►► 4Q 2023 White Paper

BKM Capital Partners

Reshoring's Ripple Effect

# THE CASE FOR LIGHT INDUSTRIAL


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# INTRODUCTION

As onshore manufacturing and reshoring by U.S. companies begins to accelerate, the demand for industrial space should continue to climb as more space will be needed to house new and relocated manufacturing facilities and their associated interdependent businesses.

In addition to creating opportunities for owners and investors in the light industrial sector, which typically houses the support network for large-scale manufacturing, there are also substantial benefits that together contribute to the overall health of the U.S. economy, such as job creation, supply chain resilience, sustainability, and innovation.

**The benefits discussed herein collectively tie into a phenomenon known as the Ripple Effect of Reshoring,** which refers to the positive impact that reshoring and nearshoring can have on various aspects of business, the domestic economy, and society at large. Reshoring has gained traction in recent years as businesses reconsider their global supply chain strategies and seek to enhance competitiveness, resilience, and sustainability in their core operations.

For those operating in the multi-tenant light industrial space, there is an opportunity to capitalize on the surge of U.S. reshoring that continues to drive industrial tenant demand to record high levels, resulting in strong fundamentals for the asset class and ultimately providing investors with an opportunity to achieve strong risk-adjusted returns.

# INCREASED DEMAND FOR SPACE

The new wave of onshore manufacturing brought with it a surge in demand for industrial space that would support the influx of new and expanding domestic businesses. Manufacturing leasing volume hit a record 136.9 MSF in 2022, a whopping 42% above the pre-pandemic average.[1] This helped the industrial availability rate reach a record low of 3.4% at YE 2022, with annual absorption at a record high of 53.8 MSF.[2] Annualized activity is trending at a slightly lower 118.1 MSF for the first half of 2023, but the figure is still sizable.[1]

Manufacturers' space demand, meanwhile, flows virtually unabated. At a national scope, manufacturing demand reached 19 MSF at the end of last year, with competition high in the most sought-after markets.[3] In San Diego for example—where manufacturing space accounts for about half the industrial inventory—spaces under 50,000 square feet are leasing at a record average pace of 2.4 months, showing just how desirable these spaces continue to be in markets that present an advantageous location.[4]

This trend continues to remain prevalent as supply chain bottlenecks impose on international operations and businesses seek to escape those holdbacks. With the exacerbation of the COVID-19 pandemic on product movement through ports and production inefficiencies, many companies' challenges remain clear. In a survey conducted by Ernst and Young, 97% of respondents in the industrial sector reported they experienced negative effects on their supply chain operations because of the pandemic. In 2021 alone, there were 11,642 disruptions to the global supply chain, with North America having the highest share of disruptive events.[5]

That's just one of many factors converging to make reshoring a key strategy for manufacturing companies. Nearly all CEOs surveyed for Kearney's latest Reshoring Index expressed positive feelings toward reshoring, up from 78% in 2022. Further, 84% of companies have already brought some or all their manufacturing operations to the U.S. or have plans to do so within the next 3 years. As businesses strategize ways to relocate their operations, the focus will likely remain on diversifying product sources, becoming more vertically integrated, and taking advantage of government incentives.

To accelerate the rate of onshoring and nearshoring, officials have allocated billions of dollars in financial assistance to companies making the transition to the U.S. Federal programs like the CHIPS Act, the Inflation Reduction Act, and the Infrastructure Investment and Jobs Act—joined by similar state programs—greatly incentivize companies for relocating key operations of their business stateside. These investments not only help to strengthen proximal supply chains, but also increase the availability of direct and indirect jobs that will stimulate local economies.

Significant portions of those policies and programs are directed toward the electric vehicle (EV) and semiconductor markets, which have consequently seen a massive surge in demand. Companies have announced $210 billion worth of investments in the EV industry, up from just over $50 billion in 2021 before the policy was enacted.[6] Similarly, companies have announced over $231 billion in commitments in U.S. semiconductor and electronics investments during the same timeframe.[7]

Massive developments including Tesla's Nevada and Texas gigafactories, as well as TSMC's multi-billion-dollar semiconductor factory investments in Arizona further highlight the secular U.S. reshoring trend and the impact on these markets as a result of this shift. As stated in a recent report from Merrill and Bank of America Private Bank, "the U.S. is in the early stages of a manufacturing investment supercycle" that could extend well into the second half of this decade.

