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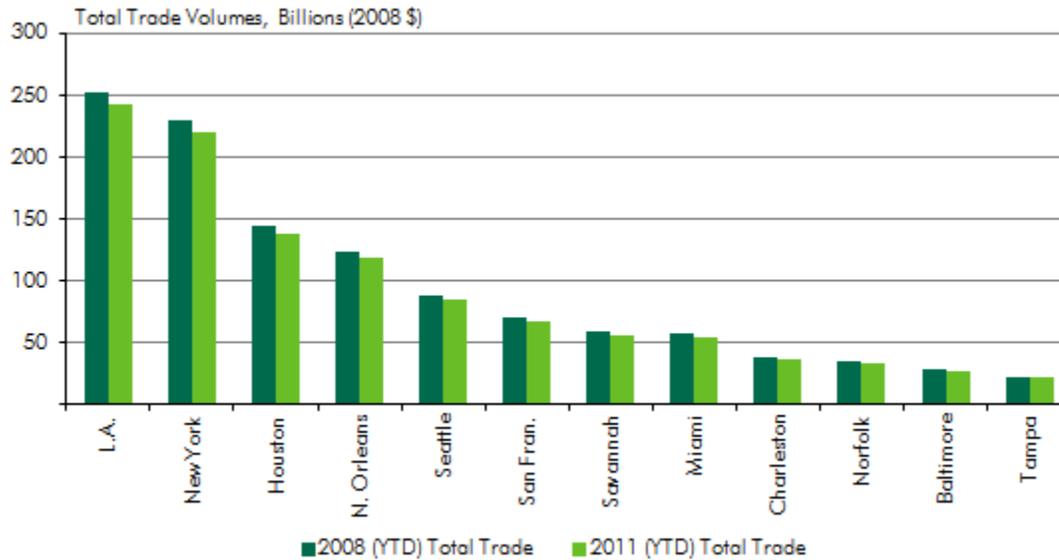
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**IS THE WIDENING OF THE PANAMA CANAL THE NEXT Y2K...LOTS OF  
HYPE WITH LITTLE REAL IMPACT?**

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During the recent recession, both exports and imports plummeted worldwide as demand evaporated for most traded goods. As the global recession ended, other economies—particularly larger emerging economies including Brazil, China, and India—have led the world in terms of economic growth, allowing the global economy to outperform that of the United States. This foreign growth has allowed export trade to rebound faster than the economy in general, with U.S. exports now at record levels. Meanwhile, imports are still slightly below their pre-recession levels, though they are recovering significantly. Naturally, the nation's ports have seen their volumes recover as trade has rebounded, and are now almost back to their pre-recession levels.

### In Real Terms, Port Trade Volume is Still Recovering in Most Port Districts



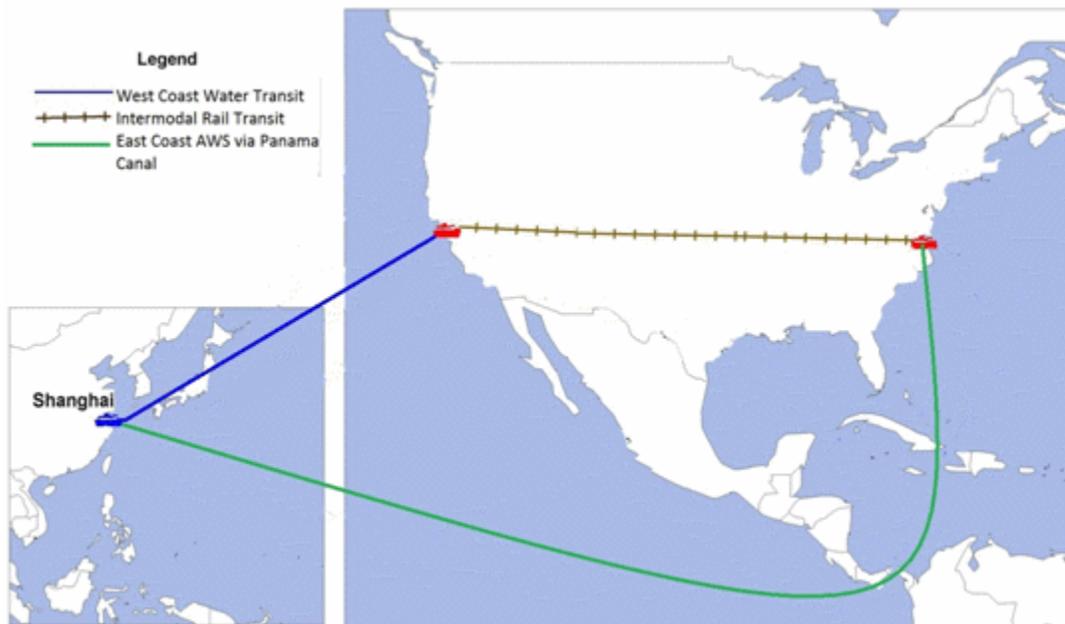
Source: U.S. Census Bureau.

