North Santa Barbara County Commercial Real Estate

Guest Authors:
***Steve McCarty*, Stafford-McCarty Commercial Real Estate**
***Steve Davis*, Stafford-McCarty Commercial Real Estate**

Key Points

- **Business are making an investment in Santa Maria**
- **Housing starts are in the beginning stages**
- **Investors are coming back into the market**

Building on Momentum

Santa Maria's slow economic inertia is easing. There is activity across all market sectors, with Agriculture continuing to be a mainstay. Vacancy is on the decrease and the area is poised to see commercial rent recovery through rising rents.

As forecasted last year, we are seeing more transactions across the board and the following is a brief description of the various market segments.

Residential

The median home values in the Santa Maria market are increasing. OREO properties and short sales are declining as a percentage of total unit sales. Median square foot home prices are just under $200 per sq. ft. ($195) and the existing inventory of resales are moving quickly. Given this long recession, especially for construction, Santa Maria is ready for housing starts.

New home inventory is being added on both ends of the economic entry level market. On the upper end Rice Ranch in Orcutt, and on the more affordable side for the Central Coast, Guadalupe just broke ground with Phase One of the first 150 units of the 800 home Pasadera development. The new housing start trend mirrors other housing starts in almost all other areas of the Central Coast.

Single Family Detached Unit Sales: Santa Maria and Orcutt

	2009	2010	2011	2012	2013	2014
Number of Single Family Sales	1309	993	1,045	1,176	1,004	947
Number of Single Family Sales REO*	668	364	677	702	307	97
Percentage of Total Sales REO (%)	51.03	36.66	64.78	59.69	30.58	10.24
Median Price ($)	240,000	247,000	220,000	227,000	278,900	320,000
Median Cost Per Square Foot ($)	157	154	139	140	168	195

Source: Central Coast Regional MLS, Stafford-McCarty Commercial Real Estate
*2011 and foward includes both REO and short sales data
**Data may vary from last year's reported statistics due to data variable change to accomodate multi-year comparisons and regional area reporting.

Retail/Commercial

The retail sector in Santa Maria remains strong despite some vacancies which have persisted for years. Available commercial/retail space decreased from last year with 3.40% vacancy at year-end 2014, which is slightly down from 3.78% in 2013. The retail vacancy presently stands at approximately ¬¬¬¬¬149,000 sq. ft. of vacant space. The retail inventory base for the City of Santa Maria is approximately 4,372,000 sq. ft.

Compared to the other market sectors, the recent retail property sales have typically been leased investment sales, as opposed to owner-user (The buyer purchases the asset with a lease in place that provided an income stream, versus the buyer purchasing a vacant building to use for its own purposes). A North Broadway leased investment (approximately 13,500 sq. ft.) sold for approximately $166 per sq. ft. Although outside the immediate market area, several retail leased buildings between 25,000 sq. ft and 35,000 sq. ft. in Lompoc have sold in the $110 to $160 per sq. ft. It is important to note that these transactions demonstrate the assets are selling below reproduction values.

Little has been built during the recession and given the current low vacancy rates there is a need for new inventory. Larger retail projects which have been shelved are keeping their applications active and now again in process.

Pending Projects:

The Westgate Marketplace – approximately 130,000 sq. ft.
Orcutt Plaza – approximately 225,000 sq. ft.
Orcutt Marketplace – approximately 295,000 sq. ft.

Also coming into the retail mix on the west side of Betteravia at US101, is a new hub for retail and commercial activity. The approximately 110 acre Enos property, annexed into the city, is being evaluated for housing, major retailers, and auto sales.

Retail Vacancy Rates-City of Santa Maria Metropolitan Area

	2007	2008	2009	2010	2011	2012	2013	2014
Rates(%)	2.70%	9.80%	12.50%	10.62%	9.98%	6.83%	3.78%	3.40%

Source: Stafford-McCarty Commercial Real Estate

Office

The office market has had a huge shot in the arm with the absorption of the 58,000 sq. ft. vacant former UPS offices by Rabobank (for their own purposes). This vacancy has been on the market, in one fashion or the other, for over 5 years. With this anticipated occupancy, the office sector vacancy has dropped from 16.61% at the end of 2013 to approximately 10.9% this year. The office component base inventory for 2014 is approximately 1,190,000 sq. ft. with just under 130,000 sq. ft. vacant.

Office users are repositioning themselves in the market place. There is movement where better properties, some of which have been vacant for years, are leasing up. As the office market sector improves we anticipate rents to start to increase, especially with new office market product not coming on the market anytime soon.

Office Vacancy Rates-City of Santa Maria Metropolitan Area

	2007	2008	2009	2010	2011	2012	2013	2014
Rates(%)	6.20	12.40	12.20	16.70	22.37	17.03	16.61	10.90

Source: Stafford-McCarty Commercial Real Estate

There has not been any significant sales for land zoned for professional office. Larger parcels are being marketed at approximately $10.00 per s.f. and have generated little interest in the last several years. Overall, the market is responding to the sale of existing buildings selling for below reproduction costs.

