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Developer Robin Hughes, a catalyst for change in Los Angeles, tackles innovative projects. Also inside, 5 other outstanding women. p. 17

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BUILDING BIG: At 616,542 sq. ft., this distribution center under construction at Watson Commerce Center Redlands is the Inland Empire's first speculative industrial building to break ground since 2009.

Empire Building in Southern California

Industrial demand has returned to the Inland Empire, but only for the largest of spaces. **By Matt Hudgins**

The bright California sun washes the thick concrete walls of Watson Land Co.'s newest industrial building in Watson Commerce Center Redlands and streams through the open space where two-story glass windows will span the entryway.

On track for completion this year, the 616,542 sq. ft. structure will be a model of energy efficiency, built to earn a Leadership in Energy and Environmental Design (LEED) certification, and is designed for the latest high-volume distribution operations.

But the most distinguishing aspect of the building is that Watson built it on a speculative basis. In fact, it is the first spec building to break ground in the Inland Empire since 2009. Even so, the developer is confident the space will land a tenant soon after its completion later this year.

"There really is a huge lack of supply for buildings over 500,000 sq. ft. in the Inland Empire," says Lance Ryan, vice president of marketing and leasing at Watson Land. "We expect that story

PREMIUM PRICING: In March, Bixby Land Co. paid $29.45 million, or a 6% cap rate, to acquire the 393,000 sq. ft. Empire Business Center in Mira Loma. The center was 100% leased at the time of sale.

center in the Moreno Valley.

Port traffic also contributes to the growth of large distribution centers, says Burback. The number of shipping containers passing through the Los Angeles and Long Beach ports fell after 2006, but has been rising since 2009.

Container traffic is measured in 20-foot equivalent units (TEUs), with one TEU equal to one container that is 20 feet long. After peaking at 8.2 million TEUs in 2006, imports through the ports of Los Angeles and Long Beach fell to 6 million TEUs in 2009.

Volume bounced back up to 7.1 million TEUs in 2010 and is on track to reach 7.6 million TEUs in 2011, according to Economics & Politics Inc., a market researcher based in Redlands, Calif.

Exports reached a record 3.4 million TEUs in 2010. To handle mushrooming volumes of goods passing through the ports, a number of retail and logistics companies have sought to establish larger distribution centers. "The Inland Empire had what everybody was looking for, and that is large blocks of available space," says Burback.

As a result, overall vacancy fell to 7.3% in the second quarter from more than 13% about 18 months ago, according to Burback. Average month-

Inland Empire emerges as automotive hub

With the ports of Los Angeles and Long Beach ushering in the majority of finished consumer goods imported to the United States, it's not surprising that Asian carmakers like Toyota and Nissan have distribution hubs in the market.

But distribution is only a part of the automotive cluster that has formed in the Inland Empire city of Ontario, Calif., a submarket that is becoming a nexus of education and assembly for the industry.

Toyota operates a 500,000 sq. ft. parts distribution center in Ontario, which is about 35 miles from Los Angeles. The company picked the location primarily for port access, since most of its inventory is imported via the Pacific Ocean, according to Ed Huante, national manager of the company's North American Part Center California.

In addition to port proximity, Toyota was drawn to Ontario's access to major interstate highways, rail, and a large commercial airport. "We also have several North American suppliers that are, or were, located in Northern or Southern California," says Huante.

"Clearly, Ontario made for a great location to consolidate and warehouse inventory from overseas and West Coast, North American suppliers," adds Huante.

Last fall, Nissan North America opened its Ontario Training Center at 935 S. Milliken Ave. The school trains dealership technicians in Southern California, Arizona, Nevada and parts of Utah to service Nissan and Infiniti products.

And one of the latest automotive developments in the region relates to Atlanta-based Wheego Electric Cars, which operates an engineering center and final assembly plant in Ontario. Hi Performance Electric Vehicles, a company that has operated in Ontario for 20 years, manages the center.

In December 2010, Wheego announced its plan to complete final assembly of the Wheego LiFe, an electric automobile, at the Ontario center.

