CIBA Real Estate

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Business Seminars

Monrovia Business Seminar
TBD

MADIA TECH LAUNCH
Wed., Jun. 13, 6:30-8:00pm
Tanner Research
Molly Schmid (TCA)
Angel Funding

Monrovia Kiwanis
Meets at the Monrovian Restaurant
Every Thursday 12-1:30 PM

Duarte Kiwanis
Meets at Westminster Gardens
Every Other Tuesday 12-1:30 PM

Quotes for the Month

"Whenever you find yourself on the side of the majority, it is time to pause and reflect."
Mark Twain

"Great minds discuss ideas; average minds discuss events; small minds discuss people."
Eleanor Roosevelt

"I have not failed. I've just found 10,000 ways that won't work."
Thomas A. Edison

"A successful man is one who can lay a firm foundation with the bricks others have thrown at him."
David Brinkley

Could Industrial Real Estate Get Caught in Trade War Crossfire?

APRIL 06, 2018|JACQUELYN RYAN

Larry Callahan heads one of the largest developers of industrial real estate in the Southeast, with projects located from Tennessee to Florida.

As the chief executive of Patillo Industrial Real Estate in Georgia, Callahan leads his family-owned business in developing and managing warehouse-distribution projects for businesses as varied as compressor creator Bitzer U.S. Inc. to King's Hawaiian Bakery.

Like the rest of what is known as the industrial real estate market, the hottest asset class in all of commercial real estate for the past two years, Callahan's business has been booming.

Right now, he's not too worried about the impact of President Donald Trump's posturing on trade.

"I do not believe that the first impact of tariffs (and retaliatory tariffs) has been fully priced into assets like industrial real estate," he said. "And I would argue that the impact of a first round of tariffs on the pricing of industrial real estate is minimal."

But late yesterday, President Trump escalated the risk of a trade war by further increasing proposed tariffs by $100 billion on a number of Chinese products as the two countries continue to exchange threats. The change from campaign rhetoric to trade policy has caught some by surprise.

This morning, Chinese officials threatened further retaliation if the U.S. moves forward with new tariffs.

If fears of a full-scale trade war come to fruition, Callahan sees a different story unfolding. He said the risk to industrial real estate becomes worrisome if a full-scale trade war erupts and slows down the overall economy.

"A no-growth economy hurts everyone," said Callahan.

Callahan echoes what many in the industrial real estate market are saying now about how rising protectionism and a threat of trade war are affecting the U.S. industrial real estate market.

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"It would have to be a pretty massive trade war for it to impact industrial real estate directly," said Rene Circ, director of U.S. industrial research for CoStar, adding that anything that impacts the entire economy would certainly affect industrial real estate.

Conditions in the industrial real estate market remain strong - with vacancy at historically low numbers across the nation - but the threats have prompted fears of an all-out trade war between the U.S. and China have left some industrial real estate stakeholders watching events unfold with anticipation.

"If these tariffs become real, they would have an enormous impact," said Richard Green, director and chairman at the USC Lusk Center for Real Estate at the University of Southern California. "If consumer goods become more expensive, people will buy them less and that's not good for industrial real estate and the warehouses that hold [those goods.]"

Last month, President Trump authorized increases on tariffs on steel and aluminum imports and is considering more in response to China's industrial and technology policies. China retaliated this week by proposing a 25 percent increase on 106 U.S. goods including on such items as soybeans, automobiles, aircraft and orange juice.

The tariffs on steel and aluminum imports prompted dire warnings from architects, contractors, REITs and real estate lobbying groups who said the tariffs could put more pressure on already rising building costs and cause developers and investors to postpone, cancel or steer clear of new projects.

This week, Real Estate Roundtable President and CEO Jeffrey DeBoer said the new proposed tariffs, coupled with the earlier tariffs on steel and aluminum and the ongoing dispute with China, could have "unfortunate and unintended effects on the U.S. economy by raising construction costs and reducing jobs in real estate development."

Everything from consumer goods to physical container traffic could be hit by the tariffs and that could have a domino effect.

"It has been on investors' minds since Trump took office because there has been discussion about trade wars and what happens if," said Mike Kendall, Western region executive managing director of Investment Services for Colliers International in Irvine, California. "There should be an impact eventually in industrial, but it hasn't happened yet. The real estate market is not like the stock market. The stock market is real time. In real estate, it takes a lot longer to find its way into the process and pricing. Since it [threat of trade war] is so new, we haven't seen it yet."