- Top industries that expanded their U.S. onshore manufacturing in 2022 included **automotive, semiconductors, packaging materials, pharmaceuticals,** and **defense**.[8] Over the past four quarters, logistics, distribution, and manufacturing tenants have accounted for **over 55% of leasing activity**.[9]
- Between 2023 and 2028, the fastest-growing US industrial manufacturing segments by revenue will be **solar power equipment** (25.5% CAGR), **3D printers** (24.1% CAGR), **drones** (24.1% CAGR), and **hybrid and electric vehicles** (22% CAGR).[10]

# Case Study

## PHOENIX, AZ

» One of the nation's fastest-growing industrial markets, with a top-tier location, strong population growth, a healthy construction pipeline, and steep industrial demand.

» Pent-up demand from port markets should drive construction activity and competition in the market given the close proximity to Los Angeles and Long Beach ports.


*Source: JLL Industrial Tenant Demand Study, 2022*

### TSMC IN THE PHOENIX MARKET

Around one-third of the total private investment pledged to green and semiconductor manufacturing is set to occur in Arizona.[11] In particular, TSMC's $40B commitment to Phoenix has had a tremendous ripple effect in the light industrial sector as space for supporting vendors becomes more in demand. Since the firm's announcement, at least 14 other companies have announced expansions in the Metro region, and more than 40 of the TSMC's suppliers have reportedly expressed interest in locating in Phoenix. The ecosystem is expected to ultimately create up to 80,000 jobs over the next five years.[12]

### ROSE GARDEN BUSINESS PARK

This BKM property features two tenants currently contracted by TSMC for manufacturing and maintenance services:

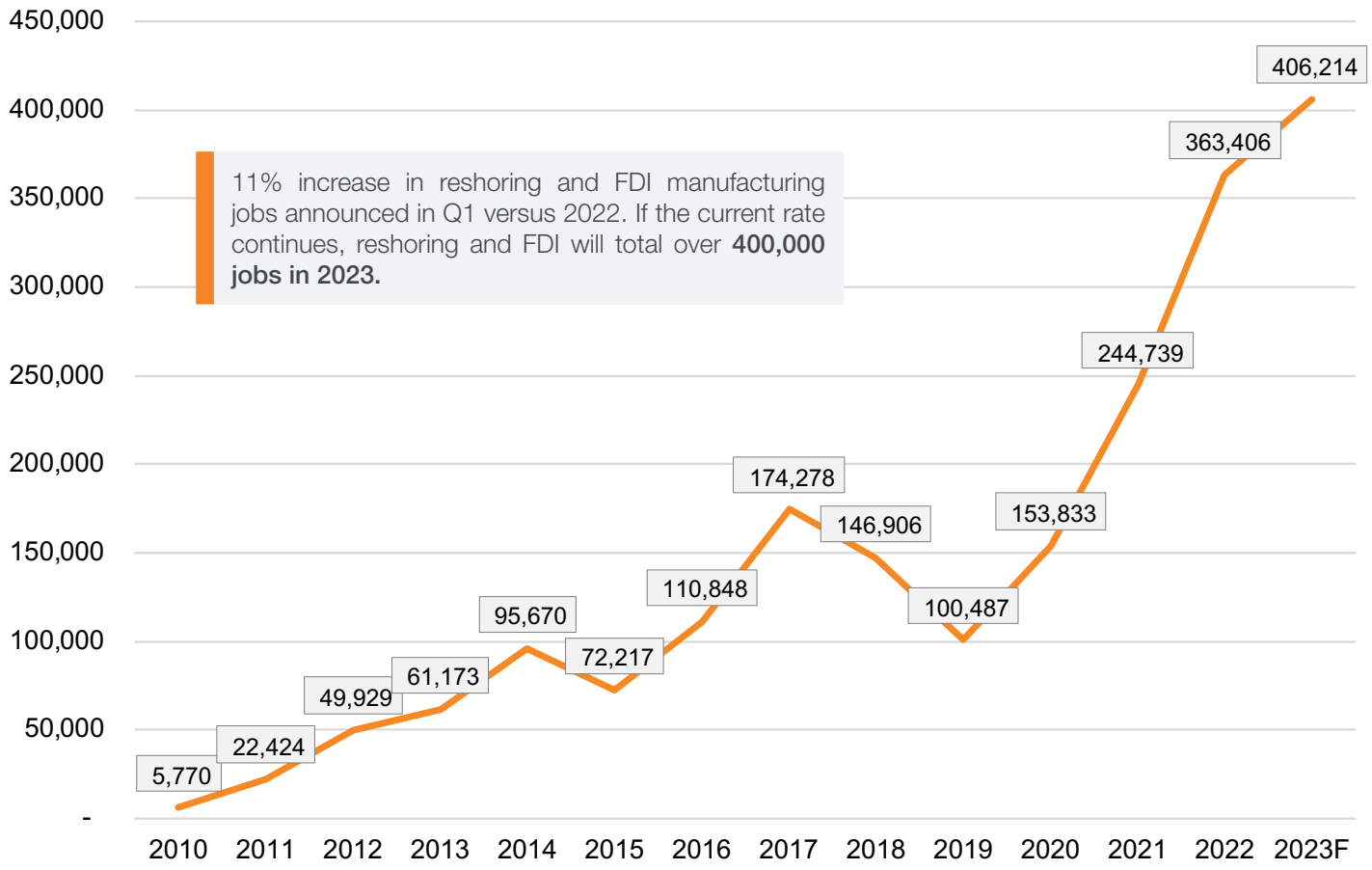
+ Li Yei Enterprise Co, Ltd.
+ ABM Industry Group

