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Real estate's growth zone: industrial

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Ask key players in the industrial development community about the effect of the ongoing real estate plunge, and you'll get universal consensus that conditions on the commercial side are not nearly as woeful as those on the residential. Beyond that, the unanimity ends. Driven by considerations of global trade growth, local land availability and regional economic factors, the outlook varies considerably by geography.

United Nations' projections call for an increase in U.S. container handling from 197 million TEUs in 2005 to 492 million TEUs by 2015. This compound annual growth rate of 9.5 percent has a pronounced effect on those industrial real estate markets more closely aligned with international trade. "This long-term trend of increasing container traffic means our customers need more distribution centers for their products before transporting them inland or distributing to regional outlets," Gerald Pientka, executive vice president of development for First Industrial Realty Trust, noted. Overall, "demand for industrial space remains strong in markets with a close tie to the global supply chain," said Anthony Chiarello Sr., vice president for customer development at AMB Property Corp.

Brian Black of Hyundai Merchant Marine painted a conservative picture for the West Coast. "Although real estate prices have dropped in recent months, there will always be a need for land. Therefore, in my opinion, the current situation will only have a temporary impact on the industrial real estate market on the West Coast."

Jon Cross, director of marketing for The Allen Group, concurred. "The residential slowdown has

a little slower growth and development of trade, but this will not be a huge negative for anyone." He projected that growth rates previously pegged at 10 percent might drop to 5 percent for the short term. In general, West Coast interests remain convinced that global trade expansion in the coming decade will generate steady growth in commercial development markets in the region.

A number of other factors impact trade driven commercial projects on the West Coast. Shippers rationalizing their supply chains have turned increasingly to all-water services to the East Coast via the Panama and Suez canals. Port congestion, equipment shortages and previous labor stoppages are among the factors that have driven many shippers to tweak their routings. The impending enlargements of both canals will further facilitate the all-water option.

California ports lead the nation in competition for scarce waterfront acreage. Often retail, commercial and residential projects vie for the same properties. Additionally, stringent environmental safeguards place limits on the location and nature of development.

James T. Edmonds, chairman of the Port of Houston Authority, pointed to the trade hinterland as another driver. "The markets served by the West Coast ports are not growing at a very robust rate. However, the markets served by the Port of Houston are quite strong and growing at twice the national average. One could conclude that the downturn of the West Coast C&I (commercial and industrial) market has actually been beneficial to the Port of Houston," he said.

Matt Tramel, manager of corporate affairs and marketing for CenterPoint Properties, had a more optimistic outlook for the Midwest. "In Chicago, there is no slump in industrial real estate. We often don't see the voluble swings that can occur on the coasts. Because of our diverse commercial community, we support a 1.3 billion-square-foot market. We're not overbuilt, and there's still a lot of new construction happening," he said. Tramel cited Chicago's fortuitous location as the prime reason for its status as a major transportation hub and predicted that irreplaceable infrastructure assets will continue to dictate a leadership role for the Windy City.

The new wish list given sufficient land availability, developers must deal with a sophisticated new breed of site seeker. Certainly, traditional demands for strategic location, accessibility, a competent labor pool and competitive utility prices still pertain. However, the proliferation of new sourcing options among global shippers has dramatically expanded their list of selection criteria.

Tramel cited the cost of transportation as the key factor driving site selection decisions. "Our goal is to have enough land to build an intermodal hub for a railroad. We need 500 to 1,000 acres to do it right. We also want to have adjacent land for development of distribution centers. To the extent that you can reduce the distribution center to rail dray, you improve the cost equation."

Many large retailers move more than 100,000 TEUs annually. For them, the cost differential between a half-mile dray and a 10-mile-trip can represent a staggering add on to their annual transportation bill.

Chiarello of AMB observed that the most traditional of site selection criteria still applies. "Location is the most important concern in most cases. Customers want to find the best location in terms of time-to market/proximity to customers, available land, infrastructure and transportation costs. AMB's strategy supports this approach with our focus on the optimal markets tied to global trade those near top airports, seaports and distribution hubs."

Historically, site seekers were eager to negotiate free land as part of their location package. However, the common sense of product distribution suggests that incremental costs related to trucking to and from remote sites often make such parcels a poor bargain.

To quantify the location decision, developers in the Dallas Logistics Hub make available a "drayage calculator." This enables the customer or tenant to specify building size and number of containers per year, and then cross-reference it with a map of potential Dallas metroplex sites to compare and contrast total costs and develop real-time drayage data.

Hyundai's Black said, "The concerns expressed that prevail consistently start with location. A distribution center must be ideally located to meet the transit time demands of the customers that are served by that distribution center. Regardless of the price of land or labor, if a distribution center is too far from the customer, it is ineffective and will be replaced quickly."

Given waterfront land constraints in many harbors, port and terminal operators must turn to increased efficiency as the means to absorb the monumental trade increases coming their way. Basically, their task becomes one of optimizing throughput across an existing footprint.

