



Reshoring: Surf's up. Key Considerations for U.S. Occupiers



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The pandemic clearly spotlighted how easy it is to unhinge even the most well-connected supply chains. As quarantine enforcements closed country borders, many manufacturers scrambled to find alternative domestic suppliers to finish their products. Companies like Apple and Microsoft had to delay their new product release dates after their offshore manufacturing plants halted production. Many pharmaceutical companies had shortages of common U.S. prescription drugs or their ingredients, many of which are sourced in China or India. Goods were held up throughout the world as several ports ceased operations temporarily and only resumed shipments in recent months. Reshoring by bringing manufacturing and services back to the U.S. from overseas may be a prudent decision for these companies to avoid being caught off-guard again.

Today, industrial companies should be asking themselves and their real estate advisors: Is reshoring some or all our operations the right decision for us, both in the current environment and for the long term?

Was the tide already turning?

Many companies started reshoring even before the pandemic hit. According to the United States International Trade Commission and Department of Commerce Bureau of Economic Analysis, 2019 had the strongest reverse import ratio since 2008. The 2017 Tax Cuts and Jobs Act (TCJA) reduced tax rates on corporate income and repatriation earnings, creating a more competitive cost environment for the U.S. A survey conducted by Thomasnet.com asked more than 1,000 of North America's manufacturing and industrial suppliers about this topic, and nearly two-thirds indicated that they are likely to bring production and sourcing back to North America.

To avoid hasty decisions, companies should take an analytical and comprehensive approach, using the "LIFER" model, detailed below, to weigh the potential impacts of decisions made across the supply chain.

It's time to ride the wave

Reshoring was already underway with the U.S.-China trade battle sparked by the 25% tariffs imposed by the U.S. on Chinese imports in 2018 that precipitated the decline of U.S. manufacturing imports from China by 17% in 2019. Since then, the U.S. has redirected trade to other parts of the world by an estimated amount of \$90 billion, according to the Kearney Reshoring Index.

The tariff war caused some U.S. manufacturers to move operations to other Asian countries, while others sought alternatives within North America, as reported on Global Trade. Instead of relying so heavily on offshore factories, many manufacturers re-evaluated the cost versus benefits of reducing their dependency on international deals and long-distance shipping by shifting production to strategic locations across North America. The pandemic further accelerated this reshoring process, making the search for where to relocate operations more urgent.

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Savills World Research recently published The Savills Nearshoring Index, which ranks countries according to their cost structures for manufacturing labor, electricity, infrastructure and trade openness. While the U.S. and Canada have overall lower scores for nearshoring potential, automation and artificial intelligence in manufacturing could offset the higher costs for more critical or less price-sensitive goods. Companies should be asking now: What role will automation/artificial intelligence play in our operations in the longer term, particularly when the technology becomes cheaper? They may also want to assess the value of having an easier route to reset operations domestically, when compared to the difficulties of moving operations to another country and navigating new jurisdictional requirements.

Fine-tuning one's position on the peak of the wave

Manufacturers must consider complex factors when deciding where to relocate. The objectives could range from proximity to existing operations, access to omni-channel distribution and fulfillment operations, availability of attractive incentives, ease of technology automation implementation, and ultimately greater supply chain control.

As complex as the decision-making process can be, companies can gain visibility by utilizing the “LIFER” approach to analyze their needs and develop plans to assess options by conducting detailed cost-benefit analyses. LIFER covers the main aspects of supply chain – labor, incentives, freight/operations, energy and real estate. A step-by-step guide to applying the LIFER process to reshoring follows:

L Labor		Access to a cost-effective, efficient, proximate workforce
I Incentives		Potential to generate public/quasi-public incentives to alleviate some pressures around heavy capital expenditure, speed to market and attraction/training of labor
F Freight/Operations		Ability to optimize supply chains based upon origin-destination pairs, transportation infrastructure (road, rail, ocean, river) and door-to-door costs, including the source of raw materials, transportation and inventory carrying, etc.
E Energy		Access to cost-effective, uninterrupted, proximate utilities to support operations
R Real Estate		Availability, accessibility, cost, control and speed to market considerations associated with real estate

Some key reshoring considerations include:

1. Labor: Workforce strategy that propels sustainability

The availability of a skilled workforce is often the top criterion in factory site selection. Manufacturers will decide where to locate their facilities by the type of workforce available within commutable distance to the site selected, and whether it can fill long-term operational needs.

In response, state governments such as Alabama, Arizona, Georgia and New Mexico have implemented world class career and technical education (CTE) programs and vocational education for residents to both attract companies and revitalize communities.

