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S.D. County industrial market reeling, but improved from '09

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SAN DIEGO — San Diego's industrial market is slowly improving this year by most accounts, and the key to continuing recovery depends on what is happening on Otay Mesa.

Cushman & Wakefield reported that while there could still be nearly 1 million square feet of negative absorption of industrial space in the county this year, it will be a vast improvement from 2009, when some 3.62 million square feet was vacated.

That figure is roughly equivalent to Otay Mesa's total available space.

The Cushman & Wakefield report attributed most of 2010's year-to-date negative absorption to a small number of larger tenants vacating space, rather than to the mass migration of tenants that occurred last year.

In the second quarter **Kratos** downsized in UTC, giving back 94,000 square feet at 4810 Eastgate Mall in Bridge Pointe Corporate Center.

Additionally, in Kearny Mesa, **AT&T** (NYSE: T) vacated 48,100 square feet at 7650 Convoy Court, and in Vista, **Eagle Creek**, a water bottle and accessories manufacturer,

vacated 90,615 square feet at 3055 Enterprise Court.

"Although year-to-date activity has yet to venture into positive territory, the negative 426,265 square feet of direct net absorption is a substantial improvement from the negative 2,409,462 square feet recorded the same time a year ago," C&W wrote.

Different brokerages can have different numbers depending on when a survey is taken, how it is conducted, whether or not a leased space is considered occupied, and how sublease space is calculated.

Colliers International, for example, reported that 21,894 square feet of industrial space was vacated in the second quarter, which translates to 79,902

square feet on the plus side through June.

Cushman & Wakefield found that at least some submarkets had positive absorption.

"At mid-year 2009, all major San Diego County industrial submarkets recorded negative absorption," C&W wrote. "This year, the Cushman & Wakefield report shows that mid-county markets are venturing into positive terrain, with the (Interstate)-15 Corridor and Mid-City areas recording 111,932 square feet and 126,855 square feet of direct absorption, respectively."

While industrial space numbers are anemic at best, Colliers reported that countywide research and development space looks better, with 306,729 square feet of net absorption in the second quarter.

"Tenant activity has certainly picked up," said Marc Frederick, Colliers associate vice president. "Some tenants currently in the market would have been prospective buyers for 'owner-user' properties in years past.

"But today they are more risk adverse, concerned more about pricing and financing a purchase," he added. "Many of them

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 have chosen to lease instead to take advantage of low rates and other concessions, and to maintain their flexibility until the economic outlook becomes clearer.”

Most of the R&D demand was concentrated in the I-15 Corridor submarkets of Rancho Bernardo (135,000 square feet) and Poway (99,000 square feet).

Colliers reported San Diego County's R&D space vacancy was about 14.8 percent, as of the end of June.

Owners of many industrial properties on Otay Mesa may not see an industrial vacancy as low as 14.8 percent for a while.

By Colliers' accounts, the Otay Mesa submarket has more than 3.3 million square feet of direct vacant space translating to several years of supply and 22.8 percent direct vacancy.

If sublet space is added, this figure rises to 25.2 percent.

Otay Mesa returned 48,367 to the market in the second quarter.

However, **Cassidy Turley BRE Commercial** claimed in its report that the Otay Mesa industrial submarket actually broke its string of five consecutive quarters of negative absorption, and finished the second quarter with 226,055 square feet absorbed.

That would give the market a net of 276,000 square feet through the first half of the year.

In any case, Otay Mesa is likely still years from filling all its empties.

Cassidy Turley noted that Otay Mesa highlights during the second quarter included **Bestech Trading** leasing 37,645 square feet for five years at the Airway Business Park; **Bikebandit.com** renewing its lease for 107,006 square feet for three years; **International Laser Group** leasing 54,404 square feet at Three Piper Ranch and an industrial laundry company taking 48,000 square feet in the San Diego Business Park.

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 “Leasing activity during the quarter showed small signs of recovery with fourteen transactions being completed for a total of 325,129 square feet.

Other tenants contributing to this included **Poly AG Corp.**, **Fairn & Swanson, Inc.**, **Intermex Foods**, **Landstar** and **HTNS America, Inc.**,” Cassidy Turley wrote.

Cassidy Turley reported average asking lease rates were stable at 54 cents per square foot, triple net for larger warehouse space and 65 cents per square foot for smaller multi tenant space.

While rents on Otay Mesa have fallen by as much as 40 percent and even more from their peak in 2007, they do appear to be firming up a little.

“Landlords are starting to push back on concessions,” said Karen Johnson, a Colliers associate vice president.

“Tenants want to ‘lock in’ now, because the market will be moving back up,” she said.

Buyers are still showing a reluctance to buy existing buildings and by Cassidy Turley accounts, land sales on the mesa

were nearly nonexistent in the second quarter.

The commercial brokerage firm found only one completed land transaction during the quarter totaling approximately three acres on Cactus Court.

The corner lot sold for \$925,000 or \$7.08 per square foot, which reflects a drop of nearly 54 percent from the last finished land sale of a similar size in November 2008.

The situation notwithstanding on Otay Mesa, Colliers wrote that it expects industrial vacancy rates to gradually diminish during the next few quarters, due to the lack of construction.

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