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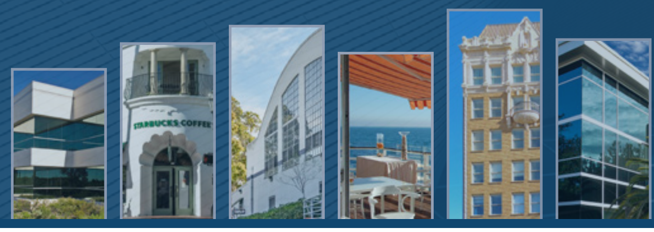

2023 Q3 Market Report

South Coast Commercial Real Estate

HIGHLIGHTS

- Higher interest rates have profoundly constricted dollar volume of sales for properties over $5 million.
- No sales of office or industrial properties over $5 million sales have closed to date, while land sales volume has exceeded the 5-year benchmark.
- A surprising series of large tech office leases in Goleta have reduced inventory, while the departure of Sonos from Santa Barbara has contributed to record high vacancy there.
- A record 71 retail lease transactions have been signed on the South Coast, though none were for large spaces.
- Achieved industrial rents are averaging $1.87 gross PSF in Goleta following a batch of large leases signed during the past 6 months.

A 1031 Exchange investor acquired the 14,500 SF retail property at 3905-3917 State St in Santa Barbara.

COMMERCIAL SALES - Price Sensitivity

National business news has painted a gloomy picture of commercial real estate in major metro areas, with one source citing $80 billion of distressed CRE loans in Q3. Against that backdrop, the South Coast has fared relatively well, with no apparent sign of commercial properties in distress or on the brink of foreclosure. However, higher interest rates have clearly had a substantial cooling effect on sales through Q3, with transactions and dollar volume (excluding hotels) down 14% and 42%, respectively, compared to 5-year averages.

Taking a closer look, though, the local commercial sales market seems to have split into two tiers based on price. For properties up to $5 million, sales volume through Q3 was on par with the 10-year average. For properties over $5 million, however, sales activity slowed to a crawl. And there were no office or industrial sales at all in the higher price tier.

The effects of higher interest rates have been more pronounced in the higher price tier. Potential buyers are understandably hesitant to undertake large loans at relatively high interest rates, which increase risk while decrease their buying power. In our market, buyers in the lower price tier are often able to pay cash or sometimes obtain financing from the seller, so their ability to close is less subject to interest rates. Here are some observations on this two-tier market, accompanied by a graph:

- Through the end of Q3 there were just 9 sales over $5 million, and the combined value of those sales was only $57 million. Both of these stats are the lowest we've seen since 2009 (aka the "Great Recession").
- As noted above, none of the 9 sales over $5 million were office or industrial properties; there were two retail

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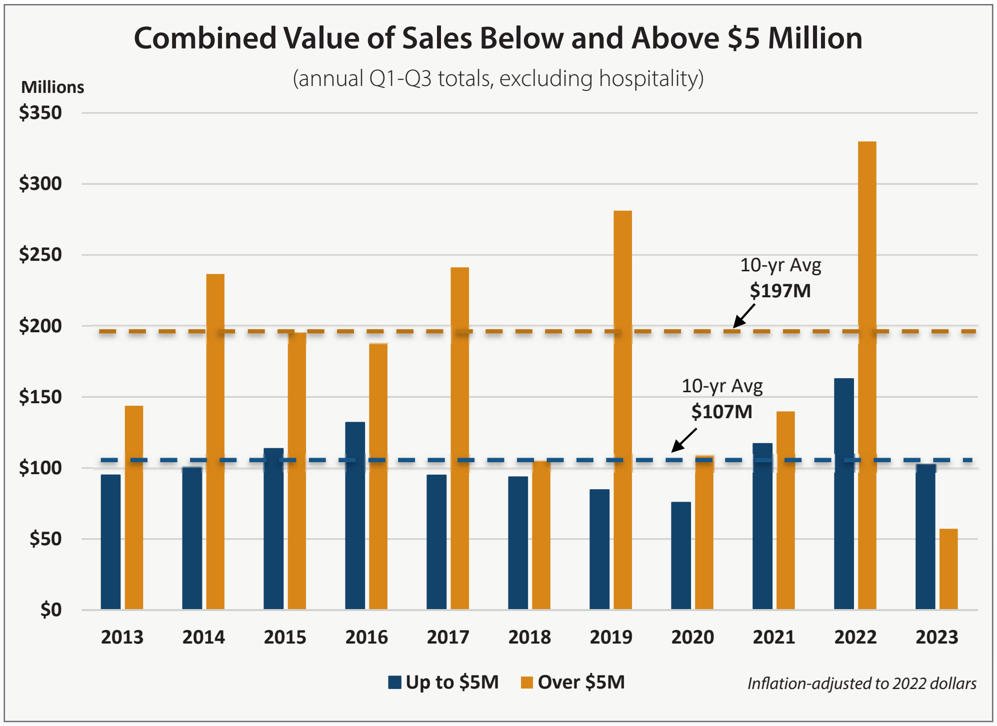
sales, and the rest were land, hospitality, mixed-use, and an assisted living facility.

