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COMMERCIAL REAL ESTATE DEVELOPMENT ASSOCIATION

CHICAGO CHAPTER

The Industrial Climate: 2018 Review & 2019 Forecast

by Matt Baron, NAIOP Chicago Staff Writer

This is a summary of the October 25, 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 decision makers for some of Chicago's most active industrial investors on what they have seen over the last year and how it has impacted their outlook for 2019.

The session moderator was **Victoria Noonan**, *Managing Principal,* Cushman & Wakefield. Panelists were **Matt Goode**, *Principal,* Venture One Real Estate; **Matt Kurucz**, *Managing Director, Chicago,* Crow Holdings Industrial; **Jonathan Rudersdorf**, *SVP, Central Region Head of Operations,* Prologis; and **Don Schoenheider**, *Senior Vice President/Midwest Market Leader,* Hillwood

Although uncertainty abounds on a deal-by-deal basis, the overarching truth for industrial real estate is that there are ample opportunities to seize. It's not a matter of "if," but where development occurs. As panelists shared how this year has gone, as well as how they perceive 2019 to be shaping up, that recurring point emerged.

For example, smaller—but more frequent—deals than prior years' experience has marked the activity for Venture One Real Estate thus far in 2018, said Matt Goode.

"The amount of institutional capital that has come into the market and to our space has driven that," said Goode. His company also has developed a "handful" of speculative properties, he added.

For Hillwood, this year has been in the realm of the typical annual range of 15-20 million square feet of development, said Don Schoenheider. However, the area where they have seen a marked decline is in finding acquisitions in the Core-plus space.

"It's been almost impossible for us to find assets to buy," said Schoenheider. "Last year, we bought almost five million feet as a company. This year, we have not acquired even one million square feet."

He attributed the drop to the amount of capital in the market and strong demand that extends all the way through secondary markets. "Capital has found a way to migrate to

Columbus and Salt Lake City and Austin," said Schoenheider. "Everybody's looking for yield...it's tough out there and it's hard to find stuff to buy."

For Prologis, a significant development this year was its **acquisition of DCT Industrial Trust**, said Jonathan Rudersdorf. In the U.S. Central market, that brought the firm from 108 million square feet to 133 million square feet in 10 market areas.

"We want to be doing more and I think you're going to see us continue to push the envelope in '19," Rudersdorf said. "We need to do more specifically in Chicago." This year the company developed two build-to-suits and one spec property, and next year the company's activity will likely double that overall figure of three developments, added Rudersdorf.

Panelists differed on whether rising interest rates would have an impact on cap rates.

"There's so much capital that wants to be in industrial real estate, and a lot of that capital is either low leverage or no leverage. It's foreign money…seeking a safe place to place capital," said Goode.

Rudersdorf, meanwhile, said he does not foresee cap rates changing: "Our fundamentals are strong on an equilibrium basis. You still have, in larger part in many markets, a demand that supports supply. We're still there."

However, an increase in the interest rate, along with other factors such as the Illinois pension crisis, the national debt (up to $23 trillion) and international tariff wars represent "brewing geopolitical issues that could potentially affect our business," he said.

Victoria Noonan noted that Cushman & Wakefield refers to Columbus, Cincinnati, Indianapolis and Louisville, collectively, as the "Heartland" market. She questioned if those markets pose a threat to the Chicago market's strength.

Part of those cities' growth is because the million-square-foot, multi-state distribution deals are rarer, according to Schoenheider. "It's the political climate, it's the business climate in Illinois that's causing a lot of people to scratch their head," he added. "It's also a very pro-business environment in places like Indianapolis and Columbus."

Another factor is the escalating consumer demand for last-mile deliveries to provide rapid fulfillment of goods purchased online, said Matt Kurucz.

"As we sit on our couches and continue to order stuff, we expect that stuff to get there sooner and sooner and sooner," he added. "If I (live in Columbus), I can't get something that I order today in three hours if it's coming from Chicago."

While there are advantages to exploring secondary markets, the fact remains that Chicago is a global market, noted Rudersdorf.

