



# KANSAS CITY'S COMMERCIAL REAL ESTATE DEALMAKERS 2022

**CERTIFIED COMMERCIAL INVESTMENT MEMBERS**

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# CCIM Kansas City President's message for 2022

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guidance. You do not need to be a CCIM designee or even pursuing the designation to be a member of our local chapter and enjoy the many benefits of membership.

The last couple of years have been tough and we are very excited to get back to normalcy. We are back to in-person monthly breakfast meetings and we have some very exciting networking events coming up. Please note that we are hosting CI 101, CI 103 and Commercial Real Estate

Negotiations classes this year. Please visit [www.ccimkansascity.com](http://www.ccimkansascity.com) to check class schedules and all upcoming event dates to get registered.

Again, a huge thank you to our sponsors, especially our annual sponsors, UES Consulting Services, Kansas City Business Journal, Farha Roofing, First National Bank of Omaha, First American Title and Q10 Triad Capital Advisors. Without our sponsors, our Chapter would not be what it is today!

# Fannie Mae, Freddie Mac, FHA/HUD dominate multi-family lending

Multi-family lending continues to be dominated by Fannie Mae, Freddie Mac, and FHA/HUD aka "Agency Lenders" with loan volume exceeding \$170 billion for 2021. The Federal Housing Finance Agency (FHFA) released Fannie Mae and Freddie Mac new 2022 caps of \$78 billion, a 11.5% increase over the 2021 level. In addition, they increased the 60% AMI threshold from 20% to 25% of total business. Competition remains strong at both Fannie Mae and Freddie Mac for 60% AMI and workforce housing business, with Freddie Mac announcing a recent across the board pricing improvement to signal their appetite for 2022 business. In the meantime, Fannie Mae remains focused on 60% AMI targets, and has stepped up their win rate for ARM business, which has historically gone to Freddie Mac.

In general, look for the agencies to get very competitive on pricing when it comes to stabilized high mission driven business including affordable housing. Ten-year treasury yields have jumped up in

recent weeks, however, they still remain historically low, despite being up over 100 basis points from extreme lows a year ago. This rise reflects more of a healthy return to sustainable levels than a significant rise in interest rates.

In addition to the above, the Berkadia Small Loan Program has been extremely active for multifamily loans in the \$1-7.5 million range. We continue to see high volume in terms of both new loan requests and signed applications since the pre-COVID-19. Freddie Mac SBL and Fannie Mae Small Loans programs offer distinct advantages such as holding that rate at application and 5 to 20 year loan terms with 30-year amortizations.

FHA/HUD has seen a huge uptick in deals signed up as the U.S. Department of Housing and Urban Development has revised its policy that previously required three years of post-construction occupancy of properties when applying for refinancing under the National Housing Act Section 223(f). Now, HUD is accepting applications for refinancing newly built



**JOHN SCHORGL, CCIM, MBA**  
Managing Director  
**Berkadia**

or substantially rehabilitated properties as soon as properties achieve the applicable programmatic Debt Service Coverage Ratio (DSCR) of 1.17x for a minimum of one full month. Lifting the three-year requirement, the new policy will make FHA-insured mortgage financing available to borrowers sooner after construction completion and lease-up. The 35-year term with a 35 year amortization make the 223(f) a very attractive option for cash-out refinances.

Both GSEs utilized their full \$70 billion caps in 2021 and are now focused on meeting their new mission goals and \$78 billion caps.

We know the agencies must win more deeply affordable business, so business mix becomes even more important in 2022. New business activity in the early weeks of 2022 shows that the GSEs are competing aggressively for 60% AMI mission business with a desire to stay ahead of that goal. Mission rich business remains most desirable and has seen broad pricing reductions targeting this business. The GSEs continue to price opportunistically for all quality business, and we expect pricing adjustments later in the quarter as more deals go to market and the GSEs assess the competition and deal flow.

I don't think anyone expects rates to go down in the near future and most anticipate owners locking in lower long-term fixed rates today as much as possible. As one of the largest agency lenders in the nation, Berkadia stands ready to be the best borrower advocate possible to win multifamily lending business via government sponsored agency programs including Fannie Mae, Freddie Mac, and FHA/HUD.

