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Railroads, Logistics, and Development

By Steve Bergsman

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Over the past two decades, the creation of global supply networks transformed the old industrial real estate sector in the United States. Until the worldwide economy hit the skids beginning in 2007, the growth markets emphasized huge distribution buildings, logistics parks, intermodal facilities, and recently, wherever possible, the return of rail-served warehouses.

The problem for many of America's cities over the past decade—and even looking forward beyond the current recession—is that the tremendous expansion fostered by the movement of goods along the global supply chain was unequally distributed. In fact, the global supply network created have–and have-not regions in United States.

If your municipality was relatively close to one of the major ports or was on the main trunk of a couple of railroads or at the intersections of a number of key interstates and rail lines, then the past decade should have been a boom period and still could be when the global economy lifts again. If your city was elsewhere, then it missed the excitement.

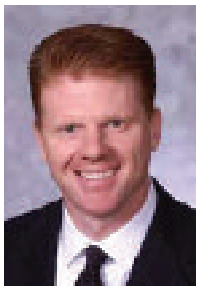
A number of locations that merely watched or came late to the prior boom are now positioning themselves to tap into the global supply network in the future. Meanwhile, older transport hubs have to adjust to the changing economic climate or, even in this soft economy, build additional infrastructure to stay ahead of the competition.

Professional Report magazine talked to a number of SIOR members across the country to get a sense of what was happening in regard to distribution, logistics, and intermodal traffic. We also asked what they are doing as brokers and SIOR members to help place their locality on the global supply chain map.

Major Distribution Hubs

Due primarily to the growth of the China trade, America's busiest ports have been Los Angeles and Long Beach. But, although billions of dollars worth of goods pass through the ports every year, the infrastructure and grounds are limited by the densely populated LA metro area.

Lucas "Luke" Staubitz, SIOR, The Klabin Company, Los Angeles, California, says his firm specializes in the logistics property business in a vast geographic area stretching from the ocean to some 60 miles inland by way of a network of freeways and rail.



"When containers come into the port, most are placed on rail or truck and shipped out directly through the Alameda corridor and freeway system" he says.

The big intermodal logistics parks and million-square-foot distribution facilities serving the ports of Los Angeles and Long Beach are found inland in Riverside and San Bernardino.

"In the 'close-in' market, the sweet spot has been buildings between 100,000 and 200,000 square feet," he says. There are larger buildings, but a relatively high rental rate because land constraints puts them at a disadvantage. If a company wants to occupy more than 200,000 square feet, it can go farther east and find significantly lower rental rates in more modern facilities with 32-foot clearance and up to one truck door per 5,000 feet.

The global recession has slowed business at the ports, and Staubitz says vacancies rose (seven percent by the end of 2008). Despite the slowdown, demand has been increasing for rail-served buildings in the Los Angeles and Long Beach port area.

"Extensive rail lines run throughout the South Bay," Staubitz observes. "Some of that rail has been discontinued over the past 20 years, but now we are seeing a comeback in the demand for rail-served buildings." And there is definitely a commitment to get rail spurs activated."

When containers are off-loaded onto rails in Los Angeles/Long Beach, one of their destinations is Dallas/Fort Worth, where the goods are broken down at two, tier-one intermodal facilities serving Union Pacific and Burlington Northern Santa Fe (BNSF) rail lines.

The Alliance Global Logistics Hub in northwestern Fort Worth offers multi-modal transportation options via BNFS, while the much newer Dallas Logistics Hub, a 6,000-acre logistics park in southeastern Dallas, surrounds the Union Pacific intermodal facility that opened in October 2005.

"About 100 percent of the containers arriving at the Union Pacific Intermodal in south Dallas and about 80 percent at BNSF Intermodal in Fort Worth come in through the Los Angeles and Long Beach ports," observes **Chris G. Teesdale, SIOR,** Executive Vice President, Industrial Division, Colliers International, Dallas, Texas.

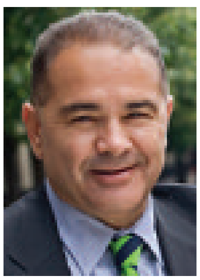
"What's interesting is that, inbound container volume at the Los Angeles and Long Beach ports combined was down from 2007 to 2008, yet the level of inbounds into the Dallas/Forth Worth area were relatively steady," Teesdale says. "To me this is evidence that more product is being sent to our market for national distribution because of our centralized location."

