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Delivering in the Clutch

Warehousing is a bright spot in commercial real estate as the supply chain reacts to the pandemic and the industry prepares for an uncertain future.

By Sarah Hoban | Summer 2020

Until the COVID-19 pandemic hit the U.S. this spring, the country's warehouse/logistics market was having a healthy multiyear run. According to Newmark Knight Frank national research, asking rents for 1Q2020 were up 4.1 percent from the year before, and vacancy was at a cyclical low of 5.4 percent. Construction was at a cyclical high - 68.2 million square feet of new space came on the market, and 322.7 million sf were under construction.

And while the coronavirus has shaken every corner of the economy, some indicators show that warehouses will remain a relatively healthy market segment. An April report from Marcus & Millichap

suggested that warehouses and distribution centers could weather the COVID-19 crisis “as much-needed supplies are funneled through a smaller supply chain.”

But that's not to say there won't be challenges.

One major factor contributing to the warehouse sector's sturdy performance coming into 2020 was the continued rise of e-commerce. As consumers took more of their retail business online - and demanded speedier delivery times - companies looked for warehouse space that was closer to their customers, often closer to larger metropolitan areas.

COVID-19, along with stay-at-home orders, shuttered stores, while consumer anxiety about public places put e-commerce into hyperdrive. An April report by Prologis noted that preliminary estimates suggested a 50-percent rise in e-commerce sales in March, versus the recent trend of around 15 percent. Especially notable, the report added, were gains in categories such as groceries.

“Certainly, grocery retailers are looking for whatever space they can get on a short-term basis,” said Gerry Shear, CCIM, president of the Shear Property Group in Las Vegas. “Every week for them is like Thanksgiving - it's been the busiest week of the year. They usually ramp up for that once in 52 weeks, but here they are at the beginning of the second quarter, dealing with it week over week, so they're trying to enhance their storage capabilities.”

Store closures also forced retailers to look for additional storage space. “We've seen a buildup of inventory in the region as new inventory for the fall buildup was commencing and already on its way here,” said Brian Knowles, CCIM, president and principal of Lee & Associates of Eastern Pennsylvania. “Inventory has not been going out the front door to the retail centers; therefore, the warehouses are full but it's still flowing into the rear door of these facilities. Where are they going to put the product that's coming off the container ships?”

“We have definitely seen a need for certain retailers to find short-term locations. Everyone is going to have a different supply chain equation to solve, whether it's a local third-party provider, a warehouse, short-term sublet, or they're going hold it in another region of the country. Whatever the supply chain team has to do to secure a solution, they're going to do.”

Other areas created demand as well. The Prologis report pointed to the increase in consumers' food stockpiling, the spike in demand for medical supplies and equipment, and the need for at-home office and school supplies.

First Priority for Last Mile

“As more Americans take advantage of delivery after the health crisis is over, demand for last-mile distribution will also increase, generating opportunities for investors,” according to the April Marcus & Millichap report. The report also noted that “logistics networks for more prompt delivery” were still being created in secondary and tertiary markets, but as larger retailers such as Walmart put more focus on delivery, “the need for warehouse and distribution space throughout the supply chain will increase.”

Even before the COVID-19 crisis, demand for smaller, close-in warehouses was on the rise. In a study from October 2019, CBRE reported that demand for light-industrial properties smaller than 120,000 sf had exceeded demand for larger properties. The availability rate for properties between 70,000 and 120,000 sf had dropped by almost 4 percentage points over the previous five years, while rent rose more than 30 percent.

But finding and developing such properties can be challenging. “When you get into last-mile solutions, you're getting into denser populations and less industrial-zoned ground that can be developed,” said Knowles. “You could consider the demolition of existing facilities, which could bring up environmental issues or perhaps impervious coverage limitations.” But Knowles, based in Plymouth Meeting, Pa., outside of Philadelphia, says he's already seen more new development “in places we haven't seen before - in Philadelphia, which is very positive,” as well as other areas around the Northeast.

“The biggest cost in the supply chain is transportation,” says Shear, “so certainly moving closer to your population centers - with smaller facilities with higher velocity items in greater demand - is a trend that continues, especially with increased expectation of faster delivery.”

But, he adds, “that hasn't come at the expense of the larger distribution system model. Not everybody in the supply chain is participating in that final mile. Amazon may be leading the charge with that network to come closer to the population centers, but for their suppliers, that investment doesn't make any sense. It's a lot easier for them to keep their large distribution hubs and then feed into the Amazon ecosystem or other e-commerce customers. You're not going to see smaller distribution centers continue to evolve at the expense of larger ones. You'll still have the wholesale side of things as well as the high-velocity, same-day delivery type of centers.”

