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Ocean Liner Cutbacks One More Blow To Industrial Real Estate

Maersk pulls eight container ships on mounting news of stagnating activity

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In a move signaling the distress the shipping industry faces with the global contraction in trade, the world's largest container shipper, Maersk Line, pulled eight of its ships from the water in November.

"In view of the market conditions, we have reached the point where laying up the eight vessels makes better economical sense than redeploying them," said Michel Deleuran, who is in charge of Network and Product for Maersk Line. "Freight rates remain under severe pressure, and in several corridors the rates do not fully cover our variable costs."

The Danish shipper's response to what is now a global contraction in trade is yet another obstacle for the short- and long-term growth of the Los Angeles and Inland Empire industrial submarkets.

Maersk dealt another blow to the Southern California ports when it said that it would move much of its business at Tacoma and Los Angeles to the Port of Seattle. And North Carolina-based shipper Horizon Lines Inc., which has operations in Southern California, said that it would cut at least 10 percent of its workforce.

Additionally, Japanese shipper Nippon Yusen Kaisha Line said it would cut back on the company's original expansion plans announced in March.

And despite optimism that slowing Los Angeles and Long Beach port activity is a short-term result of the credit crunch, a London-based maritime consulting firm said problems at the ports are indicative of more fundamental challenges facing California and the rest of the West Coast.

Drewry Supply Chain Advisors says that when the world economy picks up again, strong growth will emerge on the Gulf and East coasts. While volume at the West Coast ports is unlikely to see a drop long-term, the days of "strong growth on the Pacific Coast are behind us," according to the firm's white paper.

Maersk's decision to adjust its routes may be indicative of this trend. The consolidation occurring in the shipping industry is more evidence of change, although that is not an entirely new trend.

When the widening of the Panama Canal is complete in 2014, Drewry said it would make the Gulf and East coast ports a more attractive option to welcome in goods from Asia.

"Future growth in Asian trade to the U.S. is more likely to benefit the Gulf Coast ports - served by the Panama Canal - and the East Coast ports, handling Southeast Asian cargo routed via Suez," the paper said.

Laura Stone-Mortimer, a senior economist and vice president at **Torto Wheaton Research**, also echoed a similar sentiment saying that the expansion has the potential of bolstering trade. However, she noted

that in order for that change to actually take place, East Coast ports would have to expand their terminals to accommodate larger ships.

No one, however, is denying the significance of Los Angeles and Long Beach as a gateway for goods movement.

While Jeff Morgan, senior vice president in **CB Richard Ellis'** Torrance office, acknowledged that improvements to the Suez and Panama canals will affect container traffic going into Gulf and East coast ports, he is optimistic about the vitality of the Los Angeles and Long Beach ports.

"It will have a significant impact on container traffic going into the Gulf Coast - Jacksonville, Atlanta and other ports on the East Coast, but Los Angeles and Long Beach will still remain a vibrant port," he said, "albeit, perhaps after 2014, at a somewhat subdued growth."

Short-Term L.A. Possibilities

Many maintain that the West Coast ports will regain their strength after the market correction.

In a move that perhaps reiterated not all is bleak, the distribution and warehouse service arm of Maersk, Maersk Distribution Services Inc., did renew two significant leases totaling nearly \$20 million.

The five-year lease renewals in Carson and City of Industry may have reinforced some the company's confidence in the Southern California industrial market, according to **Voit Commercial Brokerage**. Voit brokered the leases on behalf of Maersk.

The South Bay, which has the closest ties to activity at the ports, came out of the fourth quarter with a 2.7 percent vacancy from 2.6 percent in the previous quarter, according to CB Richard Ellis. Morgan said he is continuing to see the trend of negative net absorption, but that vacancy and availability statistics are healthy.

"There was zero additional storage requirements this year," he said. "Sales are almost nonexistent because of the lack of financing."

The disappointing retail sales this past holiday season made more space available to rent, according to Nancy Sidhu, chief economist at the Los Angeles Economic Development Corp.

"What we're seeing is a question of pull-through," she said. "If retailers don't want to stock as much, they don't want to load as much and goods don't need to be stored. There's a bunch of sublease space in particular that's now available."

