

North Santa Barbara County Commercial Real Estate

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Key Points

- Large Developments are under construction in Santa Maria.
- Industrial availability is at an all-time low.
- Active Buyer markets for real estate investments.

An Active Real Estate Market Across all Market Sectors

Following in the economic footprints of last year, we are continuing to see growing numbers of sale transactions and increasing confidence with commercial real estate.

Residential

Santa Maria housing sales are on a gentle upward trend. 2016 saw a slight increase in both unit sales (1,117 for 2016 against 1,033 in 2015) and median price increase. The median 3 bedroom two bath home of approximately 1,630 sq. ft. is now \$364,000 versus \$335,000 for 2015. This is an approximately 8.5% increase in median value and equates to \$223 per sq. ft.

Single Family Detached Unit Sales: Santa Maria and Orcutt

	2011	2012	2013	2014	2015	2016
Number of Single Family Sales	1,045	1,176	1,004	947	1,033	1,117
Number of Single Family Sales REO*	677	702	307	97	84	56
Percentage of Total Sales REO (%)	64.78	59.69	30.58	10.24	8.13	5.01
Median Price (\$)	220,000	227,000	278,900	320,000	335,000	364,000
Median Cost Per Square Foot (\$)	139	140	168	195	204	222

Source: Central Coast Regional MLS, Stafford-McCarty Commercial Real Estate

*2011 and forward includes both REO and short sales data

**Data may vary from last year's reported statistics due to data variable change to accommodate multi-year comparisons and regional area reporting.

Retail/Commercial

Driving along US 101 there is a dramatic expansion of commercial development.

Enos Ranchos or Rancho Santa Maria, the 114 acre project at Betteravia and US 101 will be the new destination for Costco, Lowes, Dicks, Petco, corporate headquarters for CoastHills Federal Credit Union as well new locations for multiple auto dealers. There will be apartments—14 acres of them - and a new school site as well. Infrastructure is nearly complete and the building areas are ready to be turned over to the tenants. This was a significant transaction for the region. It sold for approximately \$36M, or \$7.75 per gross square foot.

The outcomes from the new inventory include a shifting of retail real estate shopping locations and the decreasing rents older commercial real estate will be able to command. The new buildings located close to the freeway and major corridors are occupied by national tenants, resulting in older locations competing for almost all the rest of the retail tenants. In short former A locations will shift to B locations and former B locations will shift to C locations. Midrange rents for these A, B and C locations are approximately: \$2.75 NNN, \$1.25 gross, \$1.15 Gross respectively.

Available year-end 2016 commercial/retail space is slightly down from last year with 2.65% vacancy at year-end compared to the almost nothing 3.4% in 2016. The vacant retail inventory presently stands at approximately 114,600 sq. ft. out of a base retail inventory of approximately 4,384,000 sq. ft.

Even with the above mentioned 114 acre new development, there are still other projects proposed.

The following projects are still on the books for the area:

The Westgate Marketplace – approximately 130,000 sq. ft.

Orcutt Plaza – approximately 225,000 sq. ft.

Orcutt Marketplace – approximately 295,000 sq. ft.

Zimmerman Development’s has rezoned 52 acres of industrial land on Betteravia into a mixed use project which will also be part of the absorption equation.

Given the Enos Ranchos commercial spaces coming online, seemingly all at the same time, it is yet to be seen how the added inventory will affect older building product values and absorption in the upcoming years. Older retail inventory, although well located in traditionally strong trade areas — South Broadway — is being marketed and selling for less than reproduction costs

Retail Vacancy Rates-City of Santa Maria Metropolitan Area								
	2009	2010	2011	2012	2013	2014	2015	2016
Rates(%)	12.50	10.62	9.98	6.83	3.78	3.40	3.56	2.61

Source: Stafford-McCarty Commercial Real Estate

Office

The office market activity has been tepid. More available medical space has appeared in the submarket but the overall vacancy is still floating around 11%, similar to the last three years without a significant change in the supply. The office component of the market at year-end 2016 has a base inventory of approximately 1,200,000 sq. ft. with just under 131,000 sq. ft. vacant.

Construction costs, mitigation fees associated with new buildings and projects, as well as the associated tenant improvement costs, are increasing. Basic tenant improvement costs projected at \$50 a sq. ft. have now become \$80 to \$100. These can be significant for even older buildings which need to be refurbished for new tenants. All of the above factors ultimately translate into increased rents.

Noted sales:

1411 Main Street	425,000	2,688 sq. ft.	\$162 per sq. ft.
2155 Skyway Dr,	\$900,000	4,960 sq. ft.	\$181 per sq. ft.
607 Plaza Dr.	\$1,200,000	7,730 sq. ft.	\$155 per sq. ft.
361 Town Center	\$1,560,000	13,500 sq. ft.	\$116 per sq. ft.

Office Vacancy Rates-City of Santa Maria Metropolitan Area

	2009	2010	2011	2012	2013	2014	2015	2016
Rates(%)	12.20	16.70	22.37	17.03	16.61	10.90	10.61	10.94

Source: Stafford-McCarty Commercial Real Estate

CoastHills Federal Credit Union has ground leased a site for an approximately 85,000 sq. ft. headquarters facility at the Enos Ranchos project noted above. This will be a significant project and add impressive inventory at a gateway property to the City.

Regarding land values, parcels being marketed at approximately \$10.00 per s.f. Aside from the CoastHills project, office land has generated little interest in the last several years.

Industrial

This market segment which was incredibly tighter has become even tighter with a vacancy factor of approximately 1.47%, another historic low. Presently the base inventory is approximately 8,394,000 sq. ft.

