



Long-term resilience of cold storage real estate

Chase McWhorter, Institutional Real Estate, Inc.'s managing director, Americas, recently spoke with **Kevin Rivest**, managing partner and head of BGO's U.S. Cold Chain Investment platform. Following is an excerpt of that conversation.

What led BGO to prioritize the cold storage sector, and how does the firm continue to differentiate itself?

At BGO, we've built our capabilities and track record investing in the cold storage space globally for more than a decade. We made our initial investments in the sector around 2015 by acquiring recently built, core-quality cold storage assets across a variety of vehicles – including separate accounts and our core and core-plus strategies. As we became more knowledgeable about the space, we evolved our investment strategy to include some forward commitments on development projects, and then eventually, we developed a few projects with joint venture partners on a ground-up basis. The more we immersed ourselves in the sector, the more we found it an interesting investment, delivering attractive risk-adjusted returns. We believe cold storage is resilient across cycles. Food is an inelastic demand product, and that underpins the sector. Tenants make major investments into their space, and they operate as if they're never going to leave, so leases are structured on a very long-term basis with many options.

As we learned more about the cold storage sector and what drives it, some clear patterns emerged. Cold storage assets are critical to the food supply chain, and existing inventory is increasingly obsolete. The pandemic put that obsolescence in the spotlight, which drove us to lean in and formalize our approach. Ultimately, we formed a dedicated team internally. We raised our first discretionary cold storage development fund in 2021, with a final close in early 2022. This fund is largely focused on building state-of-the-art cold storage facilities in the United States and Canada.

We believe cold storage developments are uniquely positioned to deliver strong risk-adjusted returns. First, there are high barriers to entry, especially for development. Not only are cold storage projects expensive to build, but they need to be located on sites conducive to the business, including proximity to population centers and transportation hubs, and good sites are hard to come by. The expertise to develop and understand these assets is critical – not just from a technical construction perspective, but also what's driving the economics or the opportunity inside the box for our tenants. Cold storage is operational real estate, and we treat it that way when making development and investment decisions.

We have a large, dedicated team focused on the sector, which includes specialists in development and engineering, including refrigeration engineering. We also have the full resources of BGO's national investment and asset management teams across markets, with a blend of very deep market coverage and expertise. What began as an interesting subset of our broader industrial strategy has grown into a major investment thesis across the firm.

What are the primary drivers fueling demand for modern cold storage real estate today?

Our deep relationships with customers enable us to really understand their business needs and provide value that addresses current requirements and anticipates future optimization opportunities. Third-party logistics firms (3PLs) are a large component of the tenant demand base for cold storage buildings, broadly speaking. 3PLs may serve a single customer

or they may work with hundreds of customers within their box. They're focused on securing and extending their relationships with those end customers. Typically, those subcontracts between the 3PLs and their customers are relatively short in nature – one to three years. The operators who can offer specialized services, however, maintain high standards of customer service and stay competitive on pricing are in the best position to secure longer-term business. Tenants are focused on buildings that can help them offer something that is differentiated, so that they can maximize their relationship with their customers over a long-term basis – not through contracts. This relationship and service-based model can't be easily replicated by their competition.

A related theme is the importance of optionality and flexibility. Change in the food supply chain is constant, and the pace of change has increased materially during the past five to 10 years. Whether that change is in the product mix, how the goods flow, where the goods flow or the tenant's specific systems, modern cold storage buildings must be more flexible and offer greater "convertibility." Our projects generally have fully convertible freezer/cooler rooms capable of handling a wide range of temperatures, from -20 degrees to 55 degrees. The key is having the ability to adapt the rooms properly for different products. Consumers are increasingly opting for healthier food choices overall. Both fresh and frozen foods require higher-quality cold storage to adapt to these changes in consumer preferences in the underlying products in real time.

Even before the talk of tariffs, companies had been relocating supply chains closer to home when they could, which continues to drive additional cold storage demand domestically. On average, cold storage facilities are between 40 and 45 years old. There is a high degree of functional obsolescence of the existing inventory. Food companies are focused on upgrading efficiencies and modernizing their supply chains, so that functional obsolescence is increasingly becoming a critical issue for them. Tenants are increasingly focused on reducing their carbon footprints, from a sustainability perspective as well as a dollars and cents perspective. Energy is one of the biggest costs of running cold storage buildings. There have been major advancements in the overall envelopes of the buildings, the thermal integrity of the buildings and especially in the refrigeration technologies, which create huge opportunities for savings and efficiency in energy usage and overall occupancy costs.

How have BGO's strengths in real estate development supported its ability to partner with stakeholders to deliver build-to-suit solutions across the cold chain?

Our development platform stands apart from many of our competitors in the investment management space. Our overall U.S. industrial development pipeline is greater than \$5 billion in projects, and we have approximately \$1.8 billion in projects currently under construction. We have a large, dedicated in-house development and construction management team with multidisciplinary expertise – and several of those team members are fully dedicated to the cold storage team.

