NAIOP
COMMERCIAL REAL ESTATE DEVELOPMENT ASSOCIATION
CHICAGO CHAPTER

Labor, Labor, Labor – Workforce Shortages and How Labor is Driving Occupier Decisions

by Matt Baron, NAIOP Chicago Staff Writer

This is a summary of the March 21, 2018, meeting of the Chicago chapter of NAIOP, the Commercial Real Estate Development Association.

Its members gathered at The Estate at Gene & Georgetti in Rosemont to hear insights from experts on one of the challenges that has emerged from the nearly decade-long economic recovery: record employment levels creating unprecedented concerns for occupiers searching to attract and retain quality labor.

Among other topics, panelists discussed the local and national labor markets and how labor, or the lack thereof in some instances, is driving user decisions more than ever.

The session moderator was Keith Stauber, *Managing Director*, JLL. Panelists were Meredith O'Connor, *International Director, Tenant Representation & Chairman of Headquarters Practice Group*, JLL; Mark A. Pasquella, *Executive Vice President, Advisory & Transaction Services Group,* CBRE; Michael Sessa, *Executive Managing Director, Tenant Representation Group,* Cushman & Wakefield; and Laura Sidney, *Senior Director of Client Strategy with Labor Analytics, CBRE.*

Keith Stauber opened remarks with a host of favorable statistics that underscored the U.S. economy's sustained post-Great Recession rebound. Among the numbers: the unemployment rate of 4.1 percent; a 4.5 percent hike in job openings in 2017, compared to the year before; and consumer confidence, in recent months, reaching its highest levels since 2000.

A backdrop to the discussion was Chicago's bid to edge 19 other finalist cities for Amazon's HQ2, including **hosting an Amazon site visit in the next week**.

Meredith O'Connor said Amazon's influence on the real estate industry, through its notably public search process for a second headquarters, has been seen in companies like Apple and Google. They are now following Amazon's lead in touting their impact when expanding their corporate footprint.

The city's courtship of Amazon, she said, is a "huge opportunity."

"I don't want to call it a public auction, but it is somewhat. We used to be very secretive over things that we do on behalf of our clients," said O'Connor. "This is not that way. You'll see companies have to be more forthcoming, so not only is there labor information being put out there very early, but so are the incentives, so is the demand of how much real estate they would need, and why, and what they're going to do with it."

"Live, work and play (balance) is a must," she continued, "so you're seeing developers do different types of amenities and assemble land in a different way."

In the end, however, "labor drives everything," said O'Connor.

“Incentives will never make a bad location good, so you have to look for that labor, layer on the real estate option…and then you put on the incentives into that opportunity to make the deal better.”

In response to moderator Keith Stauber’s question about how companies are defining labor markets, including which metrics they are using, Laura Sidney said the answer varies based on industry. However, across the board, technology’s impact is profound.

Because of technology’s effect on how business is conducted, “some of the traditional industries are changing the type of talent they need, and that changes their location strategy,” said Sidney.

For both office and industrial uses, she added, it is essential to “be able to look forward and understand scalability, knowing what the thresholds are before you cannibalize your own operation.”

“As we have seen massive transformation in the economic boom that’s happening, the labor demand from an e-commerce fulfillment center can be 10x that of a regular warehouse,” Sidney said.

Also, with the expansion of mobile technology, consumers who used to be satisfied with a four-day delivery cycle now want their products in four hours, she added. Those demands are “really making every industrial user think about labor now more than ever.”

“The demand on the tenant side to get (those goods) to a consumer is huge, so as we look at a dwindling supply, a pipeline of talent coming online that can be their own boss by just logging into an app like a ride-share app—as opposed to clocking in at a warehouse—is a huge challenge,” Sidney said. “It’s a cultural challenge, it’s a preferred-employer type of challenge.”

For industrial users, she added, every dollar of per-hour wage difference translates into $2 per square foot. Between mandatory minimum-wage increases that have begun and are continuing over the next few years, as well as companies voluntarily raising wages due to competitive pressures, the financial impact is significant, said Sidney.

