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Logistics

February 2021 • perenews.com

Time to shine

Warehouses take center stage

KEYNOTE INTERVIEW

Logistics 'one of modern cities' vital organs'

Fueled by technology and the pandemic, Hines' Logan Smith and Palmer Letzerich witness remarkable changes to industrial assets and supply chains in the urban environment

The first building Gerald D Hines, the founder of his namesake real estate investment management firm, developed back in 1957 was a small office warehouse in Houston, Texas. Since then, in addition to building landmark office buildings in cities around the world, the firm has developed, acquired or has in development more than 92 million square feet of industrial and logistics space globally.* Logan Smith, head of European logistics, and Palmer Letzerich, senior managing director and head of the industrial and logistics platform at the US southwest region, discuss why the future of logistics continues to look promising.

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Q Are we on the cusp of a tech revolution in warehouses? How much will it change the logistics market?

Logan Smith: Warehousing has always been on the cusp of a tech revolution, and now is no different. For example, advances in electronic data interchange in the 1990s enabled the first wave of 'big-box' warehousing in the US. The e-commerce and automation-led growth we are seeing now is in many ways simply an extension of this same trend. E-commerce providers such as Amazon and others are fond of highlighting the importance of speed of delivery, or 'last mile.' While this is of course important, it's not the whole story. The principal underlying theme in all cases is the continued march in the direction of increased inventory and order visibility throughout the supply chain.

For example, being able to understand the contents and location of a container that has not yet cleared customs or knowing how a particular parcel is moving through the city can impact the type and location of warehouse required.

*As of June 30, 2020.

So, how will it change the logistics real estate markets? Paradoxically, it is likely to lead to bigger and smaller warehouses at the same time. Bigger in the form of XXL and multi story – smaller in the form of smaller fulfillment centers and urban logistics. Considering that warehouse space is relatively cheap to rent compared to traditional retail space, more space is therefore affordable and typically required. It will also lead to more automation and sophisticated materials handling equipment. And there will be an increasing blurriness between product types.

Palmer Letzerich: I would characterize it as the fact that tenants and landlords are asking these buildings to perform more activities and to be more flexible today than ever before and I see this trend continuing over the coming three to five years. Ten years ago, the traditional distribution center was located on the periphery of a city.

The user inbounded on one side of the building, conducted some bulk break and racking activities and then outbounded on the other side. DC's were located to fit within the occupiers' existing network and where the lowest occupancy cost was achievable.

The previous construct has changed dramatically in today's warehouses. Today, tenants are still performing the same distribution activities, but they are also shipping directly to the end customer, which is the big change.

These same tenants are servicing will-call and pick-up applications; storing by destination and frequency of throughput in addition to category of product; and using the buildings as training centers for their employees and increasing their office and showroom features. This increased utilization and variety of applications means that tenants are prioritizing a different menu of requirements in today's logistics facilities, which in turn require new locations, new technologies, new building features and an incredible level of flexibility.

Q At this point of the cycle, does it make more sense to focus on logistics developments rather than buying core products?

LS: There is of course more investor interest in logistics than there used to be. However, given that we are still seeing increasing tenant demand being driven by continued e-commerce growth, it is not necessarily clear where we are in the cycle in the first place.

Rather than trying to time the cycle, we are more comfortable simply sticking to our business plan – working with our deep local teams to invest in good real estate, in good locations, at fair prices. If we continue to do this well, where we are in the cycle will become less important. We continue to see interesting opportunities in both the acquisition as well as the development side.

PL: The fundamental shift with increased demand within the industrial landscape is going to break the traditional cyclicality in an interesting way going forward. The question of whether to build versus buy depends on our investors' investment objectives. We have investors who see value in development and are looking for opportunistic returns, and others who are interested in stability of the returns and potential for rent growth, so they are looking more toward acquisitions. We believe Hines is uniquely capable of sourcing and executing both.

"The principal underlying theme in all cases is the continued march in the direction of increased inventory and order visibility throughout the supply chain"

LOGAN SMITH

Q How has covid-19 affected the supply chain and how are logistics players adjusting to these changes?

LS: Covid-19 has led to three years of e-commerce growth in a period of about three months. This has created additional demand from occupiers and also investors. In most markets, absorption and leasing in 2020 has been higher than it was in 2019, which is really remarkable if you consider that most of the planet was in lockdown for about 10 months in 2020.

During the first few months of covid-19, a lot of investors and developers were understandably cautious – postponing speculative developments, for example. They are now back, and Hines leaned into this trend from the beginning, investing through both acquisitions and developments in Europe, Asia, North and South America. We are seeing an increase in inventory levels because the coronavirus highlighted the stress in the supply chain, so building additional capacity within warehouses is something we have taken seriously.