# Making strides in affordable housing development

The most unsettling social disparity amplified by the pandemic is in the affordable housing category, which had entered crisis mode long before COVID hit the scene. The National Low Income Housing Coalition recently clocked the affordable unit deficit at 6.8 million which will never be erased at the anemic rate of the 110,000 units of housing being produced annually. The crisis represents opportunity no longer knocking, but now pounding on the real estate industry's door.

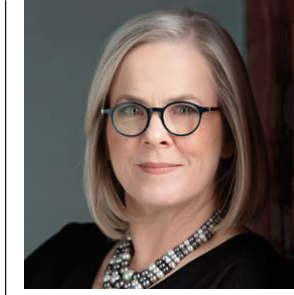
The imbalance in affordable housing supply and demand is not new. Much housing policy began nearly 100 years ago, in part to shore up economic instabilities in the wake of the Great Depression. Fewer than half of all Americans owned their own homes due to high financial barriers to entry, and a cultural norm of renting in all socioeconomic groups.

Affordable housing in the modern context is broadly defined as housing that costs less than 30 percent of a household's gross income including utilities. Such housing supply comes in many forms: new construction, conversion of non-residential structures such as schools or office buildings, and renovation of existing housing.

Affordable housing development starts with a simple math problem that solves for profit potential. A back of the napkin project feasibility test calculates if there is profit when project cost is subtracted from its estimated value, once completed. If not, then the project is either scrapped or returned to the drawing board. If there is profit potential, then the next step is to determine if the number is sufficient to meet lending criteria and attract equity investment.

Affordable housing is anything but affordable to build new. Affordability is limited by an income-related formula, so even the best projects carry a great deal more risk than comparable market projects. The incentive approval process is lengthy and program compliance is costly. Expense increases such as taxes and utilities are beyond the owner's control and threaten the solvency of even the best projects. Construction costs have risen 25% to 30% since the onset of the pandemic and the pace of supply has slowed from plodding to barely crawling.

On an encouraging note, Kansas City has a steadily increasing number of established and grassroots developers



**HOLLY LARRISON MILLS, MAI, CCIM**  
Director of Brokerage  
**Clemons Real Estate**

actively engaged in moving the needle on affordable housing supply. A common theme is a deep understanding of each neighborhood context coupled with authentic engagement of stakeholders.

Gone are the days of the 'shotgun' approach which tended to fail for emphasizing a single property without considering its role in the housing ecosystem. More than other housing sectors, urban core developers depend on a culture of collaboration with local constituents to ensure that strategies are tailored to suit neighborhood objectives, such as whether to foster ownership or rental housing alternatives.

Gregg Lombardi, Executive Director of the Lykins Neighborhood Association, touts the legal powers under Missouri's Abandoned Housing Act, as key in the association's capacity to gain control over the abandoned homes within their target 9 block area. Once under association control, properties are awarded to an approved rehabber. "Of the hundreds of blighted properties in Kansas City, 60 to 70% of them are opportunities, in the hands of a street-smart rehabber, to become affordable housing".

Audrey Navarro, managing partner of Clemons Real Estate, refers to the Lykins method as a "District Approach". She notes that diversity in all forms drives positive results, from market players to property types. "Success in the urban landscape depends on underlying forces stemming from the diverse goals of business owners, tenants and owner-occupants".

Numerous properties near the Sunfresh-anchored shopping center at 31st & Prospect offer opportunities to stimulate diverse affordable housing development. Myeisha Wright, of LocalCode KC, champions the potential there and recommends that developers and stakeholders investigate what resources may already exist such as a map of the existing properties suitable for rehabilitation or redevelopment. "You have to identify local leadership through



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community engagement prior to initiating development plans. It is imperative to build a coalition around what the neighborhood wants". Recognizing that Kansas City's housing needs are not unique, Ms. Wright sometimes interacts with workforce housing developers from the east and west coast markets to share best practices for developing in their

respective housing ecosystems. The forward momentum of these projects is promising. Particularly given the great deal of uncertainty around new construction for the foreseeable future, converting non-productive properties into productive uses is the most cost effective and lowest risk way to make strides towards meeting the demand for affordable housing.



