



# Office Report

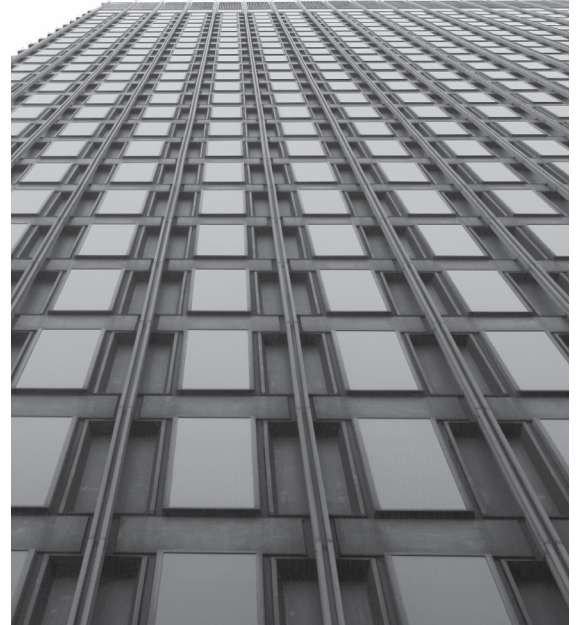
Q1 2016  
GALLELLI REAL ESTATE MARKET REPORT

## Overview

Office market momentum slowed during the beginning of 2016, as Sacramento regional office vacancy stood at 16.1% at the end of Q1, reflecting an increase over the 15.6% rate recorded three months prior. Net absorption was negative to the tune of 302,000 square feet, a large decline over the 715,000 square feet of positive growth that was recorded during Q4 2015. The negative absorption and fluctuation in vacancy this quarter was caused by a few large move-outs in the Highway 50 Corridor and El Dorado Hills/Folsom submarkets. The Highway 50 submarket saw the closure and vacancy of Bank of America's 187,000-square foot back office, while Dignity Health vacated 50,000 square feet. The El Dorado Hills/Folsom submarket saw Blue Shield of California move out of 71,000 square feet in El Dorado Hills. Overall, the Highway 50 Corridor submarket was responsible for over 250,000 square feet of the negative absorption recorded this quarter.

## Market Trends

- Regional year-over-year vacancy for office decreased to 16.1% during Q1 2016 – one year ago this metric stood at 17.0%. However, we saw a quarterly increase in vacancy from 15.6% at year-end 2015 to 16.1% this quarter.
- Absorption was mostly negative across the local submarkets, with Highway 50, South Sacramento and Yolo County experiencing the highest occupancy losses. Positive net absorption was



minimal during the quarter, with the Northeast Sacramento submarket seeing the most absorption at 25,000 SF.

- The current average asking rate for office space increased to \$1.65 per square foot during Q1, which is the highest average asking rate the region has seen since Q2 2011. One year ago, the average asking rate stood at \$1.60 per square foot.
- Class A office space is currently commanding \$2.09 per square foot; Class B has an average asking rate of \$1.65; and Class C is currently asking \$1.35 per square foot on average.
- Office leasing activity declined from the previous quarter. Q1 2016 saw 905,000 SF of deals inked compared to 1.7 million SF in Q4 2015.
- The healthcare, financial and legal sectors continue to be very active within the region.
- Large blocks of quality, Class A office space are becoming scarce within the region, especially within the Downtown CBD market. Class A availabilities of 50,000 SF or greater are currently limited to just six buildings around the region, with only one of these located in the Downtown submarket.

