

HOWARD KOZLOFF

# Ready About

**U.S. East Coast and Gulf ports are upgrading facilities in anticipation of supersized ships transiting the Panama Canal in 2014. Some smaller port cities are strategically positioned to fight for their share of the new business.**

DESPITE THE PROLONGED SLUGGISH economy, port cities up and down the East Coast of the United States and along the Gulf of Mexico are preparing hopefully for an increase of port-related activity that is expected to accompany the 2014 completion of the \$5.3 billion Panama Canal expansion. With a 300 percent increase in capacity through the locks, industrial real estate owners will be among the beneficiaries, capitalizing on a combination of current property devaluation in some markets due to the financial downturn and medium- and long-term value appreciation through economic recovery and improving real estate fundamentals.

The Panama Canal expansion project will build a new lane of traffic along the Panama Canal through the construction of a new set of locks allowing increased traffic and

wider ships. Giant container ships are now prevented from transiting the canal because their width is greater than that of the locks. Instead, they head for West Coast ports, where the freight is discharged to trains that cross the country, destined for major markets in the Midwest and on the East Coast.

As a result of the expansion, the bigger ships able to travel between the Pacific and Atlantic oceans will have nearly three times the capacity of today's ships, which carry about 5,000 twenty-foot equivalent units (TEUs). The new ships, dubbed the Super Post-Panamax Class, will have a capacity of 13,000-plus TEUs. This greatly increased capacity means it will become less expensive and more efficient for ships to travel directly to the East Coast, as opposed to the current pattern of unloading at West Coast ports and shipping goods across the country by truck or train. At an estimated savings of nearly \$1,000 per cargo container, or nearly 30 percent, the incentive to ship directly to East Coast ports is

*The MSC **Burxelles**, the largest container ship ever to call at the Port of Virginia, is guided into the Hampton Roads Harbor by tug. The port, located near Norfolk, is the deepest on the East Coast.*



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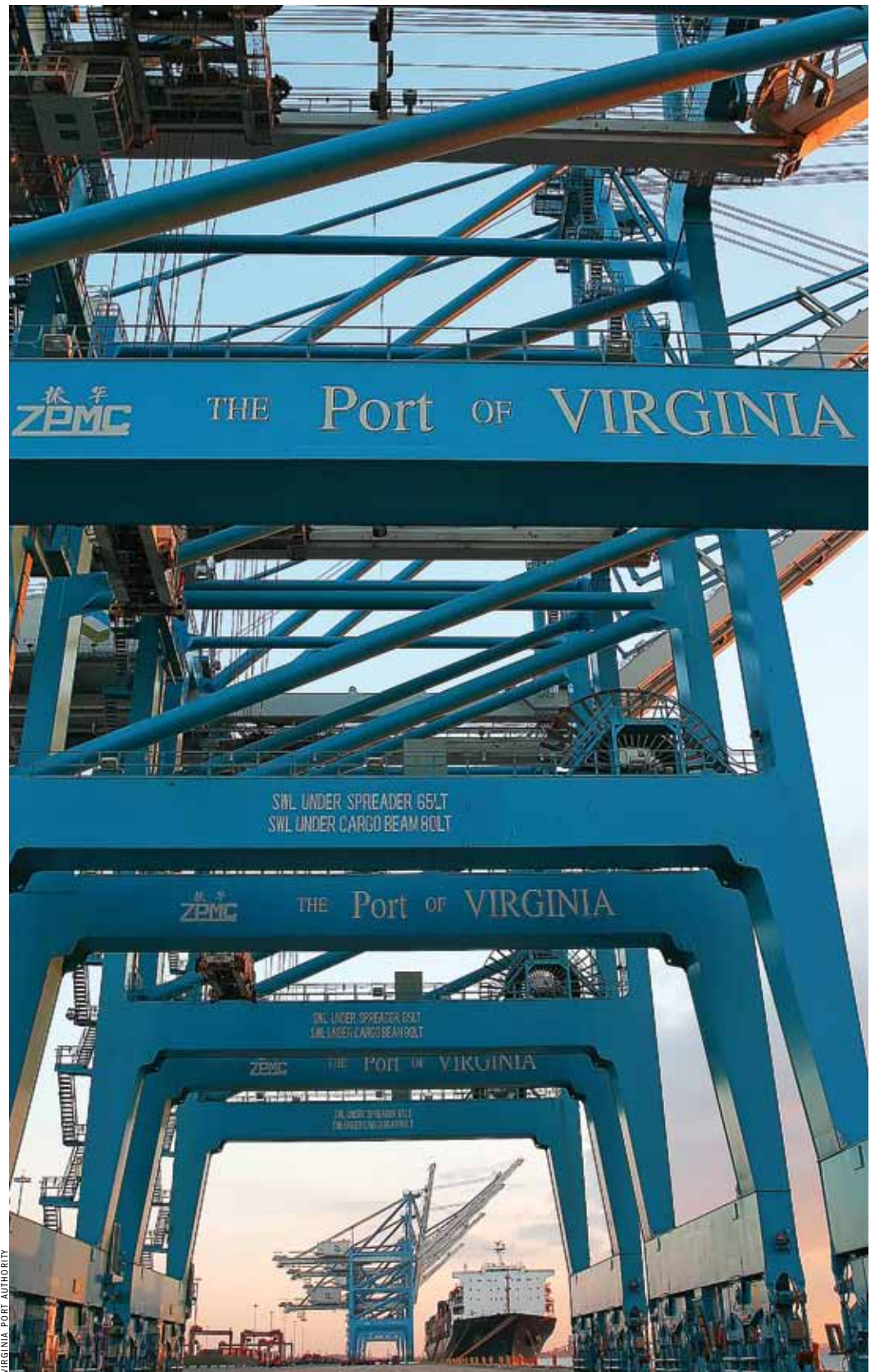
significant. As a result, East Coast ports have been upgrading, dredging, and expanding their ports in anticipation of bigger ships—and an increased number of them.

