2023 Q2 Market Report

South Coast Commercial Real Estate

HIGHLIGHTS

- The number of sales transactions at midyear was 7.5% above the 5-year average.
- However, the average price of investment sales was about half the historical norm, due to higher interest rates and underwriting challenges.
- South Coast leasing was sluggish through midyear, yielding 115 transactions valued at $65 million, both of which are among the lowest midyear totals of the last 15 years.
- Gross absorption of office space was 25% below the 5-year average, and for the first time on record all three market cities have double-digit vacancy.
- Retail transaction volume was above the recent historical average, but there were few large spaces leased, and available space has expanded by 23,000 SF since the beginning of the year.

An investor purchased "The Palms," a 10,600 SF mixed-use building at 701 Linden Ave in Carpinteria.

COMMERCIAL SALES

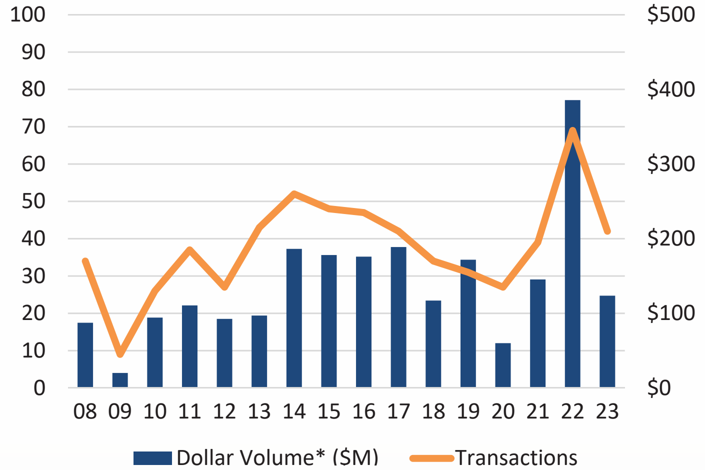
Not surprisingly, South Coast commercial sales volume has been hampered by high interest rates to date in 2023. More specifically, the steep rise in interest rates over the past year has sapped the purchasing power of buyers, while sellers' expectations generally have not adjusted accordingly. Dollar volume (excluding hotels) was down 30% compared to the 5-year average and 85% below 2022's record midyear volume. While dollar value was low, transaction velocity was solid with 43 sales at midyear, 7.5% above the prior 5-year average.

For the primary commercial property types—office, retail and industrial—dollar volume was 68% below the 5-year average, and the highest sale price was $5.5 million. The substantial transactions were other commercial types, such as the 70-unit medical residential facility at 5464 Carpinteria Ave, which sold for $13.85 million. Or the entitled land at 355 Coromar Dr in Goleta, which RAF Pacifica purchased for $12.36 million. The third largest sale to date was the Castillo Inn at 22 Castillo St in Santa Barbara, which sold for $9.25 million.

It also bears noting that all three of these sales closed in Q1, and despite a solid batch of transactions in April, sales activity in Q2 did not match the previous quarter. In fact, we are in the midst of a summer lull. Whereas the recent historical average is over eight commercial sales per month, there were only four sales in May, three in June, and five in July.

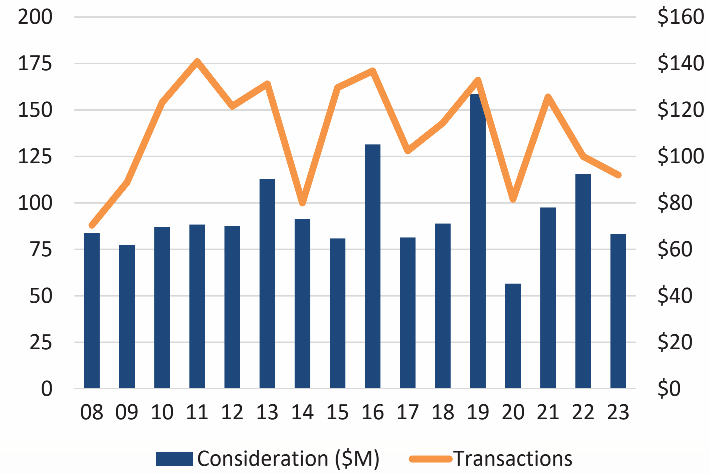
Owner-user sales to date downshifted from recent years with transaction and dollar volume decreasing 15% and 23% respectively, compared to 5-year averages. Two notable office purchases by owner-users closed in Q2: Vital Patient Care LLC acquired the 13,000 SF building at 115 S La Cumbre Ln between Five Points Center and La Cumbre Plaza; and the City of Santa Barbara purchased the