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# Momentum continues in the construction industry despite supply chain disruptions

Several factors have come together over the last few years to create the perfect storm in the supply chain. From natural disasters and logistical bottlenecks, to labor shortages and political instability – it all adds up. Over the last 20 years inflation has been generally steady at 4% to 6% annually for construction costs. However, in the last two years, this percentage has risen to roughly 5% per quarter for a total of 20%+ per year. In 2021 alone, inflation on the cost of construction materials was 24% to 26%. The days of general contractors estimating and quoting a project on a per square foot basis are over – or at least dangerous for the bottom-line in today's environment. Now, GC's rely heavily on sources like the Construction Inflation Alert from the Associated General



**CASEY MCBRIDE**  
Director of Estimating and Pre-Construction / Partner  
**A.L. Huber**

Contractors of America, which is published monthly to let clients know where costs are. Even with that resource, when every week brings new news on materials costs hitting record highs, lead



**CHRISTINA FENWICK, CCIM**  
Commercial Real Estate Relationship Manager  
**UMB Bank**  
Pronouns: she, her, hers

times lengthening or becoming ever more uncertain, the prudent GC's subcontractors and suppliers are consulted daily for local prices.

At A.L. Huber in Kansas City, the preconstruction & estimating group is doing the detailed pricing and bidding work in advance, as opposed to the historical straightforward approach of being able to estimate a range of per square foot pricing upfront. In today's environment it is not out of the ordinary to bid a project where material prices come in 2-3x higher than the historical average, with no sign of this trend slowing down.

In the first quarter of 2022, contractors continued to see the 5% per quarter escalation experienced throughout 2021 on average, with some areas of construction materials

experiencing an even higher rate. Couple the rising costs with an increased degree of difficulty in the procurement of the materials – the fun really begins! From where the products are coming has a big impact on the project and associated costs. Even if the project is using local subcontractors and suppliers, somewhere along the supply chain there has been a disruption and an inevitable impact. Resin made in Texas for PVC piping is impacted by a natural disaster, electrical components from overseas are impacted by labor shortages due to the pandemic, steel bar joists are delayed due to the demand spike related to an increase in large Amazon warehouses under construction across the country. The list goes on and on.

Meeting these new challenges

with new processes, new ways to approach timelines, contracts, and budgeting is almost mandatory.

General contractors must be creative in design, which means engaging with the design team and architects earlier in the process to plan the use of materials that are more readily available, but unfortunately are also likely more costly. With contractors assistance early in the design process, it becomes increasingly normal to issue early-release drawings and bid packages to begin the procurement process early for long-lead items to prevent construction delays.

This process, of course, creates more work and subsequently higher costs for the design teams and their consultants. GC's are also seeing new clauses in bids from subs and suppli-

ers that provides a price projection but states that final price will not be determined until the product is shipped. This is impactful when, for example, buying a door or door frame, which has a current delivery timeframe of 16 weeks as opposed to 2-4 weeks previously. The price will fluctuate over that 16-week period and won't be known until the product is delivered.

Meanwhile, the inflationary pricing trend continues its march forward and upward. In response, escalation factors are being included in GMP (Guaranteed Maximum Price) contracts that can be tracked and assessed on an individual line-item basis. This differs from the standard budgeted contingency which is general and intended to cover changes in job scope or unforeseen issues.

While the direct impact to the construction industry is clear, in many ways, this has also created additional due diligence for the rest of the stakeholders in commercial real estate, particularly the banks financing the projects. Increased material costs in a budget means increased focus on contingencies and assurance that the project is being constructed by an experienced GC who can provide accurate and well-thought-out bids and preliminary budgets. In an environment where so many factors live outside of their control, banks are favoring projects with conservative assumptions for construction timelines and consequently adequate interest reserves in addition to other contingency plans.