Black believes the opportunities are apparent and achievable. "As a simple example," he said, "If a port in Asia loads an average of 50 containers per crane per hour, but a West Coast port discharges an average of 22, a bottleneck is created and vessels and containers sit, which is not efficient." He pointed to modifications in work rules and technology advances as two primary remedies and said, "This chain of events would have a positive and efficient impact on inventory control, thereby reducing the cost to businesses that import, as lead times are reduced and less capital is invested in inventory."

Ports are proceeding on multiple fronts to do more with what they have. Dockside, faster cranes with multiple-pick capability are the order of the day, and must be specified for the coming generations of post-Panamax vessels. On-dock and terminal-proximate rail facilities expedite the loading of the unit trains that carry an increasing share of containers destined for inland population centers.

In the container yard, higher density stacking and storage facilitate increased container handling. This, of course, necessitates an entire new generation of yard handling equipment. Another burgeoning trend is the use of radio-frequency identification and scanning equipment for real-time monitoring of equipment location. The demand for increased across-terminal velocity necessitates continuous improvement of information systems utilized by port operators and their customers to view shipment status and details throughout the transportation cycle.

The Port of Savannah provides a particularly ambitious example of the trend. Under the auspices of its "Focus 2015" master plan, the port will combine technology, infrastructure and terminal layout innovations to triple handling capacity at its Garden City Terminal.

The coastal space crunch is good news for real estate developers working on inland projects. These range from stand-alone warehouse and distribution center projects to multi-user logistics parks to full-blown "inland ports."

The latter is not a new term, and in some instances the early versions were actually developed by port authorities looking for ways to alleviate the strain on existing facilities. However, private developers are now major players in this arena, and there's no shortage of ongoing projects.

While no one enjoys a copyright on the term "inland port," Cross of The Allen Group uses it to refer to some very specific criteria. The Transportation Institute of North America, the Inland Port Network, the Center for Transportation Research at the University of Texas and the real estate investment management firm Heitman have developed what they consider to be a very specific set of criteria for any location to qualify as an inland port. The site must be located away from traditional land and air facilities. It must, however, enjoy strategic access to a major container port. It should be located away from coastal borders. There must be an intermodal facility adjacent to or in the park. There must be service by a Class I railroad. A minimum of 1,000 acres is needed. Customs and Border Protection clearance services must be on-site. There should be designation of a foreign trade zone. The site should be close to, but not within, a major metropolitan area. The tract should be adjacent to a north-south or east-west interstate highway. Strong labor pool availability is vital.

While agreement on this definition may not be universal, it does point out that the defining characteristics of an inland logistics facility go far beyond acreage and a spec building. Therefore, Cross sees an expanded strategic role for companies such as his. "Development companies like us are providing realistic solutions for the global supply chain. We're enabling companies to reduce cost and be more efficient."

LEEDership

Increasingly, real estate developers must deal with a "green" agenda. Project developers and site seekers have long since abandoned the view of environmental considerations as legislatively mandated cost add-ons. "Our development philosophy is certainly becoming greener... not because it's a trend, but because it's the right thing to do," said Matt Tramel of CenterPoint Properties. Cross noted that the most compelling argument for going green is that "customers are asking for it."

Cross detailed some of the measures his firm routinely incorporates into their site plans. "We have a long-standing practice of employing environmentally friendly and energy-efficient building standards. These include lighting and day lighting specs, on-site storm water filtration, ground water recharge, and use of recycled, locally sourced and 'green' building materials."

Other examples of environmentally sound practices employed by the development community are: Recycling of building materials, including asphalt and insulation. Development of dedicated roads for trucks to mitigate traffic concerns, Wetlands preservation. AMB's commitment is evidenced by its construction of its first LEED-certified facility in Savannah, which is also the first in the Southeast. The U.S. Green Building Council created LEED, or Leadership in Energy and Environmental Design, as a voluntary green building standard and certification system. Chiarello said, "All future AMB development in the United States will incorporate LEED specifications, and we will actively seek recognition for these projects through certification. There is an incremental cost to build to the LEED standard, but we believe the payback in many cases is nearly instant with the marketing advantage provided by a more efficient facility."

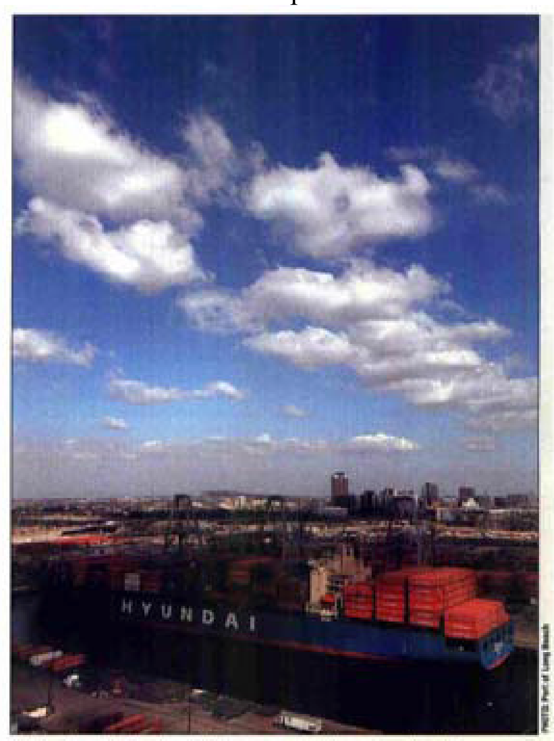
Cross discussed a parallel course: "Part of our commitment to going green is we are starting to develop industrial buildings as LEED-certified. We are beyond 'if we're doing it' to responding to a specific customer demand."

