



## The Future of Commercial Development at LA-LB

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Historically, the changing face of global trade patterns has offered industry experts a glimpse into what the future of industrial real estate will look like. From major changes in retailing and consumption to an increased demand for “green” real estate across all asset classes, industrial development has, by proxy, evolved almost simultaneously with each major change.

The new breed of industrial buildings around the Ports of Los Angeles and Long Beach—by far, the nation’s top two largest seaports in terms of container traffic volume—are a direct reflection of changes in global trade. To understand where development around the U.S.’ busiest ports is headed, it is crucial to first view the market from a 40,000-foot perspective. Consider this market snapshot:

- Container traffic volume down—Two separate reports released in February 2009 by the Ports of Los Angeles and Long Beach indicated that imports were down 38.8 percent and exports were down 32.2 percent from February 2008 levels.
- Smaller ports receiving diverted import containers—New environmental regulations, union issues and retailers’ contingency planning have led many companies to diversify their supply chains from the Ports of LA/Long Beach to smaller West Coast seaports, like Seattle/Tacoma, which are increasingly positioning themselves as a more cost-effective alternative
- Economic recession and credit crisis impacting foreign trade—At a time when credit markets are uncertain and consumer spending habits have put a noticeable dent in the strength of our nation’s economy, it comes as no surprise that foreign trade has suffered.

### Past milestones set the stage for innovation

Despite the obvious challenges posed by external market forces, industrial development around the Ports of Los Angeles and Long Beach will continue to remain strong. The evolution of industrial real estate development around both ports in the past 40 years alone is a testament to its ability to respond and adapt to changes in the global trade market. Three major milestones have contributed to the changing face of industrial development around the ports.

The advent of “containerized” cargo, for one, has driven the progression towards higher warehouse clear heights in modern port-adjacent industrial facilities. For years, shippers relied exclusively on break bulk cargo handling, where goods would be packaged in cases or pallets and stacked in the bulkhead of the ship for ocean transport. The advent of containerization, where ships only carry product in 20- to 40-foot individual containers, caused a major shift in how industrial buildings are used around the ports. Today, minimum performance requirements for most port-adjacent industrial facilities now include 24- to 32-foot warehouse clearance heights to provide optimal cubic storage capacity. Other features such as expanded and more secure truck yards that provide a greater turning radius, and the demand for more truck-high loading doors, are also a natural progression stemming from the surge in containerization.

In addition, an evolution in retailing logistics, coupled with the offshore manufacturing of goods, has changed how industrial buildings near the ports are used. Today's most successful retailers (e.g., Wal-Mart, Target, Lowe's) derive their efficiency, speed and, in turn, their profit margins, from their logistics capabilities. The introduction of these new models for how goods are handled — where individual retail stores only received product via sophisticated distribution networks — has fueled the rise of smarter, more efficient industrial facilities.

Finally, the rise in third-party logistics providers (3PLs) has influenced both the structure of the industrial building and the criteria by which industrial buildings around the port are selected. In today's market, 3PLs have essentially become a customer's real estate advisor. The business models of these outsourced logistics service providers have translated to a higher demand for industrial spaces with flexible office space, higher warehouse clear heights and lease terms which are more closely aligned with the length of provider contracts.

### **The next generation of development**

In one of the most constrained land markets in the U.S., it is difficult to envision what the next generation of industrial development around the Ports of LA/Long Beach may look like. The natural evolution of development around the ports will likely be driven by several key factors, ranging from technological advances to sustainable building mandates.

As rising fuel and energy costs squeeze the profit margins of industrial tenants around the ports, the demand for "green industrial" is expected to grow dramatically in the coming years. Coupled with the added pressure of complying with port-specific green measures, such as the recently enacted Clean Trucks Program, sustainable building will likely be a permanent development trend. Expect more buildings to be designed for LEED certification and an increased demand for green features, such as warehouse skylights, clerestory windows, and concrete truck yards (preferred over asphalt as a renewable resource coupled with superior structural integrity).

Continued advances in technology will also be a key driver of changing trends in industrial development. Today's high-performance material handling equipment and warehouse management systems require industrial buildings which are designed with stronger, reinforced concrete floors and warehouse lighting tailored to fit specific racking layouts. Today, new construction is designed with 30- to 32-foot clear, and, in the case of build-to-suit products, 36-foot and beyond. Häfele America Co., a major distributor of furniture and design hardware, for instance, occupies a build-to-suit-building in Torrance, California with a 40-foot clear height, which allows for maximum cubic storage of their products.

The lack of developable sites in such a land-constrained market has also led to an increased focus on the adaptive re-use of existing industrial facilities. The South Bay industrial market, which is contiguous to both the Port of Long Beach and Los Angeles, is primarily an infill market. Aside from the possibility of a handful of future brownfield developments, there are no remaining large parcels for development. Initially formed in the 1960s when the users were predominately manufacturers, industrial buildings in the South Bay were designed with high coverage, lower warehouse clearance, extensive auto parking and limited truck-high loading and turning radius. As the area evolved to serve the logistics industry, there emerged a need to rehabilitate early generation buildings to meet the requirements for modern distribution. To address this demand in their own portfolio, Watson Land Company instituted a multi-year rehabilitation program focused on its core holdings of over 10 million square feet in the South Bay region. Watson's approach has been to study each building in its South Bay portfolio, with a focus on improving both building aesthetics and functionality. Through updating and re-imaging building entryways, increasing dock-high door positions and expanding truck courts, Watson has successfully repositioned buildings, which might otherwise become functionally obsolete. With a strong demand from the logistics industry to be located close in to the ports and a lack of developable sites, it can be expected that adaptive reuse, along with demolishing functionally obsolete buildings to make way for new construction, will be an increasingly common approach to meeting the demand for functional distribution buildings in the region.

