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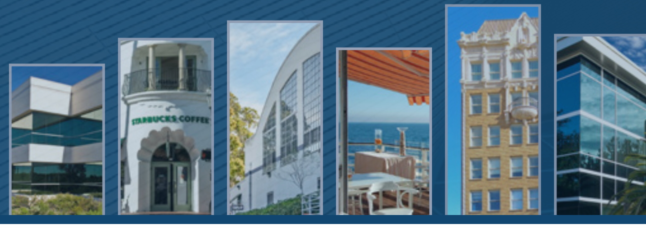


2021 Q2 Market Report

South Coast Commercial Real Estate

GOOD NEWS, BAD NEWS

The "good news, bad news" for South Coast commercial real estate is this: recovery from the economic impact of the pandemic is well underway, but there appears to be a long road ahead. Both sales and leasing markets are still in a cycle of extended supply and uneven demand. On the other hand, prices and rents have proven remarkably durable, providing stability in a time of uncertainty. As projected, Q2 proved far more active than Q1, and generated transaction momentum we are optimistic will carry forward through the balance of the year. Here are some summary points:

- After a stagnant first quarter, both sales and leases bounced back in in the second quarter, with total transaction value increasing from $86M in Q1 to $135M in Q2.
- Commercial sales volume showed a dramatic increase compared to midyear 2020, with most of the activity happening in Q2. At midyear, transactions and dollar value were up 37% and 140%, respectively, year-over-year.
- However, commercial sales are still trending below pre-pandemic levels, and inventory is at a record high.
- In most local sub-markets, vacancy hit a "pandemic peak" in Q3 or Q4 of 2020 and has since subsided. The two exceptions are Santa Barbara office and Santa Barbara retail, where vacancy rates are still on the rise.
- Tenant demand, pent-up during the depths of the pandemic, led to a surge of 93 lease transactions in Q2, the highest quarterly count in 5 years.

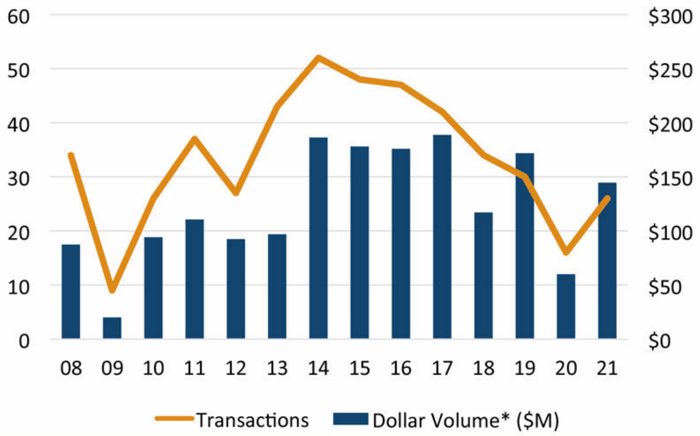
COMMERCIAL SALES

Following a lull in the first quarter, commercial sales transactions accelerated somewhat in Q2, while dollar volume got a boost from a few high-value investment sales. Overall, the market is still in recovery mode. At midyear, transactions and dollar volume were down 8% and 12%, respectively, compared to pre-COVID 5-year averages.

Investor activity has picked up, but has not recovered to the levels seen pre-pandemic. Some demand previously centered on commercial property appears to have migrated to apartments and other residential investments, which are widely assumed to offer more reliable income in the near term compared to office and retail property. Still, acquisitions by investors continued to represent the large majority (84%) of dollar volume to date. The Lobero Office Building at 924 Anacapa St in Santa Barbara was recently purchased by a local investor for $16.5 million, and a three-building retail/industrial portfolio in the Funk Zone traded for $10.3 million after attracting multiple offers. In Goleta, Majestic Asset Management acquired the 66,384 sf office/R&D campus at 110-150 Castilian Dr in an off-market transaction for $16.1 million. Looking ahead to Q3, a few notable investment sales are already in progress,

