0.7% of total retail sales increase each year between 2011 and 2019, thus the increased 3.1% in 2020 represents more than four years of growth condensed into one.[6] E-commerce growth is likely to continue rather than regress once the pandemic has subsided, as consumers have become accustomed to the ease and accessibility of online shopping.



Additionally, the millennial generation is just starting to enter their peak income earning and consumption years. This generation of 92 million people — the largest generation in U.S. history — will greatly impact the economy in the years to come and is already the largest adopter of online shopping.[7]

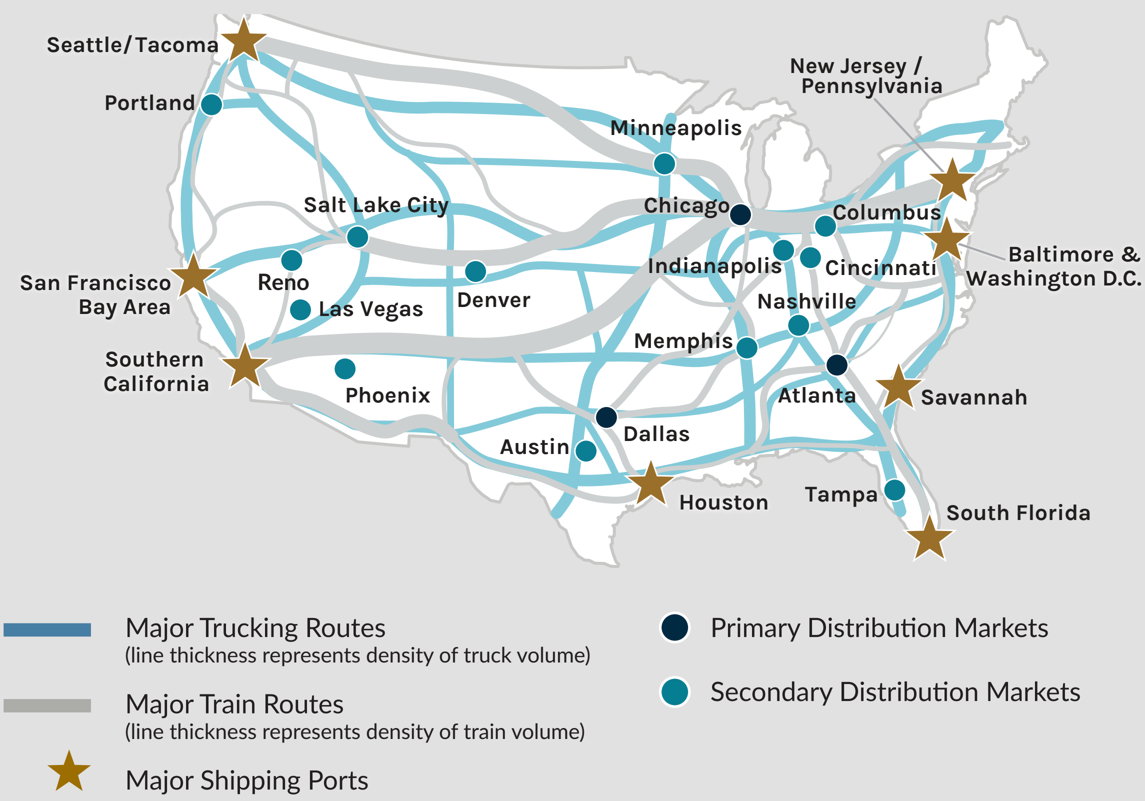
MILLENNIALS

The largest generation in U.S. history and the largest adopter of online shopping — are just starting to enter their peak income earning and consumption years, spurring future economic growth[7]

Location, Location, Location

Location matters. Markets with strong links to national and regional supply chains, such as Los Angeles, New Jersey, and South Florida, are seeing strong demand growth. Due to high barriers of development, or limited supply in warehouse space, warehouse valuations and rent growth in these markets has steadily increased, while vacancies run well below long-term averages. In 2020, industrial warehouses nationally experienced an average rental growth rate of 3.7% with occupancy trending at 95% for a fifth year in a row.[8]

Key Logistics Markets[9]



Accessing Industrial Warehouses

We believe forecasted growth in e-commerce and a return to widespread economic expansion will only further enhance the runway for industrial demand. Individual investors can access distribution warehouses through a variety of real estate investment options,[10] which are owned and operated by experienced real estate managers who understand the markets in which to invest. Our belief is that financial professionals should consider using real estate if they are seeking potential diversification benefits.

ABOUT BLACK CREEK GROUP

Black Creek Group, a leading real estate investment management firm, was acquired by a subsidiary of Ares Management Corporation on July 1, 2021. Ares Management Corporation (NYSE: ARES) is a leading global alternative investment manager providing clients complementary primary and secondary investment solutions across the credit, private equity, real estate and infrastructure asset classes. As of September 30, 2021, Ares Management's global platform had approximately $282 billion of assets under management with approximately 2,000 employees operating across North America, Europe, Asia Pacific and the Middle East.

For more information, please visit www.BlackCreekCapitalMarkets.com.

[1] Source: Green Street, as of 12/31/20.

[2] Source: Prologis Research, 06/20.

[3] Source: Iinvespcro.com, 4/11/21.

[4] Source: Per reverse logistics software provider Optoro. https://rebusinessonline.com/free-returns-how-reverse-logistics-impacts-industrial-real-estate/.

[5] Source: CBRE U.S. Industrial & Logistics Viewpoint: Reverse Logistics Stress Test 2020, December 2020.

[6] Source: US Census Bureau, as of February 19, 2021. The percentages presented for future periods are projections and there is no guarantee that those projections will be achieved.

[7] Source: https://www.goldmansachs.com/insights/archive/millennials/.

[8] Source: CoStar Advisory Services, 12/31/20.

[9] Source: CoStar Advisory Services, 12/31/20; Federal Highway Administration, 2017; U.S. Department of Transportation Maritime Administration, 2015.

[10] The amount of distributions by REITs advised by Ares Commercial Real Estate Management LLC ("ACREM") is uncertain, is not guaranteed, may be modified at ACREM's discretion, and is subject to board approval. Substantial fees and expenses will be paid to the ACREM-advised REIT's advisor, dealer manager and other affiliates of an ACREM-advised REIT's sponsor for services they provide to the REIT in connection with the offering and the operation of the REIT's business and the acquisition, management and disposition of the REIT's investments. Distributions may be paid from sources other than cash flow from operations. Distributions to stockholders may represent a return of capital.

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