Industrial developers will continue to evaluate building upwards instead of outwards in order to meet the long-term demand for strategically located land parcels around the ports. Reinforced multi-story distribution centers, like Wal-Mart's four-story distribution facility in the Tokyo suburb of Misato City, may some day become an economically feasible option around the Ports of LA/Long Beach.

Another "outward" solution may be a greater push to build distribution buildings within master-planned industrial centers, which are located further inland. The Ports of LA/Long Beach PierPass Program, for instance, which was designed to reduce idle time at the terminal gates by encouraging off-peak movement of goods (thereby reducing the number of trucks queued up to enter or leave the docks), has created new demands for state-of-the-art inland facilities to accommodate change in the time of day when goods are being shipped and received. Retailers are increasingly looking for warehouse facilities built in master-planned centers, which have larger, secure truck yards, can accommodate 24/7 operation schedules, and are completely insulated from residential areas. Watson Land Company, among the largest developers of master-planned industrial centers in Los Angeles County, has continued to meet customer demands for these amenities, with its Watson Commerce Centers in Fontana, Chino, Redlands and Apple Valley, as well as its port-adjacent Watson Industrial Center, Watson Corporate Center and Dominguez Technology Center developments in Carson, California.

Finally, recent shifts in supply chain management philosophies have also ushered in changes to how users view port-adjacent industrial buildings. Uncertain economic times have prompted companies to shift their thinking from a "just-in-time" mentality to a "just-in-case" philosophy. Companies have an increased focus on hedging their bets, establishing contingency plans to protect the organization against future uncertainty, such as port strikes and natural disasters. The demand for warehousing operations that can handle more "safety stock" inventory (i.e., occupying buildings with higher warehouse clear heights, more sophisticated vertical racking configurations, etc.), will likely increase.

### **Looking toward the future**

As shifts in global trade patterns dictate new industrial facility demands around the ports, developers will continue to develop ways to incorporate new design standards that maximize efficiency and functionality. Industrial development around the Ports of LA/Long Beach, in particular, has always led the way in adapting to changes in the global economy, as evidenced by the past 40 years of progress. With an even greater emphasis on increased efficiencies and reduction in costs in the supply chain, port-adjacent industrial development in the South Bay will no doubt experience a whirlwind of change in the coming years.

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### **Sidebar: The Port of Montreal Shares a Development 'Vision'**

While port and industrial development projects move forward at the Los Angeles-Long Beach complex and surrounding areas, across the continent at the Port of Montreal, work is underway on Vision 2020—a project that will increase the port's capacity and develop new markets, while simultaneously creating \$3.4 billion in annual value-added return for the community and 41,400 jobs.

The four-phased Vision 2020 project was announced in April 2008. Last month, the Montreal Port Authority (MPA) said it had chosen Moffatt & Nichol, a Long Beach, California-based port engineering firm, to prepare detailed plans and preliminary engineering for a new container terminal, as outlined in Vision 2020.

Although actual construction may be postponed until the economy improves, MPA spokesman Jean-Paul

Lejeune confirmed that, “our whole Vision 2020 plan is going ahead, but the schedule for it is being changed.”

Phase I of the project involved optimizing existing container facilities, while Phase II (which involves Moffatt & Nichol's contract) covers the construction of three or possibly four new terminals by early 2013. Phase III will focus on the development of new infrastructures, most likely at sites located in the eastern end of Montreal and Contrecoeur. The last phase will allow the Port of Montreal to increase its capacity to 4.5 million TEUs (in 2007, the port handled 1.3 million TEUs).

Containerized cargo has emerged as the leading cargo sector at the Port of Montreal, transporting a wide array of products, from foodstuffs, alcoholic beverages, and construction equipment, to clothing and fabric, steel and alloys, and chemical products. Box trade is also fairly evenly split: 55% for exports and 45% for imports.

Approximately half of the port's containerized cargo traffic is destined for, or comes from, the Canadian market, mainly Quebec and Ontario. The other half is to or from the U.S. market, mainly the Midwest (Illinois, Michigan, Minnesota, Wisconsin, and Ohio) and the Northeast (New England and New York state).

### **Sidebar: New Jersey Finds Value in Portfields**

Similar to industrial real estate developers in the Los Angeles-Long Beach region, those in the equally coveted market surrounding the port of New York-New Jersey have turned their attention to portfields, or underutilized brownfields, as sites that could support industrial development.

The Portfields Initiative, launched several years ago by the Port Authority of New York & New Jersey and the New Jersey Economic Development Authority, was designed to spur new development projects and economic opportunities in the Port District—defined as the area within an approximately 25-mile radius around the Statue of Liberty—in order to accommodate the growing demand for cargo and warehousing facilities.

To assist companies and developers, the New Jersey Portfields Initiative provides financial incentives, access to affordable capital, planning and other technical expertise, and coordination with state agencies for expedited project permitting and approvals to accelerate development. In addition, development assistance is sometimes available in the form of employee tax incentives, business tax credits, and workforce training grants.

At the same time, the New Jersey Economic Development Authority has created the Brownfields and Contaminated Site Remediation Program, which targets developers in the state in need of financial assistance to clean up and redevelop polluted sites and closed municipal landfills.

Under the program, a developer can enter into a redevelopment agreement with the authority and be eligible to recover up to 75 percent of approved costs associated with the remediation effort.