



# Office Report

Q2 2017  
GALLELLI REAL ESTATE MARKET REPORT

## Overview

The Sacramento office market bounced back from the Q1 slowdown, and saw an uptick in leasing activity during the second quarter of 2017. The market also experienced a number of move-ins from larger footprint tenants, which helped drop vacancy and boost quarterly net absorption figures. Local investment activity saw a noticeable uptick as well.

## Market Trends

- Quarterly office vacancy fell from 14.4% to 14.0% which is the lowest vacancy rate the local office market has seen in 11 years. One year ago, local vacancy stood at 15.2%.
- The market recorded over 231,000 square feet of positive net absorption in Q2. The market experienced a number of larger move-ins, including Interwest Insurance occupying 39,891 square feet at 8950 Cal Center Drive, Health Net occupying 22,416 square feet at 10540 White Rock Road, and Sacramento State who officially occupied 30,610 square feet at their recently purchased building at 304 S Street. The Highway 50 submarket was responsible for the majority of this quarter's net absorption, posting 114,000 square feet of occupancy growth.
- The average asking rate for office space currently stands at \$1.74 per square foot, which is the highest average asking rate the market has seen since Q4 2010. Though growth has been slow and incremental, rental rates have been on the

rise, with average rents seeing a 5% uptick in the last two years. Downtown/CBD office space is currently averaging \$2.27 per square foot, while Suburban rents are commanding \$1.65 per square foot on average.

- Regional Class A space is currently going for \$2.12 per square foot; Class B is asking \$1.74 per square foot; and Class C space is currently commanding \$1.37 per square foot, on average.
- Downtown/CBD Class A space is currently asking \$2.86 per square foot; Class B is asking \$2.25 per square foot; and Class C space is asking \$1.77 per square foot. Downtown/CBD rents have been on the rise, with Class A rents seeing an 11% increase over the last two years.
- Suburban Class A rents currently stand at \$2.02 per square foot; Class B is asking \$1.63 per square foot; and Class C is currently commanding \$1.29 per square foot.
- Local unemployment fell from 4.4% to 4.1% between April and May 2017. This compares with an unemployment rate of 4.2% for California and 4.1% for the nation. One year ago, Sacramento's unemployment stood at 5.7%. On a monthly basis, the region added 2,900 between April and May of this year. Job growth on a year-over-year basis has slightly declined, with the region adding just 2,700 jobs between May 2016 and May 2016.



**Gary Gallelli**  
Partner, Managing Director  
916 784 2700  
gary@GallelliRE.com

**Abby Friedman**  
Research Director  
916 784 2700  
abby@GallelliRE.com

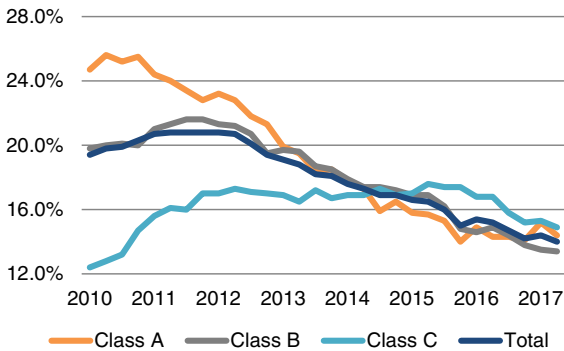
**Gallelli Real Estate**  
3005 Douglas Blvd #200  
Roseville, CA 95661  
P 916 784 2700

# Office Q22017

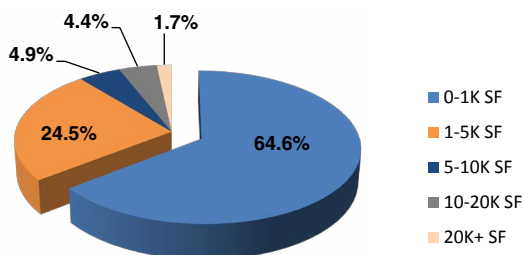
The Sacramento office market continues to strengthen, as leasing demand remains high and vacancy continue to fall.

