VANISHING SMALL INDUSTRIAL SPACE IN THE IE

As development stays focused on mega-warehouse and distribution facilities to serve e-commerce, options for users of small and mid-size industrial space are shrinking.

BY CARRIE ROSSENFELD

Smaller industrial buildings in the Inland Empire like 2104 Jay Street (above) and 4100 East Mission Boulevard (top, right) in Ontario are rare finds for users.

CBRE recently reported that the Inland Empire (IE) industrial market has become an "industrial utopia," where high demand, low vacancy, and solid rental growth drive a state of perpetual bliss. According to the firm, "the impact of e-commerce revitalized the IE over the last five years, making it a prime location for retailers and distributors. Balanced activity across all size ranges remained key to the success of the region as more tenants flocked to the market. New big-box industrial facilities drew strong interest from e-commerce-related users, while smaller product under 300,000 square feet remained popular among smaller logistics and transportation companies."

As *SoCal Real Estate* recently reported, the IE West submarket boasts the lowest vacancy in the IE region at 3.16 percent, according to a Q1 2018 report from Voit Real Estate Services. The historic vacancy rate for the IE over the past 19 years is approximately 7.05 percent, demonstrating just how much this submarket has tightened up. And, as we also recently reported, gross absorption in the IE's East Valley market for 2017 totaled 16.9 million square feet, continuing on the heels of the strong absorption performances in 2016 of 19.3 million square feet and 2015 of 15.3 million square feet, according to Lee & Associates.

Barry Saywitz

But this rise in popularity has had its drawbacks for certain industrial users in the region. Inland Empire industrial rents have continued to spike due to the limited amount of available space in the marketplace, and much of the new product being built in this market consists of very large industrial big-box opportunities in the 500,000-square-foot to 1 million-square-foot range, leaving a limited number of small to mid-size industrial opportunities for those users.

Because of the scarcity of smaller industrial buildings in this market, rents for these structures have increased 10 percent to 20 percent over the last 12 months, and landlords continue to push the rents because demand is extremely high, Barry Saywitz, president of The Saywitz Company, tells *SoCal Real Estate*. "You're at rental rates that are basically as high as they've ever been, if not higher. All indications are that, at least in the short run, there will continue to be increased pressure on upward rents."

Simple supply and demand and very low vacancy rates across the board are maintaining the upward pressure. In the 10,000 to 30,000 square-foot range, users don't have a lot of options, and prices are running up significantly. Since this is smaller space, the increase is not as big as it would be for larger buildings, so tenants end up paying the increased rent, Saywitz says. "People have to do it. The only way to get cheaper rent is to go farther east or farther away."

Since so much industrial business revolves around the Ontario Airport area, the closer tenants get to the airport, the more expensive the space is.

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While there is development where land prices are cheaper farther east — in areas like Redlands, Moreno Valley, and Beaumont — most tenants would rather be closer in.

Also, e-commerce has changed development trends from the last cycle, when more small owner/user buildings were built and sold. "This is not happening as much because the new wave of warehouse requirements is for bigger buildings," Saywitz says. This means smaller buildings are not being developed. And with 3PL companies willing to pay high for space, rents continue to rise for large buildings as well.

And, with industrial vacancy in L.A. as tight as a drum and not much availability in the other coastal markets, rents in the Inland Empire are being driven up and staying just a notch below L.A., Saywitz says. "As the coastal markets continue to push up, the IE goes along for the ride. If warehouse space rents at LAX are sky high, then the IE doesn't look so bad, so tenants have to pay it."

For those who still wish to rent, according to Saywitz, "every source we've talked to says rents are going to continue to push up, and there's not a lot of space. Until there is a correction, prices will either jump or there will be a steady increase. You will pay more the longer you wait or else you're looking farther out."

The options for buying a smaller-size industrial building are not much better, Saywitz adds. There are a number of his clients who want to buy a building, but the number of buildings for sale are far fewer than those for lease — and there are none to lease. Because of that, potential investors need to have their ducks in a row before entering the playing field and be ready to act quickly.

One might wonder if new industrial development is continuing to move east in the IE due to the tight vacancy rates. Saywitz says cities like Beaumont, Moreno Valley, and Redlands would be prime locations for future development, but Ontario and Fontana are somewhat land restricted, and those projects that do come online are in those areas with better locations, which cost more to develop. "If you're price-conscious, you have to push east."

Owner/users do tend to opt for smaller space. Most of the larger-size buildings in the 100,000-square-foot-plus range are attracting more tenants than owner/users, Saywitz says. "A lot of corporations don't want to own their own facilities, but for smaller users it makes sense to own the building and lease it back to the company."

Saywitz adds that Asian companies that have money tend to want to buy here rather than lease. "There's a lot of that going on where they prefer to buy. Some are less conscious about the price, but there is still limited opportunity out there."

The IE industrial market has definitely gotten a lot more sophisticated over the last 10 years, with more sophisticated owners, fewer mom-and-pops, and more bigger companies having a presence there. The number of players has increased, and the market as a whole has a bigger dynamic, Saywitz says. "The question then becomes, going forward, will that be able to sustain itself? Real estate doesn't go up forever, so will the inevitable correction be major or moderate, and how will people deal with that? Will people buying buildings for their own use be paying too much? Will there be more long-term plays?"

Most industrial investors in the IE tend to be well-heeled companies, so even if there is a correction, they will be OK. "Long-term, the IE has a lot to offer, and because there's limited opportunity along the coast, we will continue to see growth there regardless," Saywitz says. "Short term, I believe we will continue to see prices go up. People looking to lease or buy real estate need to look in advance and be smart about it." ■