BUILT TO LAST

Student Op-Ed

RESHORING AND INDUSTRIAL REAL ESTATE

By Antonio Lulli

What is reshoring?

Let's briefly go down memory lane.

It was the early 1990s and the Soviet Union had just collapsed. Countries around the world left behind the inefficiencies of central planning and embraced market-driven policies to boost economic growth. There was enthusiasm in the air. Technological advances and a changing political tide turbocharged globalization, defined as the "widespread international movement of goods, capital, services, technology and information". This movement had momentum for the better part of the following two decades, and after stalling somewhat after the Great Financial Crisis (GFC), it has begun to fray in earnest. The combined headwinds of a domestic political backlash to lost manufacturing jobs, the geopolitical de-coupling between the United States and China, the supply-chain disruptions arising from the COVID-19 pandemic, and the Russian invasion of Ukraine have amounted to a marked reversal in the aforementioned trend. This brings us to reshoring.

According to the Reshoring Initiative (an advocacy group), reshoring is "the practice of bringing manufacturing and services back to the U.S. from overseas". This trend has been gaining in recent years as a result of a variety of macro factors mentioned above. It has been further boosted by recent legislation (i.e. the CHIPS Act, the Infrastructure Bill, the Inflation Reduction Act and the Made in America Act), which lavishly rewards corporate reshoring efforts.

The reversal of the offshoring phenomenon makes operating in lower-cost countries less advantageous for US manufacturers and highlights the advantages of more geographically compact supply chains. In short, out with globalization and in with supply chain resiliency.

In the lines below, we will explore how reshoring could impact the US economy and the real estate sector.

Drivers

As alluded to briefly above, manufacturing in America has begun to look increasingly appealing compared to China or other far-afield locations. Even ignoring any supply chain disruptions or geopolitical considerations, Chinese labor has become exponentially more expensive in the last few decades, making the marginal benefit of operating there diminish considerably. Firms are viewing getting out of China as a "form of insurance", as hedging against supply disruptions becomes more expensive and the manufacturing paradigm shifts from a "just-in-time" to a "just-in-case" model.

Meanwhile, US manufacturing employee productivity has doubled since 2000. State and local incentive programs and domestic technological advancements in industries such as liquefied natural gas, electric vehicle and battery production are tilting the scales further in favor of the US.

As a result, a recent survey of 305 US transport and manufacturing executives stated that 62% have begun to employ reshoring or nearshoring. A related Deloitte publication estimated a 20% reduction in shipments from Asia to the US by 2025 and a dramatic 40% reduction by 2030. Not surprisingly, foreign direct investment (FDI) in US manufacturing topped $2,108.6 billion in 2021, up exponentially since 2010. In fact, manufacturing construction spending more than doubled in the past year to reach $190 billion in April 2023, accounting for 13% of all non-government construction spending, a record.

All this is sure to have significant effects on the industrial real estate ecosystem. Aside from an obvious increase in demand for manufacturing space, particularly for battery and electric vehicle assembly facilities, the reconfiguration of supply chain dynamics can also affect logistics space. Though there could be a demand spike for warehouse space from domestic manufacturers, there could also be a decreased need for distribution centers overall, especially around major international ports and transportation nodes like Los Angeles and New York/New Jersey. This could lead to a broad change of geographic focus for supply chains and the logistics properties that service them, away from the aforementioned coastal areas and into the Golden Triangle, a manufacturing hotbed roughly located between the Great Lakes, Texas and Florida.

Lower-cost markets with good labor fundamentals, convenient access to major transportation networks and local economic incentives will be in the driving seat in this new paradigm. Additionally, the reshoring phenomenon is sure to boost not only manufacturing leasing and greenfield development but also the supplier ecosystem around it and related distribution facilities.

Major structural changes are seldom straightforward, and this is unlikely to be an exception. Firms looking to bring production back to the US will have to overcome a very tight labor market, particularly in the types of locations with abundant cheap land, and a general lack of enthusiasm for manufacturing work among the younger cohorts. A strong dollar would also prove to be a significant headwind.

There will also be a major challenge in adding sufficient supply at a time when construction projects are ever more complex and more expensive, which coincides with a major infrastructure investment by the Federal government which is sure to suck up labor and resources from other uses. This is especially dire given the already-overheated nature of the industrial market today, where supply struggles to keep up with existing demand.

Nearshoring and Friendshoring

Two related phenomena are occurring parallel to the reshoring trend: what industry players call nearshoring and friendshoring. They are caused by the same geopolitical shifts driving reshoring, namely the decoupling of the American and Chinese economies and the growing polarization between the democratic Western-aligned nations and the more autocratic-leaning states allied with China and Russia.

Canada and particularly Mexico stand to benefit from this realignment. Mexico's proximity to the United States and trade benefits from the USMCA (US-Mexico-Canada) Agreement (NAFTA's replacement), plus its strong rail connectivity with the US (particularly in the northern states) and low labor costs make it ideally suited to capture significant upside. Automakers are leading the charge, best illustrated by Tesla's upcoming Gigafactory in the state of Nuevo Leon.

The industrial real estate market south of the border has begun to expand significantly as a result. Mexico's imports of machinery rose 52% from the pre-pandemic average to $152 billion in 2022, while net absorption of industrial space in Mexico's six main markets has doubled in three years, going from 3 million SF in 2019 to 16 million SF in 2022.

As Tesla and other global industrial giants shift their focus to Mexico, the manufacturing and logistics property markets are set to continue on their steep ascent.