North Santa Barbara County Commercial Real Estate

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Key Points

- **Shifts across the industrial and retail markets**
- **Construction costs are up**
- **Development increasingly complex**
- **A waning of transaction numbers**

An Active Real Estate Market Across all Market Sectors

The trend of increasing numbers of transactions across sectors continues, but with some new twists as outlined in the following sections:

Residential

The velocity of single family residential (SFR) sales have remained steady over the last several years in the Santa Maria market area at slightly over 1,060 units a year. It was approximately the same as 2017 which had 1,038 sales. For residential builders the better news is that median prices have increased from $231/s.f. in 2017 to $245/s.f. —roughly a 6% increase. Yet, just about there but not quite, Santa Maria residential pricing has not fully recovered from the recession. If you bought a home before the crash near the top of the market nearly a decade ago, present values are just about to return to that peak.

Single Family Detached Unit Sales: Santa Maria and Orcutt

	2013	2014	2015	2016	2017	2018
Number of Single Family Sales	1,004	947	1,033	1,117	1,049	1,039
Number of Single Family Sales REO*	307	97	84	56	11	13
Percentage of Total Sales REO (%)	30.58	10.24	8.13	5.01	1.05	1.25
Median Price ($)	278,900	320,000	335,000	364,000	375,000	407,000
Median Cost Per Square Foot ($)	168	195	204	222	231	245

Source: Central Coast Regional MLS, Stafford-McCarty Commercial Real Estate
*2012 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

Retail vacancy has increased. The vacant retail inventory is standing at approximately 10.01% which is just under double from last year (approximately 459,100 sq. ft. on a base of 4,587,048 sq. ft.).

Until recently, this market segment, year over year has remained very strong; it has seen minimal vacancy with a growing base of square footage. However, retail vacancy rates are increasing with box retailers and larger department stores adding vacant inventory to the market, including the former Costco, Fallas, Toy R' Us, Betty's Fabrics, Beverly's Fabrics, Welenkamps, the former Weatherby's Furniture location…possibly Sears, possibly KMart.

With all the speculation regarding on-line shopping and the concomitant demise of brick and mortar storefronts, we are in a period of transition/sorting out. Will the power centers go the way of the national malls? We think that answer will be different for each community. Neighboring community big box stores such as Sears in San Luis Obispo quickly got demised into smaller units with tenants in tow. It is uncertain what the big box solution will be for locations for Santa Maria at this time.

The retail/commercial market segment has seen the most significant expansion and has provided a window into the Santa Maria community at US 101 and Betteravia Road. The nearly completed Enos Ranch (at the time of this writing) has been the focus of this market segment expansion. CoastHills Federal Credit Union is in the process of completing its signature, approximately 85,000 sq.ft. building, within the development.

Moreover, the overall project included a portion earmarked out for multiple auto dealerships; and those are moving forward with dealer's plans progressing through the City's building and approval processes.

And, as noted in previous articles, there are still other proposed retail centers on the books:

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

Orcutt Plaza – approximately 225,000 sq. ft.

Orcutt Marketplace – approximately 295,000 sq. ft.

Regarding retail land values, retail land on North Broadway, has sold for over $18.00 per sq. ft. for less than an acre parcels – and this is a softer part of the market. Being surrounded by new development adds value. A pad ready site at the north end of town next to a new hotel and Wendy's is being offered at approximately $35 per square foot.

The City of Santa Maria has a focus of redevelopment to its downtown core proposing higher density and a more pedestrian friendly environment. Under this plan an approximate 14,300 sq.ft. parcel was purchased at +/-$76 per sq. ft. on the hard corner of Main and Broadway to construct a multiple story mixed use development project named Gateway.

Office

The office market segment remains the softest—showing the highest vacancy factors. This also holds true throughout Northern Santa Barbara and San Luis Obispo County municipalities and communities. There has been almost no change in vacancy between years ending 2017 and 2018. Approximately 151,000 sq. ft. is presently vacant. Vacancy remains at 12.53%. Modest inventory has been added which translates to a

Retail Vacancy Rates-City of Santa Maria Metropolitan Area

	2011	2012	2013	2014	2015	2016	2017	2018
Rates(%)	9.98	6.83	3.78	3.40	3.56	2.61	5.32	10.01

Source: Stafford-McCarty Commercial Real Estate functional inventory base remaining at approximately of 1,200,000 sq. ft.

What has been a significant change has been construction costs and fees. An industry standard office buildout over a shell space was approximately $60-$80 per sq. ft. several years ago; now that same build-out can be $110-130 per sq. ft.

The trickle down from this is that new construction/buildings have to perform at higher rents to attain the same return on investment. Conversely, there is downward pressure on older building values if new tenant improvements are required to achieve market rents.

This factor exacerbates the delta between new construction inventory and older product: new construction office rents are over $2.00, and up to $3.00 per sq, ft. NNN while second/third generation spaces can be $1.00 gross rent.

Industrial

After multiple years of low vacancy rates there has been a noticeable change in availability for larger spaces, although overall vacancy remains relatively low—3.3% compared to 1.91% in 2017. For 2018, the base inventory is approximately 8,597,000 sq. ft.

Office Vacancy Rates-City of Santa Maria Metropolitan Area

	2010	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Rates(%)	22.37	17.03	16.61	10.90	10.61	10.94	12.53	12.53

Source: Stafford-McCarty Commercial Real Estate

The industrial market segment has been has
demonstrated solid demand for more than three years. Oddly enough, some very functional, larger buildings, e.g., 50,000 sq. ft. have been on the market for about that amount of time. There are multiple properties in the 20,000 – 35,000 sf range that have become vacant, or have tenants who have given notice to vacate. Former C and D Aerospace/Zodiac (now Safran) has relinquished square footage in multiple buildings surrounding its core facility.

