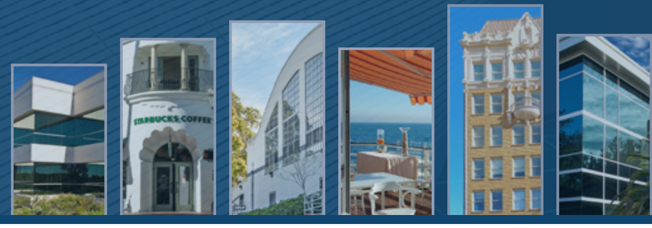

# 2020**Q4** Market Report

## South Coast Commercial Real Estate

As with most sectors of the economy, the COVID-19 pandemic profoundly affected commercial real estate during most of 2020. The emergence of vaccines promises to dramatically change economic behavior during the coming year, assuming "normal" life is restored for most people. This welcome development prompts two big questions. What shape will the curve of the recovery take for commercial real estate? And what lasting shifts in the use of commercial space—particularly office and retail space—might result from the pandemic? Since we don't have a crystal ball, we will be watching the markets very closely through the coming year with these questions in mind.

2020 was a challenging year for most tenants and property owners on the South Coast, and for a few submarkets the past nine months seemed to unravel much of the growth of the previous nine years. However, there were some surprises and bright spots in the market as well. Heading into 2021 there is cause for optimism, and there are opportunities for those in a position to pursue them. Here is a brief summary:

- Annual transaction value decreased 5% for sales and 47% for lease consideration, compared to prior 5-year averages.
- Sales activity rebounded dramatically in the second half of the year, while leasing did not.
- Five office property purchases by out-of-area investors generated half of the total sales volume.
- Inventory for sale increased 19% while available space for lease expanded 26%, year over year.
- Given the economy, demand has proven surprisingly resilient in most submarkets.

### COMMERCIAL SALES – In like a lamb, out like a lion

Given the economic headwinds, sales volume was surprisingly robust with 78 sales totaling $342 million (excluding hotel sales) during 2020, with the lion's share of activity in the second half of the year. The annual transaction count was only 12% shy of the prior 5-year average.

Five high-priced office investment sales produced half of the total commercial dollar volume. This is compelling evidence of durable demand among well-capitalized investors in a position to pursue long-term strategies beyond the pandemic. With stock markets setting new record highs, interest rates near historic lows, and property values undercut by the recession, real estate is an increasingly appealing investment class in the current environment.

Inventory was near the historical peak throughout 2020, ending the year at 75 properties for sale. Despite the elevated supply on the market, 56% of sales were off-market transactions, which is about 10% above the historical trend. This is another indicator of abundant demand, with many properties going under contract before being brought to market.


*The 165,462 sf AppFolio campus at 50-90 Castilian Dr in Goleta was sold in an off-market transaction for $60.5M.*

