

Activity in Industrial Real Estate Market Increases

REAL ESTATE: Landlords Offering Upgrades, Lower Rents to Keep Spaces Filled

■ By LOU HIRSH

San Diego County's industrial real estate prospects perked up in 2010's first quarter, as vacancies trended downward from the prior quarter, and sales and lease activity increased compared with a year ago.

As with other segments, the industrial market still favors tenants, and many are moving around to take advantage of lower rents and other incentives being offered by landlords looking to keep spaces filled.

Those incentives include upgrades and

additions to amenities offered by landlords to their tenants, and the option to renew leases well ahead of their expiration dates, to lock in today's low prices.

Building purchases are picking up as investors and business operators come off the sidelines and lender financing becomes more available. However, observers note it could still be 12 to 18 months before the industrial sector is registering consistent gains in absorption and rents, hinging largely on the local jobs climate improving.

"I would say 2012 is going to be a fairly active market," said Todd Davis, a senior adviser in the Carlsbad office of broker-



Todd Davis

age firm Cassidy Turley/BRE Commercial.

"The worst conditions have passed."

One thing favoring the local industrial market is that its problems, even at the height of the Great Recession, were never as severe as those facing other segments, such as office and retail

properties.

Lower Vacancy Rates

Experts note that because industrial users require lots of horizontal space for projects, and because land costs more and is less available locally than in neighboring

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counties, San Diego's industrial market did not become wildly overbuilt like others did.

As a result, San Diego County's industrial vacancy rates are much lower than its office and retail vacancies. Still, according to Voit Real Estate Services, local industrial vacancy in the first quarter stood at 8.67 percent, up from 6.86 percent a year ago, but lower than the 8.77 percent seen in 2009's final quarter.

Voit notes that the county posted 165,675 square feet of positive absorption in the first quarter, reversing a trend of negative absorption in the previous six quarters.

Randy LaChance, a senior vice president in Voit's San Diego office, says the first quarter marked a continuation of general improvement trends that took hold in 2009's fourth quarter. Of the 15 major industrial purchase transactions that took place in 2009 — valued at \$8 million and higher — about half took place in the fourth quarter alone.



Randy LaChance

Three other such sales took place countywide in 2010's first quarter. Some

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of the largest industrial transactions of the quarter took place in Otay Mesa, including QueensCare's \$22.5 million acquisition of a former FedEx building on Airway Road, and EastGroup Properties Inc.'s \$17 million purchase of three properties on Innovative Drive.

Businesses Relocating

However, on the tenant leasing side, which accounts for most industrial activity, LaChance says there is still a "musical chairs" climate, as companies relocate to take advantage of falling leasing rates, which have dropped 15 percent to 25 percent in the past year depending on location.

Davis says there is particular weakness among incubator-type industrial properties that house multiple tenants, usually smaller startups conducting work including research and development.

While large companies are getting more

financing from lenders for purchases than a year ago, smaller firms are not seeing the same receptiveness from banks. Those smaller firms need to see the credit climate improve before embarking on major expansions, Davis says.

Overall, experts say local industrial leasing and buying remains relatively strong in sectors including the military, engineering, electronics and medical device manufacturing.

In addition to there being nearly no new industrial construction under way, Davis notes that the supply of distressed properties coming on the market is not likely to rise significantly in coming months. Industrial real estate has seen little mortgage distress compared with other sectors, so there are fewer motivated sellers, including lenders, looking to unload properties.

A Year Away From Recovery

Chris Pascale, a senior vice president

in the San Diego office of CB Richard Ellis, says there won't be true evidence of a full recovery until the industrial sector — perhaps a year from now — is registering consistent quarter-to-quarter net absorption increases.



Chris Pascale

Local submarkets that added new industrial space in the past two years, such as Carlsbad, Oceanside and Otay Mesa, may take longer than others to approach full absorption.

"We're seeing some good activity on the tenant leasing side, but the sales and investment side is still pretty anemic," Pascale said.

He notes that San Diego County has other factors besides the current economy weighing on its industrial real estate sector.

In addition to local property being more expensive and less available for land-intensive industrial projects, California's environmental, regulatory and tax climate puts the county at a business disadvantage compared with communities outside the state.

"San Diego is really becoming a knowledge-based economy, more so than an industrial-manufacturing economy," Pascale added. "The knowledge sector does not need as much space as the others do."