North Santa Barbara County Commercial Real Estate

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Key Points

- **Medical users are in flux anticipating the effects of Obamacare and how it effects their space requirements.**
- **Industrial buildings are selling below reproduction costs.**
- **Activity is increasing across the real estate sector , but people remain cautious and are not yet bullish on the strength of continued economic growth.**
- **1031 exchanges are coming back into the market.**

The Big Picture

The Santa Maria commercial market is stabilizing and starting to show some signs of growth. Graders are starting work on new housing developments, a new school site is under construction, new, small retail centers are opening and most commercial foreclosures have worked themselves through the market.

While one can see those positive signs, there is still an abundance of caution in the market about new projects. Office and financial user demand remains soft. Leases and sales for industrial properties are occurring, but the demand is for products priced at the lower end of the market---deals are still king.

The following is a brief description of the various market segments.

Residential

Santa Maria is seeing recovery in the housing market, although not fast enough to suit the majority of homebuilders who have been sitting on the sidelines since 2006.

Santa Maria has the largest population on the Central Coast and offers the most housing stock. The backlog of distressed residential inventory has waned. The prediction of a "second wave" of distressed housing inventory coming on the market has not materialized. The volume of home sales was slightly lower than the previous year but the good news is that median prices rose from $240,000 per unit to $270,000. The REO and Short Sale market has declined to about 30% of the market versus approximately 60% of the previous year's market.

As a note for comparison, just 30 minutes up the road in neighboring San Luis Obispo, homes under $600,000 are selling quickly, often receiving multiple offers and experiencing fast closings. New construction is active and hopefully a positive indicator for Santa Maria.

Single Family Detached Unit Sales: Santa Maria and Orcutt	2008	2009	2010	2011	2012	2013
Number of Single Family Sales	1,242	1309	993	1,045	1,176	1,004
Number of Single Family Sales REO*	772	668	364	677	702	307
Percentage of Total Sales REO (%)	62.16	51.03	36.66	64.78	59.69	30.58
Median Price ($)	270,000	240,000	247,000	220,000	227,000	278,900
Median Cost Per Square Foot ($)	179	157	154	139	140	168

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 is doing well. Although there continue to be vacancies, which have been available for years, the market has tightened up dramatically. Available commercial/retail space decreased from the previous year. It presently stands at approximately 165,000 sq. ft. vacant space, translating to 3.78% vacancy at year end 2013 which is down from 6.83% in 2012. The retail inventory base for the City of Santa Maria is approximately 4,363,000 sq. ft.

Gottschalks and Mervyn's spaces are two large prior vacancies that were filled this year. The partially demoed department store was replaced with a theater complex and the vacant 80,000 sq, ft former Mervyn's was acquired by Fallas Discount Stores. The Mervyn's space was reportedly purchased in an on line auction for approximately $2,600,000 ($32 per sq. ft). Fallas' occupancy became a controversial concern as there was a faction that wanted a retailer/occupant to cater to a more upscale clientele to support the Macy's across the street and the aforementioned new finished theatre expansion.

Previously proposed larger retail projects have kept their applications active and in-process:

Retail Activity:

Completed Construction:
The Stadium Theater expansion at the mall is finished and open,offering 14 screens

Completed Construction:
A Commercial Retail Center at 715 S. Blosser – 66,500 s.f.
Now anchored by a Walmart Neighborhood Center and approximately 10,000 sq. ft.
by Community Health Centers

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

The former Stephens Auto Center at Skyway and Broadway, (approximately 40,000 s.f. on 9.4 acres), changed entities mid-year. In the past, the property has had several proposed plans and may go though yet another iteration. An existing tenant, Element Church, has acquired a portion of the land to build upon. This acquisition will change the latest proposed vision.

Retail sale transactions (of which there have been few) are reported in the commercial investment section of this article as they trend cap rate sales, as opposed to speculative investment or user expansion.

