

PLRA Daily REIT Note  
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**Taking Labor Questions Seriously**

Strike negotiations at **UPS** have broken down this week, and **FedEx** is still trying to capitalize:

In the event of an industry disruption, [our] priority is protecting capacity and service for existing customers. Therefore, shippers who are considering shifting volume to FedEx, or are currently in discussions with the company to open a new account, are encouraged to begin shipping with FedEx now.

I wrote about this situation in my FDX note two weeks ago:

This is another step removed from our direct [industrial] REIT exposure, but there are a few reasons I'm interested in these labor struggles in shipping. For one thing, **these are huge employers, and very relevant to my baseline scenario for a continued tight US labor market across the board...**

Let's start there, and circle back to warehouses at the end. And for the rest of this note, let's just try to set aside our recession odds and any other current macro views, because that's not the kind of "baseline scenario" I'm talking about.

For example, I'm obviously not denying that a recession would tilt leverage back to employers at the margin, but so what? Is that really an interesting or investable observation? When non-macro investors are spending too much time repeating these macro truisms, it can be a sign that we're avoiding some tougher questions.

So I'm focused on the structural differences between 2019 and 2023 that would still be with us in any scenario. If we do have a near-term recession, which employers would see less of a labor benefit than we might expect from prior recessions? Or if we have a soft landing with wage growth continuing to moderate, which employers would continue to see outsized or recurring pressure?

I'll start with three of these differences that I've been writing about for a while, and try to strip each one down to a single question:

### THREE SECULAR QUESTIONS

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1. **Compensating wage differentials** — Imagine two jobs A and B, competing for the same worker in the same market, where A needs to offer a premium wage because the job is more difficult. How much has this premium increased from 2019 to 2023?

For economists, the CWD discourse seems to be less about the "difficulty" of similar jobs over time, and more about cross-sector variables like social status, remote locations, or hazardous working conditions. This last point in particular became highly relevant for front-line workers during peak Covid. But with my framing, I'm trying to get you to look through that crisis period, and start with the smaller point-to-point changes...

- Which jobs are harder today than they were in 2019, relative to other jobs with an overlapping labor pool? Think about different kinds of retail and hospitality roles, for example...
- Which jobs were *gradually* becoming harder in the pre-Covid decade, in ways that workers may not have internalized until the Covid shock? Perhaps because of leaner staffing, less reliable hours, and other “efficiencies” that investors were taking for granted?

But then feel free to include the lessons of that 2020 experience that any rational employee would still be discounting today. Which employers/sectors/roles sent the loudest negative signals about their long-term career tracks, the credibility of management, or just the level of risk that workers *could* be exposed to?

At the same time, remember that this is ultimately a relative question, and a zero-sum game. One way to keep it separate from your other workers-vs-management views is to invert the language: if job B was able to offer a lower wage because the job was more attractive, how much has that discount grown?

2. **Housing markets** — For any given in-person job in 2019, how much more does it cost in 2023 to live within the same distance/commute time, with a comparable quality of life?

For this one, maybe it’s easier to think about the current hotel strike in LA, rather than UPS. The point is just to go beyond broad measures of inflation or real wage growth, which may dramatically understate the problem for certain groups of workers — especially in the large metro areas where REIT portfolios are concentrated.

(Note that there’s an offsetting effect in which tight housing markets *increase* employer leverage by reducing cross-market worker mobility — but for this narrow pre/post-Covid comparison, I don’t think it’s material enough to be much of an offset.)

3. **Winner-take-all dynamics** — If you could measure the competitive advantages of a given larger and better capitalized company A over their weaker competitor B, how much have they increased since 2019?

As with #1, we need to be careful about separating any one-time gains during peak Covid from the ongoing competitive advantages today. And another way to get sidetracked is to focus on the cutting edge of labor-saving technology that the winners are implementing, because that’s usually not moving the needle as much as it may appear.

Most of the real advantages to scale and capital are a lot simpler — either investing in wages and benefits directly, or in old technologies and existing best practices that just take money, scale and breathing room to implement. One place to start would be the recent **Dollar Tree investor day**, where they walked through a variety of these investments and tied all of them back to labor.

And in discussing that DLTR plan, I offered a metaphor that may help isolate the kinds of advantages that I’m getting at. Think of the labor market as a string winding through any large company’s operations, and think of this new post-Covid labor regime as that string

being pulled tighter from one end, knocking everything a bit out of alignment. Then for any given company, ask whether they're willing and able to invest in realigning their business around this new reality... or whether they're just waiting and hoping for the string to go slack again.