To be sure, both general contractors and commercial real estate construction lenders are

all intently watching the interest rate environment and speculating on how and when the seemingly inevitable interest rate hikes will impact the scope and rate of building projects. We'll get back to you after we've polished the crystal ball!

One silver lining to the disturbance is that while the last couple of years have forced the industry to be reactive to change, we have found ways to be proactive in implementing new approaches to better our respective businesses. From both a construction perspective and through the lending lens, we are optimistic about the commercial real estate industry in 2022. For both A.L. Huber and the Commercial Real Estate Group at UMB Bank, 2021 was a fantastic year and the momentum of projects in the pipeline continues.



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Block Construction



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Sr. Vice President  
Office Specialist



**William Block, CCIM**  
Vice President  
Development

4622 Pennsylvania Avenue, Suite 700 | Kansas City, MO 64112 | 816.756.1400 | www.BLOCKLLC.com

# The office market in Kansas City has turned a corner, and the future looks bright

As the dust continues to settle around the Covid-19 pandemic, office tenants and landlords alike are finding ways to make deals happen. New sales and leases in the last several months continue to pile up as most companies realize that office space of some form is a necessity, regardless of how often it is in use. While some national companies and some local businesses continue to work from home full time, it is evident that the office market in Kansas City has

turned a corner, and the future looks bright. The vast majority of the deals we are seeing in the Kansas City market are in Class A buildings that are highly amenitized. Even with most businesses offering the ability to work from home or offering some flexible hybrid schedules, tenants want to have a space where their employees will be happy while they are there and have as many amenities within their building or within a short walking distance as possible. One thing the pandemic



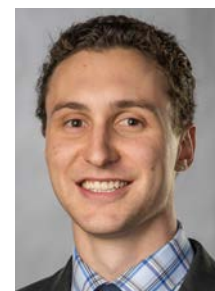
**NICK SUAREZ, SIOR, CCIM**  
Senior Managing Director, Principal  
**Newmark Zimmer**

has not changed is business owner's desire to attract and retain the top talent available for



**JOHN M. HOEFER**  
Managing Director  
**Newmark Zimmer**

their industry. Offering a combination of top tier office facilities and flexible scheduling to work from



**TOMMY GENTRY**  
Associate Director  
**Newmark Zimmer**

home as needed is more important now than ever. A few recent successful projects include 46 Penn, Lenexa City Center and The Aspiria Campus, all of which have put an emphasis on amenities and walkability. Landlords of office buildings have been competing to accommodate tenants as best they can, often times providing higher tenant improvement allowances and other concessions like rental abatement. In some cases, landlords have also been more willing

to agree to shorter term leases if their required investment in the space is considerably less, another accommodation that we otherwise did not often see in the pre-Covid office market. On the other hand, we have seen a trend for longer term leases in exchange for significant concessions of the front end of the lease; a tradeoff that many Landlords and Tenants have been willing to make. As most businesses are addressing their new day-to-day space needs, many have opted to offer

their space for sublease as they motion towards a new building that accommodates their post-pandemic office needs. Subleases began to hit the market in large chunks in the months following pandemic as companies began to embrace the work from home model. While we have seen many companies get back in the office, we have also continued to see sublease offerings rise as many companies have shrunk their footprints as the result of a hybrid work model. According to

recent Costar data there is currently 2,106,939 sq feet of available sublease space on the market. This represents an increase of 133% from a year ago. Although there has been a lot of positive momentum with Class A office space around the metro, the upcoming 24 to 36 months will be telling for many Class B categorized properties as subleases begin to roll over. Every business had to make adjustments during the pandemic, and we are still seeing the effects of those adjustments

today through negative absorption and increased vacancy rates. While the office market is certainly turning the corner with an uptick in leasing activity, it will be important for office landlords to understand what today's office users are looking for or risk losing out on tenants who are in the market. Now more than ever, having an office that represents a company's culture and makes people excited to be there is important to office users as they battle for talent in a digital world.