A more immediate concern is rising construction materials and development costs, since most of our steel and aluminum is imported from Canada, Mexico and South Korea.

Jeff Givens, senior vice president at Los Angeles office and industrial developer and owner Kearny Real Estate Co., said he has colleagues who already are hitting pause on new development projects.

"I've heard from others who are in the bidding process [for a new project], with their different subcontractors involved in steel and other commodities that are being discussed [for increased tariffs]," he said. "They have pulled their current bids and are reevaluating, I have a colleague who was ready to go forward on a big-box warehouse and the steel providers said the bid we gave you six months ago is no longer valid; we'll get back to you."

That kind of uncertainty has an effect beyond just proposed projects. Bret Hardy, who focuses on institutional industrial investment sales as executive managing director of the Western region capital markets team at Newmark Knight Frank, said while it's still too early to fully understand the result of the steel tariffs, he's heard estimates that steel costs could increase by as much as 30 percent.

"When you are looking at the infill industrial real estate market in Los Angeles metro that is priced to perfection, any incremental cost of construction could have an equal impact on the value of the land and the value of the projects," he said. "So steel costs are a concern right now."

To be sure, industrial construction doesn't appear to be slowing down. More than 2.3 million square feet are under construction in the Los Angeles metropolitan area alone, the largest industrial market in the country, according to CoStar Group data. In the industrial market around the Ports of L.A. and Long Beach, the vacancy rate is below 1 percent - and brokers report few signs of pullback.

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In neighboring Inland Empire, one of the nation's largest industrial and logistics markets, two deans of the industrial real estate brokerage market agreed that the current atmosphere of protectionism and the prospects of a trade war haven't been a factor among logistics occupiers, owners and developers. At least not yet.

"There has been no real chatter among warehouse developers or investors out here," said Paul Earnhart, senior vice president with Lee & Associates, who has completed over 1,000 transactions for a combined $4 billion in deal value over more than 30 years in the Inland Empire.

A prolonged conflict with China or worse, a collapse of the current NAFTA treaty affecting two of America's strongest trade partners, Mexico and Canada, could change that over the next year.

"The possibility of a long trade war has been on the mind of most of these logisticians to some extent," acknowledged Chuck Belden, executive vice president with Cushman & Wakefield's Ontario office since 1984.

Late last year, the possibility of a tariff on appliances, combined with fears of the demise of Sears and JCPenney during the holiday shopping season, actually created a temporary bump in demand for Inland Empire warehouse space. LG, Samsung and other appliance makers stockpiled inventory and scooped up space where they could find it in anticipation of the tariff, combined with their reluctance to ship product without prepayment to the two financially ailing department store chains, Belden said.

But recently, the prospect of new tariffs has not had the same effect.

"I haven't seen any pullback in the number of property tours or interested parties," Belden said, adding that most logistics companies and distributors are more concerned about finding available labor, especially drivers. "I've seen a slight pullback in consummated transactions, but that may be a function of a lack of available inventory."

"But if Trump blows up NAFTA, everything I just said goes out the door," Belden said.

Should a proper trade war break out, the impact among industrial real estate may vary by city.

"Population markets have insulation versus a market that is more about serving the population elsewhere," Kendall said. "Some of these markets like Memphis that are big hubs for UPS and FedEx that service national distribution, they may feel more of an impact than primary markets."

Take Southern California, the country's largest industrial market, for example.

Earnhart noted that one local client, a well-known car windshield installation company, told him late last year that its Chinese supplier, which had previously shipped windshields from China to Southern California, had recently purchased a former auto manufacturing plant in his hometown of Dayton, OH.

Now, 60 percent of the local company's windshields come to its Inland Empire distribution center from Dayton.

"No matter where those windshields are made, they're being warehoused here because this is where all the people live," Earnhart said.

Not everyone is worried about tariffs. Some are optimistic that domestic production picks up where foreign production drops off. Others are betting that the threat of tariffs is just a negotiation strategy that won't become reality.

For now, Kendall agrees, most industrial real estate stakeholders will take a measured approach, as he recalled discussion of a trade war that never came to fruition last year.

"We have seen this enough before where there's an overreaction to what happens," he said. "People are almost getting jaded by all this news and are thinking I just need to focus on what actually happens. Until we see an impact, we aren't going to change our business plans."

As for Callahan, he agrees: "There are always issues to deal with, but we are optimistic about the future."

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