Kidder Mathews

Real Estate Market Review

NORTHERN CALIFORNIA | Sacramento

2nd Quarter 2016

Sacramento Office

Market Forecast

	Trends
Absorption	↑
Vacancy	↓
Rental Rate	↑
New Construction	↑

Notable Lease Transactions

Office of Statewide Health Planning & Development
2020 W El Camino Avenue, Sacramento
124,340 s.f.

Harris & Bruno International
3625 Cincinnati Avenue, Rocklin
19,294 s.f.

Regus
500 Capitol Mall, Sacramento
14,000 s.f.

Notable Sale Transactions

Oaktree
1515 S Street (Benvenuti Plaza)
Sacramento
350,000 s.f. for $68.5M ($196/s.f.)

Insight Realty Company
2180 Harvard Street (California Plaza)
Sacramento
151,822 s.f. for $18.4M ($121/s.f.)

Oaktree
10961 Sun Center Drive
(Prospect Business Park)
Rancho Cordova
90,000 s.f. for $10.5M ($117/s.f.)

The Sacramento office market revved back up in the second quarter of 2016, reporting 323,279 s.f. of positive net absorption after a mild quarterly loss in the first three months of the year. Vacancies declined to 12.6% market-wide, but were considerably lower in coveted submarkets such as Midtown and Elk Grove. Leasing activity decreased slightly from the previous quarter, with 303 deals spanning 809,716 square feet, but asking rental rates ticked up to $1.75 per square foot, fully serviced, their highest perch since 2011. Unemployment in Sacramento MSA dipped to 4.7% in the second quarter, down a full percentage point year-over-year, and the robust local economy was reflected in the demand for office space. The October 2016 opening of the Golden 1 Center, the new Sacramento Kings arena that will serve as the centerpiece of the city's new Downtown Commons entertainment and sports complex, may further boost office demand in the downtown submarket in the coming quarters.

This quarter's 323,279 square feet of positive net absorption turned last quarter's 173,603 square-foot loss into a blip on the radar; the Sacramento market has recorded absorption gains in 16 of the last 18 periods. The downtown submarket accounted for 81,793 square feet of the overall growth in occupied space, its second-strongest quarter in the last two years. Among the suburban submarkets, Roseville/Rocklin led the way with 88,146 square feet of positive absorption, its sixth straight quarterly gain, with Gemini Duplication—a legal services firm that moved its headquarters to Rocklin in 2014—occupying a 17,836-square-foot subleased space at 6020 West Oaks Boulevard. The Highway 50 Corridor was the only submarket to show a loss in excess of 25,000 square feet this quarter, as Volcano Corporation closed its doors at Prospect Business Park in Rancho Cordova. Rio Linda/North Highlands had the highest vacancy rate (31.7%) at quarter's end, while East Sacramento (5.4%) had the lowest. The Point West submarket, where asking rents averaged $1.73, fully serviced, remains a popular destination for frugal tenants seeking space in close proximity to downtown, but price tags there are up 6% year over year.

The second quarter brought a small decrease in leasing activity to the Sacramento market, which saw 303 transactions totaling 809,716 square feet, down two deals and approximately 70,000 square feet from the previous quarter. Public-sector users were the most active,