# 2021 Investment Sales / Capital Markets Review

When I started in the real estate business in the 1980s, the memory of double-digit inflation was still fresh in people's minds. The hangover from the '70s — not just the embarrassing memory of leisure suits, shag carpet and disco, but also a series of disastrous economic policies — was palpable. Brokers pitched real estate as a hedge against inflation. Too many dollars chasing too few goods was driving up prices.

What's old is new again. In response to COVID, the federal government's fiscal policy — flooding the country with literally trillions of dollars — has created an abundance of liquidity while sale prices and rents (particularly in industrial and multifamily) are skyrocketing.

One key difference between today and the 1980s is the low cost of capital. The 10-year Treasury rate has been 250-300 basis points below its historic average of 4.3% for most of the last year. Borrowers have had access to amazingly low interest rates.

The resulting impact on real



**GIB KERR, CCIM**  
Managing Principal  
Cushman & Wakefield

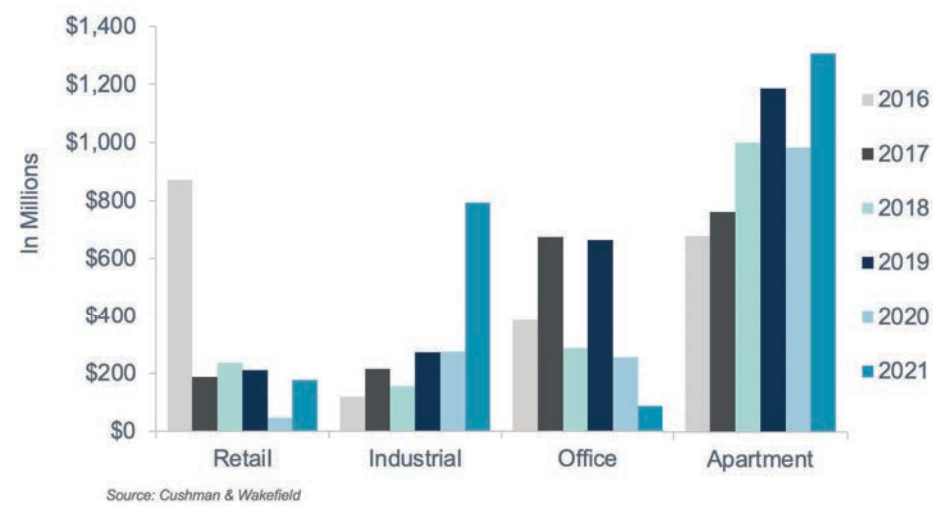
estate should surprise no one. Investment sales in Kansas City hit a record high in 2021 as investors awash with cheap capital looked to diversify outside of over-priced larger cities and/or a volatile stock market.

Among the four main property types — office, industrial, retail, and multifamily — total transaction volume reached \$2.4 billion in Kansas City last year. That's about \$30 million above the previous record set in 2019 and about \$200 million above the record before that in 2016.

What is both notable and encouraging is the breadth of

## KC Annual Sales by Product

Apartments were once again the largest category by volume



investment activity in Kansas City. There was no single, major transaction that boosted the market like in 2019 when the Aspira (formerly Sprint) campus sold, or in 2016 when the Country Club Plaza changed hands. In 2021, the \$2.4 billion tally is largely attributable to a bevy of multi-family transactions and a huge surge in industrial sales.

Speaking of industrial, the total transaction volume for industrial was more than twice the previous record. Driven by e-commerce and logistics, Kansas City's industrial market now ranks among the strongest industrial markets in the country. From 2017 through 2021, our market averaged 8.1 MSF of absorption. Last year ended with 12.8 MSF under construction.

Multifamily also experienced a record year with nearly \$1.4 billion in sales. As housing prices continue to soar and household formation shows no signs of abating, demand for apartments has created record-high rent growth — over ten percent in many submarkets — and is almost certain to continue rising. Investors, with unprecedented levels of "dry powder" capital looking to invest, are likely to maintain strong acquisition levels in multifamily at increasingly higher prices.