PL: Covid-19 has had a big effect on e-commerce, which ended 2020 with an 80 percent increase in space absorbed over 2019 levels, with a penetration rate of 20 percent of retail sales in the US. As tenants all increased their e-commerce sales, I have also seen a

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variety of product segments that have benefited during the pandemic, specifically building materials, wellness, grocery and home furnishing.

Similarly, the lowest e-commerce percentage retail segments have now moved online, specifically grocery, beauty and cosmetics and household goods. To exemplify this, Kroger, which is a US grocery store chain, has now replaced Macy's in the top-10 online sellers in the country.

At the same time, we are seeing not only the large e-commerce users taking more space, but the smaller users – under 100,000 square feet – also began ramping up mid-2020. By number of leases signed – these smaller users in most markets will end 2020 at a higher number than 2019.

It is remarkable to think that while most markets I cover were locked down for three to six months, these markets are going to post higher absorption numbers for year-end 2020 than 2019 totals. As a result of covid-19, occupiers are thinking about increased inventory levels and redundancy in the supply chain, which points to increased square footage to be required post covid-19 and into 2021.

Q Why do you see an opportunity to invest in urban logistics?

LS: Firstly, 'urban logistics' can mean different things to different investors, and many types of logistics assets can fairly be classified as 'urban logistics.' The industry has yet to arrive at a consensus definition.

For example, a new multi-level fulfillment building with a LEED certification a few kilometers outside of the city might be accurately considered urban logistics. But so might be an older, low-clear height building servicing 'trade space' type users such as building materials suppliers.

The critical factor, whether from an acquisition standpoint or a development standpoint, is to have a thoughtful, well-researched view as to the long-term value of its location, within the context of the surrounding community, its functionality for tenants (both current and future tenants) and, of course, cost basis. Proximity to population and good access to transportation links will continue to be as important as they always have.

> *"Tenants are prioritizing a different menu of requirements in today's logistics facilities, which in turn require new locations, new technologies [and] new building features"*
>
> **PALMER LETZERICH**

Q What are the right locations and products to invest in these urban developments?

PL: Every market is different. In every market that I cover, there are sub-markets where the large, modern format 500,000-square-foot to one-million-square-foot spec building makes sense, and others where multi-building, multi-format parks make more sense, and yet others where urban infill buildings are the most appropriate.

In each submarket and each specific product, we focus on providing a location with access to major transportation arteries and ample interior circulation. Today, more than ever, we are also targeting locations that offer ample labor supply and urban density, but also aspects that enhance the employee experience for our tenants. We are creating covered landscaped areas for outside dining, as well as offering sport courts and employee wellness options, in addition to food and dining options.

We are implementing the highest standards in these urban locations. This type of quality and innovation have been in the Hines DNA since our firm's inception, and our goal is to offer our tenants the most efficient location and building so their business is more profitable in our asset.

Q How do you see the future of logistics as an industry and asset class post-pandemic?

LS: This past year has certainly been one of acceleration when it comes to logistics. 2020 was the year that communities and societies around the world – along with many real estate investors – realized something about logistics real estate. In some ways, it is not really a 'real estate asset class' at all. Rather, logistics real estate is one of the vital organs within the living organism that is the modern city; just as is the case with, say, a power grid or a metro system.

PL: Industrial absorption used to be a leading indicator of economic growth and was generally tied to growth in GDP. With 2020 absorption in most markets exceeding 2019 levels, we have seen this paradigm turned upside down in 2020. On top of that, today there is higher investor interest. Those two factors create the opportunity for rent growth and cap rate compression, which of course set the table for compelling returns.

When the world emerges from the pandemic and GDP, employment and consumer confidence begin to ramp up, the growth in our markets will be notable. Given the shifts during the pandemic which I see as permanent, that means more growth and a higher percentage of that growth will be moving through our warehouses. For that reason, I see the potential for our investments in logistics to continue to outperform. ■

Important Information About Risks

Investing in shares of our common stock involves a high degree of risk. You should purchase shares only if you can afford a complete loss of your investment. Please see the "Risk Factors" section of the prospectus before purchasing our common shares. Hines Global elected to be taxed as a real estate investment trust, or REIT, for U.S. federal income tax purposes beginning with its taxable year ended December 31, 2015. Significant risks relating to your investment in our common shares include:

