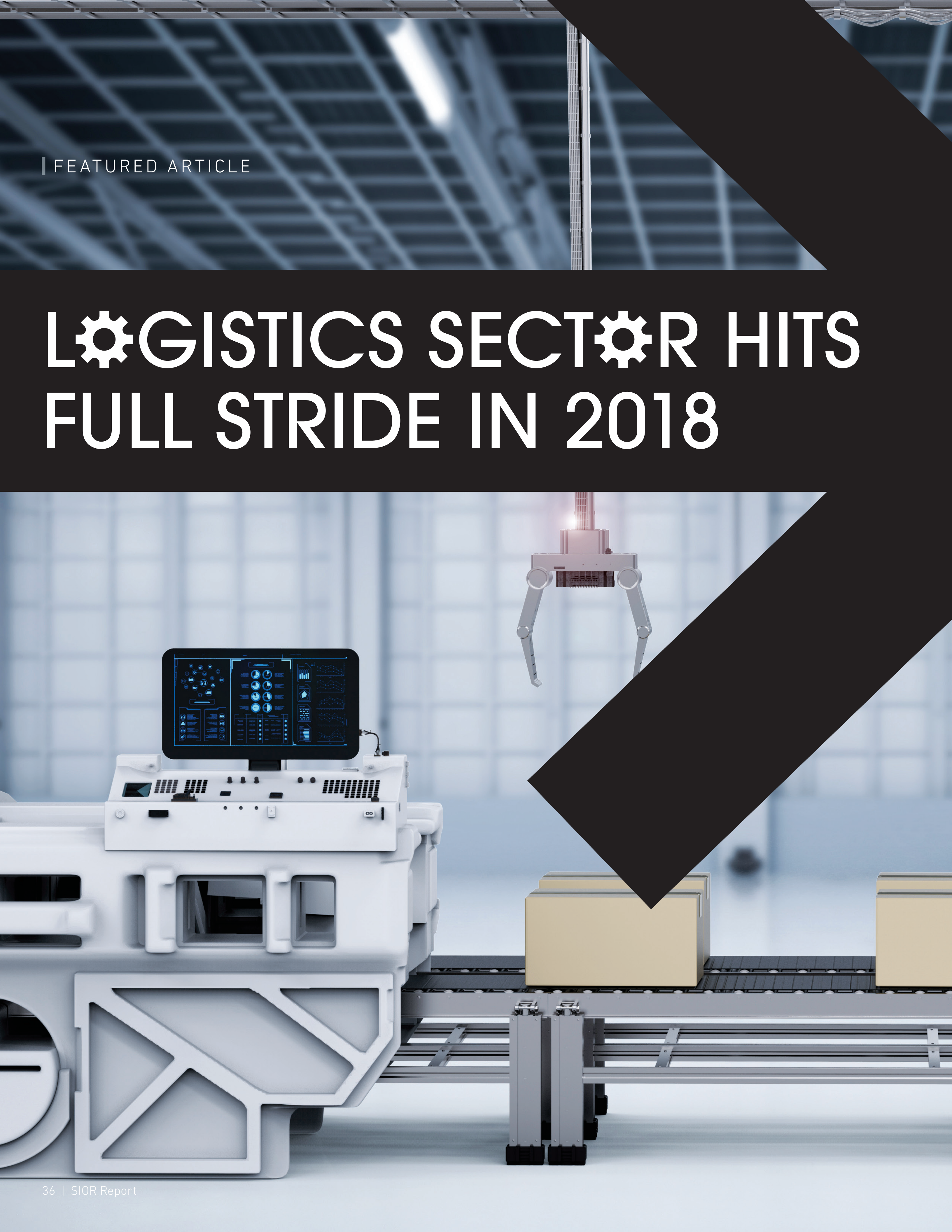
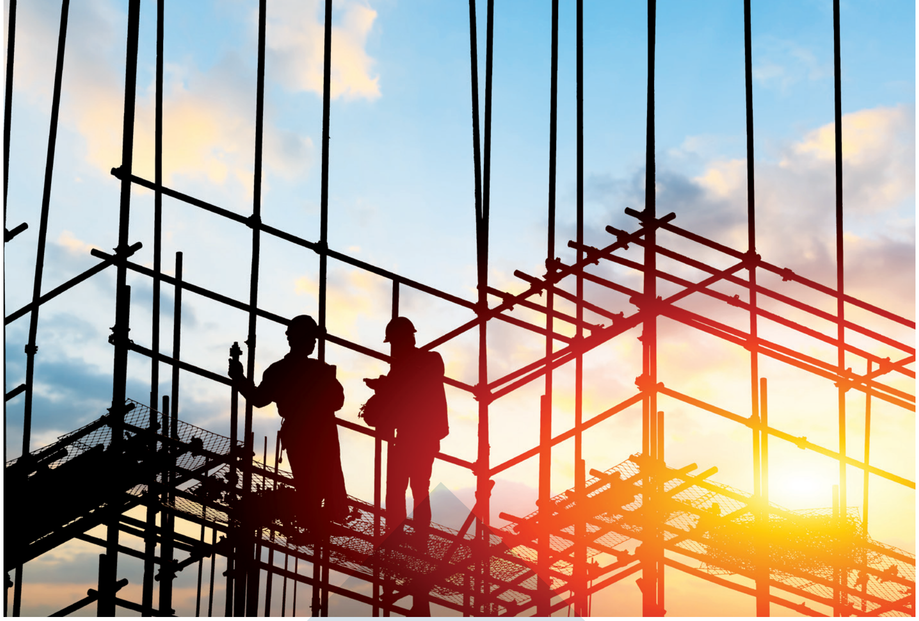
LOGISTICS SECTOR HITS FULL STRIDE IN 2018



By Brandon Birtcher

With the real estate books of 2017 now closed, the industrial sector has experienced yet another record-breaking year of absorption, rent growth, valuation, and land pricing. Entering 2018, consumers and businesses should begin to benefit from the recent passage of the Tax Reform Act and the positive effects of deregulation. We should also see Congress increase the defense budget and investment in strategic infrastructure, which will start to trickle down into the supply chain. Add to that the billions of dollars being invested in America's major ports, continued double-digit growth in internet sales, shrinking urban site availability, and growth in last-mile infrastructure, and the result is that the industrial sector, namely logistics, is in a peerless and enviable position among all other real estate classes.



