



# Office Report

**Q3 2016  
GALLELLI REAL ESTATE MARKET REPORT**

## Overview

Office leasing activity and market momentum picked up steam during Q3 2016, with vacancy falling to its lowest level in six years. Sacramento regional office vacancy stood at 15.1% at the end of Q3, reflecting a decline over the 15.6% vacancy rate recorded three months ago. Net absorption was positive for the quarter, with the market recording over 363,000 square feet of occupancy growth. This is the largest amount of positive quarterly net absorption the office market has recorded in the last three years, and was enough to bring year-to-date absorption totals out of the red. Year-to-date net absorption currently stands at just over 260,000 square feet.

Leasing activity saw an uptick during Q3, with the market seeing just over 1.1 million square feet of deals signed compared to 932,000 square feet in Q2. The majority of office demand continues to be focused on smaller spaces from 1,000 to 10,000 square feet; however, this quarter saw ten deals in excess of 20,000 square feet. Four of these deals were renewals from various state/county agencies and medical users, while the rest were new leases from local companies which will help boost absorption figures once these tenants occupy.

## Market Trends

- Absorption was largely positive across the local submarkets, with nine out of eleven trade areas experiencing positive growth. Roseville/Rocklin, Downtown Sacramento, Yolo County, El Dorado Hills/Folsom, Arden/Arcade and South Sacramento



all saw net absorption gains in excess of 30,000 square feet. Negative net absorption was minimal; the largest occupancy loss was seen in the Northgate/Natomas submarket, which recorded 65,000 square feet of negative net absorption. This was primarily attributable to the vacancy of Comcast's 81,000-square-foot call center at 4450 E Commerce Way.

- Year-over-year vacancy declined to 15.1% during Q3 2016 - one year ago, this metric stood at 16.4%.
- Local unemployment declined during Q3, falling from 5.8% in July 2016 to 5.5% in August 2016. Overall, the region added 5,200 jobs between July and August 2016, and 24,000 jobs between August 2015 and August 2016.
- The current average asking rate for office space stands at \$1.71 per square foot, which is the highest average asking rate the market has seen in five years.
- Class A space is currently going for \$2.05 per square foot; Class B is asking \$1.68 per square foot; and Class C space is currently commanding \$1.39 per square foot, on average.
- The three largest leases of the quarter were:
  - Sacramento Employment and Training Agency, who signed a renewal for 95,000 square feet at 925 Del Paso Road in the Point West Submarket.
  - California Department of Human Assistance, who signed a new lease for 81,000 feet at 4450 E Commerce Way in the Natomas submarket.
  - California Department of Food and Agriculture, who signed a renewal for 76,000 square feet at 2800 Gateway Oaks Drive, also in the Natomas Submarket.

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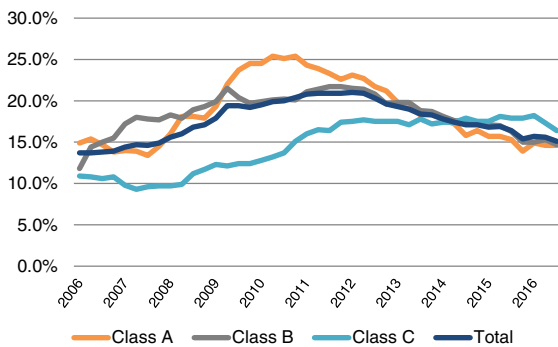
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# Office Q32016

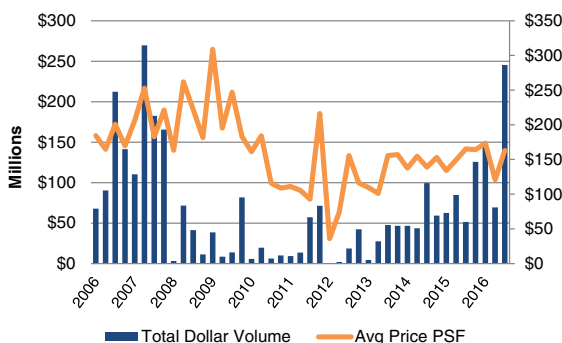
Average asking rents continue to rise and are currently at their highest level in five years.

