NAIOP
COMMERCIAL REAL ESTATE DEVELOPMENT ASSOCIATION
CHICAGO CHAPTER

The Last Mile

by Matt Baron, NAIOP Chicago Staff Writer

This is a summary of the March 9, 2017, meeting of the Chicago chapter of NAIOP, the Commercial Real Estate Development Association.

Its members gathered at the Riverway Auditorium in Rosemont to hear a panel discussion on one of industrial real estate's most significant trends in recent years, "The Last Mile." Demand for infill and "last mile" distribution facilities has never been greater, with tenants ranging from e-commerce users searching for same day delivery hubs, to food users looking for proximity to the city's restaurants.

Moderator: Scott Marshall**,** *Executive Managing Director*, CBRE

Panelists:
Mark Goode, *Principal*, Venture One Real Estate
Mike Senner, *Executive Vice President*, Colliers International
Mike Tenteris, *Managing Director*, Cushman & Wakefield
Jason West, *Executive Managing Director*, Cushman & Wakefield

E-Commerce sales continue to be on the rise, poised to grow by more than 10 percent from $440 million this year to $491 billion, according to eMarketer. And with an estimated 1.25 million square feet of distribution channel space required for every $1 billion in e-commerce sales, the anticipated year-to-year growth will translate into the need for 50 to 60 million square feet of space in the next year alone, said Scott Marshall.

"This is a systemic change," said Marshall, citing his 12-year-old son's online purchase of school supplies this year as one illustration of this shift. "Our kids' kids are going to be shopping completely different. There's a need for distribution space that is going to be corresponding with that change."

As a result, smaller buildings, which at some point may have been considered obsolete, are coming into play in metro areas. "Now these are absolutely critical facilities because of access," added Marshall. "Now they've created a whole new demand for institutional investors."

A taste of the evolving nature of deliveries is under way at Virginia Tech, where Chipotle and Google have tested delivering burritos**,** Marshall pointed out.

“The supply chain is very simply a balance between cost and service. I don’t care what you’re buying, the person you’re buying from can get it to you the same day—but it’s a balance between cost and service.”

The panel’s dialogue revolved around a case study-style overview of 2801 S. Western Ave.— a South Side warehouse that Venture One Real Estate sold 15 months ago for about $30 million.

When Venture One purchased the nearly 300,000-square-foot space in 2013, it came without any “last mile” discussion or targeting, said Mark Goode.

However, the site’s ability to accommodate a large number of delivery vans as well as employee parking, both inside and outside the facility, turned out to be a critical component of its appeal, said Jason West.

“Ceiling heights are not very important. As long as they can get a standard-sized van or small box truck inside, that’s all they need,” West said. “So it’s really all about the parking and the proximity to the customer.”

In Chicago, prospective tenants have a “pretty tight radius” in terms of where they will seek competitive locations to consider—Pulaski Road, for example, is generally deemed to be too far west of downtown, according to West. Meanwhile, in the suburbs, the radius can be as many as 10 or 15 miles away from a “centroid,” or ideally centralized location—especially if that spot on the map is in the midst of a heavily residential area situated miles away from the first industrial building.

The shift in consumer behavior has helped companies in the Fulton Market area, for example. They are enjoying a financial windfall that enables them to modernize their facilities, said Mike Senner.

On how to anticipate opportunities during the next phase in the market, Senner said that it would “continue to be a struggle” because the vacancy rate on Chicago’s North side is around 5 percent. That figure, in practical terms, is closer to zero because the bulk of the vacancies are “really obsolete” spaces, he added.

More opportunity exists in the Goose Island area, with rents going from $11 net to $15, he said, and more food-related companies are pushing westward in the city, even to Pulaski and, in the near future, Central Avenue, Senner continued.

Capital markets are interested in “some sort of exposure to the last mile,” said Mike Tenteris, but the preferred mode of getting involved is via new development rather than renovating existing facilities.

“I can’t confidently say that investors, at least institutional capital, are going to continue to pour money in secondary or B or C product,” Tenteris added. “Keep in mind these last-mile users—Amazon is an example—they’re signing five-year leases in these in-fill markets. You go to the suburbs and some of these further-out locations, they’re doing 10-year deals and even longer, which implies that (in-fill users) don’t know what this model looks like five years from now.”

Because of the “couch potato shopper,” said Goode, there is a growing imperative for companies to have distribution points as close as possible to consumers—as close as retail outlets like Walgreens and Jewel.

As for tenants, Amazon is the undisputed dominant player—its 45-percent share of the online market eclipsing the next 10 competitors combined. Those also-rans, collectively, account for about 25 percent of online sales, said Tenteris. Amazon's prevalence is illustrated by the following statistic offered by West: last year, Amazon had a facility within 20 miles of 44 percent of the U.S. population, up from 38% in 2015 and 26% the year before.

That expansion has been accompanied by the growth of its Prime service to 40 cities and the development of bookstores as well as pick-up locations in shopping centers and college campuses.

"They're raising the bar," said Tenteris, "and making it really difficult for anyone else to compete."

With fulfillment centers in Mundelein, Lisle, Wood Dale and Morton Grove among its six last-mile delivery depots in the area, Amazon has indicated plans to grow to 15 centers in the Chicago area to "actively service the market," said West. "So there's more coming eventually."

Other players are vying for space, of course, with Goode referencing Vipshop and DHL's drone delivery service as part of the mix. Vipshop, serving China, delivered 269 million orders last year, with 90 percent of those coming in the "last mile" category.

"You think they're coming here?" said Goode. "Maybe."

Acknowledging uncertainty over how it will all shake out, Goode added that "a lot of these older buildings with lower ceiling heights—those are going to be the ones in demand because they have extra parking."

On the topic of demand from the capital markets, Tenteris said they are "treating it as aggressively as they would your standard 300,000 square-foot box on I-55 or I-80, or near O'Hare, for that matter. The capital is there—they want it."

During the question-and-answer segment that wrapped up the session, Goode emphasized the importance of looking beyond Amazon. He said it is key to regard the "last mile" as "a totally different business model and industry that we have to address because it costs more to build the buildings."

"They need more parking, they need more land. If the only user is Amazon, we all fail because when they move out after their five-year lease, what are we going to do?" said Goode. "You've got to look at it as a change in the dynamic of our industry."

Some companies are building hybrid operations. A 1-million square foot project that Venture One is involved in with Georgia Pacific entails 700,000 square feet for traditional distribution and 300,000 square feet dedicated to e-commerce for direct shipping to customers, Goode said.

On the question of zoning issues that last-mile developments are facing, panelists said the influx of jobs is typically enough to override concerns such as traffic.

The only zoning issue that Cushman & Wakefield has encountered, said West, relates to the distribution of liquor: "A lot of the industrial zoning does not allow for liquor distribution, especially if it's a point-of-sale to the customer, so we've had to go in and get some variances in some spots."

On the question of how to handle returns, about 30 percent of online sales wind up getting returned, compared with 10 percent of in-store purchases, said Tenteris. Because those last-mile distribution sites are not equipped to handle returns, third-party companies will emerge to assimilate returns back into companies' distribution chains.

Even with the struggles that flow from this phase of customer engagement, it beats the alternative, said Goode. He noted that it is "a lot less expensive to take that product back than to put in another 300,000-square-foot store" and incur ongoing rent and operational costs.

For Additional Information:

NAIOP Chicago
1700 West Irving Park Road, Suite 208
Chicago, IL 60613
773-472-3072
info@naiopchicago.org | **www.naiopchicago.org**