The Investor's Conundrum: Further strengthening the industrial sector will be the impacts of continued conservative financial underwriting, which will help govern new construction starts, keep supply in check, and bolster rents. However, investors whose performance is benchmarked against the indexes face an interesting dilemma: Should they continue to chase yield in secondary and tertiary markets with characteristically lower barriers to entry and lower absorption, or seek the safety of higher-barrier markets with the highest absorption, lower yields, and where overbuilding is unlikely? For merchant building-centric, IRR-driven sources of capital, this decision could be particularly difficult. For yield-oriented capital, however, building a portfolio of Class A assets will surely be rewarded, and without reliance on cycle timing. In fact, building through the cycle in many of these ultra-low vacancy and high-absorbing markets starving for Class A product offers well-informed investors a unique competitive advantage.

Experience Unlocks Value: Developing warehouses in these highest-barrier to entry/highest-absorbing markets has obvious rewards, but also comes with significant challenges. The procurement of timely entitlements can no longer be taken for granted. Developers face opposition from government bodies, environmentalists, and lawyers who can at times be nefarious adversaries in their attempts to block development or extort developers, despite conformance with existing zoning.

Some cities are implementing moratoriums while they study how to best accommodate the need for last mile fulfillment. Progressive cities are looking for ways to deal with deteriorating infrastructure and appropriately modify their General Plans and zoning regulations to encourage warehouse development closer to major arterials.

With nearly 80 years of sponsorship, Birtcher Development believes that the ability to generate successful results in the face of such opposition requires a developer who can navigate the politics, effectively communicate with opposing stakeholders, and design projects that will be embraced not only by the community but by occupiers as well. The reward for developing in such challenging environments is the creation of an irreplaceable portfolio of ideally located, high value, recession resistant legacy assets.

Proactive Broker Advantage: As industrial land pricing hits all-time highs in most markets, developers and their investors are looking even harder to mitigate risk as they structure their offers to purchase. Seasoned brokers are well aware of the opposition and difficulties that lay ahead for top-paying developers as they work to unlock the value of a site. However, brokers of value-add properties face many challenges of their own.

Although tempted to set a prospective seller's expectation high as to market value, it is essential to manage this supposition by pre-identifying all the unknowns that a buyer must price into an offer. The sale process can be enhanced through a frank discussion with sellers about the community's political climate, concerns of neighbors, importance of thorough environmental documentation (to avoid legal challenge) and the realistic time frames associated therewith.

By reminding the seller of the value that can be created for a developer if realistic timeframes are offered to achieve entitlement prior to closing, they can better expect to maximize their sale proceeds. To shorten the time needed for the developer to deal with such unknowns, the most successful brokers are encouraging sellers to fully characterize their land prior to placing it on the market by arranging for clean title, a current ALTA survey and Phase 2 environmental studies where necessary.

Construction Challenges: 2018 will continue to see the cost of construction rise, possibly nearing double-digit escalation in some parts of the country. The most notable increases will come from construction materials and processes relying on petrochemicals, steel, lumber and labor. The biggest driver of these costs will be the competition for materials caused by the recovery efforts from recent natural disasters, a national reinvestment in infrastructure, code changes and the shortage of skilled labor.

Additional increases will come from fee escalations, especially those sponsored by municipalities whose budgets are stressed by unfunded pension liabilities and tired infrastructure. Developers looking to offset some of these costs will do so by increasing their reliance on recycled products and alternative construction designs. Meanwhile, occupiers are responding to the scarcity and higher cost of labor by implementing automated solutions and selecting infill sites that will bring long term efficiencies into their supply chain.

Threshold Opportunities: In this new year, many opportunities exist to explore the new territories opened by the internet. We will see fulfillment-oriented occupiers and 3PLs collaborate with retailers on where to locate and how to design the most efficient facilities, including addressing the often-overlooked impact of reverse logistics - the handling of returned internet purchases. In addition, there continues to be a shortage of land parcels well into the next decade that are large enough to accommodate state-of-the-art last mile logistic facilities. Enterprising brokers who can assemble and control such sites in strategic urban infill submarkets will be well-rewarded by these high-value properties.

There will always be the usual suspects that could disrupt the sector's continued upward momentum. Yet, even as the Federal Reserve pursues measured increases in the discount rate, the markets seem to have factored this into their long-term outlook. In fact, many investors consider it a healthy necessity for our government to practice quantitative tightening in monetary policy to enable future economic stimulation.

Sans any meaningful international or domestic Black Swan event before July 2019, our nation will surpass the record 120-month recovery experienced in the 1990s. As Congress pushes to grow the economy with incentives, deregulation and tax cuts, and as the supply chain continues to reinvent itself, we find ourselves within arm's reach of the longest period of economic expansion in post-war history, and with the logistics sector poised as a major benefactor. ▽