MARKET REPORT

Retail

Sacramento Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

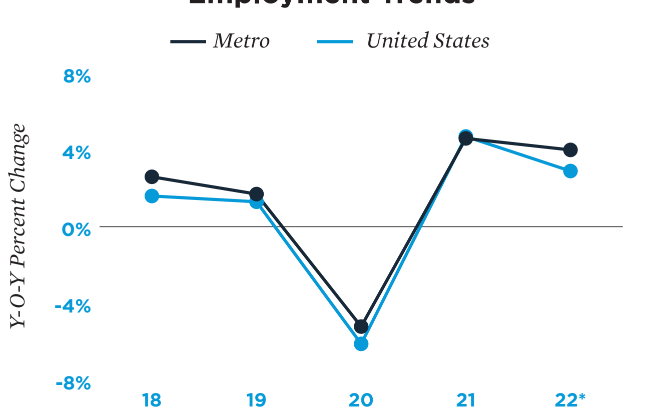
3Q/22

State Government Supports Stable Demand Base; Retailers Target Space in Diminishing Pipeline

Public sector and coastal relocations aid local retailers. Government employers served as a vital backstop for labor demand during the pandemic-induced downturn, with Sacramento's job market experiencing the smallest contraction among major California metros in 2020. The metro recouped all job losses early this year, supported by transplants from the Bay Area. The capital region retains a cost-of-living advantage over the state's coastal markets, mitigating the metro's decelerating population growth. Many of these arrivals have a higher discretionary spending capability than the existing population, which should aid area businesses as consumers pare down retail purchases in response to inflation. Furthermore, Sacramento is attracting new firms catering to higher-income clientele, exemplified by Anthropologie and ice cream eatery Salt & Straw taking on space in the city's Midtown District.

Tapering development contributes to long-term recovery. As of August, the active pipeline comprises less than 300,000 square feet, including projects slated for the latter months of 2022. Prior to the health crisis, the trailing decade-long annual construction average exceeded half a million square feet. Slower construction has supported vacancy declining to the low-6 percent zone this year, the tightest availability observed in the metro since the Financial Crisis. Adding to this, more than 80 percent of space underway has already been taken off the market, indicating vacancy will see minimal upward pressure from the supply-side for the forseeable future.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Retail 2022 Outlook

40,500 JOBS
will be created

EMPLOYMENT:

Sacramento firms will expand staffing counts by a robust 4.0 percent in 2022. However, with a record-low unemployment rate of 3.3 percent in August, further recruitment will face significant headwinds.

255,000 SQ. FT.
will be completed

CONSTRUCTION:

Sacramento will mark the second-lowest annual completion figure in multiple decades this year. As of September, the largest project in the long-term pipeline is a 100,000-square-foot neighborhood center underway in Rancho Cordova.

20 BASIS POINT
decrease in vacancy

VACANCY:

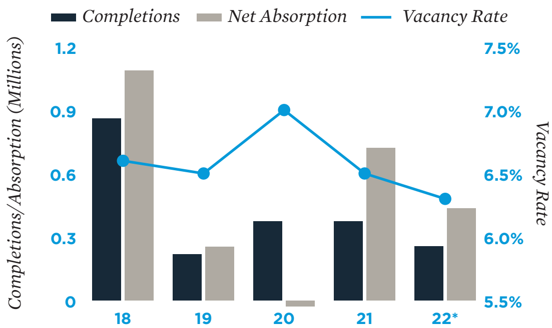
Availability is expected to close out 2022 at 6.3 percent, the lowest fourth quarter rate since 2007. Quarterly vacancy rates during the decade preceding the pandemic averaged at roughly 9.0 percent.

0.5% INCREASE
in asking rent

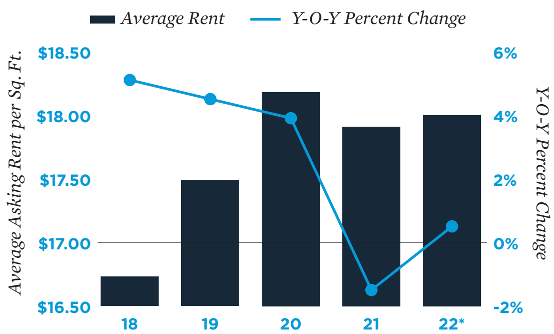
RENT:

Declining vacancy will drive competition for available floor plans, allowing rents to regain positive momentum after a 1.5 percent decline in 2021. The mean marketed rent will reach $18.00 per square foot this year.

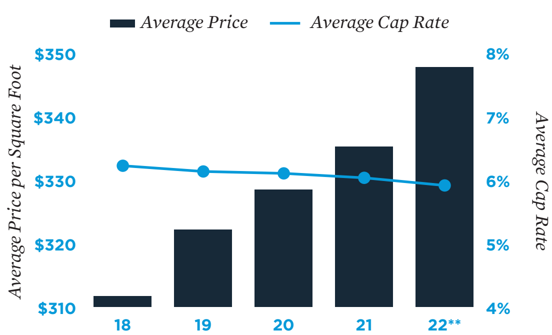
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

2Q 2022 - 12-Month Period

CONSTRUCTION

225,000 sq. ft. completed

- Construction was slow through most of the trailing year ended in June, as builders completed under 40,000 square feet for three of the four quarters.
- Nearly all development activity this period took place in Sacramento and Placer counties. Finalizations did not exceed 10,000 square feet in Yolo County and were nominal in El Dorado County.

VACANCY

70 basis point decrease in vacancy Y-O-Y

- Availability entered July at 6.5 percent, just 10 basis points ahead of the low reported during the previous cycle.
- The multi-tenant segment led compression this period, with a 160-basis-point decline to 6.3 percent. By comparison, availability fell just 50 basis points to 6.5 percent among single-tenant properties.

RENT

0.2% increase in the average asking rent Y-O-Y

- The mean marketed rent hovered below the $18.00 per square foot threshold during this period, entering July at $17.89 per square foot.
- Asking rents declined 0.2 percent in Sacramento County, despite a 100-basis-point drop in availability, indicating that higher-priced space is being taken off the market to a greater degree, influencing the overall metric.

Investment Highlights

- Investors came back in force last year, bringing transaction velocity to a record level during the 12-month period ended in June. Additionally, deal flow increased notably between the first and second quarters of this year despite mounting capital costs, indicating investor appetites remained healthy into midyear. However, interest rates are expected to continue rising through the remainder of 2022, creating additional headwinds.
- The multi-tenant sector observed the most rapid pricing growth in more than a decade and a half during the 12-month period ended in June, advancing 9 percent from the preceding span to a new record of $318 per square foot on average. Conversely, a trend toward vintage assets translated to some pricing attrition in the single-tenant segment, with the average price in this category declining 1 percent to $397 per square foot during the same time frame.
- Multi-tenant investors were heavily active in the southwestern portions of Placer County during this period. While headline deals involved institutional players targeting larger power centers along the Interstate 80 Corridor, this submarket is home to a number of neighborhood, community and strip centers in the sub-$10 million tranche.

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