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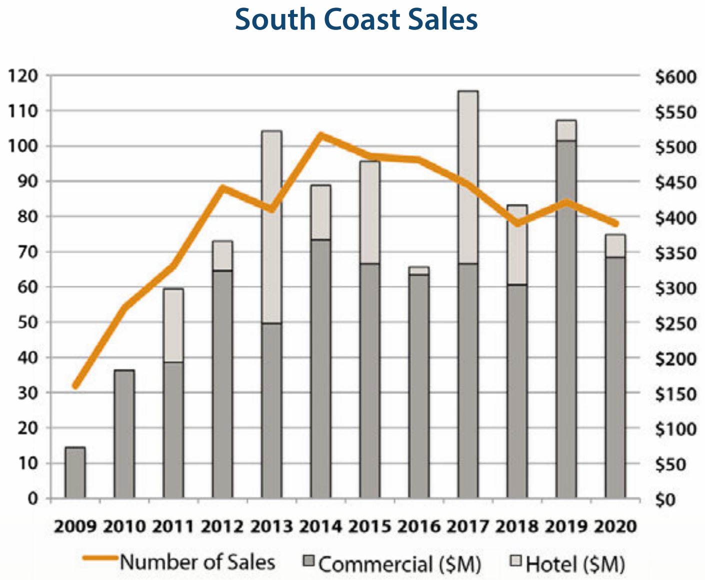
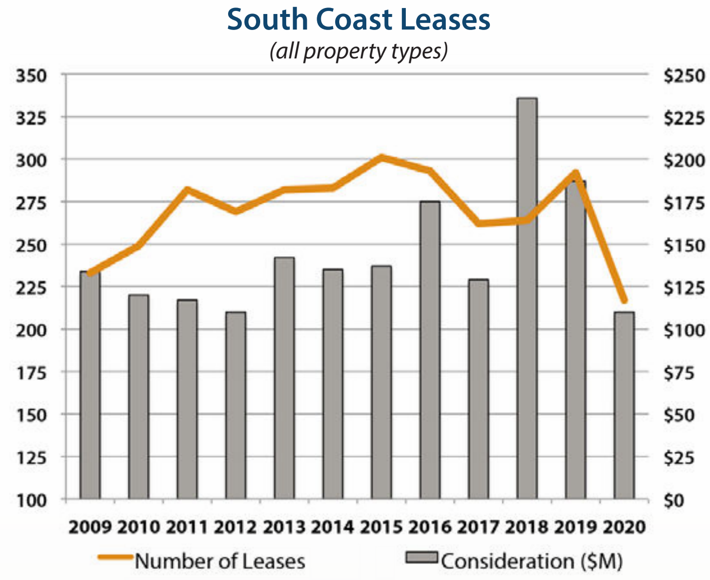



Owner-user buyers represented 51% of sales, making 2020 the third consecutive year in which owner-users purchased more properties than investors, contrary to the historical pattern. Favorable financing on SBA loans has encouraged this trend, allowing businesses to acquire real estate for their own use. Owner-users also have an advantage in the current climate because more buildings than usual are vacant and are therefore less appealing to investors. However, investors continued to generate the majority of dollar volume in 2020, producing 79% of the dollar consideration.

Office sales reached an unprecedented dollar volume of $355 million in 2019. The first two quarters of 2020 brought a profound lull in sales, and office inventory for sale expanded to a new high of 26 properties at midyear. Then—despite the pandemic, a major recession, and the fact that most office buildings had almost no one working in them—an unexpected rally emerged in the second half of the year, producing 22 office transactions totaling $203 million, along with a 35% contraction of inventory.

Office property dispositions by Santa Monica-based Montana Avenue Capital resulted in the two largest commercial sales of the year. They sold 50-90 Castilian Dr in Goleta in December after only a year of ownership. Fully leased to Appfolio, the 165,462 sf office campus on 5.3 acres was acquired by a Los Angeles-area joint venture for $60.5 million in an off-market transaction. Aside from hotels, this is the highest price paid for a South Coast commercial asset that we have on record. Montana Avenue also sold 6303-6309 Carpinteria Ave in Carpinteria, a 121,230 sf office property on 9.3 acres, for $44 million. The buyer is a Los Angeles-based investor.

The standout office sale in Santa Barbara was the 48,564 sf office building occupied by Amazon at 1001 State St, which a local investor sold for $36.25 million to Global Mutual, which is headquartered in London and Los Angeles.

Agoura Hills-based Majestic Asset Management also had a busy year, completing six sales in Goleta, including the $20 million acquisition of the 175,000 sf Logmein campus at 7414-7418 Hollister Ave. Majestic also purchased the 57,937 sf building at 120 Cremona Dr for $13.2 million from EastGroup. Both were off-market transactions.

Industrial sales were also unexpectedly active, exceeding the prior 5-year average in both transactions and dollar volume. Majestic sold four buildings at 5511-5571 Ekwill St in Goleta in separate transactions for a total of $14.1 million. Meanwhile, in Santa Barbara 10 industrial properties changed hands, including the 13,000 sf building at 224 S Milpas St, purchased by an owner-user for $5.0 million. However, despite the healthy volume of transactions, industrial inventory remains unusually high at 15 properties for sale, more than double the average of the past five years.