John Carver, executive vice president of port, airport, and global infrastructure with Jones Lang LaSalle, notes that the boundary between cargo destined for east and west regions will change. “Traditionally, anything destined for cities east of Memphis, Tennessee, has been shipped through the canal, and goods for cities west of that point have been shipped to the West Coast,” Carver recently told GlobeSt.com. “With the larger ships coming through, that pushes the line closer west, to about Dallas.”

Information culled from multiple shipping companies by the Gerson Lehman Group calls for 40 percent of imports to the United States originating in Asia to travel through the expanded Panama Canal. This includes upwards of 25 percent of traffic currently offloading on the West Coast, since shipping companies will find it more cost-effective and more efficient to switch to the new all-water route. With China’s role as the world’s largest exporter, the volume of increased container traffic is significant. U.S. export traffic is on the rise as well, as completed products are increasingly in demand in foreign countries. After all, exports are dependent on ports, too. There will also be significant boosts at inward points along the cargo chain, as unloaded cargo from ships makes its way along roads and rails to points inland. Supply-chain management will become ever more crucial, and real estate that is strategically located along those chains will continue to garner competitive advantages.

In a push to try to create more American jobs, President Obama has proposed doubling the total volume of American exports over a number of years, which would translate into the creation of roughly 2 million new jobs. If these new jobs materialize, they would fuel demand for as much as 500 million square feet (46.4 million sq m) of industrial space within America’s largest port markets. Given the ongoing political deadlock in Washington, however, no policy agendas are certain. But higher employment and growth of small-business exporters would increase traffic among ships bearing imports—and American-made exports.

The Port of Virginia is home to the largest container cranes in the country.



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The confluence of increased and improved port activity and capacity with depressed real estate prices and committed external private and public investment represents a time-sensitive opportunity to create real estate value in relatively large and growing communities.

The general industrial market in the United States, which includes warehouse and flex space, is on sound footing as it emerges from the current market downturn. The combination of minimal overbuilding in the industrial sector and overall vacancy below that of other commercial asset types leads to better fundamentals. In 2010, the World Trade Organization noted a record 14.5 percent increase in world trading volume. After falling by 12.5 percent in 2009 and averaging 6 percent annual growth from 1990 to 2008, this was a substantial uptick in activity. Brokerage firm Grubb & Ellis says the continued growth of international trade will lead to growing demand for logistics space. Recognizing this, research firm Preqin notes a target private equity raise of \$1.8 billion specifically for industrial real estate, the most since 2006. And, through July 2011, New York City-based Real Capital Analytics tracked a 46 percent increase from a year earlier for sales of industrial properties, with average cap rates at 7.8 percent, according to Cushman & Wakefield.

