



Commercial Sales: A surprising Q3 rally

The South Coast commercial sales market has been unpredictable so far in 2020. Given the economic disruption of the pandemic, it's no surprise that year-to-date sales transactions are down 27% compared to the prior 5-year average, while dollar volume (excluding hotels) is down 34%. More surprising is when the sales happened: Q1 (before the pandemic to hold) was unexpectedly quiet, but Q3 produced strong sales volume amounting to 22 of the 48 transactions and 65% of the dollar volume to date. Also unexpected was prevalence of off-market transactions, which represented a majority of the sales.

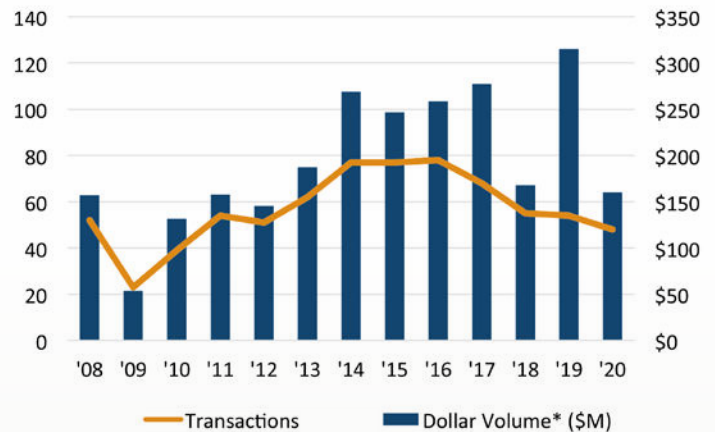
Continuing the recent trend, 58% of the buyers to date were owner-users, while investors have played a secondary role. Investors, in general, have been increasingly circumspect during the pandemic amid considerable uncertainty in the economy and therefore in projected rental income. At the same time, owner-users have taken advantage of favorable financing and the relative increase in vacant buildings, which are less appealing to typical investors. However, while owner-users were the majority of buyers, most of the dollar volume came from investors, thanks primarily to two major office acquisitions by investors in Q3. First, a Los Angeles-based investor purchased 6303-6309 Carpinteria Ave, the fully



The 121,230 sf Procore HQ campus at 6303-6309 Carpinteria Ave was purchased in Q3 by an investor for \$44 million.

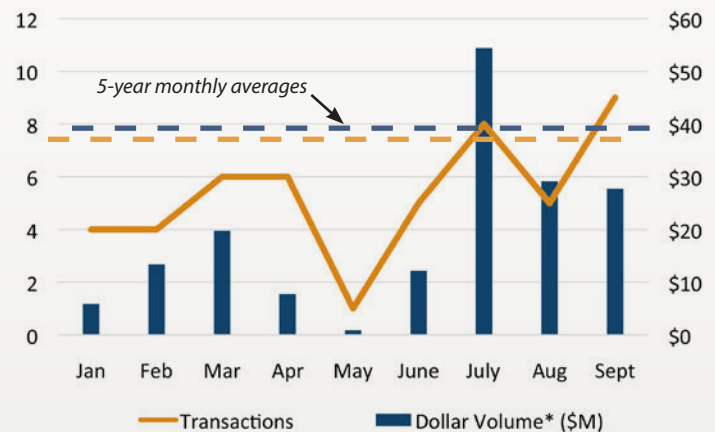
South Coast Sales Q3 YTD by Year

(all property types)



2020 Sales by Month

(all property types)



*Excluding hotel property

leased Procore campus in Carpinteria, for \$44 million. The second was 7414-7418 Hollister Ave, the vacant former Logmein campus in Goleta purchased by Majestic Asset Management for \$20 million.

With 74 properties for sale, inventory is at a historical high. Despite that, 60% of sales to date were off-market, which is an unprecedented ratio and 15% higher than the

typical level. This suggests both that demand is strong and that buyers are being selective—looking beyond the properties on the market and seeking out owners willing to sell—which is somewhat surprising given the current economy. Also of note is the correlation between owner-user buyers and off-market transactions: 75% of owner-user sales were off-market, whereas only 40% of investor sales were. This is a further indicator that investors are not as active in the market.

