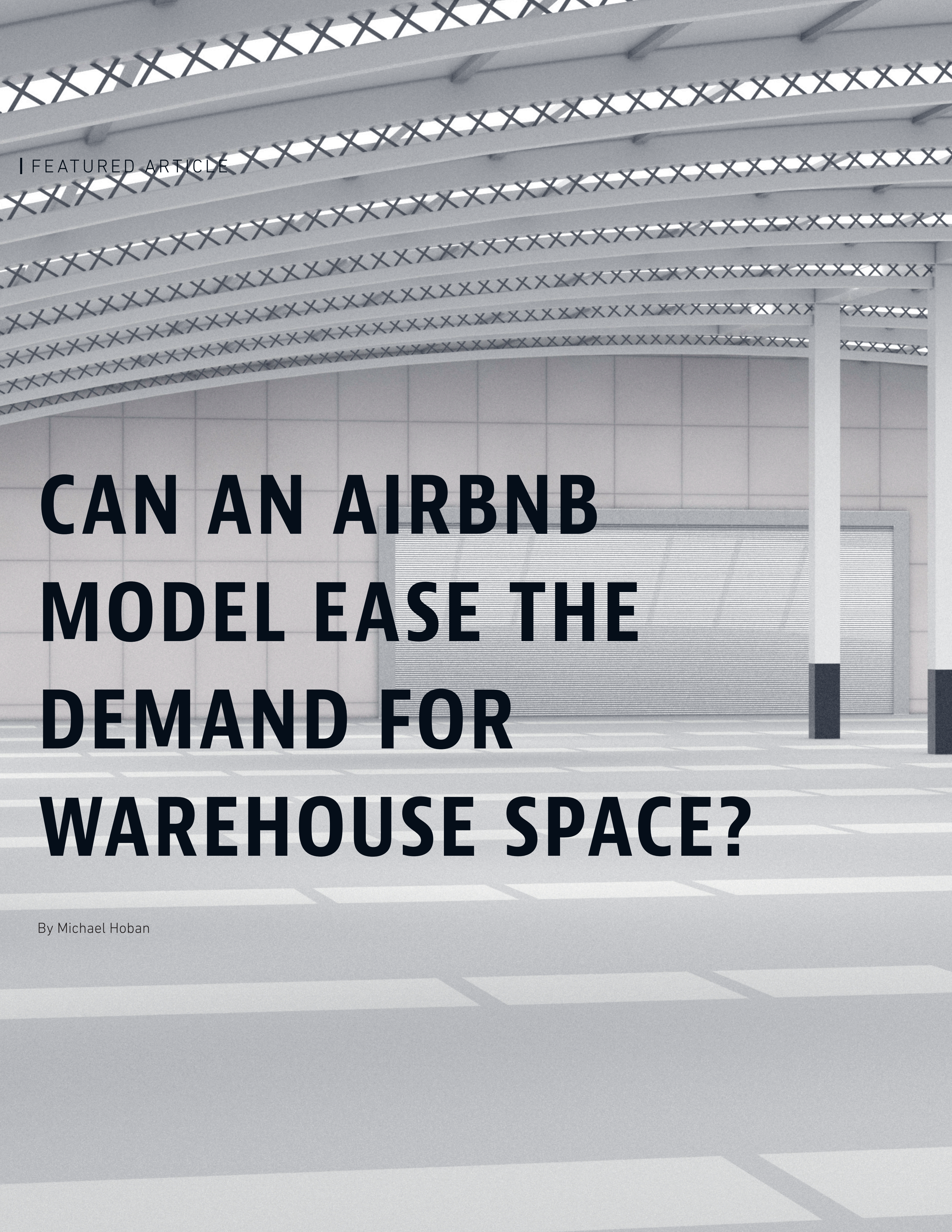
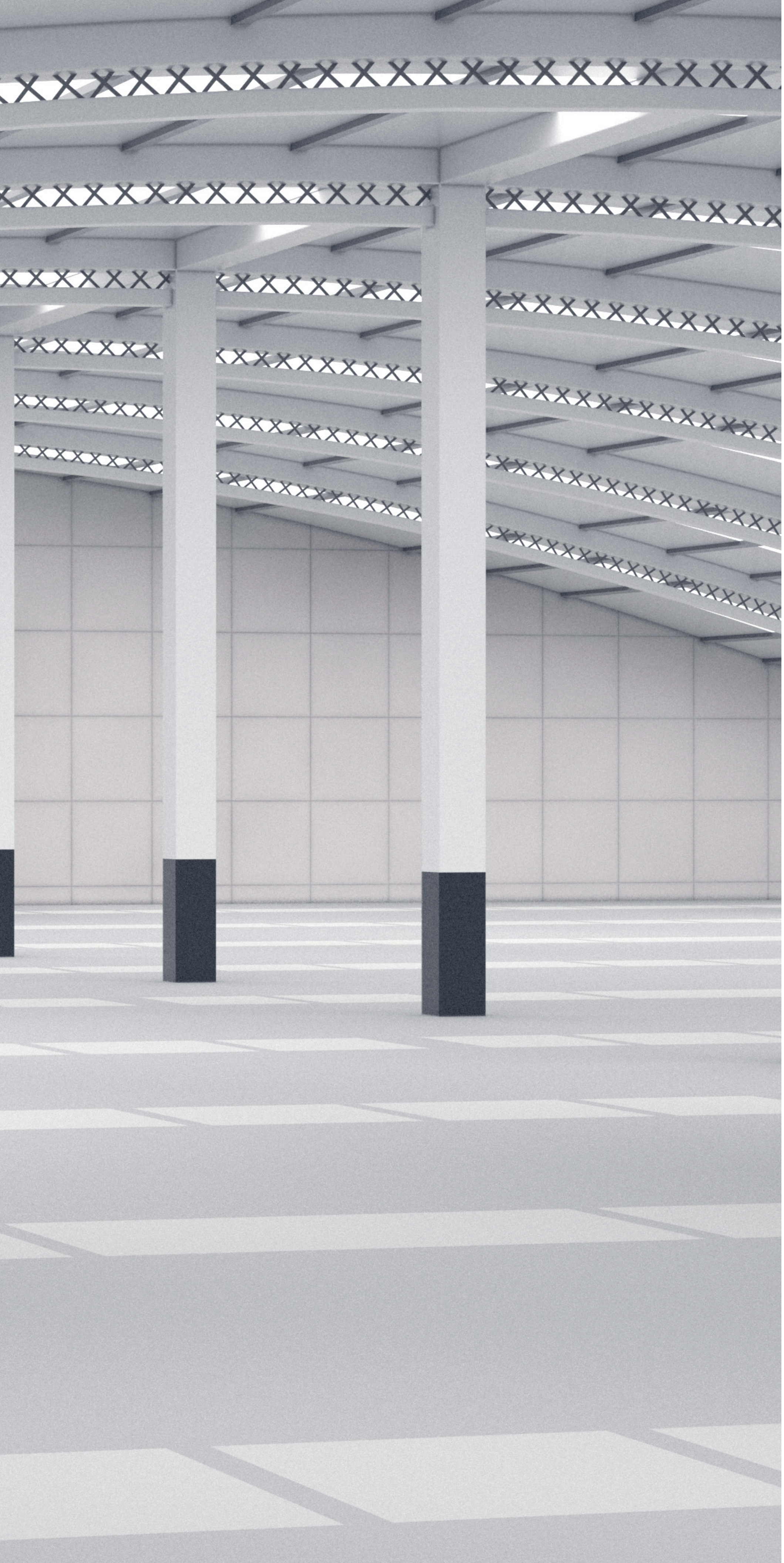