Much of the trade growth in both imports and exports has come from emerging economies—specifically those in East Asia, including China. U.S. trade with this region is growing faster than with any other region, largely driven by growth in China, which is now the U.S.'s second-largest trading partner after Canada. Because of its geographical location on the West Coast, the nation's largest port district, L.A., handles much of the import and export traffic for the Far East region.

With strong trade growth—especially from emerging economies in the Far East—port-driven markets have been among the best-performing and most stable industrial markets during the recession and recovery. Industrial investors have and continue to develop strategies that target port markets, taking advantage of the trend toward increasing globalization, which in turn, through steady growth in trade volumes, drives demand for space. At the same time, because port markets are generally mature and border a major body of water, they are often more space-constrained, which makes new construction more difficult and costly.

One view that has become pervasive among the real estate and logistics/supply chain communities is that, with the widening of the Panama Canal—scheduled to be completed by early 2015—West Coast ports face significant additional losses of share of Far East traffic. The widening of the Canal will allow for transit of container ships that have more than twice the maximum capacity permissible today. The bigger ships, when fully utilized, also have the potential to significantly reduce unit transport cost. It is argued that this combination of greater capacity and lower unit cost will divert a large amount of additional cargo from discharge at West Coast ports to East Coast ports, and, to some extent, Gulf Coast ports.

## Two Alternatives for Shipment between the Far East and the U.S. Eastern Seaboard



The West Coast ports have already lost a significant share of Far East imports to East Coast ports since 1997, as "all-water service" (AWS) from the Far East to destinations in the Eastern U.S. via the Panama and Suez Canals proved to be an increasingly effective alternative to discharging containers at West Coast ports and shipping them across the continent via intermodal rail. The steady loss of share by West Coast ports to AWS was punctuated by severe service failures at the West Coast ports in 2002 and late 2004/early 2005 and from rail services in 1997-98 and 2004-05. Also, major importers like Walmart and Home Depot aggressively expanded import distribution capacity in the vicinity of ports in the Southeast, and eventually in Houston as well. Many other importers followed suit, hoping to diversify their import distribution away from overreliance on the occasionally unreliable West Coast. Meanwhile, as the ocean carriers kept adding AWS vessel deployments in response to shipper demand, the service frequency and port coverage of AWS increased dramatically. Due to the growth of AWS in the Far East trade, some East Coast ports have seen dramatic growth since the late 1990s. The Port of Savannah GA, for example, rose rapidly to become the fourth largest container port in the U.S., while the Port of New York/New Jersey resumed rapid growth after a long period of sluggishness.

Raising a number of questions, the growth of the AWS share of Far East trade continues in 2011—albeit at a much slower pace and after a slight setback in 2010, when the West Coast ports regained share. Will this trend continue? Will AWS volume continue to grow fast enough to create a surge to East Coast ports after the Panama Canal widens in 2015? What are the implications for industrial real estate on the East Coast? Would it be wise for investors and developers to aggressively snap up industrial assets and land in the area of East Coast ports prior to 2015?

Probably not—or at least not indiscriminately. The reason is that the diversion of most of the high-potential cargo away from West Coast intermodal service to AWS has already occurred, and further AWS growth prospects for East Coast ports are modest. Consider the table below, which focuses on container shipments from the Far East to destinations in the U.S. Northeast.

