



2015 YEAR END MARKET REPORT

INVESTMENT MARKET



GARY GALLELLI

Partner, Managing Director

“The Sacramento investment market saw a great deal of activity during 2015, and regional investors are continuing to turn to our market as a more affordable and secure place to place their capital.”

- » **INVESTMENT OUTLOOK** 2015 was a great year for the Sacramento investment market and all property types saw increases in the number of transactions and total dollar volume.
- » Multifamily investments dominated local demand and we anticipate this trend will continue during 2016. Rents will continue to climb as long as demand continues to outpace supply and vacancy continues to decline.
- » Retail will also continue to be popular with investors as the lack of high-quality, Class A projects in the region have translated into more investment activity at Class B neighborhood and community centers. This trend will likely continue as there are currently very few speculative retail projects in the development pipeline.
- » Sacramento remains a more affordable alternative to the Bay Area, which continues to see skyrocketing prices and heavy competition for investment assets. 2016 will likely see even more out-of-town investor interest in the region, especially in submarkets like Downtown and Midtown, as the new arena nears completion and the surrounding new developments go vertical.
- » **RETAIL INVESTMENTS** Local retail investment activity was strong during 2015, with the retail marketplace seeing over \$787 million in total transactional volume.
- » This marks an increase of over \$139 million from 2014 transactional volume which is one of the largest amounts of transactional volume seen in the last five years.
- » The average price per square foot stood at \$145 at the end of 2015.
- » Average cap rates for retail product have been on the decline with 2015 seeing one of the lowest average cap rates at 6.51%.
- » Acquisitions of neighborhood, community and power centers by both private entities and institutional investors made up the bulk of retail investment sales during 2015.
- » The largest retail investment sale of the year was the sale of the Marketplace at Birdcage in Citrus Heights, which sold for \$76.3 million during July.

Investment Sales Volume – All Property Types

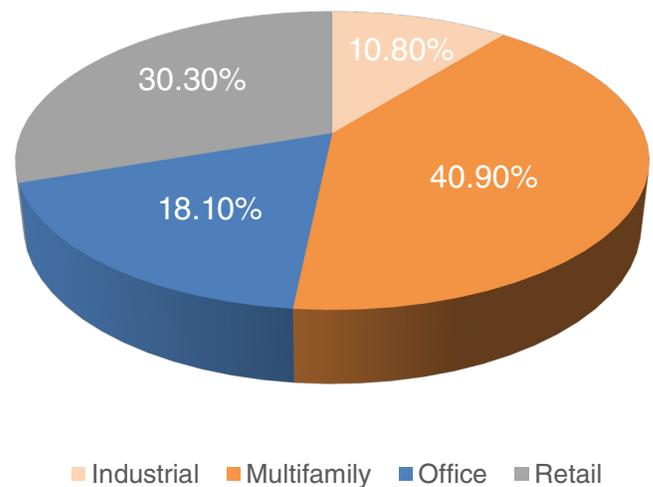


- » **APARTMENT INVESTMENTS** Investor demand for multifamily product in the Sacramento region has been huge in the last few years and 2015 continued this trend.
- » The multifamily market saw 239 transactions, valuing more than \$1.3 billion dollars, which is the largest amount of transactional volume the multifamily market has seen in the last 10 years.
- » The average price to per unit in 2015 increased to \$104,107 from \$98,892 in 2014. The average price per unit has seen an increase of 26.3% over the last five years.
- » Local employment growth, coupled with low single-family and multifamily inventory, has resulted in high occupancy and fast increasing rental rates, which has made the Sacramento region more competitive and attractive to investors looking for stronger yields than can currently be found in the Bay Area.
- » The largest multifamily sale of the year happened in July when the 612-unit Slate Creek at Johnson Ranch Apartments in Roseville sold for \$100 million.