For retail property, 2020 was the slowest sales year since 2014. There were four sales on State Street in downtown Santa Barbara, including most recently 330 State St, which traded for $6.3 million. As of year-end, there were 31 retail properties for sale on the South Coast, a record high.

Looking at prices, average cap rates compressed only 30 basis points compared to 2019, with the caveat that the comparison is based on a limited data set. The average price per square foot for office and retail decreased 10% and 20%, respectively, while industrial increased 5% and land remained level, compared to 5-year averages.

We head into 2021 having just witnessed one of the most active six-month periods for commercial sales in the past 10 years, which gives the market considerable momentum. The unusually large inventory of property for sale makes it a buyer's market, although price discounts granted by sellers will likely vary by property type. Given all the challenges surrounding State Street, it is worth noting that there were 13 sales on or within two blocks of State Street's downtown corridor, several of which were purchased with visions for development or adaptive repurposing intended to have a positive effect on downtown Santa Barbara.

## OFFICE LEASING

National surveys of industry insiders predict that the percentage of office employees permanently working from home could double compared to pre-pandemic levels and end up around 15%. Demand for office space in dense urban markets is expected to take longer to recover compared to places like the South Coast, where use of public transportation and elevators is optional for most office employees. Our local market was burdened by the pandemic in 2020, evidenced by decreases in transactions and gross absorption of 26% and 34%, respectively, compared to prior 5-year averages, while producing negative net absorption of 216,000 sf. In addition, space for sublease expanded 40% year-over-year.

**Santa Barbara**

Before the pandemic, Santa Barbara's office vacancy rate was already very high (by historical standards) at 6.0%. By the end of 2020, the vacancy rate grew to 8.5% with 103 available spaces, both record highs. Q3 is when the cracks started to show, and the past six months brought the net addition of 25 spaces and 121,000 sf to the market, including 9 new sublease listings. Deal velocity also suffered: 81 transactions is the lowest annual count in 12 years and 20% below the prior 5-year average.

On the positive side, leasing activity recovered substantially in Q4. UCSB signed a 15-year lease for 15,065 sf at 1021 Anacapa St, which was vacated by Union Bank. Also downtown, the Community Environmental Council leased 9,966 sf in the Hutton Foundation-owned building at 1219 State St.

Renewals were unusually abundant throughout the year, representing 32% of transactions and more than half of the total leased area. In Q4, for example, two tech companies exercised options as HG Insights renewed 17,326 sf at 1 N Calle Cesar Chavez, while Analog Devices renewed their 7,180 sf office at 911 Olive St.

This is a concerning moment for Santa Barbara's office market. After all, vacancy has more than doubled since the low of 3.7% in 2016. However, this recent expansion in inventory is likely to be a peak associated with the pandemic rather than a new plateau. The volume of

*UCSB leased 15,065 sf at 1021 Anacapa St in downtown Santa Barbara on a 15-year term.*

renewals is a tangible reminder that there are brighter days ahead: a tenant that renews during a pandemic is obviously banking on employees coming back to the office. In the meantime, this is an opportune moment to be a tenant looking for office space in Santa Barbara.

**Goleta**

Following a year of record leasing volume in 2019, Goleta saw a pronounced decrease in activity during 2020. Gross absorption decreased 40% compared to the prior 5-year average. Leases by large companies like Google, Microsoft, IBM, and Lockheed Martin provided much of the volume, while demand from smaller businesses was muted. Google leased 17,897 sf at 5385 Hollister Ave in Q4, bringing its footprint in Goleta to 102,000 sf.

