

The Impact of E-commerce on Industrial Real Estate

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Mark Albertson with California Public Employee Retirement System is the Moderator.

Moderator: Good afternoon. Our panel has been given the daunting task of holding your attention immediately after lunch, and with the subject of industrial buildings. But not to worry, we have a terrific panel comprised of three gentlemen living the impact of technology and e-business on industrial space.

(Speaker #1) Walt Rakowich is Managing Director and CFO of Prologis. Today Prologis is the largest builder of industrial space in the world, last year constructing over 10 million square feet of space. E-business changes have propelled Prologis to expand its business into the broader logistics market. An example is Prologis has developed business to business soft ware which manages the entire refrigerated storage logistics of over 10,000 customers from storing product, all the way through the distribution through the entire supply chain, including managing the delivery fleet.

(Speaker #2) Blake Baird is president and chairman of the investment committee of AMB Property Corporation. AMB is on the forefront of the impact of technology on industrial space. And in fact, to help understand how e-business is impacting industrial space, AMB is an active investor in emerging businesses. An example of that is their investment in Webvan. Blake will argue that the landscape is so changed that the storage model that we know is bad and that a new business model will emerge.

(Speaker #3) Scott Elliff is President of Capital Consulting & Management, Inc, and is a consultant to Fortune 500s and major international corporations, as well as to medium and smaller firms and, these days, some start-ups as well. Scott's expertise is in supply chain management topics, including product development, scheduling, transportation and logistics. Scott recently had an article published by Federal Express which commissioned a study of the importance of supply chain management in e-commerce. Scott will help us understand the impact of e-commerce on all the logistics industry.

In preparing for the panel, I've benefited greatly from the insights of these gentlemen and I'm sure over the next 75 minutes you will also. What we're going to do is go over a few key issues on how e-business and technology is impacting the value of industrial space and the risks of investing and owning industrial space. Then we are going to turn it over to the audience for adequate time for question and answer so that you can take advantage of the tremendous experience represented by this panel.

Moderator: Scott, let's start with a broad view of the logistics business model. What has changed from e-business and technology advancements that has affected the overall logistics model?

Scott: A couple of things. One is that there is a big myth out there, that e-commerce is this magic and mystery that you click your mouse and the product automatically shows up at your doorstep. There is a tremendous increase in the importance of logistics and inventory fulfillment, and so forth, in the success of all of these start-up companies. I was at a conference earlier this week in San Francisco where a lot of the dot-coms and third party providers and IT companies and so forth were there, and everybody is trying to figure this out. Nobody has a very good answer for it – where their space should be, what it should look like, whether insource it or outsource it, what kind of technology requirements it has, and so forth.

There is going to be a tremendous upsurge in space requirements associated with dot-coms, because a lot of them rely on very quick delivery. Webvan is a good example of that; we will talk about it a little bit later. But to do that you have to be in a metro area and you have to be close to the customer which is sort of the opposite what has happened over the last 10 years where people have been closing smaller regional warehouses and going to bigger, more centralized, nationally managed type of warehouse fulfillment space. So maybe it's swinging back the other way.

Moderator: So you are saying that e-commerce and technology has not eliminated the need for moving product but with the trend of inventory-to-sales ratio dropping over the

last 20 years it indicates there is some greater efficiency in inventory management. So you are saying that all the inventory that has previously been in warehouses won't end up on trucks for just-in-time delivery?

Scott: Well, I think it's a mix of revolution and evolution maybe. The inventory to sales ratio has gone down admittedly, and overall supply chain costs as the share of GDP have gone down, but it has been over a 20 year period. A lot of that overall reduction in supply chain costs is actually transportation reduction and deregulation of transportation. Warehousing has gone down, to some extent, as well. But it has been over a 20-year period.

I work a lot for Fortune 500 companies and I would say supply chain management is still a huge buzzword for all those companies. And pretty much all the industrial companies that I work with still feel that they have, lucky for me I suppose, (laughter) still feel that they have way too much inventory in their pipeline. There is still a very big focus on how to make better optimal use their space, use technology, not just IT but physical technology also to get better use on deployment and fulfillment and so forth out of that inventory.