→ **Continued, page 2**

Area Review

Submarket Statistics

Submarket	Number of Buildings	Total Inventory	Direct Available	Sublease Available	Total Vacancy	Direct Availability Rate	Sublease Availability Rate	Total Vacancy Rate	Net Absorption YTD
Downtown	**269**	**19,663,060**	**1,969,046**	**64,370**	**1,971,050**	**10.00%**	**0.30%**	**10.00%**	**81,793**
Suburban	**2,711**	**76,068,418**	**11,953,559**	**418,226**	**10,066,680**	**15.70%**	**0.50%**	**13.20%**	**241,486**
Auburn/Lincoln	111	1,720,202	141,137	0	136,470	8.20%	0.00%	7.90%	31,357
Campus Commons	75	1,483,352	246,795	0	216,022	16.60%	0.00%	14.60%	14,081
Carmichael/Fair Oaks	141	1,605,323	288,069	0	189,661	17.90%	0.00%	11.80%	21,207
Citrus Heights/Orangevale	108	1,812,534	269,107	19,483	229,166	14.80%	1.10%	12.60%	2,900
Davis/Woodland	151	2,493,626	253,194	13,579	231,118	10.20%	0.50%	9.30%	30,564
East Sacramento	54	2,215,493	140,768	0	119,241	6.40%	0.00%	5.40%	6,168
El Dorado	132	2,082,815	551,288	49,325	463,544	26.50%	2.40%	22.30%	20,087
Elk Grove	85	1,880,611	169,069	1,894	142,020	9.00%	0.10%	7.60%	149
Folsom	155	4,945,046	596,179	25,258	593,481	12.10%	0.50%	12.00%	-5,125
Highway 50 Corridor	358	17,757,362	2,971,547	180,450	2,447,506	16.70%	1.00%	13.80%	-27,334
Howe Ave/Fulton Ave	128	2,786,701	771,216	4,801	685,945	27.70%	0.20%	24.60%	-4,453
Midtown	187	4,258,237	400,907	2120	304,519	9.40%	0.00%	7.20%	28,237
Natomas/Northgate	151	6,766,143	1,263,182	35,863	1,045,280	18.70%	0.50%	15.40%	45,191
Point West	75	2,904,385	538,694	32,944	490,268	18.50%	1.10%	16.90%	4,393
Rio Linda/N Highlands	46	1,134,123	436,812	0	359,129	38.50%	0.00%	31.70%	-4,095
Roseville/Rocklin	450	11,881,916	1,805,490	36,152	1,440,933	15.20%	0.30%	12.10%	88,146
South Sacramento	164	3,529,428	535,117	5,034	473,800	15.20%	0.10%	13.40%	2,316
Watt Ave	87	2,660,498	371,079	0	301,913	13.90%	0.00%	11.30%	707
West Sacramento	53	2,150,623	203,909	11,323	196,664	9.50%	0.50%	9.10%	-13,010
Class A	**189**	**26,231,479**	**3,078,770**	**172,065**	**3,011,751**	**11.70%**	**0.70%**	**11.50%**	**78,983**
Class B	**1,310**	**43,874,538**	**6,820,383**	**227,629**	**5,519,950**	**15.50%**	**0.50%**	**12.60%**	**61,784**
Class C	**1,481**	**25,625,461**	**4,023,452**	**82,902**	**3,506,029**	**15.70%**	**0.30%**	**13.70%**	**182,512**
Total	**2,980**	**95,731,478**	**13,922,605**	**482,596**	**12,037,730**	**14.54%**	**0.50%**	**12.57%**	**323,279**

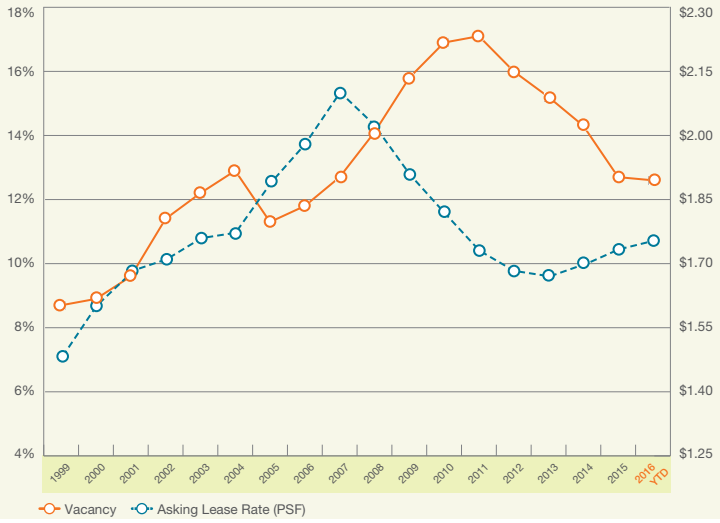
led by the Office of Statewide Health Planning & Development, which took 124,340 square feet at 2020 West El Camino Avenue in Sacramento. The plug'n'play office and executive suite provider Regus inked one of the largest private-sector pacts, signing on for 14,000 square feet on the 23rd floor of 500 Capitol Mall, its third location in Sacramento's CBD and ninth in the region. Regus' continued growth in the market indicates strong demand for coworking spaces and small-scale, flexible-term offices, both signs of an emerging technology sector. Harris & Bruno International struck the quarter's largest private-sector suburban deal, grabbing 19,294 square feet at 3625 Cincinnati Avenue in Rocklin.