South Coast SALES at Midyear
(all property types)



*Excluding hotel property

South Coast LEASES at Midyear
(all property types)



8,500 SF building at 222 E Anapamu St in Santa Barbara. All six of the industrial sales to date have been owner-user buyers, and all were under $2.0 million. Two retail owner-user purchases to mention were the 5,900 SF service retail building at 6900 Hollister Ave in Goleta, purchased by a dental user in Q1, and the 5,500 SF restaurant building at 231 W Montecito St in Santa Barbara acquired in Q2 by the proprietor of the former Seven Bar & Kitchen restaurant.

Investors have remained fairly active, generating 23 sales as of midyear, but they tended to purchase less pricey investments than in years past. The average investment sale price YTD was only $3.3 million, about half the prior 5-year average. As mentioned, there were no industrial investment sales as of midyear and just four office investments, the largest being the 6,600 SF building at 600 Chapala St in Santa Barbara purchased for $4.35 million. Retail property investments numbered six sales, with the Sacred Space property at 2594 Lillie Ave in Summerland fetching the highest price at $3.15 million. By comparison, investments in land and mixed-use property were more pronounced. In the latter category, an investor acquired 701 Linden Ave in Carpinteria, aka The Palms, for $5.65 million in June. A 1031 Exchange investor purchased contiguous properties totaling one acre at 117 & 135 E Ortega St in downtown Santa Barbara. The properties have improvements generating income, including a residence dating to 1890, but the buyer may eventually redevelop the commercial portion with new apartments.

As the lack of high-value investment sales suggests, investor sentiment is cautious. Off-market sales were down 17% at midyear, which indicates fewer active buyers in the market. With commercial loans trading at around 6.5% interest, buyers are understandably not jumping at offerings with 5.5% capitalization rates, especially in the higher price ranges. In addition, though the prospects for office property are not as dire as often portrayed, investors are contending with greater risk surrounding office assets than they would have faced five years ago, which is softening demand. Meanwhile, compared to other market areas, owners of South Coast real estate tend to be well-capitalized, and distressed sellers are not common. As a result, many owners are in a position to hold a property rather than dramatically reduce the price. Given these conditions, there are parties on both sides that may decide to step back for now and return to the market when interest rates come down.

Cash and exchange buyers are inherently in a strong position, but now even more so since they can sidestep the current financing and underwriting challenges. Exchange buyers have the additional advantage of the natural disaster extension due to floods earlier this year, which gives them until October to complete their exchanges. Those extensions may explain some of the scarcity of transactions during the past few months and will hopefully trigger some additional sales in Q3 and Q4. That, combined with properties currently in escrow give cause for cautious optimism that sales activity will recover some momentum heading into the fall.

OFFICE LEASING

Santa Barbara

Santa Barbara's vacancy remains near its historical peak with a rate of 11.0% at midyear. The upper floors of the two former anchor buildings in Paseo Nuevo represent more than a third of the available space. Setting those buildings aside, the vacancy rate would be 7.5%, which is still much higher than we are used to.

Santa Barbara office leasing picked up steam in Q2, posting 32 transactions during the quarter. However, the final midyear transaction count and gross absorption were both about 20% below the 5-year benchmarks. The deals were dominated by professional office tenants, especially financial services firms. Most notably, Morgan Stanley leased the 9,200 SF second floor of 1332 Anacapa St in Q2, to which they will move from 1014 Santa Barbara St. Mission Wealth renewed 7,400 SF at 1111 Chapala St for five years, and renewals were also inked by Wells Fargo Advisors, Fidelity Title, Fidelity Brokerage, Raymond James, and others. As this activity underscores, demand in Santa Barbara for professional space has been more stable than creative office (tech) space both during and since the pandemic.

On the tech side, apart from an 11,500 SF renewal by Impact Tech in January, there was minimal creative office leasing activity as of midyear. In July, however, the building at 419 State St that Invoca recently vacated was subleased to Umbra Lab, which removed 27,700 SF of available space from the market in downtown Santa Barbara. The building was converted to creative office by Sonos ten years ago, then passed to Invoca five years ago. Speaking of Sonos, the smart speaker company will soon move its South Coast operations from downtown Santa Barbara to Goleta. Much of their downtown space has been sparsely used for many years, but by every measure Sonos has been downtown's largest tech company for over a decade, so this is big news which will likely lead to availabilities at 614 Chapala St and 25 E Mason St in the Funk Zone.

