

2019 All-Star Industrial Broker Panel

by Matt Baron, NAIOP Chicago Staff Writer

This is a summary of the September 25, 2019, 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 learn insights on the Chicago Industrial Market from leading industrial experts. Panelists shared their perspectives on big box industrial, current market fundamentals, as well as what they see for the remainder of 2019.

The session moderator was Amy Rzepka, *VP, Investment Officer*, Prologis. Panelists were Kris Bjorson, *International Director*, JLL; Dan Leahy, *Executive Vice President*, NAI Hiffman; Traci Buckingham Payette, *Executive Vice President*, CBRE, Inc.; and Jason West, *Vice Chair*, Cushman & Wakefield.

In a lively discussion spanning over 45 minutes, panelists covered a broad cross-section of topics. But the overriding thread that coursed through their remarks could be boiled down to this dual tension: the region has maintained its longstanding leader status even as disruptive market forces are shaking up the status quo.

For the Chicago industrial market, some elements remain the same: a large population base, a central location nationally, and solid rail and roadway infrastructure, all of which are key assets that make it a strong player across the country.

At the same time, it's an era of dramatic change, driven by advances and innovations in technology embodied perhaps no greater than Amazon's expanding footprint locally, nationally and globally.

In the view of Traci Buckingham Payette, the activity drivers for the region are e-commerce, the inland port, and consolidation, especially within industries such as consumer goods, food, and automotive.

"If any of you have been at the intermodals over the past few months, it's truck after truck after truck," Payette said. "There are so many goods coming into that inland port that I think that is the driver for the uptick of activity that we are seeing here in Chicago."

When asked about the prospect of speculative building, in light of the ongoing absorption of space, Payette said she does not foresee that happening to any significant degree until more buildings come off the market.

“This is a unique time where we’re seeing two- to three-million-square-foot campuses that tenants are requiring,” Payette added. “That ends up being a build-to-suit.”

On the topic of factors hampering the local market, Kris Bjorson cited governmental fiscal woes.

“For years, my clients have challenged us that they don’t want to be in the state of Illinois,” Bjorson said. His clients are saying “If we could be just across the border” in a neighboring state they would. “A lot of our clients, being super-regional or manufacturing-type clients, they chose to do that.”

On the other hand, he forecasts continued “steady” industrial real estate activity.

“Why I am still optimistic and why I’m still in Chicago is what we have to offer in terms of population density” that provides a strong customer as well as employee base, Bjorson noted.

Jason West echoed that view, both in terms of the overall population and its diversity. Together, they allow the Chicago market to “score fairly well” when its labor force availability is viewed against a national backdrop.

Asked about the impact of the tariff war, Bjorson said it has caused “about two million square feet of deals to be put on ice.”

“A lot of that is heavy equipment and large purchases that are coming from China, so it’s a real impact, and until we find a path forward, these clients aren’t putting these projects back on,” he added. “Unfortunately, it’s really impacting our business on the occupier side.”

Last year, the prospect of tariffs on the horizon prompted some companies to accelerate the importation of products and the absorption of space, said Dan Leahy.

“Labor is a challenge. It’s on the top of everybody’s mind,” said Leahy, with “creative” efforts necessary to attract and retain labor. He cited a Prologis initiative with the Miami-Dade County Public Schools [to create a trade and logistics lab](#) to train students for the workforce, as well as NAI Hiffman working with ride-share organizations to subsidize rides to bring workers to their shifts.

In real estate development meetings, he added, “the HR (human resources) person is in the room and they’re very vital in the decision-making process.”

Other challenges that affect the demand for warehouse space, said Leahy, include public pension fund liabilities, increased taxes, and “governmental interference,” such as annexation, zoning and occupancy regulations.

“The timeframe we’re now taking to get these occupancy permits—it’s taking months now to get through these,” Leahy said. “There’s just a litany of extra steps, in my opinion, that you have to go through today that you did not have to go through five or seven years ago...Nothing’s easy any more (because of) the bureaucracy to get a site that should be a slam dunk. There are no slam dunks anymore.”

A growing segment, said West, is packaging both in manufacturing and distribution.

“I used to run to the store and buy the bag of dog food and throw it in my own car and carry it into my own house. Now it shows up in a huge corrugated box with bubble wrap around it,” he related. “My recycle bin is overflowing every week, like everyone else’s. Packaging products in every industry are booming.”

