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Departments

Railroad Renaissance

By Matt Hudgins

The surging flow of imports to U.S. consumers is fueling a boom in the century-old railroad industry, and savvy real estate investors are already laying tracks for growth along newly flourishing supply routes. From Dallas to Columbus, rail service is driving millions of square feet in distribution center development.

Impelled by ravenous consumer demand for inexpensive merchandise, the volume of containerized goods imported to the United States mushroomed 140% in the past decade, from 48 million tons in 1994 to 120 million tons in 2004. That volume has boosted demand for rail service to unprecedented levels.

Intermodal freight, or the shipping containers and trailers conveyed by multiple transportation modes, are a lucrative business for the railroads. Intermodal shipments on U.S. trains last year constituted a little more than 6% of total tonnage yet provided nearly 15% of revenue, or about $7 billion, for the nation's major railroad companies.

Intermodal freight recently surpassed coal as the greatest revenue maker for rail operators, so it's little wonder that railroads are scrambling to expand capacity in order to move more containers. BNSF Railway devoted $400 million of its $2.6 billion capital program this year to expanding capacity, laying 32 miles of double track and 8 miles of triple track on sections of its main line between Chicago and the Ports of Los Angeles and Long Beach.

Double tracking, or adding a second track, enables two trains to pass each other without requiring one to pull onto a siding. Union Pacific is adding more than 50 miles of track alongside its main line between Los Angeles and El Paso this year, part of an ongoing effort to double track that entire 750-mile run.

In the Northeast, Norfolk Southern is spending $250 million — including $150 million in government funds — to raise tunnel and bridge clearances between ports at Norfolk, Va. and Columbus, Ohio. The new clearances will enable trains on the company's Heartland Corridor route to carry double-stacked shipping containers, dramatically increasing capacity on the line.

Expansion is a welcome change for an industry that was in decline a generation ago, according to rail expert Ken Withers, an engineer and vice president of R.L. Banks & Associates in Washington, D.C. Unable to set their own pricing or abandon unprofitable routes without federal approval, most major railroads were bankrupt by the mid-1970s.

Deregulated along with the trucking industry in 1980, however, the major railroad companies emphasize efficiency and have largely shed or spun off low-volume routes. “They want the unit trains of 100 cars or more, and they want to go to a distant place,” Withers says. “That's their most productive move, and therefore their best profit producer.”

Now that railroads are adding capacity, what does that mean for real estate investors? In a word, opportunity, according to Will Friedman, vice president of supply chain and intermodal real estate at Duke Realty Corp. “Real estate is going to follow rail hubs,” he says.

“Railroads are putting billions of dollars into their main lines, and that opens the door for developers to set up shop on these rail superhighways,” Friedman says. “For industrial developers, the last five years has been an awakening, the realization that this is the new frontier.”

Development a la mode

Duke is betting on railroads in a big way. Late last year, the publicly traded REIT and its investment partner Capital Square Ltd. launched Rickenbacker Global Logistics Park, a 1,200-acre industrial project adjacent to Rickenbacker International Airport in Columbus, Ohio.

Then in May, Duke and Indianapolis-based developer Browning Investments Inc. formed a joint venture to develop AllPoints Midwest and AllPoints Anson, which together total 1,500 acres and could yield 20 million sq. ft. of industrial space near Indianapolis.

Both Rickenbacker and AllPoints are based in large part on proximity to intermodal rail yards, which are specially equipped to quickly transfer shipping containers from trains to truck trailers. The parks are already garnering tenant interest.

Duke kicked off the Rickenbacker project by launching a 572,000 sq. ft. speculative industrial building last December. By February, logistics provider Exel Inc. had leased the entire space. The developer has already announced plans to expand that first phase with an additional 624,000 sq. ft. of spec development.

Even some railroad companies hope to tap the real estate potential generated by intermodal yards, acquiring land on their own and then seeking fee developers to oversee their projects. Examples include a Union Pacific project in San Antonio and a BNSF development in Kansas City. Railroad owner CSX Corp., meanwhile, is developing an industrial park around its intermodal yard in Winter Haven, Fla.

Texas firsts

Many of the industrial parks under development around the nation are patterned after AllianceTexas, believed to be the first massive real estate development built around an intermodal facility. Ross Perot Jr.'s real estate company, Hillwood, began the 11,600-acre industrial portion of AllianceTexas in 1989 as part of a larger mixed-use project north of Fort Worth, Texas. The park is home to more than 140 tenants spanning in excess of 25 million sq. ft.

AllianceTexas offers traditional rail access to some buildings via spurs into the park, and car maker Hyundai unloads automobiles from trains on the Union Pacific line at the eastern end of the complex. The real engine behind AllianceTexas' success, however, is a 289-acre intermodal yard that handles about 600,000 containers annually, according to Hillwood spokesman David Pelletier.

“The BNSF intermodal yard is probably the single most important factor in the growth of AllianceTexas and is what truly makes it a logistics hub,” Pelletier says. “We just completed two land sales and two tenant expansions in the past month that were all done because of the intermodal yard and its connection for imports from Asia.”

