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MANAGERS

Look Ahead 2024: Re-, near- and friend-shoring points to a different logistics market

Lauren Hochfelder, co-chief executive officer for Morgan Stanley Real Estate Investing says logistics will remain a favorite asset class for her firm. But she predicts there will be less of a rising tide lifting all boats now.

The rise in e-commerce has driven a sharp increase in industrial demand over the past decade, accounting for approximately 35 percent of US industrial leasing. At Morgan Stanley Real Estate Investing, we developed high conviction on e-commerce growth and invested early and heavily in industrial around the world.

We and others benefited from enormous value creation, including appreciation of two to three times in major US markets tied to the global flow of goods to large population centers.

While Morgan Stanley's research projects US e-commerce sales to grow by a still robust 8-9 percent per annum over the next five years, we also must now focus on a second secular shift: the reconfiguring global supply chain.

Seeking to diversify supply chains in response to the supply shocks of covid and an increasing trend to deglobalization, companies are shifting where they manufacture goods and thus shipping routes – favoring a model that includes reshoring, near-shoring and friend-shoring. We expect the US, Mexico and India to be among the greatest beneficiaries.

But investing in industrial real estate – even within the US – now requires a nuanced understanding of how each of these global supply chain shifts is impacting demand for space.

Reshoring

The US stands out as a major beneficiary of supply chain de-risking. We expect an increase in traditional manufacturing, advanced manufacturing and biomanufacturing, funded both privately and publicly. According to the Reshoring Initiative, a US organization focused on repatriating commercial activity, reshored manufacturing jobs have increased 40 percent per annum since 2019, while Morgan Stanley research expects industrial automation to grow by 65 percent through 2030, two times the rate of the past decade.

Additionally, US domiciled investment in semiconductors and batteries has climbed to $320 billion in the past two years. Together, we believe this will drive demand for light manufacturing facilities, including in the Southeast, Texas and Arizona, where 50 percent of reshoring investment is expected to occur. Given these facilities are capital intensive and corporate credit is constrained, business owners may seek to monetize their industrial real estate via sale-leasebacks as an alternative source of financing.

Near-shoring

US industrial real estate also benefits from near-shoring, as growth in imports from Mexico catalyzes warehouse demand there. Morgan Stanley Research expects industrial production in Mexico to grow by 2.4 percent per annum over the next five years, compared to virtually no growth over the past five. Additionally, our research team expects Mexico to experience a $90 billion surge in exports to the US over that period, 25 percent above today's levels.

Mexico-US supply chains are already entrenched, as complex manufactured goods cross between the two countries multiple times before final assembly, spawning demand in those US markets that closely tie to this cross-border trade. However, that demand differs based upon which manufacturing node in Mexico they are closest to and what product is manufactured. Investors need a refined appreciation of the underlying drivers. Our understanding has seen us invest in various projects in San Diego, California, and El Paso and Laredo in Texas.

Friend-shoring

The supply chain reconfiguration in Asia also affects relative port demand within the US. Shifting manufacturing from China to India is shifting shipping routes from West Coast to East Coast ports. While West Coast ports should continue to benefit from consumer-oriented production like fashion remaining in China and Vietnam, global shippers are diversifying further to mitigate risks around labor shortages and climate. Some are decentralizing US entry points into a 'Five Corner' strategy – the Southwest, Pacific Northwest, Northeast, Southeast and the Gulf of Mexico. Consequently, investors must understand forward-looking demand drivers and supply constraints within each port market.

While the rising tide of e-commerce lifted most industrial boats over the past decade, investors now need a nuanced strategy accounting for the direct and indirect impacts of these multi-polarization trends that are shifting demand within the US and elsewhere.