Third-Party Logistics Companies (3PLs) Impact on Industrial Real Estate

WHAT IS A 3PL?

Due to growing competition for e-commerce sales, retailers and wholesalers are focused on expanding their supply chain operations. While some companies have the in-house capabilities needed to manage the logistics and transportation of their products, many corporations are unable to manage them in an efficient manner. Thus, many companies are outsourcing this business function to a third-party that specializes in supply chain optimization.

Third-party logistics (or "3PL") refers to a company that provides outsourced supply chain services such as providing inbound freight management, distribution services, warehousing, order fulfillment and outbound freight management. Additionally, a 3PL company may provide other specialized services such as inventory management, cross-docking, packaging, and last-mile delivery.

A company may decide to utilize a 3PL to satisfy its supply chain needs versus maintaining the operations in-house for several reasons. For example, companies engage 3PLs to gain access to a 3PLs' deep workforce without having to hire warehouse employees. Additionally, 3PLs provide companies with enhanced inventory management capabilities, low transportation costs, and overall supply chain efficiencies through a diversified, multi-location distribution network. As a result, companies that engage 3PL companies can often lower their supply chain operating costs and decreasing shipping times while simultaneously increasing the predictability of their deliveries. As a result of the growth in e-commerce sales and the resulting need for faster delivery times, we believe more companies will recognize these benefits and engage 3PLs to fulfill their supply chain needs.

JOE YIU
Chief Investment Officer / Managing Partner
314-828-4217
jyiu@elmtreefunds.com

MACAULEY STUDDARD
Vice President, Investments
314-828-4207
mstuddard@elmtreefunds.com

ANDREW TRUETZEL
Vice President, Acquisitions
314-315-1133
atruetzel@elmtreefunds.com

AUSTIN DAVIS
Analyst
314-828-4216
adavis@elmtreefunds.com

MARK CLINTON
Analyst
314-828-4210
mclinton@elmtreefunds.com

ElmTree Funds, LLC
314.828.4200
www.elmtreefunds.com

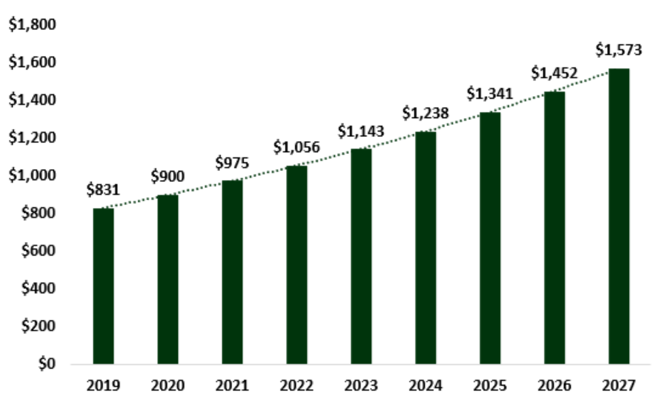
ELMTREE FUNDS
PRIVATE EQUITY REAL ESTATE

3PL MARKET OVERVIEW

MARKET GROWTH TRENDS

According to Grand View Research [(A)], the global third-party logistics market size was valued at ~$831 billion in 2019 and is expected to grow at a compound annual growth rate of 8.3% from 2020 to 2027. We expect growth in e-commerce sales, consumer demand for faster delivery times, and an increased focus on supply chain management following the supply chain inefficiencies caused by COVID to drive demand for 3PLs.

Exhibit 1: Global 3PL Market Size (USD Billions)



Source: Grand View Research. *Third-Party Logistics Industry Report: Jul 2020.*

MAJOR COMPANIES

Some of the largest third party logistics providers in the United States include C.H. Robinson, XPO Logistics, J.B. Hunt, Expeditors and Kuehne + Nagel.