As we have built our cold storage platform over the years, we have focused on bringing a diversity of backgrounds, experience and ideas to the team. One team member joined us from one

of the largest cold storage operators in the United States and brought 15 years of experience developing and operating cold storage facilities – true industry experience and insider knowledge. It's our team's expertise that allows us to oversee all phases of the development lifecycle, from the due diligence stage through entitlements, from the design stage through construction and into operational oversight of the assets. We have built the cold storage platform and team in a way that enables us to be flexible in how we manage projects. Most often, we partner with development companies, bringing our design, development and construction management expertise alongside those partners in a collaborative way to combine best practices from everyone's experience. Our team, however, also has the ability to manage projects directly.

How is BGO Cold Chain positioned to execute on this market opportunity in cold storage?

BGO Cold Chain is our dedicated cold storage platform developed specifically to invest capital in the modernization of the food and pharmaceutical supply chain. We are focused on the most innovative and sustainable cold storage and food infrastructure solutions. It is our differentiated approach, grounded in our sector expertise, specifically the technical aspects of understanding cold storage construction deeply, as well as the operational aspects of the real estate, that enables us to execute on this vision. We understand how tenants generate revenue and evaluate expenses, why they choose buildings, the reasons for certain required specs, etc. Cold storage is operational real estate, and we treat it that way.

The deep industry relationships we've built over the years are critical for our success. We refer to them as our flywheel, comprising a variety of long-standing relationships with tenants, contractors, consultants, brokers, capital partners and many large subcontractors that build cold storage and food manufacturing facilities. It is a grassroots relationship base. We tend to see more opportunities for new projects from contractors and trusted consultants than we do through more traditional channels.

Scale also matters in this market. We have been the largest cold chain real estate investor in North America, at least for the past four or five years. Our scale gives us the ability to move with speed and certainty across ground-up development, acquisitions and debt financing. In addition to our equity business, we've provided debt capital on cold storage projects through our U.S. debt business, as well. Our ability to be flexible in how we structure our deals to meet both the tenants' needs, as well as our partners' needs, and ultimately our return requirements, are key to our success in building long-term relationships.

Finally, the last element is our asset management. We manage these assets very actively, even though they may be leased on a long-term basis to a single tenant. Active management and maintenance are critical to ensuring we get the most out of the asset and have the greatest longevity.

Who are the other major players in the cold sector space? And how is BGO positioned competitively within this landscape?

There are two categories of players in the cold storage sector from an institutional investment perspective. First, there are real estate-focused investors such as BGO that focus on developing, owning and leasing the facilities to tenants – cold storage 3PLs, pharmaceutical companies or various types of food manufacturers and/or distributors. We lease on a triple-net basis, which

generates long-term stable cash flows with built-in contractual escalations. We do not take any of the operational risks that a cold storage operator – a 3PL or PRW – takes. The other type of player is a vertically integrated operator, or an owner operator. Many of them are backed by institutional capital, but they both own the real estate and operate inside the four walls of the warehouses. That model, in our judgment, carries a wholly different type of risk, including exposure to everything that comes with owning an operating company, such as occupancy and storage rate fluctuations, labor costs, energy costs and service-level risk.

How do you anticipate the cold storage sector will perform amid the current economic volatility?

Near term, there are challenges. Construction costs remain elevated. Tariffs could further exacerbate both costs and import and export volume. The global food supply chain is complicated, and food is a big component of volume. The uncertainty leads to indecision. Corporate tenants have generally been more cautious and are delaying large capex decisions and commitments to long-term leases. Another challenge involves new technologies in the pharmaceutical space, notably the GLP-1 weight-loss drugs that are already affecting food-consumption trends. They may decrease the amount of food people will consume. That said, while there may be an overall decrease in calories consumed, the quality of those calories will likely increase, as will the amount of protein, meaning healthier eating habits, which are factors that point to more – not less – need for cold storage space. The product mix will continue to change and adapt, and that will require flexible buildings that can accommodate more SKUs of products and different temperature zones.

In the medium-to-long term, we remain very optimistic. Despite short-term fluctuations, the long-term need for more fresh and frozen foods will only continue to grow. Global population growth, estimated at 2 billion more people by 2050, will continue to drive the need for more food and more cold chain logistics. The cold storage sector has delivered a very stable 3 percent plus compound annual growth rate (CAGR) on revenue growth during the past 20 years. That resilience is rare, and that is a key reason why cold storage belongs in every long-term real asset portfolio.

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ABOUT BGO COLD CHAIN

BGO Cold Chain is the firm's dedicated business line representing its global breadth of cold storage real estate investment management, asset management and development activity on behalf of its institutional investors. BGO Cold Chain is among the largest cold storage investors in the world, with approximately 30 million square feet of transaction activity since 2015. Leveraging deep expertise in cold storage real estate, BGO Cold Chain has extensive experience in leading build-to-suit and speculative projects, with an established track-record for delivering high-performance, sustainable solutions. For more information, visit www.bgo.com.

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