- » **OFFICE INVESTMENTS** Local office investments were strong in 2015.
- » The Sacramento market saw 106 transactions, totaling just over \$580 million in total dollar volume, which is increased over the \$505 million recorded during 2014.
- » This is the most transactional volume the office market has seen in the last five years.
- » The average price per square foot also increased during the year, rising to \$151 per square foot.
- » The average asking cap rate currently stands at 7.0%, which is the lowest average cap rate in the last five years.
- » The office market is seeing a lot of activity coming from out-of-town investors, seeking a more affordable and stable alternative to the skyrocketing prices and limited inventory of the Bay Area.
- » The Downtown submarket in particular, was a big hit with investors this year as the construction of the new Downtown arena has stimulated investment activity in the blocks surrounding the new home of the Sacramento Kings.

- » **INDUSTRIAL INVESTMENTS** Investment activity in the Sacramento industrial market increased during 2015.
- » The industrial market saw \$211 million in total transactional volume, which is one of the highest amounts of post-recession transactional volume the industrial market has seen.
- » This marks an increase of just over \$129 million over the \$89 million of transactional volume recorded during 2014.
- » The average price per square foot increased from \$47 during 2014 to \$70 during 2015.
- » The number of total industrial investment transactions has steadily increased over the last five years as market conditions continue to improve.
- » Institutional investors have been primarily active in the industrial market with distribution and warehouse product being their investment of choice.

2015 Total Investment Sales by Property Type - 585 Total



RETAIL MARKET



JASON GALLELLI

Partner, Senior Vice President

“The Sacramento retail landscape continues to thrive and become more dynamic. New and creative retail concepts that have been popular in larger metropolitan areas are beginning to make an appearance in our marketplace.”

Retail vacancy falls to lowest level in seven years.

- » **TRENDS** The Sacramento retail market has shown significant improvement over the last few years and 2015 continued this trend.
- » Regional retail vacancy fell from 11.0% during Q1 to 10.3% during Q4, which is the lowest vacancy rate the retail market has seen in seven years.
- » Regional vacancy is now edging closer to pre-recession levels and we anticipate that it should fall under 10% by mid-2016.
- » Although net absorption levels for 2015 were not as high as those seen in 2013 and 2014, the retail market still experienced notable growth during the year, recording 723,000 SF of positive net absorption.
- » **TENANT TRENDS** 2015 was a year of expansion for many existing tenants in the region.
- » Health and fitness tenants were primarily active with companies like Crunch Fitness and Fitness Evolution signing leases and opening new locations within the region.
- » Discount retailers and grocery tenants also continue to be very active – 99 Cents Only, Dollar Tree, Ross Dress for Less, Smart & Final and Walmart Neighborhood Market all signed leases or opened new locations during the year.
- » Tenants new to the region include Bass Pro Shops, Dunkin’ Donuts and Twin Peaks.

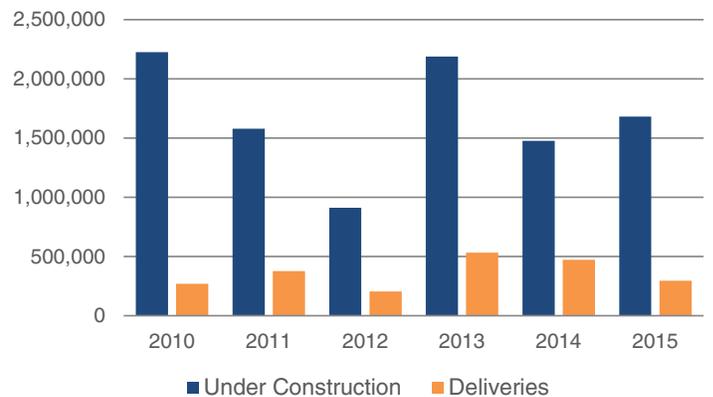
Retail Vacancy vs. Net Absorption





- » **RETAIL OUTLOOK** Though 2015 saw a slight slowdown in overall market growth, retail demand and leasing activity were still very strong, and we expect this will continue heading into 2016.
- » Retail vacancy will continue to decline with rates falling into the 9% range by mid-year.
- » With vacancy rates nearing pre-recession levels, it is likely rental rate growth is not much further away.
- » The main challenge heading into 2016 will be whether or not the region can deliver enough new space to satisfy current demand levels.
- » Retail demand has been primarily focused on high-quality, Class A centers for quite some time. However, as the majority of available space in the region is concentrated in older, Class B and C centers, Sacramento has little in the way to accommodate retailers seeking Class A space.
- » While there is currently 336,000 square feet of new retail currently under construction, some of which may help fulfill demand, the majority of this space consists of expansions at existing centers that either already have tenant commitments in place, or will lease up soon after completion.
- » The question will be whether retailers will hold out for newer space or if demand will start to carry over into the older, Class B and C shopping centers.

