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2023Q1 Market Update

South Coast Commercial Real Estate

HIGHLIGHTS

- Commercial sales activity stalled in Q1, as high interest rates and pricing friction took many investors out of play.
- Owner-users generated above-average sales activity.
- Office inventory is in over-supply, as remote work has left a glut of large office spaces on the market while limiting demand to absorb vacancies.
- Retail vacancy has fully recovered to pre-pandemic levels, though State Street's downtown corridor continues to wrestle with a surplus of empty storefronts.
- Industrial leasing activity and vacancy are both very limited, though a handful of large spaces have recently come to market.

An owner-user purchased 6900 Hollister Ave in Goleta, a multi-tenant retail/office building at the corner of Hollister and Storke.

COMMERCIAL SALES – Investors take a Breather

As expected, commercial sales volume decreased dramatically in Q1 compared to the record deal flow of 2022. Elevated interest rates—combined with recent turmoil in the banking sector—have created a challenging lending environment for commercial financing. Sellers have not adjusted pricing expectations accordingly, and as a result deals have not been coming together as they did a year ago. Investors in particular have been sidelined by these market conditions, and barring substantial interest rate cuts by the Fed, we anticipate relatively low sales velocity through the balance of 2023. On the bright side, owner-user sales have remained surprisingly resilient to date this year.

- There were 20 transactions in Q1, 17% below the 5-year average for first quarter sales. However, dollar volume (excluding hotels) was 54% below the 5-year trend because there were just a few high-priced sales. The market rebounded in April, though, posting 10 sales valued at $40.8 million for the month.
- At year-end 2022, the inventory for sale was at a historical peak of 76 offerings. Since then, the number of properties for sale has decreased 24%. The number of office properties for sale has decreased by one third.
- Investors have largely pulled in the reins due to higher interest rates. Asking prices have decreased somewhat, but not proportional to the rise in interest rates. Investor dollar volume was down more than 70% compared to the Q1 5-year average.
- With investors in a diminished role, 60% of the transactions were closed by owner-users. In fact, owner-user sales in Q1 were above the 5-year average for both transactions and dollar volume. For example, the 6,000 SF retail building at 6900 Hollister Ave in Goleta was purchased by an owner-user that will use a portion

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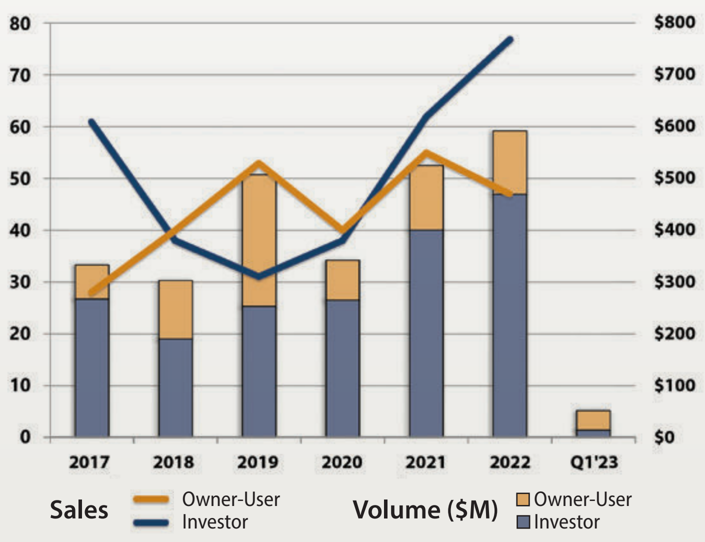
of the building and lease the rest. Similarly, in Santa Barbara the owner of Seven Bar & Kitchen purchased the former Neighborhood Bar building at 235 W Montecito St as a new home for the restaurant, while keeping the Rodeo Room as a tenant at the property.

- Investor demand for office property has been sapped by higher vacancy, the resulting underwriting barriers, and high interest rates. However, thanks to owner-user buyers there have been more office sales to date in 2023 than there were at this point in 2022. The important caveat is that the sales this year have been all been under $5 million, which is the typical price range for owner-users.

- Two notable land sales were transacted in April. RAF Pacifica purchased an undeveloped 7.6-acre site in Cabrillo Business Park with approved plans in hand for a 93,000 SF industrial or flex building. Two adjacent parcels in downtown Santa Barbara were purchased by Ed St. George, reportedly with the intent to eventually redevelop most of the 1-acre site with residential units.

- The two highest price sales in Q1 were a senior assisted living facility and a hotel. The 70-room memory care facility at 5464 Carpinteria Ave, converted from an office building about seven years ago, was just purchased by an owner-operator for $268 PSF. The Castillo Inn at 22 Castillo St in Santa Barbara's West Beach neighborhood sold for $992 PSF. West Beach has attracted increasing attention from investors and developers in recent years, coinciding with the swell in demand for hospitality and apartment properties, which are both prevalent in this well-situated area of town.