C.H. Robinson, based on 2019 annual revenue, is considered the largest third party logistics provider in the United States. C.H. Robinson primarily provides freight transportation services and logistic solutions to companies across multiple industries. During 2019, CH Robinson handled approximately 18 million shipments and served more than 119,000 customers. Furthermore, the company utilized approximately 78,000 contracted transportation companies. The company's distribution network currently consists of 1.6 million square feet in 20 locations located within the United States. [(B)]

XPO Logistics is a global provider of supply chain solutions that offers clients various transportation and logistics solutions. In 2019, the company had approximately 10,000 independent carriers and owner-operators under contract to provide last mile and less-than-truckload (LTL) services to its customers. In North America, the company is the largest provider of last mile logistics for heavy goods, the largest manager of expedited shipments, and a top three provider of LTL transportation. Given the company's distribution network, XPO is a prominent industrial tenant in North America, Asia, and Europe. In 2019, the company operated 200 million square feet of logistics space globally. Approximately 104 million square feet was located in North America and Asia, where XPO is a market leader in logistics capacity, and 96 million square feet was located in Europe, where XPO is a top five industrial tenant.

A) Grand View Research. Third-Party Logistics Industry Report: Jul 2020.

B) CH Robinson. "Annual Report 2019" 2019.

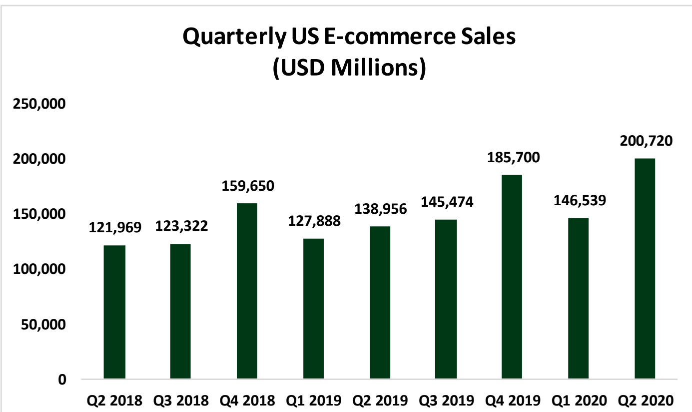
C) XPO Logistics "2019 Annual Report" 2020.

DEMAND DRIVERS FOR 3PLS

EFFECT OF E-COMMERCE ON 3PLS

Even prior to the coronavirus pandemic, consumer demand had been shifting toward e-commerce. However, COVID-19 has kept customers inside causing e-commerce spending to spike in Q2 2020, rising 44% year-over-year as illustrated in the graph below.

Exhibit 2: Quarterly E-commerce Sales



Source: US Census Bureau *Report: Jun 2020.*

With consumers spending more online than ever before, retailers are quickly being driven to find solutions to expand their logistics capabilities. We believe 3PLs' diversified logistics operations provide companies with an immediate solution and allow them to capitalize on rapidly growing e-commerce sales.

CONSUMER DEMAND FOR QUICKER DELIVERY TIMES

As competition in the e-commerce marketplace continues to escalate, online retailers are expected to focus on providing shorter delivery times to gain a competitive advantage over their peers. Amazon started the race to shorter delivery times in 2005 when the company announced free 2-day shipping through its Amazon Prime membership. Since then, Amazon further shortened their delivery window through same-day and 1-day deliveries in select markets. This, in turn, has forced Amazon's competitors like Walmart and Target to expand their supply chains as well, in an attempt to offer shorter delivery times to compete with Amazon.

Companies with supply chains that are significantly inferior to these large e-commerce players may engage 3PL companies to quickly bolster their supply chain capabilities and compete with larger industry players. To that end, 3PL companies provide mid-sized and small online retailers that lack the capital and scale of their larger competitors with the ability to leverage a diversified supply chain that these retailers could not replicate themselves.

