INDUSTRIAL UPDATE

Southern California focuses on its lack of space, while San Francisco's tech boom buoys its East Bay industrial submarket.

The Resurgence of Manufacturing in Southern California Will Produce More Deals

By Barry Saywitz

As the economy continues to recover, so will Southern California's commercial real estate market. In fact, we have already seen signs of some recovery in certain sectors. The fact that virtually no new construction has taken place in the past several years will help improve the overall market as vacancies continue to decrease.

One of the sectors that seems to be thriving is the industrial market for larger industrial and manufacturing facilities. This is due, in part, to a limited supply. It is also due to the corporations that are now in growth mode after years of reductions and consolidations.

Southern California's geography, particularly in Los Angeles and Orange County, also provides for a limited amount of opportunities to build new larger industrial and manufacturing facilities. This fact, combined with the number of older buildings that are now deemed inefficient by today's standards (many do not provide adequate power requirements, ceiling height, loading capacity or functionality), makes many of the region's vacant spaces obsolete and not realistic options for prospective tenants.

The overall available space for larger big box industrial and manufacturing facilities in Los Angeles and Orange County is extremely limited. Estimates have put vacancy at 1 percent to 3 percent in this region. While the vacancy in the overall market may be as much as 10 percent to 15 percent, these specific submarkets have limited opportunities. A few of the other markets throughout Southern California, such as the Inland Empire and parts of San Diego County, have higher vacancies. However, the amount of vacancies for these bigger buildings has dropped dramatically over the past 18 months.

During the economic downturn, many of the smaller, entrepreneurial manufacturing companies based in Southern California either went out of business, were acquired by larger companies or elected to relocate out of the area due to the high cost of doing business in this region. Those companies, which did not have to be in Southern California, found opportunities either overseas, in Mexico or other Western states that were significantly cheaper than this area.

This space, at 15022 Parkway Loop in Tustin, is home to companies like Ronco Plastics and Ellsworth Adhesive Systems.

Saywitz

The companies that stayed and are in older and/or inefficient buildings now have an opportunity to take advantage of the real estate market while rental rates are at an all-time low. In the leasing sector, concessions like tenant improvements, free rent and lower rental rates provide an additional incentive for a tenant to relocate. Many manufacturing companies have significant upfront expenses to relocate equipment and make the necessary improvements for their businesses. These upfront concessions provide the user with the opportunity to defray these initial relocation costs. Being located in a more efficient and/or newer building makes these businesses more profitable and efficient.

The benefits to a landlord of renting to a manufacturing company are twofold. The manufacturing company will typically be in a position to pay a higher rental rate, while a manufacturing company will be interested in signing a longer-term lease (i.e. 10 to 15 years, as opposed to a distribution company that typically looks for a three- to five-year lease). The upfront costs and disruptions to relocate a manufacturing company make relocation a rare event. Distribution companies will have more opportunities for changes in their business and spatial requirements and may not want to be locked into a longer-term lease. A landlord who is looking for long-term cash flow may want to consider renting to a manufacturing company rather than having to re-lease the building every few years.

As the real estate market continues to recover, it will present new challenges and nuances both for landlords and tenants as they try to find the right partners to structure mutually beneficial transactions. Tenants that are consolidating or relocating should utilize professionals and consultants to help them assess relocation costs and structure a transaction that accommodates their business requirements. Savvy tenants will be able to take advantage of the market and will benefit from a new and hopefully more efficient facility while prices are still on the lower end of the spectrum.

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