Seek Thermal renewed 30,800 SF of office/R&D space at 6300 Hollister Ave in Goleta.

Goleta

In Goleta, the midyear transaction count was 41% below the 5-year average, but thanks to a few large leases, dollar consideration was close to the historic mean. In one of the biggest transactions in recent years, Raytheon signed a five-year renewal on 121,100 SF at 75 Coromar Dr in Q1. Then there were two sizeable transactions at the end of Q2 as Seek Thermal renewed its 30,800 SF office/R&D space at 6300 Hollister Ave, and an undisclosed tech company leased 26,000 SF at 5425 Hollister Ave. These were the start of a cluster of significant deals that are emerging as summer progresses. In July, two subleases totaling 86,000 SF were signed, and there are several substantial leases under negotiation, expected to be signed in Q3. Almost all of these deals involve tech and/or R&D tenants, the type of users that seemed scarce in Goleta a few months ago as employees had gone remote and multiple spaces—in some cases entire buildings—were put up for sublease. While these leases may not indicate a durable increase in demand for large spaces, the activity is bringing some welcome vitality to a submarket that appeared headed for hibernation.

At the same time, there continues to be an oversupply of inventory as several large spaces were added to the market in recent months. The cannabis distribution startup Herbl has ceased operations in Goleta and is vacating 749 Ward Dr, a 17,200 SF office flex building. Also new to the market in Q2 were 23,000 SF at 425 Pine Ave offered for sublease by Yardi and 15,400 SF of flex office at 26 Castilian Dr. These additions helped keep the vacancy rate in double digits for the second consecutive quarter, posting 10.3% at midyear, and it's hard to predict which direction it will head in Q3. What remains clear is there are many large pieces of the Goleta office puzzle in motion, certainly more so than we anticipated six months ago.

Carpinteria

There were only three transactions as of midyear in Carpinteria, the largest being the renewal by Brown & Brown Insurance of 8,700 SF at 1001 Mark Ave. The lone Q2 lease was 2,300 SF at 1110 Eugenia Pl secured by McKenzie Cervini. Five spaces have become available since the beginning of the year, the largest being the 18,000 SF professional building at 1155 Eugenia Pl, vacated by AGIA's move to Oxnard. Factoring in Procore's 78,000 SF of available sublease space, the vacancy rate is over 20% for the first time on record.

One of Carpinteria's selling points for office users has been its 20-minute commute from both Goleta and Ventura (not to mention the short drive from Montecito for top executives). However, given current employee priorities and the rise of remote work, a 20-minute commute is considered much more of a burden than it used to be. And the multiyear 101 freeway construction project from Santa Barbara to Carpinteria is not helping either. Location is always a top consideration for tenants and, for the near term at least, one that is not necessarily working in Carpinteria's favor, in spite of its desirable coastal setting.

RETAIL LEASING

The South Coast's retail picture has remained pretty consistent in recent years, marked by low vacancy in the neighborhood centers and relatively high vacancy along State Street and in Santa Barbara's two regional malls. In a new and burgeoning category, two adaptive reuse projects underway are designed to provide multiple vendors in a destination setting: one is "The Post" next to the bird refuge, and the other is 700 Linden Ave in Carpinteria. The Public Market (along with several smaller endeavors) has proven that this general concept can succeed, and reportedly both new projects have signed multiple tenants in advance.

For the South Coast, strong deal velocity produced 43 retail transactions at midyear, which is 15% above the 5-year average. However, only three of the leases were larger than 3,000 SF, leading to gross absorption 30% below average.

Along the State Street corridor, there were seven leases through midyear, a marked improvement from eight leases during all of 2022. Q1 brought leases by Sonoma Fit at 530 State St, Bibi Ji at 1213 State, and Sweet Reef Boba at 620 State St. Then, in Q2 O' My Sole renewed 1021-B State, The Yes Store went in at 1100 State, and Domecil leased 1223 State. Apparently, the former Cold Stone space at 504 State was leased as well. At midyear, storefront vacancy for the 400 to 1300 blocks was 14%, maintaining the level it has hovered around for the past few years. The Paseo Nuevo mall interior has a very similar storefront vacancy rate of 13%. It bears noting that several of the businesses currently operating in the mall don't appear to be credit tenants on long-term leases.

While the downtown Master Plan is still being crafted, there are a few initiatives designed to make it easier for people to come to the central business district. The State Street freeway undercrossing will undergo an $11 million

The departure of Bed Bath & Beyond creates a 24,000 SF vacancy at Fairview Shopping Center in Goleta.

upgrade to make it more pedestrian- and bicycle-friendly, while providing a more appealing gateway to the State Street corridor or the waterfront, depending which way you are going. The project is scheduled for completion by summer 2025. The South Coast Chamber also launched a pilot downtown shuttle program to help visitors get around.

