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Circling the ports

By Paul T. Rosynsky

For the last decade, California's Inland Empire has been a gold mine for businesses that build and lease warehouse and distribution centers.

With its vast tracts of open land, a ready labor force, friendly municipalities and close proximity to the largest port complex in the nation, the Inland Empire was a haven for businesses seeking to build and lease space for distribution operations. The Inland Empire is an area that begins about 50 miles east of Los Angeles and includes parts of San Bernardino and Riverside counties.

One by one, large centers of 100,000 square feet or more shot up like a forest in what was once a barren desert.

The frantic growth even led some to speculate that outlying areas such as the Kern County cities of Lebec (93 miles north of the port complex) and Bakersfield (134 miles north of the ports) would become prime locations for the business of transferring goods.

But as the economy continues its slow pace and fuel and other costs and fees associated with transportation rise, the rush to construct new distribution and warehouse centers in the Inland Empire is slowing.

Instead, companies that build and lease the centers say, more companies are looking for locations close to the ports, which bring in more than 15 million containers a year.

"It has slowed down a bit as people go back to infill," said John Magness, senior vice president for Hillwood Properties, a company that has built several distribution centers including Alliance California in San Bernardino.

Following the old real estate adage that location trumps all other factors, companies constructing distribution centers frequently searched for sites closest to the ports and other transportation links such as freeways and railroads.

But during the real estate boom of the last decade, finding a location close to the Southern California port complex was difficult.

The Allen Group is developing properties farther out from the ports than the Inland Empire.

Land prices were high, and many cities chose to use the land for other purposes such as housing or commercial real estate.

The high demand for land led companies to the Inland Empire where municipalities were starved for development particularly the kind that came with jobs.

For shippers, the Inland Empire also paid dividends as the price to operate there was cheaper than opening a center in the population center of Los Angeles County.

The area exploded with development as did outlying areas where speculators build centers and industrial parks on spec, hoping to attract new distribution centers with cheap labor and land costs.

The idea appeared to catch on, and distribution centers were developed even farther out than the Inland Empire.

IKEA built a distribution center in the Tejon Ranch development just along Interstate 5 in Lebec. Target opened a 1.7 million-square-foot center at the International Trade and Transportation Center near

Shafter, which is 125 miles north of the ports of Los Angeles and Long Beach.

"The developers saw (the demand), and the real estate leaser saw it; it had tremendous growth opportunities," said Paul Bingham, principal with Global Insight. "When you have trade growth, people need new facilities."

The growth led to an almost frantic effort by shippers to construct new facilities.

"There were companies that felt pressured, it was the new thing, and everyone else was doing it," Bingham said.

Shippers followed the big retailers to Inland locations. "You can't get fired for going to Los Angeles or the Inland Empire," added Jon Cross, marketing director for the Allen Group.

At the same time, many municipalities in the Inland Empire were welcoming the new development with tax breaks and other incentives.

But as the economy began to soften, shippers found they had more options available. Bingham compares it to the housing market.

During peak economic times, the price for housing in city cores skyrockets, leading many to find homes in outlying areas such as Tracy in the Bay Area or San Bernardino County in Southern California.

But when the economy goes soft, the real estate market follows, making it more affordable to buy a property closer to the city core. Mattel Inc. built a distribution center at San Bernardino's Alliance California. With more options available, companies can calculate the risk and rewards of a certain location and find the balance between costs when finding a new location.

"You can think of it, in simple terms, like the housing market," Bingham said. "When the market falls, you don't need to go that far away because you can afford the closer-in places."

With more options available, factors such as drayage costs, congestion on local highways and real estate prices become determining factors during site location studies.

"The more sophisticated companies are trying to do those computations," Bingham said. "You calculate the labor costs, the transportation costs, the taxes."

At the same time, there is less pressure to find space because there is less trade.

As a result, companies might not need a large new distribution center; their needs can be met with a smaller building closer to the ports.

"Companies are pulling back because they do not have the volume they had before," Bingham said.

Another factor adding to the slowdown is a cautious lending market, which makes financing a little more expensive.

"We had had a softening of the residential market, which has softened the lending market," Magness said.

The slowing economy, however, will not last, and many say the growth that sustained the Inland Empire's distribution center construction boom in the past will return, although with a little less rigor.

In fact, many of the companies that have centers east of the Los Angeles-Long Beach port complex said even with the slower economy they continue to see some growth in their market.

"There is still much more property remaining," Magness said. "As long as the ports of Los Angeles and Long Beach continue to grow, that is good news for us."

While imports of containers will not reach the growth levels seen in the first half of the decade, many predict they will rise again, spurring another round of distribution center construction.

The rush to build massive new distribution centers in the Inland Empire has slowed somewhat as the economy has slowed. "It is not going to go away," Bingham said. "We are confident in saying the market is going to come back."

And when it does, companies that built centers in outlying areas could benefit.

"The Bakersfield region has been a little slower than we projected, but I think in the next three to five years, we are going to see a dramatic increase," Cross said. "The new spot was the Inland Empire, but what we are seeing now is that the Inland Empire only has about three years worth of land left."

Cross predicts that, eventually, the higher costs of transportation that come with building outside of the Inland Empire will be offset with the cheaper cost of land and ready labor force.

"Someone might say that your drayage cost to take a container to the Inland Empire from the port might be cheaper," Cross said. "However, it is all about total cost savings; there is no way your drayage costs can outweigh the cheaper lease costs."

Cheaper lease costs will also become a factor as companies search for larger facilities to match the growth in size of containers and ships.

As ships become larger, companies will have to handle more cargo at one time increasing the need for large warehouse space, Cross said.

"The Fortune 500 companies of the world are seeing the boxes get larger," he said. "At the same time, there is becoming very little room to handle those boxes in the Inland Empire for a feasible cost."

For some companies, such as large retailers like Target, that day has come, but for others, the Inland Empire will continue to be the prime location at least for now, others argue.

Bingham agrees and said the current slowdown will not last.

"The real question is how much longer, is it two years or five years?" he said. "Those areas do not get crossed off the list; there is no situation where I see that happening.

"It's not a boom time now, but that doesn't mean you abandon the market and it has no role any more," he continued.

Even companies with interests in the Inland Empire agree that the outlying areas will see their heyday.

"Those days will come for Tejon, Bakersfield and Shafter," Magness said. "But before those markets hit their stride, you are going to see a lot more infill."

In fact, Magness said his firm is constantly searching for new areas for speculation construction.

"We are actively pursuing other properties in and around Southern California," he said. "There continues to be healthy competition."