- Assess whether the prospective locations for your manufacturing plant have a robust and sustainable workforce and whether talent can be nurtured locally when deciding where to reshore your operations.

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- Find out which states and local governments offer tailored training programs for companies they want to attract to their areas.

Automate vs. Operate: Artificial intelligence, robotics and technology's impact

Previously, manufacturers offshored to countries like China for its low-cost workforce. But as China has become more developed, its cost competitiveness has eroded. Unit wage costs (the average cost of wages per unit of output) for manufacturing have risen by 285% over the past 20 years, according to Savills World Research. On the flip side, domestic production costs have decreased as robotics and artificial intelligence have replaced workers. Advanced technology has replaced many of the monotonous and repetitive tasks with automation while limiting labor use to functions that cannot be automated.

One barrier to large-scale automation is the upfront capital expenditure. Additionally, there are political sensitivities in some markets because low-skilled jobs are often the most vulnerable to automation. Nonetheless, we are seeing a shift recently, particularly as technology becomes cheaper, for companies to redeploy labor to focus on completing more sophisticated tasks throughout the supply chain.

- Find out whether the cost of implementing automation can be categorized as capital investment for your business. Then, find an incentives expert who can advise which federal, state and local governments are likely to incentivize such capital investments with additional tax breaks.
- Can you leverage technology as a hedge against future labor market disruption? The use of artificial intelligence will be most widespread across manufacturers in assembling, picking, packing and fulfillment. Analyze your operations to evaluate whether automation could increase productivity, lower the risk of worker injuries, and enable operations to meet omni-channel demands.

2. Incentives: Sales, property, and income tax relief, infrastructure offsets, and grants



Most states also offer a myriad of incentive programs to lure new corporate and manufacturing facilities into their communities. The property tax abatements and economic development incentives may offset the costs of moving, real estate investment and equipment purchases, resulting in a positive financial reporting impact.

Prior to the 2017 Tax Cuts and Jobs Act, U.S. tax policy penalized companies for bringing back into America earnings generated in other countries, i.e., they were double taxed on these funds. The tax structure has since evolved, making reshoring a more attractive move. The tax was restructured, reducing the top corporate income tax rate from 35% to 21%, bringing the U.S. rate below the average in other key competitive countries.

In addition, many states implemented their own tax incentive programs to motivate companies to set up operations in their states. For instance, the state of Maryland offers tax credits for 10 years incentivizing technology and advanced manufacturing companies to set up facilities in one of 149 distressed communities to create jobs in former steel mill and mining towns. With the heightened need to increase employment opportunities, these programs will likely continue. Many tax breaks are negotiable with state and local economic development teams, but some tax credits for creating jobs are statutory, which often takes professional advice to determine eligibility. Rebates and incentives are offered based on the number of new jobs and investment a new operation creates.

- Manufacturers should investigate and take a multivariate approach to determine where to reshore.
- Evaluate your capital and headcount to determine if your prospective expansions or reshoring projects could qualify for new incentives. And, if your company has existing incentive commitments, determine if they are at risk, strategizing to avoid claw back exposures.

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3. Freight/Operations: Efficiency



Some manufacturers already reshoring have indicated their revenue-cost-and-risk analyses are proving it is more efficient to manufacture within North America than in China. This is partly because wages for manufacturing jobs in China have tripled since 2005 and long-standing quality and productivity issues persist today. The lack of quality control, intellectual property theft and the less-than-desirable responsiveness due to the distance between American headquarters and Chinese operations compound offshoring headaches.

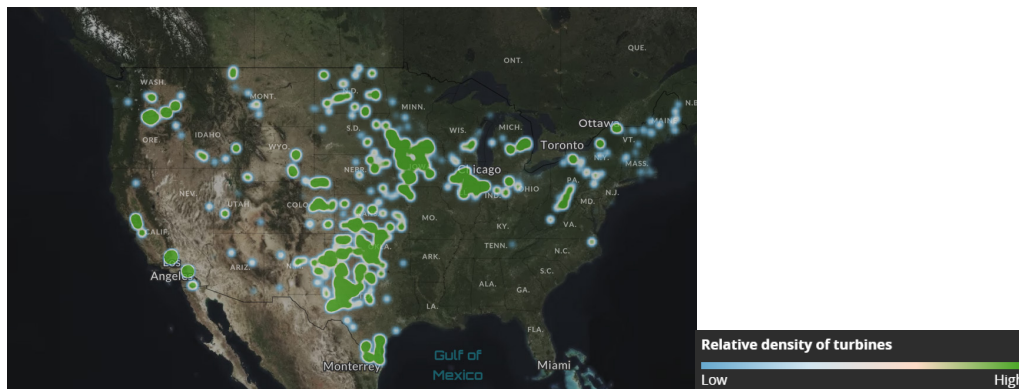
- Examine how locating manufacturing and assembly plants within North America can help your organization implement a more robust just-in-time inventory management system. Would your operations benefit from proximity to the fulfillment and logistics hub to accommodate increasing e-commerce sales?
- If stretching the supply chain across the ocean has proven impracticable during the COVID-19 pandemic, consider how reshoring might remove breakpoints along the supply chain. Assess how much inventory you still need to maintain, not just for finished goods, but also for raw materials needed for production.