Moderator: Walt, you built over 10 million square feet of space last year. Somebody is demanding industrial space. Is demand increasing, staying flat or decreasing based on changes in technology?

Walt: I think that is a good question. And I agree with everything Scott said, he's right on point. Statistically, if you look at gross domestic product in the last 10 years on a

nominal basis it's up by roughly 50%. You look at distribution space and it's up by roughly 25%. Look at the growth in inventories nationally and they are up by roughly 25%. Have we become more efficient as an economy? Absolutely. Is it driving negative growth in space? Absolutely not.

As a matter of fact, Mark had mentioned earlier that we own the largest global third party refrigerated/temperature controlled logistics company. And I would tell you that this company, over the last 3 to 4 years has been working on technology and not too different than all the shippers and other third party logistics companies which allow their customers to track and trace product through their system. So at any one time their customers, the Sara-Lees, the Krafts of the world, etc., know exactly where their product is, exactly what truck its on, and where it's going.

Now, has that lessened the overall inventory for these companies? Absolutely not. But if you were to track the growth in inventory for these companies, vis-à-vis_ their sales growth, you would find that it would be growing at a slower pace, admittedly, and that the efficiencies are clearly in the system. But you would also find, interestingly enough, the companies have less stock locations today, for example. They have a more balanced inventory approach across the United States in regional or local distribution centers, faster order times and better and more accurate deliveries. In our view, that will continue.

The other interesting trend that we see is if you were to look at the overall size of goods 15 years ago the average shipment was 150 pounds. Today it's 60 lbs. So in essence,

goods have dropped in overall weight and size, which is allowing corporate America to get the product out to market in a more efficient manner. Yes it's driving inventory space, not driving it at the same pace as sales, so those are two things that are sort of efficiency related that arguably will slow the growth of inventory.

The flip side of that, as Scott mentioned, and as we see it at Prologis, especially last year, is that business to consumer growth is phenomenal. That's not to say that it's going to displace retail – I think that's ridiculous. There's clearly a market for the retailer, but there are also companies that today are distributing directly from warehouses. We built the 700,000 square foot building for Amazon last year in London. We built the 600,000 square foot building for Barnes and Noble in Reno, Nevada. Clearly, this is product that at one point and time would have been shipped (or bought) out of a retail center. It's definitely driving the growth in our company. Our build-to-suits were up 15% as a result of this last year. There's a lot of different trends that are taking place. My guess is that by the end of 2005 what we'll see is a continuation of growth in the overall space, albeit at a slower pace than GDP. And the wild card is what is going to happen in the business to consumer end to drive it the other way.

Moderator: Scott, what is happening at the consumer end to drive inventories?

Scott: I guess we all focus on the business to consumer end of it... that's important. And it's growing exponentially. Maybe it's just where I come from, which is usually working for big industrial companies which is heavily business to business, but B-to-B is about 10 or 15 times bigger than business to consumer today. The amount of

intermediate product, raw materials, sub-assemblies and so forth that are shipped from one business to another for later assembly dwarfs all the books and records and so forth, and has a lot of more time critical delivery than business to consumer. As individuals, we've become used to having it show up the next day. But it's more important for a plant because if that plant shuts down as a result of not getting the delivery the next day, it wreaks total havoc on the whole supply chain and that company's operations. So, I think there is some balance here. We talk about business to consumer, and I think that has a lot of impact, especially local geographic markets because of the need for replenishment deliveries. But the business to business aspect is still going to grow and continue to be a much bigger part of the overall economic landscape.