In his opening remarks, Michael Sessa provided an overview of shifts in workplace design. After the introduction of the cubicle in 1967, for about 35 years the workplace strategy was “pretty straightforward.”

Then collaborative work environments, stoked by the integration of technology, came on the scene around 2000 and resulted in “one size fits all” open-floor layouts that helped minimize real estate and related costs.

The pendulum, however, has been swinging back to tailored spaces that will only grow in demand as the labor market continues to improve, said Sessa.

“It’s only getting to more challenging,” he added. “As you look out over the next 10 years with a projected 3 percent growth rate in the labor force, and 9 percent projected growth in the overall population, those labor challenges are only going to get worse----now it’s time to get real about how the workplace really aligns with the workforce.”

One strong trend is toward more flexibility of space usage, and more focus on team dynamics and fostering an environment that taps into the “power” that comes with various generations working effectively together, he said. Other qualities on the rise are increasing natural light, access to outdoor space, amenities that foster informal interactions, and overall wellness initiatives.

In the final analysis, companies need to reflect on how they work best and then develop a space-usage strategy that supports that dynamic, Sessa said.

“When you’re in that type of tight labor market, you have a couple choices: you can either be the highest paying employer—and even then it’s not going to work—or you can create an environment where people feel good about where they work and how they work,” said Sessa.

On the topic of the increasingly global nature of business, Mark Pasquella noted the trend has been fueled by advances in communication, technology as well as access to data that provides insights about various markets' workforce makeup and potential to serve as a "back office" for companies.

Unemployment dipping to 4.1 percent, with forecasts calling for it to drop below 4 percent later this year, is prompting companies to seek labor offshore for certain skill sets, said Pasquella.

"Their appetite for technology and all of the labor required to support that, most of that is being done outside the U.S.," he added. "The front end is getting invented here, but the actual implementation of writing that code is not being done here."

There is "abundant" labor abroad, including Europe, Asia and particularly India, which Pasquella termed a "force to be reckoned with" on the strength of its 450 million workers among its 1.3 billion residents. In his three recent trips there, Pasquella has seen growing Westernization of the country that also bodes well.

"They made a bet 10 years ago that they were going to become America's back office, and they've done it," he said. "…now it's much easier to do business in India as an institutional investor---the REITs have tremendous tax advantages."

To provide a sense of scale of occupancy among U.S. companies in India, Pasquella noted that Accenture, with 14 million square feet, is the largest non-Indian tenant, with IBM (10 million square feet), Capgemini (10 million) and Honeywell (4 million) also major players. Wages in India, he added, have "stayed reasonable" while rents have "skyrocketed"—going from $7 or $8 net up to $15 or $20.

Prompted by Stauber, Sidney outlined consolidations by McKesson **in Irving, Texas** (500,000 square feet, 2,500 jobs, and an estimated $250 million in labor savings over the next decade) and Scottsdale.

In both markets, a driving force was McKesson's desire to be a "preferred employer."

"I can't say it enough," said Sidney. "That's the name of the game in today's competitive landscape, where the culture attracts the best talent and retains the best talent."

O'Connor related her experience working with the joint venture client of Toyota and Mazda as they winnowed a list of potential sites across the country to **the choice of Huntsville, Alabama.**

The parameters of the project (2,000-acre minimum, $1.6 billion investment, creaton of 4,000 jobs) led her team to zero in on roughly 20 locations after initially casting a net that encompassed over 300 possible spots.

In all, there were 42 variables factored into the search, with the big three being logistics, labor and location. One key factor for companies: making sure they feel welcome in a community.

As cities and states sought to woo the business, they grew "very creative with their incentives," she said. "You can't think about a traditional toolbox anymore. You have to think about what's particular to a company and what's going to drive their decision."

Another essential piece for municipalities is to make infrastructure investments and otherwise have mega-sites ready for development. She noted that two sites in Illinois were among the finalists in the Toyota-Mazda search, and the pitch by the state's economic development officials and the governor was strong.