# JOB CREATION

The employment growth associated with reshoring is multifaceted, as it involves not only the direct creation of jobs in the manufacturing sector but also indirect and induced job creation in other areas of the economy. This can lead to a decrease in unemployment rates, an increase in income per capita, and a general improvement in the overall economic well-being of the communities where reshoring takes place. It's essential to recognize that the extent of job creation through reshoring may depend on various factors, such as the industry, the specific reshoring strategy, and the local labor market conditions.

According to the Reshoring Initiative, a business advocacy and research organization, more than 1,800 U.S. companies in a variety of industries returned their manufacturing operations stateside in 2022. Further, U.S. manufacturing investments tied to reshoring created 101,500 new jobs in Q1 2023. That number is on pace to top 400,000 by year's end, with the bulk of new jobs being created by investments in U.S. electric vehicle battery production. "Additionally, the cumulative number of jobs brought back since the manufacturing low in 2010 will reach 2 million – about 40% of what we lost to offshoring", the organization said in its recent first-quarter report. It's expected that the industry, which reached nearly 13 million workers in August 2023, will likely need another 4 million jobs by the end of this decade.[13]

## Manufacturing Job Announcements per Year, Reshoring + FDI, 2010 through 2023 Projected




*Source: The Reshoring Initiative 1Q20232*

With this influx of new jobs in the labor market we will also see increased opportunity for skilled workers to enter/re-enter the workforce. As advanced manufacturing and tech facilities develop their home bases in the U.S., their recruitment efforts will drive a higher need for these skilled workers to run their facilities efficiently. Semiconductor giant TSMC announced in August that they are seeking to recruit an additional 2000 skilled workers for its Phoenix facility, creating a domino effect across the local job market.

Job creation is a critical aspect of the Ripple Effect of Reshoring. When companies bring manufacturing and other business operations back to their home countries, it can lead to the creation of new jobs for local workers in various sectors.

**DIRECT JOB CREATION:** The direct creation of jobs in the production facilities themselves. This includes roles such as assembly line workers, technicians, engineers, and plant managers. These jobs can provide stable employment opportunities and may also offer higher wages than jobs in other sectors.

**INDIRECT JOB CREATION:** This can include roles in logistics, warehousing, and transportation to support the distribution of goods. It also extends to the growth of local suppliers, who may need to hire additional staff to meet the increased demand for their products and services.

**INDUCED JOB CREATION:** As more people become employed, their spending power increases, which in turn stimulates demand for goods and services in the local economy. This can lead to the creation of additional jobs in retail, hospitality, and other service sectors.

**RESEARCH AND DEVELOPMENT:** When companies bring their operations back home, some establish or expand their research and development (R&D) facilities in the same location. This can lead to job creation in the fields of engineering, design, and innovation, as companies strive to remain competitive and develop new technologies and processes.

**WORKFORCE TRAINING AND DEVELOPMENT:** Reshoring can spur investments in workforce development, including training and skill development programs. This can lead to the creation of jobs in the education and training sectors, as companies collaborate with local institutions to develop curriculum and offer on-the-job training opportunities.

