




SAM NEWBERG

Retooling Industrial Development

Deals will tend to be build-to-suits as companies streamline, consolidate, and take advantage of locations near multimodal transportation options.



Located southwest of Atlanta, IDI's LEED Silver-certified Westpoint Building A was entirely leased by Colgate-Palmolive in December 2009.

WITH GLOBAL TRADE DOWN by over 20 percent in 2009—although there has been some rebound in 2010—containers stacked high at seaports are still a common sight. Correspondingly, the industrial sector of real estate is experiencing record vacancy. Even if economic recovery begins anew this year, most estimates show a full recovery in 2011 or later.

Amid the morass, business may not be brisk—but deals are still occurring. “Companies are focused on retooling or repositioning for the turnaround,” says Rich Thompson, executive vice president at the Chicago office of Jones Lang LaSalle’s port, airport, and global infrastructure group. Thompson terms it “network optimization,” in that companies are streamlining their operations. For example, perhaps they are consolidating from three smaller warehouses to one large distribution center, which could allow the new facility to take advantage of locations near multimodal transportation options such as any combination of truck, rail, sea, or air.

Most, but not all, recent deals are build-to-suits, and though well located, these newer and green speculative buildings report seeing some activity. “It is all food companies,” says Sean Fitzsimmons, vice president of national business development for IDI, an industrial developer based in Atlanta. Fitzsimmons cites several grocers and grocer suppliers like General Mills, Smuckers, and Colgate, for example, that all added one or more distribution centers in the past couple years.

Those that are not necessarily expanding are streamlining and consolidating their operations, seeking more efficiencies in their supply chains, notes Fitzsimmons. “Companies with three 300,000-square-foot [27,871-sq-m] warehouses are consolidating to a single million-square-foot [92,903-sq-m] distribution center.” Home Depot, in an example of increased efficiency, is building 24 distribution warehouses, or rapid deployment centers (RDCs), as they’re referred to, around the country. Home Depot formerly relied on its large-format stores to serve as de-facto distribution warehouses. This model has driven up logistics costs over time, and the new RDCs will cut truck trips to stores by around 50 percent. Fitzsimmons says he believes this streamlining will improve inventory efficiency. “They are able to get products faster, even if a stop [at a distribution center] is added.”

Several significant infrastructure improvements are in the pipeline that will improve the efficiency of how goods are moved. “Time is money,” comments Rodney Goulet, vice president of supply chain strategy and infrastructure at Seattle-based Colliers International. “Consistent and reliable delivery may be more important than the planned time in transit. Companies are looking to remove variability.”

Perhaps most significant, the Panama Canal is being expanded and, beginning in 2015 (the first full year of scheduled operation), will accommodate significantly larger container ships. This will increase the appeal of East Coast ports as a means of delivering goods to customers in the eastern United States, rather than through the congested ports of Long Beach and Los Angeles.

At present, several infrastructure investments are being made that will improve speeds for both trucks and freight rail lines within the continental United States. Some are being funded by the Transportation Investment Generating Economic Recovery (TIGER) discretionary grant program, part of the American Recovery and Reinvestment Act. TIGER, for example, is targeting billions of dollars to the Crescent Corridor from Memphis and New Orleans across the Southeast and up to New York, as well as the National Gateway Corridor connecting the Port of Virginia to Ohio and beyond to Chicago. In addition, 2014 will bring the upgraded Panama Canal, which could greatly increase cargo passing through East Coast ports.

John Carver, executive vice president of port, airport, and global infrastructure services at Jones Lang LaSalle’s Los Angeles office, notes that ports used to be focused on capacity, but now the focus is on throughput. In other words, it is not just how much cargo is unloaded at the seaport, but what the capacity is for trucks or rail companies to increase the flow of goods through their port. “Savannah throughput may be solved in South Carolina,” he says, indicating that an improvement anywhere along the supply chain can create economic development opportunities 1,000 miles (1,610 km) away.

Infrastructure improvements can ripple through the supply chain. Just as the Panama Canal expansion can increase port activity on the East Coast, that plus rail improvements

Land prices and the corresponding value of helping customers conduct their business from closer-in urban infill locations are driving construction of new multistory industrial buildings in Tokyo, such as AMB's Shinkiba Distribution Center (right).

can make inland locations more attractive for distribution centers or factories.

Goulet observes that the relationship between supply chain subject matter expertise and commercial real estate providers used to be ad hoc, but there are more and deeper partnerships evolving. He says he believes that economic development agencies are beginning to gain a better understanding of what private companies have embraced already—a holistic view of logistics.

One example of this is the National Gateway Corridor, an effort to improve the freight rail line between the East Coast and Chicago, literally shortening the distance between the two. The website for the corridor credits all the members of the coalition that support the effort, including elected officials and companies. The coalition includes the governors of six states, eight senators from four states, 30 members of Congress from seven states, and an extensive network of businesses and associations. This underscores the importance of leadership and cross-jurisdictional efforts.

"I couldn't agree more," says Neil Doyle, executive vice president of infrastructure and transportation at Chicago-based CenterPoint Properties. "People are realizing the value of trade and cargo." CenterPoint is pursuing a public/private partnership in which the firm would enter into a 60-year lease to operate, manage, and develop the Port of Virginia. Linking the two are the Heartland Corridor and the National Gateway Corridor. "If Hampton Roads grows, Chicago and everywhere in between will benefit," explains Doyle.