Investment activity cooled slightly in the second quarter, with $147.2 million of Sacramento office real estate changing hands at an average cap rate of 6.5%. The quarter's largest transaction was a three-building sale pairing 1515 S Street in Downtown Sacramento with 10961-10971 Sun Center Drive in suburban Rancho Cordova—purchased by Oaktree Capital Management from Hines REIT— for a total of $79 million. In the Point West submarket, Insight Realty Company shelled out $18.4 million ($121 per square foot) for 2180 Harvard Street. That investment was underwritten at a 6.4% cap rate, just below the market's quarterly mean.

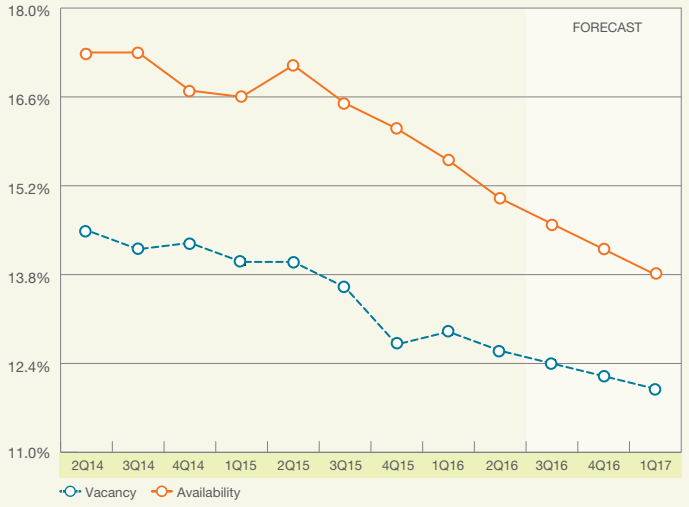
The Sacramento MSA economy strengthened during the second quarter. Unemployment fell to 4.7%, down half a percentage point from the first quarter and a full point year over year, completing a return to pre-recession levels. Construction remains the fastest-growing industry in Sacramento, with an 11.2% hike in employment from the same time a year ago, which amounts to some 5,500 new jobs. Among office-based sectors, Educational & Health Services remains a bedrock of the regional economy, adding about 4,000 jobs year over year, for a 2.8% growth rate. The Folsom-based educational technology company PowerSchool announced in June that it will add 70 more local jobs, on top of the 150 workers it has hired in the last nine months. Conversely, food manufacturers slashed 15.4% of their Sacramento-area workforce, a 600-job decline, and the Arts, Entertainment, and Recreation sector was down 1,000 workers, a 7.0% dip from this time in 2015.