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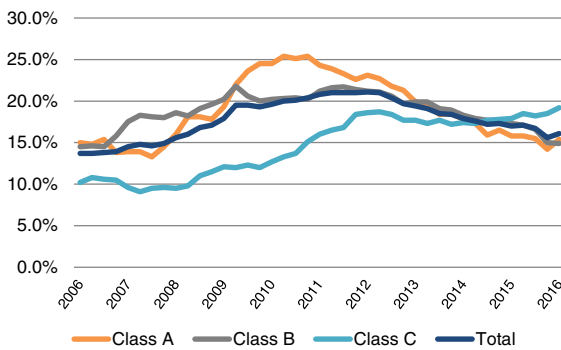
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# Office Q1 2016

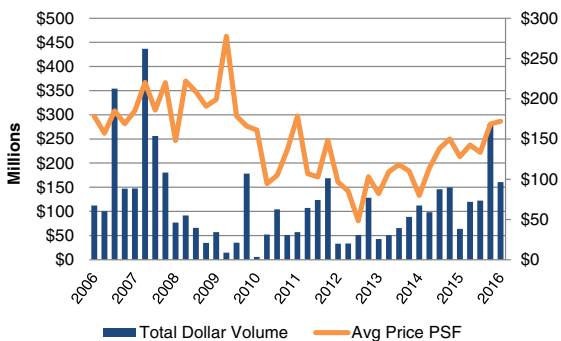
The Downtown submarket continues to be popular with investors...

<p>Vacancy</p> <p><b>16.1%</b></p> <p>▲</p>	<p>Net Absorption</p> <p><b>302,457</b></p> <p>▼</p>	<p>Avg. Asking Rate</p> <p><b>\$1.65</b> PSF</p> <p>▲</p>
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Historical Office Vacancy by Class



Office Investment Volume

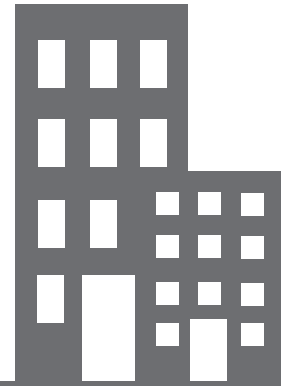


## Investment Highlights

- Local office investments have been strong, with 2015 seeing a record year in transactional volume. This trend continued into Q1 2016, with the Sacramento market seeing 42 transactions totaling \$160.6 million in total dollar volume. This is the second highest amount of quarterly transactional volume seen since 2011 – the highest amount being the \$280 million recorded during Q4 2015.
- The average price per square foot increased to \$172, which is the highest average price per square foot the market has seen since 2011.
- The average asking CAP rate fell to 6.84%; average asking CAP rates have fluctuated within the 6% to 7% range for the last eight consecutive quarters.
- The Downtown submarket continues to be popular with investors – the largest sale of the quarter was the sale of Renaissance Tower at 801 K Street for \$80 million.

## Spotlight: Rental Rates

Though regional office vacancy has been trending downward since peaking at 21.1% at the beginning of 2012, the market has not seen any movement in rental rates – until now. After four years of non-existent rent growth, the average asking rent has increased 3.1% over the last year and, at \$1.65 per square foot, is currently the highest average asking



Construction

0<sub>SF</sub>  
-

Sacramento Unemployment

5.4%  
▼

US Unemployment

5.0%  
▲

rent the region has seen since Q2 2011. Increasing occupancy levels across the submarkets and high demand has begun to shift the market in favor of landlords, who have responded by increasing rents for quality space, particularly in the Central Business District. Class A rents have increased across the board, and the Downtown submarket in particular has seen Class A rents rise 7.2% over the last year. As long as leasing activity and demand remain strong, and market fundamentals continue to improve, expect to see rent growth gain some momentum heading into the rest of the year.

### Outlook

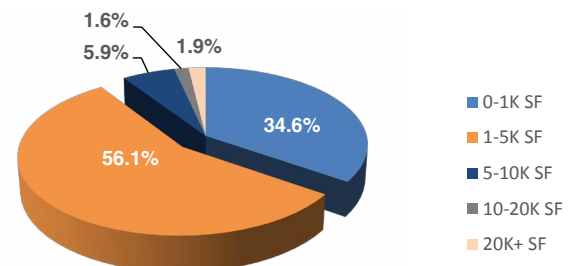
Though Q1 2016 got off to a slow start, office leasing activity and demand are still going strong, and we anticipate that market momentum will pick up going into the rest of 2016. Though there were a few large move-outs during the quarter, we expect these spaces will likely get leased-up quickly, primarily due to the lack of availability of Class A and Class B spaces over 50,000 square feet. Office leasing requirements are on the rise and the market saw 905,000 square feet of leases signed during Q1, which should help drive vacancy back into the 15% range once these tenants occupy. Investor interest in the region continues to be strong, as many regional and out of town investors look to Sacramento as a more affordable and secure area to put their capital. The market is also starting to see movement