# Job Multipliers

When evaluating how an industry influences both the local and national economy, it is crucial to identify shifts within that industry and how these changes have a cascading impact on the surrounding community. To gain a deeper understanding of these effects, job multipliers are frequently employed as a valuable tool.

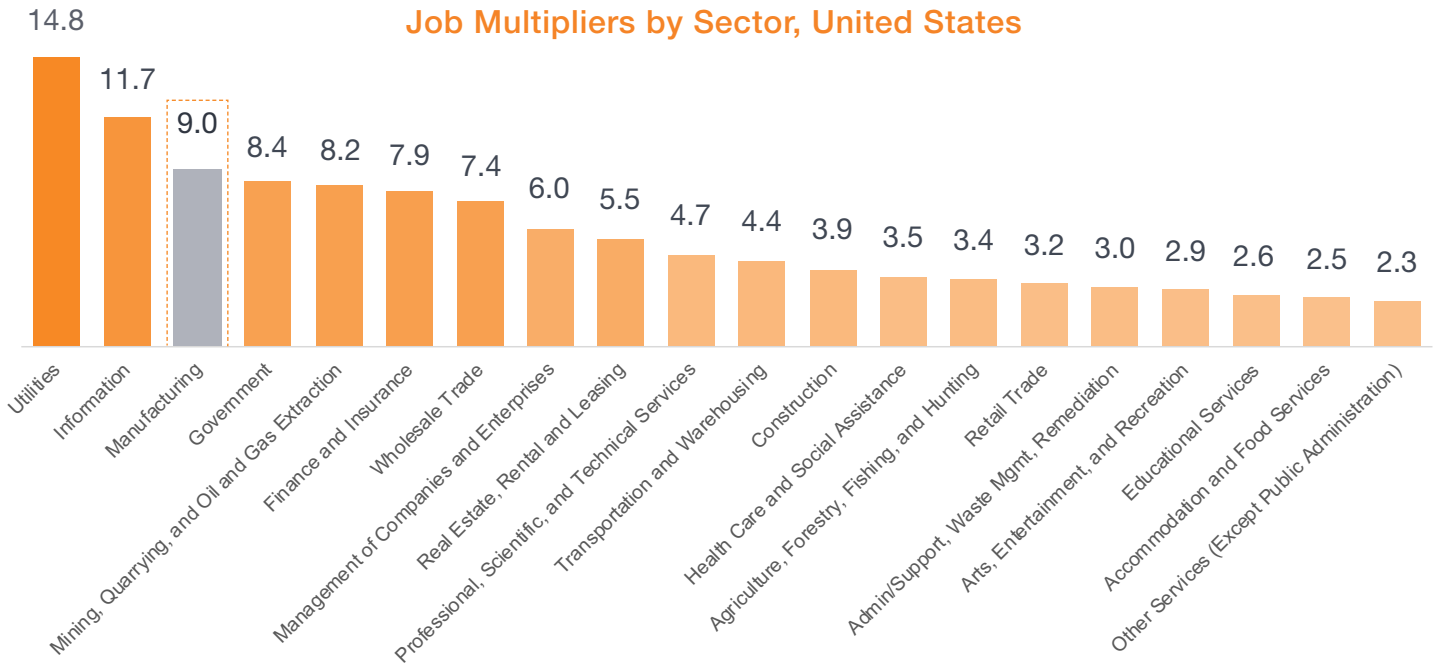
Multipliers go beyond evaluating the immediate influence of a specific industry; they also account for the industry's secondary and induced impacts on job creation. Each industry is intricately linked with one another, providing essential resources and inputs to create a complex network of influence.

Through the use of multipliers, manufacturing has proved to have a significant and growing impact on employment and the broader economy:

+ Every $1.00 spent in manufacturing has a $2.60 total direct and indirect impact on the broader U.S. economy, representing one of the nation's largest sectoral multipliers. Additionally, each dollar earned by a manufacturing employee translates to $3.75 in earned labor income added to the overall U.S. economy.[14]

+ Goldman Sachs analysts reported that every $1 million increase in manufacturing construction spending leads to roughly nine new manufacturing jobs. With $65 billion in spending expected over the next two years, that amounts to over half a million new jobs.

+ For every direct manufacturing job, 8 indirect jobs are created within the economy as a result (i.e., 9.0x job multiplier), far outpacing many other industries. These jobs can be found in supporting industries such as mining, warehousing, and distribution space, and often consist of vendors within the multi-tenant light industrial real estate space.