SF Under Construction vs. Deliveries



Retail Investment Sales Volume



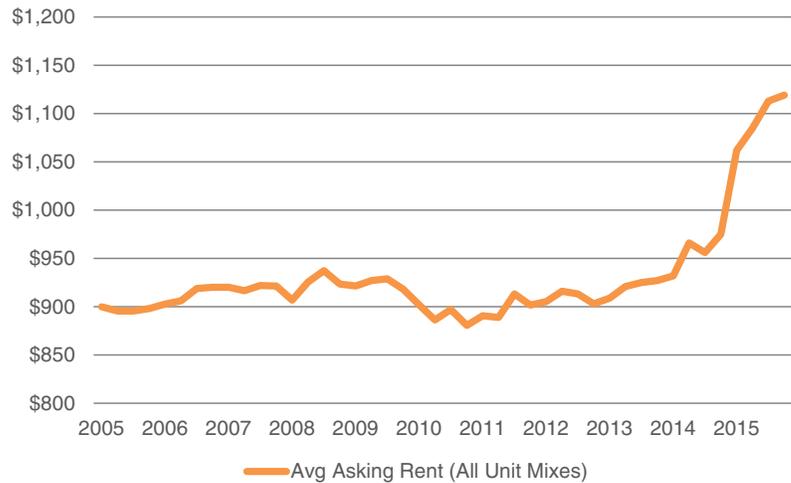
APARTMENT MARKET



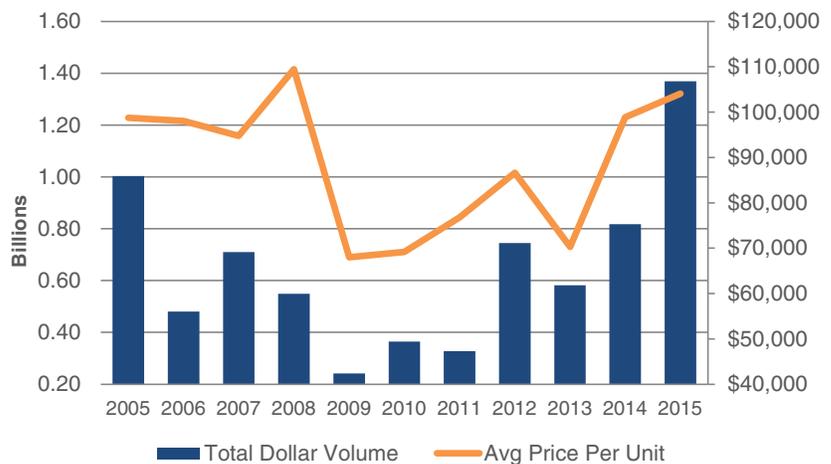
The Sacramento multifamily market remains red-hot heading into 2016

- » **TRENDS** 2015 was an impressive year for the Sacramento regional multifamily market which continued the trend of falling vacancy and rising rental rates that have been in place for the last few years.
- » Regional apartment vacancy fell from 2.4% during Q1 to 1.6% during Q4, which is one of the lowest post-recession vacancy rates the area has seen.
- » Overall apartment vacancy has declined nearly 3% over the last year – during 2014, apartment vacancy consistently hovered within the 4% range.
- » High occupancy rates and little available inventory continues to put upward pressure on overall rental rates – the average overall rent for apartment units in the Sacramento region currently stands at \$1,119 per unit, per month.
- » Rents are rising fast throughout the region, and during 2015, Sacramento has ranked in the top 10 of multiple national lists for cities with the fastest rental rate growth.

