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KEYNOTE INTERVIEW

Building core logistics that endures

Rising construction costs, limited supply of prime space and growing rents are helping logistics outperform other income-focused real estate strategies across Asia-Pacific, says ESR's Phil Pearce

Core investors today are increasingly seeking assets that can deliver both income stability and long-term growth, according to Phil Pearce, president of ESR.

In Asia-Pacific, logistics, rising construction and replacement costs, combined with constrained supply of high-quality space, new automation requirements and growing customer demand, are creating a compelling backdrop for sector-specific core capital.

Meanwhile, build-to-core strategies and data centers are emerging as new destinations for long-term, income-focused investors.

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Q Many investors have struggled to find attractive, risk-adjusted returns in today's market. Why has APAC logistics remained a compelling option for core capital?

Asia-Pacific remains one of the most attractive investment destinations globally. Strong GDP growth, an expanding middle class and rapid urbanization are driving increased consumption, manufacturing activity and e-commerce penetration across key markets including India, Southeast Asia and parts of northern Asia. At the same time, geopolitical shifts and supply chain diversification are reshaping global trade patterns, prompting businesses to establish new production and distribution networks.

Together, these forces are accelerating demand for high-quality logistics assets near major population centers, transportation hubs and manufacturing clusters. This compelling combination of structural growth, favorable demographic trends and long-term demand drivers is supporting rental growth and value creation.

Adding to this, demand for high-quality logistics assets continues to outstrip supply. In the past, this has meant operators have had to develop new assets, but rising construction costs across the region, particularly in Japan, have led to a more cautious approach to development. As a result, it is now possible to buy high-quality logistics assets at below replacement cost. That is unique in any cycle and has attracted even more capital seeking stable, long-term income.

Another dimension of rising construction costs is that they create a positive outlook for income growth. When replacement costs are higher than current asset prices, rents must go up to support development returns. We are seeing this dynamic play out in APAC, especially in developed markets such as Japan, Korea, Australia and Singapore. Rental growth, combined with these structural factors and strong underlying performance, is delivering good risk-adjusted returns for core investors.

Q What characteristics are separating the most sought-after core logistics assets from the rest of the market?

Institutional-grade assets capable of supporting modern automation requirements remain relatively scarce across many APAC markets. The need for larger-scale assets is one factor. Robotics and automation systems generate the strongest economics in larger-scale environments – typically regional distribution centers with the capacity and configuration required for sophisticated operations. This may take the form of single-level, high-bay automation in Australia or multi-story logistics campuses in Japan, Korea and Singapore.

It also goes to the nature of warehousing today. Traditionally, warehouses were very much a blue-collar workplace. Now, technology deployment is driving demand for a more skilled workforce, especially in developed markets. Warehouse design is evolving accordingly, incorporating a broader range of amenities that help customers attract, retain and support employees.

In Japan, we now provide extensive facilities for workers and drivers, as well as daycare centers that help customers support working parents. In Australia, we have introduced outdoor gyms, basketball courts and wellbeing-focused amenities. Increasingly, the most valued logistics assets are those that bring together operational performance, strong employee experience and community impact.

Q Given the shortage of institutional-quality logistics assets, how are investors using build-to-core strategies to create income-producing portfolios?

Build-to-core is effectively how the ESR business started. We develop projects for capital partners seeking development opportunities and, once stabilized, recycle those assets to investors further down the risk curve who are looking for strong income in the long term.

Build-to-core remains an attractive strategy for capital partners looking to create high-quality, high-value portfolios that are difficult to replicate or acquire on the market. Throughout my career, I have seen investors take the view that if they want exposure to high-quality assets, they often need to create them. These investors also tend to have a long-term investment horizon, which aligns naturally with core strategies.

Importantly, build-to-core can still make sense in today's environment despite higher construction costs. Given the scale and volume of

Q How are automation and evolving customer requirements influencing what core investors consider a high-quality logistics asset?

As technology advances, end-users seek greater efficiency through automation. With labor costs continuing to rise, demand for automation also increases. Investors are therefore placing greater value on assets that can support increasingly sophisticated operations over the long term. In Korea and Japan, where land supply is constrained, it is difficult to build facilities to the scale that automation requires, creating scarcity of quality supply and boosting rental growth.

