# Small-Bay Properties Showing Resiliency in San Diego

## Little New Construction Is Coming To Accommodate This Demand

By Joshua Ohl

Leasing activity across the San Diego industrial landscape has moderated over the past few quarters.

Tenants looking for larger spaces have become more cautious amid economic concerns, which could spell further moderation in overall new leasing activity throughout 2023.

However, demand among small-bay users in San Diego remains firmly in place. The vacancy rate for buildings under 50,000 square feet is 100 basis points below the 2019 year-end rate and roughly 150 basis points below the 2020 peak. Some local brokers are advising owners to break up larger spaces into smaller offerings to tap into this demand.

Available spaces under 50,000 square feet are leasing in record time in San Diego. The median time for available space to lease in this sector is 2.4 months. That's more than one month faster than the median time between 2020 and 2022. It's also one of the fastest rates in the United States among major industrial markets, and a shade below the speed at which spaces in this set are leasing at Southern California counterparts in Orange County, Los Angeles and the Inland Empire.

One of the leading reasons smaller spaces are leasing faster than larger spaces is that very little small-bay space has been added to San Diego's industrial inventory in recent years.

Developers instead have concentrated on building sprawling logistics facilities in Otay Mesa that span several hundred thousand feet and lease to larger tenants. Those buildings are tapping into demand for cross-border trade with Mexico. However, according to the most recent data from California's Employment Development Department, small businesses with fewer than 50 employees represent more than 95% of San Diego's business landscape and employ nearly 50% of the local workforce.

More than half of San Diego's existing industrial inventory is comprised of buildings smaller than 50,000 square feet, totaling more than 100 million square feet. But small-bay facilities account for less than 6% of San Diego's pipeline, or about 200,000 square feet.

In the past five years, only 1.2 million square feet has been added to this small-space group of buildings, and less than 40,000 square feet was available during the first quarter. That amounts to about 9% of San Diego's new inventory over the past five years.

A few recent deals highlight the trend. At the end of 2022, Frontier Water Systems leased 38,300 square feet at a manufacturing facility in Spring Valley with an asking rate below $1 per square foot on a triple-net basis. That space had been on the market for only two months at the time of the engagement. The firm was acquired by Evoqua Water Technologies in 2022, and its new space is a significant expansion from its 5,000 square feet in the Sports Arena area.

Similarly, Irvine, California-based Orange Circle Studio branched out into Oceanside with a 38,000-square-foot sublease at First Park at Ocean Ranch. The distribution space had been on the market for only two months before the sublessee committed to the space for three years at a rate of $1.15 per square foot, triple net.

Of course, economic headwinds could stifle demand in the coming quarters among this set of users as higher interest rates and persistent inflation disrupt business plans. But for now, tenants are scooping up small-bay space in record time.