Walt: Mark, I want to add one thing to what Scott said. Again, I think he is absolutely right. One of the things that we have seen in our space, in particularly in the last three to four years, those of you who own industrial product would agree, is that this whole notion of postponement is not only alive and well but increasing substantially. What is that? Companies now don't like to store finished goods because they are expensive. But what they will do is ship raw materials to our warehouses and in our warehouses there is not only a storage and distribution function but, importantly, there is a light assembly and / or a manufacturing function and it may be reverse logistics, it may be product coming back to the building that has something wrong with it and sent back out. It might be shrink-wrapping, it might be packaging, whatever it might be. But the people are now in our buildings doing a different function than just storing and or distributing. They are actually "light" manufacturing, and in some cases manufacturing, which is significantly driving the space. We've done a study internally as to how many of our customers are

doing that and today over 40% of our customers have some light manufacturing operation in the building, which is very interesting. This is another trend that could drive space in completely the opposite way.

Moderator: So with continuing demand, like thinking about locations, many in this audience have built portfolios of industrial space centered around 5 or 6 key distribution hubs. Does that model fit the new economy? And what are the preferred locations for industrial space as you see it?

Blake: I think overall we are in a pretty crummy business. (laughter) If you look at the industrial business, and everybody is talking about it. Why are we getting so exciting about it? If we are in a business that is growing at 2/3 the rate of GDP, no wonder that prices are doing what they are doing... what a “bad” business. That is a business that is basically, I don’t want to say secular decline, but certainly not very exciting. Also, when you talk about location, and maybe this is a lesson I learned on Wall Street, but what makes markets are differences of opinion; there is always a buyer every time there is a seller. So we can all look at the same trends and come to very different conclusions.

I would agree with a lot of what Walt and Scott said overall about the trends. Inventory to sales ratios have been falling for 50 years, if you go back and chart the data, which we’ve done. And the Internet is accelerating that change because it used to be EDI systems where you spent all this money to have very complicated systems to have GM’s computers talk to their suppliers’ computers and figure out how to make your just-in-time inventory work a little better. Think about the Internet. The Internet has lowered the cost

of information because you can share information B-to-C and B-to-B better with that technology. What's happened is information is being substituted for inventory. If you know where a good is, if you know how you can get it, you don't need to have it. And that's the fundamental change going on. Inventory is being squeezed out of the system because more information is available for that inventory. That leads you to say that the storage business is a crummy business. Why do I want to store goods? I don't. But a lot of what these guys were talking about is the movement of goods. And talking about just-in-time; speed matters. In the new economy what matters is speed; what matters is cycle time; what matters is velocity. Walt made a very good point about package sizes getting smaller. Package sizes are getting smaller. Shipments are also more frequent and shipments are moving with more time sensitivity.

All of that leads to having buildings that are built to maximize horizontal efficiency as opposed to maximizing vertical efficiency. We don't think you can make money with high-cube, high-clear, super flat floors in the middle of nowhere. We actually don't invest in the square States... we think that is a bad investment strategy. We think you want to own buildings built for speed, built for horizontal efficiency, where what is important is moving goods through the building as quickly as possible because that's what matters in the new economy. Michael Dell can't afford to have a business model like Compaq had. You can't afford that long supply chain with many, many steps. It doesn't really work.

What we think matters, in terms of location, is being close to the customer which leads you to in-fill locations. And having buildings that allow you to move the goods in and

out more quickly – high door ratios, good truck access, trailer storage. I'm sure you talk to your logistics 3PL clients and they would kill for a little extra trailer storage! Because they care about moving those goods. This has led us to focusing on the larger markets. If you take the top 6 industrial markets domestically, about 55% of our NOI comes from those top 6 markets and that ratio is going up, not going down. We're actually deploying our capital in fewer markets as opposed to more markets. But I think the fundamental trend, close to the customer buildings built for speed is where we think you will create value all the time, and avoid the storage business which is pretty crummy.

Moderator: That's interesting... that sounds like a recipe for high rent – urban buildings; large markets; large floor plates; adequate truck storage; adequate maneuverability for trucks. Are tenants less rent sensitive than we knew them to be in the warehouse business in the past?