- There were 48 sales under $5 million, which represents a modest 9% decrease compared to the prior 10-year average.
- The graph shows that 2023 has been an "average" year for dollar volume of sales under $5 million. But for sales over $5 million, dollar volume is down 71%.



Who's Buying?
Investor sales through Q3 kept pace with the prior 5-year trend, based on transaction count. However, the sales strongly favored the lower price range, and consequently dollar volume was down 66%. The highest-priced investment sale of Q3 was the neighborhood retail center at 3905-3917 State St, purchased by a local investor completing a 1031 Exchange. It traded for half the price (inflation-adjusted) that it sold for previously in the "frothy" days of 2007. The limited data we have suggests cap rates across all property types have centered around 5% to 5.5%, but the range is quite wide.

For owner-users, the strong momentum of sales last year has not continued in 2023, resulting in a 27% decrease in owner-user transactions, compared to the 5-year average. For many businesses and other organizations considering their real estate options, higher interest rates have made leasing relatively appealing compared to buying. One exception to this was Sun Coast Rentals, which purchased the property it has leased for many years at 4745 Carpinteria Ave in Carpinteria. That said, there were only 3 owner-user sales in Q3.

Off-market sales have been relatively rare to date as well, representing 36% of transactions, which is 11% below the 5-year average. Typically, off-market sales correlate with buyer demand, so this decrease makes sense in a year with fewer sales overall.

Property Types
Office property sales have been very limited, with dollar volume 71% below the 5-year average, due to the absence of sales over $5 million. Q3 was the slowest quarter to date with less than $4 million transacted. Office inventory is skewing toward higher priced offerings, with 8 properties currently for sale asking over $5 million. The South Coast's office vacancy of 10.7% remains near the historical peak, which is another factor softening investor demand for this property type, while potentially creating opportunities for owner-users.

Industrial sales have also been sparse, though lack of inventory likely contributed to sluggish activity more than lack of demand. Compared to 5-year averages, dollar volume decreased 65%, while transactions were down 21%. However, sales picked up recently with four deals in Q3, including 4745 Carpinteria Ave mentioned previously.

Retail property sales have shown more momentum than office or industrial, but dollar volume was still 40% below average. The stand-out deal was the previously mentioned 14,500 SF multi-tenant property at 3905-3917 State St, home to Peet's Coffee and the UPS Store, purchased by a local investor in Q3. Also of note in Q3, an investor purchased the Supercuts building at 726 State St, which sold for the first time since 1986.

Land is the only property type for which sales have outpaced the historical trend, producing 8 transactions valued at $36.3 million through Q3. Most substantial was the $12.3 million sale of 355 Coromar Dr in Goleta. (This property just sold again in October and will feature in our year-end report.)

Historical Perspective

As we near the end of 2023, it's helpful to keep historical perspective. 2021 and 2022 were record-breaking years for sales, which by comparison makes the current year seem even slower than it is. True, the 57 sales completed so far in 2023 is a major step down from the activity in 2021 and 2022, but it actually surpasses the number of sales at the same point in 2018, 2019 and 2020. Clearly, higher interest rates have had a marked impact on commercial sales this year, though mostly in the higher price tier. The Fed seems inclined to keep interest rates at or above the present level for some time, so unless sellers lower their price expectations, current market conditions are expected to continue well into 2024. This likely means challenging times ahead for many sellers and buyers at higher price points. However, for cash/exchange/private equity buyers not reliant on financing, this is an opportune moment. And it bears repeating that for property below $5 million, supply, demand and deal momentum appear stable.

