INDUSTRIAL

Stocking Up on Industrial

The latest trends in warehousing are driving shifts in supply chains and increasing appetites for modern facilities.

By Beth Mattson-Teig | Sept.Oct.19

Industrial real estate is no longer simply the steady workhorse operating quietly behind the scenes. The market sector has jumped to the forefront as the property everyone is talking about.

That attention is well deserved, with secular shifts that are spurring steady demand for space and overall performance that is tough to ignore. According to the NCREIF Property Index, industrial is expected to generate returns of 10.3 percent this year, well ahead of the 6 percent returns expected in both office and apartments and 2.9 percent for retail.

The market has been riding a significant tailwind from e-commerce, and that breeze is only expected to grow stronger. “Logistics real estate remains strong and, in most markets, customers are waiting for new supply to come online due to the limited availability of standing inventory in nearly all U.S. cities,” says Kim Snyder, president of the west region at Prologis. Industrial also is seeing demand coming from sources across the board - third-party logistics and logistics firms, manufacturers, light assembly, and even cannabis growers.

According to the Urban Land Institute's Real Estate Economic Forecast for Spring 2019, the industrial/warehouse vacancy rate is hovering around 7 percent, well below its 20-year average of 10.2 percent. CBRE puts warehouse vacancies even lower, at 4.4 percent. Industry sources agree that demand has been fueling a surge in warehouse development in recent years. CBRE estimates 255 million square feet of warehouse space was under construction at midyear, of which 70 percent was speculative. The firm also noted that since 2015, warehouse demand has outpaced completions by 169 million sf, with rents increasing 19.2 percent over that period.

Against that backdrop, developers and investors are trying to get a read on changing occupier needs related to shifting supply chains, last-mile delivery, and more modern space.

E-Commerce's Effect on Supply Chains

Growth in e-commerce is transforming warehouse, distribution, and fulfillment space, along with the way companies view supply chains. That shift is only going to increase as e-commerce continues to grow and expand into other sectors such as grocery, furniture, vehicles, and pharmaceuticals. “You are going to need more places to store these goods and be able to get product out to different parts of the region and the country,” says Cedric Matheny, CCIM, a principal and vice president at T. Dallas Smith & Company in Atlanta.

Increasingly, consumers are demanding faster and faster delivery times. Next-day or same-day delivery is moving toward two-hour delivery in some urban locations; consumers are insisting on a broader selection and availability of goods, notes Snyder. “As a result, properly selecting a market and a logistics property are now business-critical decisions that favor high-quality space in prime locations near large population centers,” he says.

In a recent report on logistics real estate, Prologis noted that future supply chains are being impacted by mega-trends such as e-commerce, shifting consumer behavior, demographic trends, and urbanization. Supply chains will be required to focus on greater efficiency driven by technology such as autonomous vehicles, robotics, automation, and predictive analytics.

Transportation Drives Location Decisions

Whether companies are moving goods locally, regionally, or nationally, transportation infrastructure is the backbone of supply chains and a critical factor in the size, type, and location of key facilities. “Transportation is a big driver for how we look at logistics and how we look at the industrial real estate market,” Matheny says. “Having multiple modes of transportation is so important.” Companies are moving goods via trucks, rail, airports, and inland rivers.

Many are taking note of Amazon's strategies for maximizing efficiency in managing supply chains and delivering goods to the end consumer. “Obviously, the elephant in the room in supply chain would be Amazon,” says Matheny. The e-commerce giant is gobbling up space in markets across the country. Still, many distributors and e-commerce companies are growing or shifting their supply chains according to models that vary depending on the user and type of goods, as well as location of the end customer.

Port markets on both the East and West coasts continue to be a target for distribution companies and serve as gateway markets for growing industrial hubs. For example, the deepening of Georgia's Port of Savannah is fueling more growth in the surrounding region, including key distribution hubs. The Atlanta metro area has one of the largest spec development pipelines in the country, with 16.1 million sf of space under construction as of 1Q2019, according to CBRE. Access to rail is also increasingly important as a cheaper way to move goods.

In the Midwest, Kansas City is one market that is benefiting from changing supply chains. The metropolitan statistical area ranks 28th in the country in terms of population. Historically, it was considered more of a tertiary market for distribution, but the e-commerce boom has elevated Kansas City as a top secondary, or even primary, distribution market for companies that need to reach a consumer population within a day or two. “With that change, we have seen a development boom in big-box distribution facilities,” says Nathan Anderson, CCIM, SIOR, a partner at NAI Heartland in Kansas City.

Since 2011, the metro area has seen more than 30 million sf in new industrial space built at an average of about 4.5 million sf per year, Anderson notes. The surge in development is coming from both e-commerce demand and manufacturers that have been expanding or upgrading facilities post-recession.

Development has slowed to about 2 million sf, as most e-commerce companies have made their moves for this cycle, Anderson says. In Kansas City, companies also are looking for facilities that have good proximity to rail hubs. “A lot of this product is coming from the intermodal chain via the ports of Los Angeles and Long Beach,” says Anderson. “The ability to take a container from Kanas City's intermodal port directly to your warehouse is an advantage that we didn't have here prior to the last cycle,” Anderson says.

It can be a slow process to “turn that battleship” and moderate existing supply chains and infrastructure, Anderson notes. Some companies are switching to models based on two or three regional distribution centers that dispersed, making it easier to cover the last mile to the consumer within one to two days from when an order is placed, Anderson says. “We are seeing a lot less users that would be in the 500,000- to 1-million sf range and more smaller users that are in the 100,000- to 300,000-sf range, as they try to move buildings into smaller footprints, in more locations where they can reach population zones,” he says.