Industrial

There have been a series of small industrial building sales (of concrete tilt up construction) in the Myers Development on A Street. These sales have been a mixure of bank owned properties as well as other, private sales which have clustered around $125 per square foot as noted in the example in the table below. Other sales noted below represent the broad range of inventory in the Santa Maria market, from larger buildings of more recent construction to an older warehouse that sold at $25 per square foot. The selected sales are typical in the market which evince both the wide range, and narrow depth, of product type. Even with the wide range in sales prices, they have all sold below reproduction cost.

Industrial rents are typically $0.50 to $0.70 modified gross for second or third generation space. Asking industrial rental rates for Flex space from 1,500 sq. ft. units and larger are in the $0.50 to $0.65 sq. ft. gross range.

This sector increased its base inventory by approximately 222,777 sq. ft. creating a total industrial inventory which now stands at just over the 8,225,000 sq. ft. mark. Current vacancy has stayed under 5% for the last three years and is showing a slight improvement, decreasing from 4.67% in 2013, to 4.5% this year.

With the combination of a relatively low vacancy rate for industrial product over the last several years and the present market vitality, Zimmerman Development has broken ground on two high bay (49,895 sq. ft. each) industrial buildings on Fairway Drive. This is a reworked project that had been taken back by a lender and then resold to the current developer.

Agricultural support facilities continue to be a mainstay to the Santa Maria industrial market. Logistics Holdings added an approximate 224,500 sq.ft. building on 10 acres on La Brea. Windset Farms continues its expansion by consuming land and, yet again, adds millions of square feet of greenhouses.

Industrial Vacancy Rates-City of Santa Maria Metropolitan Area

	2007	2008	2009	2010	2011	2012	2013	2014
Rates(%)	5.70	8.80	9.60	9.08	8.47	4.00	4.67	4.50

Source: Stafford-McCarty Commercial Real Estate

Area 9, the extensive annexed area for future industrial growth, continues ongoing discussions of cost recovery and fees regarding funding of its infrastructure and development. If you find it, industrial land is maintaining its value in the $5.00 to $8.00 per square foot range for 2 to 3 acre parcels. Industrial sale transactions continue to be limited.

Agricultural

There have been no significant "arms length" sale transactions this last year to reset the Santa Maria Valley prices for good ground: they remain at approximately $50,000 to $60,000 per acre for prime row crop and berry land. This is on par with some of the best areas in the State, ergo the country. During this last year there have been some interfamily/partnership transfers which have been recorded in this price range, but not any open market sale transactions.

The trend continues to moving food production under hoop huts or in green houses. Typically these have been raspberries and blueberries but we are now starting to see strawberries grown under hoops as well. The installation of hoop huts are approximately $12,000 to $15,000 per acre. As a rule, leases for berry ground are approximately $2,200 to $2,600 per acre annually, vegetable ground is approximately $1,500 to $1,800.

It has been difficult to parse 2014 transactions for vineyard valuations as other assets were part of the transaction. These have included large homes, large open spaces (non-plantable) and other specialty assets. The vineyard values are still around $40,000 to $50,000 per planted acre.

Other commercial related agricultural support sales are spilling over into the acquisition of older hotels being repurposed for the H2A farm worker housing. We may see more repurposing for older motel inventory as several older hotels are presently listed and under contract for such purposes.

Commercial Investment

Commercial investors are coming back to the Central Coast but they are faced with a challenge. The emerging issue is lack of suitable product at returns investors are seeking.

As anticipated, there have been more transactions in the investment sector but the products typically have been second tier. Investors choosing returns have elected to purchase product in weaker market areas (older buildings and lower rents) versus top tier properties, which, if they can be found, have been selling at lower capitalization rates (5s and sub 5s).

This being said there has not been much movement in cap rates and appraisers are targeting 7s as caps. However, in transactions under $5,000,000, 7s are rare to find as those cap rates are typically lower—please note that the quality of investment is key to this discussion.

Note that we are reporting a broader range of capitalization rates than in recent reporting periods. We think this reflects the fact that more investors coming in to the market are willing to accept a variety of offerings. Imputed values for owner user sales are still a common practice and a 7 cap rate is often applied.

Following are capitalization rate ranges evinced over the last thirteen years:

Capitalization Rates-City of Santa Maria Metropolitan Area

	2010	2011	2012	2013	2014
Cap Rate Ranges	7.0-9.5	7.0-9.5	6.5-8.0	5.3-7.0	5.0-7.0
Corresponding Valuation* (Millions of $)	1.42-1.05	1.42-1.05	1.53-1.25	1.89-1.43	2.00-1.43

Source: Stafford-McCarty Commercial Real Estate

*Value based upon $100,000 annual net operating income

Summary

The noticeably absent construction component of the market is reestablishing itself and it is our opinion that this new construction will add tremendous velocity to the market. It will take a period of time for new commercial product, now in planning, to come to the market. In the meantime we expect to see rents increasing due to the lack of available inventory.

Notes:

For the purpose of this report, databank numbers include functional, non-competitive inventory (older buildings and warehouses) and excludes non-market square footage such as mini-storage, airport hangers, etc.

A Cap Rate (Capitalization Rate) is calculated by dividing the annual net operating income (NOI—which does not include debt service) by the purchase price, e.g. $100,000 NOI/ $1,500,000 purchase price equals .0667 or a 6.67 cap rate.