While all that is good news, what has moderated considerably are real estate deals involving distribution centers. For example, there were 28 transactions larger than 250,000 square feet in 2007 versus eight in 2008. That's because companies have been re-evaluating their supply chain strategy, and that puts taking up new space on hold. "Our development community understood this and responded by putting several projects on hold," says Teesdale. "Still, a few larger deals were done recently—including two transactions totaling more than 1,300,000 square feet—but most business has been in short-term renewals."

One major build-to-suit—an 800,000-square-foot facility—was completed last year for Unilever. They required a facility near the Union Pacific intermodal. The Allen Group completed a couple of spec buildings last year near the Union Pacific Intermodal at their Dallas Logistics Hub, one of which is a 650,000-square-foot cross-dock facility.

Teesdale advocates patience. "There is activity out there, but we just haven't seen the volume of deals close yet. I am confident though that bigger users are just waiting to pull the trigger."

Chicago remains the biggest distribution and logistics market in the country, but like Dallas, even this well-established transportation corridor attracts some fresh blood.



J.D. Salazar, SIOR, Managing Principal, Champion Real Advisors LLC, Downers Grove, Illinois, reports his company has been doing a considerable amount of work at a new multi-modal park being developed outside of Chicago in the smaller city of Diamond, Illinois. Called RidgePort Logistics Center, the 1,500-acre park is being developed just a few miles from BNSF Railway's Logistic Park Chicago.

Salazar uses the word "multi-modal" instead of "intermodal" because Ridgeport will add a new wrinkle to the distribution of goods. It is developing new individual buildings that are rail-served for the delivery of bulk goods.

"Most rail-served buildings in Chicago are located in older, very congested areas where rail service is expensive and time consuming," explains Salazar. "BNSF's new model is to serve parks like RidgePort, where railcar users can be clustered. BNSF can bring in a trainload of cars, then the park manager can decouple the cars and move them around within the park to various users."

"For the last year and a half, we have been working on zoning and annexation and coordinating with BNSF to get rail switches," he says. "Also there are remnant pieces of land RidgePort Logistics needs to acquire to complete the puzzle. We have been working with the U.S. Department of Transportation also to access infrastructure bonds that are available for rail projects, and we are trying to establish a tax increment financing district."

One of the other major distribution centers in the Midwest can be found in Memphis. "Chicago brings in probably the largest amount of rail in this region, but second to that is Memphis," notes **Hank C. Martin, CCIM, SIOR,** Vice President of NAI Saig Company, Memphis, Tennessee. "We have all the major railheads here, with intermodal facilities located within the city or in the surrounding suburbs."

Most of those intermodal facilities have been expanded in recent years, with the largest and most recent project being BNSF's. Once complete, the expansion will double BNSF's capacity from about 250,000 to 500,000 intermodal lifts a year.

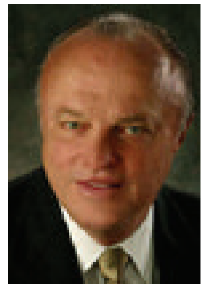
In addition to all the major intermodal build-out, there has been a countervailing trend to revitalize older, rail-served individual buildings, even though, as Martin points out, the buildings are small and not as functional.

Martin recently worked with an international cotton company that moved to Memphis for the first time. "We found them a 336,000-square-foot building that had rail," he explains. The company took possession in July 2008 with a five-year lease.

"A big plus for older buildings is that most of them have rail," Martin says. "Any building that is rail-active with switches in place is getting leased up."

Next Generation of Intermodal Tigers

When the U.S. and global economies were red hot in the 1990s and early 2000s, the container ship traffic coming into the ports of Los Angeles and Long Beach increased so much that at times the wait to enter the port was excessive. The delays caused global supply chain specialists to investigate alternative seaports since there is no entitled, vacant land near the ports of Los Angeles or Long Beach for expansion. The same lack of nearby developable industrial land holds true for the Port of Oakland. As Oakland's port started to receive more container ships, larger distribution buildings and business parks were, and still are required. Big box distribution business has migrated 80 miles east to northern California's Central Valley, in a triangle formed by Stockton, Tracy, and Patterson.



