

Santa Maria Commercial/Industrial Real Estate Market Update

First Quarter, 2016

General Update

Commencing in January 2014, we began to see a noticeable increase in demand. Construction (both residential and commercial), which came to a screeching halt in early 2009, began to increase moderately. Projects that were halted with an unknown re-commencement date started to show signs of life. New Retail projects began to show signs of life after a prolonged dormancy (Regal Cinemas Town Center Mall, Joann's Fabrics, WalMart Market- 2 locations, Fallas Department Store). Residential tracts that were paused during the downturn started building once again (LaVingna, Westgate Ranch, Rice Ranch-Orcutt). Though our residential market (like similar markets nationwide) was dramatically affected by illogical sales and equally illogical lending, adjustments were made and our home buying public seems to have returned, albeit at a materially lower price point. We are once again approaching a Seller's market with anemic interest rates making very attractive opportunities to 'qualified' buyers.

General Market Values: Rental rates and sales prices have increased from recent years as market trends continue to improve. Higher demand and lower supply are allowing slow but steady increases in lease rates with higher rates of appreciation for sales values. Capitalization Rates for quality investment properties in the Santa Maria Valley are hovering in the 5% to 6% range. Many tenants (across all market sectors) are renegotiating their leases with landlords in an effort to establish longer-term tenancies based upon previously suppressed lease rates.

Specific Lease Rates: Within the last 18 months, overall market values have experienced reasonable adjustments. Industrial lease transactions that peaked in the \$.75nnn to \$.95nnn range dropped dramatically and are now being executed in the \$.50 Gross to \$.75 nnn range. Retail rents once found in the \$1.75nnn to \$2.50nnn range are now found in the \$.80 nnn to \$2.50 nnn range. Office rents are by far the least affected by increased market variables and remain in the \$1.00 nnn to \$1.75 nnn range (with the exception of Medical Office Rents, which are generally higher due to increased parking requirements and heavy utility needs within the space).

Specific Sale Prices: Although we have seen significant increases in the sale prices of Industrial buildings, we are not nearing 'top of the market' (2007) prices once found in the City of Santa Maria. Some of the highest recent Industrial Sale Comparables are found in the \$110 to \$125 per square foot range. Most of the higher priced sales were smaller, owner-occupied buildings (3,000 sf to 10,000 sf) in the Southwest Sector. Retail building sales once recorded in the \$300+ per sf range are trading in the \$200 to \$250 square foot range for newer properties (with several exceptions to due to specific high-demand locations). Office building sales range from +/- \$125 to \$200 per square foot. Industrial Land Sale comparables are generally found at \$6 to \$7/sf range, and Retail and Office Land Sale comparables are found in the \$14 to \$25 per sf range. In general, overall commercial/industrial sale prices are increasing, but remain off of their peak by +/-20%.

Significant Market-wide Events & Developments

Area 9: The addition of approximately 900 acres of industrial land into the City of Santa Maria by annexation of parcels bordered by Betteravia, Black, and Stowell Roads (Area 9) were initially thought to be long-term industrial growth for Santa Maria. However, Windset Farm's large scale Hydroponic Greenhouse operation acquired a significant portion of the annexed land and is operating over one million square feet of greenhouse/growing/processing facilities on Black Road.

Betteravia Plaza: Approximately 56 acres of land, which was part of the Santa Barbara Research Center/Hughes Aircraft Company was being processed for subdivision into +/-30 industrial parcels. However, lack of demand by industrial users for that location prompted a 'rethinking' of the property's future. Bordered by two of the most highly traveled thoroughfares in the Southwest Sector (Betteravia & S. Blosser/Skyway Drive) this future subdivision was re-zoned through a General Plan Amendment and will be home to significant Retail/Commercial services, Commercial Professional Offices, and Multi-family units serving the Southwest Sector

Santa Maria Police Department: The culmination of nearly seven years of effort resulted in the occupancy of 1111 West Betteravia by the City of Santa Maria's Police Department. In a very strategic move to meet the long-overdue facility needs of the Police Department, the City went above and beyond in the refurbishing of a 72,000 square foot former R&D building to create a state-of-the-art Law Enforcement facility that has the capability to provide Regional and Statewide Law Enforcement Training and Emergency Services.

