Companies Shift Real Estate Strategies While Navigating Through Pandemic-Fueled 'Supply Chain Hell'

Manufacturing and Distribution Disruptions a Recurring Theme This Earnings Season

Tesla has boosted its own battery production facilities in Texas and other locations over the past few years. (Tesla Media)

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A great race is on in corporate America to sort out tangled supply lines and redeploy personnel and real estate, including bringing manufacturing and warehousing closer to distribution centers and embedding employees with suppliers.

In earnings call after earnings call this quarter, executives at many of the largest companies across the U.S. blamed supply chain disruptions for production snafus, construction project delays, late deliveries, price hikes and downsized profit expectations.

To combat what Tesla CEO Elon Musk called “supply chain hell,” companies across industries are "onshoring" production and distribution facilities from overseas regions still being hit hard by the pandemic — while overhauling inventory, hiring and other core management systems.

“You have a rightsizing going on in retail and all of these other industries," Robert Showghi, who lectures on supply chain and other management processes at San Diego State University, told CoStar News. "Everyone is trying to figure how much of this product they need or don’t need, or how much space they need or don’t need for this department or service, or where they should put that space.”

The pandemic, plus geopolitical ripples from the war in Ukraine that caused fuel prices to soar, have caused many industries to reassess operations.

Showghi said it could be more than two years, maybe into early 2025, before corporate leaders have some kind of normalized picture from which to draw conclusions on their future needs for supply, inventory and multiple production issues.

While global shipping and other transportation and manufacturing delays have eased considerably from what was seen a year ago, supply chain dysfunction is still being felt. Companies in many industries now know how Musk has felt since well before the pandemic, as Tesla struggled to produce electric vehicles in the face of limited production and deliveries of batteries and other crucial components.

“We have the potential for a record-breaking second half of the year,” Musk said on a July 20 call with analysts regarding Tesla’s earnings that beat expectations. “The past few years have been quite a few force majeures, and it’s been kind of supply chain hell for several years,” the billionaire CEO said.

Closer to Home

Like Musk’s Tesla, which has significantly boosted its own battery production facilities in Texas and other locations over the past few years, many other companies are now expanding, “onshoring” or otherwise relocating their manufacturing and distribution real estate.

Corporate executives continue to deal with effects that have rippled throughout the industrial economy in the form of materials shortages, port congestion, price hikes for cargo handling and storage, and manufacturing and shipping delays for key components including semiconductors.

Some companies, in particular chipmakers and the companies that depend on them, are now pushing to occupy more U.S. locations in order to head off current and future supply chain headaches caused by lingering pandemic problems in overseas ports, factories and distribution centers.

“As we move forward, we will increasingly localize our supply chain just as we have localized battery cell production,” CEO Mary Barra said during Detroit-based General Motors’ July 26 earnings call, noting due diligence is underway to expand capacity at facilities in the U.S. and Canada.

A General Motors plant in Janesville, Wisconsin. (CoStar)

Defense and aerospace giants Boeing and Lockheed Martin both reported supply chain woes were cutting into profits,= and said they are looking to deal with those in coming months. Boeing Chief Financial Officer Brian West told analysts in July the company is taking steps including keeping more of its personnel on-site with suppliers, fabricating some parts in-house rather than outsourcing them and keeping extra parts on hand for some types of manufacturing.

Chipmakers including Intel and Micron are now planning significant new investment in domestic production facilities in states including Arizona and Ohio, though those plants could take a decade or more to become operational.

Multiple companies are now making real estate decisions that have implications well beyond the current pandemic-choked, inflationary economy.

“These are multimillion and multibillion-dollar decisions that could affect a company’s bottom line for the next 10 years or more,” Ben Harris, an Atlanta-based senior managing director with brokerage Cushman & Wakefield, told CoStar News. “There are companies where people’s jobs could be on the line if they don’t get this right.”

Harris, who represents industrial tenants nationwide, authored a late July report from Cushman estimating that global shipping costs are still nearly five times higher than their pre-pandemic levels, accounting for as much as 30% to 40% of global inflation.

'Not Out of the Woods'

“Supply chains are flowing better than they were a year ago, but we’re not out of the woods,” UPS CEO Carol Tome said during the global package shipping giant’s July 26 earnings call. “A lot of it has to do with the rolling COVID lockdowns in China. We’re shut down in Shenzhen again.”