Increased demand from world trade, increased transactional activity, and general optimism in the face of larger economic concerns have all led to improvements in national market fundamentals. Cushman & Wakefield's midyear 2011 industrial market report revealed the following national trends:

- ▷ The overall vacancy rate declined to 9.7 percent, down from 10.6 percent a year earlier and the lowest since the first quarter of 2009;
- ▷ Year-to-date leasing activity totaled 144.8 million square feet (13.4 million sq m), an increase of 14 percent over the first half of

- 2010, when 126.6 million square feet (11.7 million sq m) was leased;
- ▷ 8.9 million square feet (827,700 sq m) of new industrial space was delivered year to date, an increase over 2010's first-half delivery of 8.2 million square feet (762,600 sq m), with the report noting that 30.1 percent of the 2010 space was built on spec, whereas 11.2 percent of 2011 space was built on spec; and
- ▷ Overall absorption year-to-date is 38.1 million square feet (3.5 million sq m), marking three straight quarters of positive absorption and up from negative 12.9 million square feet (1.2 million sq m) at the same time in 2010 (absorption for the first quarter of 2011

in industrial demand—that for every 1 percent gain in TEU volume, industrial demand goes up approximately 0.33 percent.

The recovery of global economic growth will continue to gain momentum, and demand for industrial space is expected to follow suit. The Gerson Lehrman Group and Global Real Estate Monitor cite industrial real estate as a top investment prospect moving forward, noting that “stability and growth opportunities put the sector head and shoulders above other types of commercial property.”

East Coast ports are readying for the changes that will accompany the Panama Canal expansion. The expected shift in



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was about 8 million square feet [744,000 sq m] and the second quarter of the year saw over 30 million square feet [2.8 million sq m] of positive absorption).

As the recovery matures, industrial users will be at the forefront of activity to meet demand, and landlords may be able to increase rates at that time, likely in advance of office and retail owners. Recent reports from multiple industrial real estate brokerage firms and industry organizations note the clear relationship between port activity and change

**Trucks drop off and pick up containers in the transfer zone at Norfolk International Terminals. Increased traffic through the Panama Canal is expected to benefit manufacturing and logistics businesses.**



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wcustomers to those ports is resulting in a set of upgrades and intermodal expansion to facilitate the movement of containers. This includes dredging waterways, lengthening and reinforcing wharves, procuring Super Post-Panamax gantry cranes, and improving intermodal centers to process and transport containers faster and more efficiently.

Although most ports along the eastern seaboard and Gulf of Mexico—including some of the nation’s busiest ports in the New York/ New Jersey metro area, Philadelphia, Baltimore, Jacksonville, Miami, Alabama, southern Louisiana, and Texas, among others—have plans and strategies in place to capitalize on the canal expansion, some smaller markets seem relatively overlooked, despite the significant advantages they offer. These include the Port of Virginia (near Norfolk in the Hampton Roads area); Charleston, South

Carolina; and Savannah, Georgia, all of which act as gateways to the major regions of the Piedmont—Atlanta, Charlotte, and Richmond—and beyond.

The Port of Charleston has begun a ten-year plan at a total cost of \$1.3 billion aimed specifically at improvements to handle expected additional cargo. The director of the Virginia Port Authority, Kevin Burwell, says he expects that the Port of Virginia will see an increase of 500,000 TEUs or more. In Savannah, the Georgia Ports Authority is seeking permission from the Army Corps of Engineers to dredge its waterway, possibly adding an entire new port area to accommodate additional cargo.

Increased economic activity in these areas, specifically in manufacturing and logistics, increasingly rely on imports of foreign goods. Imports will continue to rise for both complex goods (i.e., those used in manufacturing) and

**East Coast ports are upgrading intermodal centers to transport shipping containers more efficiently. At Norfolk International Terminals, the truck gate handles hundreds of trucks every day, but nearly one-third of the port’s annual cargo volume moves on rail.**

common goods, such as household items, electronics, and toys. Increased imports benefit port business and ancillary services, create jobs, and drive demand for workforce housing.