SUPPLY CHAIN COMPLEXITY

Due to rising e-commerce sales, U.S. supply chains have undergone drastic growth over the last decade. We believe this trend will continue as intense competition for e-commerce sales will force online retailers to continuously look for ways to improve their supply chain efficiency, decrease delivery costs and reduce delivery times.

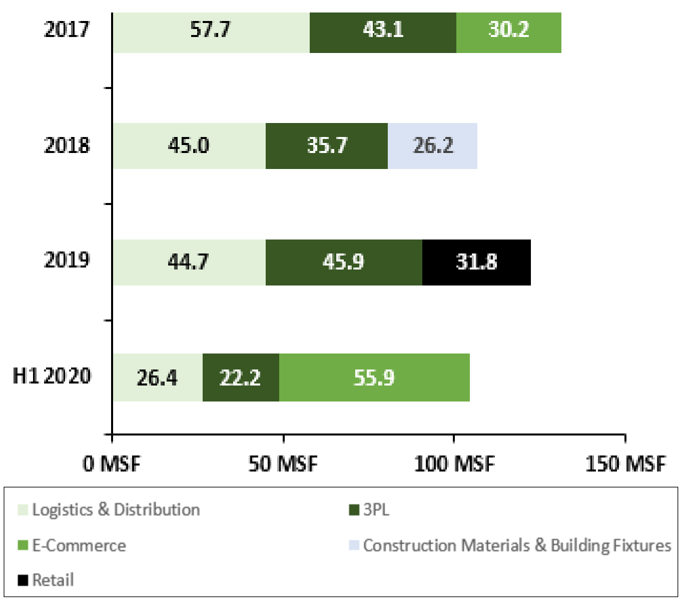
Additionally, modern supply chain operations are more complex than prior supply chains and require a high level of expertise to properly navigate. Thus, as many retailers expand their supply chain operations, they may choose to partner with 3PLs to leverage 3PLs' significant industry expertise. 3PLs have evolved from simply supplying retailers with warehouse space to providing more sophisticated services such as inventory management and proprietary supply chain analytics. These services add additional value to companies focused on e-commerce sales by identifying inefficiencies in their current supply chain operations.

3PLS IMPACT ON INDUSTRIAL REAL ESTATE

DRIVER OF INDUSTRIAL DEMAND

3PLs have had a profound impact on leasing activity and the underlying demand fundamentals associated with industrial real estate. As a result of growing e-commerce sales, 3PLs have been increasing their occupancy in warehouse and logistics space throughout the U.S.

Exhibit 3: Top Industrial Tenant Sectors (Absorbed SF)



Source: JLL. *Industrial Outlook: Q2 2020.*

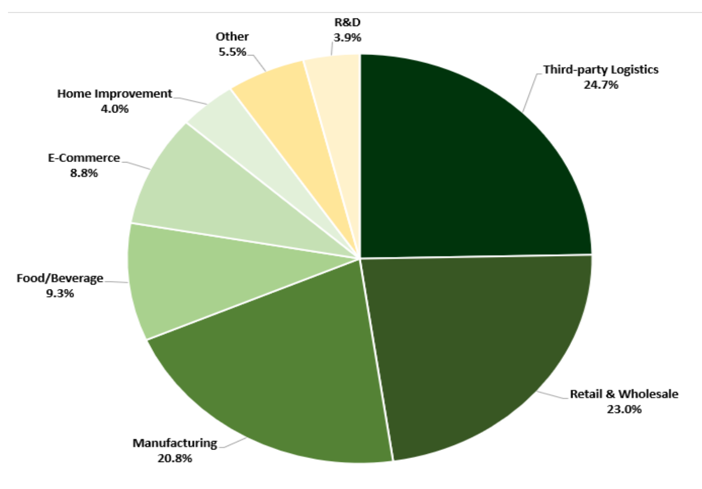
From 2017 to 2019, third-party logistics companies have leased 124.7 million SF of industrial space which represents 34.6% of the total leasing demand. During this period, 3PLs leased an average of 41.6 million SF annually. In the first half of 2020, 3PLs continued to lease space at a pace similar to pre-COVID levels.(A) Looking forward, we expect smaller and mid-sized e-commerce users to continue turn to 3PLs to capitalize on growing e-commerce sales in an efficient manner. Additionally, we believe total leasing activity of nearly 105 million SF in the first half of 2020 indicates demand for industrial real estate has continued to grow during COVID.