Blake: I don't think anyone is rent insensitive completely. If you take this to the extreme, and we talk a lot about airports, if you are a freight forwarding guy and you have a facility near Dulles airport and storage is totally unimportant to you, but you know you may have international flights to make; cut off times to get the goods on that flight; and your business is the movement of goods with a specific time constraint, you are relatively insensitive to rent. What you care about is making the flight. If Fed Ex has to absolutely-positively get the goods to you by 10:00 am, they don't have they luxury of trucking it an extra 10 miles and sitting in traffic, like I did on 495 yesterday. (laughter) They don't have that luxury.

The ultimate example of this would be an air cargo building, with planes pull-up on one side and trucks pull-up on the other. That guy doesn't have a lot of choice – he can't drive his 747 down the road and unload it somewhere else. He is relatively price insensitive because he cares about location. We like customers that care about location, not that are necessarily trying to minimize storage cost per cubic foot.

Walt: I think we have to be very, very careful that we don't over-generalize what's happening in the marketplace today. I would agree with Blake that the storage feature, that people are not holding goods in storage as long. And they are clearly moving goods through a facility faster. Frankly, all of us have been building buildings over the last 9 to 10 years with more doors, more flow-through capability, etc. But, if you build a building without some storage capability today, and your plan is to make money in it, I can tell you that; number one, you will get a very small percentage of the population; if you really want something generic that fits all needs you need a facility with more flow-through, or more doors, or greater truck ports that still has a storage capability to it, otherwise most of the market will not be able to lease it.

Look at Dell computers as an example. Dell did not have much inventory on their balance sheet. They have been brilliant about taking finished goods inventory, and keep in mind that they have a very high-value product, and shipping that directly to the consumer. What they've done is push the raw materials into their inventory, except it's not on their balance sheet. The raw materials are on their suppliers' balance sheet. If you look at Dell in Austin, for example, they own and lease about 500,000 square feet of space for manufacturing and distribution. Their suppliers lease over 1.9 million square

feet of space, or 4 times what Dell leases. Are they paying for inventory carrying costs? Absolutely. They are paying their suppliers for inventory carrying costs. Where they have been brilliant is that they haven't stored finished goods; they've sent finished goods directly to people. That makes sense.

But I have to tell you that if you segregate the market into "high value goods" and "intermediate / lower value goods," and the preponderance of goods, let me tell you, over 80% of the goods shipped are in that second category, companies have an inventory/freight trade off to make and they will continue to have that trade off. Freight costs are rising at a more rapid pace than inventory and most companies pay over 50% of their overall logistics costs in freight. There is absolutely, unequivocally no way that people are going to do the Dell model and ship a preponderance of product directly to your door/distributor. In fact, what you see happening is that over half of the buildings that we've built in the last 5 years have been regional distribution centers.

If you look at the hauls that people make – short hauls versus intermediate hauls – are growing at over 8% per year. Intermediate hauls have negative growth. Why? Because companies don't have one distribution center and send it to your home. They have 5 or 6 regional distribution centers, send it there in a raw materials fashion, break it down, do whatever needs to be done. They are close to the customer but not on top of the customer. That is what is happening in the business. You have to be very, very careful that you don't over generalize and pitch your companies bringing things into a warehouse and out the next day. Because it's happening to a very, very small percentage of the population. You are thinking of owning buildings in the next 10 years, not in 50 years.

If you don't have some storage component you're going to miss the highest percentage of the marketplace.

Let me leave you with one final point. As a developer, to build a building that costs \$40 per square foot, to build 5 or 6 additional feet on the top of the building basically costs 20 to 30 cents per square foot. It is a nominal cost in the overall development of the building. Personally, I would hedge my bet and own a building that has storage capability, distribution capability, lots of doors, lots of truck ports, and parking for people working in there, and for trucks that are going to service those buildings.

Blake: I'm glad Walt brought this up because this is a very illustrative point. Walt is absolutely right on the trends, absolutely right on the statistics of what moves by truck versus what moves by air, what moves fast versus what moves slow, where you need to store and where you don't need to store. Where we would have a difference of opinion would be that we're actually not interested in serving the majority of those customers. We're interested in serving the customers that we think are going to be in growing businesses and where these big secular changes going on are going to benefit those industries.