*Source: Emsi, Camoin Associates*

# ECONOMIC BENEFITS

In addition to job creation, other key impacts associated with the Ripple Effect of Reshoring have clear benefits for manufacturing companies and the broader economy alike.

+ **Global GDP Giant:** Increased domestic production can stimulate economic growth by increasing the GDP, local consumption, and tax revenue. U.S. manufacturing is already a major force in the global economy, ranking second only to China in terms of value.[15] Taken alone, U.S. manufacturing GDP ($2.79T) would represent the world's 7th largest economy, behind the U.S., China, Japan, Germany, India and the U.K. Manufacturers' annual contribution to the domestic economy hit an all-time high of $2.905 trillion on an annual basis in Q1 2023, accounting for 10.9% of GDP. The sector is forecast to grow at a 3.05% CAGR through 2028, despite potential economic headwinds.[16]

+ **Power in Proximity:** By bringing manufacturing closer to home, companies can better manage and control their supply chains, reducing risks and improving their ability to respond to unexpected disruptions. Being able to shorten lead times aids in inventory management, resulting in cost savings that would otherwise be tied up in supply. Reshoring also provides companies with the ability to maintain better oversight on all steps of their production process and procedures, consequently improving overall quality control.

+ **Innovation Leader:** Reshoring can allow companies to work more closely with research and development teams, universities, and other partners to develop and implement new technologies and processes. U.S. manufacturers perform 55.2% of all private-sector R&D in the nation, driving more innovation than any other sector.[16] Companies in manufacturing industries conducted $326B in domestic R&D in 2021, 88% of which was self-funded.[17]

+ **Reach Sustainability Goals:** Shorter transportation times and distances don't only cut costs, they also cut carbon emissions and overall environmental impact. Reshoring can reduce the carbon footprint associated with transportation and logistics, contributing to a more sustainable business model. U.S. manufacturing also has greater levels of regulation and transparency than many other large global manufacturing markets, such as China, which still relies on pollutants like coal for energy. As ESG requirements become increasingly prevalent in business operations and investment strategies, the need for sustainable practices is more essential than ever.