- We have a limited prior operating history and the prior performance of other Hines affiliated entities may not be a good measure of our future results; therefore, there is no assurance we will be able to achieve our investment objectives.
- Our charter does not require us to pursue a transaction to provide liquidity to our stockholders and there is no public market for our common shares; therefore, you must be prepared to hold your shares for an indefinite length of time and, if you are able to sell your shares, you will likely sell them at a substantial discount.
- This is a blind pool offering and you will not have the opportunity to evaluate the additional investments we will make prior to purchasing shares of our common stock.
- This is a best efforts offering and as such, there is a risk that we will not be able to accomplish our business objectives and that the poor performance of a single investment will materially adversely affect our overall investment performance, if we are unable to raise substantial funds.
- Distributions have exceeded earnings. Some or all of our distributions have been paid, and may continue to be paid, and during the offering phase, are likely to be paid at least partially from sources such as proceeds from our debt financings, proceeds from this offering, cash advances by our advisor, cash resulting from a waiver or deferral of fees and/or proceeds from the sale of assets. We have not placed a cap on the amount of our distributions that may be paid from any of these sources. If we continue to pay distributions from sources other than our cash flow from operations, we will have less funds available for the acquisition of properties, and your overall return may be reduced.
- The purchase and redemption price for shares of our common stock generally will be based on our most recently determined NAV (subject to material changes) and will not be based on any public trading market. While there will be independent appraisals of our properties performed annually, at any given time our NAV may not accurately reflect the actual then-current market value of our assets.
- There is no public market for our shares and an investment in our shares will have very limited liquidity. There are significant restrictions and limitations on your ability to have any of your shares of our common stock redeemed under our share redemption program and, if you are able to have your shares redeemed, it may be at a price that is less than the price you paid and the then-current market value of the shares. Our board of directors may amend, suspend or terminate our share redemption program in its sole discretion and without stockholder approval.
- Due to the risks involved in the ownership of real estate investments, there is no assurance of any return on your investment in, and you may lose some or all of your investment.
- International investment risks, including the burden of complying with a wide variety of foreign laws and the uncertainty of such laws, the tax treatment of transaction structures, political and economic instability, foreign currency fluctuations, and inflation and governmental measures to curb inflation may adversely affect our operations and our ability to make distributions. Because the performance participation allocation payable to our advisor is calculated based in part on changes in our NAV, our advisor may be entitled to a greater or lesser allocation even if the changes in NAV are due solely to foreign currency fluctuations.
- If we internalize our management functions, we could incur adverse effects on our business and financial condition, including significant costs associated with becoming and being self-managed and the percentage of our outstanding common stock owned by our stockholders could be reduced.
- We rely on affiliates of Hines for our day-to-day operations and the selection of real estate investments. We pay substantial fees and other payments to these affiliates for these services. These affiliates are subject to conflicts of interest as a result of this and other relationships they have with us and other investment vehicles sponsored by Hines. We also compete with affiliates of Hines for tenants and investment opportunities, and some of those affiliates may have priority with respect to certain investment opportunities.

This investment is not suitable for all investors. Please refer to the prospectus for the particular suitability standards required in your state. You should read the prospectus carefully for a description of the risks associated with an investment in real estate and in Hines Global.

Forward-Looking Statements

Statements in this material that are not historical facts (such as those concerning the impact of the pandemic on the future economic performance of logistics assets, and related assumptions or forecasts) are forward-looking statements based on Hines' current expectations, plans, estimates, assumptions and beliefs, that involve numerous risks and uncertainties, including without limitation, the risks set forth above and in the "Risk Factors" section of Hines Global's prospectus. These statements are only predictions and are typically identified using terms such as "may," "will," "should," "expect," "could," "estimate," "believe," "continue," "predict," "potential" and other comparable terminology. Any of the assumptions underlying the forward-looking statements could prove to be inaccurate and results could differ materially from those expressed or implied. You are cautioned not to place undue reliance on any forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements.

Important Information About Hines Global's Distributions
The availability and timing of distributions Hines Global may pay is uncertain and cannot be assured. Distributions have exceeded earnings. Some or all of Hines Global's distributions have been and may continue to be paid, and during the offering phase, are likely to be paid at least partially from sources such as proceeds from Hines Global's debt financings, proceeds from Hines Global's offering, cash advances by Hines Global's advisor, cash resulting from a waiver or deferral of fees and/or proceeds from the sale of assets. Hines Global has not placed a cap on the amount of distributions that may be paid from any of these sources. If Hines Global continues to pay distributions from sources other than cash flow from operations, Hines Global will have less funds available for the acquisition of properties, and your overall return may be reduced.

Important Information About the Coronavirus and Global Real Estate Markets
The Coronavirus (COVID-19) pandemic has had, and is expected to continue to have, an adverse impact on global commercial activity and has contributed to significant volatility in financial markets. Investments in real properties and real estate-related securities have not been immune to the impact of the pandemic. The rapidly evolving nature of the pandemic makes it difficult to ascertain the long-term impact it will have on commercial real estate markets and Hines Global's investments.

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