In the Hampton Roads market, specific opportunities present themselves as the area's port infrastructure and locational advantages combine to create unique fundamentals. The Hampton Roads area, which includes Norfolk, Chesapeake, Virginia Beach, and Suffolk, is the largest metropolitan area between Atlanta and Washington, D.C., with a population exceeding 1.5 million. Hampton Roads lies within 750 miles (1,200 km) of 75 percent of the U.S. population, according to the city of Portsmouth, part of the Hampton Roads region. The economy is diversified, with major employers focused on ports, the military, education, shipbuilding, and tourism. Due to its affordable housing, high quality of life, and excellent health care, the region has excellent growth prospects even in the face of economic doldrums.

As one of the major population centers in Virginia, Hampton Roads benefits from a generally pro-business environment. This is attributable to factors including workers' compensation rates that are 47 percent below the national average, a corporate income tax rate of 6 percent that has not been increased since 1972, and a regional diversity represented by 180 international firms from 27 countries.

Hampton Roads is composed of the Southside and the Peninsula. The Southside comprises the cities of Norfolk, Virginia Beach, Suffolk, Chesapeake, and Portsmouth; the Peninsula includes the cities of Hampton and Newport News. Of the region's more than 1.5 million people, over 100,000 are military personnel. As military base realignments continue, the region has benefited through the expansion of Navy and Marine Corps bases. Northrop Grumman Shipbuilding has a headquarters in the region, and Old Dominion University in Norfolk, with more than 23,000 students, provides an educational bulwark with quality of life, well-trained prospective employees, and regional recruitment benefits. In addition, the region's major health care center—Sentara Norfolk General Hospital—is repeatedly cited by *U.S. News and World Report* as ranking among "America's Best Hospitals," providing another population recruitment tool and a further boost

to quality of life. When considered in tandem with the tourist destinations of Virginia Beach and nearby Williamsburg, the Hampton Roads region is diversified across various industries and among a strong foundation of attractive quality of life-based amenities.

The population in the region continues to grow as a result of the South's relatively low cost of doing business, available productive workforce, a solid business climate, easy access to markets, and appeal as a place to live. Improved education, continued economic diversification, a mild climate, and easy access to ports are positive attributes upon which to build.

**Although most ports along the eastern seaboard and Gulf of Mexico have strategies in place to capitalize on the Panama Canal's expansion, some smaller markets seem relatively overlooked, despite the significant advantages they offer.**

Norfolk, home to the Port of Virginia, is the center of the Hampton Roads region, itself a gateway to the Southern Piedmont region. The Piedmont megalopolis, also referred to as the Piedmont Atlantic Mega Region or the Southern Cross, is centered on the major axes from Nashville to Chattanooga, Tennessee, and Atlanta to Macon, Georgia. This includes other major population centers such as Charlotte and Raleigh-Durham, North Carolina; Birmingham, Alabama; and Greenville-Spartanburg, South Carolina. These are established cities with diverse economies at varying scales.

Already the deepest port on the East Coast—and among the busiest in the country—the Port of Virginia is making investments in upgrades needed to compete in a Super Post-Panamax world. In 2007, APM Terminals opened the most technologically advanced container terminal in the world.

Two years later saw the beginning of development of the Craney Island Terminal, which will be the largest terminal in the harbor; it is projected to open around 2020.

In addition, the Port of Virginia is the coastal base of the Heartland Corridor, a rail line traveling directly to the Midwest through Ohio and into Chicago. The Heartland Corridor was recently upgraded to permit double-stack trains for the length of the railway, thereby doubling capacity. In general, there is an expectation within the Hampton Roads business community that Virginia will handle more container traffic in the future than the port of New York/New Jersey.

The large port, which is well ahead of the curve on preparations for growth, and the presence of the Heartland Corridor are significant positives for the Hampton Roads region, which appears ideally situated to capitalize on current and anticipated port activity through undervalued industrial properties.

A general strategy of real estate investment that capitalizes on the combination of depressed prices already in place, a slow but gradual economic recovery, and a smaller supply overhang due to a lack of overbuilding provides support for property exposure. Furthermore, with multiple reports calling for sluggish commercial real estate markets, an industrial strategy to take advantage of low valuations now to benefit from appreciation due to port growth and economic recovery later holds promise. With the combination of depressed property values as a result of the protracted economic downturn, sound asset-type fundamentals, and multiple sources of external investment in port-related facilities, industrial real estate is poised for value creation as the global economic recovery takes hold and the Panama Canal expansion reaches completion. **UL**

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