<p>Vacancy</p> <h1>14%</h1> <p>▼</p>	<p>Net Absorption</p> <h1>231,355<sub>SF</sub></h1> <p>▲</p>	<p>Avg. Asking Rate</p> <h1>\$1.74<sub>PSF</sub></h1> <p>▲</p>
--------------------------------------	--	--

Historical Office Vacancy by Class



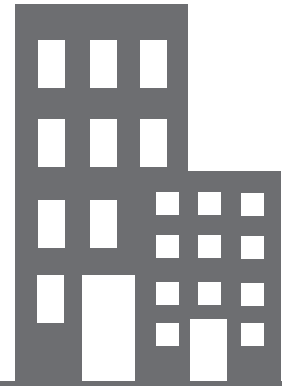
Q2 2017 Office Leasing Volume by SF



## Investment Trends

- Quarterly transactional volume saw an uptick in Q2, with the market recording 15 investment transactions totaling over \$363.4 million in total volume. This figure is increased over Q1, which saw over \$198.4 million in total volume. Year-over-year volume also saw a significant increase, rising from \$69 million to \$363.4 million between Q2 2016 and Q2 2017.
  - Suburban office sales volume saw an increase over Q1 2017, with the market recording \$232.9 million compared to \$195.2 million. Year over-year suburban sales volume has also increased – one year ago, the market recorded just \$64.9 million in total sales volume.
  - Downtown/CBD sales volume also saw a significant increase, recording \$130.5 million in total sales volume compared to just \$3.1 million in Q1. Downtown/CBD sales volume also increased on a year over-year basis, with sales volume increasing from \$4.1 in Q2 2016 to \$130.5 million in Q2 2017.
- Year-to-date, all classes of Suburban office space have averaged \$152 per square foot, while Downtown/CBD space has averaged \$168 per square foot. The majority of 2017 sales in the Downtown/CBD market have been for older, Class B and C product that is either highly vacant or prime for redevelopment.
- Overall, the regional average sold cap rate currently stands at 5.4% - this is primarily lower due to a high-vacancy, Downtown investment sale that sold at a 4.0% cap rate (see below). Suburban cap rates currently stand at 6.8%.\*
- The largest investment sale of the quarter was the sale of Park Tower at 980 9th Street in Downtown. This 463,556-square-foot office tower sold for \$97.5 million (\$210 per square foot). The building fetched a 4.0% cap rate, which was primarily due to the building's higher vacancy – the office tower was approximately 70% leased at sale.

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



Construction

416,790<sub>SF</sub>

Sacramento Unemployment

4.1%



US Unemployment

4.1%



### Spotlight On: Roseville/Rocklin

The Roseville/Rocklin submarket has historically been and continues to be one of the strongest and core office submarkets in the Sacramento region. With over 9.7 million square feet of space, Roseville/Rocklin is the 3rd largest office submarket in Sacramento, after Downtown Sacramento and the Highway 50 Corridor. The trade area's dense population and large concentration of newer office space has made it home to numerous public and private companies.

The area was extremely hard-hit by the economic recession, primarily due to overbuilding during the early 2000's housing boom, and office vacancy rates peaked at 32.5% at the height of the downturn. Unlike submarkets such as Highway 50 and Northgate/Natomas, which continue to struggle with higher vacancy rates, the Roseville/Rocklin submarket had an easier time recovering from the recession. Lower rental rates and abundant free parking made the area a great alternative to the Downtown/CBD market, and many office tenants migrated to Roseville and other suburban markets during the economic downturn, getting better and more space for far less money. The area's large population of executive housing has also made the submarket more attractive to new and existing companies, as many executives and their employees can cut down commute times by choosing Roseville/Rocklin for their location. Roseville/Rocklin has since gotten down to pre-recession vacancy levels and the market continues to thrive. Vacancy currently stands at 10.5 % and the market has seen over 474,000 square feet of positive net absorption in the last two years.