<p>Vacancy</p> <p><b>15.1%</b></p> <p>▼</p>	<p>Net Absorption</p> <p><b>363,406</b></p> <p>▲</p>	<p>Avg. Asking Rate</p> <p><b>\$1.71</b> PSF</p> <p>▲</p>
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Historical Office Vacancy by Class

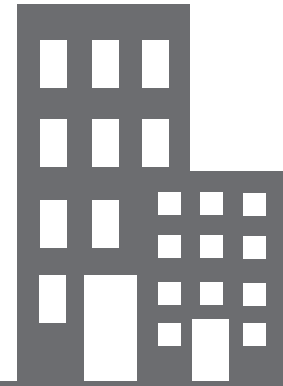


Office Investment Volume



## Investment Highlights

- Quarterly transactional volume increased during Q3, with the Sacramento market seeing 29 transactions totaling \$245.3 million in total dollar volume. Dollar volume was significantly increased over Q2, which saw 25 transactions totaling \$69.3 million in volume. Year-to-date, the market has recorded \$512.7 million in transactional volume over 113 transactions.
- The average price per square foot increased from \$121 during Q2 to \$163 during Q3. The majority of investment sales during Q3 were primarily Class B and C office properties.
- Year-to-date, Class A product has averaged \$185 per square foot; Class B product has averaged \$169 per square foot; and Class C product has averaged \$109 per square foot.
- During Q2, three buildings located Downtown on Capitol Mall were put onto the market. Two of these buildings (400 and 520 Capitol Mall) have since gone into escrow and are slated to close during Q4.
- The three largest investment sales of quarter were:
  - The sale of the Blue Shield campus in Rancho Cordova. The two adjacent, 100%-leased office buildings located at 3300 Zinfandel Dr and 10834 International Drive sold for \$39.7 million (\$228 per square foot) at a 7.00% cap Rate.
  - 1100-1102 Q Street in Downtown Sacramento, which sold for \$29.4 million (\$194 per square foot) at a 7.60 cap rate.
  - The sale of Progressive Corporate Center located at 10940 White Rock Rd and 10929 Disk Dr in Rancho Cordova. These buildings sold for \$19.7 million or \$123 per square foot.



Construction  
**263,431** SF  
 ▲

Sacramento Unemployment  
**5.5%**  
 ▼

US Unemployment  
**5.0%**  
 ▲

### Spotlight: Highway 50/Rancho Cordova

The Highway 50/Rancho Cordova submarket has traditionally been one of the core office submarkets in the Sacramento region along with Downtown Sacramento and Roseville/Rocklin. The second largest office submarket in Sacramento, the trade area's easy access to Highway 50 and large amount of office space has made it home to numerous public and private companies, as well as corporate headquarters.

However, Highway 50 has struggled to recover from the recession. Office vacancy here has hovered in the 18% to 19% range for the last two years. The Highway 50 submarket currently has the most vacant space in the Sacramento region, with over 2.3 million square feet of the submarket's 13.3 million-square-foot inventory sitting vacant. Part of the problem is attributable to the types of tenants that Highway 50 attracts, which are typically large floorplate, back office tenants. Both public and private sector demand has declined in recent years, with many private companies closing back offices and downsizing or relocating operations. Companies like Bank of America, Blue Shield of California, Dignity Health and now Verizon Wireless have either already closed or will be closing offices in Rancho Cordova. Verizon recently announced plans to shutter their Rancho Cordova call center, relocating 1,000 jobs to Florida, Texas and South Carolina, and vacating just over 166,000 square feet of space. As these tenants typically have larger footprints over 20,000 square feet, they leave large gaps when they close.

Despite struggling market fundamentals, the Highway 50 corridor has been and continues to be popular with both private and institutional investors. Since 2015, the Highway 50 submarket has seen 20 investment sales totaling nearly \$154 million in total dollar volume. The public and private tenants that remain in Highway 50 have longevity and the established area, lower building prices (compared to other submarkets), and value-add opportunities make Highway 50 attractive to investors. In addition, Highway 50 is one of the few submarkets that

can accommodate large office footprints - of the five office properties with over 100,000 square feet of contiguous space currently available for lease in the Sacramento MSA, four of these properties are in the Highway 50 corridor.