Enos Ranch: The last sizable retail development with Highway 101 visibility in the city limits of Santa Maria is on slate to become a reality in 2016. The long-awaited Enos-Buss Site will be transformed into Enos Ranch. This +/-111 acre site bordered by S. Bradley, Betteravia, College, and Battles roads will contain Regional Retail, Auto Dealerships, and Residential uses. Regional Retail users include Costco, Lowes, Dicks Sporting Goods (& a host of smaller retailers), along with +/-13 acres of new automobile dealerships.

Federal Express Ground Transportation Facility: Construction bids have gone out for a new +/-160,000 square foot Fed Ex facility to be located in the 1500 Block of Fairway Drive. With anticipated ground-breaking in 2016, this facility will add to Santa Maria's stable industrial employment base.

Spec Warehouse Facilities. Two new 50,000 square foot warehouse facilities immediately adjacent to the future Fed Ex site were recently built and are ready for occupancy.

Santa Maria's agricultural employment base that continued to thrive throughout the general economic downturn still thrives. Included in the agricultural segment are numerous Wineries, Wine Processing/Storage/Bottling facilities and Processing/Cooling/Packaging operations (Lineage Logistics, Seaside Packaging, Gold Coast Packaging, Brothers Best Produce/Agro-Jal, Maxco Packaging).

Industrial Sector

Our database shows that the Santa Maria Industrial Market is comprised of approximately 8,650,000 square feet of buildings (both vacant and occupied). This total includes all existing buildings and substantially completed new construction in the M1, M2, and CM zoning areas (excluding mini-storage).

A recent survey shows a total current vacancy in the Industrial Market of approximately 325,000 square feet (up/ from +/- 190,000 square feet as reported in 2013, but +/-100,000 sf represents new inventory on the market). The overall vacancy factor in our Industrial Sector now stands just below 4% percent.

Industrial Land: There are relatively few parcels of industrial land available for sale in the Santa Maria Valley. Those available are listed for sale in the \$7.00 to \$9.00 per square foot range. Most of the vacant parcels of land that were being processed with development plans or for build-to-suit opportunities saw little or no activity during the downturn. When our Industrial market vacancy dipped below 5%, we started to see the return of speculative construction.

Industrial Buildings: New, speculative development opportunities broke ground in 2014 in anticipation of demand for mid-year 2015. However, the total area of these projects does not exceed 150,000 square feet. Large industrial facilities vacated in recent years were leased on long-term commitments by some of Santa Maria's most prominent private employers (Zodiac Aerospace, Windset Farms, Agro-Jal).

Santa Maria Office Sector

The Office component of Santa Maria's commercial real estate market is comprised of approximately 1 million square feet, both occupied and vacant.

For the purpose of tracking information, observing trends, and maintaining statistics, we have demised Santa Maria's Office real estate market into four Sectors within the City Limits (SW Sector, SE Sector, NW Sector, & NE Sector). For the purpose of establishing geographic boundaries, the Sectors are demised by the Broadway/Highway 135 (running north & south) and Stowell Road (running east & west). For the purpose of this study, office properties owned and occupied by governmental agencies are not included in our Office Sector Base

Vacancy Factor: It is believed that our Vacancy Factor in the Office Market (contained in all three product types) is less than 3.5%. This low vacancy factor represent a considerable advantage to existing building Owners with respect to market lease rates ("Landlord's Market") and potentially higher lease rates being paid by tenants (especially those with specific criteria/amenities in their Site Searches.

2013 through 2015 saw significant movement in Santa Maria's Office Sector. With the leasing of 2050 South Blosser (32,000 sf) and 302 West Carmen Lane (12,000 sf) the largest vacant office properties are now occupied by long-term tenancies. Furthermore, the medical office spaces within

the 116 S. Palisades Building ('Marian Hancock Building') have been leased, and that project is enjoying 100% occupancy.

Vacant land that can be used for the construction of new Office product is also substantially below what is considered typical for most markets. There is one remaining lot at McCoy-Depot project with the most recent construction of a new 7,200 square foot 'spec' office building. The Santa Maria Wisdom Center project will soon break ground as part of the McCoy-Depot project. There are few ready-to-build parcels of land suitable for the construction of new Office Projects at this time.

Office Space/Product Types: There are two general types of Office Space within the City of Santa Maria: General/Professional Office Space, and Medical Office Space. Demand and values for each vary greatly based upon location, age, and tenancies.