Though sales volume is down, prices are holding up better than one might expect. For the on-market sales to date, the average price discount from the listed price was 7.75%, which is a typical discount, historically. Capitalization rates are also right in line with the prior 5-year average. Whether or not prices continue to hold will depend on many factors that defy prediction, but the strength of owner-user demand and the durability of prices are encouraging signs for the health of the local economy.

Leasing: Vacancy on the rise

OFFICE

By the end of Q3, the effects of the pandemic economy were rippling through office vacancy. Since Q1 the South Coast's available office space grew by 37%, with Santa Barbara, Goleta and Carpinteria expanding by 37%, 20%, and 240%, respectively. In the end, the South Coast office vacancy rate of 7.2% is roughly back to where it was four years ago. However, during that time, Santa Barbara's vacancy has doubled while Goleta's vacancy has halved. In addition, the volume of lease transactions during the past two quarters was 35% lower than the prior 5-year average. On the other hand, average achieved rents have not shown a significant decrease. Also, transaction velocity picked up substantially in Q3 compared to Q2.

GOLETA

After reaching a historic low of 4.6% before the pandemic, Goleta's vacancy rate has increased to 5.6%, which still represents remarkable recovery from 12.5% vacancy four years ago. Leasing activity has slowed somewhat during the pandemic, but there have still been 25 transactions totaling 225,000 square feet to date. Leasing was solid in Q3 with 10 transactions, including long-term leases by Lockheed Martin (25,623 sf at 340 Storke Rd), Cottage Health (21,793 sf at 7410 Hollister Ave), and Skate One (12,936 sf at 6860 Cortona Dr). These were three examples of leases signed during the pandemic by well-capitalized tenants executing real estate strategies based on long-range business plans. Average rental rates in Goleta have been level so far this year, and in fact over the



Cottage Health leased 21,793 sf at 7410 Hollister Ave in Goleta on a long-term basis.

past three years. In terms of available space, the former Logmein office buildings totaling 78,888 sf at 7414 & 7416 Hollister Ave came to market at the end of Q3, becoming the largest available floor plates in Goleta. The 82,000 sf former Medtronic building at 125 Cremona Dr has seen four leases this year and has about 20,000 sf remaining to backfill. Given current demand by tenants, Goleta is likely to see the continuing trend of steady leasing and relatively low vacancy.

SANTA BARBARA

In Santa Barbara, the past two quarters combined produced only 35 transactions, which is 30% below the 5-year average. In that time, 140,000 sf of space has come to market, resulting in a record-high vacancy rate of 8.0%. There is an unprecedented supply of space for sublease,

including six downtown spaces totaling 28,000 sf that have hit the market during the pandemic. The transactions to date have been unusually weighted toward renewals, which already exceed the count for all of 2019. In terms of square footage, the five largest transactions were all renewals, and 55% of the total leased area to date has been renewals and expansions by existing tenants. Most notably, FastSpring's Q3 renewal and expansion totaling 17,000 sf at 801 Garden St makes it one of downtown Santa Barbara's largest office tenants. Turning to rents, the average achieved rate is even with the 2019 average. The average asking rate is just over \$3.00 per sf gross, which

does not indicate a softening of pricing so far during the pandemic, though given the vacancy rate and the present economy, landlords will likely feel substantial market pressure to make concessions.

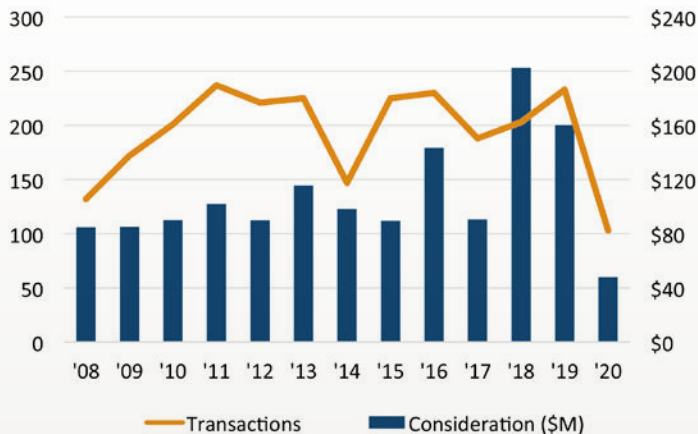
CARPINTERIA

Available space in Carpinteria has expanded amid limited leasing activity. The current 7.4% vacancy rate is the highest in more than five years. Five spaces have come to market during the past six months, the largest of which is 10,060 sf at 6383-A Rose Ln. There has only been one lease in the past two quarters, 2,396 sf at 1110 Eugenia Pl signed by the Carpinteria Sanitary district in August. With a sparse supply of tenants actively seeking space in Carpinteria, the status quo of high vacancy and low transaction volume will likely persist in the near future.