Source: CoStar

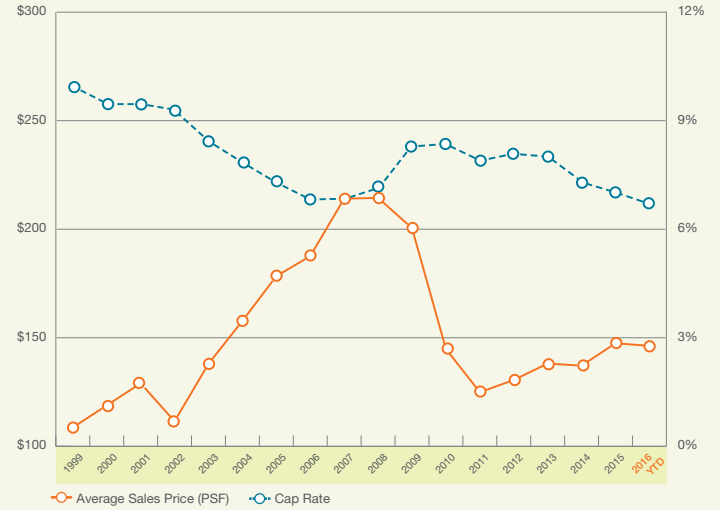
VACANCY VS ASKING LEASE RATE



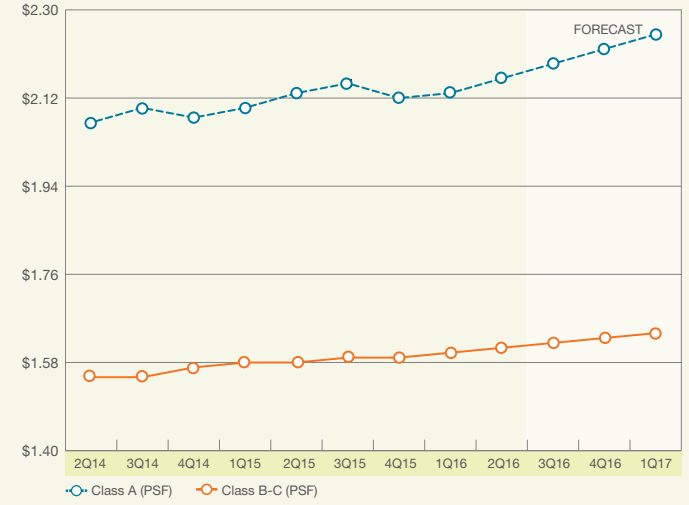
VACANCY VS AVAILABILITY



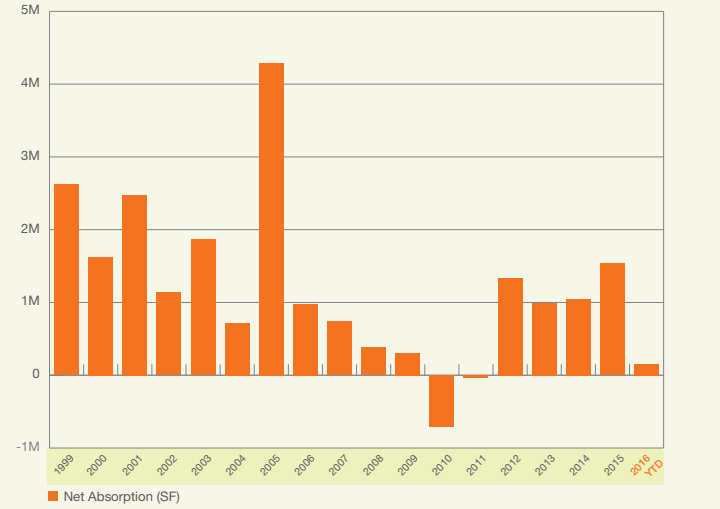
AVERAGE SALES PRICE & CAPITALIZATION RATES



