

Q1 2018

Quarterly Report

SOUTH COAST COMMERCIAL REAL ESTATE

COMMERCIAL SALES

	Q1'18	vs 2017*	vs Q1'17
Sales	13	- 42%	- 50%
Volume	\$58 M	- 60%	- 54%

* Annualized

Commercial sales slowed considerably in the first quarter of 2018, which is not surprising given the physical, economic, and psychological impact of the Thomas Fire and Montecito debris flow. Q1 produced 13 commercial sales valued at \$58 million, about half of the volume of the same quarter last year.

The lingering question is what effect the fire and debris flow will have on commercial property sales in Montecito. Fortunately, considering the scale of the disasters, physical damage to commercial property was relatively minor. However, economic damage was immense due to road closures, evacuations, and poor air quality. On the sales side, there weren't any Montecito properties brought to market in Q1, but one notable sale was completed: the 5,250 sf retail/office property at 1101 Coast Village Rd occupied by Compass Realty was bought by a 1031 Exchange investor for \$7.7 million.

There were two prominent sales of large retail properties in downtown Santa Barbara in Q1. The vacant 135,000 sf Macy's building at 701 State St was purchased by the owners of Paseo Nuevo mall for an estimated \$12 million. The sale did not include the land. The new owners will likely use the 135,000 sf building for entertainment-oriented retail and dining to complement the mall's new image as "destination retail." Three blocks up, the 46,813 sf Saks Off 5th building at 1001 State St was purchased by a local investor for \$18.5 million. Its future, beyond the scheduled departure of Saks in 2019, is also not yet known. The Marshalls building at 900 State St and the Urban Outfitters building at 624 State St are prominent downtown retail properties with national tenants that are trying to attract buyers.

California's legalization of cannabis is having a noticeable effect on real estate as urgent demand for agricultural and warehouse property is distorting prices in certain submarkets. The 14.7-acre growing facility at 3561 Foothill Rd was purchased by an owner-user for \$9.9 million, which represents a 150% increase over the sale price four years ago. While there are plenty of cannabis businesses ready to set up operations, the regulatory framework is still taking shape to determine which activities can take place where on the South Coast.

The normally quiet commercial property market in Summerland is ramping up. There are two properties in escrow, one for sale, and several more reportedly coming soon, including the Summerland Firehouse building at 2375 Lillie Ave.

Looking ahead, it is not clear yet whether the sharp loss in momentum during Q1 was entirely due to the disasters or if there may also be an underlying market deceleration at play. After seven full years of economic recovery and five-plus years of sustained commercial sales volume, a drop in activity is anticipated sooner than later. Supply remains consistent with the levels seen during the last five years. Although, only three of the 13 sales to date were off-market transactions, which is below the rate seen in recent years and could indicate a softening of demand.

OFFICE LEASING

	Santa Barbara	Goleta	Carpinteria	All
Vacancy:	5.7%	7.6%	6.5%	6.6%
Available Space:	- 2%	- 13%	+ 7%	- 7%
Transactions:	+ 0%	+ 3%	- 43%	- 1%
Achieved Rents:	- 9%	+ 3%	- 9%	- 6%
Gross Absorption:	- 19%	+ 13%	- 78%	- 7%

* Percent change since 12/31/17. Other change percentages are annualized against 2017.

The South Coast aggregate office vacancy rate of 6.6% is at its lowest level since 2008. The contraction has occurred in Goleta and to a lesser extent in Carpinteria. Tenant demand

for small and medium spaces is driving most of the activity and should keep transaction volume healthy in coming quarters. Finding tenants to fill larger spaces continues to be a challenge.

SANTA BARBARA

- Santa Barbara's office availability has expanded by 19% during the past year. The vacancy rate of 5.7% is near the high end of the historic range.
- The owners of 333 E Haley St successfully repositioned the industrial property as "creative" office. After a variety of improvements, the 6,000 sf building was leased by Honey, a software company, in Q1.
- Q1 leases of note: Green Hills Software leased 6,070 sf at 21 E Victoria St; Stradling, Yocca, Carlson, & Rauth renewed 6,614 sf at 800 Anacapa St; WFG National Title Insurance leased 2,695 sf at 126 E Carrillo St.