Cap rates — defined as the sale price divided by the Net Operating Income — have reached eye-popping, low levels. Many Class A apartment and industrial sales have been in the 4.0-4.5% range, which was almost unimaginable just a couple years ago. Nonetheless, with cap rate compression — i.e. lower and lower rates — in larger (primarily coastal) markets, Kansas City pricing seems like a bargain to many out-of-towners.

The "red-headed step-children"

(no offense to you red-heads) over the last couple years have been office and retail. Many investors adopted a wait-and-see approach to companies' future use of office space. Will businesses return to offices like before, or will work-from-home become the new norm? Most likely we will see hybrid arrangements, but the emerging consensus is that employees are more productive working collaboratively in a mission-focused office environment.

We are witnessing a definite "flight to quality" among office tenants as they upgrade to nicer, newer buildings. We expect the office investment trend to follow suit. The top researchers at Cushman & Wakefield predict a strong office recovery in the second half of 2022, which is certain to lead to a corresponding return of bullishness among office investors.

In the retail sector, the surge in e-commerce has taken its toll on many retail centers. Yet occupancy remains surprisingly strong in most properties and investors' appetites are still healthy for credit tenants — particularly for internet-resistant businesses with long lease terms.

Last year, Kansas City ranked #8 among 38 major markets for net in-migration of population since the start of the pandemic. (Source: <https://www.linkedin.com/pulse/migrations-new-map-florida-utah-win-favor-two-giant-metros-anders/>) In the Great Reawakening, people are flocking to cities that offer good quality of life — affordability, low congestion, the arts, major league sports and more — and KC is on their radars.

The same holds true for investors — including a growing number of international players — who are attracted to KC by our sound fundamentals and promising future.

## RETAIL'S METAMORPHOSIS

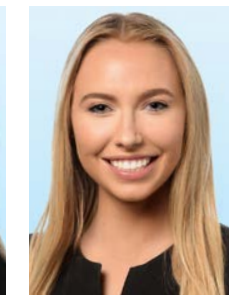
# The shift led by Covid-19 and next generation of consumers

This year has already been a breath of fresh air for the retail sector. Around Q3 2021, junior anchor and big box leasing activity in our portfolio started picking up steam, a positive sign given the amount of rental abatement requests Landlords have seen over the past two years. Space vacated by traditional brick-and-mortar retailers previously seen as stable (Tailored Brands, Pier 1, J Crew, Stein Mart) has motivated Landlords and brokers to get more creative with backfilled uses. It's not surprising anymore to see grocery store conversions, hospitals, or self-storage users taking a portion of a shopping center. The Barstow School, an independent K-12 school, will be opening their space which will focus on STEAM: science, technology, education, art and math at the former Hy-Vee on 123rd and State Line. In Gladstone, over 176,000 square feet was recently sold at 64th and N. Prospect Ave to the North Kansas City Early Education Center. That shopping center was previously anchored by Hobby Lobby, Salvation Army and Price Chopper.

As expected, more restaurants are seeking smaller footprints and second-generation spaces are becoming more difficult to find. There has been an uptick in demand for drive-thrus and patios for users that never required them in the past. Pad sites are highly



**ALLI MORAN, MBA, CCIM**  
Associate I  
Kansas City  
Retail Services Group  
Colliers



**KAYLA GILCHRIST, CCIM**  
Associate I  
Kansas City  
Retail Department  
Colliers

marketable with a lack of existing drive-thru infrastructure and users seeking A+ sites will likely have to look off-market. Owners with excess parking might have an interesting opportunity right now to pursue build-to-suit or ground lease options.

Increasingly, consumers are taking note of retailers' sustainability practices and technology processes with alternative forms of payment, app offerings, and frictionless transactions becoming more and more popular. Companies including Amazon have been experimenting with cashier-less purchases enabled by artificial intelligence. KFC, Dominos, and Taco Bell are experimenting with robotics which may make some stores fully autonomous in the future.

Newer fast-food prototypes by brands such as Burger King feature food lockers, giving customers a contactless way to pick up their orders.

