
Why Lenders Are Turning Attention to San Diego Industrial

| By Kelsi Maree Borland
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San Diego

Lenders are showing a growing interest in the San Diego industrial market, thanks to strong transaction volume and long-term growth over the last 12 months. While Los Angeles and the Inland Empire typically get the most attention for industrial activity, the industrial boom has moved south. We sat down with **Kevin Pleasant**, regional manager for commercial mortgage lending for **Chase**, to talk about the lender interest in the San Diego market, investment activity and how rising interest rates could potentially impact the market.

GlobeSt.com: In general, lending sources have shown a greater interest in major industrial markets, like the Inland Empire and Los Angeles. Have lending sources also been more bullish on industrial product in a more secondary industrial market like San Diego?

Kevin Pleasant: We've noticed this trend extends to sub markets of San Diego as well. Although San Diego's fundamentals are not as spirited as other Southern California industrial markets, recent CoStar data shows its healthy demand has led to better than average long-term rental growth of 5.4% over the last 12 months. Additionally, the San Diego industrial market has experienced an increase in investment volume over the last two years. With these market attributes, a few years ago I made the strategic decision to have a dedicated Client Manager, Shane Randall, in the San Diego market to serve our clients and maintain a pulse on what is taking place in the market. Over the last year or so, we have seen more lenders in the market competing to finance industrial properties.

GlobeSt.com: What industrial property types are performing best in San Diego, and why?

Pleasant: San Diego has been experiencing a strong industrial market overall. When it comes to property types, logistics and specialized industrial properties are considered to be the strongest, non-multifamily commercial real estate asset classes in the local market. From a lending perspective, we've seen this property type perform well through the last real estate cycle. Particularly, multi-tenant properties are doing well, with the overall industrial vacancy rate in the San Diego market currently below 5%, compared to flex industrial property types, which now has a vacancy rate of 7.5%, according to CoStar.

One interesting and fairly new type of industrial trend we've seen recently is an interest in industrial properties that combine creative office design elements and on-site amenities, with a high-quality and state of the art industrial building that features standard clear heights, loading doors and warehouse space. There have been multiple creative industrial projects delivered recently in North County San Diego, and more are currently under construction. This seems to be catering to a demand from companies in certain sectors for industrial/warehouse type workplaces that are not only conducive to innovation, but also designed to retain employees for the long term.

GlobeSt.com: How has the recent growth in the San Diego industrial market impacted investment activity?

Pleasant: As I mentioned earlier, the investment activity of San Diego has been very strong. We're seeing more clients looking to take money out to refinance and invest in other properties, but there's not as much inventory currently in the market as there has been the last couple of years. A significant amount of capital is also coming from 1031 exchanges and investors are looking to place that capital in industrial assets.

It will be interesting to see whether or not the increasing activity coming in through the local port, as well as the rise of e-commerce, will continue to impact demand for industrial space. This activity has been a key driver in the local distribution industry and contributing to a higher investor demand for warehouse space.

GlobeSt.com: Have you seen a change in the type of investment capital active in the market?

Pleasant: San Diego has historically seen activity that's been tied to local investors and smaller scale properties and transactions. The market is now attracting capital from larger institutions, who in the past focused on larger scale properties or portfolios. We're also noticing a lot of investors are more comfortable with the idea of investing in single-tenant industrial or flex industrial type properties with NNN leases. This allows investors to acquire larger properties with minimal expenses and easier management. Due to the tight vacancy rate and high demand for property, single-tenant industrial properties have become easier to re-tenant in the event of an unexpected vacancy.

GlobeSt.com: How has the tight market impacted cap rates and pricing for San Diego industrial product this year?

Pleasant: Logistics properties in San Diego have been experiencing the tightest market, compared to all other industrial asset classes. As a result, investors are finding it more and more difficult to purchase industrial assets with their 1031 exchange funds. Over time, investors will become less likely to overpay for an asset due to the significant reduction in capital rates.

GlobeSt.com: Do you expect rising interest rates to impact industrial investment activity?

Pleasant: It's no surprise that rising interest rates will have an impact on investment activity as the gap between interest rate and cap rate diminishes. From a lending and portfolio management perspective, we anticipate investors will consider putting more equity into deals. At this point in the cycle, doing the right due diligence on each property is extremely important. Keeping a lower leverage position, being mindful of the tenant demand and knowing the intricacies of a particular submarket, are all key to helping investors successfully manage their industrial assets throughout the cycle.
