



# Office Report

Q1 2017  
GALLELLI REAL ESTATE MARKET REPORT

## Overview

The Sacramento office market saw an uptick in vacancy, as well as a decline in leasing activity during the first quarter of 2017. The market experienced a number of large move-outs and relocations during the quarter, which pushed quarterly net absorption into the red. Despite the slowdown in activity, the Sacramento office market continues to improve and investor and tenant demand remains high.

## Market Trends

- Quarterly office vacancy increased from 14.3% to 14.5% during the quarter, which marks the first uptick in vacancy in 12 months. However, year over-year vacancy has seen a decline - one year ago, this metric stood at 15.6%.
- Quarterly net absorption figures were negative to the tune of 136,000 square feet. The largest move out of the quarter was Verizon, who announced last year that they were moving their call center operations and 1,000 local jobs from Rancho Cordova to Florida, South Carolina and Texas. Verizon vacated two buildings and nearly 183,000 square feet on the Highway 50 Corridor.
- More local jobs will be disappearing in the near future, as Aerojet recently announced they were relocating or eliminating 1,100 of their 1,400 positions in Rancho Cordova, and Advanced Call Center Technologies, LLC announced layoffs for 135 employees at their North Highlands location.



- Office leasing activity slowed during the quarter - the market recorded just over 866,000 square feet of deals, which is down from the 1.2 million square feet of deals inked during Q4 2016.
- Local unemployment fell from 5.3% to 5.1% between January and February 2017. This compares with an unemployment rate of 5.2% for California and 4.9% for the nation. One year ago, this metric stood at 5.5%. Overall, the region added 5,700 between January and February 2017 and 15,900 jobs between February 2016 and February 2017.
- The average asking rate for office space currently stands at \$1.73 per square foot, which is the highest average asking rate the market has seen since Q4 2010. Average asking rents peaked at \$1.96 per square foot prior to the recession. Downtown/CBD space is currently averaging \$2.25 per square foot, while Suburban rents are averaging \$1.63 per square foot.
- Overall regional Class A space is currently going for \$2.11 per square foot; Class B is asking \$1.69 per square foot; and Class C space is currently commanding \$1.38 per square foot, on average.
  - Downtown/CBD Class A space is currently asking \$2.85 per square foot; Class B is asking \$2.12 per square foot; and Class C space is asking \$1.77 per square foot.
  - Suburban Class A rents currently stand at \$2.01 per square foot; Class B is asking \$1.59 per square foot; and Class C is currently commanding \$1.29 per square foot.

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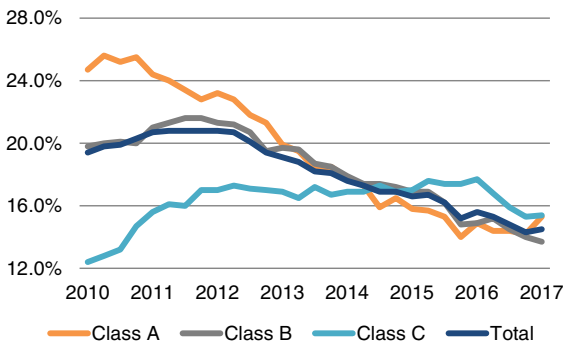
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# Office Q12017

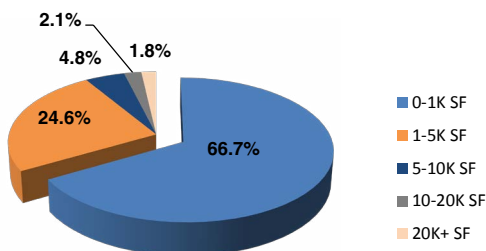
## The Sacramento office market continues to strengthen and local office demand remains high.

<p>Vacancy</p> <p><b>14.5%</b></p> <p>▲</p>	<p>Net Absorption</p> <p><b>-135,639</b> SF</p> <p>▼</p>	<p>Avg. Asking Rate</p> <p><b>\$1.73</b> PSF</p> <p>▲</p>
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Historical Office Vacancy by Class



