

## Market Analysis

Fourth Quarter 2017

### Contacts

#### Jeff Adler

Vice President & General  
Manager of Yardi Matrix  
Jeff.Adler@Yardi.com  
(800) 866-1124 x2403

#### Jack Kern

Director of Research and Publications  
Jack.Kern@Yardi.com  
(800) 866-1124 x2444

#### Chris Nebenzahl

Senior Analyst  
Chris.Nebenzahl@Yardi.com  
(800) 866-1124 x2200

#### Veronica Grecu

Senior Real Estate Market Analyst  
Veronica.Grecu@Yardi.com  
(306) 955-1855 x7583

### Author

#### Razvan Cimpean

Associate Editor  
Razvan-I.Cimpean@Yardi.com

Aggregated and anonymized expense and lease expiration data is available to Yardi Matrix subscribers. Please contact us for details!

### For more information please contact:

#### Ron Brock, Jr.

Industry Principal, Matrix  
JR.Brock@Yardi.com  
(480) 663-1149 x2404

### To Subscribe:

#### Hollie Zepke

Audience Development Specialist  
Hollie.Zepke@Yardi.com  
(800) 866-1124 x5389

## Office Market Gains Momentum



Sacramento's office market is picking up, fueled by a recovering office-using employment sector, growing demographics and increasing leasing activity. Demand is bolstered primarily by public initiatives—such as the Mayor's Office for Innovation and Entrepreneurship's multimillion-dollar programs—that aim to transform the metro into a startup- and entrepreneur-friendly market.

Some 15,500 new jobs were added year-to-date through October. Office-using jobs **account for 20.5%** of Sacramento's total employment pool of more than 970,000 jobs. Job growth has been moderate in the metro; gains in the leisure and hospitality sector (5,900 new jobs added year-to-date through October) and education and health services (4,500) have been offset by losses in other sectors, such as manufacturing and construction.

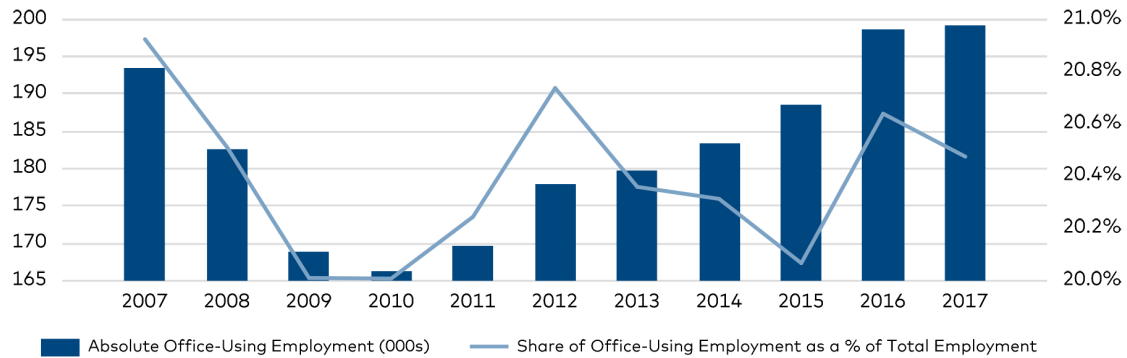
A shortage in development in recent years **pushed down the vacancy rate** across the metro to 13.9%. Vacancies are highest in suburban submarkets, which account for 72% of the metro's office inventory. Meanwhile, vacancy rates in the submarkets of Elk Grove (5.0%) and Roseville–Rocklin (9.9%) are well below the metro average.

Overconstruction in the late 2000s led to a significant slowdown in development in recent years. Only **110,000 square feet of office space** is scheduled for completion by the end of 2017, and less than 170,000 square feet is under construction. However, office development is expected to pick up, as companies continue to look for cheaper alternatives to Los Angeles and San Francisco.

## ECONOMIC SNAPSHOT

Sacramento counted some **199,200 office-using jobs** at the end of June. That equates to 20.5% of the total employment pool and is well below the 22.8% national average. Office employment remained relatively flat.