What is not known is the impact on logistics of Warren Buffet's purchase of the Burlington Northern Santa Fe rail system in late 2009. "We can talk a big game of rail freight, but



when someone writes a check for \$44 billion," the industry takes notice, remarks Doyle.

Thompson maintains that the use of rail will only increase, particularly as fuel costs rise. "Wal-Mart didn't used to use rail [to move goods; it does] now," he notes, citing the retailer's decision to build two massive warehouses at CenterPoint Intermodal Center in Elwood, Illinois, 50 miles (80 km) southwest of Chicago. Wal-Mart "paid more for real estate, but saved millions on drayage," Thompson points out.

Steven Campbell, senior vice president and director of environmental and development services for AMB Property Corporation, a global industrial real estate developer based in San Francisco, believes that green buildings have survived the downturn because they are economically sustainable. Fitzsimmons agrees, noting that his firm, IDI, has developed several LEED structures, and that leasing is significantly higher in those buildings. "It is a conscious decision by the tenant to be sustainable when they can," he says, adding, "while being cost efficient."

Campbell thinks buildings that incorporate sustainable features are more efficient to operate, reduce costs, and increase profit. He adds that increasing efficiency at the building level is a great first step, but believes the bigger story is where AMB chooses to locate its facilities, in

infill markets. "What can our customers do to dramatically reduce their carbon footprint and operating cost? It's simple—they need to be closer to their customers," says Campbell. "Our focus on infill is about locating our customers closer to their customers; this has a massive impact on the environmental balance of the supply chain that our customers are starting to look at and ultimately reducing environmental impact and overall cost."

Campbell cites AMB industrial buildings in Tokyo that are new and multistory, a decision driven largely by land prices and the corresponding value of helping AMB's customers conduct their business from urban infill locations that bring them closer to their customers. "Japan and certain other Asian markets exemplify the value of having concentrated distribution in urban areas," he says, referring to how warehousing in major cities such as Tokyo is largely done from multistory buildings. "The U.S. will ultimately move toward this model, which is more efficient and environmentally sustainable. We believe that it will happen first in Los Angeles and New York/northern New Jersey."

Gene Reilly, president of the Americas at AMB, explains that online retailing was once feared but is now embraced in the industrial sector. "Ten years ago, there were dire predictions for both stores and warehousing,"



Infrastructure improvements can ripple through the supply chain. Throughput issues for the Port of Savannah (left) may be solved in South Carolina.

and-mortar stores moving into online retailing have the added advantage of customers being able to make online orders and deliveries from either their home or a store.

According to the Urban Land Institute's *Emerging Trends 2010* report, investors should continue to focus on gateway ports. Investors also need to better understand logistics, and how to get goods to market faster and keep leaner inventories. Carver says the last boom began at ports, airports, and other terminuses,

and the next one will as well, including inland ports. In the meantime, he says, "for developers, this is a year of positioning."

Thompson suggests that the industry will see strategies for cost reduction, better asset use, and consolidation. Thus, the forecast in the near term is that deals will tend to be build-to-suits as companies streamline and consolidate. Since the real estate market lags the economy by roughly one year, it will be 2011 before any reductions in vacancy occur in the industrial market.

The right location with good transportation options to reduce costs for companies in the long term will win the day. "Nobody needs a new warehouse for the space," says Doyle. "If we offer a cost savings, the ability to consolidate, or the right location next to a rail terminal where they can save fuel and money, that's where the opportunity is. Cheap land is a short-term solution." Reilly agrees. "You won't see distribution centers out in cornfields, even with incentives." **UL**

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he says, explaining that products must still make the journey from origin to destination, even if they bypass a bricks-and-mortar store. "A product may touch us at a tarmac facility [airport warehouse], a port-adjacent warehouse, or a distribution center. I don't see further growth in online retailing as negatively affecting us."

Thompson explains that online retailers tend to follow a very centralized model for logistics. As well, their warehouse operations often include more automation, as they typically involve picking smaller parcels for delivery to individual customers—often at their homes—versus picking pallets for delivery to a store. Goulet calls this "unit-picking versus pallet-picking."

One example of a pure online retailer is Omaha, Nebraska-based Hayneedle, a seller of home and lifestyle products. The company was formed as an aggregate of 200-plus different online "stores," and to streamline the distribution of its goods, it recently signed a lease for 501,357 square feet (46,577 sq m) at the Monroe Logistics Center in Monroe, Ohio, near Cincinnati.

Since online retailers operate in a "direct-to-consumer" environment, where goods do not get distributed to a bricks-and-mortar store before being purchased, online retailers seek a distribution facility that bal-

ances transportation of incoming goods with end users, or is close to customers.

Tom Clement, director of network strategy at Hayneedle, explains that the firm wound up choosing between several potential distribution centers located in either Indiana or Ohio. "In a direct-to-consumer environment, the answer for where to locate is often the same," he says. At its Monroe facility, the online retailer could take advantage of inbound goods being moved by rail or truck from seaports, balanced with not only being a relatively short truck drive from a large percentage of customers, but also being close to a convenient air cargo hub in Indianapolis and Louisville (FedEx and UPS operations, respectively). The key, says Clement, is efficient movement of goods from their origin and then quickly to the most possible customers.

Companies that are purely e-commerce based are not the only ones taking advantage of online sales. A number of traditional retailers—even old-guard stores that have been around for over 100 years—are moving to e-commerce, and several have separate fulfillment distribution centers specifically for this purpose.

JCPenney is one example. The longtime retailer has 13 store support centers that service 80 to 125 stores each, but it also has four separate direct distribution centers that fulfill orders from catalog and online orders. Bricks-