

What's driving distribution? CBRE experts weigh in on the industrial market

BY BRANDI SMITH

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Jack Fraker



Jonathan Bryan

In the pre-pandemic world, e-commerce was already a giant. Industry observers predicted it would account for more than a third of all retail sales by the year 2030. Now, roughly a year since we first heard about COVID-19, the virus helped accelerate the growth of e-commerce in a way few could have predicted in 2019.

“Even older Americans are now accustomed to buying things online, so it’s pervasive,” said Jack Fraker, vice chairman and managing director at CBRE.

Now that threshold of 39 percent of retail sales is viewed as something e-commerce could reach by mid-2027. To meet that consumer demand, Fraker said, there is and will be a need for much more industrial real estate.

Texas markets, such as Dallas-Fort Worth, Houston, Austin, San Antonio and El Paso, are benefitting from that push because of their ever-growing populations. On the one hand, explained Fraker, manufacturers want to get distribution hubs closer to their customers to satisfy the existing demands. More than ever, customers expect to receive goods within days of ordering, if not the very next day.

“All those retail products have to reside inside warehouses for a while,” Fraker said.

Along with satisfying retail needs, warehouses and logistics hubs are essential for growing communities. Before the tub, shower head, curtains, washer, dryer, carpet paint, floor tiles and ceiling fans can be installed in a new home or apartment, they must take up space in a warehouse located nearby.

The pandemic also revealed systemic flaws in the international supply chain, prompting manufacturers to relocate to the U.S. or Mexico.

“A lot of real blue chip U.S. corporations like the low cost of labor in Juarez, for example. They can assemble products on the Mexico side of the border, ship them across to El Paso and to distribute into the United States from there,” said Jonathan Bryan, executive vice president at CBRE, adding that those goods might end up in a warehouse in San Antonio as well.

On top of all that, Texas is an affordable place to set up shop compared to popular hubs on the east and west coasts.

“We have freeways that crisscross the state, as well as a number of great railroads. It’s a friendly right-to-work state with a low cost of living and tremendous population and job growth. Not to mention it’s really flat. That makes it easy to build,” Fraker said. “There’s a whole list of Chamber of Commerce reasons companies want to be here and that’s why the Texas markets are exploding.”

As much of a bargain as Texas industrial prices are, they’ve certainly increased in the past few years. Fraker points out that some of the new prototypes or big e-commerce companies are paying \$200 per square foot or more. That isn’t a deal breaker these days, however.

“The number one question the investor would ask us when we sell a property used to be ‘What’s the price per square foot?’” said Fraker. “It’s still asked, but it’s not the overriding question.”

That, he emphasizes, is usually related to other fundamentals. Investors want to know how much space is already available in the market, what the tenant profile looks like and the range of lease rates. They’re also keenly aware of the value of location over just about any other factor.

“A lot of users have realized they can’t only have three distribution centers that serve the entire United States. Just-in-time demand has created a need for more dots on the map, more locations,” Bryan said. “So we’re seeing a lot more demand in what we would categorize as secondary strategic markets.”

As examples, he cites Indianapolis, Columbus, San Antonio, Savannah and Reno, which provide more touch points closer to the population base as key for companies to be competitive. Many of those companies have developed algorithms based on where the customers are and where they need to be to get the product to the customer quickly.

“We like to say, ‘location trumps functionality’ or ‘location trumps age,’” Fraker

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said, explaining that many companies looking for an industrial footprint will take an older infill site over a shiny new building. “They sacrifice the clear height of the building. They don’t care as much about the length and depth of the truck court. What matters most to them is how long it takes to drive to the best customers.”

While the huge industrial deals are the ones that usually make the headlines, CBRE’s experts say smaller tenants are the core of the market right now.

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“We all talk about the million-square-footers, which are happening left and right. But at the same time, 20 or 30,000-square-foot leases are signed,” said Fraker. “If you visualize the national inventory of industrial real estate as a pyramid, the million-square-footers are at the top. The base of the pyramid is all the smaller tenants, who represent the vast majority of the universe of industrial real estate.”

The challenge now, besides fighting off the competition, is finding space for those small tenants. Most require infill interior sites, which are few and far between these days. Even when a site is located, it can be cost-prohibitive because you lose the economies of scale on a smaller building, resulting in higher rent. Fraker predicts that will prompt the industry to consider new prototypes, such as the multilevel industrial examples in Tokyo, Singapore and Hong Kong.

“In those cities, it’s not uncommon to see a 10-story, 1-million-square-foot building,” he said. “However, the floor plan is only 100,000 square feet. The buildings go vertical.”

That, Fraker added, isn’t something that’s necessary in a market like Dallas, where the topography is flat and there’s plenty of land. It’s more likely an option in urban markets such as Seattle, San Francisco or New York.

While they expect the sector to evolve and change over time, Fraker and Bryan agree that the white-hot demand for industrial will continue for at least a decade, possibly more.

“Some of these major e-commerce companies are trying to make sure they can have delivery to everybody within one or two days. That requires a very ambitious and long-term expansion plan,” Fraker said.

If you have to choose between throwing money in a savings account or even the stock market, it’s hard to argue against industrial real estate, especially in the current market.

“You get some very attractive returns,” Fraker said. “That’s what’s driving our asset class.”