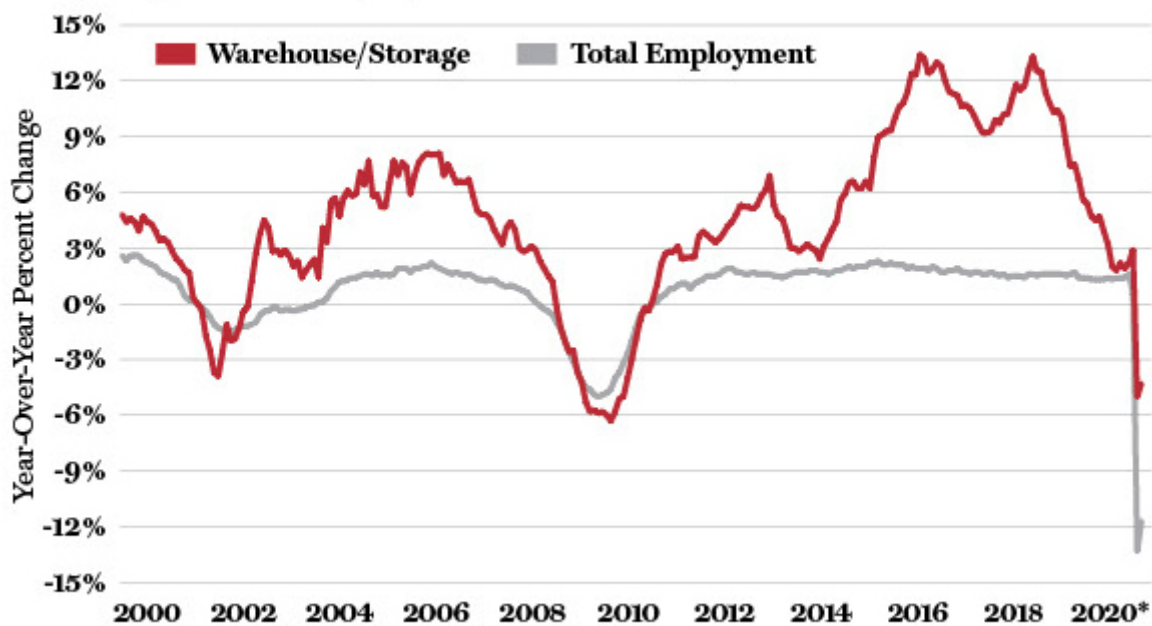
Because businesses often encountered inventory shortages during the initial wave of the pandemic, the Prologis report anticipates that inventory levels will rise as supply chains “emphasize resiliency over efficiency.” The company estimates that a 5-percent increase in total business inventories could mean 500 million to 700 million sf of additional space demand, but supply chain volatility “underscores the need for flexibility and business continuity.”

“There's a lot of contrast in the supply chain right now,” added Shear. “Parts of it are being overwhelmed, and parts of it are being severely underutilized or even idle. For every busy grocery store distribution center, there's a restaurant food supply distribution center that's sitting idle.”

Looking Ahead

Experts agree that many consumers who increased their online shopping practices will retain them even after the crisis is over, keeping the need for warehouses high. And, Newmark Knight Frank points out, “with same-day delivery no longer confined to large cities, markets without a significant warehousing and distribution presence are likely to see an uptick in industrial groundbreakings to serve these functions.”

Warehouse and Storage Job Growth Outpacing Overall Employment Gains



* May 2020

Source: Marcus and Millichap

Consumers may do more grocery shopping online as well, leading to increased demand for refrigerated warehouses. A March CBRE report predicted that because online grocery deliveries are often fulfilled by local grocery stores, these stores' footprints now may include more storage and fulfillment space.

Even if demand for warehouse space remains sturdy, meeting that demand could face some obstacles in the short run, such as shortages of construction materials, labor restrictions, and general skittishness about new projects.

“One of the challenges that's an unknown right now is, 'How will social distancing impact the supply chain moving forward?’” Shear says. “When you talk about the supply chain, efficiency is a word that's always used. How do we make it more efficient? What's our throughput? What's our cubic utilization? Now, all of a sudden, you look at it and say, 'I have 500 people working in this distribution center. I used to have them consolidated in one area for processing. I can't do that now. I have to spread them out. I have to have a much larger footprint to accommodate the break room. So how does that affect efficiency? I can't just share equipment anymore. Do I have to get more equipment? Do I have to bring more people in to sanitize equipment?’”

“There are a lot of distribution centers that run two or three shifts, and they use the same equipment over and over. Will they be able to maintain these levels of efficiency? These are open-ended questions that need to be addressed, and there's no clear guidance at this point as to what that's going to look like. We're all taking precautions. It also depends on what state you're in.”

To address those kinds of issues, Cushman & Wakefield has created “Recovery Readiness: Industrial Solutions,” a guide for best practices for recovery efforts. The six-part plan includes step-by-step recommendations for facilities on preparing the building following local and federal health and safety guidelines; preparing the workforce, vendors, and third parties on new protocols; controlling access for health and safety checks; creating a social distancing plan; reducing touch points while increasing cleaning; and communicating regularly (including recognizing the fear in returning).

In any event, says Shear, “the supply chain is definitely getting a lot more recognition as to how important it is in our day-to-day life.

“While there have been some shortage flare-ups, I really feel that we need to be thankful that we can stay at home with our families and we're not going without. There are still food deliveries from restaurants. There's still food availability at a variety of grocery stores and drug stores. With as much of a strain that our supply chain has been under, it has really come through for the people of our country. I have a debt of gratitude for people showing up at warehouses every day. It's those people who have allowed the American public to maintain and get through this, where there otherwise might have been shortages and panic.”

Sarah Hoban

Sarah Hoban is a business writer based in Chicago.