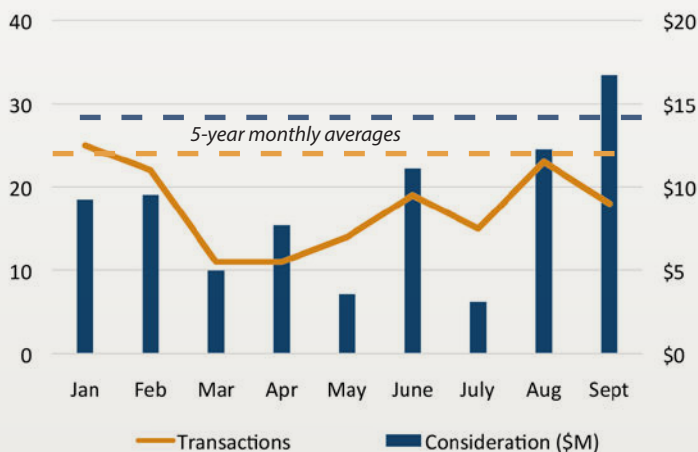


FastSpring (Bright Market LLC) signed a renewal /expansion in Q3 and now occupies 17,000 sf at 801 Garden St in Santa Barbara.

South Coast Leases Q3 YTD by Year
(all property types)

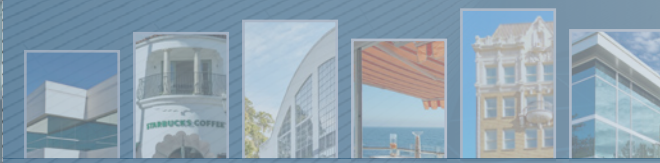


2020 Leases by Month
(all property types)



RETAIL

Seemingly overnight the pandemic divided the retail sector into "essential" and "non-essential," and those businesses in the latter category predictably suffered a dramatic drop in revenue, at least at their brick-and-mortar locations. Retail lease transactions in 2020 are trending 50% below the prior 5-year average, while the number of available spaces has expanded by 20%. This is similar in scale to the rapid expansion of inventory that followed the crash of 2008 and comports with what we see around us: stores, restaurants, and gyms are struggling and in



many cases closing. On the bright side, the total available square footage (as distinct from the number of spaces) has expanded by less than 5% since the beginning of the year, compared to expansions of 29% and 58% for office and industrial space, respectively.

In Santa Barbara, the State Street promenade's outdoor dining has provided a crucial lifeline to restaurants along the corridor. In fact, there are reports that many of those restaurants are enjoying higher revenue with the promenade than before the pandemic. Nevertheless, the overall picture of downtown retail continues to be toward increasing vacancy and loss of traffic for soft goods retailers, many of which were already struggling before the public health crisis struck. On the State Street corridor, there have been only five lease transactions this year, representing a 70% drop from the prior 5-year average. There were two leases in Q3: 927 State St signed by Viva Oliva and 429 State St leased by Salt Bros. Since the beginning of the year, the number of vacant and/or available storefronts along the 400 to 1300 blocks has increased by 20, pushing the storefront vacancy rate to 17.7%, a record-high, heading into the holiday season.

Six months into the pandemic, Goleta's "daily needs" centers are faring better than the Hollister Avenue corridor in Old Town. Five new vacancies came to the market during the past two quarters, three of which are in Old Town. At Camino Real Marketplace, Costco and Home Depot appear to be thriving anchors, bringing

shoppers to the center who may visit other stores or one of the restaurants. The net change in Goleta's vacancy rate so far this year has been negligible, as the handful of new vacancies were offset by the 21,577 sf lease by Planet Fitness at 7127 Hollister Ave. However, the disparity has widened between the east and west areas of the city: 76% of the vacant space is located east of the airport, where the average asking rate is 55% lower than in the west area.