Automation is also raising the bar for building specifications. Super-flat floors are essential for the deployment of robotics. High-bay racking, which allows more efficient use of space, also needs super-flat floors for equipment stability and safe operations. What was an acceptable tolerance of floor flatness in a warehouse 15 years ago may no longer meet today's customer requirements.

SOURCE: ESR

construction that we do, we are able to make development stack up through our strong contractor relationships built over years of repeat business. Returns are realized over a longer-term investment, with risks mitigated by a stable outlook, and future rental growth supported by construction inflation and higher replacement values.

Q How has the buyer universe for core logistics portfolios evolved across the APAC region and what does that mean for liquidity?

In markets like China and India, the development of domestic REIT sectors is creating avenues for value realization. China, in particular, is a relatively new REIT market and we have listed our logistics REIT there, which we will use to exit some premium assets, broaden liquidity pathways and recycle capital.

In more developed markets, the picture is somewhat different, with REIT performance closely correlated to interest rates, which influence valuation.

At the same time, the sheer depth of capital seeking exposure to the region means the market for private capital remains strong, especially given that foreign investors are currently 25-30 percent below targeted APAC allocations. There is strong demand for institutional-grade investment products from sovereign wealth funds, insurance companies and pension funds looking for long-term assets with stable cashflows that match their long-term liabilities.

Upcoming rental reversions reinforce the appeal. Across several of our portfolios, we continue to see attractive embedded rental growth. In Australia, built-in rental growth is delivering very attractive risk-adjusted returns, and we see similar dynamics in Japan. From that perspective, logistics real estate offers both defensive characteristics in times of global uncertainty and the benefit of visible growth coming through rental increases in cashflows.

Q As data centers mature into an institutional asset class, are they becoming a more significant allocation for core investors?

Yes. Data centers is a new asset class where the focus was on developing assets and leasing them out. As assets are increasingly stabilized, the next question becomes liquidity. These projects are very capital-intensive, and developers are going to have to recycle capital to fund future growth and the next wave of development.

"Build-to-core remains an attractive strategy for capital partners looking to create high-quality, high-value portfolios"

This means that attention is turning to creating income-focused products or finding income-focused investors to buy them. There are now some listed REITs in Singapore, Australia, the US and other markets – not a lot of them yet, but that number is definitely going to grow. Depending on end-user covenant, there will always be strong demand for these assets because they offer characteristics similar to CPI-linked bonds, with leases extending up to 20 years.

Beyond REITs and other established core products, data centers are increasingly well-suited to insurance companies and pension funds looking for long-term, stable cashflows as the asset class matures.

Q Which APAC markets currently offer the strongest performance for core logistics investors?

Core capital would typically be focused on developed markets – in APAC, that means Singapore, Korea, Japan and Australia.

Cap rates have been relatively stable, with investors looking beyond headline yields to the durability of cashflows, rental growth potential and the long-term scarcity value of high-quality logistics assets.

Singapore is clearly land-constrained. It has relatively low interest rates, so there is a healthy spread between the cost of debt and asset yields. Cap rates range depending on remaining land lease tenure and are typically around 6 percent or higher.

There has been a real mind-shift in Japan. Traditionally not considered a market with rental growth, we are now seeing rents rise on the back of favorable supply demand dynamics, with demand outstripping supply due to higher construction costs. Yields remain attractive at 3.5-4 percent, supported by Japan's low interest rate environment.

Australia has always been a core market, with cap rates ranging between 5 and 6 percent depending on the state. Strong economic fundamentals – underpinned by continued population growth, a key driver of Australian GDP and consumption – are sustaining increased demand for logistics space. At the same time, new supply entering the market has moderated, supporting occupancy and rental growth outlook.

Korea is also benefiting from favorable supply dynamics, although the drivers are different. Access to financing for development has become more challenging, limiting new supply as many developers or market participants have found it difficult to secure debt financing for new projects. As a result, the previous supply glut has largely been taken up. ■