

April 2, 2024

Michael Flynn  
Senior Director – Rail Advisory Group  
Cushman & Wakefield  
(908) 868-2022  
michael.flynn@cushwake.com

### **Modern Alchemy: Turning Rail Dirt Into Rail Served Real Estate**

From a site selector's perspective, developing a new rail-served site can present challenges. Sites with any meaningful manufacturing or distribution capacity have high financial thresholds for purchase and capitalization, mainly due to the scale and complexity of development projects and the limitations on permitted use of these sites. The railroads serving these sites have an opportunity to ease and simplify the development process with the knowledge they possess, greatly increasing the chances of success.

Rail served industrial site developments come together only after years of work. Communities, counties, and states want the prize of a large Original Equipment Manufacturer (OEM) but in most cases they do not know what it really takes and often get lucky in landing a project. They get lucky because the executive leadership in the winning state finds a way to step up with a fortune in incentives that goes toward the engineering and physical infrastructure to get a site "shovel ready" so that the occupant can then begin their own vertical construction. This approach works but only occasionally, and it gives the community limited control over the type of industries that come to their area. Sites with higher levels of preparedness and greater levels of industrial capacity usually win the better projects which have higher rail volumes, employee numbers, wage rates; etc. that communities desire.

The difference between rail served real estate and rail dirt is night and day, and it is hard for the outside observer and communities with sites to know that. Properly educating the general public and economic development community about the proper path towards the creation of rail served real estate sites may well be one of the most important jobs that the people reading this article can do. That education groundwork is often the "lightning in a bottle" that goes a long way toward landing a project.

This might seem simple, but keep in mind that a 1,000,000 SF warehouse covers 23 acres of land and by the time you factor in the supporting rail needed for proper service along with truck parking, roads, land for utility infrastructure, stormwater remediation elements, etc., you need 50 acres minimum but the site usually winds up being a few hundred acres. Because developers have become so much more sophisticated in their development process, all of the "easy sites" are pretty much gone in the United States. To build anything with scale, developers are having to look more and more to rural communities or urban infill sites that require extensive site remediation to fulfill the site size requirements they are looking to develop.

This adds cost and pressure on potential rail served sites because the majority of new buildings constructed are truck based and developers never give any consideration to the creation of an OEM or a major rail served distribution facility on the site. This omission is due in large part to a lack of knowledge on the part of developers and local economic development agencies on the value that rail can bring to a site. In addition to the ongoing need for railroads to continually educate and communicate what rail

access truly means and requires, creating more clarity around the value rail brings could change if railroads start sharing some basic site information collectively, starting with the examples below.

**Electricity** – It’s good to know not only the proximity of electric transmission lines and substations to the subject site but their capacity as well. While the utility company may be the best supplier of answers on capacity, you sometimes have to think outside the box for them. It always costs money but it is easier to install additional capacity via new transmission lines and substations than it is have to go out and find all new rights of way for new physical infrastructure. If a project is big enough the infrastructure will pay for itself when existing easements and equipment can be leveraged. This is not always the case when you have to start from scratch even with the most lucrative projects.

**Natural Gas** – Natural gas is often overlooked. It is a reliable energy source and can be used to co-generate electricity in certain circumstances. When considering a site, the distance to the interstate natural gas pipeline and proximity to a gas gate should be noted. Proximity to an interstate natural gas pipeline should be viewed in the same light as proximity to electric transmission lines, and a gas gate should be viewed in the same way as an electrical substation. Overlooking the proximity of a gas gate to a site is a mistake because it often offers a significant competitive advantage. It defines the volume and pressure that can be delivered to a site and if a manufacturer needs intermediate or high pressure at moderate to high volumes, proximity to rail and a gas gate can set a site apart from the outset and drive a deal forward quickly. Class II and Class III railroads especially should be aware of the locations of gas gates near rail lines adjacent to sites with 50-100 acres of flat land and will want to work to market these sites where possible, especially in areas with limited electricity access.

**Water & Wastewater** – Feast or famine is often the case here. Most industrial users look to use 200,000 – 1,000,000+ gallons per day. This is hard when there is a gallon for gallon capacity requirement of potable water and wastewater. Even if a site does not have access to these levels of water and wastewater, if it otherwise has land, rail access, electric, and gas it is worth spending the time with local, county, and state representatives to get them to consider applying for grants to build the water/wastewater facilities needed. Typically, once they are educated in the process and can do their own cost benefit analysis it results in the go ahead towards the design so that when a bonafide occupant shows up it will put a site one or two years ahead of a comparable site that has not been through the process. When an occupant does arrive and brings the job numbers and tax generation with them it can be easy to get the green light for construction within a timeframe that meets the occupant’s vertical development requirements of the new facility.

### **Railroads and Site Information**

Railroads are one of the largest, if not the largest, recipient of RFIs and RFPs for industrial manufacturing and distribution facilities. Railroads typically do not share how many RFP/RFI opportunities they receive and this can be harmful. This may sound counter intuitive, but it is not. It hurts the railroads more than anyone else not to share this data because there is very limited creditable information that identifies demand. This lack of data limits public and private investment in rail served sites because there is no formal joint document between the railroads that shows the government entities and economic development agencies (that actually provide grants and have bonding authority) willing to go out on a limb to prepare “the site of the future”, debt & private equity sources, third party developer, etc. that there is real demand for rail served property.

The majority of recent spec warehouse and distribution developments built are truck based. Even in cases where properties are adjacent to rail lines or have existing rail on site, the rail is largely ignored or removed. Why is this? One reason is that developers, EDCs, States, utilities, banks, insurance companies, and institutional investors tend to be unaware of the level of perceived or actual demand for rail-served spec developments. The real estate industry frequently circulates and compares regional comp data for industrial sites, whereas information on the inventory of rail served real estate is limited, or inconsistent at best. This can create the illusion of a lack of demand for rail served distribution facilities, driving the growth of exclusively truck-served facilities instead.

Indeed, a search of industrial real estate listing sites such as CoStar reveals that less than 0.5% of the available warehouse buildings in the United States are rail served, and these buildings tend to be small, functionally obsolete buildings that have limited rail capacity and do not allow for modern manufacturing or distribution. Many companies that want to ship via rail cannot find buildings to lease or purchase in a timely manner.

When new rail served industrial parks are placed in areas ripe with demand, they tend to succeed. An example is the Broe Group's Savannah Gateway Industrial Hub, which has been a resounding success since its opening in 2018. The casual observer might attribute this success to luck, but the fact is that research, good investment fundamentals, and market demand created the formula for the development's success. If this type of railroad-generated research was circulated more readily, it might drive the development of similar sites throughout the U.S., which in turn could justify spending of speculative dollars by States and regional EDCs toward site preparedness and certification.

The site selection community sees billions of dollars in investment capital sitting on the sidelines seeking opportunities in new rail served manufacturing, warehouse, and distribution facilities along with their supporting infrastructure. It's likely that the greater availability of some basic data points on regional demand, coupled with continual education and communication of how rail works and what value it brings, will help to unleash this capital for railroads well positioned to take advantage of it.