OFFICE LEASING

Santa Barbara

Santa Barbara's office vacancy crept up to 11.7%, the highest rate on record after 18 office listings totaling 160,000 SF came to the market during Q3. This includes 81,000 SF of new vacancy vacated by Sonos in its impending move to Goleta. The Sonos spaces are primarily office in the current format but could be repurposed for other uses. They consist of 47,000 SF of office/R&D at 25 E Mason St in the Funk Zone, plus adjacent buildings totaling 34,000 SF of creative office at 600-614 Chapala St near Paseo Nuevo. Excluding the upper floors of the former Nordstrom and Macy's buildings, the vacancy rate is still high, but less daunting at 8.2%.

Sonos is relocating from downtown Santa Barbara to 301 Coromar Dr in Goleta, a 50,500 SF building vacated by Inogen.

Two significant subleases were signed in Q3: Umbra Lab subleased the 27,000 SF building at 419 State St from Invoca, and ATCO subleased the 7,700 SF space at 420 E Carrillo St vacated by Zoom. These deals dispelled the expectation that there might not be tenants to backfill these downtown tech office spaces. Another notable Q3 transaction was JP Morgan Chase's 5-year renewal of 14,700 SF at 1200 State St.

The average achieved rent year-to-date in Santa Barbara is $3.23 gross PSF, which represents a 7% bump compared to 2022. This indicates the high vacancy rate is not persuading landlords to lower rates.

Goleta

The summer months were action-packed with tech leases in Goleta, producing the city's biggest leasing year since 2019 and defying the assumption that creative office is a product on the brink of extinction. After more than 15 years in downtown Santa Barbara, Sonos found a new home in the 50,500 SF building at 301 Coromar Dr in Cabrillo Business Park, vacated by Inogen. The move allows Sonos to "right-size" while consolidating all of its local operations under one roof. This relocation by one of the South Coast's most prominent tenants is big news for both Santa Barbara and Goleta. Inogen did some right-sizing as well, moving from 301 Coromar Dr to 18,000 SF at 859 Ward Dr, former Curvature space.

In another major deal, an undisclosed tech tenant subleased the entire 36,000 SF building at 90 Castilian Dr from Appfolio with 8.5 years of remaining term. There were also two renewals: Seek Thermal exercised a 5-year option on 30,800 SF at 6300 Hollister Ave, and Impulse Advanced Communications renewed 10,700 SF at 6144 Calle Real. When the dust settled, 185,000 SF totaling $26 million in gross consideration had transacted from June through August. The activity helped bring the vacancy rate down from 10.7% at the end of Q1 to 8.2% at Q3. Achieved rents to date are up 9% compared to the 5-year average.

Carpinteria

The lull in Carpinteria leasing continued, with just one lease signed in the past six months: Reality Church's lease of 4,700 SF at 1180 Eugenia Pl in Q3. The total consideration for the year to date is under $1 million. No new spaces were added to the market during Q3, but the vacancy rate remains very high at 19.7%, owing mainly to sublease spaces offered by Procore and the former AGIA building at 1155 Eugenia Pl.

RETAIL LEASING

There haven't been any big-box leases on the South Coast so far this year, but the 71 retail transactions completed to date is the highest YTD Q3 total on record. Not surprisingly, combined vacancy has decreased and is below 3% for the first time in more than 5 years.

In Santa Barbara, there have been 13 retail and restaurant leases on the State Street corridor. Some of the recent examples include Cookie Plug going into the former Good Cup space at 918 State St, Nick the Greek headed for the former Natural Café space at 508 State St, and Mister Softee Ice Cream taking over the former Creamistry space at 935 State St. Just off State, Poke House will open its lucky 13th location at 811-D State St in the Pavilion, while Tyler Winery and Lieu Dit tasting rooms will soon be pouring at 23-25 E Canon Perdido St. Despite the strong deal flow, storefront vacancy on the 400 to 1300 blocks remains virtually unchanged at 14.5%, due to tenant turnover and additional spaces coming to market.

Elsewhere in Santa Barbara, Third Window Brewing is planning to expand its operations at The Mill after leasing 3,200 SF at 406 & 410 E Haley St. Validation Ale will launch its "Annex" next summer at 2840 De La Vina St. Town & Country Event Rentals leased 3,151 SF at 3905 State St just a few weeks after the property sold (mentioned in the commercial sales section). Turning toward Montecito, the team behind several L.A.-area restaurants will bring Jemma Montecito to The Post at 1801 E Cabrillo Blvd, having claimed 2,700 SF plus a 1,200 SF patio there.