### Office-Using Employment



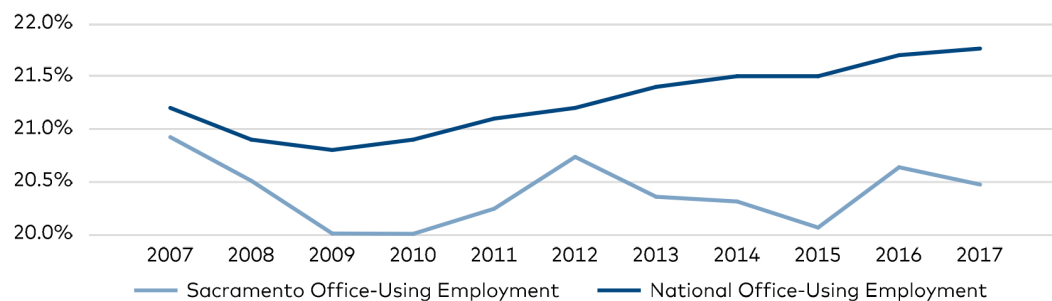
Source: Bureau of Labor Statistics (BLS). Data through June 2017

### Employment Growth by Sector as of September 2017 (Year-Over-Year)

Code	Employment Sector	Current Employment		Year Change	
		(000)	% Share	Employment	%
70	Leisure and Hospitality	106	10.9%	5,900	5.9%
65	Education and Health Services	152	15.7%	4,500	3.1%
<b>60</b>	<b>Professional and Business Services</b>	<b>133</b>	<b>13.7%</b>	<b>3,700</b>	<b>2.9%</b>
90	Government	235	24.2%	2,800	1.2%
<b>55</b>	<b>Financial Activities</b>	<b>54</b>	<b>5.6%</b>	<b>2,100</b>	<b>4.0%</b>
40	Trade, Transportation and Utilities	154	15.9%	2,100	1.4%
<b>50</b>	<b>Information</b>	<b>13</b>	<b>1.3%</b>	<b>-500</b>	<b>-3.7%</b>
80	Other Services	31	3.2%	-900	-2.8%
30	Manufacturing	36	3.7%	-1,500	-4.0%
15	Mining, Logging and Construction	56	5.8%	-2,700	-4.6%

Source: Bureau of Labor Statistics (BLS). Data as of September 2017

### Office-Using Employment as a % of Total Employment



Source: Bureau of Labor Statistics (BLS). Data through June 2017

## LEASING | Vacancy

- Following a slowdown in development over the past few years, **office vacancy was 14.2%** across the market in October. Class A and A+ office properties combined were 8.9% vacant, while vacancy for Class B assets was 15.7%. With health insurance company Centene on track to relocate its corporate headquarters to North Natomas, we expect more companies to show an interest in the Sacramento office market.
- The **lowest vacancy rate** is in suburban secondary areas (20.7%), followed by suburban primary submarkets (14.5%). More than 70% of the office inventory is concentrated in these areas. However, Roseville–Rocklin outperformed all large suburban submarkets and reached a vacancy rate of 9.9%, thanks to its proximity to McClellan Airfield and easy access from Interstate 80. Office vacancy continued to drop in the Highway 50 Corridor to 15.7%, almost on par with the metro average.
- Urban submarkets remain in demand**, with lower-than-average vacancy rates in both primary (7.2%) and secondary (4.1%) areas. Although development is mainly focused in suburbans where rates are as much as 30% cheaper, Downtown (8.0%) and Midtown (13.0%) will continue to experience healthy leasing activity and remain below the metro’s average vacancy rate.
- Demand for office space in **Point West has decreased**, and the submarket was 28.9% vacant as of October. Point West’s office inventory consists mostly of 1970s and 1980s properties, and rent rates there (\$22.16 per square foot) are on par with submarkets with more recent development activity. However, more than 70% of this submarket’s office inventory is made up of Class B properties, as opposed to Roseville–Rocklin (\$22.69 per square foot), where Class B space accounts for only 35% of inventory. As a result, Point West continues to lag.

