

Oil Costs Change Indus Real Estate's Supply/Demand Equation

By Angela Pruitt, of Dow Jones Newswires

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NEW YORK (Dow Jones)--One way to cut fuel costs is to reduce the distance traveled.

That's the argument being made by industrial real estate companies with distribution centers near populated markets. Among those companies, San Francisco-based AMB Property Corp. (AMB) is considered among the best-positioned because over 90% of its distribution centers are located in so-called infill markets, or developed areas.

"When fuel was cheaper, people would opt to go further and further away from population centers," Chief Executive Hamid Moghadam said in an interview, adding that companies were willing to pay the higher transportation costs in remote locations for lower rent. Now truck drivers, feeling the pain at the pump, may be compelled to travel less distance to move products to designated distribution centers. As a result, Moghadam is betting that infill real estate will become more valuable and tenants less rent-sensitive as they look to cut down on fuel-related expenses.

Most of AMB Property's facilities are located in the infill submarkets of its targeted markets and stationed near airports, seaports and ground transportation systems.

"With higher energy prices, ... (companies) are less likely to go in far-out locations (and more) likely to put their distribution centers closer" to population centers, Moghadam said.

Fuel costs amount to 15% to 20% in the trucking sector. Comparatively, the cost of renting a distribution facility may not exceed 5% of total logistics costs, according to Green Street Advisors in a recent report. The firm also said higher transportation costs will likely compel manufacturers and logistics providers to review the total costs of goods. As a result, fewer products will move and less distance will be traveled for delivery, the report added. Wall Street is already sizing up which industrial real estate investment trusts are best suited to prosper amid exorbitant gas prices tipping \$5 a gallon for diesel fuel.

Owners of larger distribution centers in peripheral areas will be negatively impacted, said Cedrik Lachance, a senior analyst at Green Street. "Those are the companies that will have to ask, do they really need something in Columbus, Ohio?"

Lachance said AMB Property and ProLogis (PLD) are best-positioned because of their ability to develop infill and brownfield land. DCT Industrial Trust Inc. (DCT) and First Industrial Realty Trust Inc. (FR) are among the most vulnerable companies because of their significant exposure to markets in relatively remote parts of middle America, he added.

Denver-based DCT Industrial did not return phone calls seeking comment.

First Industrial said it's comfortable with the location of its properties. "We like all the markets that we are in," said Art Harmon, director of investor relations and corporate communications for the company. He noted the majority of the company's properties are in the major industrial markets in North America and "diversified across a number of markets."

"We're not seeing companies radically changing, as supply chains are constantly evolving," he said, noting it takes a while to move facilities.

Nonetheless, First Industrial is positioning itself to capitalize on the shifting market dynamics by exploring fuel-efficient developments for its customers. The Chicago company is eyeing distribution centers linked to intermodal transportation and rail access. And the majority of the land First Industrial has acquired for future development with joint venture partners is located near major population centers, Harmon said.

Amid concerns about profit margins and ambitious development pipelines, stocks of major industrial REITs have pulled back after outperforming last year. AMB Property's share price has declined about 9.9% year-to-date. ProLogis' and First Industrial's shares have dropped roughly 9.9% and 16.1%, respectively, in the same period. DCT shares

have fallen approximately 5.5% so far this year.

Bank of America recently downgraded ProLogis to neutral from buy, citing concerns about a global economic slowdown and that escalating fuel costs may pressure sentiment.

“Given that transportation comprises 70% of total logistics expenditures, we believe even a moderate shift in the supply chain could put pressure on global demand trends longer-term and impede the company’s ability to expand its global development footprint,” Bank of America said in a report. The bank cited a PricewaterhouseCoopers survey noting that rising transportation costs were a key barrier to cost savings and growth.

“We are very in tune to our customers’ needs across the globe and pay attention to their changing supply chain dynamics. Our customers continually evaluate their networks to make sure they can provide the maximum service at a given cost level,” said Mike Peters, first vice president of global services at ProLogis, the world’s largest owner, manager and developer of distribution facilities.

“To date, we haven’t seen any of them make wholesale changes to the location of their facilities as a result of the runup in fuel costs,” he said.

Another possible side effect of prolonged fuel woes is that developers will maximize space at existing properties, including selling or replacing certain real estate and creating multi-story developments.

“As an acquirer and developer of the major facility types in the industrial real estate supply chain, First Industrial can serve a customer by developing a new built-to-suit facility or leasing existing space,” said Harmon.

“We can also acquire the facilities they are replacing to add to our portfolio to serve another customer’s needs,” he added.

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