Retail Vacancy Rates-City of Santa Maria Metropolitan Area

	2006	2007	2008	2009	2010	2011	2012	2013
Rates(%)	2.00	2.70	9.80	12.50	10.62	9.98	6.83	3.78

Source: Stafford-McCarty Commercial Real Estate

The most speculative property for larger scale retail remains the approximately 110 acre Enos land annexed into the city at the NEC of US 101 and Betteravia. Land comparable sale prices for retail development are difficult to determine. In prior years, retail land transactions, depending upon the size and location of the property, ranged from $10 to $25 per sq. ft. As future transactions occur, the land value base will be recalibrated.

Office

The office sector is still in recovery, having added no new inventory for the second year in a row as consequences of the financial fall-out continue to dampen any heat the market has generated. The office component base inventory for 2013 is approximately 1,189,678 sq. ft. with just over 197,500 sq. ft. vacant.

Office vacancy has improved only slightly from last year (from approximately 17.03% in 2012 to now 16.61% at the end of 2013). The largest single vacancy in the market is the UPS call center, which has now remained vacant for two years, (approximately 58,000 sq. ft.).

As occupancy ebbs and flows within the market, health care provider CHC absorbed a large former vacancy--the Lockheed 32,000 sq.ft. facility for its administrative purposes.

Office market rents remain soft compared to cost of construction and pre- recession high water marks. Following previous years, typical deals for well-located spaces are being cut at $1.15 NNN and up. Second generation asking rates are anywhere from $.50 to $1.25/sq. ft./mo./NNN. Newer space has asking rates as high as $1.85/sq. ft. Modified Gross. Owners continue to work with their existing tenants to encourage lease renewal.

Noted Sales			
Location	**Size(SF)**	**Price($)**	**($/SF)**
1670 South Broadway	4,822	1,100,000	228
915 E Stowell	10,000	1,345,000	135

Noted sales:

The surplus 8,032 sq. ft. Union Bank building is still on the market after a year on the market at an undisclosed price.

Land sales of properties zoned for office buildings have been minimal, however we note that 740 Century, a 1,26 acre site, sold for $675,000 ($12.35 per s.f.).

Office Vacancy Rates-City of Santa Maria Metropolitan Area

	2006	2007	2008	2009	2010	2011	2012	2013
Rates(%)	2.10	6.20	12.40	12.20	16.70	22.37	17.03	16.61

Source: Stafford-McCarty Commercial Real Estate

Asking rates for Office zoned land have dropped—some larger parcels are being marketed at $10.00 per s.f. and have generated little interest in the last several years. CPO zoned land has fallen from its high water mark of $20 to $25 per square foot as well. The market is responding to existing building sale transactions selling below reproduction costs.

Industrial

This sector increased its base inventory by approximately 36,000 sq. ft. for a total just over the 8,000,000 sq.ft. mark.

Due to absorption of several larges spaces on Fairway, Skyway and Industrial Drives, the current vacancy still hovers around 4%, slightly increasing to 4.67% this year. Standing vacancy of for 2013 is approximately 374,200 sq. ft. Overall, this is not an unhealthy rate and does not indicate the need for new product.

Agriculture support and processing is a noted category of expansion. Among the larger lease transactions, Seaside Packaging leased approximately 48,000 sq. ft of a building and an associated yard (which was not on the market). Needing new product, Lineage Logistics is completing construction on approximately. 224,500 sq. ft of freezer and processing on an approximate 10-acre site on La Brea.

On the other side of the absorption coin, some larger assets have remained vacant for over 12 months.

Some noted sales transactions (all below reproduction values for the asset):

The City of Santa Maria, demonstrating its desire to keep businesses in town and provide jobs, rezoned approximately 20 acres to accommodate Atlas Copco in its expansion plans.

A few years ago, Windset Farms completed 165,000 sq. ft. of warehouses, offices and millions of square feet of state of the art greenhouses, and now are back on the radar adding another phase of millions of square feet of production warehouses.

Noted Sales

Location	Size(SF)	Price($)	($/SF)
1340 West Betteravia	22,600	2,600,000	115
2905 Industrial Parkway	33,860	2,950,000	87
1230 McCoy Lane	13,000	925,000	71
834 W. Century	10,250	532,500	52

Asking industrial rental rates have stabilized and in some cases increased. Flex space from 1,500 sq. ft. units and larger are in the $0.30 to $0 .65 sq. ft. gross range.