"Ontario has a very pro-business culture, which makes it easy to get things done, and that's important to us," Wheego CEO Mike McQuary said in announcing the plan last year.

"While California's business climate is often challenging, Ontario has an excellent local talent pool, low-cost commercial real estate and great logistics."

— **Matt Hudgins**

ly rent for distribution space was about 31 cents per sq. ft. at midyear in the Inland Empire, and he expects that average rent to increase over the next 12 months to about 33 cents.

Unequal demand

Many of the Inland Empire's industrial landlords are struggling to attract and retain tenants, however. Of the roughly 500 million sq. ft. of space developed in the market since the mid-1980s, only about 20% falls under the highly sought after size of 500,000 sq. ft. or higher and is fully occupied, according to investor Jason Schirn.

Space in the super-sized industrial sector has typically leased or sold to large public companies with the necessary liquidity to close those deals, says Schirn, who is a principal at Hager Pacific Properties.

The Los Angeles-based commercial real estate company owns and manages nearly 100 properties nationwide with an aggregate value in excess of $1 billion.

Another 90 million sq. ft. of the Inland Empire's buildings measure between 250,000 and 500,000 sq. ft., estimates Schirn. The remaining inventory consists of hundreds of smaller buildings.

This smaller stock makes up more than half of the market, and caters mostly to private companies and small corporations that are likely to delay space decisions until the economy improves.

That is why virtually all of the Inland Empire's industrial vacancy is concentrated in these smaller properties, says Schirn. "Exclude those massive, fully occupied buildings from the market, and the vacancy rate is in the middle teens," he says. "The only segment that has really recovered is the big-box industrial segment."

Brokers say the rest of the market is catching up with absorption, however. In the softer segments of the market, a flight to quality is driving tenants to lease space in the Inland Empire, according to Brian Bennett, a principal in the Irvine, Calif. office of commercial real estate firm Newmark Knight Frank.

A tenant that leased distribution space in Los Angeles five years ago was probably paying 57 cents to 60 cents per sq. ft. per month on a triple-net lease, says Bennett.

By moving to new space in the Inland Empire in 2011, that same company can expect to lease higher-quality, newer space for about 35 cents per sq. ft. on a triple-net lease. (A tenant who enters into a triple-net lease pays the costs associated with operating and maintaining the property in addition to base rent.)

In Los Angeles, where the indus-

PORT ACTIVITY HEATS UP

Both imports and exports passing through the ports of Los Angeles and Long Beach are steadily climbing after a recessionary dip in 2009. Exports are at an all-time high.

*One 20 ft. equivalent unit or TEU equals one 20 ft. shipping container.

Source: Economics & Politics Inc.

trial stock is growing obsolete and vacancy is about 3%, a move to the Inland Empire may be the only option for a tenant that seeks to open a large distribution center, says Bennett.

"If you're in the L.A. basin and you're 150,000 sq. ft. or larger, the chance of you finding a good-quality facility is minimal," he says. "Now if you're 50,000 to 100,000 sq. ft., you have tons of space to look at."

Investment outlook

The largest and highest-quality industrial properties in the Inland Empire command premium prices, say investors. In March, for example, Bixby Land Co. paid $29.45 million to acquire Empire Business Center, a five-building, 393,000 sq. ft. industrial park in Mira Loma.

"We paid a 6% cap rate for it," says Mike Severson, vice president of investments at the private REIT based in Irvine, Calif. "We think it's a great piece of property, and it was 100% leased at the time."

Bixby owns approximately 1.4 million sq. ft. in 10 buildings in the Inland Empire. That accounts for about 20% of its 5 million sq. ft. portfolio of office and industrial space.

While Severson would like to buy more real estate in that market, the company has shifted its attention to value-add properties that offer a better opportunity to boost returns through upgrades and leasing vacant space.

Schirn of Hager Pacific confirms that prices on stabilized assets in the Inland Empire are growing prohibitively high. His company acquired several older properties just after the recession at prices equivalent to the cost of vacant land.

"The Inland Empire buying opportunities are gone," emphasizes Schirn. "There's so much competition there. To get anything above a 6.5% cap rate is difficult."

Matt Hudgins is an Austin-based writer.