The industrial inventory in the neighboring communities of San Luis Obispo and South Santa Barbara County is both tight and more expensive. As always, there is interest to relocate or expand into these larger spaces and they do come but it is not a steady stream. It will be interesting to see if this can become a trend given 1) higher housing costs in the those communities and 2) much of the work force is local to north county.

5,000-20,000 sq. ft. buildings with enclosed yard areas have been consistently the bread and butter of this segment and continue to be in high demand. Industrial asking rental rates for flex space are from 1,500 sq. ft. units and larger are now in the $0.65 to $0.85 sq. ft. gross range. Second or third generation space rents are typically $0.50 to $0.70 modified gross. For newer space industrial rates, owners are asking $0.75 to $0.85 sq. ft./mo. NNN. A modest number of sales for the year, but an example: 5,080 sq. ft. on 1451 Fairway sold for $850,000--which works out to +/- $167 sq. ft.

The most visible new space added to the market is the new approximate FedEx 182,000 sq. ft. facility. The sale of this site, on approximately 20 acres, finally wrapped up with the Airport District at approximately $4.5 million which did not include off-site landbank and other mitigations, which added approximately $1.4

million to the transaction. This transaction involved a plethora of agencies and compliance piling on both cost and time. As developers are sharing with us, "the easy sites have been taken and we are left with the tough ones".

Industrial land sales have been scant for 2018. 2 to 3 acre parcels of Industrial land are listed in the $6.00 to $10.00 per square foot range. 1.37 acres on Tama Lane sold for $575,000 or approximately $9.60 sq. ft.

Industrial Vacancy Rates-City of Santa Maria Metropolitan Area

	2011	2012	2013	2014	2015	2016	2017	2018
Rates(%)	8.47	4.00	4.67	4.50	1.82	1.47	1.91	3.32

Source: Stafford-McCarty Commercial Real Estate

Windset Farms is the PacMan of Area 9 as it continues to gobble acreage for green houses. In fact, so much so that the City is feeling they are out of room to grow and in discussion of where and when to expand industrial inventory in a community that is surrounded by valuable agricultural lands and endangered species. The remaining acreages in Area 9 are still waiting for an infrastructure plan to be implemented in order to be effectively developed—even to create ready to build upon parcels.

Agricultural

Agricultural transactions in the County for 2018 are at the upper end of Ag transaction values and the demand for vineyards and plantable ground continues. The roughly 534 acre Sierra Madre Vineyard sold for approximately $30,000,000. In the reported breakout analysis the planted vineyard portion was valued at $60,000 an acre. 285 farmable acres sold for $10,500,000. In this sale, row crops are reported to being replaced with vineyards, translating to approximately $36,800 per plantable acre.

The strawberry industry is still recovering from both weather and soft markets, similar to markets in Oxnard to the south and Salinas to the north. Quality row crop and berry ground values are still in the $55,000 to $65,000 an acre range.

The need to harvest crops has resulted in key growers relying on the H2A guest worker program. Housing for the program has become a key issue. With lack of a clear solution, the H2A programs have spilled over into residential neighborhoods. The City of Santa Maria has held multiple public forums regarding intensity, zoning and locations; outcomes are still on the horizon.

Commercial Investment

Also following the trend of fewer transactions, Apartment sales, which have dominated the commercial transactions type, were far fewer: from 37 transactions in 2017 to less than 20 for 2018.

Following are some noted investment transactions by market type demonstrating the range in capitalization rates:

Office:

2861 Airpark | 25,909 sq. ft. | $7,600,000 | 6.55 cap

Industrial:

1017 W. Central | 1,687 sq. ft. | $6,150,000 | 6.6 cap

Apartments:

215 N. Miller Street | 11 units | $1,262,000 | 3.18 cap

Current rules of thumb are still being used, investment properties are selling in the range of 6 to 7 caps. Smaller quality tenant investments--are in the 5's. Apartments, in a league of their own; 3 to 5's. It remains challenging to find investment product for investors seeking higher returns within the Central Coast region.

Land zoned for apartments is selling for $16.00 sq. ft

As a current rule of thumb, investment properties are selling in the range of 6 to 7 caps. Smaller, higher quality properties –and apartments--are in the 5's. Higher returns for investors are hard to find in the Central Coast area.

Capitalization Rates-City of Santa Maria Metropolitan Area

	2014	2015	2016	2017	2018
Cap Rate Ranges	5.0-7.0	5.0-7.0	5.0-7.0	5.0-7.0	5.0-7.0
Corresponding Valuation* (Millions of $)	2.00-1.43	2.00-1.43	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

Trends are continuing to emerge. There is a split in the market where many business continue to have confidence and expand, while others are shrinking and consolidating.

Driven in large part by the completion of Enos Ranch, increased vacancies in larger retail spaces are continuing. Larger industrial properties without significant yard areas are coming on the market. Lenders say they are watchful and are starting to see bankruptcy files showing up on their desks. The office market, especially for those businesses without an ag or industrial related component continues to be soft. Building and development are increasingly complex due to mitigating measures required from multiple agencies, i.e., nexus issues, green house gas emissions, traffic, aging infrastructure, etc.

2019 will continue to see the evolution of the economy across all sectors in the Santa Maria area.

Notes:

For the purpose of this report, databank numbers include functional, selected 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.