



Changing dynamics of industrial real estate



Compared to a decade ago, today's warehousing and industrial real estate world is more strategic, more complex and, as a result, more challenging.

In the past, corporations have used their supply chains and warehousing tactics to gain a competitive advantage. Increasing the use of transloading and cross-docking freight reduced cycle times and inventory levels while meeting stringent customer service demands.

Investments in warehouse information systems and material-handling technology significantly increased productivity and supply-chain velocity. Also, strategies such as locating warehouses close to customers shortened the order response time.

At the same time, the industrial real estate industry has developed larger warehouse facilities, changed building configurations to allow for more dock doors and developed larger and secured container-trailer parking with as short a distance between inbound origins and distribution to customers as possible.

Some industrial real estate developers and brokers began providing warehouse site-selection consulting to increase their value-added services to potential tenants.

The result has been that companies in the business of distribution have worked reasonably well with their industrial real estate partners — in the end, both have been generally satisfied with the process as well as with the results.

But the courtship is becoming much more strategic for prospective tenants, and the decision-making process is becoming more complex. This is being driven by several major supply-chain trends. Site location decisions are becoming less tactical and more strategic. By 2010, it is estimated that two-thirds of the world's largest corporations will make all of their site location decisions based on strategic, global considerations.

Jon DeCesare is chief executive of WCL Consulting in Long Beach, Calif. He can be contacted at (562) 435-2600, or at jondecesare@wclconsulting.com.

This is especially true for corporations that increasingly rely on technology, outsourcing and extended business processes.

Rather than make site-by-site decisions on the lowest-cost location for the next distribution center or plant, companies look at how any site decision impacts their entire supply chain.

Whether a function is outsourced or remains within the organization, flexibility is increasingly built into the site-location strategy with such techniques as joint ventures, short-term leases, contract labor and, most important, exit strategies in place for all facilities.

Another factor that has gained more importance is risk management. Within the U.S., risk-avoidance factors in site selection include union climate, restrictive business regulations, potential of extreme weather and/or natural disasters, and security (related to disruptions caused by real or potential terrorist activities and the resulting response from authorities).

Some shippers have diversified a portion of their import shipments to multiple ports to avoid possible congestion and delays. At the same time, more tenants are seeking larger warehouse facilities near key container ports and intermodal facilities.

Many real estate insiders say that current drives to downsize networks (reduce the number of warehouses and increase the size of remaining locations) stem from today's age of mergers and acquisitions, where reductions in all areas often are the norm. Also, the pressure to globalize logistics networks demands that distribution networks be optimized. This calls for consolidation of facilities and purging inefficiencies from the supply chain.

Countering the rationalization trend is a move by some companies to add locations to get closer to customers. Corporate supply-chain initiatives that require vendors to manage inventory are largely responsible,

because these often put the onus on the supplier to bring in goods as needed based on visibility into orders or production schedules. Typically, this means moving within close proximity to the customer, certainly within short-haul ranges of 150 miles or less.

However, maintaining multiple distribution centers adds significant complexity to inventory management. It is widely estimated that a second center would boost inventory levels by 30 to 40 percent. In actuality, however, the jump in inventory often is considerably higher, because most companies' ability to forecast and plan is not as accurate as it should be. In addition, products often sell differently in different areas of the country; therefore, inventory will need to be leveled between distribution centers.

These supply-chain trends, along with other business demands for growth, profitability, customer satisfaction, etc., present a daunting challenge to the courtship of the warehousing and industrial real estate industries. These challenges are like trying to solve a 1,000-piece puzzle in the middle of the night, outside, with a hurricane blowing.

Today's warehouse operations challenges

Warehouse operators are under pressure to use advanced processes, systems and facility layouts to participate in the growing e-commerce business. Labor quality and trainability have become much more critical as warehouses have evolved to encompass customization, and value-added, high-tech operations.