The vacancy rate notched up to 6.5%, which represents a 22% expansion, year-over-year. However, this is not primarily due to the COVID-19 economy. A handful of large availabilities came to market that had been in the works before the pandemic. LogMeIn's departure added 78,000 sf of office vacancy at 7414 and 7416 Hollister Ave. Inogen will soon vacate 38,000 sf at 326 Bollay Dr as it moves to the newly constructed building at 301 Coromar Dr. Cottage Health's 19,000 sf space at 5425 Hollister Ave was also brought to market in 2020, after it leased 21,793 sf at 7410 Hollister Ave on a long-term basis. Sublease inventory also grew with 12,976 sf offered by Texas Instruments at 6750 Navigator Way and 9,750 sf offered by Resonant at 175 Cremona Dr.

Goleta was at record low vacancy prior to the pandemic. Although inventory expanded noticeably in 2020, the added supply was mostly expected and not the result of the recession. On the demand side there was definitely a lull during much of the year, but current tenant activity in the market puts Goleta on a trajectory to emerge from the economic crisis in relatively good shape.

**Carpinteria**

Being the smallest office submarket on the South Coast, Carpinteria sometimes has slow leasing years, but 2020 was easily the slowest one yet. There were just three transactions totaling 7,600 sf, two of which were back in Q1. Four spaces have come to the market since midyear, pushing the vacancy rate upward to 7.4%.

## RETAIL LEASING

The South Coast's retail sector has been profoundly affected over the past year, as the pandemic economy has forced most stores, restaurants, and service businesses to contend with dramatic loss of revenue. The number of available spaces increased 17% year-over-year and is at a level comparable to 2011, which was the peak inventory in the wake of the last economic crisis. Accordingly, the vacancy rate is at a historic high rate of 4.2%, though the increase has not been evenly distributed geographically.

In Santa Barbara, the "destination retail" areas—especially the two malls and the State Street corridor—have been hit hardest by the economic downturn, most dramatically evidenced by Nordstrom's departure from Paseo Nuevo last summer. The disparity between the State Street corridor and the rest of the city has become even more pronounced during the pandemic. Vacant storefronts facing the State Street corridor expanded by 55% in 2020, while in the rest of Santa Barbara (excluding the malls) available space actually contracted by 19%.

Storefront vacancy on the 400 to 1300 blocks of State Street is unprecedented at 15.5%, and along three of the central blocks (800 to 1000) the storefront vacancy rate is 30.9%. There were only 10 lease transactions on the State Street corridor in 2020, less than half the volume of recent years. One of the corridor's largest vacancies was filled as the 17,000 sf former Staples building at 410 State St was leased by Reality Church for a one-year term. All of the

*This forever-vacant corner restaurant space at State and Ortega was finally leased by a local distillery tenant.*

retailers that signed leases were local, as demand from national chains has been practically nonexistent.

Landlords had to be flexible on rent to secure a tenant. The average gross rent decreased 36% on the 600 to 1000 blocks, compared to the prior 5-year average. Lower rates have enabled local entrepreneurs to lease storefronts on State Street to try out concepts, such as YonaRedz Tacos at 532 State St, Viva Oliva at 927 State St, Wylde Works Tasting at 609 State St, and a local distillery concept that will finally fill the perennially vacant space at 700 State St, formerly Left at Albuquerque.

The makeshift State Street promenade has helped many restaurants to keep their doors open, at least between lockdowns. Compared to the rash of soft goods and fitness business closures, there have been relatively few restaurant spaces brought to market on State Street during the pandemic, and outdoor dining surely helped. By our count, 12 food and beverage establishments closed permanently on State Street in 2020, while 6 opened. The prominent Starbucks at 800 State St, which has been open since 1994, will close in 2021, and the space is for lease.

Unlike Santa Barbara's more upscale malls, Goleta's "big box" mall at Camino Real Marketplace seems to be weathering the pandemic very well. A major reason is that its anchors, Costco and Home Depot, are thriving in the pandemic economy, especially compared to a traditional soft goods anchor like Nordstrom. Goleta's vacancy rate remains remarkably low at 2.5%, and most of the available space is focused in the eastern half of the city, especially in the Calle Real and Magnolia shopping centers, which have 38,000 sf of vacancy combined.