### Vacancy by Building Class

Top Submarkets	Vacancy Rate (%)
Class A Combined Office	8.9%
Class B Office	15.7%

Source: Yardi® Matrix. Data as of October 2017

Note: Vacancy including sublease

### Vacancy by Location Class

Location Class	Vacancy Rate (%)
Urban-Secondary	4.1%
Urban-Primary	7.2%
CBD-Primary	8.3%
Suburban-Primary	14.5%
Suburban-Secondary	20.7%

Source: Yardi® Matrix. Data as of October 2017

Note: Vacancy including sublease

### Vacancy by Submarket

Top Submarkets	Vacancy Rate (%)
Davis-Woodland	5.0%
Elk Grove	5.0%
Downtown	8.0%
Roseville-Rocklin	9.9%
West Sacramento	10.9%

Source: Yardi® Matrix. Data as of October 2017

Note: Vacancy including sublease

## LEASING | Listings

- More than **4.4 million square feet** of office space was listed in Sacramento as of October, at an average asking price of \$30.95 per square foot for combined Class A and A+ properties and \$21.91 per square foot for Class B assets.
- Downtown Sacramento** was by far the most expensive submarket, with an average asking price of \$32.53 per square foot as of October, followed by suburban Davis–Woodland with an average asking rate of \$28.60 per square foot. Sacramento has been trying to attract tenants that are priced out by more expensive California markets, which could lead to increasing rates during the coming quarters.
- Additionally, the local authorities' programs to revitalize the office market are expected to increase leasing activity. RiceBran Technologies announced in April that it will move its corporate headquarters from Scottsdale, Ariz., to Sacramento; in September, Luxer One relocated its headquarters from San Francisco to Sacramento.
- Some of the **lowest asking prices** were in Carmichael–Fair Oaks (\$15.86 per square foot) and the Highway 50 Corridor (\$19.35 per square foot). These submarkets benefit from an abundance of Class B office properties.

### Available Properties

Top Submarkets	Square Feet Available	Properties Available
Highway 50 Corridor	1,201,323	38
Downtown	621,803	20
North Sacramento	566,409	22
Point West	539,779	17
Roseville-Rocklin	471,638	37
<b>Total Market</b>	<b>4,417,258</b>	<b>174</b>

Source: Yardi® Matrix. Data as of October 2017

## Top Leases

**Public institutions signed the most leases** during the past four quarters. Earlier this year, the California Department of Corrections and Rehabilitation signed two leases totaling a combined 257,488 square feet of Class B office space in the Highway 50 Corridor (at 9838 Old Placerville Road and 10000 Goethe Road). In Elk Grove, California Correctional Health Care Services leased some 110,000 square feet at the Laguna Springs Corporate Center. Pappas Investments recently completed a four-story office building, the first structure of a four-phase project.

### Top Leases Signed (Last 12 Months)

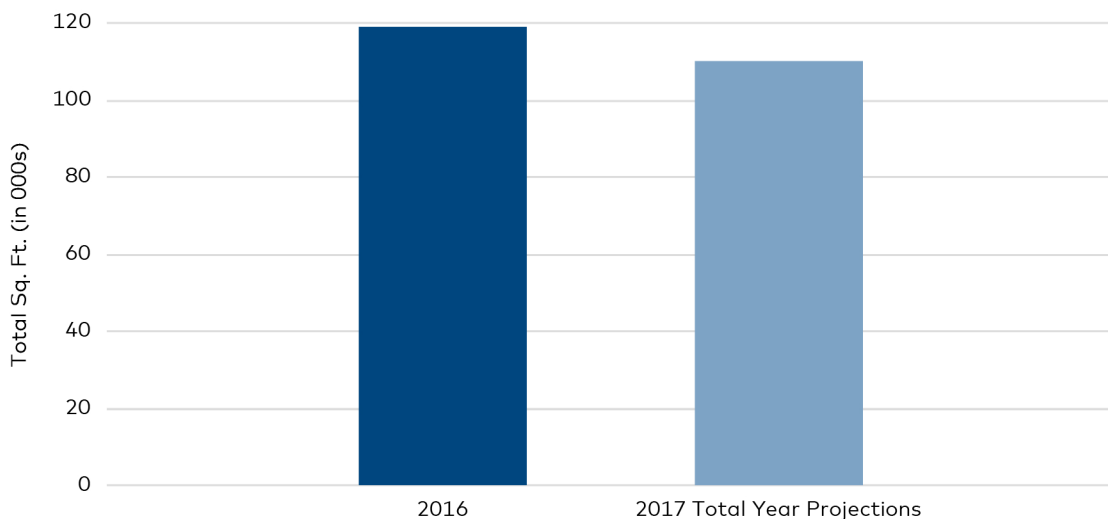
Address	Square Feet Leased	Tenant
9838 Old Placerville Road	139,500	California Department of Corrections and Rehabilitation
10000 Goethe Road	117,988	California Department of Corrections and Rehabilitation
8220 Longleaf Drive	110,372	California Correctional Health Care Services
4450 E. Commerce Way	81,225	Sacramento County Department of Human Assistance
3720 Dudley Blvd., 1st Fl.	77,574	Northern California Regional Public Safety Training Authority