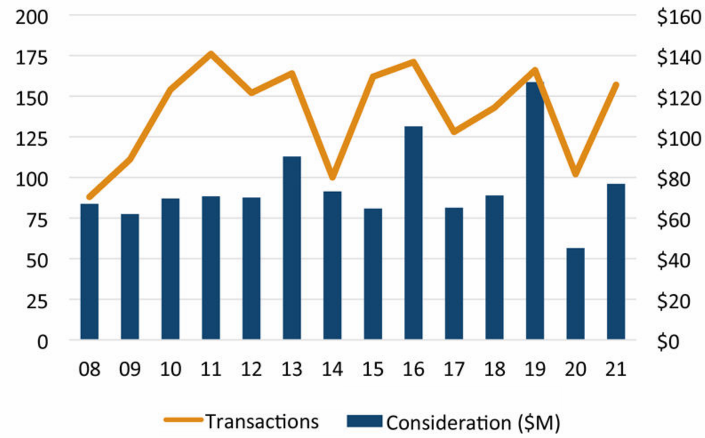
The 41,000 sf multi-tenant office building at 924 Anacapa St in Santa Barbara traded off-market in April for $16.5 million.

South Coast SALES at Midyear
(all property types)



*Excluding hotel property

South Coast LEASES at Midyear
(all property types)



including the former Nordstrom building at Paseo Nuevo, expected to close escrow by August.

Owner-users were nearly absent in Q1 but re-engaged in Q2, completing 12 sales as the economic outlook for local businesses continued to improve. Two owner-user purchases in Santa Barbara were the Oreana Winery building at 205 Anacapa St in the Funk Zone for $4.2 million, and the Tienda Ho building at 1105 State St for $2.5 million. The pandemic has disrupted revenue streams for most local businesses and made the idea of buying a building seem like too much to take on, but as the economy recovers, potential owner-users will have an easier time obtaining financing, particularly SBA loans. For those with the means to buy, there are abundant opportunities—both on- and off-market—in the current market.

Retail inventory is at a historical peak of 33 properties available, including seven on the downtown State Street corridor. Concerns about the future of brick-and-mortar retail, combined with curtailed consumer behavior during the pandemic, have induced more retail owners to market their properties for sale. Retail sales increased in recent months, producing 8 transactions in Q2. Most notably, a local investor purchased the multi-story former Sur La Table building at 821 State St for $4.6 million.

As with retail, there is more hospitality property on the market than usual. There are 5 offerings for sale in Santa Barbara, including the Hotel Santa Barbara at 533 State St listed for $49 million and the Franciscan Inn at 109 Bath St offered for $21.7 million. No hotel properties have traded hands to date this year.

Following the explosive latter half of 2020, sales of office property have been relatively modest to date in 2021, as both transactions and dollar volume are trending well below pre-pandemic levels. There hasn't been an appreciable increase in office inventory, however. The largest office sales were the Q2 acquisitions of 924 Anacapa St and 110-150 Castilian Dr (mentioned above). For industrial property, there have been 6 sales to date, all in Santa Barbara. Most of the action happened in Q2, including the $8.7 million purchase of 4171-4183 State St in by an investor.

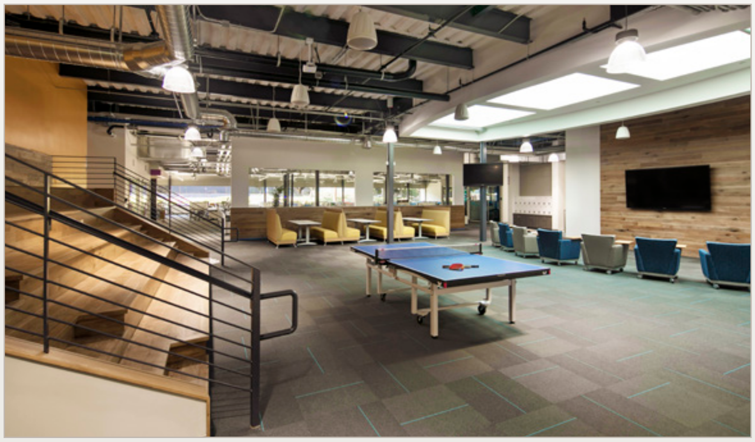
We expect the second half of the year to bring continued growth in sales activity, provided emerging coronavirus variants don't place too much drag on the economy. There is an unprecedented inventory of 82 properties on the market, and both owner-user and investor demand appears to be growing to address that supply. In addition, with residential investments becoming relatively expensive, some investors will likely shift their focus back to commercial property, especially for those willing to accept some near-term uncertainty in their risk analysis. Competition has compressed cap rates for apartment and industrial investments, but pricing on office and retail property generally leaves more room for play on the risk/reward spectrum.