4. Energy: Infrastructure and energy availability ⚡

As with incentives, many state and federal initiatives in the energy and waste management areas can ease operations for all types of manufacturers. This is vastly different from many parts of Asia, where these resources do not exist. North America's well-constructed and interconnected roads and rail and air networks give companies located here the advantage of being closer to their customers. More recently, state and federal initiatives have boosted access to reasonably priced, reliable energy and utility sources that some of the developing countries lack.



The wind energy initiative is one of the many energy programs launched to attract manufacturing to the United States. The areas highlighted in green on the map are locations of land-based and offshore wind turbines (source: United States Wind Turbine Database-USWTDB). The Department of Energy (DOE) and Wind Energy Technologies Office (WETO) have helped to fund an exponential rate of growth in wind energy, with operations in every state to build the capabilities and make it available and affordable to the both public and private sectors. For example, New York State Electric & Gas (NYSEG) just launched a substantial RFP for offshore wind manufacturing.



Source: <https://eerscmap.usgs.gov/>

- In considering new onshore locations, factor in your operations' energy use and seek out areas that have upgraded their renewable energy infrastructure.
- Look to the future: With world-class wind expertise and infrastructure resources both on land and offshore, in the West, across the Rockies, Midwest, Great Lakes, Northeast and Eastern Seaboard, identify areas of the U.S. that are primed to scale up production of wind power.

5. *Real Estate: Determining the right space for manufacturing, warehousing, logistics and fulfillment*

As manufacturers look towards reshoring, industrial real estate is deemed an attractive investment. Industrial property investments offer several advantages, such as stable and predictable cash flow, high income returns and distributable cash flow. Additionally, industrial real estate is the only asset class that is weathering the pandemic crisis, and finding the right space in the required prime location remains a challenge. Owning rather than leasing may be a good long-term investment. The short supply is already exacerbated by e-commerce aggregators like Amazon gobbling up much of the market inventory within the last-mile-delivery zone of many metropolitan cities. The last-mile-delivery zone real estate inventory is rapidly shrinking.

- Take a closer look at the “middle-mile” zones: While many of the brownfield and old industrial sites in the last-mile area are already redeveloped, there are still real estate spaces available in the middle-mile areas close to your primary logistics routes worth considering. This includes areas in southern Pennsylvania, Maryland and West Virginia (Northeast Corridor), north of the Gulf of Mexico, Southwest Arizona and the New Mexico regions. The lower cost of labor, favorable incentives offered and proximity to population density areas make these regions great options for manufacturing sites.
- Depending on your company's financial strategy, conduct financial modeling to determine the impact on your balance sheet of leasing or acquiring the site or location. The financial focus of your company will determine the makeup of your real estate portfolio.

Riding the wave. Where do we go from here?

Rethinking reshoring is not something new for many companies. According to Paul Tostevin, Director of Savills World Research, who recently conducted the [Savills Global Market Sentiment Survey](#), the U.S.-China trade war had already started reshaping global manufacturing and supply chains, boosting trade in other parts of the world, such as Mexico and Vietnam. But under the COVID-19 cloud, companies evaluating their global supply chain footprint are accelerating their reshoring plans and looking domestically. This crisis has added challenges that companies need to take into consideration to identify the most suitable real estate spaces. Depending on the industry and type of operational needs, the real estate needs will be different.

Before undertaking the process, companies should prepare by considering all the relevant factors:

- Examining the latest and most comprehensive insights into the markets under consideration.
- Scrutinizing how their supply chain dynamics would shift if operations are moved back to North America from offshore, including sourcing of materials, energy needs, and proximity to suppliers and customers.
- Studying all locations that offer not only the sustainable labor talents needed today, but training programs for tomorrow's needs.
- Considering how automation affects capital expense, labor needs and their position vis à vis incentives.
- Determining if the expertise exists in-house or whether outside advisors are required to negotiate incentives that might be available.

There are many intricacies that go beyond a company's financial and operational structures when evaluating manufacturing capacity. The location decisions made today will underpin the success or failure of the business in the years to come. Planning how to ride the wave and pinpointing which way the wave will break will ultimately help businesses come ashore successfully.

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