Asking industrial rental rates for Flex space from 1,500 sq. ft. units and larger remain in the \$0.50 to \$0.65 sq. ft. gross range. Typical industrial rents are typically \$0.50 to \$0.70 modified gross for second or third generation space. New industrial space will command \$0.75 NNN given the increasing cost of production. Building sales are still occurring below the price of production.

Noted sales:

2240 Thornburg	\$1,200,000	14,484 sq. ft.	\$83 sq. ft.
914 West Boone	\$1,913,000	36,000 sq. ft.	\$53 sq. ft.
2325 A Street	\$785,000	8,000 sq. ft.	\$98 sq. ft.

Sale Leaseback

2105 South Blosser \$3,100,000/23,000 sq. ft. with surplus land (6.5 Cap)

Industrial Vacancy Rates-City of Santa Maria Metropolitan Area								
	2009	2010	2011	2012	2013	2014	2015	2016
Rates(%)	9.60	9.08	8.47	4.00	4.67	4.50	1.82	1.47

Source: Stafford-McCarty Commercial Real Estate

Industrial land is maintaining its value in the \$6.00 to \$8.00 per square foot range for 2 to 3 acre parcels. A current escrow for approximately 1.35 acres of M1 zoned land on Skyway drive is reported to be near the asking price of approximately \$7.65 per square foot.

Windset Farms continues to absorb additional land for its existing and massive greenhouse operation. It is both staggering and impressive to view the amount of buildings under glass. The consumption of Area 9 industrial land by Windset is triggering City planning conversations of further land to be designated for industrial purposes. This being said, Area 9 still has yet to resolve its overall infrastructure funding, fees and reimbursements for the initial developments. Parcels in Area 9 are on the lower end of the value scale due to the cost of delivering infrastructure to those sites. Infrastructure fees discussed are potentially adding \$4.00 per sq. ft.

Agricultural

As noted in previous years, Santa Maria continues to grow its reputation and see rising values in the strawberry industry. A by-product of this success is that a shortage of labor has become a major issue. The H2A program designed to import labor to harvest requires the employers also house the workers. This creates an issue of where to house the labor. Some growers have been buying “older” hotel inventory in northern Santa Maria to accommodate the guest workers. The community at large is not sure of the best location and there is a “not in my back yard” sentiment growing as well. Regardless of attitudes toward immigration and guest workers, the fact is there are crops that need to be harvested and there is not enough domestic labor to meet the need.

Hotels and motels constructed along the former US101, now North Broadway, have commanded interest in repurposing them for H2A purposes. This trend has been going on for several years and this year sees yet another transaction: 127 Agnes sale price - \$1,500,000 for 13 rooms, or \$115,384/room

Key agricultural transactions which reset the market are infrequent. This last year has been no exception. Quality row crop and berry ground remains in the \$55,000 to \$65,000 an acre range. Rents for strawberry ground are stilling ranging between \$2,400 and \$2,700 annually per acre. In comparison annual lease rates for vegetables are in the \$1,500 to \$1,900 per acre range.

Vineyard pricing also remains stable, with \$40,000 to \$60,000 per planted acre remaining the rule of thumb.

Commercial real estate is affected by resources and the drought has been a major cause of concern for agriculture and continued development. Given the heavy rains this season, it will be interesting to note changes, if any, in discussions, resolutions and their intensity regarding water issues.

Commercial Investment

Hotels, shopping centers and apartments are hot items for investors. Tax deferred exchanges are a major driver of transactions and we see this trend continuing into the future as exchanges trigger exchanges. Buyers from outside of the area are entering the market seeking returns. Following are some noted investment transactions by market type:

Hotels:

210 Nicholson \$5,600,000 64 units \$87,000 per unit 5 Cap

Shopping Centers:

2430 South Blosser \$28,600,100 142,944 sq. ft. 6.5 Cap

Self Storage

1920 N. Preisker \$21,240,000 159,914 sq. ft. 5.3 Cap

Apartments:

333 N Enos \$37,000,000 208 units \$177,855 per unit 5 Cap
 Mesa Circle \$20,000,000 22 units \$163,934 per unit 6.07 Cap

The current cap rate target has migrated downward from a targeted 7 cap to a 6.5 Cap and now even in the low 5's. However, investors seeking properties will say they are "looking between a 6 and 7 Cap depending on the property". Investment property is hard to find and apartments and income property with credit tenant will sell between 4.5 to 6 caps.

Capitalization Rates-City of Santa Maria Metropolitan Area

	2012	2013	2014	2015	2016
Cap Rate Ranges	6.5-8.0	5.3-7.0	5.0-7.0	5.0-7.0	5.0-7.0
Corresponding Valuation* (Millions of \$)	1.53-1.25	1.89-1.43	2.00-1.43	2.00-1.43	2.00-1.43

Source: Stafford-McCarty Commercial Real Estate

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

Summary

Santa Maria is, and will be, dealing with major changes and space availability within the retail and industrial market segments. Retail will soon be adding significant inventory and industrial will need to expand to meet a backlog of demand. Aside from the bricks and mortar real estate perspective, the City of Santa Maria continues to undergo major socio-economic and demographic shifts. There is growing demand for farm labor employment and a need to add higher head of household jobs.

Not all areas of the Central Coast have emerged from the recession at the same rate. Using housing prices as an index, they have not still risen above pre-recession prices but at the same time they are expensive relative to the local median income. However, there is a feeling of confidence in real estate evinced by increased numbers of transactions and the declination of capitalization rates.

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.