OFFICE LEASING

The "future of the office" has been a hot topic as experts speculate what impact remote work has on how—and how much—office space will be used going forward. Now that we are in the vaccine phase of the pandemic, there are early indications where office use may be heading in our market. Anecdotally, we are aware of companies who plan to downsize offices because of a pronounced shift to remote work. However, it seems that the majority of tenants are expecting to return to their office spaces at full or near full capacity, and leasing activity—particularly in Q2—reflects that. The volume of office lease renewals returned to pre-pandemic levels, with virtually all tenants keeping their existing square footage. More than 150,000 sf of office space has been renewed to date. In addition, the average leased space size has remained consistent with pre-pandemic sizes. Admittedly, we are still in the pandemic with conditions evolving, but our current best guess is that most office users will end up working at the office most of the time, and over the longer term, demand for space in our market will not deviate substantially from historical trends.

Santa Barbara

Santa Barbara's office vacancy continues to grow into uncharted territory, a trend that started before the pandemic. The 10.8% vacancy rate at midyear is the first double-digit rate on record, and the inventory of 108 spaces available is also a new high mark. The conversion to office of the upper two floors of the Ortega Building (former Macy's) at Paseo Nuevo added approximately 87,500 sf to the market. However, even without that building available, the city's vacancy rate would still exceed 9%. In recent months, two sizable downtown office buildings have been listed for sale or lease: the 19,597 sf office building vacated by Stantec Consulting at 111 E Victoria St, and the 17,128 sf building leased by PayJunction and others at 12-14 E Carrillo St. Also newly listed is 14,562 sf of creative office at 530 E Montecito St. Meanwhile, new vacancies at the Riviera Business Park on Alameda Padre Serra have extended total availability there to 21,814 sf.



L3 Technologies leased 40,487 sf of creative office at 7414 Hollister Ave, the largest office lease to date.

On the bright side, Santa Barbara leasing activity has rebounded with vigor so far in 2021. Transactions at midyear outpaced the pre-COVID 5-year average by 12%, while gross absorption was up 14%. There were several large renewals, including 14,364 sf at 1014 Santa Barbara St renewed by Morgan Stanley; 13,880 sf at 530 E Montecito St by Lion Re:Sources; and 11,534 sf at 223 E De La Guerra St by Impact Tech. These prominent examples of tenants both staying put and not downsizing provide food for thought on the future of office demand. Most of the leasing to date has been traditional office tenants, including financial services, legal, and real estate firms.

Average achieved rents have increased slightly, compared to 2019, which indicates the pandemic has not induced a softening of rates. However, if high vacancy persists, prices will inevitably be pressured by market conditions favoring tenants.

By the time this report publishes, the Nordstrom building at Paseo Nuevo will likely have a new owner, who reportedly will market the upper floors of that building as office space. This repositioning of retail floors to office could easily push Santa Barbara's vacancy rate above 13%. There are office tenants interested in portions of the Ortega Building, which is promising. However, attracting enough 20,000+ sf tenants into downtown to fill two former retail anchor buildings will be a very tall order. In other words, Santa Barbara's vacancy rate will likely be in the 10% range for the foreseeable future.

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Goleta
Goleta's office deal flow to date has rebounded compared to 2020 but is still trending below pre-pandemic levels. Transactions and gross absorption are down 20% and 35%, respectively, compared to pre-COVID 5-year averages. Nevertheless, recent leasing has produced net absorption of 64,000 sf year-to-date, trimming the vacancy rate down to 5.1%.