We'll get to the landlord/investor perspective next — but note that from an employer's perspective, these are questions to *answer*, not just questions to ponder. In particular, #2 is one that should often be straightforward to estimate. For example, if you're meeting with the management of any large office tenant that's struggling with their RTO policy, and they don't have a good estimate for this cost-of-living increase for their own employee base... but they *do* have other carrot-and-stick theories about their employees' psychology and how to bring them back... that may be a sign that they don't really understand the problem, or they don't really want to.

## APPLYING THEM TO REITS

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1. **Compensating wage differentials** — Again, this is a zero-sum game in the labor market, and I offered some examples during Covid where it works that way within our tenant base. But we should also consider the cases where facility-based jobs are becoming less attractive across the board (just ask any home care agency) or the facilities that REITs are exposed to are becoming less attractive relative to newer ones (e.g. hospitals vs. ASCs).

I haven't thought of any clear-cut examples that cut the other way, where the location-based jobs are becoming more attractive... but that's certainly possible too.

2. **Housing markets** — Beyond hotels, the easiest examples here would be in the office sector. Even where employees want to come back to the office full time, employers may still be forced into more remote work or satellite offices — because they just can't afford to cover the rising cost of living around their current HQ.

Of course, you could also flip that around and ask why the CEO won't move to a cheaper metro area; from this perspective, the core problem is this growing economic and cultural disconnect between senior management and their employees.

Either way, you could summarize this as a rising tax imposed by residential real estate on commercial property types. And this is a tax we've been paying for a long time... though it would not be easy to net it out of other historical return drivers.

Here's one rough way to think about it: the more that returns for office and retail uses are driven by NIMBYism and rising wealth, rather than increasing population density... the more these REITs will be drawn into these "flight to quality" strategies that give back most of those returns in the long run.

Partly because of the frictional cost of those constant portfolio "upgrades." But mostly because we'll end up overbuilding the high end, and financing too much of our tenants' operations. In other words, as "quality" becomes more about amenities than location, it devolves into selling capex rather than capturing the scarcity value of land. Since capital is less scarce (and more mobile) we should not expect the same excess returns.

So when I talk about housing policy and production being even more important for these other sectors than the residential REITs, this is what I'm talking about. Even in markets where NIMBYism felt like a pre-Covid tailwind for commercial property types — or at least a push — it will likely be a market-level headwind in the future.

3. **Winner-take-all dynamics** — This is the easiest read across of the three. Beyond a certain point, strong tenants taking even more market share is a clear net negative for CRE returns. You can always point to individual cases where a given landlord is aligned with these winners, and benefits from their improving credits, or building them a larger HQ, or their halo effect as retail anchors ... but those are not serious counterpoints to what I just wrote. At the market level, we want more competition for our space, and a more fragmented and competitive tenant base.

## SHIPPING & WAREHOUSE DEMAND

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Returning to my FedEx note:

...secondly, I'm interested in market share — or **more specifically, I'm concerned about Amazon taking even more share of parcel volumes**, because that would open up multiple paths for them to disintermediate warehouse landlords. So all else being equal, I'd rather see FedEx or others benefit from a UPS strike...

So that's a special case of #3 above, with Amazon's third-party fulfillment as a further example of how an overly-concentrated tenant base can lead to less value for landlords. We could also talk about how the consolidation of hotel brands and OTAs has made the returns to hotel ownership even worse... or the ways that stronger large-format retailers are using their growing traffic share to act even more like landlords... but if we've acknowledged the basic winner-take-all problem, then none of these second-order dynamics should be a complete surprise.

...but it's kind of hard to tell what Amazon wants from their ongoing UPS breakup, and FedEx and Amazon are both still vulnerable (from different angles) to further unionization of their own networks. And **what really interests me about a rising labor share across the industry is that it could be the catalyst for a slowdown in the delivery speed arms race...**

And this is sort of a third-order cross-sector effect, where the tighter labor market collides with other consumer trends. With (1) e-commerce facing less of a threat from discretionary B&M retail (as stores retreat into convenience/pickup/less selection/etc)... and (2) the cost of alternative customer retention tools falling (e.g. this glut of streaming content)... it's becoming less critical for sellers to subsidize rapid shipping, and more likely that (3) these rising labor costs of delivery will ultimately be offset by slowing deliveries down — at least for most of the long tail of products.