Historical Average Rental Rate Growth



Multifamily Investment Sales Volume



- » **INVENTORY** With local housing prices on the rise and single-family home inventory becoming scarce, regional apartment demand is reaching all-time highs.
- » In other MSAs around the country, apartment demand and rental rate growth is being primarily driven by strong job growth.
- » The Sacramento region saw strong job growth during 2015, with unemployment falling to 5.5%. Between December 2014 and December 2015, the number of jobs in the region increased by 2.5%. 2015 also saw the Sacramento region officially recover all the jobs lost during the recession.
- » Though local job growth has been strong, local demand is being primarily driven by a lack of available inventory.
- » While there has been an increase in construction projects around the region, there hasn't been as many new multifamily projects under construction as there have been in previous years.
- » The number of units the region is delivering per year has also declined, with 2014 and 2015 seeing only 1,300 new units added to the inventory, which is not even half the number of units delivered during the same period ten years ago.
- » The projects currently under construction will only add a total of 1,400 units to the overall inventory, which is not nearly enough to help alleviate demand.

- » **APARTMENT OUTLOOK** The Sacramento apartment market has been on fire for the last few years, and it is showing no signs of slowing down any time soon.
- » As long as occupancy remains high and inventory low, rents will continue to climb, especially in highly sought after areas like Downtown/Midtown, Roseville/Rocklin and Folsom.
- » The question heading into 2016 will be whether or not multifamily construction will remain flat or if we will start to see it ramp up in light of current market conditions.
- » Developers have been slightly reluctant to build new multifamily projects in recent years, primarily due to the long, drawn-out process of entitlements, financing and construction, which can sometimes take years, even in the best of markets.
- » However, with such high occupancy, increasing rental rates and little available inventory, the benefits of new construction may start to outweigh the risks for developers.



ROD BALLINGER
Senior Vice President

“2015 was a great year for apartments in the Sacramento region. Occupancy remains high, rental rates continue to climb, and momentum doesn't seem to be slowing down any time soon. As long as Sacramento continues to be more affordable than the Bay Area and interest rates remain low, investor interest will remain high in 2016.”

OFFICE MARKET

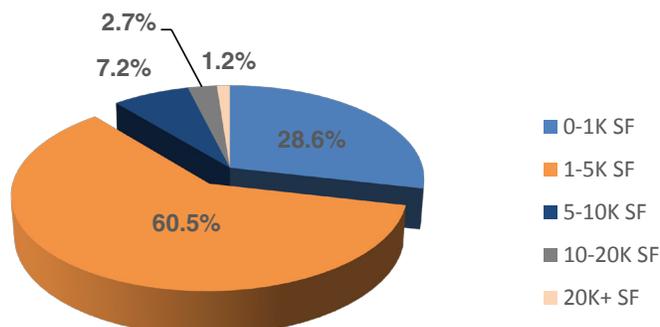


- » **VACANCY & ABSORPTION** The Sacramento office market has been steadily improving over the last couple years and 2015 saw its best performance yet.
- » Regional vacancy continued to tighten, falling from 16.8% during Q1 to 15.6% during Q4 (the lowest vacancy rate the office market has seen in seven years).
- » The market absorbed just over 1 million square feet of space during the year, which is a significant increase over the nearly 700,000 square feet that was recorded in 2014.
- » More than half of the 1 million square feet was absorbed during the 4th quarter.

- » **TRENDS** The healthcare industry has been a huge driver of demand in the local office market for the last couple of years and 2015 continued this trend.
- » Dignity Health, UC Davis Medical and Blue Shield of California all either signed leases or took occupancy of space during 2015.
- » The legal, financial and technology sectors were also very active during 2015.
- » Tenants new to the region include California Northstate College and engineering firm Dragados.
- » 89% of the total leasing volume during the year stemmed from small to mid-sized users under 10K SF.

The Sacramento office market saw its best post-recession year in 2015.