Whether the pandemic is fundamentally transforming shopping behavior or simply accelerating the shift from brick-and-mortar to online commerce remains an open question. In response to the growth of internet commerce, the shopping center industry has embraced the goal of creating an experience for patrons—recasting the mall as a destination of interest beyond simply housing a cluster of stores and restaurants. As the pandemic wears on, there is likely pent-up demand for leisurely visits to malls and shopping districts, and once people finally emerge from quarantine, retailers positioned to provide a positive experience for customers will have a leg up during the recovery.

## INDUSTRIAL LEASING

At the national level, industrial property has reportedly been the type least impacted by the pandemic, as the surge in online shopping drove demand for warehouse and distribution space. In addition, businesses in industrial space can more easily operate as usual while maintaining COVID-19 safety protocols. On the South Coast, industrial has indeed proved to be the most resilient property type over the past three quarters. Gross absorption during 2020 was 20% below the prior 5-year average, while transaction volume was up 4%. In the process, achieved rents bumped up nearly 10% year-over-year to set a new high mark of $1.64 gross per sf. Several large spaces came to market, causing a 44% expansion of vacancy compared to 2019. While still modest, the combined vacancy rate of 3.8% is the highest since 2011.

*Gavial Holdings renewed its lease on 27,353 sf at 869 Ward Dr in Goleta.*

In Goleta, the momentum of record deal volume in 2019 carried into 2020, resulting in 30 leases totaling 212,000 sf. There were a few large renewals, such as Gavial Holdings securing of 27,353 sf at 869 Ward Dr and Raytheon's renewal of 12,077 sf at 26 Castilian Dr. However, most of the large deals were new leases. Hazelwood Allied Moving signed a 10-year lease on 25,940 sf at 6338 Lindmar Dr. GTX Turf Farms leased 11,763 sf at 151 Castilian Dr, which represents a move to a larger space within the project. Vacancy remains relatively high at 5.8%, due largely to the 102,000 sf offered at 30 S La Patera Ln, vacated by Skate One at the beginning of 2020. On top of that, the 96,000 sf building at 7418 Hollister Ave vacated by LogMeIn was brought to market in Q4. Thirdly, there are three buildings under construction in Cabrillo Business Park totaling 79,000 sf that are not yet included in the vacancy rate. While it will take time to fill these large spaces, demand for smaller spaces is healthy.

Santa Barbara's industrial market rebounded from record low leasing volume in 2019 to produce 19 transactions in 2020. However, the vast majority were smaller spaces, which resulted in modest gross absorption 22% under than the prior 5-year average. The average achieved rent exceeded $2.00 gross per sf for the first time, landing at $2.11. The year's largest leases were Kamran & Company's lease of 14,368 sf at 415 N Salsipuedes St and Andros Floor Design's signing of 9,292 sf at 35 N Calle Cesar Chavez. Santa Barbara's lean industrial vacancy rate of 1.5% actually represents a 64% expansion of available space year over year. This is due to three spaces arriving on the market in during the past year: the 25,050 sf Tent Merchant space at 436 E Gutierrez St; the 12,500 sf Kamran & Company space at 411 E Montecito St; and Telegraph Brewing's 10,600 sf space at 418 N Salsipuedes St.

Carpinteria saw very little industrial leasing activity in 2020. In fact, it was the slowest year on record with five transactions totaling 27,000 sf. Procore put 52,000 sf of space on the market for sublease, which pushed the vacancy rate above 6% for the first time in ten years. In Q4, Big Sale Group subleased 14,400 sf of that Procore space at 6385 Cindy Ln, which proved to be the year's largest lease.