Challenges are also being faced by companies that themselves oversee multimillion-dollar developments, as they seek to meet rising demand from their own tenants. While not falling behind on projects yet, executives at biotech-focused Alexandria Real Estate Equities pointed to rising costs for fuel and numerous construction materials.

"Elevated diesel prices have a significant impact on construction costs as earthwork machinery runs on it and our contractors have been seeing fuel surcharges in the billings" from their subcontractors, Alexandria CEO Peter Moglia said during a late July earnings call.

At that time, Moglia noted the cost of gypsum, used in making drywall, was up more than 1,500% from a year ago due to competing demand from homebuilders, semiconductors were up 276% due to demand from automakers and switchgear and other industrial and electrical equipment was up 73%, caused by competing demand and shortages of materials that go into making that crucial gear.

“Extraordinary lead times remain for equipment used in our product types, including generators, building controls, transformers, switching gear, electrical panels, air handlers and chillers, all of which have lead times which are double what they normally are — many exceeding a year,” Moglia told analysts.


Alexandria Real Estate Equities' proposed Alexandria Tech Center in the Sorrento Mesa neighborhood of San Diego. (CoStar)

Alexandria so far has protected itself through moves including procuring some supplies on behalf of incoming tenants and signing construction contracts with guaranteed maximum costs factored in. Higher rents that it commands in several of its ongoing projects also will help it recoup rising project costs, executives said.

Some real estate companies dealing with industrial properties are looking to play the current demand trends to their advantage on the industrial side.

In addition to citing rising demand for multifamily and last-mile logistics space that had begun to increase before the pandemic, Blackstone Group President Jon Gray said during the company's July earnings call that "this redundancy desire of companies who are concerned about supply chain and the need to hold more inventory closer to home, that's creating real demand there, too."

Big public companies are not the only ones facing real estate-related decisions spurred by supply chain problems. Petaluma, California-headquartered Amy’s Kitchen, a family-owned private company that makes plant-based frozen and convenience foods, confirmed in July it was closing a production facility that it had opened just last year in San Jose, citing supply chain disruptions as a primary factor.

Executives at Amy’s Kitchen said the facility was losing $1 million per month, mainly because delivery of a key piece of equipment that it needed to scale production was delayed.

Shifting Focus

With these pandemic effects not going away anytime soon, Cushman & Wakefield's Harris said companies over the next two years could be facing multiple similar decisions on new developments and other real estate right-sizings, which could take the form of contractions, expansions or relocations.

He said the pandemic has accelerated companies' scouting of regions in the Southwest and Southeast that have the most land and labor available at more affordable prices than are now seen in East and West Coast cities. Those getting the most attention in the Southwest include Phoenix and Reno, Nevada, with companies scouting Southeastern hubs such as Atlanta and Savannah, Georgia; Tallahassee and Jacksonville, Florida; and several regions in the Carolinas.

"The demand is going be especially high on the manufacturing side, but right now at least it's still pretty steady on the distribution side," Harris said of real estate prospects through 2023 and 2024.

Among the caveats, Harris cautioned domestic real estate projects aimed at curbing the effects of global supply chain dysfunction could themselves encounter delays in obtaining needed workers, equipment and construction materials in the months ahead. And that could mean more quarterly earnings conversations about supply chains.

Christine Cooper, chief U.S. economist for CoStar Group, noted that that industrial project completions and lease-ups are still rising during the pandemic, and any moves to further "domesticate" U.S. manufacturing are going to add to that demand.

"I don't anticipate manufacturers or retailers de-emphasizing inventory accumulation for a while, despite a pending — or current — recession and falling demand for goods, as that is unlikely to last long and space decisions are made for the longer term," Cooper said.

Showghi said there are difficult decisions ahead for corporate leaders as they decide how quickly and to what extent they "onshore" or otherwise overhaul operations. Those actions could involve paying higher wages to domestic workers, adhering to much stricter production regulations for certain types of supplies that also add to costs and making significant new investments in real estate that previously were not deemed necessary.

"Companies know that if they make a decision to onshore or just invest in new facilities, they could fall behind their competition who decided not to change over so quickly so they could keep saving money and increasing profits on their labor and materials after the pandemic and these other conditions end," Showghi said.

CoStar reporters Katie Burke, Randyl Drummer and Thomas James contributed to this report.