### Outlook

The Sacramento office market continues to see high demand and decreasing vacancy rates. Q3 saw an uptick in market momentum and leasing activity and the market will likely maintain this momentum through the end of the year. Average asking rents continue to rise and are currently at their highest level in five years. Class A rents are also on the rise, as the lack of large blocks of Class A space has put upward pressure on rents. Class B space is seeing an increase in activity as a result, with Class B vacancy declining from 15.3% in Q2 to 14.7% in Q3. Investor interest in the region also remains strong, and this trend will continue through the end of the year and into the next, as office market fundamentals continue to improve and assets in the Sacramento region remain more affordable than the coastal markets.



# Office Q32016

Submarket	Inventory	Direct	Available Space Sublease	Total	Vacancy Q3-16	Net Absorption		Avg. Asking Rate (NNN)	
						Q3-16	Q3-15		
<b>Arden/Arcade</b>									
Class A	1,089,648	303,226	3,903	307,129	28.2%	(53,124)	27,084	\$1.93	
Class B	3,110,230	576,420	0	576,420	18.5%	33,264	(3,367)	\$1.67	
Class C	1,772,937	330,246	0	330,246	18.6%	69,592	3,519	\$1.43	
<b>Total</b>	<b>5,972,815</b>	<b>1,209,892</b>	<b>3,903</b>	<b>1,213,795</b>	<b>20.3%</b>	<b>49,732</b>	<b>27,236</b>	<b>\$1.68</b>	
<b>Auburn/Lincoln</b>									
Class A	-	-	-	-	-	-	-	-	
Class B	421,212	34,920	0	34,920	8.3%	6,396	53	\$1.29	
Class C	525,479	38,705	0	38,705	7.4%	9,938	(1,593)	\$1.12	
<b>Total</b>	<b>946,691</b>	<b>73,625</b>	<b>0</b>	<b>73,625</b>	<b>7.8%</b>	<b>16,334</b>	<b>(1,540)</b>	<b>\$1.21</b>	
<b>Downtown Sacramento</b>									
Class A	5,745,114	856,184	4,034	860,218	15.0%	(5,062)	(52,867)	\$2.74	
Class B	4,680,487	575,584	10,955	586,539	12.5%	76,219	(412)	\$2.04	
Class C	2,967,068	373,860	0	373,860	12.6%	9,742	10,290	\$1.53	
<b>Total</b>	<b>13,392,669</b>	<b>1,805,628</b>	<b>14,989</b>	<b>1,820,617</b>	<b>13.6%</b>	<b>80,899</b>	<b>(42,989)</b>	<b>\$2.10</b>	
<b>El Dorado Hills/Folsom</b>									
Class A	1,145,861	212,613	16,657	229,270	20.0%	9,274	(19,310)	\$1.95	
Class B	2,826,195	544,584	14,233	558,817	19.8%	30,066	32,151	\$1.67	
Class C	746,312	55,040	0	55,040	7.4%	11,882	(6,572)	\$1.39	
<b>Total</b>	<b>4,718,368</b>	<b>812,237</b>	<b>30,890</b>	<b>843,127</b>	<b>17.9%</b>	<b>51,222</b>	<b>6,269</b>	<b>\$1.67</b>	
<b>Highway 50/Rancho Cordova</b>									
Class A	3,912,957	650,894	5,775	656,669	16.8%	821	(20,711)	\$1.82	
Class B	7,160,010	1,159,210	99,947	1,259,157	17.6%	19,926	34,011	\$1.55	
