

February 9, 2009

## **Industrial Vacancies Increase; Decline in Retail Blamed**

**By MICHELLE MOWAD**

SAN DIEGO BUSINESS JOURNAL STAFF

Although spending in defense and the life sciences industries anchor the local economy, the two are not able to help fill the vacant industrial space left behind by ambitious developers.

More than 16.6 million square feet of industrial space sat vacant in the fourth quarter, or 8.7 percent of the total rentable space, with an additional 751,000 square feet under construction, according to CB Richard Ellis' fourth quarter market report.

The downturn is hitting the industrial real estate market because of strong ties to the retail sector.

Rob Hixson, an executive with CB Richard Ellis, said the slowdown in consumer spending curtails tenant activity, especially in South County where he leads an industrial broker team.

"When there is a slowing in consumer goods purchases, it will affect what's being stored in warehouses," said Hixson.

U.S. consumer spending fell for the sixth consecutive month in December, according to the Department of Commerce.

Bryce Aberg, a Grubb & Ellis|BRE Commercial broker, said that of the industrial spaces, warehousing has been hit the hardest.

"There are large vacancies in the border cities, including Otay Mesa and Oceanside, and they were not being leased because there is just not the deal volume," Aberg said. "Distribution is fed off of retail and retail has halted."

Countywide, the amount of available space by landlords hit 7.8 percent in the fourth quarter compared to 7.2 percent in 2007.

### **County Fares Well Overall**

Despite the increase, the rate can be deemed healthy. A rate under 10 percent is considered the divide between a healthy market and one with a glut of space. However, numerous submarkets have hit the double-digit vacancy levels. In Otay Mesa, the vacancy rate rose to 17.7 percent. In Carlsbad, vacancy reached 15.7 percent and in Rancho Bernardo and Oceanside vacancy was close to 12 percent.

February 9, 2009

Hixson said the supply of industrial space in Otay Mesa could take three to four years to absorb. Most products made in the maquiladoras in the Tijuana area, including furniture and televisions, are warehoused in Otay Mesa after being transported across the border.

"We are starting to see landlords be more aggressive to lure tenants in," said Hixson. "They are starting to lower lease rates. In the past three or four months they have been providing concessions, but we are now starting to see a change in lease rates."

Rates saw a decline for the third straight quarter at the end of last year.

The weighted average asking lease rate for all industrial space in the county, including multi-tenant research and development, warehouse and light industrial, dropped 2 cents during the fourth quarter to \$1.06 per square foot per year compared with \$1.08 in the third quarter.

However, Aberg said he is not seeing declines in rents in the central market. He said another positive factor is that subleasing, usually a sign of a downturn in a market, has not increased.

"The good news is rents are flat," said Aberg.

Unfortunately, industrial leasing was down countywide. Activity totaled 2.4 million square feet in the fourth quarter compared to the most recent quarterly average of 3.5 million square feet. And because of the drop in tenant activity, vacancy rates are expected to increase, despite decreasing construction deliveries in 2008 and planned deliveries for 2009.

However, rates can dramatically change with the signing of just a handful of leases.

"We have 1 million square feet more of supply (in Otay Mesa) than we what we ideally want, but ... you can get rid of 500,000 to 600,000 in two transactions," said Shane Harmon, an industrial specialist with CB Richard Ellis.