FEATURED ARTICLE

CAN AN AIRBNB MODEL EASE THE DEMAND FOR WAREHOUSE SPACE?

By Michael Hoban



The unrelenting growth of e-commerce continues to drive demand for warehousing and distribution space, and while that demand certainly validates the heightened interest by investors in the asset class in recent years, industrial users in those markets are increasingly finding themselves scrambling for available space.

According to research by Newmark Knight Frank, the vacancy rate for industrial space in Q3 of 2017 dwindled to lows not seen since the dot.com era – 5.5 percent nationally (with a corresponding 5.5 percent increase in average asking rents), with vacancy especially tight in markets such as Los Angeles (1.0), Orange County (2.0), the Inland Empire (3.1), and Seattle and Cincinnati (3.4).

"We've been through economic expansion periods before, but this is definitely a longer and more vibrant expansion than we've seen for quite some time, and it's being driven in large extent by the boom in e-commerce," says 32-year industry veteran Elise Couston, SIOR, industrial specialist and managing director at Newmark Knight Frank. "There is a sea of change in the way companies are implementing their distribution business, and it's requiring additional warehouse space, which is really being driven by the Amazon model. This has had a direct impact on the demand for space."

Despite nearly 1.0 billion square feet of new construction between 2014 and the close of 2018 (according to a Q2 2017 industrial report by JLL), analysts question whether the additional supply will be enough to meet demand, as e-commerce is expected to constitute 17 percent of retail sales by 2022 – up from a projected 12.9 percent in 2017.

But necessity is the mother of invention, and an enterprising firm has devised an innovative solution to help ease the soaring space needs fueled by the e-commerce boom. FLEXE, dubbed the "Airbnb of Warehousing" by various business and trade publications, is disrupting the traditional warehousing model as it continues to gain traction nationwide. The Seattle-based firm was the cornerstone of a talk given at the 2017 SIOR Fall World Conference in Chicago, "Trends & Threats in Warehousing Management & Brokerage," by Zachary Rogers, assistant professor of supply chain management at Colorado State University.

