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The Resurgence of Manufacturing in Southern California Will Produce More Deals

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

One of the sectors that seems to be doing much better than most is the industrial market for larger industrial and manufacturing facilities. This is due in part that there is a limited amount of supply and the corporations that have gone through reductions and consolidations are now in a growth mode. Additionally, the constraints of the Southern California geography, particularly in Los Angeles and Orange County, provide for a limited amount of opportunities to build new larger industrial and manufacturing facilities. This aspect, combined with the fact that there are a number of older buildings which are inefficient by today's standards and do not provide adequate power requirements, ceiling height, loading capacity and functionality for many of today's users, makes many of the available buildings obsolete and not realistic options for those prospective tenants in the marketplace.

The overall vacancy for larger big box industrial and manufacturing facilities in Los Angeles and Orange County is extremely limited. Estimates have put vacancy at 1%-3%. While the vacancy in the overall market may be as much as 10%-15%, these specific sub-markets have limited opportunities. While other markets throughout Southern California such as the Inland Empire and parts of San Diego County still have higher vacancy, the amount of vacancies for these bigger buildings has dropped dramatically over the last 18 months.

During the economic downturn, many of the smaller entrepreneurial manufacturing companies, located 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 to do business in this region. Those companies, which did not have a necessity to be located in Southern California, found opportunities either overseas, in Mexico or other Western states which were significantly less expensive than Southern California. The companies who stayed in Southern California have survived the storm of the economy and their own business issues. Those companies, which are in older and/or inefficient buildings, have an opportunity while the rental rates are at an all-time low to take advantage of the real estate market. In the leasing sector, concessions such as tenant improvements, free rent and lower rental rates provide an additional incentive for a tenant to relocate. Many manufacturing companies have significant upfront expense for them to relocate equipment and to make improvements necessary for their business. These upfront concessions provide the user the opportunity to defray those upfront costs in relocating. 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 two-fold: Typically the manufacturing company will be in a position to pay a higher rental rate and a manufacturing company will be interested in signing a longer-term lease i.e. 10 to 15 years as opposed to a distribution company which typically look for a three to five year lease. The upfront costs and disruption to relocate a manufacturing company makes relocation a rare event. Distribution companies will have more opportunities for changes in their business and space 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 in trying to find the right partner to do business with in structuring mutually beneficial transactions. Those tenants, which are consolidating or relocating, should take advantage of utilizing professionals and consultants to help them in not only assessing the relocation costs but in structuring a transaction that accommodates their business requirements. Savvy tenants will be able to take advantage of the market and benefit their business in a new and hopefully more efficient facility while prices are still on the lower end of the spectrum.

About the Author:

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