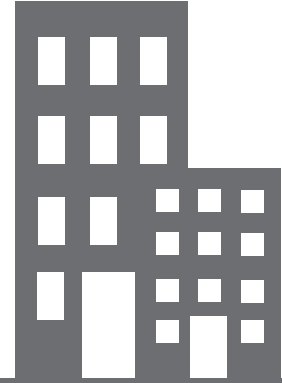
Q1 2017 Office Leasing Volume by SF



### Investment Highlights

- Quarterly transactional volume was down in Q1, with the Sacramento market seeing 12 transactions totaling over \$182.7 million in total volume. Though dollar volume was down from the previous quarter, which recorded over \$359 million in total volume, year-over-year volume actually saw an increase. Dollar volume increased from \$135.2 million to \$182.7 between Q1 2016 and Q1 2017.
- Suburban office sales volume was increased over Q4 2016, with the market recording over \$179.6 million in total volume, compared to \$130.1 million. Suburban sales volume has also increased on a year-over-year basis - one year ago, the market recorded just \$50.3 million in total sales volume.
- Downtown/CBD sales volume was down during Q1, as the trade area only saw two office sales totaling \$3.1 million in sales volume. In contrast, Q4 saw \$229.3 million in total sales volume, primarily due to the sales of 400 and 520 Capitol Mall. Year-over-year volume was also down - Q1 2016 saw \$87.7 million in total sales volume.
- Year-to-date, all classes of Suburban office space have averaged \$160 per square foot, while Downtown/CBD space has averaged \$229 per square foot.
- Year-to-date, the Downtown/CBD market has not seen any Class A or Class C transactions; Class B space in the Downtown/CBD market is currently averaging \$229 per square foot.
- Year-to-date, the Suburban market has not seen any Class C sales. Class A suburban office is currently averaging \$185 per square foot and Class B office is averaging \$148 per square foot.
- Average asking cap rates for Downtown/CBD office space currently stand at 6.0%, while Suburban office space is averaging 7.3%. Overall, the regional average asking cap rate currently stands at 6.6%.\*
- The largest investment sale of the quarter was the sale of Gateway Oaks office park in Natomas. This Class A, four-building, 361,000-square-foot office park sold for \$43 million or \$136 per square foot.

(\*Based on publically quoted cap rates. Unreported cap rates are not included in this survey.)



Construction

7,500<sub>SF</sub>

Sacramento Unemployment

5.1%



US Unemployment

4.9%



### Spotlight: Office Investments

While local apartment product has been the investment of choice among buyers, many apartment owners are holding onto their assets, and if they do decide to sell, their assets are purchased quickly, leaving investors with a lack of available product to purchase. Quality retail assets are also a tough find in the region and as such, we have begun to see more and more interest in local office assets. The last few years have seen a resurgence of buyer interest in the Sacramento region, as the local office market continues to tighten and regional buyers are getting priced out of the coastal markets. Local and regional buyers have been the most active in the Sacramento region, with companies such as Swift Real Estate Partners and Barker Pacific Group purchasing a number of local assets. Buyers continue to be drawn to the Sacramento region due to its stability, improving market fundamentals, and a number of assets priced well below replacement cost.

Though revitalization efforts to improve the city and the addition of Golden 1 Arena has spurred new interest (and a few high-profile building sales) in the Downtown submarket, the majority of investor interest continues to be focused on suburban markets such as Highway 50/Rancho Cordova and Roseville/Rocklin. These submarkets remain attractive to buyers due to their lower building prices, established markets, and strong private and public tenants.

### Outlook

Despite a slowdown in leasing activity during the quarter, the Sacramento office market continues to strengthen and local office demand remains high. Vacancy remains at a post-recession low of 14.5%, while rental rates are currently at their highest level in seven years. Class A rents are also at their highest level in six years, as the lack of available large blocks of Class A space has continued to put upward pressure on asking rents. Continued growth by small businesses, a tightening rental market, and assets priced well below replacement costs will continue to keep local and regional investors interested in the Sacramento region, and we anticipate this trend will continue throughout the rest of the year, as the Sacramento area remains a more affordable place for both investors and tenants alike.