The trade area also continues to be hugely popular with investors, particularly due to its large concentration of newer Class A and B product and lower building prices (compared to the Downtown/CBD market). Since 2015, the Roseville/Rocklin submarket has recorded over \$352.2 million in total sales volume, and year-to-date, the submarket has recorded \$147.5 million in total transactional volume, accounting for well over half of the Sacramento region's overall sales volume.

### Outlook

The Sacramento office market continues to strengthen, as leasing demand remains high and vacancy continues to fall. Vacancy remains at a post-recession low of 14.0%, while overall rental rates continue to see incremental increases. Large blocks of Class A space remain a rare find in the region, and Class A rents have increased accordingly. We are also beginning to see demand spill over into Class B product, which is beginning to put upward pressure on Class B rents – Class B rents have risen 4% in the last twelve months. Investor demand remains strong as well, as the tightening market and assets priced well below replacement cost continue to draw investors to the region. Though the market has seen a few Class A sales over the last few months, Class A owners are holding onto their assets, leaving very little product left on the market. Investors are instead turning to Class B and C assets, as these product types are far more abundant in the region.

### 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 Q22017

Submarket	Inventory	Direct	Available Space Sublease	Total	Vacancy Q2-17	Net Absorption		Avg. Asking Rate (NNN)
						Q2-17	Q2-16	
<b>Arden/Arcade</b>								
Class A	1,089,648	256,379	0	256,379	23.5%	24,667	(6,125)	\$1.95
Class B	3,022,462	478,859	5,244	484,103	16.0%	(15,768)	14,952	\$1.76
Class C	1,771,749	291,308	0	291,308	16.4%	53,782	8,280	\$1.49
<b>Total</b>	<b>5,883,859</b>	<b>1,026,546</b>	<b>5,244</b>	<b>1,031,790</b>	<b>17.5%</b>	<b>62,681</b>	<b>17,107</b>	<b>\$1.73</b>
<b>Auburn/Lincoln</b>								
Class A	-	-	-	-	-	-	-	-
Class B	446,395	32,262	0	32,262	7.2%	(515)	11,434	\$1.44
Class C	500,296	34,003	0	34,003	6.8%	4,370	803	\$1.06
<b>Total</b>	<b>946,691</b>	<b>66,265</b>	<b>0</b>	<b>66,265</b>	<b>7.0%</b>	<b>3,855</b>	<b>12,237</b>	<b>\$1.25</b>
<b>Downtown Sacramento</b>								
Class A	5,782,383	768,297	14,662	782,959	13.5%	10,297	3,306	\$2.86
Class B	4,608,936	513,533	12,309	525,842	11.4%	36,361	6,092	\$2.04
Class C	2,944,544	372,831	0	372,831	12.7%	(2,849)	20,660	\$1.68
<b>Total</b>	<b>13,335,863</b>	<b>1,654,661</b>	<b>26,971</b>	<b>1,681,632</b>	<b>12.6%</b>	<b>43,809</b>	<b>30,058</b>	<b>\$2.19</b>
<b>El Dorado Hills/Folsom</b>								
Class A	1,024,483	181,202	16,657	197,859	19.3%	21,559	28,255	\$2.05
Class B	2,802,997	462,035	13,082	475,117	17.0%	7,338	(20,524)	\$1.75
Class C	745,960	52,541	0	52,541	7.0%	978	22,657	\$1.33