# LEASING MARKET DATA

| Market | Vacancy Rate | | Transactions | | Gross Absorption | | Achieved Rent | |
|---|---|---|---|---|---|---|---|---|
| **OFFICE** | | | | | | | | |
| Santa Barbara | **8.52%** | +43% | **81** | -14% | **303,964** | -4% | **$2.89** | -4% |
| Goleta | **6.51%** | +23% | **31** | -42% | **270,260** | -59% | **$1.95** | -1% |
| Carpinteria | **3.99%** | +94% | **3** | -40% | **7,597** | -79% | **$1.91** | +10% |
| **RETAIL** | | | | | | | | |
| Santa Barbara | **4.69%** | +26% | **37** | -46% | **101,902** | -48% | **$3.17** | -12% |
| Goleta | **2.51%** | +10% | **8** | -56% | **50,443** | -41% | **$2.18** | -21% |
| Carpinteria | **6.54%** | +2% | **3** | +0% | **33,781** | +413% | **$2.45** | -23% |
| **INDUSTRIAL** | | | | | | | | |
| Santa Barbara | **1.50%** | +64% | **19** | +90% | **65,723** | +160% | **$2.11** | +15% |
| Goleta | **5.83%** | +23% | **30** | -17% | **212,675** | -14% | **$1.56** | +3% |
| Carpinteria | **1.89%** | +181% | **5** | -17% | **27,346** | -50% | **$1.18** | -6% |

Change percentages are compared to 2019 values


**SOLD** — *Representing the seller*
165,462 sf office on 10.8 acres in Goleta


**SOLD** — *Representing the seller*
11-unit apartment in Santa Barbara


**SOLD** — *Representing the seller*
121,230 sf of office on 9.3 acres in Carpinteria

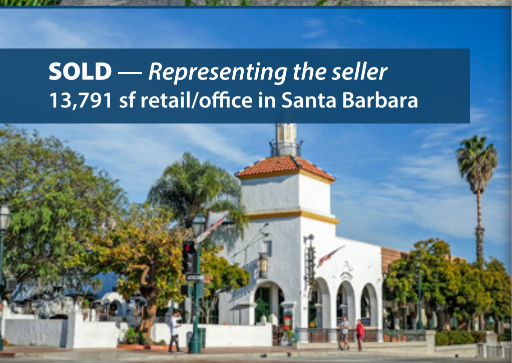
Hayes Commercial Group would like to thank our clients for making 2020 another successful year!


**SOLD** — *Representing the buyer*
24,772 sf office on 1.6 acres in Carpinteria

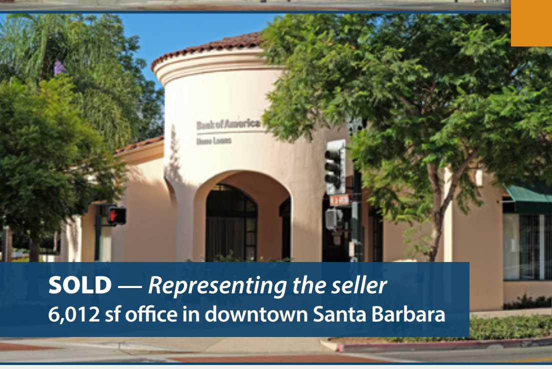

**SOLD** — *Representing all parties*
57,937 sf office on 2.9 acres in Goleta

**32** SALES valued at **$212** MILLION

**184** LEASES valued at **$86** MILLION


**SOLD** — *Representing the seller*
13,791 sf retail/office in Santa Barbara


**SOLD** — *Representing the seller*
44,800 sf industrial on 4.1 acres in Goleta


**SOLD** — *Representing the seller*
6,012 sf office in downtown Santa Barbara


**SOLD** — *Representing the seller*
5,700 sf mixed-use on Lillie Ave in Summerland


**SOLD** — *Representing the seller*
15,450 sf industrial on 0.9 acre in Lompoc

We are grateful for the opportunity to help you achieve (and exceed) your real estate goals. Please don't hesitate to call. We are here for you!

| | | | | | | | | | | |
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