In Goleta, most of the available space is in neighborhood centers east of the airport, primarily Calle Real Shopping Center, Fairview Center, and Patterson Center. There are just two small spaces listed west of the airport. The 24,000 SF former Bed Bath & Beyond space at Fairview Center is still the largest retail vacancy on the South Coast, though lease negotiations are reportedly in progress. Even including that space, the vacancy rate is low at 2.1%. There have been 17 deals signed to date, the highest count since 2015, though most occurred early in the year. The largest signing to date was 3,757 SF at 290 Storke Rd by San Luis Obispo Donut Company, aka SloDoCo.

In Carpinteria and Summerland, activity has slowed since several deals were signed in Q1 and Q2. One of the Q2 leases was Linden Hall (sibling restaurant to Santa Barbara's Revolver), which is expected to open soon at 890 Linden Ave. The lone Q3 lease was 3815 Santa Claus

The Jemma Montecito restaurant will be featured at The Post, an adaptive re-use retail project at 1801 E Cabrillo Blvd.

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Ln, signed by PacWest Blooms & Dirt Botanicals. There appears to be about 14,000 SF still available in the infill project at 700 Linden Ave. Otherwise, there is very little vacancy in Carpinteria.

INDUSTRIAL LEASING

After zero leases in the first quarter, Goleta's industrial market—similar to the office market—kicked into gear during Q2 and Q3, generating 15 transactions totaling 157,000 SF. In the largest Q3 deal, Karl Storz Imaging leased 35,300 SF at 149 & 151 Castilian Dr on a 10-year term. In addition, Soilmoisture Equipment leased 12,900 SF at 601 Pine Ave, while Bell-Everman leased 8,100 SF of former Herbl space at 759 Ward Dr. Average achieved rent, which stepped up 12% in 2022, has held steady so far in 2023 at $1.87 gross PSF. Vacancy remains relatively lean at 3.1%, but is slightly above the year-end rate with the addition of two former Herbl spaces totaling 44,000 SF at 749 and 839 Ward Dr.

Santa Barbara's industrial leasing has been dominated by activity at the Vercal Building at 1 N Calle Cesar Chavez, the site of 7 transactions to date totaling 97,000 SF. Six of these deals were renewals, most recently 11,800 SF by US Air Conditioning Distributors and 11,600 SF by Bella Vista Designs. Santa Barbara's gross leased area to date is 133,000 SF valued at $8.7 million, both of which are the highest totals since 2017. The largest available space is 17,200 SF in—you guessed it—the Vercal Building. The vacancy rate in Santa Barbara is quite low at 1.0%, and inventory is not sticking around for long: 6 of the 7 available spaces came to market within the past six months.

Carpinteria has only four spaces available, but all are sizable, and consequently the vacancy rate is relatively high at 5.8%. No leases have been signed in 2023.

So far in 2023, seven tenants have signed leases or renewals at 1 N Calle Cesar Chavez in Santa Barbara (The Vercal Building).

LEASING MARKET DATA

	Market	Vacancy Rate		Transactions		Gross Absorption (SF)		Achieved Rent (PSF GR)	
OFFICE	Santa Barbara	**11.69%**	+12%	**67**	-17%	**235,554**	-15%	**$3.23**	+7%
	Goleta	**8.22%**	-4%	**19**	-6%	**341,427**	+282%	**$2.19**	+7%
	Carpinteria	**19.74%**	+3%	**5**	+233%	**19,912**	+272%	**$2.29**	-7%
RETAIL	Santa Barbara	**3.19%**	-18%	**45**	-3%	**93,139**	-46%	**$3.95**	-4%
	Goleta	**2.12%**	-8%	**17**	+13%	**29,575**	-18%	**$3.26**	+4%
	Carpinteria	**3.01%**	+54%	**9**	+1100%	**11,673**	+681%	**$4.78**	+19%
INDUSTRIAL	SSanta Barbara	**1.04%**	+832%	**17**	+62%	**133,615**	+131%	**$1.88**	-13%
	Goleta	**3.08%**	+8%	**15**	+5%	**157,716**	-24%	**$1.87**	+2%
	Carpinteria	**3.36%**	+72%	**0**	-100%	**0**	-100%	**n/a**	

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

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BUSINESS
Santa Barbara News-Press
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