



OFFICE & INDUSTRIAL *Quarterly*

INDUSTRIAL – INVESTOR INSIGHTS

The Rocky Mountain region's case for industrial

How has industrial real estate in the Rocky Mountains evolved from a once overlooked sector by the national occupiers and institutional investors to one of today's darlings of commercial real estate? In short, this evolution is driven by three major themes, each of which strengthens the others: the fundamental shift in consumer behavior, the decentralization of the national supply chain and a change in population growth relative to gateway coastal states in the west.

■ **The fundamental shift in purchasing behavior by businesses and consumers.**

Long gone are the days when that Terrell Davis jersey could only be purchased from the shelf after driving 5 miles in traffic both ways. Today, we live in a culture of immediacy. The certainty and immediacy when purchasing a product in five minutes on a smartphone is a significant enough feeling of control for most people that they're willing to wait a day or two (rarely) to receive that product. This online purchasing power we hold today is the driving force changing businesses and consumer behavior, a phenomenon often referred to as the "Amazon effect." According to a Nov. 18 report issued from the U.S. Department of Commerce, e-commerce, which accounted for less than 5% of total retail sales in 2012, continues to gain its fair share of the market at over 13% today. In the third quarter,



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speedy deliveries to remain competitive in the marketplace – loyalty is now not as much relationship driven, as it is performance driven – and e-commerce buyers are quickly shifting their purchasing power to the fastest and most reliable common denominator. This is a compelling driver for industrial real estate – these industrial occupiers are expected to continue to stretch their footprints to meet the consumer in their backyard. Today, to be a top contender in the list of online options evaluated by the consumer, companies ideally need their inventory within a 30-mile radius of their expected end user.

■ **Decentralization of the supply chain.**

This end user distribution footprint – often referred to as "last-mile distribution" – is the decentralization of the supply chain. Free same-day

e-commerce retail sales were up 6.6% year over year on an adjusted basis. This acceleration in consumer behavior is expected to continue as e-commerce extends its reach across the country, to markets with populations of even less than 100,000. Manufacturers, suppliers and employees are demanding



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delivery is code in industrial real estate for "companies are extending their supply chains." Amazon has most notably set the bar with what we refer to as its hub-and-spoke model: a 2.5-million-square-foot hub facility, accompanied by one to three 100,000- to 250,000-sf warehouses within a 60-minute drive of its hubs. Instead of continuing to warehouse a high concentration of its inventory in gateway industrial markets like the Inland Empire, we're seeing other credit tenants following suit by increasing their footprint in cities like Denver and, subsequently, inking first-time leases in the high-growth secondary and tertiary markets like Northern Colorado, Colorado Springs and Boise, Idaho. Walmart will deliver items from its store and/or warehouse to your doorstep the same day; Home Depot will deliver its inventory from its store and/or warehouse to your job site the following day.

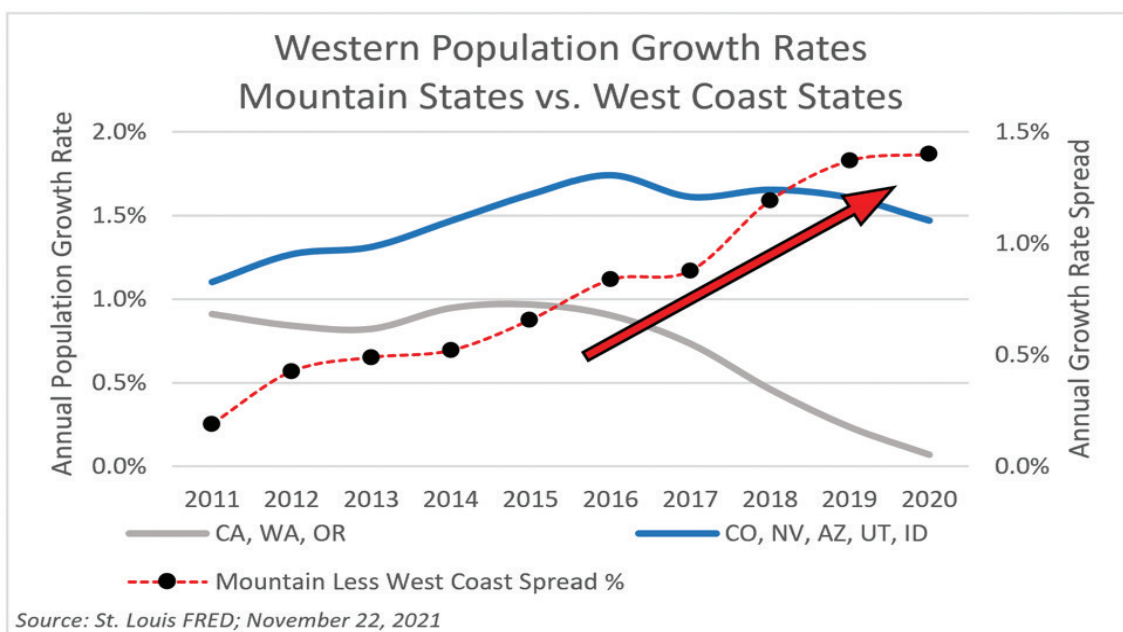
We believe this fundamental decentralization of the supply chain from offshore to onshore now all the way to smaller population centers is an inflection point for Rocky Mountain industrial markets, which are by nature smaller (but growing) population centers. This is a leading reason why key centers in the Rocky Mountain geography are experiencing below-average vacancies in the region, an indicator we expect to remain relatively stable going forward. Additionally, liquidity in this region has increased as more institutional buyers are adding these high-growth markets to their portfolios for the first time – following credit tenancy in this trend toward decentralization. Institutional buyers can acquire a Home Depot warehouse in Northern Colorado with the same underlying credit at a positive yield spread to gateway

markets. As more institutional buyers add these markets, compressed yields may continue relative to gateway markets. The icing on the cake for industrial in the mountain states is that population growth is also at a similar (and compelling) point of inflection.

■ **Population growth amplifies tail winds.** Our favorite real estate metric and the oldest in the book is population growth. In our view, there's reason to believe that Rocky Mountain industrial is well positioned given the shifts in population growth. Mountain states have grown every year for 75 consecutive years, most recently by 15.9% over the last decade. Not every region in the country can say the same, and some states are now experiencing consistent population declines. By way of example, according to the St. Louis FRED, as of Nov. 22, New York state's population has declined each year since 2015, losing 1.6% over that time. Similarly, the state of Illinois' population has declined each year since 2013, losing a total of 2.4% during that stretch. The case for mountain states is detailed further by the spread between growth rates in the western United States shown in the chart on Page 27.

This spread in population growth between mountain states and western coastal states has widened over the last decade. Interestingly, this spread has remained positive for mountain states in the last five decades except for five years between 1986 and 1990. This has not always been the case. Between 1921 and 1971, mountain states had a positive growth rate spread in only 15 years, or 30%. Strong population growth means higher levels of consumption compared to previous years, resulting in an expected growth of industrial inventory requirements over the coming years. We believe that the recent widening of this spread over the last decade, coupled with the fundamental shift in purchasing behavior and the decentralization of the supply chain to the benefit of end user markets, creates a compelling trifecta for industrial out-performance in the Rocky Mountain area going forward.

These are the trends that we believe will continue driving growth in Colorado and the Rocky Mountain region and why we're especially bullish on industrial in our backyard. ▲



Source: St. Louis FRED; November 22, 2021

The mountain states have experienced population growth every year for 75 consecutive years, most recently by 15.9% over the last decade. Meanwhile, the spread in population growth between mountain states and western coastal states has widened over the last decade.