in rental rates, particularly for quality, Class A space. The dwindling availability of large blocks of contiguous office space will likely put even more upward pressure on Class A rents, as competition for these quality spaces increases.

### Research

Our team focuses on providing high quality, data driven, accurate market information to our clients. We provide in-depth commercial real estate market analysis and insight into market trends in order to help optimize our clients' real estate decisions.

Q1-2016 Office Leasing Volume by SF





# Office Q12016

Submarket	Inventory	Direct	Available Space Sublease	Total	Vacancy Q1-16	Net Absorption		Avg. Asking Rate (NNN)
						Q1-16	Q1-15	
<b>Arden/Arcade</b>								
Class A	1,088,930	247,880	0	247,880	22.8%	25,739	4,319	\$1.89
Class B	3,171,822	664,027	4,061	668,088	21.1%	(15,325)	5,353	\$1.64
Class C	1,706,881	426,493	1,662	428,155	25.1%	(1,707)	4,735	\$1.38
<b>Total</b>	<b>5,967,633</b>	<b>1,338,400</b>	<b>5,723</b>	<b>1,344,123</b>	<b>22.5%</b>	<b>8,707</b>	<b>14,407</b>	<b>\$1.64</b>
<b>Auburn/Lincoln</b>								
Class A	-	-	-	-	-	-	-	-
Class B	421,212	66,627	0	66,627	15.8%	(1,388)	1,371	\$1.31
Class C	528,223	47,429	0	47,429	9.0%	1,063	(1,848)	\$1.08
<b>Total</b>	<b>949,435</b>	<b>114,056</b>	<b>0</b>	<b>114,056</b>	<b>12.0%</b>	<b>(325)</b>	<b>(477)</b>	<b>\$1.20</b>
<b>Downtown Sacramento</b>								
Class A	5,756,906	855,492	21,151	876,643	15.2%	30,026	16,587	\$2.75
Class B	4,603,332	675,913	10,955	686,868	14.9%	(-27,282)	13,298	\$2.02
Class C	2,939,426	408,119	0	408,119	13.9%	9,439	(-18,890)	\$1.51
<b>Total</b>	<b>13,299,664</b>	<b>1,939,524</b>	<b>32,106</b>	<b>1,971,630</b>	<b>14.8%</b>	<b>12,183</b>	<b>10,995</b>	<b>\$2.09</b>
<b>El Dorado Hills/Folsom</b>								
Class A	1,217,427	310,285	15,682	325,967	26.8%	(66,248)	790	\$1.95
Class B	2,759,381	505,340	17,850	523,190	19.0%	54,600	(5,061)	\$1.66
Class C	753,926	89,579	0	89,579	11.9%	(804)	2,130	\$1.34
<b>Total</b>	<b>4,730,734</b>	<b>905,204</b>	<b>33,532</b>	<b>938,736</b>	<b>19.8%</b>	<b>(12,452)</b>	<b>(2,141)</b>	<b>\$1.65</b>
<b>Highway 50/Rancho Cordova</b>								
Class A	3,900,604	627,264	5,775	633,039	16.2%	(185,613)	15,225	\$1.79
Class B	6,955,053	1,079,180	49,507	1,128,687	16.2%	(11,706)	(5,032)	\$1.54
Class C	2,219,945	555,920	50,000	605,920	27.3%	(53,356)	8,183	\$1.19
