The Inland Empire Is Running Out Of Space. This Area Is Poised To Take The Spillover

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It is difficult to understate the strength of the Inland Empire (http://www.bisnow.com/tags/inland-empire) as an industrial behemoth. Newmark puts its overall vacancy at a mere 0.6% in Q1, the lowest of all major U.S. markets it tracks and less than a quarter of the national average. Its average rent of $12.37 blows away the national average. It is the third-most-active construction market in the country with 33M SF underway and projects regularly fully lease before delivery. Everyone wants to be in the Inland Empire, and for years it seemed like maybe everyone could be.

"The Inland Empire: We used to call it the endless empire, thinking we would never run out of dirt," said Cushman & Wakefield Vice Chairman Chuck Belden, who has worked in industrial real estate in the Inland Empire for nearly four decades. "Well, in a way, we have."

The conditions in the Inland Empire are pushing companies to look to adjacent areas that are largely unproven — places that a few years ago might not have garnered a second thought. Few developers want to be the first to test-drive a new area, which, among other factors, has been holding these areas back from becoming the beneficiaries of spillover from the tightest parts of the Inland Empire. But industrial experts say it is only a matter of time before those hurdles fade, either through the hard work of developers and other stakeholders to market these areas, because the demand for space overtakes them, or a combination of the two.

That is where the high desert comes in.

The high desert most often refers to the Mojave Desert-adjacent California cities north of the eastern Inland Empire, including the Victor Valley (Apple Valley, Victorville, Hesperia, Adelanto, Barstow and Phelan) and the Antelope Valley (Palmdale, Lancaster), though not all those areas are seeing industrial interest.

Scannell Properties Director of Development Jay Tanjuan isn't currently looking at the high desert for potential sites, nor is he seeing a mass move from other companies, but he said it makes sense that developers and potential tenants would look for alternatives to the Inland Empire because of the record-low vacancy numbers and the decreasing amount of land for new projects.

"With pricing getting really high, it's bound to happen, for folks to start venturing out into some of what we would call tertiary or pioneering submarkets," said Tanjuan, whose company works internationally on build-to-suit and speculative industrial development. "There's definitely a need to look outside of the Inland Empire."

World Class Logistics Consulting President Jon DeCesare said areas of Kern County around Bakersfield and farther east on the 10 Freeway, around Palm Springs and Indio, could be early beneficiaries from IE spillover. Belden said he's also seen a rising interest in the Kern County/Bakersfield area.

E-commerce behemoth Amazon has two projects in Victorville: a more than 1M SF fulfillment center that is expected to open (https://www.vvng.com/amazon-fulfillment-center-coming-to-victorville-commerce-center-in-2022/) in late 2022, and an under-construction conversion of a Walmart to a last-mile fulfillment center. The Walmart had been vacant for more than eight years and is 126K SF, according to the Victor Valley News (https://www.vvng.com/amazon-last-mile-delivery-station-moving-to-old-walmart-building-in-victorville/).

Covington Group has a 200-acre project in Hesperia and sold a site (https://www.prnewswire.com/news-releases/covington-group-completes-first-sale-of-1-055-360-square-foot-build-to-suit-for-modway-industries-in-hesperia-california-301259718.html) to developer Exeter in 2021. Exeter will develop a roughly 1.2M SF facility for furniture distributor Modway there.

There is about 2M SF of construction in the submarket now, a Q1 2022 report (http://www2.naicapital.com/wp-content/uploads/sites/2/IE_IND_Market_Outlook_Q1_2022.pdf) from NAI Capital shows. While that is dwarfed by the tens of millions of SF under construction in the western and eastern Inland Empire, NAI Capital Managing Director of Research J.C. Casillas notes that's a jump from zero projects under construction in Q1 '21. The numbers can easily fluctuate fairly dramatically in the high desert because properties being built in the area are very large due to the availability of land.

The combination of that availability of land plus the area's strong connectivity to highway networks, making it easier to get goods where they need to go, are pluses in the high desert's column.

But industrial professionals say the area is still largely unknown to many companies looking for space, and that's a major hurdle.

The pandemic-spurred supply chain crisis has made many companies that would be filling buildings extra risk-averse, DeCesare said. As such, they will likely need to be convinced to try a Victorville or a Hesperia location, even though land in these areas is both cheaper and more readily available.

Land prices "are not the No. 1 reason people will say, 'Well, I'll go to the high desert' and it alone isn't going to be a reason people want to be there," DeCesare said.

Some companies that have unsuccessfully sought space in the Inland Empire have instead gone to Phoenix or Las Vegas, several sources that spoke to *Bisnow* said. Though those cities are undoubtedly farther away from the population center of Southern California than high desert locations, they offer some advantages.

General business-friendliness is one. Nevada and Arizona are business-friendly whereas, in California, “the anti-business legislation never stops,” DeCesare said. That doesn’t pair well with the heightened risk-aversion he sees in company decision-making about warehouse space now.

Approvals for new ground-up projects are also faster and easier to get in Las Vegas or Phoenix, as projects don’t have to contend with the California Environmental Quality Act, Belden said. The Inland Empire is also seeing more frequent instances of community pushback (https://www.bisnow.com/los-angeles/news/industrial/southern-california-warehouses-air-pollution-trucks-108853) against last-mile and distribution facilities over concerns they negatively impact the environment in which they operate.

There is also plenty of labor in the areas around Las Vegas and Phoenix, which the high desert cannot compare to. While it may cost more to get products from the ports in Los Angeles and Long Beach all the way to Nevada or Arizona, Belden said that is just one cost in an array of them. When considering the time saved to build a project and the cost and quality of labor, as well as other factors that go into weighing a project, Arizona or Las Vegas could prove more advantageous.

But Phoenix and Las Vegas are also seeing low vacancies, which could lead to some potential tenants giving a second look at the high desert. A Colliers year-end report (https://www.colliers.com/en/research/las-vegas/2021-q4-las-vegas-industrial-market-research-report) for Southern Nevada, which includes Las Vegas, found the market saw record demand, with 11.6M SF of net absorption and a year-end industrial vacancy of 2.3% — the lowest on record for the market, the report’s authors wrote.

In Phoenix, 2021 year-end vacancy was 4.8%, setting a new record low, and net absorption set a record high, with 24.1M SF in 2021, a Colliers year-end report found (https://www.colliers.com/en/research/phoenix/2021-q4-greater-phoenix-industrial-market-report).

DeCesare said developers need to anticipate the wariness of potential tenants in the high desert and craft studies and reports in response to those concerns, showing what the labor pool is and what amenities are there, really selling the area to a potential client and doing some of the work for them to eliminate the unknowns of a new area.

“If you don’t deal with that element, you’re going to leave the tenant concerned and he might not even consider that option,” DeCesare said.

Tanjuan echoed that.

“Once you start going out into these other areas, there's a lot more research and market studies that will have to be conducted to feel comfortable with moving forward with these sites, because it's not just me that I would have to convince, I also have to convince my superiors at my firm and potential lenders,” he said.

In the Inland Empire, there isn’t a lot of convincing that has to be done, he said.

As long as developers and clients can still find space and deals in the Inland Empire proper, or in the immediately adjacent areas, the high desert isn’t going to see a mass influx of development.

But there is already gradual progress into the area and it's likely only a matter of time before the high desert and other Inland Empire-adjacent areas become more viable options for companies looking to access the Southern California region.

"Once, it was said that the Inland Empire was too far out, and well, look what happened: It got built out," DeCesare said. "So when they say the high desert or the low desert is too far out, just be patient."

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