If you look at the 3PL business, for example, which is growing at 2 to 3 times GDP, if you look at the air freight business and how that is growing, if you look at the directional trends you can draw some conclusions. There are lots of people who want to manufacture snow tires 12 months a year, store them 9 months a year because you only sell snow tires for 3 months a year. That guy is going to have a big use for high clear,

high buildings, and is a big user of industrial space across the country. He probably won't be a customer that we want to service. We don't want to service everyone, we want to service the guys where speed is important, where location is important, and where the secular trends going on in the supply chain are going to make them more of a winner. I wouldn't disagree with Walt at all about what's going on, just leads different people to different investments.

Moderator: Let's take that and start talking about physical product and what these tenants and other tenants that both of you are serving would demand in physical product. Scott, maybe you can start with what technologies are impacting your tenant that then need to be incorporated in these buildings and delivered by the producers?

Scott: I'll do that. I can't help but add one other thing on price. Your question before was "it sounds like the evolution might be toward more higher cost space, in close in metropolitan areas." First, I think the market is big enough for both of you; you each have different strategies. Two data points on price and the relative unimportance of price in real estate as part of the overall logistics equation. Recently I've helped industrial companies pick third party logistics providers because everybody is saying it's not a core competency for us, we want somebody else who is better at it to do it, so a variety of very focused third party logistics companies are coming in and taking over the activities of managing inventory, doing the shipping, the replenishment, and so forth. It is a \$50 billion industry and it is growing about 20% a year. The space cost, as a share of third party logistics companies' costs, depending on where they are, is 25-30% or so. When we did the selection process for third party providers, virtually none of the industrial

companies put the price of the third party logistics services, and therefore the embedded real estate costs in it, anywhere near the top of the list in their selection criteria. What's important to them is the competency, the capability of handling seasonality of businesses, quick replenishment deliveries, reliability, etc. regardless of whether it's B-to-C or B-to-B. First point then, if there is any silver lining, it's that price is not the number one selection criteria for industrial companies when they are looking for people to provide space to help them run logistics.

The second point came out of the dot-com conference I attended the other day. It's very different out on the West Coast with Silicon Valley, and so forth. In the hallway if you hear people asking each other "what space they're in" it has nothing to do with real estate! (laughter) It's what e-business space or what e-business niche you are in. They couldn't care less about the real estate costs. What they want to do is serve a particular unserved, hot new niche, and real estate is just one of the side effects of something they have to write a check for. Their business is not organized around that at all. But as you start to have a discussion with them about space, what does your warehouse space look like and where is it? You get a blank look, because their focus is all on the front end -- eyeballs, websites, market niches, and so forth.

Moderator: Then are the producers of space left to making the decisions for these other space users as it's defined in the physical product? Who is deciding what changes need to occur for the physical product? Both Blake and Walt, you are building space, and you must be noticing that tenants are looking for something different.

Blake: That's really a chicken or egg question. You talk to your customers. You try to find out what's important to them, and the ranking of criteria, i.e., will they drive an extra few miles. It's funny, we had a session with a half dozen 3PLs last week and we were interviewing them, and you get into details, i.e., will they take off-site trailer parking and how much will they pay for that.

The answer is you have a broad spectrum of customers trying to provide solutions in turn for their customers. So there isn't any one answer. The conclusion that it leads us to is location is the most important factor. Functionality is the second most important. And we try not to get into the point of building buildings that have too specific a purpose because you don't know how the world is going to change. We're making a life's work owning these real estate properties; we're not going to flip them in 2 or 3 years. We want to think about how the product will age and how it can be functional. To some people clear height and super flat floors are the most important thing to them, because of the way their racking systems works or their picking process works. It's a negotiation.

Moderator: Is customization becoming the key process in the business today?

