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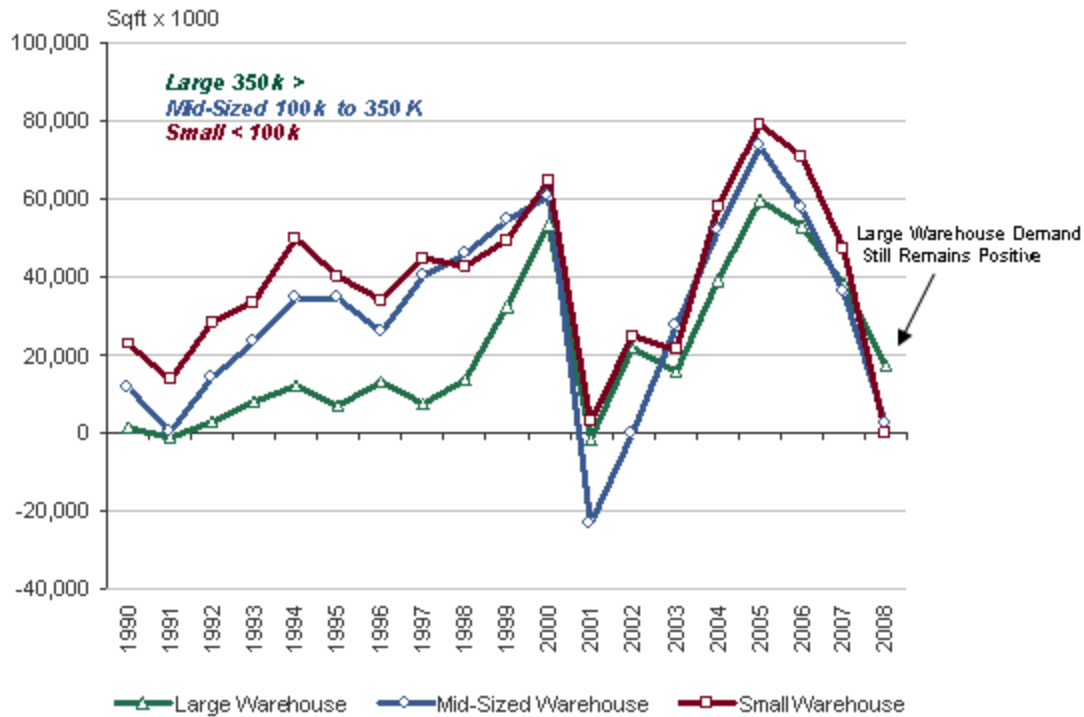
THE IMPACT OF HIGH FUEL COSTS ON SUPPLY CHAIN
DECISIONS

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For the first time since the oil shocks of the 1970s, high fuel costs are prompting manufacturers and importers to rethink their supply chains in response to rising transportation costs. With the twin goals of optimization and bolstering shrinking profit margins, companies are using higher energy costs to gain more efficiency and long-term sustainability from their distribution networks. A variety of things are happening to achieve this: companies are shifting to alternative transportation modes such as rail or all-water services to the East Coast; they are consolidating warehouses, pooling equipment and loads, moving full containers and truckloads, and opting for slower truck speeds and fuel-saving technologies—all to find the most efficient mix of warehouse and distribution locations in order to reduce transportation costs.

The challenge for businesses is to find the right balance among optimal location, higher inventory and increased transportation costs. Some smaller companies with only a few warehouses located far apart might want to consolidate their warehouses in order to cut driving times and transportation distances. In contrast, larger companies may want fewer distribution centers to maximize truckloads. Additionally, some smaller manufacturers and distributors of lower-valued import goods are finding it harder to absorb the transportation costs of manufacturing goods in China, and are increasing their production in the U.S.—a phenomenon called reverse globalization.

Demand For Large Warehouse Space Remains Positive, Despite Weak Fundamentals



Source: TWR Fall 2008 Industrial Peer Select.

All these factors are leading to continued demand for larger warehouse space nationally, despite lackluster fundamentals. This is a reverse of the national trend that has many markets exhibiting negative net absorption year-to-date, as businesses continue to cut costs and move toward consolidation or reverse globalization. As a result, 17 million square feet (msf) of large warehouse space was absorbed in the first half of 2008. Many of the markets that are benefitting are centrally-located, away from the land-constrained port markets. These include Memphis, Kansas City, Pittsburgh, Las Vegas, South Central PA, Dallas, Indianapolis and Nashville, all of which experienced positive warehouse net absorption in the first half of 2008.

Businesses are adjusting their supply chains in various ways: Wal-Mart recently stopped construction of all new distribution centers and is looking to double fuel efficiency by 2015. Ikea has moved some of its furniture production from Asia to the U.S. as part of its green initiative to save on transportation costs. Kimberly-Clark, in another example of consolidation, has reduced its number of manufacturing and distribution centers over the past four years, moving from 70 regional distribution centers to just nine. These centers are more centrally-located with respect to key retail markets, which allows them to reach 90% of the North American population within 8 hours.

Manufacturing may not move back to the U.S. for all goods—particularly smaller, lower-value goods that are easier and less costly to ship—however, we may start to see a trend in which the production of bulkier goods that do not travel well in containers or are already being partially manufactured in the U.S. is brought home to save on the transportation costs. Wages and transportation costs in China in particular, might push activities such as labeling and tagging back to the U.S. as well. Overall, we are seeing many inland markets benefit from increases in warehouse demand as businesses attempt to mitigate transportation costs by consolidating distribution centers and relocating manufacturing.

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"Bill Wheaton and Ray Torto founded modern, econometric analysis of commercial real estate. We have been long-term users of CBRE/Torto Wheaton Research's products, and our investment process proactively integrates their resources and forecasting models."

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