Container Volume from the Far East to Northeast U.S. Destinations via Intermodal Service over West Coast Ports vs. AWS to East Coast Ports: 2000-2010

Year	Intermodal Service via West Coast Ports (TEU*)	All-Water Service via East Coast Ports (TEU*)	Total	West Coast Share	East Coast Share
2000	554,881	547,845	1,102,726	50.3%	49.7%
2010	105,865	1,756,050	1,861,915	5.7%	94.3%

\*TEU = Twenty-foot Equivalent Unit, a standard measure of container volume

Sources: *Trans Systems estimates, Journal of Commerce PIERS data, Intermodal Association of North America, inter-regional intermodal container flow data.*

It is estimated that in the year 2000, just under half of the Far East imports destined for the U.S. Northeast were moving through East Coast ports (via either the Panama or Suez Canal), while the rest were discharged at West Coast ports and then moved via rail intermodal service. By 2010, five years before the projected completion of the widening of the Panama Canal, the East Coast port share of the same cargo was already over 94%. Data for intermodal volumes to U.S. Southeast destinations are less readily available or comparable, but analysis indicates that the result is basically the same: by 2010, nearly all of the container volume moving from the Far East to destinations along the U.S. Eastern Seaboard had already been diverted away from West Coast intermodal service. Partial data from 2011 indicate that the AWS share today is even higher than it was in 2010.

What other West Coast intermodal cargo could be diverted via Panama Canal AWS to East Coast ports? Today, nearly all of the West Coast intermodal cargo from the Far East moves to destinations in the region between the Rocky Mountains the Appalachian Mountains. For East Coast ports to capture this traffic via the Panama Canal, significant "backtracking" would be required, either by truck or rail, and this would add significantly to the time and expense of the AWS shipment. (Note, however, that if the AWS shipment is via the Suez Canal, there is still a substantial overland requirement but no backtracking.) Meanwhile, service via the West Coast to its core intermodal market (the center of the country) has sharply improved since its nadir around 2005. Meanwhile, many carriers have introduced "slow-steaming" to their vessel deployments, which further widens the transit time advantage of West Coast intermodal service. In our judgment, AWS via East Coast ports is unlikely to divert a significant amount of this core West Coast intermodal market—especially not with a routing through the Panama Canal.

In sum, in looking at the shipment data, it appears that the shift away from West Coast port discharge that was predicted to occur *after* the widening was complete is already close to being realized, four years *before* the planned completion date. From this point on, most of the growth of East Coast port traffic via the Panama Canal will have to come from "organic" growth of Eastern Seaboard destinations. Import volume to Northeast destinations from all overseas origins is likely to grow at a below-average rate relative to the U.S. as a whole, while the Southeast is likely to show about average growth. And, that overall growth is likely to be significantly lower than pre-recession rates. For example, in the decade 1996-2006, overall U.S. containerized imports grew at an average annual rate of 10.8% to 19.0 million TEU in 2006, which remains the peak year for U.S. containerized imports. TranSystems' forecast indicates that this peak will not be passed until either 2013 or 2014—only a year or two before the projected widening of the Canal—and that the 10-year average annual growth rate from the 2006 peak to 2016 will be only about 3.0%. In the peak year of 2006, Panama Canal traffic was not yet at capacity. Moreover, to accommodate the wave of newly-built container ships which are currently unable to fit through the Panama Canal, ocean carriers have already shifted many AWS deployments from the Far East from Panama Canal routings to Suez Canal routings. In 2015, when the Panama Canal widens, this may increase traffic moving via Panama, but to the extent that it represents re-routing of Suez deployments, it will not have any effect on East Coast port traffic.

Industrial real estate investors betting that the Panama Canal widening is going to lead to a boom at East Coast ports may need to reevaluate their strategies. The volume of Far East goods coming into East Coast ports is unlikely to change dramatically from the canal's expansion. This does not mean that the project will have no impact on the shipping industry, however. If larger ships replace multiple smaller ships that currently serve the East Coast ports, shipping cost should be reduced. Also, where it would reduce transit times, some shipments might be diverted from a

Suez Canal route to the Panama Canal. And because East Coast ports are often shallower than West Coast ports, the deepest East Coast ports may benefit from increased volumes if shippers indeed trade multiple smaller ships for fewer larger ones. Norfolk, NY/NJ and Miami are among the East Coast's deepest ports, and are currently in a better position to benefit from larger ships. The logistics industry is very complicated, with many variables influencing how and where businesses ship goods; understanding these variables is of key importance when making bets on the success of ports and their land-side infrastructure requirements.

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