The two largest leases so far this year backfilled office buildings vacated by LogMeIn: Asylum Research leased 38,401 sf at 7416 Hollister Ave in Q1, and L3 Technologies leased 40,487 sf at 7414 Hollister Ave in May. There were also several large renewals in Q2, including 16,631 sf at 315 Bollay Dr secured by Alcon Research and 13,116 sf at 150 Castilian Dr renewed by CACI. Two leases totaling 15,745 sf were signed at 125 Cremona Dr, bringing the 82,132 sf former Medtronic building to 95% occupancy. Rents have held steady despite the pandemic economy, and the average achieved rate at midyear was 10% above the prior 5-year average.

The largest available spaces are 38,183 sf at 326 Bollay Dr, formerly occupied by Inogen, and the 31,499 sf space at 6310 Hollister Ave vacated by Asylum Research. Both tenants relocated within Goleta. Finding tenants for these large spaces could take some time, while demand for spaces under 20,000 sf remains healthy.

Carpinteria
Office leasing in Carpinteria perked up in Q2 with 5 transactions totaling 17,000 sf. All of the leases so far this year have been small spaces, with one exception: 10,060 sf leased at 6383 Rose Ln by an unnamed tenant in Q2. The vacancy rate is relatively low and stable at 4.0%. However, the inventory has become fairly stagnant; on average, the available spaces have been on the market for more than 5 quarters.

RETAIL LEASING

Overall, the South Coast retail market has proved surprisingly resilient during the pandemic. Transactions at midyear are just 3% below the pre-COVID 5-year average. The number of available spaces has increased 12% since the beginning of 2020; however, Q2 brought a net absorption of 7 spaces compared to Q1.

The glaring vacancies continue to be three of Santa Barbara's four mall anchor buildings, formerly Sears, Nordstrom and downtown Macy's. The latter two are having their upper floors marketed as office space, while the Sears building is available for short-term lease while ownership ponders its long-term strategy. The owners of these buildings have evidently concluded that multistory retail anchor buildings cannot be leased to retail tenants in the current market.

To put a finer point on this, the trend that the pandemic has brought into stark relief is the divergence between "daily needs retail" compared to "destination retail" locations. Daily needs is grocery-anchored centers (like Five Points Center or Fairview Shopping Center) or strip malls. Santa Barbara's destination retail is La Cumbre Plaza, Paseo Nuevo, and the State Street corridor. Setting aside the city's three vacant anchor buildings, the two malls and State Street are carrying double-digit vacancy, while daily use retail vacancy is around 2.5%. The restaurants at La Cumbre Plaza are doing well, but the rest of the mall is struggling. This reflects the shift in consumer behavior happening nationally, and retailers and mall operators are struggling to adapt. It's worth noting that Goleta's "big box" mall, Camino Real Marketplace, features a mix of daily use and destination retail and has weathered the pandemic with little to no vacancy.


A clothing and accessories retailer will set up shop in the 1,673 sf storefront at 923 State St.

Belying the trends cited above, State Street's storefront vacancy has been gradually decreasing, and the number of available spaces has dropped 27% since peaking in Q3 of 2020. Even after this improvement, the storefront vacancy rate for the 400 to 1300 blocks is still high at 13.1%. The central and highly visible 700 to 900 blocks are carrying 21.6% storefront vacancy. (For context, in the wake of the great recession these blocks peaked at 13.5% vacancy in 2011.) The most notable newly available space is 8,862 sf at 710 State, long occupied by Restoration Hardware, one of the increasingly rare national retailers on State Street. Which is to say that conditions have been improving, but State Street's inner blocks are still in a state of distress.

Within this gloomy picture, there have been some deals signed, however. Among the Q2 leases on the State Street corridor, Pu'u Muay Thai kickboxing leased the former Killer B's space at 1107 State. In addition, an apparel concept reportedly named MayBerry will set up shop at 923 State, and the former Brighton space at 809 State was leased by an unnamed tenant.