2015 Office Leasing Volume by SF

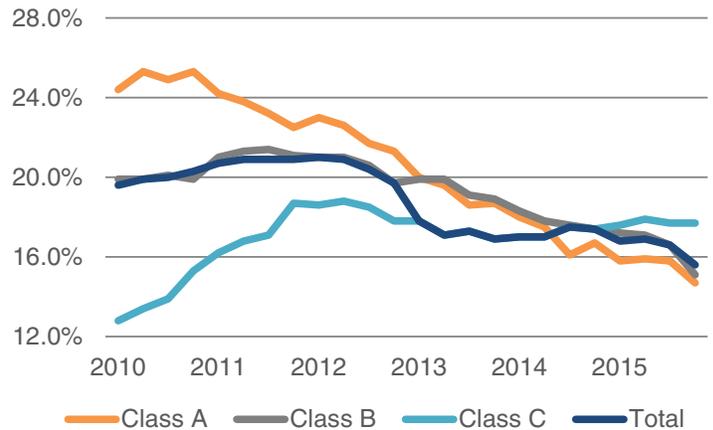


- » **CONSTRUCTION** Though market fundamentals continue to improve, we have yet to see the return of speculative construction to the office market.
- » 661,000 SF of office space has been delivered to the market in the past 5 years.
- » Nearly all of these projects were build-to-suit construction, primarily for government entities.
- » Though we continue to see strong leasing activity and high demand, current market fundamentals do not justify new speculative projects
- » Vacancy remains too high and rental rates are too low to allow for speculative construction. Until vacancy declines further and rental rates increase, it is unlikely that any new speculative office construction will commence.

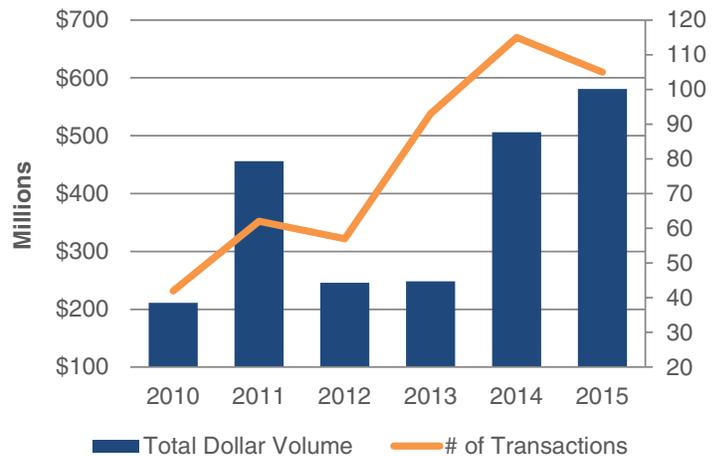
- » **EMPLOYMENT** Local job growth was strong during 2015.
- » The unemployment rate for the Sacramento MSA fell to 5.5% by the end of the year.
- » Local unemployment peaked at 13.1% at the beginning of 2010 and has fallen over 7% in the last five years.
- » The number of jobs also increased during the year – between December 2014 and December 2015, the region added 22,900 jobs, an increase of 2.5% over the last year.

- » **OUTLOOK** 2015 was a year of continued growth for the Sacramento regional office market and, barring any unforeseen circumstances, we expect this growth will continue in 2016.
- » Vacancy continues to tighten and though vacancy rates are not quite back to pre-recession levels, they are on the right track.
- » Regional office demand and leasing activity is still very strong and we anticipate that this trend will continue heading into 2016, as we still have yet to see any notable movement in rental rates.
- » We have seen slight rental rate growth at the submarket and class levels, but this has yet to affect the overall rate, which has wavered between \$1.50 and \$1.65 per square foot for the last two years.
- » The good news for landlords is that rental rate growth is not far off – as long as vacancy continues on a downward trajectory, we should start to see movement in rates in the next 12 to 18 months.