A significant factor driving trends in the market is consumers’ desire to obtain products faster, said Bjorson. “How that ties back into our real estate world is every building has more parking now, whether it’s (for) trucks and trailers or employees. We are designing for more through-put.”

In the future, as has already happened in other parts of the world, building design in the U.S. will increasingly anticipate Uber and bus drop-offs, he added.

“The human-centric design is what we see in the Asia Pacific (market),” Bjorson said. “...the high-end bar, the workout center, they’re developing these buildings, multi-story million-square foot buildings that have the same amenities that we see at a downtown WeWork. How do you keep employment engaged? How do you create speed to the customer?”

Leahy said “bigger, taller, and closer to urban” are trends in recent years, as well as 40-foot clear design and a mezzanine layout—or at least the potential to add a mezzanine level in the future.

There is a demand for greater electrical supply, largely because of increased automation, although keeping pace with that demand has been a challenge, said Bjorson.

“Eventually, to reduce labor you need automation. Automation needs significant power, so a lot of these new buildings we walk into are very under-powered,” Bjorson continued. “It takes ComEd to come out and put in another 10,000 amps. These buildings have 4,000 amps and three out of four of my clients walk in and need 15,000.”

“Guess what our response is? `ComEd may be out in six to 12 months.’ Pretty quickly (the prospective tenants) shift the focus to another state—even if we have a big box sitting there. It’s just unacceptable on our (lack of) speed.”

Industrial building costs have risen to the \$200-to-\$300 per square foot range, which makes them difficult to finance, said West.

One of the factors that has diminished spec building, said Payette, is Corporate America “realizing they are going to need to do build-to-suits” because of their unique requirements.

Panelists noted Amazon’s undeniable impact on other tenants and the market as a whole, including its presence as a tenant and its formidable recruitment of labor.

“Amazon is always in the market,” Payette observed. “You never know if they’re going to transact. When they decide to transact, they come out of nowhere and as a tenant in the market, I think you always have to have your Plan B in place. Amazon can just come out of nowhere and their credit is going to trump anybody else in the market, and they’re going to take that building.”

Other companies prefer to be as far away from Amazon plants as possible, to reduce competition for labor, said West. In addition, landlords need to think about what effect bringing in Amazon would have on their other tenants, he said.

Another key facet is “the seasonal spike” experienced by all retailers, said Bjorson. West noted, too, that it is beneficial for industrial park neighbors to have those spikes at different times of the year.

As for what landlords should be preparing for in the future, Bjorson cited a movement toward more transparent lease structures. Tenants are also asking for more extensive tenant improvement packages, Payette said, while West pointed to life-safety and sprinkler system upgrades necessitated by increased storage of packaging materials such as plastic, foam and rubber.

There has also been a shake-out in the trucking industry, noted Leahy. To wit: over 600 companies in that sector have gone out of business this year, compliance with regulation on Electronic Logging Devices (ELD) is required **by the end of this year**, and there is the emergence of Uber Freight, including a **\$200 million investment in Chicago**.

Landlords benefit when they explore creative ways to underwrite and fund various operational costs, such as tenant improvement packages, West said.

“I think capital creativity is definitely key and the owners that can align themselves with multiple sources and creative sources of capital tend to win,” he added.

Regarding what advice they would offer young real estate professionals, panelists emphasized continually growing your knowledge, nurturing professional relationships, being open to change, and developing expertise that distinguishes you from your peers.

“Whatever path you go down, you need to be the expert,” said Leahy. “You need to be top-of-mind of `why is someone going to call you when they need assistance?”

During a question-and-answer period, audience members posed several questions seeking to delve deeper into subject that had been covered. On the topic of technology, Leahy said the development of robotics is one he is monitoring closely because of its ability to lower labor costs.

At the same time, “Europe is light years ahead of us, so I think robotics...inside the warehouse is going to continue to evolve,” Leahy continued. Amazon, for one, has invested heavily in it in recent years as it buys “enterprises to become more efficient,” he said.

Panelists also shared the outlook that the consolidation trend would continue. One factor driving it, said West, is the “Wall Street pressure for publicly traded companies to grow”—something much more readily done through acquisition than organic growth.

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