Source: Yardi Matrix. Data as of October 2017

## SUPPLY

- Office deliveries in Sacramento have dropped dramatically since 2008—when a record-high 1.4 million square feet of space was completed—leading to very low post-recession absorption levels. Some 119,000 square feet came online in 2016, and office deliveries are projected to reach a **mere 110,372 square feet** by the end of this year.
- Construction is underway on two projects totaling some **167,000 square feet** of office space. The projects under development—Heller Pacific’s first phase of Ice Blocks, in Midtown, and Panattoni Development’s Dignity Health Medical Office Building, in Carmichael–Fair Oaks—are expected to be completed in Spring 2019.
- As available space grows increasingly scarce and the demand for quality office assets rises, we expect an **uptick in development activity** in the coming years. More businesses are likely to shift from the CBD to less established submarkets.
- Another **4 million square feet** is in the planning and permitting phases across the metro.

### Office Completions (Square Feet)



Source: Yardi® Matrix. Data as of October 2017

### Construction Activity

Top Submarkets	Square Feet Under Construction
Midtown	98,754
Carmichael-Fair Oaks	68,727
<b>Total Market</b>	<b>167,481</b>

Source: Yardi® Matrix. Data as of October 2017

### Construction Distribution

Top Submarkets	% of Inventory
Midtown	8.0%
Carmichael-Fair Oaks	6.5%
<b>Total Market</b>	<b>0.4%</b>

Source: Yardi® Matrix. Data as of October 2017

## INVESTMENT TRANSACTIONS

- The ongoing revitalization of Sacramento’s CBD has paved the way for increased transaction activity. More than **5.3 million square feet traded** for a combined \$968 million in the 12 months ending in October.
- Investors have been focused on **Downtown Sacramento and Roseville–Rocklin**, two established submarkets where sales volume amounted to more than \$550 million, equal to 55% of total transactions across the market. More than 65% of Roseville–Rocklin’s office inventory comprises properties completed since 2000.
- Since 2014, office properties completed during the 1980s and 1990s have attracted the most transaction activity, with sales volume reaching a combined **\$1.5 billion**. Older office assets built in the 1970s commanded some \$317 million, while circa-2000s buildings were sold for nearly \$335 million.
- Trophy office buildings were in high demand in the 12 months ending in October. Starwood Capital Group emerged as Sacramento’s biggest buyer during that time period. The company acquired the 502,000-square-foot Wells Fargo Center from Hines for \$176 million. Meanwhile, Hines paid \$120.5 million for the nearby Park Tower, a 447,000-square-foot high-rise developed by CIM Group.

### Transaction Volume

Top Submarkets	Total Transaction Square Feet	Total Transaction Volume (000s)
Downtown	1,084,279	\$323,006
Roseville-Rocklin	1,109,165	\$225,129
North Sacramento	1,027,879	\$167,004
Highway 50 Corridor	920,110	\$102,770
Folsom	492,061	\$95,125
<b>Total Market</b>	<b>5,323,397</b>	<b>\$968,184</b>

Source: Yardi® Matrix. Data as of October 2017

### Average Price

Top Submarkets	Avg. Price Per Square Foot
Downtown	\$239.79
Roseville-Rocklin	\$208.07
Folsom	\$186.54
North Sacramento	\$173.36
Highway 50 Corridor	\$139.68