The rapid growth of big box development in this area happened in the last 10 years, says **Ted Anspacher, SIOR,** Principal, Anspacher Commercial Real Estate Services LLC, San Rafael, California, "The Central Valley has become an integral part of the global supply chain, instead of a regional logistics center with buildings averaging 200,000 square feet. We now enjoy much greater demand, plus building sizes are increasing from 700,000 to more than one million square feet with extra room for trailer storage." Although our market is still active, requirements are slowing down. Stockton boasts a couple of 1.2 million-square-foot buildings under construction from Tesco PLC and Opus West. Earlier in 2008, Crate & Barrel leased 1.2 million square feet in Tracy, with expansion rights for another 525,000 square feet.

The market in the northern and Central Valley has work to do to enhance its position as a major supply chain solution. BNSF and Union Pacific have rail service from Oakland and intermodal yards in the Central Valley. But, Anspacher says, they are underused because of inadequate rail infrastructure. We expect the railroads will have this problem solved in the near future.

As large parcels of entitled land have been in short supply, we have had to convert farm land to satisfy the needs of large distribution centers" he explains. "But that land needs adequate infrastructure and must be entitled for industrial development. Typically, the entitlement process for new sites now requires about three years."

Currently there are 10 active deals of 500,000 square feet and larger in the Central Valley market. The current vacancy rate is 7.5 percent for space 50,000 square feet and larger.

Irvine, California-based Ware Malcomb, a planning, design, and architecture firm for commercial real estate, has in recent years devoted substantial research in to the design of large-scale rail service sites and logistics parks. The work has paid off with a major project in Florida.

"We are developing a master plan for an 6,000-acre intermodal park in Jacksonville, Florida," says **Jay Todisco,** Vice President, Ware Malcomb.

Jacksonville has made substantial investments into its port infrastructure to complement its existing rail network to take advantage of its well-positioned location relative to the southeastern United States population centers to attract major developers and distribution end users."

Todisco explains that Jacksonville's deepwater port can handle the largest Panamax class ships and "we think when the Panama Canal widening is complete in 2014, East Coast bound cargo ships will bypass Miami for Jacksonville. Containers will get offloaded at the port, put on trucks, and taken to nearby logistics parks to get broken down. "Jacksonville won't have major industrial development like Chicago because it doesn't have the population, but the intermodal and the accompanying distribution park development could get pretty large" he explains.

Outside the Fray—for the Moment

Another older port city considering a future in distribution, logistics, and intermodal can found much farther north in Wisconsin. Despite a good-sized port on Lake Michigan, Milwaukee was never a distribution center because most of that activity takes place just to the south in Chicago.

Despite an active port and good rail service from Canadian National Railway Co., Milwaukee has not been on the global supply network. However, **Terence C. McMahon, SIOR,** Principal, The Boerke Co. Inc./Cushman & Wakefield Alliance, Milwaukee, Wisconsin, is trying to change that. Working with SIOR, he has been lobbying Wisconsin's Department of Commerce to create incentives for distribution and logistics development near the port.

"I'm also working with the port authority, to help it realize that to expand operations they are going to need the help of public/private partnerships. "I'm counseling the port to bring in logistics companies to build the warehouse/distribution centers and add to the intermodal yards," relates McMahon.

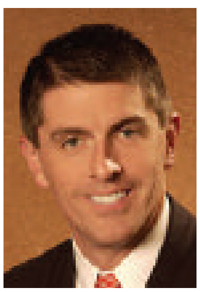
Commodities such as steel and grain come through the port, but McMahon would like to see container ships arrive as well.

The port is very interested, says McMahon, but there are some problems. Another group of the Milwaukee citizenry wants to gentrify the coastal area and limit port expansion.

Says McMahon, "I'm trying to get everyone to the same vision because everybody has got their own idea of what the city should look like 10 years from now."

St. Louis, located in the center of the country along key interstates and crossed by several rail lines, would seem to be an ideal location for an inland port or at least a major distribution hub. However, in the Midwest, numerous cities—Chicago, Memphis, Indianapolis, and Kansas City—have done a better job of attracting that kind of business.

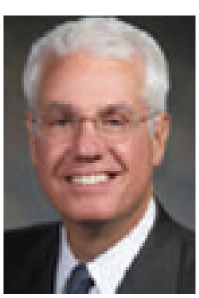
"We are in the ramp-up process but have been so for a while," notes **J. Patrick Reilly, SIOR,** Senior Director and Principal, Gateway Commercial/Cushman & Wakefield Alliance, St. Louis, Missouri. "We are on the I-70 Corridor and have significant commodity flows through the region via truck and rail. However, Indianapolis and Memphis built more momentum sooner with concerted efforts by the municipalities to get intermodal investment and big box development in place."