Industrial Vacancy Rates-City of Santa Maria Metropolitan Area

	2006	2007	2008	2009	2010	2011	2012	2013
Rates(%)	3.60	5.70	8.80	9.60	9.08	8.47	4.00	4.67

Source: Stafford-McCartu Commercial Real Estate

Industrial Land

Like the other sectors, land sales have been few. 1.35 acres were sold along the freeway on Preisker for $5.37 per sq. ft. to a distribution user. As improved properties are selling below reproduction cost, little value if any is attributed to the land. Throughout the recession and the present recovery, land values have been difficult to establish and there is limited existing land inventory available. To that end the City of Santa Maria is readying extensive industrial land inventory within Area 9 of the City planning areas. This effort has been ongoing for several years—presently user demand has been off. This has prompted some land owners in Area 9 to re-entitle their land to residential use.

Agricultural

For Santa Maria Valley, prices between $50,000 to $55,000 per acre for "the good stuff," meaning prime row crop and berry land. As noted previously, values in the Santa Maria Valley now compete with the major farming regions in the Salinas Valley.

However, a 23-acre parcel sold for approximately $48,000 per acre in June to Tiexiera Investments and Donati's purchased the Minami Home Ranch next to the City of Guadalupe, which was 87.43 acres at approximately $48,000 per acre. Although these are slightly lower than the $50,000 acre price noted above, we do not see these sales resetting the registers. as the sale prices were adjusted to the quality of the assets.

More and more hoop huts have appeared to accommodate the demand for premium raspberries and blueberries. These are typically 5- year leases and garner $2,200 to $2,600 per acre in rent.

In addition, Verna's vineyard in Cat Canyon sold. The 100- acre property had 50 acres of planted vines. Adjusting for the non-plantable acreage and dwelling units, analysis supported values of the approximately 12-year old vines at approximately $48,000 per planted acre.

Commercial Investment

The commercial investment part of the market is showing some life. Many of the entry level home sales---both REO and short sales -- have been investor- driven as opposed to owner occupied. And now that the economy and housing markets have stabilized compared to the earlier years of the recession, investors are again looking at commercial real estate.

The controversial capitalization rate still hovers around 7%. Transactions are still relatively few. Appraisers have been imputing cap rates for owner occupied purchases using this factor.

Although we are reporting lower caps (see data below) than the previous reporting periods, these rates reflect better quality investments, which still support the local dichotomy: low caps for the credit worthy tenants with good leases and/or strong locations; and higher cap rates associated with investments of lesser quality tenants or locations.

We anticipate more investor related transactions over the coming years.

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

Noted Transactions

Location	Size(SF)	Price($)	Cap Rate	Description
1864 N. Broadway	2,408	2,947	5.05	20 years remain on lease
2400 N. Broadway	80,000	1,505,000	5.30	30,969 Ground lease NNN.
2200 South Broadway	5,560	7,225,000	6.20	Major tenants Pep Boys/Smart and Final

Capitalization Rates-City of Santa Maria Metropolitan Area

	2009	2010	2011	2012	2013
Cap Rate Ranges	8.0 -10	7.0 -9.5	7.0 -9.5	6.5-8.0	5.3-7.0
Corresponding Valuation* (Millions of $)	1.25-1.00	1.42-1.05	1.42-1.05	1.53-1.25	1.89-1.43

Source: Stafford-McCarty Commercial Real Estate
*Value based upon $100,000 annual net operating income

Summary

Santa Maria is moving out of the lingering recession and establishing a new normal in which there is a mix of troubled asset and market rate transactions. A healthy indicator is that, although few, there have been transactions across all market segments. Tax deferred exchanges are resurfacing—all positive signs of growth. That being said, any significant residential construction has been noticeably absent from this recovery, and we await the upward impact and overall economic activity when that kicks in.

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.