Warehouses built near residential areas are subject to restrictions on operating hours. They also are subject to regular monitoring to reduce noise, light and exhaust pollution.

In the face of new challenges such as higher fuel and insurance costs, high driver turnover rates and supply-demand imbalances, truckload carri-

ers are choosing to serve trucker-friendly warehouse operations and locations. A big challenge on the horizon will be the new federal Transportation Worker Identification Credential, which will potentially reduce harbor container drayage fleets by 15 to 20 percent.

In addition, major U.S. ports have begun to reduce free time at marine terminals and are significantly increasing port demurrage rates. This is pressuring importers to move containers off the docks and stage them in the harbor drayage and/or warehouse yards.

What will the future hold?

One of the most telling of all warehousing and industrial real estate forecasts relates to the demand for space in the next five years. As indicated in the chart on Page 92, the top 10 metropolitan cities currently have 44 percent of the total U.S. industrial base and are expected to increase their share in five years to 53 percent.

Other keys to the future indicate that corporations will continue to focus on cash-to-cash cycle reductions and supply-chain velocity tactics such as transloading, distribution center bypass, cross-docking and drop shipping using point-of-sale data.

In addition, importers will continue to divert portions of their import volumes to alternative U.S., Canadian and Mexican ports to avoid having all of their eggs in one basket.

Third-party logistics providers will be pressured to vertically integrate their various operating divisions (i.e. customs brokerage, intermodal marketing companies, warehousing, trucking, etc.) to maintain and expand their business.

Across the U.S., more warehouses will transition to 24-7 operations to shorten supply-chain cycle times, increasing the likelihood of clashes with residential areas. The distance to rail intermodal yards will continue to

TOP 10 METRO LOCATIONS FOR INDUSTRIAL SPACE DEMAND

In thousands of square feet

Location	Industrial base	Five-year supply forecast	Five-year demand forecast
Chicago	1,060,053	63,000	69,000
Los Angeles	914,493	38,800	43,900
Dallas-Fort Worth	669,398	57,000	66,000
Atlanta	524,994	53,000	55,000
Central New Jersey	521,489	27,600	29,100
Houston	401,492	29,000	25,000
Riverside, Calif.	332,717	89,000	79,500
Oakland	266,631	13,700	19,500
Seattle-Tacoma	261,031	22,150	25,700
Phoenix	222,835	29,100	31,000
Top 10 metro areas	5,175,583	422,350	444,200
Percent of U.S. total	44%	55%	53%

Source: National Real Estate Investor

play an increasingly important role in warehouse site selection decisions. Importers will demand that their private and 3PL warehouse operations provide real-time, supply-chain purchase order visibility.

And, as has been observed, “C”-level executives will increasingly take more interest in their global supply-chain strategies and will demand more thorough and comprehensive warehouse site-selection analysis.

The window of opportunity

Over the last 10 to 15 years, while corporations have been increasing the strategic importance of their warehouse operations and site-selection decisions, they have been significantly downsizing and reducing corporate staffs and field operations headcounts.

Today, when a company conducts a warehouse site location optimization study, it usually is working with a lean project team with limited internal resources, making the project that much more challenging.

This situation presents a true window of opportunity for industrial real estate developers and brokers. In the vast majority of cases, developers and brokers present a facility proposal that only describes the warehouse and lot layout design features to potential warehouse tenants.

number of warehouse site location elements such as demographics, transportation costs and nodes, legislation, infrastructure and other area and regional information to the potential tenant.

This is clearly a missed opportunity to effectively provide more value to their clients and gain a

By 2010, it is estimated that two-thirds of the world’s largest corporations will make all of their site location decisions based on strategic, global considerations.

They usually do not attempt to relate how their real estate solution supports a company’s global supply chain, warehouse network and business plan strategies.

They leave the challenging job of researching and analyzing the vast

competitive advantage.

Today’s courtship between warehouse tenants and industrial real estate professionals requires that developers and brokers become better supply-chain information providers. ◆