Ports play an equally proactive role in the effort. Edmonds said, "We're certainly focused on environmental impact reduction and mitigation. The PHA is ISO-14001 certified, the first port in the United States to be so certified, and the first to become recertified."

Port authorities and terminal operators have no shortage of environmental issues to consider. A recurring issue for many of them is the intelligent disposition of dredge spoil. On the equipment front, many are moving away from diesel electric cranes and yard equipment to fully electric options. Given their vast paved container yards, they must constantly incorporate provisions for storm water runoff into their master plans. Traffic control and green building design are other focal points. The use of long-haul rail for inland container moves offers additional potential for environmental mitigation. Given sufficient infrastructure and adequate bridge clearance, unit container trains reduce total emissions by removing hundreds of trucks from the road. This option is even more attractive for long distances, given the identified cost advantages for rail versus motor carriage beyond 500 miles.

The Seattle development First Park Meridian Campus, a First Industrial Realty Trust project, will incorporate many green design and energy saving elements including energy efficient lighting, reflective roofing, water conservation, bicycle storage and hybrid car parking. The upfront cost for these elements is higher explained Gerald Pientka, but due to the strong consumer demand. First Industrial now "factor(s) them into the design and our investment underwriting," he said.

Whenever the potential for demand in excess of capacity exists, competition emerges. Limitations in the U.S. port complex suggest that new gateways in Canada and Mexico could soon come into play. Black summarized, "Port developments in Canada and Mexico should be praised for introducing new ideas and solutions to the port sector.



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At the moment, their impact is minimal to traditional West Coast ports and resulting real estate because the container volume being handled by Canadian and Mexican ports is not consequential. However, that does not mean these developments are not positive because any relief they provide in reducing congestion in the West Coast can be helpful for the ports, the carriers, importers and, ultimately, the consumer."

Edmonds also sees Mexican and Canadian facilities as potentially viable alternatives, but he cited certain limitations. "Capacity constraints of these emerging ports will have an impact on their use. Additional handling requirements and Customs considerations will also impact the shipper's decision to use these alternatives. Of course, landing a container is only part of the consideration efficient intermodal transit from port to market is the more compelling consideration," he said.

The tea leaves

Edmonds summarized the shared optimism of the development sector by saying, "The need for C&I real estate has always been directly correlated to the population growth and economic growth of target market areas. Population growth will continue to fuel demand, and economic growth will continue to provide the wherewithal to produce and procure. As such, growth in global trade and growth in the industrial C&I Page real estate marketplace will continue."

PHOTO: The Allen Group

Dallas Logistics Hub is situated for prime connectivity and features a "drayage calculator" for clients' cost comparison of local site use.

PHOTO: CenterPoint Properties

Chicago's industrial real estate profile has been bolstered by projects like the redevelopment of the former Joliet Arsenal into CenterPoint Intermodal Center in Elwood, Ill.

"As global trade continues to grow, supply chains are lengthening, being reconfigured and new designs are being developed in emerging markets. These factors, in addition to customers continually rationalizing supply chains and looking for more efficient systems, translate into growth for the industrial sector," Chiarello said.

CenterPoint's Tramel echoed this sentiment, "We're confident in the strength of the U.S. economy, and we foresee that there may be a balancing out of import-export ratios. There will be a time when we'll be exporting a lot more. As far as the trend in real estate, growth in major metro areas will continue. We don't see any lessened appetite for consumer goods, which drives our growth."

Within the overall development landscape, two specific trends are gaining momentum. Vertical expansion in strategic markets that rely on international trade and demand in submarkets surrounding key areas in the global supply chain is increasing. "With limited land availability in the areas immediately surrounding locations tied to global trade, the demand in adjacent areas will continue to grow," Chiarello said.

While the residential mortgage crisis has had a chilling effect on the commercial sector in certain locales, nationally the impact is seen as minimal and short-term. Particularly among entities reliant on inter- national commerce, the domestic effect of the slowdown is offset in multiples by continuing fulfillment of ambitious global trade projections. The equation is basic: Consumer demand drives trade, which in turn drives commercial real estate development. A healthy prognosis would seem indicated for all three players. Port development in Mexico may soon provide some congestion relief at West Coast ports such as the Port of Long Beach and Los Angeles. Dallas Logistics Hub is situated for prime connectivity and features a 'drayage calculator" for clients' cost comparison of local site use. Chicago's industrial real estate profile has been bolstered by projects like the redevelopment of the former Joliet Arsenal into CenterPoint Intermodal Center in Elwood, III. AMB Morgan Business Park will provide the Savannah, Ga., region with 3.3 million square feet of LEED-certified speculative distribution space. The Port of Houston was the first U.S. port authority to achieve ISO 14001 certification, an international standard that manages an organization's environmental impact.


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