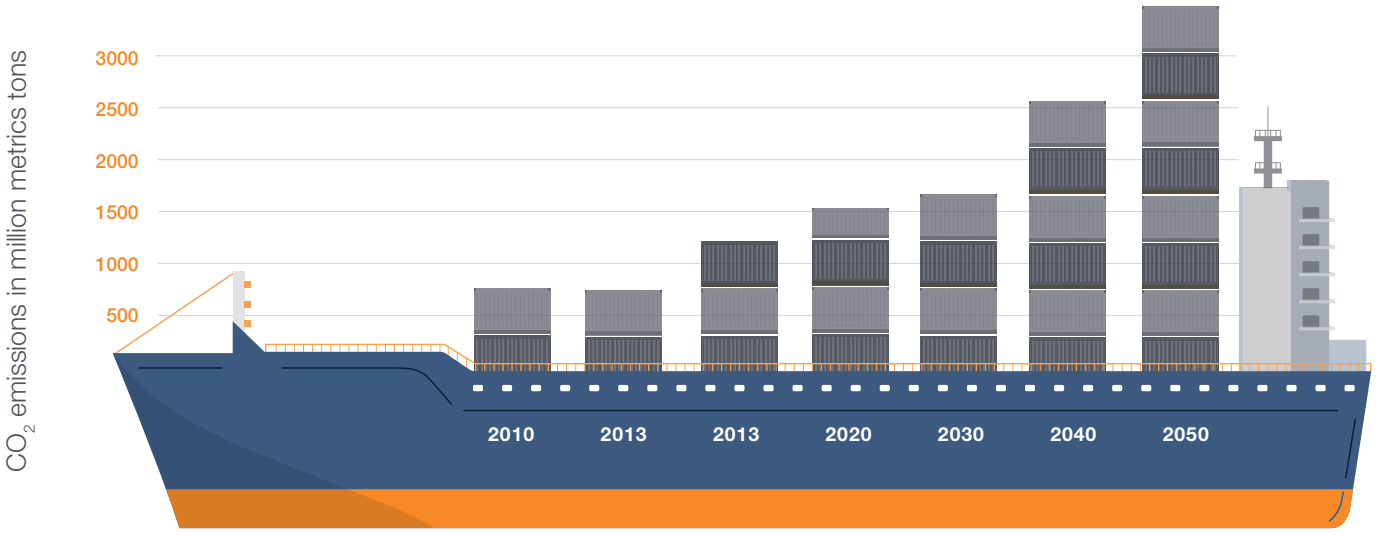
# Carbon Emissions and Reshoring

To better understand the impact of overseas transportation from offshoring, let's take a look at the carbon impact as it relates to various shipping methods. In this simplified example, carbon emissions will be compared between importing goods from China with offshore production and onshoring operations to an infill manufacturing facility in Southern California's Inland Empire.

| | |
|---|---|
| **9 Mile Avg** | Distance for last mile delivery between warehouses and consumers in the Inland Empire. |
| **0.48 kg** | Approximate CO2 emitted to deliver a 20-pound package 9 miles to the consumer. |
| **89 kg** | Approximate CO2 emitted to deliver the same package from an aircraft flying from China to California. |
| **185x** | **More CO2 emitted by air travel as a result of offshoring.[18]** |

In this simplified yet relevant example, onshoring manufacturing in the U.S., more specifically in last mile markets, can reduce CO2 emissions from product transportation and shipping significantly. As we see the levels of CO2 steadily rising with the increased demand for imported goods, it's important to recognize the need for more sustainable operations that can not only help companies increase efficiencies, but can help reduce their impact as well.

## Projected Annual $CO_2$ Emissions from the Shipping Sector




*Source: Container Exchange*

# NEED FOR LIGHT INDUSTRIAL SPACE

With the introduction of new government incentives and the realization of onshoring's numerous positive impacts on local economies, businesses, and the planet, the case for strong future demand in the light industrial asset class is promising. Particularly, the resurgence of large-scale manufacturing in the U.S. will likely come with a corresponding boom in demand for light industrial space.

Though large companies account for a greater share of manufacturing jobs, more than 90% of the manufacturing market consists of firms with fewer than 100 employees.[19] As previously highlighted, many of these supporting businesses can operate in smaller spaces with more flexibility, making them the ideal candidates to occupy light industrial spaces.

Developers are actively trying to meet the growing demand for manufacturing space; spending on U.S. manufacturing construction has nearly doubled since the end of 2021[20], and manufacturing starts rose 211% from Jan 2019 to June 2023.[21] Still, the availability of modern, appropriately sized facilities remains extremely limited for several reasons.

At about 6.7 BSF, manufacturing accounts for just one-fifth of U.S. industrial stock. Nearly half of that space is owner occupied, leaving 4 MSF of rental product, most of which was built prior to 2000.[22] Space under construction won't add much to the available inventory, either—more than 70% of the nearly 60 MSF of manufacturing space under construction as of H1 2023 was either BTS or owner occupied.[1]

Manufacturing already accounts for just 1 in 10 industrial vacancies nationwide.[1] Given the low availability of space and limited future development planned, fundamentals are expected to remain strong for the foreseeable future. In such a competitive environment for space, a new wave of high credit tenants is expected to emerge, likely driving up rent growth and reducing vacancy as a result. Maintaining these healthy fundamentals will deliver a promising opportunity for operators to experience strong portfolio performance and for investors to receive strong risk-adjusted returns, even in today's turbulent economic environment.

> **Light industrial made up only 15.5% of the industrial supply in 2020, with inventory growth of 5.1% between 2010-2021.[23] Recent pullbacks in construction starts will continue the downward trend of available supply, most notably in port markets where space remains limited.**

# CONCLUSION

The Ripple Effect of Reshoring goes beyond the direct benefits to the companies that choose to bring their operations back home. It can have a significant positive impact on the domestic economy, the environment, and society as a whole. As a result of this resurgence of the local manufacturing sector, operators in the light industrial space are poised to experience a continued push in demand via the job multiplier created by large manufacturing investments throughout the U.S.

# SOURCES

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## ABOUT THE AUTHOR

BKM Capital Partners was founded in 2013. Headquartered in Newport Beach, California, BKM Capital Partners is a leading real estate operator and fund manager specializing in the acquisition and improvement of value-add light industrial multi-tenant properties in major markets across the Western U.S. The firm has 13 offices and over 90 employees and continues to produce top quartile performance for its investors.

**Please visit our website below for more information.**

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