"We go where consumers are. There are 10 million consumers in Chicago," he said. "They want their stuff tomorrow. There's going to continue to be demand here. There's outside influence that can maybe slow that progress, but Chicago is Chicago. It's a global market, and there's people here that need stuff…All in all, I think things are actually really healthy here in Chicago."

That relative health comes despite the state's related fiscal and political troubles, according to panelists. "Imagine what we would be doing in Illinois if we didn't have that (negative) climate hanging over us?" said Goode. "I would think: taking off."

While Goode expressed optimism that the state could be turned around relatively quickly, Schoenheider alluded to Governor Bruce Rauner as "bright" and "intuitive" but also as someone who has found it is "very difficult to change the culture of how we operate in the state."

"It takes a long time to turn this ship around…we see (coming) more than likely another change in the governor's office," he added. "And it doesn't necessarily bode well for making that ship go in a different direction."

Panelists also discussed the impact of construction in southeastern Wisconsin, particularly with the Foxconn construction that is anticipated to use 10,000 construction workers at its peak in a few years.

"We're a little panicked about getting somebody to be able to build a product for us in '19, just because it's hard to find not only permanent workers, but potentially people that build our development projects," said Schoenheider.

Another topic raised was the impact of turmoil abroad, in places like Europe with the United Kingdom leaving the European Union (aka **"Brexit"**). Rudersdorf referred to Brexit as "a real struggle."

"Will that manifest itself enough to change how that capital is deployed here in the States? I don't know. I can tell you that's a worry for us, for sure…(However), I go back to the fundamentals of our business (that) are really strong."

The more turmoil exists across the world, the better economic news that represents for the United States, said Goode.

"People are looking at the U.S. as a safe place to invest their capital," Goode continued. "And furthermore, I think U.S. industrial is a target investment globally."

Schoenheider emphasized that people individually and markets more broadly "crave certainty" and are leery of instability.

"We're in a window right now where there's a lot of uncertainty," he added. "It's pre-election, it's China's tariffs, it's what's going on in Europe…15,000 people marching to the U.S. border. The markets generally don't like uncertainty; they don't like lack of clarity. (After the mid-term elections), I think we're going to see a lot more clarity as we go into '19 and it's going to be positive for our business as well."

Looking ahead, panelists noted the role that technology will play in creating more efficiency. Those trends should result in more in-fill locations "to get closer to the consumer," said Goode. And with so few open spaces, Kurucz predicted a trend toward "functional obsolescence and in-fill redevelopment."

"The next wave of development is not ground up," Kurucz noted. "It's how do you rip that building down and build a new one?"

With 750 million square feet of properties across the globe, Prologis is investing in companies and exploring how to use technology to boost efficiency, said Rudersdorf.

"Save a penny here, a penny there, that really adds up to real money for us, so I think we'd be naïve not to look at how technology is influencing almost every other category in our industry," he added.

Conversation turned to the topic of autonomous vehicles, given the shortage of long-haul drivers. A company called Embark is developing autonomous delivery trucks to travel the bulk of the 2,400-mile distance between Jacksonville and Los Angeles. One of the biggest hurdles for that technology is navigating the congested cities themselves at the journey's start and end, but Embark has begun **enabling the interstate highway portion of that trek**, said Schoenheider.

"That's happening today," he said. "Driverless trucks are right around the corner."

For the first time in over 20 years, **there are more job openings available than there are people looking for work**, and that sparked several points among panelists. Among them: the importance of trade schools to train more people who are interested in a traditional college path, and the importance of job training and education.'

"More companies are now viewing their $13-$15 an hour warehouse worker as a long-term employee" and even providing training for other types of work, said Schoenheider.

During a brief question-and-answer segment, panelists fielded a question on the outlook for rent growth. They agreed that it would be modest, especially compared to the coasts, in the Chicago-area market. At the same time, the days of tenants receiving five months of free rent when they sign a long-term lease "are done," said Schoenheider.

There is a low supply of product in every major market, which will also have a favorable impact on rents, he added.

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