BULK INDUSTRIAL LEASING ACTIVITY

In recent years, 3PLs have emerged as a top source of bulk warehouse leasing activity and demand in the United States. According to a recent report issued by Colliers International, U.S. occupier leasing and sales activity in bulk industrial space (greater than 100,000 SF) totaled ~137.5 million square feet at the end of Q1 2020.

According to the report, 3PLs were the top occupier of bulk space as of Q1 2020, with 24.7% of bulk industrial occupier activity (similar levels as 2018 & 2019).(B) We believe 3PLs will continue to drive leasing velocity higher in the industrial sector. More specifically, we believe 3PLs will focus on newly constructed, Class A industrial facilities that offer the most efficiency within supply chain operations. These trends should continue to support positive supply and demand fundamentals in the industrial sector, which should drive rental growth over a medium-term horizon.

Exhibit 4: Bulk Industrial Leasing Activity (Q1 2020)



Source: Colliers International. *3PLs Remain Top Bulk Occupier of Industrial Space: May 2020.*

A) JLL. "Industrial Outlook". Q2 2020.

B) Colliers International. "3PLs Remain Top Bulk Occupier of Industrial Space" May 2020

CONCLUSION

We believe 3PLs will continue to see strong demand from companies seeking to expand their supply chain capabilities and capitalize on growing e-commerce sales. We believe this demand growth will be supported by three primary trends: 1) consumers will continue to demand shorter delivery times 2) e-commerce spending will continue to grow and 3) supply chains will continue to become more advanced and complex.

Due to the increase in demand for 3PL services, we believe 3PLs will aggressively expand their distribution networks by leasing new facilities. In terms of the impact on the industrial real estate sector, we believe 3PLs will primarily focus on newly constructed, Class A logistics facilities that meet the design criteria needed to efficiently operate modern supply chains. This growth in demand for warehouse space from 3PL companies is expected to continue to fuel healthy fundamentals for industrial real estate in the US.

From a tenant perspective, we believe 3PLs will likely see increased demand from small and mid-sized companies looking to quickly build out their supply chain capabilities and better compete with larger competitors that have already invested significant capital to build out their supply chains. We believe larger corporations will also selectively partner with 3PLs on build-to-suit projects moving forward. These partnerships will likely occur when larger corporations determine that a 3PL's infrastructure will allow them to operate a new build-to-suit facility in a more efficient manner. These partnerships typically feature a long-term contract between the 3PL company and the corporation with a contract period that matches the lease term between the 3PL company and the landlord of the build-to-suit facility. Due to the similar duration of the contract and lease as well as the lease and the contract often incorporating interrelated language, the credit quality of the corporation is often analyzed during underwriting even though the 3PL company is the actual tenant on the lease.

Overall, these trends should continue to support strong leasing activity in the industrial sector while also potentially creating new investment opportunities for investors focused on new construction within the industrial sector.

ELMTREE FUNDS

PRIVATE EQUITY REAL ESTATE

About ElmTree Funds

ElmTree Funds, LLC, headquartered in St. Louis, Missouri, is a real estate private equity firm that manages capital on behalf of institutional and private investors. ElmTree's investment philosophy focuses on creating attractive risk-adjusted returns for its investors in the commercial real estate net lease and build-to-suit sectors with a focus on industrial and office properties. Since its founding in 2011, ElmTree Funds has acquired, developed, or financed an extensive portfolio of commercial real estate. ElmTree Funds targets commercial real estate investments in primary and secondary markets across the United States that are net-leased to investment grade tenants on a long-term basis.