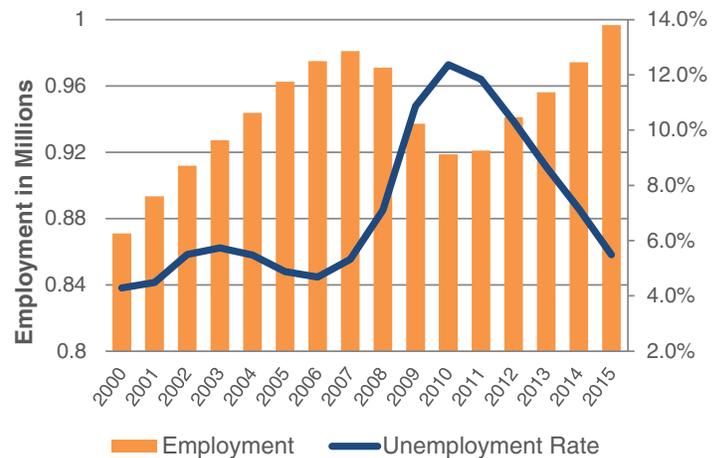
Historical Office Vacancy by Class



Office Investment Volume



Historical Job Growth & Unemployment



INDUSTRIAL MARKET

The Sacramento industrial market experienced continued growth during 2015, as vacancy edged closer to pre-recession levels than ever before.

- » **TRENDS** Despite a slight slowdown in market momentum, the Sacramento regional industrial market saw continued improvement throughout 2015.
- » 2015 saw regional vacancy levels fluctuate within the 13% range throughout the year before increasing slightly to 14% at year-end. Vacancy levels throughout 2015 were closer to pre-recession levels than ever before.
- » The fluctuation in the vacancy rate was caused by a few large move outs in the Davis/Woodland and West Sacramento submarkets during the year. However, as industrial demand is very strong, it's unlikely that these blocks will sit vacant for very long.
- » The industrial market absorbed 1.4 million square feet of space throughout 2015, which is the second highest amount of post-recession net absorption the industrial market has seen.
- » **NEW CONSTRUCTION** 2015 saw the first speculative industrial projects in several years come to completion.
- » With the exception of a speculative warehouse building on Raley Boulevard in the McClellan submarket, the majority of these projects were built in the Southport area of West Sacramento and started construction during the latter half of 2014.
- » One of these projects – 3600 Massie Court – has already been fully leased by Nor Cal Beverage, which vacated various spaces in West Sacramento to consolidate operations to one location.
- » Though the rest of these speculative projects currently have space available, they will likely get leased up in the coming months, primarily due to the lack of large blocks of industrial space in the Sacramento region.
- » 2015 also saw the lifting of the Natomas building moratorium, which had been in place since 2008. The lifting of the moratorium opened up new opportunities for future commercial and industrial development in the Natomas submarket.