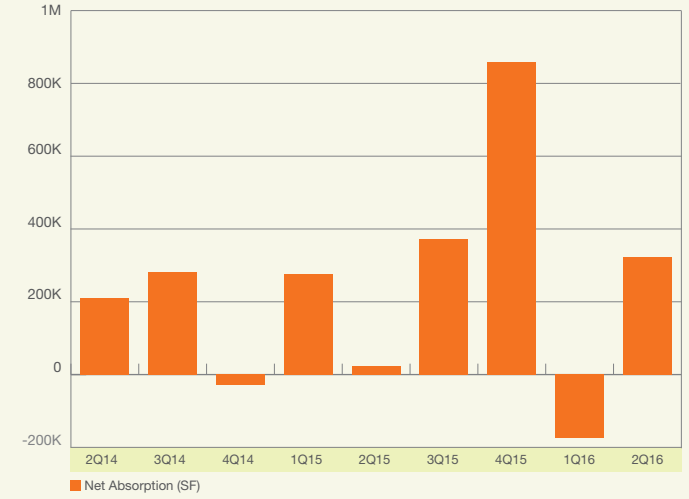
ASKING LEASE RATE



NET ABSORPTION - HISTORICAL



NET ABSORPTION - QUARTERLY



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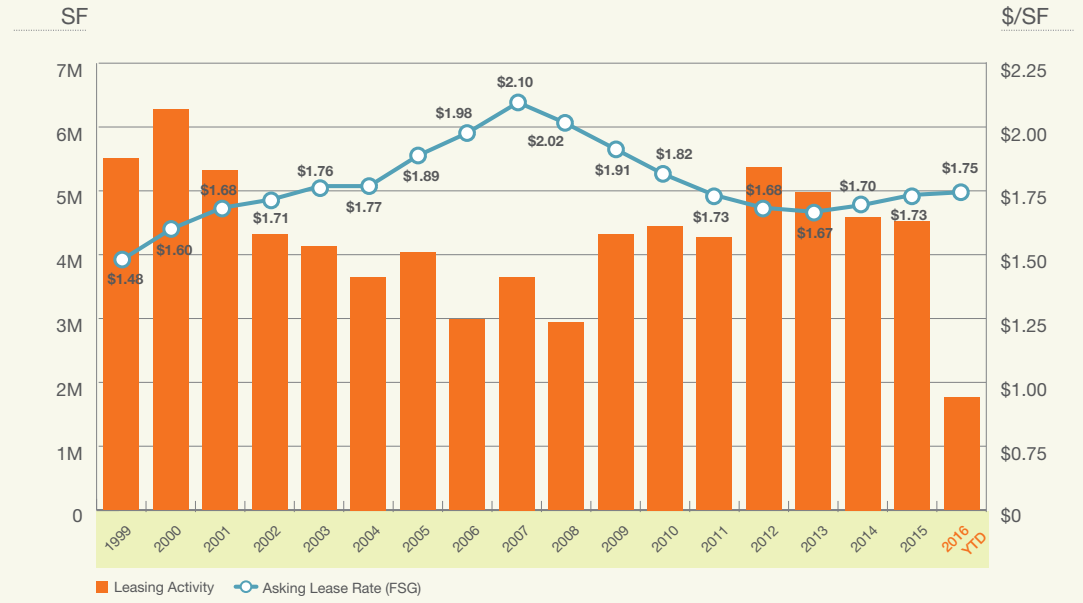
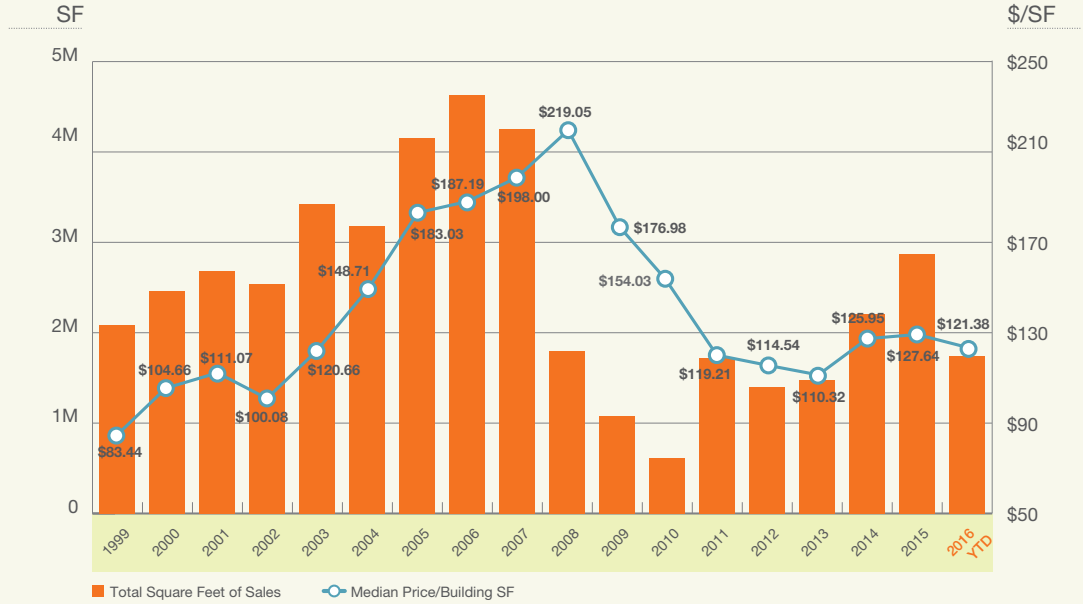
Market Breakdown

	2Q 2016	1Q 2016	2Q 2015	Annual % Change
Vacancy Rate	12.57%	12.86%	13.96%	-9.96%
Availability Rate	14.54%	15.15%	16.73%	-13.09%
Asking Lease Rate	$1.75	$1.73	$1.71	2.34%
Leased SF	809,716	881,724	1,213,270	-33.26%
Sold SF	749,995	1,180,668	715,329	4.85%
Net Absorption	323,279	-173,603	24,588	N/A

HISTORICAL LEASING ACTIVITY & ASKING LEASE RATES



HISTORICAL SALES SF & MEDIAN SALE PRICE



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