This is hard to see right now because of the current temporary slack in many networks, and because of Amazon's continued push for speed in the *short* tail of popular and high frequency products... but underneath those cross-currents, it feels like the slowdown may already be happening. And in the long run, it's *much* more of a potential threat to the last-mile industrial boom than any of these overblown short themes about banking contagion, or a supply glut...

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## APPENDIX FOR NERDS

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As always, I'm interested in feedback on anything in this note, and especially grateful for disagreement... but just to flesh out two drive-by points that may have raised a few eyebrows:

*“tight housing markets [may] increase employer leverage by reducing cross-market worker mobility — but for this narrow pre/post-Covid comparison, I don't think it's material...”*

Mostly because US geographic labor mobility was already quite low. Also, housing costs were not the only thing driving it down, and Covid may have had an offsetting impact on some other drivers.

But even within housing, I'm just skeptical about the individual mechanisms and cohort effects. For example, the lock-in effect from low mortgage rates is certainly weighing on intra-market moves, but do we know how much it's *really* reducing cross-market relocations? For one thing, aren't these homeowners overexposed to remote work occupations?

And in the rental market, couldn't there be just as many workers being pushed into other metro areas vs. pushed further out in their current metro?

I would love to see any research at this level of granularity, but most of what I've seen seems like the same old speculation based on the same old blunt, lagging high level data sets. And against that backdrop, I'm inclined to put more weight on what's actually happening (like these continued strikes) than anyone's theories about why the labor market *should* be softening on paper.

*“the cutting edge of labor-saving technology [is] not moving the needle as much as it may appear”*

I'm not talking about the complete vaporware (like self-driving trucks) but rather the leading edge of tech that's actually being implemented. And I know it's tempting to say “well, if labor is getting more expensive, and these newest robots (or whatever) are even better at replacing/augmenting labor, then the companies who can afford them will clearly have an edge.”

But often the costs of this cutting-edge tech are still rising even faster than the benefits. For example, this was my core problem with the Kroger/Ocado story a couple years ago. I may have made a joke or two when their robots collided and caught fire, but I was never really questioning Ocado's ability to keep improving their product. My objection was that they were not coming in on time or on budget, and these “sheds” were chunky long-term investments that would outlast the peak wage growth of the Covid years.

So the question was not whether the technology was improving, but whether the fully-loaded *returns* to Kroger and their other customers were improving. Even as someone with this higher-than-consensus view of long-term wage growth, I just didn't buy it. And now it's starting to sound like Kroger doesn't believe it anymore either.

In the few cases where I *have* referenced new labor-saving tech in a more hopeful way... well, take the new RFID self-checkout bins at Uniqlo, for example. RFID and self-checkout are two 20+ year old ideas that maybe didn't quite work for apparel, but in the current environment they're both coming back for other reasons, and we're finding new synergies between them. I'm probably oversimplifying that story, but it's the *kind* of story we should take more seriously, and the kind of

story you'll find in those DLTR slides. If the goal is to offset a structurally tighter labor market, and you're looking for the lowest-hanging fruit that's available to market leaders who can spend billions in capex and amortize it over a huge sales base... this is usually what it will look like.

Now, let's switch to a non-RFID setting, and think about the new camera-based self-checkout systems at Circle K. I haven't really looked into the tech, but certainly computer vision is a "newer" or faster-advancing field than RFID. And I like this pitch a lot better than the Ocado robots, because it's more granular and incremental to the current c-store operating model. But the newer the tech, the more I'm going to worry about the Ocado cost problem, where the retailers are depending on a handful of inefficient startups seeking VC returns.

Or just think of this from the other end: if we do get any *true* breakthroughs in robots/AI/whatever, wouldn't they be more likely to reverse these current winner-take-all dynamics than to reinforce them? I mean, if anything, it's kind of a sad sign for the tech world that they've lowered their standards for "disruption" to the point that these legacy market leaders are so eager to fund it.

But in general, it's not that I'm a tech skeptic or pessimist... it's just that investors in non-tech sectors should be realistic about our exposure to the leading edge of the curve. Even with a tenant like Walmart that's investing all over the tech spectrum, I think you'll find that most of their real gains — and most of the capital — are in *synthesis* of existing technologies.

## SAMPLE NOTE

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