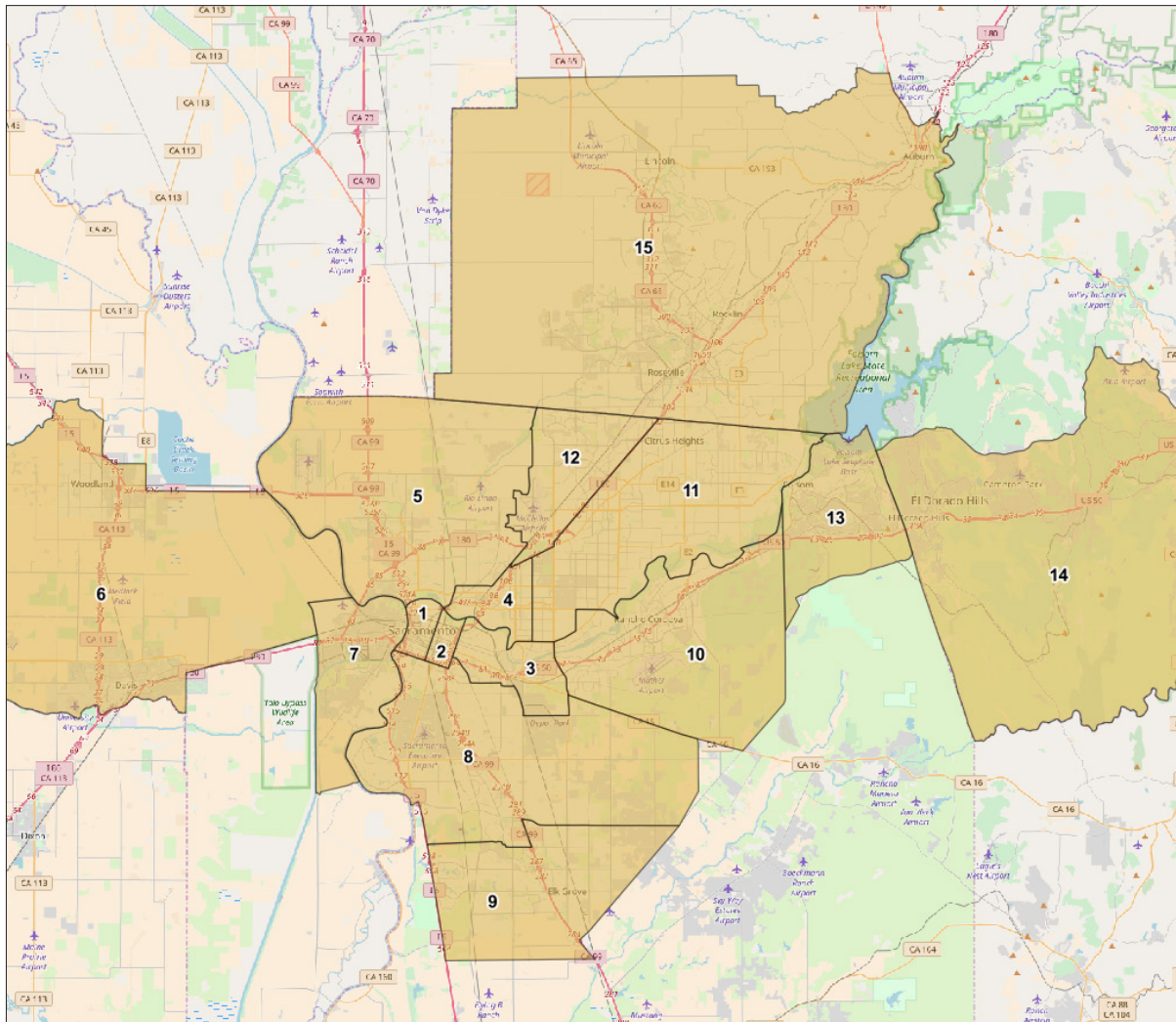
Source: Yardi® Matrix. Data as of October 2017

### Investment Activity

Top Buyers	Total Transaction Square Feet	Total Transaction Volume (000s)
Starwood Capital Group	502,365	\$175,630
Hines Interests	447,000	\$120,500
Strada Investment Group	196,324	\$105,100
Flyers Energy	378,522	\$63,340
Ridge Capital	416,425	\$57,405

Source: Yardi® Matrix. Data as of October 2017

## Yardi Matrix Office Submarkets – Metropolitan Sacramento



Area #	Submarket
1	Downtown
2	Midtown
3	East Sacramento
4	Point West
5	North Sacramento
6	Davis–Woodland
7	West Sacramento
8	South Sacramento
9	Elk Grove
10	Highway 50 Corridor
11	Carmichael–Fair Oaks
12	North Highlands
13	Folsom
14	El Dorado
15	Roseville–Rocklin

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