General/Professional Office - The majority of Santa Maria's Office Market could be described at either General Office Space or Professional Office Space. The 'Use' of the building is the determining factor between 'Professional Office' or 'General Office'. In many cases, there is a subjective line between the two categories of office space users, and some multi-tenant properties contain both General and Professional Office users. Professional Office uses include: Accountants/CPAs, Lawyers, Architects, Engineers, Escrow & Title Offices, Real Estate Brokerages, Appraisers, Financial Advisors, and Insurance Agents. General Office uses include Corporate Offices, Non-Profit Agencies, Consultants, Service Providers, and Government Offices.

Santa Maria's Office Market consists of buildings that have been built using a wide range of construction methods. General Office space and Professional Office buildings are found throughout the City on both major arterials and secondary streets. Buildings in Santa Maria's General/Professional Office categories include a wide range of variables, including:

- Older construction, refurbished to current Building Codes
- Converted/Up-zoned structures (commercial, industrial, and/or residential)
- Single-story/Multi-story; Elevator served; ADA Compliant; current Building Code
- Varied Parking Ratios

Office Space/Buildings are dispersed throughout the City. Because the north end of the City Limits tends to be older residential units & commercial space, most of Santa Maria's General and/or Professional Office Space is found along the Main Street corridor south to the Community of Orcutt. Santa Maria's Office Base consists of newer & older structures, single-tenant & multi-tenant buildings, and single story or multi-story structures. Similar to Medical Office Buildings ("MOBs"), building trends and the general age of Office Space/Buildings often determines the type of construction used when they were built. Most of the older structures are made of wood/stucco, while the newer structures are made of either concrete tilt-up panels or steel frame/stucco. The City of Santa Maria requires General and Professional Office Space/Buildings to meet a Parking Ratio of 4 parking spaces/1000 square feet of building area. General/Professional Office Space is generally found in the CPO (Commercial Professional Office) Zoning, C2 (Commercial/Retail) Zoning, or PF (Public Facilities) Zoning.

Medical Office Buildings (“MOBs”) - A significant majority of the Medical Office Space is within close proximity to Dignity Hospital. However, there are multiple medical ‘submarkets’ in the City wherein medical office uses and MOBs are clustered. Santa Maria MOBs are constructed from various building materials (often determined by age/trends) and in a wide range of sizes. City Zoning Ordinance requires MOBs to meet a Parking Ratio of 6 spaces/1000 sf of building area.

Within the City of Santa Maria, there are several geographic areas where a higher concentration of MOBs are found, including:

- Dignity Hospital Area (includes Palisade Drive, Cypress, & Stratford)
- Broadway Corridor (and one-block side streets both north and south)
- Main Street Corridor (both east and west)
- East Stowell Road
- Betteravia Road (east and west)/W. McCoy Lane

Commentary

The Commercial/Industrial Real Estate market of the Santa Maria Valley remains stable. Demand for existing facilities has been steady throughout the last twelve months with a mixture of prospects looking for facilities to lease or buy. Our strong employment base of local and regional employers in both medium technology and agricultural sectors remains our City’s greatest asset.

Most of the vacancy factor throughout the market can be found in larger freestanding buildings in the range of 25,000 to 50,000 square feet. Most multi-tenant industrial parks with smaller unit sizes (less than 1,500 square feet) have experienced increasing demand from smaller firms looking to either start up in Santa Maria or expand from other regional locations. Similarly, demand for medium sized units (3,000 to 6,000 sf) has increased over the prior 12 months.

As discussed in prior Industrial Market Profiles, the Santa Maria Industrial Market is segmented into four main Areas:

| <u>Area</u> | <u>Major Streets</u> |
|--------------------|-----------------------------|
| Southwest | Skyway/Betteravia |
| Northwest | Blosser/W. Stowell/Main |
| East | E. Stowell/E. Boone |
| North | Roemer/Preisker/Carlotti |

Southwest Area – The Southwest area recognized several significant events during the 2013 through 2015 time period. Company expansions coupled with construction of new facilities has increased the overall base and the vacancy factor as well. The current vacancy factor in the Southwest area (including completion of the buildings under construction) represents approximately 2.3% (or approximately 200,000 square feet). One half of the SW Sector vacancy is attributed to two brand new, state of the art, High Bay Distribution buildings (totaling 100,000 square feet); The 58,000 square foot facility at Skyway/Betteravia (formerly occupied by UPS Teleservices) was purchased, remodeled, and occupied by Rabobank in January 2015. This facility now serves as the permanent home to Rabobank’s Regional Banking Center; Several Wine and

Agricultural companies expanded their related companies in the SW Sector, and Zodiac Aerospace leased an additional 157,000 square feet (two former Den Mat facilities on Skyway Drive) during the 2013 through 2014 time period. Federal Express will break ground on a new +/-160,000 square foot build to suit on Fairway Drive; and Hayward Lumber is under construction with an additional +/-20,000 square foot warehouse building materials on West McCoy Lane. The North County Jail Facility is scheduled to break ground in 2016. This 500 bed, state of the art Detention Facility will create even more stable jobs to the Santa Maria Valley and further drive demand for services and housing in the Southwest Sector.