We expect owners and developers to progressively implement experiential retail into their projects. Experiential retail creates engaging experiences and forms of entertainment that cannot be found inside the home. Pop-up retail, for example, has driven repeat purchases and keeps consumers coming back to brick-and-mortar shopping versus online. In 2021, CBL Properties hosted Kansas City Fashion Week inside Oak Park Mall and now there are booths available for local designers to showcase and sell their products. The "thrill of the hunt" is another common theme among brick-and-mortar tenants that has been persevering despite e-commerce's grip on overall consumer purchases. Five Below, TJ Maxx, and Home Goods are great examples of this approach which keeps consumers engaged throughout their shopping experience.

Retailers continue to experience labor shortages and supply chain disruption. Thriving businesses that are eager to grow are not able to find good, reliable employees. Similarly, less employee-intensive brands have put expansion plans on hold due to Tenant Improvement costs and supply wait times.

Looking forward, we anticipate the trend of medical tenants leasing retail space to continue to rise. Specialized doctors historically located in traditional office buildings are opting for street frontage and signage visibility to attract patients and strengthen their brand name. Urban-based hospitals looking to offer urgent care among other services are turning to shopping centers in the suburbs to fulfill those needs. Conveniences offered by these retail properties include close highway access, first floor accessibility, and often free parking. These advantages have encouraged a surge of urgent care facilities to spill over into retail areas and has attracted QuikTrip into the healthcare sector with their new concept, Medwise Urgent Care. Medical spas and infusion centers have been on the rise as well. The COVID-19 pandemic has not diminished consumers' preference for personal appearance and wellness in discretionary spending.

As brokers in the commercial real estate profession, especially the retail sector, we're used to in-person networking, site visits, market tours, and traveling to conferences to win business and make deals. Like others, we have gotten creative in our use of virtual communication, remotely attending conferences, and using online education to keep up with the latest trends and market leaders.

## Industrial Real Estate growth is continuing at a record pace

Industrial real estate development continues to grow at a record setting pace as companies work to navigate through the effects of the COVID-19 pandemic and surge of e-commerce. NorthPoint Development has experienced this firsthand both in Kansas City and across the country as we have continued to be a market leader in developing space for companies. In the past five years alone, NorthPoint has developed over 69.4 million square feet representing a valuation of over \$6.44 billion dollars. With over 40 million square feet of construction taking place across the country, we have been able to observe and react to the everchanging environment that exists in the industrial space.

Demand for industrial space continues to rise as supply has become constrained given the recent surge. Kansas City's vacancy rates are around 4.6%, which is

near record lows as the historic average has trended around 7.0%. Similarly, the national average is trending near a record low 3.2%. This has now created an environment where companies are beginning to look 1-3 years out when analyzing their real estate needs and making decisions that affect their business in 2023 and beyond, rather than in the immediate term.

In addition to low vacancy, contractors and other developers are facing major challenges when it comes to construction material procurement — not only are the prices continuing to increase but the lead times for materials have grown longer and often hard to pin point. To combat this, companies are looking further out to secure their more immediate needs versus expecting spaces to be available when they inquire in a market.

In addition to space availability and timing of delivery, companies are also taking a deeper look



**BOB GUDE, CCIM**  
Vice President  
NorthPoint  
Development



**NATHAN BRINKER**  
Director of Industrial  
Leasing  
NorthPoint  
Development

at market wage rates, labor availability, and transportation costs related to their operation. While these have certainly been long time variables in the equation, they have become more top of mind as more companies continue to enter new markets and compete for labor, trucking, and other associated services related to distribution. With respect to transportation costs, for many

port users specifically, they are beginning to look more inland as rental rates continue to rise near ports. Instead of simply taking the nearest available warehouse, companies are analyzing cheaper real estate that requires additional trucking but allows them to be more competitive on total costs related to handling and storing their products.

NorthPoint Development continues to stress the importance of being client focused and help solve the problems our clients are facing. Our push for stronger internal labor analytics, drayage analyses, and expansion into the 3PL / freight forwarding business have only helped us create solutions for clients. We pride ourselves on being market leaders in our industry and certainly look forward to continuing to deliver industrial product both here in Kansas City and on a national level to help combat the growth of e-commerce and distribution.

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