Montecito's retail areas have virtually no vacancy. Clark's Oyster Bar is slated to open in 2024 in the former Cava space on Coast Village Road, following a Jeff Shelton-designed remodel. As mentioned, The Post at the corner of East Cabrillo and Lost Patos Way has signed tenants for all but a few spaces in the center, according to the developers, and plans to launch next year.

La Cumbre Plaza continues to struggle with a dozen spaces either vacant or without a paying tenant, which equates to 24% storefront vacancy. Otherwise, the Upper State area has few vacancies, and leasing activity has been limited. The lone lease of Q2 was signed by Prevail Conditioning for a 2,500 SF space at 3445 State St in San Roque Plaza.

In Goleta, Bed Bath & Beyond closed, creating a 24,000 SF anchor vacancy at Fairview Shopping Center. Reportedly, the building is already attracting inquiries from national retailers, so hopefully it won't lie fallow for long. In the same center, the MedCenter clinic also closed, adding 2,000 SF of availability. On the other hand, a dog food kitchen concept called Just Food for Dogs leased the former Cash Advance America space at 159 N Fairview Ave. Even including the Bed Bath & Beyond space, Goleta vacancy remains very low at 2.2%.

INDUSTRIAL LEASING

Santa Barbara has seen a healthy level of industrial leasing, despite very limited inventory being marketed for lease. The gross absorption of 83,000 SF at midyear was nearly double the 5-year average. Two large deals were signed in Q2: Downtown Storage Partners renewed 34,320 SF in the Vercal Building at 1 N Calle Cesar Chavez, and SCP Distributors leased 13,600 SF at 402 E Gutierrez St, a space most recently leased by Fluidstance. There are only two spaces available, including a recently added 10,000 SF space at 224 S Milpas St. The 0.3% vacancy is among the lowest rates we have on record, and reflects the perpetual imbalance between supply and demand for industrial space Santa Barbara.

In Goleta, following record-high gross absorption in 2022, there have been just four industrial leases to date totaling 17,700 SF. All of the transactions were signed in Q2, most notably MOS Equipment leased 11,126 SF at 26 Castilian Dr, and Food For My Soul leased 5,000 SF at 789 S Kellogg Ave. Vacancy remains low at 3.3% but has crept upward in recent months with the addition of the 25,800 SF building vacated by Herbl at 839 Ward Dr, and the 13,000 SF building at 801 S Kellogg Ave, which is also for sale.

Carpinteria's industrial market appears to be on pause, as there hasn't been an industrial lease signed since last October. There four availabilities, two of which came to market during Q2. One of these is 509-517 Maple St, where there are three suites totaling 19,000 SF. The other is 15,850 SF offered for sublease in the S&S Seeds building at 6155 Carpinteria Ave. If you have a requirement for a blufftop industrial warehouse with unobstructed ocean views, look no further. These two additions bring the vacancy rate to 6.0%.

MOS Equipment specializes in RF shielding products and leased 11,126 SF at 26 Castilian Dr in Goleta

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LEASING MARKET DATA

	Market	Vacancy Rate		Transactions		Gross Absorption (SF)		Achieved Rent (PSF GR)	
OFFICE	Santa Barbara	**11.03%**	+6%	**44**	-19%	**152,324**	-17%	**$3.18**	+5%
	Goleta	**10.29%**	+21%	**12**	-11%	**217,998**	+266%	**$2.11**	+4%
	Carpinteria	**20.62%**	+8%	**3**	+200%	**14,132**	+296%	**$2.08**	-15%
RETAIL	Santa Barbara	**4.01%**	+3%	**26**	-16%	**54,998**	-52%	**$3.54**	-14%
	Goleta	**2.19%**	-6%	**10**	+0%	**18,687**	-23%	**$3.16**	+0%
	Carpinteria	**3.01%**	+123%	**7**	+1300%	**9,112**	+814%	**$5.22**	+30%
INDUSTRIAL	Santa Barbara	**0.27%**	+146%	**8**	+14%	**83,670**	+117%	**$1.93**	-11%
	Goleta	**3.27%**	+14%	**5**	-47%	**22,789**	-84%	**$1.98**	+8%
	Carpinteria	**3.36%**	+78%	**0**	-100%	**0**	-100%	**n/a**	

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