Walt: What is interesting to me is a lot of these companies are moving at light speed, particularly the e-commerce companies. The ones that are obvious to everyone in the audience are the ones that are moving so fast that they are making decisions that, 10 years from now, they may regret. Amazon for example has built 7 buildings in the last 18 months. The one we built for them in London is a superb location – phenomenal. But the two that they built and own in Kentucky make absolutely no sense to me. The one

that they built in Delaware makes no sense to me. And I think about the distribution points. Prologis, we don't own any property in Boston, we don't own any property in Minneapolis, and why? Because those are not cities that serve the remainder of the population. Likewise I wouldn't think Delaware would be a great location. But, nonetheless, they are doing it.

Companies today are trying to move so fast that they are not making prudent real estate decisions. In our view, on a long-term basis, whether you are in in-fill markets, and most of our assets, interestingly enough, are in in-fill markets, or in the next city out, the regional distribution location – the Bollingbrooks of Chicago and the Exit 8As of New York. The best real estate is near large regional population bases. There is so much in the way of distribution needed, and if Amazon doesn't need it Barnes and Noble or someone else will. We see a lot of mistakes being made on the front end. The good news is that most of those buildings are being owned by those companies, because most landlords like ourselves won't build them those buildings for anything but a fee.

Prologis invested three years ago in a company called Insight. Insight does network optimization studies for companies. They say here are your suppliers, here are your customers, etc., where should you put your buildings? They have developed proprietary software to do that and us being plugged into that has significantly helped our development business in building and owning where we need to own, and they would confirm the same thing – stay close to the regional population bases. Columbus, Ohio isn't intuitively a location that is in a large location to the population base, but if you look at everything going on around Columbus or Indianapolis, or in particular, Louisville,

Kentucky, with UPS and you have a 1 day truck drive, you now have phenomenal regional locations, and destined to grow over time. What customers are looking for today are not necessarily what they are looking for tomorrow because of the speed with which they have to roll these things out.

Blake: Walt made a great point, what customers want may not be what you want to own. That distinction is very important.

Moderator: Is that something you don't want to own from location, from basic structural building, or from the fit out that the tenants are expecting you to pay for?

Blake: Usually the buildings are fine. I think the fit out is an important issue. You are signing a 10-year lease with a guy who has been in business for about 10 weeks! (laughter) How you underwrite that credit, etc., is a very tricky, difficult issue. We generally try to avoid putting in a lot of specialized tenant improvements or at least understand how much it will cost to rip them out if they go bankrupt. Generally, it's location and demand for that space. Walt got it right. Some of the buildings that these guys want to be in – take an overhead picture and all you see for 50 miles is desert! It's a great building for the user. I just can't understand how it can ever be a great building for the owner.

Moderator: Why does it work for the user in that location and not for subsequent users? Why is it so specific that you wouldn't want it as building that could be used for someone else in the future?

Blake: Because if you are in the middle of nowhere, even with a generic functional building, what is your upside? Land is cheap. Could you really... presumably you are developing that building at replacement cost, unless you did a really dopey land deal in which case you are developing at above replacement cost. What is your ultimate upside protection, in terms of the value of that real estate over time? If there is no upside in land values, and no upside in aggregate demand, then even if you have a lot of demand, if you have a supply of land where you can build buildings forever, where's it going to lead you? I don't think it leads you to a good capital deployment decision.

Moderator: All three of you have argued that the trend is towards locations that are near major transportation hubs, major metropolitan markets. What are these tenants seeing in locating in these places where you wouldn't build buildings?

Walt: What they are seeing is a labor force that they can't access outside of Chicago or New Jersey at a reasonably cheap price. In some cases they are seeing unions vis-a-vis no unions. For the most part, it is a labor decision as opposed to "my warehouse is going to cost me \$0.10 or \$0.20 per foot less." We'll build a building in New Jersey for \$40 per square foot and the land component is only \$4 to \$5 per square foot. So, if we can buy a lot cheaper land in Delaware and build the building at \$38, the overall logistics costs are not going to be that great. What is great is the labor costs. The reason why you want to invest back in the regional location is because the tight labor situation, you can't count on it forever. It is what it is today. And that's where I would not want to own a building. Don't get me wrong... I think you can access labor outside the Chicago, LA, etc. But

certainly a lot more expensively than you can in the desert communities that Blake is talking about.