Industrial Goes Vertical

Companies are still trying to figure out last-mile delivery with distribution points that move closer to urban population centers. “In the land of Amazon, we have seen many different, unique ways to address that problem,” says Sean Durkin, CCIM, MSRE, SIOR, principal at Lee & Associates in Seattle. In most cases, the solution is simply to deal with what is available. For example, Amazon has space in the Starbucks headquarters building in downtown Seattle, where space in the aisles for sorting and packaging is extremely tight. “Amazon also has to deliver things in shorter trucks to even have access to the area, and it is a quick pick and pull,” Durkin says.

One new trend in Seattle in its close-in market is multi-level industrial facilities that use a freight elevator that can accommodate a forklift to access second-, third-, and fourth-floor distribution or light assembly/manufacturing spaces, Durkin says. Seattle is also a test case for one of the first multistory distribution facilities in the U.S. Prologis completed Georgetown Crossroads last year, minutes away from downtown. The three-story, 590,000-sf warehouse features truck ramps leading to loading docks on the second level, while the third floor is served by forklift-accessible freight elevators for lighter-scale warehouse operations.

Developers are going vertical on urban sites to maximize density and justify higher building and land costs. However, it can be difficult to make multilevel sites work in an urban setting. One challenge is the space required to allow for truck docks and maneuvering. For example, the Seattle project included an earthen truck ramp on both sides of the building, whereas most close-in land sites are already maxed out on the square footage. “Prologis delivering this to our market is still being proven,” Durkin says. The first lease has been signed, but until the building achieves full occupancy, people are hesitant to jump in and embrace multilevel development, he adds.

Amazon is certainly leading the charge to procure efficient space to accommodate last-mile delivery. “The configuration is quite a bit different than what you have seen in traditional warehousing,” says Vanessa Herzog, CCIM, SIOR, a principal at Lee & Associates in Tacoma, Wash. Typically, companies are looking for 15 to 20 acres that can accommodate a 100,000-sf building, with the rest of the site devoted to truck parking and vehicle storage. Amazon also is looking at opportunities to acquire vacant retail big-box stores that are close to the consumer, such as Sears and Sam's Club. Those are examples of properties that could be modified to accommodate last-mile distribution that also have a lot of parking, she adds.

New Facilities Combine Efficiency, Aesthetics

Warehouses are no longer the windowless, concrete boxes that were the norm in the past. Users are demanding modern, efficient, sustainable buildings that can accommodate the latest in automation and robotics - all while helping them attract and retain workers.

Prologis also has started incorporating health and well-being into building design. In January, the firm's Park Tacoma, Building D, in Tacoma, Wash., became the first logistics facility in the world to be awarded a WELL certification by the International WELL Building Institute, an industry benchmark that assesses how building design and management can enhance human health. The facility achieved certification with an emphasis on natural light with skylights, clerestory windows, and dock doors positioned to maximize daylight exposure. It also features murals painted on select portions of the building.

In automation and warehouses that utilize robotics, “Amazon is leading the trend,” adds Tony M. Guglielmo, CCIM, president and owner of Allied Commercial Real Estate Inc., in Ontario, Calif. For example, Amazon warehouses pick products on a lower level, send it up a conveyor belt to a mezzanine level where it is packaged, and then sorted automatically depending, for example, if UPS or the U.S. Postal Service will ship it. Other big retailers such as Walmart and Target also are increasing their use of automation in warehouses.

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For many users, functionality is still the focus. Developers building new industrial facilities to stand the test of time over the next two decades need to create large boxes with high, clear ceiling heights and open floors unrestricted by columns. The 1990s-era buildings that were 24 feet tall have been replaced by a new standard where heights typically reach 32 to 38 feet, sometimes topping out at 42 feet. “A lot of these companies look at not just your square footage, but the cubic footage and how much product they can fit,” Guglielmo says. An example is a 100,000-sf building with 40 feet of clear height versus that same footprint with a 24-foot clear height in terms of cubic footage.

Some users are still building mega-facilities ranging from 400,000 sf upward of 1 million-plus sf. Home Depot is building a new 1.3 million-sf warehouse near the Port of Tacoma that is split into three divisions. The facility is anticipated to feature a traditional import center that houses new seasonal product, a will-call component where people can pick-up online orders, and a division that provides last-mile distribution, says Herzog.

Although e-commerce tends to dominate conversations in the industrial sector, manufacturers also are upgrading facilities to account for increased use of technology and robotics. Manufacturing facilities generally need more power and are less concerned about ceiling heights. Automation for both manufacturers and distributors requires immense power, which in turn is driving a bigger appetite for more sustainable, energy-efficient buildings. Distribution users are looking for functionality in getting products out the door quickly and efficiently. Tenants are demanding more loading dock doors, including multiple grade-loading dock doors to accommodate different truck sizes as well as more truck and trailer parking to support the transportation of goods. In addition, facilities are being equipped with dock doors that allow cargo vans and trucks to drive into facilities for loading.

A common theme across property types these days is flexibility, allowing building facilities to adapt and change. However, such flexibility can be difficult in an ever-changing supply chain, Snyder notes. Two key characteristics to achieving such flexibility are land dedicated to expansion and sufficient power to capitalize on emerging technology for product movement, he says. “A logistics property with too little electricity; insufficient clear heights for modern racking and conveyance systems; or inadequate parking for either trailers or employees can be the difference between a successful logistics property and one that fails,” he says.

For more on this topic, check out CCIM Institute's "Evaluating Industrial Development Projects" course.

Beth Mattson-Teig

Beth Mattson-Teig is a freelance business writer based in Minneapolis.

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