<b>Total</b>	<b>13,075,602</b>	<b>2,262,364</b>	<b>105,282</b>	<b>2,367,646</b>	<b>18.1%</b>	<b>(250,675)</b>	<b>18,376</b>	<b>\$1.51</b>
<b>Midtown/East Sacramento</b>								
Class A	323,701	5,746	0	5,746	1.8%	(4,134)	2,186	\$2.75
Class B	2,937,594	143,494	0	143,494	4.9%	(2,357)	(5,099)	\$2.15
Class C	1,251,964	264,164	0	264,164	21.1%	(12,644)	1,770	\$1.74
<b>Total</b>	<b>4,513,259</b>	<b>413,404</b>	<b>0</b>	<b>413,404</b>	<b>9.2%</b>	<b>(19,135)</b>	<b>(1,143)</b>	<b>\$2.21</b>
<b>Northgate/Natomas</b>								
Class A	3,550,477	562,599	12,920	575,519	16.2%	(1,033)	39,107	\$1.97
Class B	2,072,616	310,713	10,425	321,138	15.5%	7,373	50,702	\$1.53
Class C	474,303	170,092	0	170,092	35.9%	(1,094)	0	\$1.17
<b>Total</b>	<b>6,097,396</b>	<b>1,043,404</b>	<b>23,345</b>	<b>1,066,749</b>	<b>17.5%</b>	<b>5,246</b>	<b>89,809</b>	<b>\$1.56</b>
<b>Northeast Sacramento</b>								
Class A	79,163	0	0	0	0.0%	0	0	-
Class B	1,728,280	267,146	0	267,146	15.5%	18,427	3,483	\$1.35
Class C	2,972,158	594,423	0	594,423	20.0%	6,639	(2,455)	\$1.24
<b>Total</b>	<b>4,779,601</b>	<b>861,569</b>	<b>0</b>	<b>861,569</b>	<b>18.0%</b>	<b>25,066</b>	<b>1,028</b>	<b>\$1.30</b>
<b>Roseville/Rocklin</b>								
Class A	3,211,564	347,989	8,702	356,691	11.1%	(6,240)	65,131	\$1.94
Class B	4,338,641	666,140	0	666,140	15.4%	19,074	(1,395)	\$1.64
Class C	1,327,717	234,728	0	234,728	17.7%	4,974	1,054	\$1.32
<b>Total</b>	<b>8,877,922</b>	<b>1,248,857</b>	<b>8,702</b>	<b>1,257,559</b>	<b>14.2%</b>	<b>17,808</b>	<b>64,790</b>	<b>\$1.63</b>
<b>South Sacramento</b>								
Class A	358,282	4,304	0	4,304	1.2%	0	0	\$2.17
Class B	1,852,060	254,807	0	254,807	13.8%	2,851	13,404	\$1.69
Class C	1,576,973	241,384	0	241,384	9.0%	(58,056)	2,600	\$1.38
<b>Total</b>	<b>3,787,315</b>	<b>500,495</b>	<b>0</b>	<b>500,495</b>	<b>13.2%</b>	<b>(55,205)</b>	<b>16,004</b>	<b>\$1.75</b>
<b>Yolo County</b>								
Class A	522,792	39,742	11,323	51,065	15.2%	(29,793)	0	\$1.81
Class B	1,633,966	102,045	0	102,045	14.9%	9,659	6,307	\$1.61
Class C	853,310	99,860	0	99,860	13.9%	(13,541)	(306)	\$1.52
<b>Total</b>	<b>3,010,068</b>	<b>241,647</b>	<b>11,323</b>	<b>252,970</b>	<b>8.4%</b>	<b>(33,675)</b>	<b>6,001</b>	<b>\$1.65</b>
<b>Totals</b>								
Class A	20,009,846	3,001,301	75,553	3,076,854	15.4%	(237,296)	143,345	\$2.11
Class B	32,473,957	4,735,432	92,798	4,828,230	14.9%	53,926	77,331	\$1.65
Class C	16,604,826	3,132,191	51,662	3,183,853	19.2%	(119,087)	(3,027)	\$1.35