"The story that they told and the labor that Illinois was able to offer stacked up against all kinds of cities across the country," O'Connor said. "There are some sites in Illinois that need some work and part of the reason why Illinois was eliminated is because it wasn't as ready as Huntsville."

Referring to the Amazon HQ2 search, with the roughly 300 communities completing the company's request for a proposal, Sessa said that the process forced leaders in those places to reflect on their strengths as well as shortcomings. That exercise, he said, is "certainly positive for the entire country" because it will help spark necessary changes that will support other business development.

One change from a decade ago, said Pasquella, is that his firm is no longer "chasing cheapest labor" (totaling about 300 jobs, with potential expansion by another 400 jobs) in places like Yuma, Cheyenne and LaCrosse.

During the economic recovery, corporations have shifted their focus to attracting, and retaining, employees with better working conditions and other incentives.

"It has resulted in this consolidation play. We've been working for the last five years on unwinding all the Cheyennes and putting them into major locations of 1,000 to 5,000 jobs," Pasquella said. "That's definitely more than a trend right now. That is happening. There's economies of scale, there are incentives, and they are all trying to create the perfect kind of corporate culture environment."

Southern belt cities are among the hottest markets now, added Pasquella, led by Charlotte and Dallas, as well as Phoenix, Atlanta, and Nashville. Another highly regarded city is Denver.

Those are not the only options, of course. Chicago also has a variety of attractive features. Sessa noted its inclusion, along with Kansas City, St. Louis and Detroit, among the top 10 or 11 fastest-growing cities with college-educated millennial populations.

He also offered a prescription for communities looking to draw business. In addition to being "business friendly" in terms of taxation levels, "The best thing municipalities can do is focus on their infrastructure, create a business-friendly environment and get out of the way," said Sessa.

During an extended question-and-answer segment, panelists covered a host of topics. Among their remarks:

*For large-scale industrial projects, logistics and transportation represent roughly 70 percent of costs, labor is 20 percent, real estate is 5 percent, and taxes and utilities another 5 percent, said Sidney.

*An audience member asked if governments will scale back on incentives to business because of increased public scrutiny about the costs associated with those incentives.

In reply, O'Connor said such scrutiny is "inevitable" and companies should focus on meeting the terms of its agreement with a given government body.

"I see incentives as a fiduciary responsibility of corporations…you want to find a balance of actually taking incentives, because it's the responsible thing to do and they are available," she said. "There's a reason they exist--cities and states want you to come to their state and there's a cost associated with it."

Far from reducing their incentive packages, "states are not taking their foot off the gas," O'Connor concluded. "They're creating new ones."

*Relocating is part of a business strategy for some companies, such as those with long-tenured employees whose higher salaries can be replaced by lower-salaried new employees after a move, said Pasquella.

*A "reverse migration" for millennials will be in the offing, as they get accustomed to a "live-work-play" environment but are drawn to the suburbs to raise their children, according to Sessa. As a result, suburban business campuses are strong candidates for conversion in the years to come.

Another emerging factor: autonomous vehicles and other alternative forms of transportation “will help save suburban campuses, for sure,” said Pasquella. “If people can get there much more easily, they can live downtown and get to a suburban campus, that changes the game for those surplus real estate pieces.”

“The fate of a vacant building,” added Sidney, “depends on the workforce complexion around it.”

*One attendee asked what labor-related data should be used by professionals such as lenders, appraisers, developers, and investors as they evaluate industrial real estate.

That same question has come increasingly from developers over the past 18 months said Sidney. One key, she counseled, is is to keep the marketing metrics “realistic.”

“It’s going to be concentration of talent within a fixed drive time,” she added. “It’s a bit aggressive to think that 45 minutes is realistic from a commuting perspective. I can’t think of a single industrial market in the country where that makes sense.”

Other factors, said Sidney, are understanding head count for full-timers versus seasonal workers, the titles of positions being filled, as well as being aware of neighboring industrial park tenants’ employee makeups, which could enable companies to “play off each other’s demand in the market.”

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