NAIOP
COMMERCIAL REAL ESTATE DEVELOPMENT ASSOCIATION
CHICAGO CHAPTER

Bricks and Clicks: The E-Commerce Evolution & Its Impact on CRE

by Matt Baron, NAIOP Chicago Staff Writer

This is a summary of the March 16, 2016, meeting of the Chicago chapter of NAIOP, the Commercial Real Estate Development Association.

Its members gathered at the Riverway Auditorium in Rosemont to hear an expert panel discuss e-commerce and its effect on commercial real estate. Their discussion encompassed a broad array of topics, including location selection, building improvements, workforce analytics, labor challenges, and the profile of the next wave of providers and customers.

Jeremy Giles, *President*, US Central Region, Prologis, Inc., served as moderator and was joined by expert panelists Kris Bjorson, *International Director*, JLL; Bryan Jensen, *Vice President*, St. Onge Company; and John Morris, *Executive Managing Director*, *Senior Management/Leasing Industrial*, Cushman & Wakefield.

Operating an e-commerce business is no longer a novelty, with a rising percentage of the population having no experience of a marketplace without the ability to click and consume. Meanwhile, companies in this sector possess heightened technological and industrial sophistication in navigating the ebbs and flows of maximizing service to customers, year-round, while turning a profit.

Solving the problems that come with those peaks and valleys—such as how to ramp up a drastically larger number of employees during the busy holiday shopping season—creates opportunities for professionals in the commercial real estate sector.

At the outset, moderator Jeremy Giles couched the discussion in terms of e-commerce's transformative impact on retailing as a whole.

“It is fundamentally changing the way we are consuming products,” said Giles. “But, as a result, it is also fundamentally changing logistics real estate in so many interesting ways.”

Bryan Jensen noted some of the more “mundane characteristics” that reflect e-commerce's industrial real estate needs, in comparison to other industrial users: fewer doors, a bigger proportion of employee parking and a related larger number of people per square foot inside the building.

Those features, in turn, “drives interior infrastructure service,” he said. “If I have 2,000 bodies in my building over two shifts, I need a lot more amenities than when I have 100 forklift drivers over three shifts.”

Also, because of the need to power its larger automation needs, e-commerce buildings require upwards of double the amount of power service than a typical industrial distribution center, Jensen said.

“Even if they don’t know what they want in the future, a wise e-commerce (company) will want to be positioned to install automation and heavy mechanization, should their volume and work profile warrant that in the future,” noted Jensen.

He also laid out the “peak problem” faced by e-commerce operators, who may experience as much as 10 times their usual volume during the holiday shopping season.

Installing automation that addresses that high-volume period is expensive, particularly if most of the automation is unnecessary for almost the entire year. Consequently, “what has grown is a mix of automation and then peak creative labor utilization,” said Jensen. Over time, as e-commerce grows, there will be a continued, incremental increase in investment in automation, Jensen added.

One tactic taken by the e-commerce industry to smooth out its volume over the year is to dangle deals to customers earlier—even as early as the summer, said Kris Bjorson.

“They’re trying to take that 10x peak to 8x, to 6x, trying to spread it out from those two to four weeks, and that helps us on the workforce side,” Bjorson said.

The approach his firm takes is to identify the “workforce story” for a given client to match it up with the most suitable location. That story flows out of learning about the company’s characteristics, defining the market problems they are facing, and through steps such as predictive analytics that anticipate, among other things, the available workforce in a given area for upwards of five years.

Service expectations are another key component to consider, said John Morris.

“If two days (delivery time) was good enough for all of us, FedEx has 95 percent of households covered, so the idea that we need all of this in-fill space is really completely driven by what happens at the service level,” Morris said.

Giles raised the issue of capital investment in the category, particularly in light of e-commerce’s larger players such as Amazon and Walmart and their continual willingness to be in an “experimental mode.”

Amazon's "long first mover run is unprecedented," Morris said. "…What this is facilitating is a lower expectation for a return on invested capital," which in turn fuels continued innovation that "forces competition to be four steps behind."

"At some point soon, we're not going to be able to call that a 'first-mover' from them," Morris continued, "because they'll actually have enough scale to become the dominant player, maybe in the entire retail space."

In a related move, Amazon recently launched their own private label clothing and shoe lines—a development, according to Morris, that shows Amazon recognizes "that if they're going to eliminate whatever retail advantage is left, it's got to be about branded product."

Mid-size retailers can compete in the field, and some may opt to move their products through the Amazon distribution network, said Jensen. It depends on a host of factors, including brand identity and the profile of a given company's customer base.

