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# ACWI ADVANCE

David Sparkman, Editor | Volume 10, Issue 23 | December 1, 2022

# Warehouse Demand Is Cooling

In spite of growing evidence that the United States is spiraling down deeper into a recession, the demand for warehouse space is expected to cool a bit but remain healthy, according to the global industrial real estate giant CBRE.

"The U.S. industrial market is continuing to see robust demand, and companies are adding warehouse and distribution space to protect their inventories, diversify their supply chains and process growing ecommerce sales," observes John Morris, CBRE President of Industrial & Logistics in the Americas.

"Even with a more challenging economic backdrop, we're still seeing that companies are interested in expanding their footprints in the short-term."

CBRE's Industrial Occupier Survey found that 64% overall and 81% of third-party logistics companies responding plan to expand their real estate footprint over the course of the next three years, in spite of economic uncertainty.

Of these companies, 47% say that they are planning to expand by more than 10%, while 29% say they plan no change, but only 7% expect to downsize.

When it comes to building more space 3PLs are in the lead with 81% planning to expand their footprint over the next three years, while 75% of both Food & Beverage, and Building Materials & Construction companies will do the same also intend to expand their real estate footprints despite supply chain disruptions, labor shortages and high occupancy costs.

On the other hand, most manufacturers say they are not planning change in their footprint, with only 25% expecting to expand.

3PLs also play an important role in warehouse and distribution center space expansion plans: 66% intend to lease on open market (second-hand facilities), while 44% say they will partner with a developer to lease build-to-suit facilities.

At the same time, 37% reported that they intend to purchase land and self-develop their own facilities. However, 31% are planning to meet their future space needs by operating in customer-owned facilities -- meaning 3PL warehouses.

**Location, Location, Location**

When it comes to preferred locations, more than a third of respondents told CBRE they plan to expand in the Southeast over the next 12 to 24 months.

This region boasts several large logistics hubs serving growing population centers, large affordable labor forces and seaport connectivity. This region also benefits from a supportive business climate for manufacturers, CBRE points out

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Growing industrial markets like Atlanta, Nashville, Orlando, Charleston and Charlotte are attracting occupiers in need of additional warehousing or manufacturing facilities.

Other regions that ranked high for expansion include the Southwest and Midwest, where markets like Reno, Phoenix and Minneapolis have become optimal locations for occupiers due to their strong demographics and infrastructure, which supports industrial demand.

Within regions, occupiers are looking at different characteristics. When it comes to the top decisive factors for building selection, nearly three-fourths (74%) of respondents cited occupancy cost (rent) as the top factor when selecting a building within a market, followed by lease options (50%), transportation (47%) and building design (45%).

Other important factors considered during site selection, although weighted less heavily, include quality of local infrastructure, developer or owner reputation and sustainability rating.

Regarding essential building features, distributors and ecommerce occupiers have returned to a "bread and butter" mentality, according to CBRE When selecting a new warehouse, 81% of occupiers identified clear height as one of the most important building features.

Other features sought out most often include the total number of loading bays/dock doors (76%) power supply (81%), column spacing (76%), and the capacity for expansion (76%).

Power supply is also top of mind given heavy use of electricity from manufacturers and warehouse operators; and this also is expected to continue driving site selection, CBRE says.

"Major distributors and ecommerce occupiers require highly functional properties to process high volumes and need modern buildings containing such features," CBRE says. This is a primary factor fueling the record 662 million square feet of new development underway in the United States.

"The average age of a U.S. warehouse building is 43 years, and 28% are more than 50 years old," the company points out. "Given the continued growth of ecommerce and retailer omnichannel offerings, warehouses approaching obsolescence in these markets will present opportunities for redevelopment, particularly in infill locations that support last-mile delivery."

**Supply Chain Challenges**

When it comes to the major supply chain challenges facing IRE occupiers, 61% of respondents report that labor availability is a major impediment for the growth of their business, while 58% say they are most concerned about rising rents.

In regard to the labor shortage 78% of responses pointed to improving wages and conditions and 49% to improving training programs as solutions.

"The fact that occupiers are improving conditions for workers and looking to increase automation means they are expecting leaner operations with more skilled labor," CBRE observed.

Seen as less important strategies for employee recruitment and retention of employees included wellness programs and promoting the company's sustainability credentials.

In addition, 48% point to the challenges they face from higher transportation costs. "Occupancy costs accounts for just 3 to 6% of total logistics spend, whereas transportation costs account for about half or as high as 70% of total spend," CBRE explains. "However, rents are rising rapidly, so occupiers clearly have sticker shock."