But Morgan said he is not seeing a large amount of sublease space in the South Bay. However, he said it is possible that trend will surface at the beginning of the year.

"This whole financial meltdown only occurred in October," he said. "It takes a while for people to go through their savings and business plans before they jump out of the airplane."

The Los Angeles and Long Beach ports were on track to report their slowest year since 2004, according to the most recent Port Tracker report put out by the **National Retail Federation** and IHS Global Insight.

According to the report, a 4.9 percent drop in 20-foot equivalent units, or TEUs, is forecasted for January followed by a 9 percent decline in February. However, a 2.5 percent increase from the year-ago period is anticipated for March.

According to Morgan, the effects of imports and export volumes directly impact the industrial market in the South Bay.

"We have, plus or minus, 40 percent of the market is a manufacturing-assembling base and 60 percent of the actual square footage is warehouse distribution-related," he said. "But manufacturers and users don't tend to turn over as quickly or as routinely as third party logistics companies because the amount of investment required to set up a manufacturing plant."

The bad news did not stop **Western Realco** from breaking ground on its 400,000-square-foot speculative distribution facility in the City of Commerce. Gary Edwards, Western Realco principal, said the facility's proximity to the ports, freeway access and central location within Southern California will attract potential companies.

"We're cognizant of the marketplace, and we know that there are a number of external factors which are affecting values going forward," said Edwards. "We're hopeful that given the location and uniqueness of product that we'll be positioned to withstand the negative issues."

The facility is slated for completion in late April to early May.

Continued I.E. Slowdown

Farther inland, Western Realco also has several projects in the Inland Empire. However, Edwards said the company's current focus is on submarkets closer to the ports.

"We will always be a proponent of the Inland Empire," he said. "We do view that as a long-term viable industrial marketplace, but in the near-term we will be focusing on opportunities that we're seeing closer in. We won't abandon the Inland Empire marketplace by any means."

With the ports component acting as an engine that helped push industrial development into the Inland Empire now sputtering, Jay Dick, senior vice president in CB Richard Ellis' Ontario office, said the impacts have been significant on the region's industrial market.

"A large part of our demand is retailers that are importing into Los Angeles and Long Beach," he said. "If you look at the tenant mix, it's Wal-Mart, Costco, Home Depot, and while they may not get all of their goods from the ports, a lot of it comes from there."

Overall, vacancies increased to 8.6 percent with cities such as Redlands and Moreno Valley seeing an oversupply of speculative development, according to a **Grubb & Ellis** third-quarter 2008 report.

"For a lot of the West Coast markets, especially those in California, a lot of demand there is driven by the flow of imported goods," said Luciana Suran, an economist at Torto Wheaton Research. "The West Coast markets in California are driven by demand. A lot of what ends up in Riverside comes from Los Angeles."

For the time being, Collette Hanna, business development manager for the city of Victorville, said that industrial development is still occurring within the city.

Dr Pepper Snapple Group invested \$120 million for the construction of an 850,000-square-foot facility at Southern California Logistics Airport consisting of warehouse and manufacturing space. Construction began in October on what will be the company's Western distribution hub. It is expected to be complete in mid-2010.

"We are seeing some activity with companies that are financially stable and financially sound that might be looking into this market whether they have a port-related activity or not," Hanna said.

One factor that may bode well for the Inland Empire is interest from out-of-state and international companies looking for space. However, Dick said that type of interest is nothing new.

"I worked with a large company that initially wanted to be in downtown L.A., but because of the size of their facility, there was no additional land to accommodate that," he said. "They went to the east Inland Empire, not because it was their choice, but it was the only place to develop their distribution center."

In the case of suppliers, Dick said it just makes sense for some to be in the Inland Empire where their clients are, but he remains optimistic that in the future import growth will return to the ports.

"I think one sign that will lead us down the road to a stronger market will be an increase in inbound TEUs," he said. "Inbound TEUs are an important factor to healthier market conditions."

For those brokers and developers doing the deals on the West Coast, Southern California industrial will continue to be the least volatile of the asset classes and the expectation is that when the market recovers, growth will resume.

"There's still 18 million people in Southern California," Morgan said. "There still has to be product that comes through here."