### 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.



# Office Q12017

Submarket	Inventory	Direct	Available Space Sublease	Total	Vacancy Q1-17	Net Absorption		Avg. Asking Rate (NNN)
						Q1-17	Q1-16	
Arden/Arcade								
Class A	1,089,648	281,046	0	281,046	25.8%	19,009	25,739	\$1.94
Class B	3,110,233	488,100	0	488,100	15.7%	(6)	23,903	\$1.72
Class C	1,760,849	342,003	1,773	343,776	19.5%	(20,331)	(2,107)	\$1.42
Total	5,960,730	1,111,149	1,773	1,112,922	18.7%	(1,328)	47,535	\$1.69
Auburn/Lincoln								
Class A	-	-	-	-	-	-	-	-
Class B	446,395	31,747	0	31,747	7.1%	4,930	(1,388)	\$1.32
Class C	500,296	38,373	0	38,373	7.7%	1,543	1,063	\$1.06
Total	946,691	70,120	0	70,120	7.4%	6,473	(325)	\$1.19
Downtown Sacramento								
Class A	5,729,357	778,594	14,662	793,256	13.8%	29,416	30,026	\$2.85
Class B	4,649,896	547,286	14,917	562,203	12.1%	(4,225)	(15,847)	\$2.06
Class C	2,996,843	374,939	0	374,939	12.5%	(12,035)	6,439	\$1.56
Total	13,376,096	1,700,819	29,579	1,730,398	12.9%	13,156	20,618	\$2.16
El Dorado Hills/Folsom								
Class A	1,024,483	197,489	16,657	214,146	20.9%	5,146	(6,534)	\$2.00
Class B	2,814,412	482,395	11,037	493,432	17.5%	740	(19,572)	\$1.75
Class C	746,312	53,519	0	53,519	7.2%	(4,278)	(804)	\$1.42
Total	4,585,207	733,403	27,694	761,097	16.6%	1,608	(26,910)	\$1.72
Highway 50/Rancho Cordova								
Class A	3,924,962	853,207	5,775	858,982	21.9%	(226,897)	(192,650)	\$1.84
Class B	7,184,339	1,155,583	111,947	1,267,530	17.6%	(2,907)	(44,352)	\$1.52
Class C	2,110,186	526,268	0	526,268	24.9%	3,274	(3,356)	\$1.30
Total	13,219,487	2,535,058	117,722	2,652,780	20.1%	(226,530)	(240,358)	\$1.55
Midtown/East Sacramento								
Class A	329,289	2,113	0	2,113	0.6%	0	1,080	-
Class B	3,219,765	194,769	9,950	204,719	6.4%	4,737	(19,384)	\$2.18
Class C	1,247,062	208,800	0	208,800	16.7%	(10,336)	(12,644)	\$1.97
Total	4,796,116	405,682	9,950	415,632	8.7%	(5,599)	(30,948)	\$2.08
Northgate/Natomas								
Class A	3,566,665	530,434	45,798	576,232	16.2%	(58,405)	(1,033)	\$1.98
Class B	2,082,538	210,139	0	210,139	10.1%	115,343	8,521	\$1.57
Class C	498,824	134,711	0	134,711	27.0%	(104)	(1,094)	\$1.23
Total	6,148,027	875,284	45,798	921,082	15.0%	56,834	6,394	\$1.59
Northeast Sacramento								
Class A	79,163	0	0	0	0.0%	0	0	\$0.00
Class B	1,739,280	366,546	0	366,546	21.1%	(46,239)	18,427	\$1.44
Class C	2,993,378	448,338	0	448,338	15.0%	26,549	6,257	\$1.14
Total	4,811,821	814,884	0	814,884	16.9%	(19,690)	24,684	\$1.29
Roseville/Rocklin								
Class A	3,229,679	251,204	26,763	277,967	8.6%	(2,120)	(14,373)	\$2.00
Class B	4,529,362	498,237	15,569	513,806	11.3%	16,473	19,074	\$1.58
Class C	1,300,771	209,387	1,403	210,790	16.2%	(2,958)	4,974	\$1.19
Total	9,059,812	958,828	43,735	1,002,563	11.1%	11,395	9,675	\$1.59
South Sacramento								
Class A	358,282	7,571	0	7,571	2.1%	5,804	0	\$2.30
Class B	1,982,192	284,116	0	284,116	14.3%	(2,063)	(10,454)	\$1.62
Class C	1,444,395	119,857	0	119,857	7.7%	8,325	(29,071)	\$1.29
Total	3,784,869	411,544	0	411,544	10.9%	12,066	(39,525)	\$1.74
Yolo County								
Class A	553,592	21,376	11,323	32,699	13.8%	0	(29,793)	\$1.98
Class B	1,623,424	135,699	0	135,699	12.1%	17,229	9,659	\$1.81
Class C	829,482	66,776	0	66,776	12.5%	(1,253)	(15,854)	\$1.58
Total	3,006,498	223,851	11,323	235,174	7.8%	15,976	(35,988)	\$1.79
<b>Totals</b>	<b>69,695,354</b>	<b>9,840,622</b>	<b>287,574</b>	<b>10,128,196</b>	<b>14.5%</b>	<b>(135,639)</b>	<b>(265,148)</b>	<b>\$1.73</b>
Class A	19,885,120	2,923,034	120,978	3,044,012	15.3%	(228,047)	(187,538)	\$2.11
Class B	33,381,836	4,394,617	163,420	4,558,037	13.7%	104,012	(31,413)	\$1.69
Class C	16,428,398	2,522,971	3,176	2,526,147	15.4%	(11,604)	(46,197)	\$1.38