INDUSTRIAL

Industrial leasing is the only sector to see robust activity through this very challenging economy. South Coast transactions to date have surpassed the prior 5-year average by 10%. At the same time, vacancy has expanded by more than 50% since the beginning of the year. The combined South Coast vacancy rate is 4.1%; still quite low by national standards, but the highest rate since 2012, and a dramatic expansion from the cyclical low of 1.0% four years ago. Achieved lease rates have drifted upward in 2020, increasing 9% compared to the 2019 average.

GOLETA

With 25 lease transactions to date, Goleta industrial is on pace for another big year, following record deal volume in 2019. Activity was unusually strong in Q3, with 11 transactions totaling 73,000 sf, including Hazelwood Moving's lease of 25,940 sf at 6338 Lindmar Dr, Raytheon's renewal of 12,077 sf at 26 Castilian Dr, and CZERO's lease of 9,900 sf at 650 Ward Dr. Achieved lease rates have remained level, on average, with the prior two years. Vacancy ticked up to 6.0% with 96,323 sf at 7418 Hollister Ave newly brought to market. Aside from that, there has been very little new space added to the market during the pandemic. Based on deals in negotiation, it would not be surprising to see vacancy back down around 4.5% in the next three to six months.

SANTA BARBARA

Santa Barbara is seeing what passes for a spike in vacancy there, rising from below 1% at the beginning of the year to a rate of 1.5% currently. Three spaces larger than 10,000 sf have come to market during the past six months, most



Smart & Final renewed its Carpinteria location on a long-term basis, securing 29,673 sf at 850 Linden Ave.

notably 25,050 sf of warehouse space at 436 E Gutierrez St, in addition to 12,500 sf at 411 E Montecito St, and 10,600 sf at 418 N Salsipuedes St, formerly Telegraph Brewing. At the same time, leasing velocity has been relatively healthy, though the majority of spaces leased have been under 3,000 square foot size. Q3 deals included a sublease of 7,528 sf at 820 Bond Ave and a renewal of 3,900 sf at 126 E Haley St for fitness use by Prevail Conditioning.

CARPINTERIA

As in Santa Barbara, the industrial inventory in Carpinteria expanded recently with the emergence of three large spaces on the market. Two of those are adjacent properties offered for sublease by Procore totaling 52,830 sf at 6385 Cindy Ln and 6384 Via Real. About 14,000 sf of that space has been subleased so far in Q4. The third new vacancy is 14,500 sf in Carpinteria Business Park at 1025



Hazelwood Moving & Storage leased 25,940 sf at 6338 Lindmar Dr in Goleta in Q3, the largest industrial space leased to date.

Cindy Ln. Through Q3, there were just four lease transactions to date totaling less than 13,000 sf, well below the typical historical volume.

LEASING MARKET DATA

| Market | Vacancy Rate | | Transactions | | Gross Absorption | | Achieved Rent | |
|---------------|--------------|-------|--------------|-------|------------------|-------|---------------|------|
| OFFICE | | | | | | | | |
| Santa Barbara | 8.05% | +35% | 58 | -18% | 201,778 | -15% | \$2.97 | -2% |
| Goleta | 5.61% | +6% | 25 | -36% | 225,874 | -53% | \$1.96 | -0% |
| Carpinteria | 3.99% | +94% | 3 | -20% | 7,597 | -72% | \$1.91 | +10% |
| RETAIL | | | | | | | | |
| Santa Barbara | 3.92% | +5% | 20 | -61% | 53,704 | -63% | \$2.92 | -18% |
| Goleta | 2.28% | +0% | 5 | -63% | 33,087 | -48% | \$2.30 | -16% |
| Carpinteria | 6.54% | +6% | 2 | -11% | 32,445 | +557% | \$2.28 | -28% |
| INDUSTRIAL | | | | | | | | |
| Santa Barbara | 1.54% | +69% | 16 | +113% | 58,393 | +208% | \$2.04 | +11% |
| Goleta | 6.04% | +28% | 25 | -7% | 164,189 | -11% | \$1.53 | +1% |
| Carpinteria | 1.89% | +264% | 4 | -11% | 12,946 | -68% | \$1.25 | -1% |

Change percentages are compared to 2019 values, annualized where appropriate.

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