The double whammy of long-term shifts in consumer behavior combined with the pandemic have obviously taken a toll on downtown retail. A new 15-member "State Street advisory committee" has been empaneled to guide policy. With the success of the outdoor dining promenade over the past year, there is momentum to keep some portion of State Street closed to vehicles on a permanent basis. In addition, there are developers—most evidently Peter Lewis—seeking to build housing within a block of State. These are two steps long recommended by consultants and local experts as necessary for State Street to evolve and thrive. Hopefully the new advisory committee will provide leadership to navigate through challenging issues and clear the way for action.

INDUSTRIAL LEASING

National surveys report that industrial has been the commercial property type least impacted by the pandemic, and this has proved true on the South Coast as well. Whereas the local office and retail sectors have seen significant increases in vacancy since the pandemic began, available industrial space has actually decreased 22% on the South Coast since the beginning of 2020.

Goleta saw two large leases signed in Q2. First, Kate Farms leased 34,551 sf at 30 S La Patera Ln, part of the space vacated by Powell/Skate One. That leaves about 67,000 sf still available there. The other lease was 47,047 sf signed by Deployable Space Systems at 7418 Hollister Ave at the former LogMeIn campus. That building now has about 49,000 sf remaining for lease, the last of the LogMeIn space yet to be backfilled. Following those leases, the vacancy rate is down to 3.6%, its lowest level since 2017. Achieved rates continue to rise, averaging $1.68 gross per sf so far in 2021.

In Santa Barbara, vacancy popped up into the 1.5% range for three consecutive quarters, but Q2 leases helped reverse that trend. An unnamed tenant leased 12,500 sf at 411 E Montecito St, and the Tent Merchant renewed 12,525 sf at 436 E Gutierrez St. In addition, a construction tenant leased 80,000 sf of yard plus a 4,000 sf industrial building at 27 N Nopal St. At midyear, the vacancy rate was down to 0.74%, lower than before the pandemic.

Similarly, Carpinteria's vacancy rate was whittled down to 1.7% at midyear following above-average deal flow of 6 leases totaling 60,000 sf. Dakar leased 19,400 sf at 1015 Cindy Ln in Q2, the largest lease to date.

Kate Farms leased 34,551 sf at 30 S La Patera Ln in Goleta.

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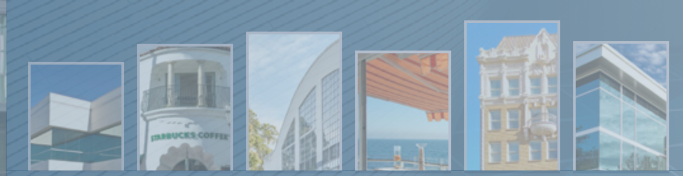

LEASING MARKET DATA

Market	Vacancy Rate		Transactions		Gross Absorption (SF)		Achieved Rent (PSF GR)	
OFFICE								
Santa Barbara	**10.76%**	+29%	**62**	+53%	**207,701**	+37%	**$3.12**	+8%
Goleta	**5.10%**	-22%	**19**	+23%	**186,381**	+38%	**$2.11**	+8%
Carpinteria	**7.45%**	-46%	**7**	+367%	**21,529**	+467%	**$1.92**	+1%
RETAIL								
Santa Barbara	**4.73%**	+24%	**30**	+62%	**49,737**	-2%	**$3.81**	+20%
Goleta	**2.68%**	+7%	**9**	+125%	**17,486**	-31%	**$3.17**	+45%
Carpinteria	**6.65%**	-25%	**2**	+33%	**3,041**	-82%	**$2.14**	-13%
INDUSTRIAL								
Santa Barbara	**0.74%**	-50%	**12**	+26%	**70,793**	+115%	**$1.79**	-15%
Goleta	**3.56%**	-39%	**10**	-33%	**106,555**	+0%	**$1.68**	+8%
Carpinteria	**5.31%**	-68%	**6**	+140%	**60,049**	+339%	**$1.24**	+5%

Change percentages are compared to 2020 values, annualized where appropriate.