Other concerns include the lack of suitable warehouse/manufacturing space and inflexible lease options Top industries represented in these responses include 3PLs, electronics and appliances, building materials and construction, and food and beverage manufacturers.

To address ESG considerations, occupiers are planning to meet their net zero carbon targets via their real estate footprint by switching to LED lighting, using alternative energies on-site and using electric material-handling equipment. Fewer responses included adding electric charging points for delivery fleets and capturing rainwater.

In regard to sustainability, three-fourths (75%) of occupiers told CBRE that they would be willing to pay higher rents to switch to green energy. The majority would pay more if the savings on future operational costs would be matched. Still, more than a quarter said they would not be willing to pay a premium to switch to green.

# IRE's Growth Seen Sustainable

Industrial real estate is settling down into a more sustainable rate of growth, according to the international industrial real estate giant Prologis.

The Industrial Business Indicator (IBI) is a statistical tool developed by the company's research staff that attempts to capture a moving target. IBI activity shows resiliency by staying above average but has moderated, the Prologis researchers found.

Third quarter IBI activity decreased 620 Basis Points (BPS) from the second quarter to 60.2 in October. Logistics users continued to expand their networks and absorbed 90 MSF of space in the third quarter, which is on par with absorption from the prior quarter, Prologis says.

Utilization of space increased as inventory build has continued. Prologis researchers note that another driver is the lack of new supply and low vacancy rates that hinder expansion into new space.

The utilization rate held steady at 86% through October, up 40 BPS from what it registered in the second quarter. The functional ceiling for utilization is in the 86-87% range.

Developers continued to break ground, even with capital markets in flux. Commitments made earlier in the year and, in some cases, ownership of lower cost-basis land spurred more development.

Construction starts reached a record high of 142 MSF in Q3, pushing the construction pipeline to 550 MSF. As the cost of capital continues to rise, development activity may slow in coming quarters.

In 2023, leasing momentum is expected to normalize from the frenzied tempo of recent years. Users will have more options as the construction pipeline empties.

Compared with 2022, Prologis expects more deliveries and slightly lower net absorption, roughly in line with the annual demand run rate at the current level of IBI activity. The vacancy rate is expected to expand. Market rent growth should to outpace inflation, and TMS is seen rising.

# *Is the Railroad Strike Still On?*

Despite the efforts of the Biden administration, a railroad strike may be a very real prospect because of rejection of the proposed contract by members of four of the 12 freight railroad labor unions.

Negotiators who represent the union workers of the nation's Class 1 railroads had agreed to a new multi-year contract prior to the mid-term elections, but the rank and file members of three of the unions voted to reject the negotiated settlement.

Representatives of management and the unions are scheduled to return to the bargaining table on Dec. 4 to try to work out a new agreement with the help of federal mediators. In the meantime, the union leadership has promised that their members will not strike until after that date.

The unions whose members voted down the pact are the SMART Transportation Division, International Brotherhood of Boilermakers, Brotherhood of Railroad Signalmen and the Brotherhood of Maintenance of Way Employees.

The American Association of Railroads has warned that a rail strike will damage the economy to the tune of $2 billion a day. If a strike occurs, Congress has been urged to mandate a settlement, which is something that it can do under federal law.

Financial terms regarding wages and benefits are not at issue, Instead, rail workers are unhappy over working conditions imposed under a radical cost cutting operations model called Precision Scheduled Railroading that has been adopted by most Class 1 freight railroads over the past five years.

In particular, the workers want major changes made to the companies' draconian attendance policies that even restrict sick leave and have forced workers miss being home for holidays and family events.

# *Retail Sales Hurt By Food Prices*

General merchandise retail sales revenue declined during the three weeks ending Nov. 5, 2022. In addition, year-over-year sales revenue in October dropped 5% below a year ago, followed by a 14% decline in the first week of November.

Higher food prices are the reason, according to the NPD Group, a global technology, analytics and data provider firm.

"The growing weekly grocery costs and monthly credit card bills have begun to chip away at discretionary purchases," said Marshal Cohen, chief retail industry advisor for NPD. "Consumers can only absorb climbing expenses for so long before they begin to reassess their spending capacity."

For much of 2022, elevated average prices kept general merchandise sales revenue hovering at or above 2021 level. Until recently sales have maintained healthy gains compared to 2020 results.

At the same time, spending on food and beverage and other consumer packaged goods (CPG) continue to exceed results of any of the past three years. NPD said rising food and beverage prices and the shift toward consumer spending on food in general is now impacting spending in other areas.

"Rising interest rates and other aspects of the economy are affecting consumer confidence, and the lack of new product is impairing their need and desire to spend," Cohen said.

