How Amazon became the leasing king of e-commerce

The Real Deal takes a deep dive into Amazon's leasing strategy, and why the Everything Store doesn't own its giant distribution network

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Amazon leases nearly 154 million square feet of warehouse space compared to the 4 million square feet it owns (Credit: iStock)

In a four-story, concrete warehouse on Staten Island, 2,000 workers and hundreds of highly specialized robots work simultaneously to deliver brown and blue boxes to the nation's largest metropolitan area.

Packages run along nearly 13 miles of conveyor belt throughout the warehouse until they are loaded onto trucks and delivered to customers who clicked on the product less than 24 hours earlier. The "JFK8" warehouse in New York is one of nearly 470 facilities Amazon operates in North America alone, but the e-commerce behemoth owns only a tiny fraction of those.

The company leases nearly 154 million square feet of warehouse space compared to the 4 million square feet it owns, SEC filings show, making it the biggest tenant of the largest landlords in the country. Most of its industrial space is located on the edge of cities and there's an additional 41 million square feet planned, according to a report by logistics consulting firm MWPVL.

Amazon's rental expense for both property and equipment last year was $3.4 billion, according to its 2018 annual report, and the company's operating lease commitments total $26.6 billion over the next five years.

Amazon's strategy of leasing rather than buying massive amounts of warehouse space has cemented the new standard of how e-commerce companies structure supply chain networks, according to company insiders, competitors and analysts. In the process, they say, it is creating a game of catchup for the rest of the industry.

Jack O'Leary, who covers Amazon as an analyst for Edge by Ascential, said the e-commerce giant "pretty much invented the model" of leasing rather than buying because "it allows them to be in more spaces, more quickly."

The company declined to comment for this article.

Jeff Randolph, a former director of Amazon's worldwide real estate team, said leasing space allows a company to keep costs down, enabling it to invest in other areas.

"A building is just a cost," said Randolph, who worked for Amazon from 2015 to 2017, and before that led PepsiCo and Diageo's real estate divisions. "Bricks and mortar are kind of a necessary evil."

But it's a necessary evil that is at the heart of the Everything Store's success. The company's property portfolio is the primary engine that powers its e-commerce machine, having created a sophisticated system of warehouses and last-mile distribution centers to ensure packages are delivered in lightning speed, according to O'Leary.

In 2019, Amazon's focus has been on executing one-day delivery, which has come at a hefty cost. In a second quarter earnings call in July, Amazon CFO Brian Olsavsky said expenses related to one-day service ran higher than the $800 million predicted for the quarter. In a subsequent earnings call, he said that the company surpassed $800 million in the third quarter and expects to run up a bill of $1.2 billion in its fourth quarter.

Though the CFO didn't explicitly discuss the cost of real estate, a source with direct knowledge of Amazon's current investments said the company has accelerated its leasing activity across all business lines over the past year. The person described Amazon's leasing team as a military-like operation with a sharp attention to detail.

Amazon's one-day delivery push comes at a time when the industrial market is booming with high rents and competition driven by consumers' insatiable preference to shop online. According to JLL's third quarter report, the national industrial vacancy rate was down 10 basis points to 4.9 percent and rent was over $6 per square foot, up more than 30 cents from the same period last year.

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Leasing up

During Randolph's tenure, he said Amazon's real estate holdings grew "dramatically." According to public filings, in 2015 the company had leases for about 58 million square feet of distribution centers in the U.S. and owned less than 1 million square feet. That would balloon to 154 million square feet in leases by December 2018. Randolph said the company decided to lease as it expanded its distribution network, but he noted that the strategy is far from unique.

"The bottom line is that leasing property has been a trend that's been going on for 20 years and most large companies do this," he said. "Amazon is probably the only company that leases everything, but they started at a different time. They weren't encumbered by old ways of thinking."

Amazon's distribution centers vary widely in size from region to region. The Staten Island warehouse is 855,000 square feet. That compares to its 237,000-square-foot facility in Skokie, Illinois, about 15 miles north of Chicago. In the Los Angeles area's Inland Empire, the company leases 1 million square feet in Eastvale; and in Miami's Opa-Locka, it has an 855,000-square-foot facility.

Tom Catherwood, a Prologis analyst with BTIG, pointed to Walmart as one of the first retailers that began selling off its holdings. Other private companies that previously owned the majority of their real estate portfolios have similarly begun to favor leasing, such as Home Depot and Target. One massive government agency, the U.S. Postal Service, has done the same.

Meanwhile, a private company with a major distribution network, FedEx, leases about 9.6 million square feet of warehouse space around the U.S., according to its 2018 annual report. The delivery services company has nine major warehouse distribution centers, the largest a 3.6 million-square-foot behemoth in its headquarters city of Memphis, Tennessee.

The USPS is one of the largest land owners of a logistics network, with more than 33,000 facilities spanning over 300 million square feet nationwide. In 2012, it claimed to lease nearly 25,000 of those properties and openly debated whether to monetize its holdings by selling or renting them out. Amazon’s real estate team is flush with many former employees from major parcel delivery companies, Randolph said.

Catherwood said the leasing trend has helped propel the rise and convenience of Amazon and e-commerce, rendering the ownership model “outdated.”

“Supply chain was changing so rapidly, [companies] didn’t want to be tied into any one model or any one asset longer than they needed to be,” he said.

A landlord partner

Landlord Duke Realty has been leasing space to Amazon for more than 15 years. It has leases with the company that range from 18,000 square feet up to 1.1 million square feet, said Duke chief operating officer Steve Schnur. He believes the preference of leasing over buying industrial space shows no signs of reversing.

For the Blackstone Group, that means opportunity. The massive asset manager inked one of the largest industrial deals on the books this summer buying 11 warehouses near John F. Kennedy International Airport in New York for nearly $19 billion.

Thanks to interest from institutional players industrial real estate’s average sales price has doubled over the past decade, according to John Morris, CBRE’s head of industrial and logistics in the U.S.

For Amazon, the speed and cost of leasing those properties is still preferred to owning them, as it continues building out one-day delivery and refining its supply chain.

"Leasing," said ex-Amazon director Jeff Randolph, "inherently makes you reevaluate your needs every 10 to 15 years."

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