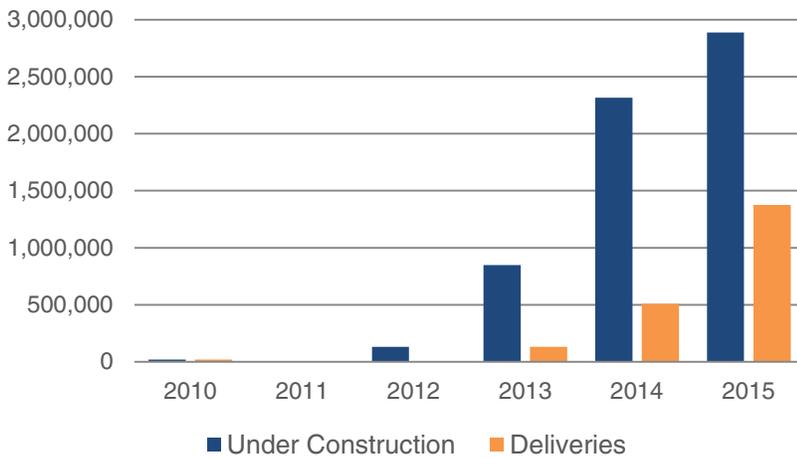
Industrial Vacancy vs. Net Absorption



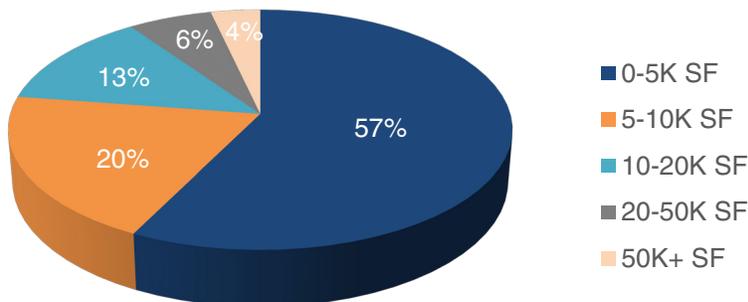
- » **INDUSTRIAL OUTLOOK** The Sacramento industrial market has seen continued growth and improvement over the last few years, and though the pace of growth has slowed slightly, we anticipate that this trend will continue heading into 2016.
- » Vacancy rates will to tighten.
- » Regional industrial demand remains strong, but the challenge in the coming months will be whether or not the Sacramento region has enough space to keep up with demand.
- » Though nationally, industrial demand has trended towards large blocks of distribution and manufacturing space, local demand is primarily being driven by smaller to mid-sized industrial users, as the Sacramento has little in the way to accommodate these larger requirements.
- » The newly completed speculative projects will definitely help, but it is likely these spaces will get leased up quickly, and developers are waiting to see this happen before they commit to any more speculative projects that will add additional space to the overall inventory.



SF Under Construction vs. Deliveries



2015 Industrial Leasing Volume by SF



TOP RETAIL DEALS

SALE						
Building Name	Address	Buyer	Seller	SF	Sale Price	Submarket
Marketplace at Birdcage	Sunrise Blvd	Gerrity Atlantic Retail Partners	LaSalle Investment Management	322,905	\$76,300,000	Carmichael/Citrus Heights/Orangevale
Country Club Centre	3308-3460 El Camino Ave	Tourmaline Capital	Buzz Oates	488,682	\$55,500,000	Arden/Watt/Howe
Marketplace 99	9117-9184 E Stockton Blvd	NewMark Merrill Companies	Donahue Schriber	211,097	\$42,500,100	Elk Grove
Auburn Village	2120-2460 Grass Valley Highway	Epic Real Estate Partners, LLC	First Washington Realty	133,950	\$31,300,000	Auburn/Lincoln/Loomis
Rancho Cordova Town Center	10801-10937 Olson Dr	Inland Private Capital Corporation	Pacific Castle, Inc.	152,454	\$29,750,000	Highway 50

LEASE						
Building Name	Address	Tenant	Owner	SF Leased	Date	Submarket
Florin Square Shopping Center	2326 Florin Rd	Fitness Evolution	Ethan Conrad Properties	39,917	10/1/2015	South Sacramento
Capital Nursery Plaza	7945 Madison Ave	Smart & Final	Capital Nursery Land Investors	28,243	10/1/2015	Carmichael/Citrus Heights/Orangevale
8787 Elk Grove Blvd	8787 Elk Grove Blvd	Smart & Final	Wong Family Investors	27,060	4/1/2015	Elk Grove
6124 San Juan Ave	6124 San Juan Ave	99 Cents Only Store	Red Mountain Retail Group	25,851	5/1/2015	Carmichael/Citrus Heights/Orangevale
Walmart Central	1002-1014 Riley St	99 Cents Only Store	Hill Companies, LLC	23,560	5/1/2015	Folsom

TOP INDUSTRIAL DEALS

SALE						
Building Name	Address	Buyer	Seller	SF	Sale Price	Submarket
Southport Business Park	3030 Mulvaney Pl	Bixby Land Company	Ridge Capital	250,000	\$24,750,000	West Sacramento
Silverbrook Business Park	625 Coolidge Dr	Mima Capital	Wendy M. Cramer	103,943	\$13,910,000	Folsom/El Dorado Hills
1100 Tinker Road	1100 Tinker Rd	Westcore Properties	1100 Tinker Rd, LLC	200,000	\$11,215,000	Roseville/Rocklin
North Market Business Center	1326-1340 N Market Blvd	MKD North Tech LLC	Pinnacle Property Management	86,510	\$6,100,000	Northgate/Natomas
4291 Pell Drive	4291 Pell Dr	All Real Property, Inc.	Sylvia Chen	108,120	\$5,900,000	Northgate/Natomas