"Over the holidays and into the new year, consumers will be looking for exclusive product offerings, uniquely compelling benefits, and promotions that break through the noise and create a sense of urgency to make the purchase."

In addition to the growing competition for the consumer's wallet, NPD said many consumer needs are still being fulfilled by purchases made in the past two years, resulting in lower demand levels.

# Crisis Changes Transportation

The supply chain crisis has sparked a revolution in freight transportation management, according to a survey of transportation and manufacturing executives conducted by the management consulting firm of Deloitte.

Transportation is at an inflection point, as massive shifts like nearshoring bear down on it, Deloitte says. "Nearshoring efforts are underway across a significant number of industries as companies strive to shorten and bolster supply chains."

China's dominance in global trade is expected to wane, its trade growth dropping from 26% to 13% in the next five years. Countries in Central and Southeastern Europe, Central America and Mexico, are picking up the slack with competitive labor and closer proximity to end-use markets.

These developments on their own would constitute a seismic shift in the future of freight, but the consulting firm says they are accompanied by revolutions in data science (IoT, analytics and artificial intelligence), material science (electric vehicles), and engineering (autonomous vehicles)..

"Every shift represents an opportunity for new competitors to enter the market, as startups, megaretailers, and hyperscalers all vie for a piece of the trillions of dollars at stake," Deloitte says.

Data fluency and transparency will be table stakes for tomorrow's transportation companies, it adds. Innovation and rigorous alignment with strategic priorities will set true leaders apart, along with the ability to partner and acquire wisely.

"The next few years could be critical as companies decide which of their operations are their core competencies and which are better handled by outside partners," Deloitte concludes.

In regard to public policy, transportation companies should adopt an approach dealing with globalization and national economic strategies, and more targeted engagement at the state level. Deloitte urges, "Public sector priorities and private sector opportunities continue to be closely intertwined."

# Military Rehiring Still Required

A recent Supreme Court decision held that a state cannot invoke sovereign immunity, a doctrine prohibiting a government from being sued, to avoid liability under the Uniformed Services Employment and Reemployment Rights Act.

Unlike other employment related laws, USERRA applies to all employers. This includes public and private employers, federal, state and local governments, as well as employers of all sizes, because there is no minimum number of employees required for coverage under that particular law.

"In fact, USERRA's definition of 'employer' is so comprehensive that some courts have even recognized individual liability under certain circumstances, such as a police chief who had the personal authority to hire and fire individuals," note attorneys Emily Ayvazian and Phillip Harris of the Akerman law firm.

The USERRA prohibits employment discrimination based on past, present, or prospective military service and generally requires employers to reemploy servicemembers upon their return from uniformed service.

"While most people would agree it is a noble goal for a servicemember's job to be waiting for them when they get back from active service, it is not always an easy task for employers to simply reinstate an employee, especially if circumstances with the employer or employee have since changed," the attorneys say.

"It is integral for employers to continuously be aware of their obligations under USERRA to ensure compliance with the many protections it affords active-duty and veteran employees."

The main purpose of USERRA is to protect the civilian jobs of servicemembers who take a leave absence from their employment in order to serve in the uniformed services, which includes the armed forces, national guard, commissioned corps of the public health service, and any other category of persons designated by the President of the United States in time of war or national emergency.

Under the law, the employee is obligated to provide advance written or verbal notice of their military service to their employer; have no more than five years of cumulative service in the uniformed services during their employment with the particular employer; and return to work or apply for reemployment in a timely manner after conclusion of service.

Employees also don't qualify under the law if they have been separated from service for a disqualifying reason, such as a dishonorable discharge.

Upon their return from military service, the qualified servicemembers are entitled to prompt reemployment in the position they would have attained, along with the same seniority, status, pay, rights and benefits they would have achieved had they not been absent from work for military service.

For public and private employers, the requirements of USERRA and related state laws can be confusing and intimidating. Ayvazian and Harris advise that now is the time for employers to do the following:

1) Review your company's handbook and ensure all polices on uniformed services leave comply with USERRA. Depending on your state, you may need to address state specific laws. Florida, for example, has laws designed to help veterans obtain and maintain employment by giving preference in employment and promotions after being deployed.

2) Review your company's current census and determine whether you now have employees out on military leave. If there are, ensure there is an open line of communication and a plan in place for when the employee returns. Also, make sure the employee's leave is coded or classified correctly as service-related leave in your payroll system.

3) Determine whether there are current employees that have returned to their jobs after deployment and make sure their "similar pay and status" were restored in accordance with USERRA.