South Coast Sales (excluding Hotels)



OFFICE LEASING

The combined South Coast office vacancy rate of 11.4% is a new high mark, and for the first time on record all three market cities are carrying double-digit office vacancy. Not surprisingly, remote work has been the single largest factor behind the expansion of available inventory over the past two years. The effects are not unique to our market; Orange County office vacancy is 17%, and Bay Area vacancy is pushing 30%.

Office leasing transactions in Q1 were 44% below the 5-year average, but a handful of significant renewals generated dollar consideration on par with the recent trend. Renewals have been the main bright spot in the office market over the past few years, while finding tenants to fill vacant space, especially larger tech office spaces, has become increasingly difficult. There are 34 spaces larger than 10,000 SF available on the South Coast. Meanwhile, aside from renewals, only 16 office leases larger than 10,000 SF have transacted during the past three years, and none of those were signed in the past 12 months. While that sounds grim, there are some deals in the pipeline to fill a handful of large vacancies. For some landlords, dividing vacant space into multiple suites to attract smaller tenants may be worth the expense.

SANTA BARBARA
With the recent addition of the former Nordstrom building to the office market, Santa Barbara's vacancy is at a record-high 11.0%. As we have previously suggested, the Nordstrom and Macy's buildings are so different from any other office property in Santa Barbara that one can essentially view them as a separate submarket. The ownership of the Nordstrom building, now marketed as 817 State Street, has completed interior demo and is beginning construction on the remodel. By contrast, the path forward for the Ortega Building (former Macy's), is unclear in the wake of a recent shift in ownership and intermittent negotiations with the City over extending

Wells Fargo Advisors renewed 11,930 SF at 3660 State St, a suite they have occupied for the past 12 years.

the ground lease under the mall. Finding tenants for these large floor plates in the current office leasing environment is a tall order.

Excluding the two Paseo Nuevo anchor buildings, Santa Barbara office vacancy is 7.5%, still relatively high but not double-digits high. The three transactions to date for spaces larger than 10,000 SF have all been renewals: Wells Fargo Advisors at 3660 State St; Impact Tech at 223 E De La Guerra St; and Kiva Cowork at 10 E Yanonali St.

GOLETA
Goleta office vacancy was below 5% a year ago and has since more than doubled to 10.7%, its highest rate in six years. There are 17 properties with 10,000 SF or more available, which we consider an oversupply of that size range in this submarket. As in Santa Barbara, there aren't many large tenants out looking for space, but there are several pending deals that will likely bring vacancy back under 10% during Q3.

Most of the recently added inventory is sublease space. Goleta has the most sublease space we have ever seen—more than 200,000 SF in total. In addition to the two large buildings offered by AppFolio at 50 & 90 Castilian Dr, Yardi recently added 23,000 SF for sublease at 425 Pine Ave, and Inogen is now offering its 50,500 SF building for sublease at 301 Coromar Dr as they prepare to move out of the area. Most of that building is high-end creative office space, and the asking rate of $2.69 gross PSF is the highest among the large spaces currently available in Goleta.

In one of the largest lease transactions in recent memory, Raytheon signed a five-year renewal of 121,000 SF at 75 Coromar Dr, which single-handedly kept Q1 dollar consideration in line with the 5-year average amidst otherwise lackluster leasing. Microsoft also renewed 7,000 SF at 5383 Hollister Ave. Besides those two signings by Fortune 500 corporations, there were just five small leases in Q1.

CARPINTERIA
In Carpinteria, two large creative office spaces offered by Procore for sublease comprise 60% of available inventory: 50,000 SF at 6267 Carpinteria Ave and 28,500 SF at 6307 Carpinteria Ave. The former is a real-world example of the effects of remote work: a well-appointed creative office building overlooking the ocean that is sitting empty. A recent addition to the market is the 18,000 SF class A professional building at 1155 Eugenia Pl, long occupied by AGIA, which is moving out of the area. The property is also for sale. There were two transactions in Q1: Brown & Brown Insurance renewed 8,700 SF at 1001 Mark Ave, and Forgeline Solutions leased 3,000 SF at 4188 Carpinteria Ave.

RETAIL LEASING

On the downtown State Street corridor, the storefront vacancy rate for the 400 to 1300 block increased slightly from year end to 14.1%. There was only one lease along this corridor in Q1, but it was a large one as Sonoma Fit secured the 11,450 SF former Samy's Camera space with plans to open a gym in December. Reportedly, Vuori renewed its 2,900 SF space at 833 State St in early Q2. On the departures list, Rooms & Gardens vacated its storefront on State and moved to Montecito's Upper Village. This follows the recent revelation that Restoration Hardware is doing the same, and demonstrates that some retailers are deciding to move where the high-end clientele are more likely to be. It's been a tough stretch for food-use businesses as seven restaurant and beverage spaces on State Street have become vacant and/or available during the past 12 months. Now that the City has finalized a $2.00 PSF levee on parklets, it will be interesting to see if any restaurants decide to add, resize, or remove outdoor dining installations. In other moves, Black Sheep restaurant moved closer to State, from 28 E Ortega St to 18 E Cota St, and Open Air

Sonoma Fit will launch a gym in the 11,450 SF building at 530 State St, formerly Samy's Camera.

Bicycles moved from State Street to the former deli space at 135 E Carrillo St.

