

San Diego County's vacant industrial space continues to be absorbed

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SAN DIEGO — The industrial market appears to be on the mend both nationally and in San Diego, but some ugliness remains.

The Cassidy Turley BRE Commercial commercial brokerage firm reported that San Diego County's industrial market had 535,785 square feet of absorption in the second quarter — bringing the year-to-date figure to 458,205 square feet.

Different surveys may have very different results depending on factors such as timing, what is or isn't included in a sample and whether or not leased space is considered occupied.

For example, Cushman & Wakefield reported that more than 426,000 square feet of industrial space was vacated in the first half of 2010 and projected that about 1 million square feet will be returned to the market by year's end.

As bad as that sounds, by Cushman & Wakefield's accounts, more than 2.4 million square feet of industrial space was vacated in the first half of last year.

On the national front the CoStar Group (Nasdaq: CSGP) research firm concluded that after several quarters of negative absorption, the industrial market appears headed to recovery with 13 million square feet of absorption — the first quarter on the plus side since mid-2008.

"Overall, "we think the outlook is better than it has been in a few years," said Jay Spivey, CoStar director of analytics. "It's been a long time coming. We think the outlook is good and we'll continue to see positive absorption," Spivey said.

The CoStar report also noted that "for owners, the warehouse sector is still working through some significant market turbulence. Broad-based growth in rental rates probably won't resume until 2011, and the investment sales market

remains choppy, with total transaction volume still well below the historical average.

Liquidity hasn't yet returned for owners and industrial capitalization rates and pricing, though improving, still shows a mixed picture."

Cassidy Turley reported that 16 of the county's 25 submarkets posted positive absorption compared to 12 in the first quarter.

The South County accounted for the majority of positive absorption, with 298,443 square feet, followed by Central County with 189,675 square feet and North County with 47,667 square feet of positive absorption.

If current absorption activity is any indication it could be several years before new industrial construction — other than specialized build-to-suits — are constructed on Otay Mesa.

Plus or minus 3.5 million square feet of industrial space has yet to be absorbed there.

Cassidy Turley reported Otay Mesa's absorption amounted to 226,055 square feet in the second quarter, but it will take many quarters like that to bring this submarket into balance.

However, Cassidy Turley is

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upbeat, overall.

"San Diego's healthiest industrial submarkets are slowly improving while submarkets with high vacancy rates are showing signs of stabilizing," Cassidy Turley wrote. "Among submarkets that are seeing a decrease in vacancy rate from a year ago are Rancho Bernardo, Sorrento Mesa, Escondido, Chula Vista and East County."

Cassidy Turley said that unlike the second quarter of 2009, when all product types recorded negative absorption, only distribution space went negative during the second quarter of 2010.

Research and development (R&D) space accounted for the majority of the positive absorption this quarter.

The signing of industrial and R&D leases continue.

Pfizer Inc., a San Diego-based biotechnology company focused on the development of recombinant proteins, has fully leased the 22,833-square-foot flex building at 10790 Roselle St. in Sorrento Valley's Roselle Technology Park. The 10-year deal was valued at \$3.6 million.

Both national and local surveys conclude that industrial vacancy rates are either improving or at least have bottomed out.

Nationally, CoStar reported the national industrial vacancy rate declined for the first time in two years.

"Given the positive absorption and low levels of construction, the national vacancy rate edged down in the (second) quarter from 10.1 percent to 10 percent — the first drop in over two years," CoStar wrote. "Availability (space being marketed even though it may not yet be vacant) also edged down from 14.8 percent to 14.7 percent."

Cassidy Turley reported a countywide direct industrial vacancy rate of 10.4 percent in the second quarter, which isn't much higher than the national average of 10.0 percent.

While this figure was a decline of 20 basis points from the first to the second quarter, the vacancy rate was still a full percentage point higher than that of the second quarter of 2009.

CoStar reported new indus-

trial construction continued to decline in the second quarter — a trend expected to continue through 2012.

"And 2010 will likely mark an all-time low in deliveries, with little new supply entering the pipeline over the next two years," CoStar wrote. "In fact, more properties are being taken out of inventory due to obsolescence and other factors than are being added in new construction."

San Diego County has followed the national pattern — only more so, with zero industrial permits pulled at all in four of the first five months of the year, according to the Construction Industry Research Board.

CoStar, Cassidy Turley and Cushman & Wakefield have each suggested this lack of new construction is needed to ensure industrial vacancies return to the single digits.

Cassidy Turley reported that a total of 193,156 square feet, all of which was in North County, was under construction at the second quarter's end.

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