



# The ElmTree Edge

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## The Cold Chain Expands

Investors are warming up to cold storage



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Over the last 12-18 months, one specialized industrial sector is getting more attention—and presenting intriguing investment opportunities as part of a diversified portfolio of commercial real estate assets: cold storage.

### Rising demand

The increased interest in cold storage as an alternative industrial asset class is being driven by evolving consumer preferences as well as the rise of e-commerce grocery sales. Consumers are looking for more organic, fresh food offerings (with fewer preservatives), a product type that needs to be cooled throughout the distribution process. Additionally, with e-commerce food and beverage sales hitting an all-time high of \$31 billion in 2023 and expected to account for approximately 20% of overall grocery sales by the end of 2025, the underlying demand drivers are robust. Another factor to monitor is the need for increased automation in cold storage facilities. With the average age of existing facilities of approximately 40 years, and the significant level of automation typically required in the cold storage distribution process, newer facilities with the requisite higher clear height, greater slab depth, and critical MEP infrastructure are needed.

### Widespread market strength

Cold storage development is generally widespread throughout the U.S., given that newer assets are needed within a variety of gateway, primary, and secondary markets. Demand for new facilities is more constrained in tertiary markets given tenants are currently focused on building new assets in areas with the highest population density. Overall, the dependence on food consumption makes

cold storage demand fairly inelastic and widespread, helping to drive steady growth relative to some other commercial real estate asset classes that are more sensitive to market forces and broader economic cycles.

## **Growing interest, increased volume**

Perhaps unsurprisingly given strong fundamentals, we have seen greater interest in cold storage from institutional investors, which is increasing liquidity and transaction volume in the space. Looking forward, as more institutional investors target the sector and become more comfortable with the unique characteristics of cold storage facilities, we expect to see further growth in transaction volume.

## **Hesitation and mitigation**

Not all investors entering the cold storage market are jumping in aggressively. Some are hesitant about the comparative complexity of cold storage assets relative to traditional industrial facilities. Items such as the need for sub-slab cooling, more sophisticated electrical infrastructure, insulated wall panels, and potential automation components can all drive up the cost per square foot for cold storage facilities. Other investors have questions around identifying the right type of facility to meet market and tenant demand. Cold storage includes manufacturing and processing, gateway and regional distribution facilities, and last mile facilities—as well as a range of different product types: refrigerated/cooled, freezer, and tri-temp (which feature a combination of cold, freezing, and ambient/dry storage capabilities). In contrast to the somewhat cookie-cutter design of traditional industrial space, that variation within cold storage facilities is noteworthy. However, we believe newly constructed cold storage properties with the characteristics needed to house modern automation components are best positioned to capitalize on the growth in tenant demand.

## **Solutions and opportunities**

The positive news for investors is that these questions are hardly slowing cold storage momentum. While the number of developers and operators focused on the cold storage sector is limited due to the unique expertise required to build and operate cold storage facilities, investors can still identify and work with managers and developers with experience in the space. Focusing on investments with long term leases can help mitigate some of the risks associated with investing in more specialized assets, and, with demand continuing to grow, the number of potential cold storage tenants is on the rise. Because of the higher cost and complexity, developers have historically been somewhat reluctant to build cold storage on speculation. Given the uptick in demand and the low vacancy numbers, we are starting to see more speculative cold storage development. However, the unique characteristics of cold storage facilities should result in development in the sector remaining primarily build-to-suit. That build-to-suit nature makes cold storage a natural fit with ElmTree's strategy and our tenant-focused approach. Accordingly, we are identifying select cold storage assets to integrate into our larger portfolio of traditional industrial assets.

## **Moving forward**

There is a wide range of diverse tenant types active in the cold storage space right now: from grocery brands to larger fast casual operators, food service and distribution companies, and consumer companies (including everything from large food and beverage brands to big box retailers). One characteristic most cold storage tenants tend to share is a thoughtful and strategic approach, which is consistent with continued steady growth in the space moving forward. As that growth continues, initial skepticism from investors will likely erode. With online and e-commerce grocery continuing to grow, we are likely to see more capital flow into the space. Another trend to watch is the push for larger, specifically higher clear height, cold storage facilities. As tenants look to introduce automation and maximize cooling efficiency and cubic square footage, we are already seeing some assets with clear heights in excess of 80 to 100 feet—more than doubling traditional cold storage facility heights.

## The bottom line

The bottom line is that connecting the cold storage dots paints an intriguing picture for net lease industrial investors.

- Consumer demand for grocery delivery and a push towards fresher food will continue to fuel growth in tenant demand within the cold storage space.
- With a lack of speculative development limiting supply growth, the growing mismatch between supply and demand should result in strong rental rate growth, positive leasing trends, and asset appreciation.
- Due to that significant demand growth, and limited competition due to perceived complexity of the product type, there is an opportunity for a large-scale manager to fill the void through build-to-suit construction.

For investors like ElmTree that can leverage extensive experience in credit underwriting, sourcing investment opportunities, and aggregating portfolios, a cold storage strategy seems to represent both a natural evolution and a relevant and even robust opportunity in the months and years ahead.

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