LEASE						
Building Name	Address	Tenant	Owner	SF Leased	Date	Submarket
Capital Commerce Center	6200 Franklin Blvd	Macy's	Hackman Capital Partners	385,077	1/1/2015	South Sacramento
3500 Cincinnati Ave	3500 Cincinnati Ave	IndoorRV.com	Coastal Partners, LLC	180,000	4/1/2015	Roseville/Rocklin
Lincoln Air Center	3130 Venture Dr	The Rogers Family Company	Buzz Oates	156,750	3/1/2015	Roseville/Rocklin
819-849 N 10th St	819-849 N 10th St	River City Boat & RV Storage	10th North Industrial LP	113,000	11/1/2015	Richards
9971-9975 Horn Rd	9971-9975 Horn Rd	Daltile	Crankbrook Group, Inc.	72,000	2/1/2015	Mather

TOP OFFICE DEALS

SALE						
Building Name	Address	Buyer	Seller	SF	Sale Price	Submarket
Farmer's Market Complex	1820 Alhambra Blvd, 1727 30th St, 1801 30th St	Pappas Investments	Americus Real Estate	388,152	\$72,581,000	Midtown/East Sacramento
Parkway Corporate Plaza	1620-1680 E Roseville Pkwy	Broe Real Estate Group	Grubb & Ellis Realty Investors, LLC	287,224	\$46,550,000	Roseville/Rocklin
North Pointe Corporate Centre	4330 Watt Ave	Boyd Watterson Asset Management	Amstar	136,858	\$32,900,000	Northeast Sacramento
Senator Office Building	1121-1123 L Street	Swift Real Estate Partners	Starwood Property Trust	159,637	\$31,762,500	Downtown/Midtown
Folsom Corporate Center	2365 Iron Point Road	Swift Real Estate Partners	UBS Realty Investors, LLC	148,534	\$28,100,000	El Dorado Hills/Folsom

LEASE						
Building Name	Address	Tenant	Owner	SF Leased	Date	Submarket
Zinfandel I	3300 Zinfandel Dr	Blue Shield of California	Farallon Capital Management	128,075	10/1/2015	Highway 50
Gateway Corporate Center	160 Promenade Cir	State of CA Board of Equalization	KBS Realty Advisors	66,593	2/1/2015	Northgate/Natomas
University Office Park	7667 Folsom Blvd	California Northstate College	University Enterprises	60,500	10/1/2015	Highway 50
Prospect West Business Park	10901 Gold Center Dr	Dignity Health	B & Z Properties	50,928	10/1/2015	Highway 50
Zinfandel II	10834 International Dr	Blue Shield of California	Farallon Capital Management	46,384	10/1/2015	Highway 50

TOP APARTMENT DEALS

SALE							
Building Name	Address	Buyer	Seller	# of Units	Sale Date	Sale Price	Submarket
Slate Creek at Johnson Ranch	1751 E Roseville Pkwy	Kennedy Wilson Properties	DiNapoli Capital Partners	612	7/29/2015	\$100,000,000	Roseville/Rocklin
The Preserve at Creekside	1299 Antelope Creek Dr	Oakmont Properties	TA Realty	336	12/22/2015	\$65,000,000	Roseville/Rocklin
The Element	6730 4th Ave	Vermilion Development	Horizon Realty Advisors	288	12/31/2015	\$59,000,000	Tahoe Park
800 J Lofts	800 J St	The Wolff Company II, LLC	CIM Group, LP	225	3/3/2015	\$57,400,000	Downtown
Tanglewood Condominium Rentals	1880 Cowell Blvd	Thomas Tomanek	Sequoia Equities	216	6/26/2015	\$54,000,000	Davis



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ABOUT GALLELLI REAL ESTATE

Gallelli Real Estate is a boutique, full-service commercial real estate company. We provide comprehensive and integrated services and specialize in all aspects of commercial real estate including brokerage, property management, consulting, ground-up development and land entitlement. From our family roots to the combined 80 years of industry experience of our principals, our history reveals the respect and passion we have towards commercial real estate and the dedication to providing service and long lasting relationships. We believe that as a boutique firm whose understanding of the business runs as deep as our core values, our advantage is large. Located in Northern California, Gallelli Real Estate has completed numerous transactions throughout the western United States. We take pride in our unique approach to the industry and aim to offer more individual solutions that address the ever changing needs of our clients.

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