GOLETA

- Available space in Goleta decreased 35% in the past 12 months, ending Q1 with a rate of 7.6%, the lowest level in ten years.
- Leases totaling 60,464 sf were signed at 301 Mentor Dr in Goleta. The building has been vacant for approximately three years since the departure of Mentor Worldwide from the area.
- Gross absorption year to date is 29% higher than 2017 on an annualized basis and, surprisingly, none of the Q1 leases were renewals.
- 45% of the available square footage is in three buildings: 70 Castilian Dr (formerly FLIR), 175 Cremona Dr (formerly Karl Storz Imaging), and 6300 Hollister Ave (formerly Wyatt Technology).
- Q1 leases of note: An undisclosed tech company leased 46,058 sf at 301 Mentor Dr, and EmployBridge leased 14,406 sf in the same building; Surgical Eye Expeditions International leased 11,947 sf at 175 Cremona Dr.

CARPINTERIA

- Carpinteria's vacancy rate held steady around 6% in Q1. There was just one small lease at 5320 Carpinteria Ave, and the tenant is not an office use (yoga).
- Early in Q2, the remaining 10,395 sf at 1001 Mark Ave was leased, which has brought the vacancy rate back below 5%. The largest availability is the 19,063 sf former Lynda.com office/R&D building at 6398 Cindy Ln.

RETAIL LEASING

	Santa Barbara	Goleta	Carpinteria	All
Vacancy:	2.8%	2.1%	7.5%	2.8%
Available Space*:	-25%	-5%	+1%	-20%
Transactions:	-8%	+67%	-100%	+2%
Achieved Rents:	-12%	-21%	n/a	-26%
Gross Absorption:	-34%	+447%	-100%	+51%

* Percent change since 12/31/17. Other change percentages are annualized against 2017.

Available retail space across the South Coast decreased 24% during the past six months, due largely to the lease of the Sports Authority space at Camino Real Marketplace. Transactions are tracking right at the 2017 level and 10% below the prior 5-year average. The improving economy appears to be bolstering demand by local retailers.

- There are 23 retail spaces available on State Street from the waterfront to Sola Street. While high, the count is lower than six months ago. There were only two leases signed along this corridor in Q1.
- Goleta's Camino Real Marketplace has some new tenants. As mentioned above, HomeGoods leased the Sports Authority space, finally ending months of speculation over what tenant would take the only "big box" availability on the South Coast. Also, Carlos Luna (founder of Los Agaves) will launch Vicenta's Restaurant in the former Pascucci's space.
- The recent disasters forced several Montecito businesses to lay off staff and put a few on the brink of permanent closure. On a bright note, Frankland's Crab & Co. just

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opened at the Montecito Inn, a property inundated by the debris flow three months ago.

- Q1 leases of note: HomeGoods leased 30,147 sf in Goleta's Camino Real Marketplace; a cosmetics tenant leased 1,605 sf at 925 State St; Libertine Brewing leased 1,654 sf at 430 State St.

INDUSTRIAL LEASING

	Santa Barbara	Goleta	Carpinteria	All
Vacancy:	0.4%	4.1%	1.5%	2.1%
Available Space:	+ 46%	+ 26%	+ 0%	+ 25%
Transactions:	+ 11%	- 64%	- 11%	- 18%
Achieved Rents:	+ 41%	+ 1%	+ 7%	+ 8%
Gross Absorption:	- 81%	+ 29%	- 20%	- 11%

* Percent change since 12/31/17. Other change percentages are annualized against 2017.

The South Coast's industrial vacancy rate, while low at 2.1%, has more than doubled in the past year. There are

22 spaces available, up from 10 spaces a year ago. To date, the largest transactions – and 89% of the total square feet leased – have been renewals. Looking ahead, demand remains strong across a variety of use types, and vacancy is expected to contract in coming quarters.

- There were only two industrial leases in Goleta in Q1, and the vacancy rate has increased to 4.1%, the highest rate in nearly five years. A year ago there was one space available over 20,000 sf. Today there are five available, including two at the Channel Technologies property at 839-859 Ward Dr.
- In Santa Barbara, the last two quarters produced 15 industrial leases, the highest six-month count in five years. However, the Q1 leases were all for smaller spaces averaging just 1,470 sf.
- Q1 leases of note: Curvature renewed 57,600 sf at 80 Coromar Dr in Goleta; DSY Educational Corp renewed 13,509 sf at 525 Maple Ave in Carpinteria.

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