Aside from State Street, vacancy in the rest of Santa Barbara and Montecito is tight at 2.7%. In the Upper State area, the La Cumbre and Five Points shopping centers have most of the vacancy, while in-line retail properties are mostly leased up. Montecito's commercial areas continue to thrive, and available retail space there has all but dried up. Montecito's most notable Q1 lease was Rooms & Gardens' new 1,800 SF home at 1482 East Valley Rd.

Goleta's vacancy of 1.9% is the lowest rate in three years. There were a handful of leases in Q1, but none were of notable size, and dollar consideration was 40% below the 5-year average. The owners of the Calle Real center announced plans for an exterior remodel which includes new facades and converting some existing parking to outdoor dining and gathering space. The center has the mixed blessing of a five-lane thoroughfare running through the middle of it, and the planned updates may help mitigate the inherent strip-mall character of the project.

In Carpinteria, the adaptive reuse project at 700 Linden Ave is starting to take shape with Bettina, Old Town Coffee, and Ramon Velasquez of Corazon Cocina reportedly having signed leases, which would leave about 14,000 SF of retail space still in play. Meanwhile, Mollie Ahlstrand of Mollie's fame leased a space in the Shepard Place center for a restaurant & market concept.

INDUSTRIAL LEASING

The South Coast industrial market continues to exhibit low vacancy and sparse deal flow. Dollar consideration for Q1 was down 70% compared to the 5-year average, with no transactions signed in Goleta or Carpinteria. Vacancy increased from year end, but the rate of 2.0% is still very low.

The two notable Q1 leases were both at 1 N Calle Cesar Chavez, where Andros Floor Design renewed 15,250 SF and ServiceMaster leased a 11,700 SF space formerly occupied by Abatex. There were three other leases of small spaces on Santa Barbara's Eastside. That neighborhood is also the locus of two new sizable listings: 13,600 SF at 402 E Gutierrez St and 10,000 SF at 224 S Milpas St. However, Santa Barbara vacancy remains very lean at 0.65%.

Other new listings on the South Coast include 13,000 SF at 801 Kellogg Ave and 12,250 SF for sublease at 165 Castilian Dr, both in Goleta. In Carpinteria the newest addition to the market is three spaces totaling 13,000 SF at 509-517 Maple St. The new inventory represents a good test of current demand for industrial space, which appears to have diminished somewhat from a year ago but is still more abundant than office demand.

Andros Floor Design and ServiceMaster both signed renewals in the Vercal building at 1 N Calle Cesar Chavez in Santa Barbara.

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SALES DATA (COMPARED TO 5-YEAR AVERAGES)

Property Type	Dollar Volume		Transactions		Off-Market Sales		Properties For Sale	
Office/Medical	**$13 M**	-75.6%	**6**	-25.5%	**2**	-42.9%	**18**	-7.2%
Industrial	**$5 M**	-67.7%	**4**	-10.1%	**2**	-11.1%	**3**	-66.7%
Retail	**$13 M**	-50.4%	**4**	-26.6%	**3**	20.0%	**20**	-16.7%
Land	**$4 M**	-67.0%	**2**	-18.4%	**0**	-100.0%	**6**	7.1%
Mixed Use	**$2 M**	-63.2%	**1**	-37.5%	**0**	-100.0%	**6**	3.4%
Hotels	**$9 M**	-83.9%	**1**	-28.6%	**0**	-100.0%	**2**	-16.7%
Other	**$16 M**	260.4%	**2**	207.7%	**1**	150.0%	**2**	233.3%
Total	**$61 M**	-64.1%	**20**	-16.84%	**8**	-29.2%	**57**	-14.7%
Excl. Hotels	**$52 M**	-54.3%						

Change percentages are compared to 5-year averages, annualized where appropriate.

LEASING DATA (COMPARED TO 2022)

Market	Vacancy Rate		Transactions		Gross Absorption (SF)		Achieved Rent (PSF GR)	
OFFICE								
Santa Barbara	**11.03%**	+6%	**13**	-52%	**65,190**	-29%	**$3.25**	+8%
Goleta	**10.69%**	+25%	**7**	+4%	**142,368**	+377%	**$2.06**	+1%
Carpinteria	**19.15%**	+3%	**2**	+300%	**11,736**	+558%	**$2.13**	-14%
RETAIL								
Santa Barbara	**3.85%**	-1%	**11**	-29%	**29,753**	-48%	**$3.77**	-9%
Goleta	**1.90%**	-18%	**5**	+0%	**12,252**	+1%	**$2.83**	-10%
Carpinteria	**3.01%**	+61%	**2**	+700%	**2,254**	+352%	**$3.20**	-20%
INDUSTRIAL								
Santa Barbara	**0.65%**	+482%	**5**	+43%	**32,895**	+71%	**$2.10**	-2%
Goleta	**2.72%**	-5%	**0**	-100%	**0**	-100%	**-**	-
Carpinteria	**3.36%**	+43%	**0**	-100%	**0**	-100%	**-**	-

Change percentages are compared to 2022 values, annualized where appropriate.

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1997
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