Similar to Airbnb, FLEXE is a cloud-based marketplace that connects businesses in need of additional warehouse space with organizations that have excess capacity via a single unified software platform. Founded in 2013, the firm took its model to a new level this year, launching a fulfillment service for e-commerce companies, Next-Day Delivery, which enables businesses to reach 98 percent of U.S. customers via next-day ground shipping, delivering their goods even faster than Amazon Prime – without investing in facilities themselves.

Karl Siebrecht, co-founder and CEO of FLEXE, offers this simplified version of how it works. "Providers come to the FLEXE marketplace and sign up to become service providers. If they are accepted, they name a price that they want to charge for their services – maybe $8 dollars a month to store a pallet, and X dollars to pick and pack and ship, for instance – and then we put a markup on top of that. The customer pays us and we pay the warehouse their fee," he explains. "Our software platform allows the client and the provider to work with each other, and that's everything from managing inbound and outbound inventory, to keeping track of it for the client, to performing all of the warehousing functions as their warehouse provider." The client pays a unitary price which is not based solely on the square footage of the real estate, but includes the logistics services. "And they only pay for as much as they use," adds Siebrecht.

FLEXE currently has over 800 warehouse locations in major and secondary markets in its growing network, as well as 500-plus warehouse partners that offer pick-and-pack services, and numbers Iron Mountain and Ace Hardware among its customers. Two-thirds of their service providers are 3PLs.

The model was intriguing enough to draw the attention of Prologis, the largest industrial REIT in the world, which formed a partnership with FLEXE last year. "We're looking at it as a different business model than how our customers would use space," said William O'Donnell, Senior VP with Prologis, of the partnership. "It could change and be disruptive to how people traditionally think about warehouse space utilization, so for us it was really important to understand and partner with someone who is driving that change." Prologis is not directly using FLEXE themselves, (because they don't operate the warehouses), but are working with their customers to help them to develop their strategy and understand what the implications are in terms of optimizing their space. And the relationship is still evolving, says O'Donnell.

The value proposition for businesses and providers was clearly spelled out by Rogers during his SIOR Fall World Conference presentation. In 2016, he was commissioned by FLEXE to conduct a survey of over 100 warehouse executives across a wide spectrum of businesses (of which 63 percent earned $100 million or more in annual revenue – including 25 percent in excess of $1 billion), to determine the percentage of actual utilization of space versus occupancy.

Over 90 percent of the businesses reported having 10-25 percent excess inventory during the course of the year, forcing them to seek short-term leases or other remedies, while nearly all the warehouses reported having between 20-40 percent of their space unused for significant portions of the year. In addition, over 90 percent of businesses had some degree of predictability as to when they would have excess warehouse capacity, with 46 percent reporting that the excess was absolutely foreseeable – as in the case of seasonal fluctuations.

The most striking element from the survey, however, was that nearly 70 percent of the businesses have no plans for the excess capacity, other than to accept it as the price of doing business. Which is the driver behind the FLEXE space-sharing platform.

"It used to be that companies would say, 'We've got peak in October, November, December and we need enough space for those three months, so we'll just eat the sunk costs for the rest of the year'. But now that it's becoming more expensive for transportation and warehousing, you've really got to cut costs wherever you can, and just having dead space around for nine months doesn't make sense anymore," explains Rogers. "So when a platform like FLEXE comes along, I can go from having this extra capacity being a loss center to a profit center, because now I'm leasing it out – and that is a huge game changer."

So what are the implications for industrial real estate brokers?

Les Boudwin, SIOR, and managing director at Jones Lang LaSalle in Bellevue, WA, says that he has limited experience with the platform, but is impressed with its potential and sees it as a way to solve problems for his customers. "I've got clients that ask, 'I need 2,000 square feet for three months, can you help me?' And while I'd like to, it's just not (practical). So lately I've been saying, call this guy at FLEXE," says Boudwin. "Also, if I'm sitting there with a customer checking in, and I see that they've got 10, 20 percent extra floor space they're not using, I can offer this as a suggestion, where they might be able to pick up a little bit of revenue. And that's nice."

Siebrecht agrees that currently, the primary benefit for brokers is to be able to bring a new solution to a client or a prospect that is different than the traditional leasing of a building on a fixed term. "Because for a lot of client needs, a flexible, pay-as-you-go solution is just a better fit," he says. He gives the example of a large company doing a project launch in a new market, where, instead of signing a two-year lease or sublease on a building, opts for FLEXE, which can provide a 3-4 month turnkey solution – with labor and equipment already in place – to test the waters. There is also a commission program based on the gross fee to the client, which includes the logistics services in the pricing.

"If you're client-focused, and you view yourself as a strategic advisor, you ought to be bringing the right solution for each of your client needs," asserts Siebrecht. "So you can solve the problem, and do right by the client quickly and efficiently."