Northwest Area – This submarket is the second largest in the City. Current Vacancy in the Northwest Area stands at close to zero. Several events occurring in the Sector are noteworthy. Bonita Packing, Cal-Giant, Driscoll Strawberries, Gold Coast Packing and Linneage Logistics have built and occupied large processing and cooling facilities near the westernmost City Limits. Three separate industrial buildings of +/-10,000 square feet each in the NW sector were sold within +/-6 months of each other (Western Avenue/Morrison). The former Sears Warehouse (36,000 square feet) was leased to On-Trac (an overnight package delivery service).

East Area – The most significant property in this Sector is represented by the Columbia Business Center. There remains minimal availability in the +/-157,000 sf CBC complex of less than 10,000 square feet. A portion of the CBC was sold to Shepard Eye Center in 2014 and converted into an Optomology Facility.

North Area –The combined Gateway Business Park and Gateway Plaza projects remain at approximately 90% occupancy. Those projects along with several trucking, equipment, and food related companies currently make up the bulk of the North Sector. Three new projects to be built (with construction to start 4th quarter 2016 or early 2017) will absorb the +/-4.5 vacant acres south of Gateway Plaza. The North Area was further boosted by the addition of two new Hotels at N. Broadway and Preisker Land. The North Area inventory is approximately 560,000 square feet with +/-27,000 square feet vacant resulting in a vacancy factor of 4.8%.

Summary Commentary

- The supply of finished, industrial zoned land has essentially been depleted. Most all of the parcels which were 1 to 5 acres have been sold. The Santa Maria Public Airport District appears to have commenced with the marketing of their industrial parcels south of the Airport.
- Investor interest in the Santa Maria market is steady and growing. Unfortunately, quality leased investments are few.
- Demand for Retail services continues to be a very strong component of Santa Maria's economy.

We believe that Central Coast of California will continue to outpace the rest of the nation. Quality of life remains one of the strongest factors affecting demand. Affordability of housing,

labor, and pro-business/development climate will retain Santa Maria's position as an economic leader in Santa Barbara County.

SUMMARY OF PROPERTY VALUES

Sales and Lease values are summarized as follows (all values are expected to remain in these ranges through 2016 but will likely rise as vacancies are absorbed):

INDUSTRIAL

Projected Building Sales:

| | |
|---------------------------------------------|----------------------|
| High-end space over 50,000 square feet | \$90.00-\$120.00/sf |
| High-end space 20,000 to 50,000 square feet | \$100.00-\$125.00/sf |
| High-end space under 20,000 square feet | \$110.00-\$135.00/sf |
| Lower-end space | \$75.00-\$95.00/sf |

Projected Lease Rates:

| | |
|---------------------------------------------|------------------------|
| High-end space over 50,000 square feet | \$0.60-\$0.75/sf NNN |
| High-end space 20,000 to 50,000 square feet | \$0.65-\$0.80/sf NNN |
| High-end space under 20,000 square feet | \$0.50-\$0.70/sf NNN* |
| Lower-end space | \$0.50-\$0.60/sf Gross |

*or lower due to higher percentage of older buildings

Projected Land Value:

\$6.00-\$8.00 per square foot

RETAIL/OFFICE (excludes leased investments & MOBs)

Projected Building Sales:

| | |
|---------------------------------------------|------------------|
| High-end space 20,000 to 50,000 square feet | \$180 - \$200/sf |
| High-end space under 20,000 square feet | \$190 - \$225/sf |
| Lower-end space | \$100 - \$125/sf |

Projected Lease Rates:

| | |
|---------------------------------------------|----------------------|
| High-end space 20,000 to 50,000 square feet | \$0.75-\$1.50/sf NNN |
| High-end space under 20,000 square feet | \$1.50-\$2.50/sf NNN |
| Lower-end space | \$0.80-\$1.25/sf NNN |

Projected Land Value:

\$14.00-\$25.00 per square foot