<b>Total</b>	<b>4,573,440</b>	<b>695,778</b>	<b>29,739</b>	<b>725,517</b>	<b>15.9%</b>	<b>29,875</b>	<b>30,388</b>	<b>\$1.71</b>
<b>Highway 50/Rancho Cordova</b>								
Class A	3,924,962	750,243	5,775	756,018	19.3%	84,169	22,788	\$1.87
Class B	7,182,969	1,172,482	111,947	1,284,429	17.9%	14,461	(61,775)	\$1.54
Class C	2,102,056	510,779	0	510,779	24.3%	15,489	12,403	\$1.31
<b>Total</b>	<b>13,209,987</b>	<b>2,433,504</b>	<b>117,722</b>	<b>2,551,226</b>	<b>19.3%</b>	<b>114,119</b>	<b>(26,584)</b>	<b>\$1.57</b>
<b>Midtown/East Sacramento</b>								
Class A	329,289	2,113	0	2,113	0.6%	0	532	-
Class B	3,230,056	178,879	0	178,879	5.5%	10,278	(5,315)	\$2.45
Class C	1,251,784	210,455	0	210,455	16.8%	(1,655)	39,596	\$1.71
<b>Total</b>	<b>4,811,129</b>	<b>391,447</b>	<b>0</b>	<b>391,447</b>	<b>8.1%</b>	<b>8,623</b>	<b>34,813</b>	<b>\$2.08</b>
<b>Northgate/Natomas</b>								
Class A	3,569,445	529,329	58,319	587,648	16.5%	3,247	(5,218)	\$1.97
Class B	2,082,538	194,758	0	194,758	9.4%	15,381	30	\$1.52
Class C	499,503	133,589	0	133,589	26.7%	1,122	29,465	\$1.23
<b>Total</b>	<b>6,151,486</b>	<b>857,676</b>	<b>58,319</b>	<b>915,995</b>	<b>14.9%</b>	<b>19,750</b>	<b>24,277</b>	<b>\$1.57</b>
<b>Northeast Sacramento</b>								
Class A	79,163	0	0	0	0.0%	0	0	\$0.00
Class B	1,747,444	440,385	5,504	445,889	25.5%	(59,635)	(26,460)	\$1.47
Class C	2,993,395	414,313	0	414,313	13.8%	34,025	16,220	\$1.13
<b>Total</b>	<b>4,820,002</b>	<b>854,698</b>	<b>5,504</b>	<b>860,202</b>	<b>17.8%</b>	<b>(25,610)</b>	<b>(10,240)</b>	<b>\$1.30</b>
<b>Roseville/Rocklin</b>								
Class A	3,229,679	253,163	14,670	267,833	8.3%	(4,089)	48,432	\$2.01
Class B	5,187,795	519,055	15,714	534,769	10.3%	(15,353)	41,014	\$1.58
Class C	1,312,588	222,127	0	222,127	16.9%	(11,337)	16,510	\$1.18
<b>Total</b>	<b>9,730,062</b>	<b>994,345</b>	<b>30,384</b>	<b>1,024,729</b>	<b>10.5%</b>	<b>(30,779)</b>	<b>105,956</b>	<b>\$1.59</b>
<b>South Sacramento</b>								
Class A	358,282	1,496	0	1,496	0.4%	6,075	(5,804)	\$2.30
Class B	1,982,864	282,484	0	282,484	14.2%	1,632	(16,241)	\$1.77
Class C	1,444,395	145,986	0	145,986	6.8%	(26,129)	(23,048)	\$1.30
<b>Total</b>	<b>3,785,541</b>	<b>429,966</b>	<b>0</b>	<b>429,966</b>	<b>11.4%</b>	<b>(18,422)</b>	<b>(45,093)</b>	<b>\$1.79</b>
<b>Yolo County</b>								
Class A	553,592	21,376	0	21,376	13.5%	0	18,366	\$1.98
Class B	1,623,424	117,052	0	117,052	11.4%	18,647	(24,549)	\$1.87
Class C	832,344	50,579	0	50,579	12.7%	4,807	(850)	\$1.60
<b>Total</b>	<b>3,009,360</b>	<b>189,007</b>	<b>0</b>	<b>189,007</b>	<b>6.3%</b>	<b>23,454</b>	<b>(7,033)</b>	<b>\$1.82</b>
<b>Totals</b>	<b>70,257,420</b>	<b>9,593,893</b>	<b>273,883</b>	<b>9,867,776</b>	<b>14.0%</b>	<b>231,355</b>	<b>165,886</b>	<b>\$1.74</b>
Class A	19,940,926	2,763,598	110,083	2,873,681	14.4%	145,925	104,532	\$2.12
Class B	33,917,880	4,391,784	163,800	4,555,584	13.4%	12,827	(81,342)	\$1.74
Class C	16,398,614	2,438,511	0	2,438,511	14.9%	72,603	142,696	\$1.37