Class C	2,101,229	531,234	0	531,234	25.3%	8,325	(19,594)	\$1.27	
<b>Total</b>	<b>13,174,196</b>	<b>2,341,338</b>	<b>105,722</b>	<b>2,447,060</b>	<b>18.6%</b>	<b>29,072</b>	<b>(6,294)</b>	<b>\$1.55</b>	
<b>Midtown/East Sacramento</b>									
Class A	323,701	0	0	0	0.0%	532	0	-	
Class B	2,925,609	146,208	0	146,208	5.0%	(374)	31,240	\$2.12	
Class C	1,251,964	206,383	2,120	208,503	16.7%	16,065	(1,462)	\$1.90	
<b>Total</b>	<b>4,501,274</b>	<b>352,591</b>	<b>2,120</b>	<b>354,711</b>	<b>7.9%</b>	<b>16,223</b>	<b>29,778</b>	<b>\$2.01</b>	
<b>Northgate/Natomas</b>									
Class A	3,556,652	490,496	43,727	534,223	15.0%	6,494	124,615	\$1.95	
Class B	2,072,142	340,361	10,425	350,786	16.9%	(74,286)	77,973	\$1.57	
Class C	498,824	137,826	0	137,826	27.6%	2,801	0	\$1.23	
<b>Total</b>	<b>6,127,618</b>	<b>968,683</b>	<b>54,152</b>	<b>1,022,835</b>	<b>16.7%</b>	<b>(64,991)</b>	<b>202,588</b>	<b>\$1.58</b>	
<b>Northeast Sacramento</b>									
Class A	79,163	0	0	0	0.0%	0	0	\$0.00	
Class B	1,703,330	314,932	0	314,932	18.5%	(1,171)	(2,259)	\$1.43	
Class C	2,976,830	591,126	0	591,126	19.9%	(8,695)	14,524	\$1.22	
<b>Total</b>	<b>4,759,323</b>	<b>906,058</b>	<b>0</b>	<b>906,058</b>	<b>19.0%</b>	<b>(9,866)</b>	<b>12,265</b>	<b>\$1.33</b>	
<b>Roseville/Rocklin</b>									
Class A	3,229,679	274,223	9,613	283,836	8.8%	32,556	20,055	\$2.01	
Class B	4,364,141	574,783	4,836	579,619	13.3%	66,474	71,562	\$1.63	
Class C	1,298,278	210,337	0	210,337	16.2%	7,881	(8,148)	\$1.33	
<b>Total</b>	<b>8,892,098</b>	<b>1,059,343</b>	<b>14,449</b>	<b>1,073,792</b>	<b>12.1%</b>	<b>106,911</b>	<b>83,469</b>	<b>\$1.66</b>	
<b>South Sacramento</b>									
Class A	358,282	14,678	0	14,678	4.1%	(4,570)	(1,574)	\$2.11	
Class B	2,120,062	263,246	1,182	264,428	12.5%	39,608	(8,956)	\$1.79	
Class C	1,312,519	127,089	0	127,089	7.4%	(74)	18,423	\$1.38	
<b>Total</b>	<b>3,790,863</b>	<b>405,013</b>	<b>1,182</b>	<b>406,195</b>	<b>10.7%</b>	<b>34,964</b>	<b>7,893</b>	<b>\$1.76</b>	
<b>Yolo County</b>									
Class A	553,592	21,376	11,323	32,699	15.0%	42,123	0	\$1.86	
Class B	1,633,966	178,224	0	178,224	12.5%	(1,630)	(8,971)	\$1.75	
Class C	838,562	74,031	0	74,031	12.6%	12,413	26,565	\$1.54	
<b>Total</b>	<b>3,026,120</b>	<b>273,631</b>	<b>11,323</b>	<b>284,954</b>	<b>9.4%</b>	<b>52,906</b>	<b>17,594</b>	<b>\$1.72</b>	
<b>Totals</b>									
Class A	69,302,035	10,208,039	238,730	10,446,769	15.1%	363,406	336,269	\$1.71	
Class B	19,994,649	2,823,690	95,032	2,918,722	14.6%	29,044	77,292	\$2.05	
Class C	33,017,384	4,708,472	141,578	4,850,050	14.7%	194,492	223,025	\$1.68	
Class C	16,290,002	2,675,877	2,120	2,677,997	16.4%	139,870	35,952	\$1.39	