Some 50 miles to the southeast, another project may soon steal the spotlight for state-of-the-art integration of real estate with intermodal access. The Dallas Logistics Hub is a 6,000-acre project launched by San Diego-based developer The Allen Group, and features the newest intermodal yard in the nation. In addition to the existing yard, owned by Union Pacific, the developer is in talks with BNSF to open a second intermodal facility within the park. If successful, Dallas Logistics Hub would be the only park in the world with intermodal access to more than one carrier.

The Allen Group plans to develop the $2.5 billion project over the next 20 years, delivering as much as 60 million sq. ft. of commercial space, according to Ed Romanov, the company's CEO. “This is the future of the industrial business in this country,” he says.

Warning signals

There are pitfalls to avoid in rail-oriented development. Railroads are a high-volume business, so a new project must be capable of generating tremendous freight volumes in order to convince a railroad to establish a new intermodal yard. The best places to generate those volumes are at the end of a lengthy route, or where intermodal freight is transferred from one railroad company's lines to another to continue a cross-country journey.

BNSF won't consider opening a new intermodal facility for fewer than 250,000 container lifts per year, according to Vann Cunningham, assistant vice president of development at BNSF. “Most communities will never have the volume they need for an intermodal yard,” Cunningham says.

Places where goods are transferred from trains to trucks or another transportation medium are likely candidates for large-scale development, says John Carver, executive director of the Colliers Multi-Modal Services Group in Los Angeles. “Wherever the forms of transportation cross, somebody has to touch that cargo, and that's where it makes sense to build your real estate infrastructure,” he says. “The opportunities are at the crossing points.”

While most users need truck bays to receive containers and trailers, some want the low cost and greater efficiency of direct boxcar access from a rail spur to the building. Tenants that deal in paper, building materials or other bulk commodities may favor this method, known as carload service, explains Neil Doyle, senior vice president of development at Centerpoint Properties. “You can fit three to five semi-trailer loads in a box car, so it's very efficient if you're not pressed for time.”

Extending a rail spur to a building requires a flat grade and enough track to clear the main line. Spurs range from 200 feet to a half-mile and may cost $100,000 to $500,000 to construct, says Craig Engelhardt, managing director at tenant representation firm Studley in Rochelle Park, N.J.

The critical selling point to companies receiving containerized goods, however, is proximity to an intermodal yard, port, or the customer. “If the port is the source and the customer is the destination, you want the distribution center close to one of those and not somewhere between them,” Engelhardt says.

How long will rail traffic drive real estate development? Friedman of Duke Realty expects the demand for distribution space at ports and rail hubs to remain strong through the next decade and beyond, due to the nation's reliance on imported consumer goods.

Trucking companies plagued by driver shortages and increasing costs for fuel and equipment may cut back services, says Friedman, forcing more companies to consider rail as an alternative. “This railroad renaissance is going to be our world for the foreseeable future.”

Matt Hudgins is an Austin-based writer.

Distribution centers: the closer, the better

When Wal-Mart Stores Inc. was deliberating where to place a distribution center to serve the Chicago area, Centerpoint Intermodal Center in Ellwood, Ill. was among the more expensive options. Yet that's where the company is now building its 3.4 million sq. ft. facility.

Why? In short, developer Centerpoint Properties was able to demonstrate how the retail giant would realize $12 million to $16 million in annual savings by hauling its shipping containers from a nearby rail yard to a distribution center within the park, rather than to less expensive sites 10 or 20 miles away.

Wal-Mart will receive about 100,000 containers annually at Centerpoint Intermodal Center, says Neil Doyle, senior vice president of development at Centerpoint based in Oak Brook, Ill. “I'm sure there was cheaper land available elsewhere in the Chicago area, but the annual transportation savings will pay that [additional cost] off in a year or two.”

At Centerpoint Intermodal Center, tenants spend about $40 per container for drayage, a term for trucking a container from a port or rail yard to a distribution center. That figure compares favorably with drayage costs of $200 to $300 per container to less expensive warehouse locations 20 or 30 miles away, Doyle says.

Minimizing drayage costs is the greatest value developers can offer in a rail-served logistics park, Doyle says. The higher cost of real estate near a port or intermodal facility pales in comparison with the high operating costs associated with a lengthy drayage run. “You can't be penny wise and dollar foolish,” he says.

Drayage costs vary widely depending on the distance traveled. Drayage from the Port of Los Angeles to the Los Angeles suburb of Compton is $155 per container, compared with $300 from the port to San Bernardino, says Craig Engelhardt, a managing director at tenant representation firm Studley in Rochelle Park, N.J.

Efficient use of labor is another advantage of close proximity to the rail hub, and is related to drayage costs. A large retail distributor may receive dozens of shipping containers on a single train, and is responsible for picking up those goods quickly to make way for new shipments arriving. After 24 hours, most railroads charge $200 or more for each day a container remains in the yard.

A lengthy drive to the distribution center may require the use of 20 or 30 drivers for several days to move a large number of containers. A short drayage run to a distribution center adjacent to the intermodal yard, on the other hand, enables a handful of employees to clear the same number of containers in an equal amount of time or less, and with less equipment. — Matt Hudgins