"Certain brands, Amazon will be a turn-off to the customer," he said. "Other brands, it will be a benefit."

Service level is tied into the "customer promise" of a company, said Bjorson, and "a lot of the midsize guys are very comfortable" with three- to five-day delivery times, which in turn drive decisions on where to locate distribution centers.

"A lot of them have become more flexible, too," Bjorson added. "They do have a prototype design that fits with the automation, but given the tightness of our real estate market, they are realizing that sometimes, to meet the demand they have to open the facility, they have to compromise on that."

Clients are also increasingly interested in exploring the purchase of facilities, rather than leasing, because e-commerce is an integral part of their long-term strategy.

On Amazon's plans to lease 20 Boeing planes, Morris said that he would have thought "no way" a year ago. However, as those plans have taken shape, it's apparent the "investment paradigm" for the company enables it. In addition, Amazon's announcements are often "forward looking…and some of them are very intelligently placed to keep people confused," he said.

"Whoever wins the last-mile conversation is the big winner here," Morris added. "That's what the three major players are trying to do, along with USPS."

On the question of how the decision process for locating e-commerce real estate has evolved, Jensen said, "Stop thinking about a warehouse as a warehouse and start thinking of it as a store…Retailers aren't opening a lot of stores."

Instead, they are focusing their resources not on retail locations but fulfillment centers—which is a much more complex process.

In his 15 years of working on e-commerce related projects, Bjorson said oversight of those projects has shifted toward customer-focused leadership. While they would first be overseen by the "non-retail real estate guy," they gradually came under the purview of VPs of distribution, then logistics, then supply chain, then e-commerce and, most recently, people with titles like CCO, "Chief Customer Officer."

"It's a person who says, 'I know what the customer wants and I'm going to be leading the projects that touch the customer,'" he said.

Morris said that when industrial real estate jobs open up, it is becoming harder "to plug someone in there" because of its multi-disciplinary demands.

"That job is more central," he continued. "Having the retail people and the supply chain people in the same room for these meetings—we all knew this needed to happen, but it took us a long time to get to that point."

During an extensive question-and-answer period, panelists tackled a diversity of subjects, such as:

**The state of the labor market, and how that ties in to locating e-commerce facilities.*

Panelists agreed that, contrary to many investors' perception, it's "not safe" to simply build next to existing buildings.

Industrial real estate professionals, Bjorson rued, "keep on building where the other buildings are…when we do our labor analysis and say, 'You should be on this side of town,' it's rare to find a developer that may have done anything more than try to get some title to land."

"I think we need to be better thought leaders, knowing work force is an issue, and take some different stakes in different markets and different sub-markets, and give us some other options," he added. "It's so critical."

**Unlike a flat sales paradigm (such as distribution of toilet paper) that is easy to staff, going from 300 to 1,200 people for an eight-week span poses a variety of challenges, said Jensen.*

"I now have to start hiring months in advance to get them trained up. I now have to make sure I structure my compensation so they don't bail on me when I need them the most," Jensen continued. "Seasonal labor has a funny tendency: they come in, they get the money they want for the holiday, and boom, they're gone."

"The tighter the labor market gets—and the labor market is getting tighter—the worse that situation becomes," Jensen said, because more people have the opportunity to gain full-time employment instead of working seasonally.

Millennials have college educations at a much higher rate than prior generations and are less likely to take the jobs, said Morris.

“We suffer through more of these flare-ups because of the peak (periods) and of the seasonal nature of electronic fulfillment,” Morris continued. “But fundamentally there’s a core problem in that the post-Internet educated generation just won’t take the job.”

**The role that incentives play in attracting industrial tenants.*

Morris said incentives “exist for a reason…and a bad decision driven by incentives will still just be a bad decision.”

Giles, meanwhile, ventured that property tax incentives “don’t make a dent” in the overall decision. His comment prompted Bjorson to clarify that those incentives “mean a lot” to tenants with, for instance, seven-year cash flow models, as opposed to others with 25-year cash flow models.

**Self-driving trucks’ impact on the industry.*

“Self-driving trucks still need someone in the cab,” said Morris. “I see self-driving vehicles as being a lot more effective around the facility, in the yard, where there aren’t the same kind of safety concerns.”

Self-driving vehicles will have “tremendous impact,” said Jensen, but it won’t be for at least another 10 to 20 years, and perhaps longer, when the technology becomes cost-effective.

“Robotics work in a distribution center,” said Jensen. “But if you go to a fulfillment distribution center, you won’t see that many robotic applications because the cost point is still too high, or the labor is still too cheap.”

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