Still, Reilly is optimistic. "We are gaining recognition as a low-cost labor market, and St. Louis ranked in the 99th percentile of all 5-Star Logistics Metros in a recent Logistics Quotient study."

For now, the steady work is for small- to medium-size distribution centers of 50,000 to 250,000 square feet in St. Louis.

The closest thing the St. Louis metro has to a logistic park is the Gateway Commerce Center (GCC), across the Mississippi River in Illinois. The 2,700-acre site sits at the intersection of I-255 and I-270 and is served by Norfolk and Southern rail service.



"The GCC is a 20-minute drive from downtown St. Louis," says **Allen Klippel Jr., SIOR,** First Vice President, CB Richard Ellis, St. Louis, Missouri. "We have about nine million square feet in the park now and some of the major companies taking space there include Dial Corp., Hershey Foods, Unilever, and Proctor and Gamble. We have a couple of buildings around 500,000 square feet that are up and looking for tenants. And we have another 900 to 1,000 acres available for additional build-to-suits."

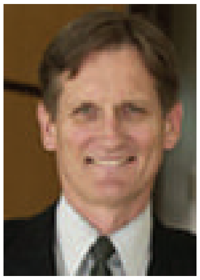
Klippel cautions that GCC is more a distribution center than a logistics park.

Although he has seen the trend in St. Louis to bigger buildings, moving from 150,000 and 200,000 square feet to 500,000 square feet with cross-dock loading and trailer parking spots, he recognizes that St. Louis remains a secondary market in regard to distribution.

He, too, is optimistic and working hard for his city. "We are promoting St. Louis within our CB Richard Ellis network and with SIOR," he says. "And we have economic development people on both sides of the river promoting St. Louis as a distribution hub. It will be hard for us to compete with some of the stronger second-tier cities, but we can at least attract a million to two million square feet a year in new distribution."

Another city that has missed becoming an intermodal hub is Denver, although Union Pacific and BNSF run active lines through the metro area.

The problem, explains **Paul B. Kluck, RPA, SIOR,** Vice President, CB Richard Ellis in Greenwood Village, Colorado, is that the rail lines focus on large commodities—coal and lumber. "If you do not have a national contract for Union Pacific and you do not ship eight to ten rail cars a day, they are not interested in taking your business," Kluck explains.



As noted, in other cities, buildings that have existing rail service have come back into vogue. Not in Denver. "There are a number of buildings in the Denver area that have rail spurs that feed off the Union Pacific line, but they are basically worthless," says Kluck.

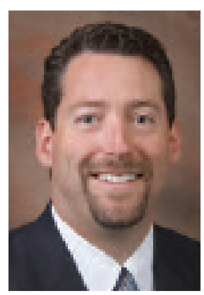
He gives this example. A client, who was already a regional customer of Union Pacific cities, wanted to lease 30,000 square feet in a building with rail and switches already in place. Union Pacific wouldn't offer rail service to the building, so the client had to choose another facility that had short-line service, which in the end doubled fees.

This is how bad things are in Denver, Kluck says. "Big shipping containers come into the port of Los Angeles, get unloaded and shipped east through Denver to Chicago or Kansas City, where the goods are off-loaded, and then trucked back to Denver."

As for companies looking for intermodal or rail service in Denver, Kluck warns, "If you are a national customer (not even regional) of the railroads with lines coming through Denver or a large user of rail, then you can get service—otherwise no. It's gotten so bad that national developers such as ProLogis are not building rail-served buildings here anymore."

There are hopeful signs for some communities off the global supply network. Although Michigan is not centrally located in the country, and it would be hard to create logistics and distribution hubs there, being an older manufacturing state, it has been well served by railroads in the past.

Grand Rapids, for example, boasts a centrally located rail yard, but it is used primarily for switching cars, not for unloading and loading goods, says **Samuel C. "Chip" Hurley IV, CCIM, SIOR,** Director of Industrial Services, The Wisinski Group, Grand Rapids, Michigan. However, he reports that the city is getting ready to do a feasibility study as more local manufacturers want to explore the use of rail.



"As fuel prices increase, depending on the product being shipped, there can be significant cost savings realized by using economies of a larger scale."

A couple of different end-users, primarily in the agriculture and lumber businesses, are seeking to create an intermodal terminal that would also attract other companies that could use rail access, says Hurley. "The existing infrastructure is out there, the venues are out there, so it would be crazy not use the rail."