Moderator: Before we open up the question and answer, let's put in perspective the buzz of the impact of e-business and technology on the industrial space market. Scott, you can start with how much of the tenant base is directly technology-related and then Blake and Walt speak about whether we are in the same business we've been in or there are fundamental changes that have been driven by e-business and technology.

Scott: I don't know the number exactly. I'm sure it's going to grow substantially. My intuition is the number is probably relatively small, right now. And probably ultimately, will still be some substantial minority of the space because there is still a tremendous amount of everyday B-to-B movement of goods around in the economy, and that's the part that doesn't get any attention, but is still going to be there. We talked mostly about the last mile, the last piece of fulfillment, especially on the consumer side.

The thing though that is surprising to me relates to one of the earlier questions – when I go around sometimes as part of a project, I'll go and survey the tenants in an industrial park and I'm always very surprised at how different they are to what they do in that space, then what you thought they did. You get a database that says here are these 20 tenants and these 3 are “manufacturers,” and these 2 are “warehouse” guys, and these 2 are somebody else, and you go in there and you find it's much more of a mix: a variety of light manufacturing in there, call centers, office, so forth.

Even back to some of the dot-coms, it's almost the commercial equivalent of a funky Soho loft. Some of these guys want to go into these spaces because it's great to have a completely unfit-out space, and they don't care if there are wires all over the floors and wooden desk tops and boxes; that's kind of cool, as part of being a start up! (laughter) But it's very different when you go in these spaces then what your database back at corporate headquarters tells you the space is getting used for. I think that means, for the particular services and amenities that are in there, that you have to know a lot more about what those companies are doing in that space and why they are in that physical space, and how they are evolving. Security, three shift operations, good lighting for parking for people who are driving in to run the night call center, and the other things that you have already mentioned about truck storage and turn-around and cafeteria and food service. All kinds of things that you think are way beyond the sort of traditional square footage and how high is it and how flat the floors are, and so forth. That's obviously part of it. But all those ancillary or support services or whatever is a very big part of the mix. That's the part that really is going to become drastically much more important for a lot of tenants.

Blake: There is some channel shift going on, which is the "sexy" part to talk about. You don't go to the super market any more, you go to Webvan, and isn't that cool? But that is a very small trend at the moment, and that B-to-C channel shift, and that will benefit Prologis' business and our business, and a lot of people that own industrial. Some of this speeding up of the supply chain, which is related to e-commerce, does affect a lot of things. It affects the growing business of the 3PLs; it affects the growing business of

airfreight companies. And all of that is going to ultimately affect demand for good quality industrial real estate.

So, it's not only the direct effect it's also the indirect effect. And the indirect effect is a lot bigger than just leasing to e-commerce customers, which we'll all do, unless you're in a crazy place like Silicon Valley. I continue to be amazed when people knock on our door and want to rent warehouse space and pay office rent for it – twist my arm – but that is a very unusual small phenomena.

Walt: I would conclude by saying I've agreed with Blake on about everything, but I do not agree that this is a crummy business. I think it's a phenomenal business. As a matter of fact, I would tell you that logistics and distribution of product will loom as an incredibly large factor in the next 10 years for companies that are great marketers that don't know how to get their product to market. I think if you make the right decision in real estate, you could be in a great position down the road.

I also think that what we might see is that there is displaced demand. In other words, companies know today where their demand comes from. In the future, they will not know where their demand comes from. Companies are going to begin to see more and more international demand from people ordering over the internet in Singapore and asking them to ship product there. And most companies will not, cannot, ship their products directly to your doorstep because the cost of that transportation is out of sight. This business is going to create havoc for shippers for a while, and in essence companies

will hedge their bets through additional regional distribution centers and particularly globally.

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