

MARKET REPORT

Office
Sacramento Metro Area

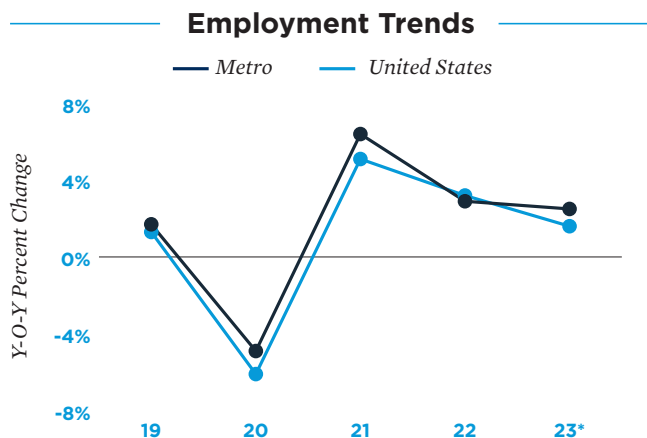
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4Q/23

Public/Private Move-Ins Offer Differing Operator Outlooks; Mid-Tier Asset Performance Improves

Office demand begins to stabilize. A number of government agencies are re-entering the marketplace following lease expirations early on in the pandemic, in some cases moving into long-planned expansions or relocations. While this trend contributed to less net space relinquished in the first half of 2023, overall, the state intends to consolidate the amount of office space it leases by more than 1 million square feet across California. Still, this returning office utilization may serve as an example for private organizations locally. Over the latter half of the year, lease commitments by consulting, insurance and law firms will help lift Sacramento's quarterly office absorption into positive figures, prompting vacancy to stand just 20 basis points above its 14.8 percent historical average by year-end.

Tenant preferences shifting toward lower-cost alternatives. Entering July, Class A vacancy stood 430 basis points above its long-term average amid continued tenant demand realignment. Conversely, positive Class B/C net absorption was recorded across each of the last seven quarters ending in June, allowing segment vacancy to compress 100 basis points during that stretch. Leasing activity within this class cut was well dispersed across Sacramento submarkets, with each of the metro's five areas noting vacancy below their respective historical means. The Class B/C average asking rent was 29 percent under the Class A mean in June, a draw for budget-conscious firms and those accommodating hybrid work schedules.



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2023 Outlook



**27,000
JOBS**

will be created

EMPLOYMENT:

Government agencies accounted for more than 60 percent of the net 23,300 positions added during the initial eight months of the year. This will aid an overall employment growth rate of 2.5 percent in 2023.



**365,000
SQ. FT.**

will be completed

CONSTRUCTION:

Builders will complete roughly half the amount of new office space as the metro's historical annual average this year. Three-fourths of this pipeline comes from CalSTRS' build-to-suit office near the River Walk Park.



**80
BASIS POINT**

increase in vacancy

VACANCY:

Despite lifting to 15.1 percent by year-end, metro vacancy will stand just 30 basis points ahead of its long-term average. This measure will also register 250 basis points below the national metric in 2023.



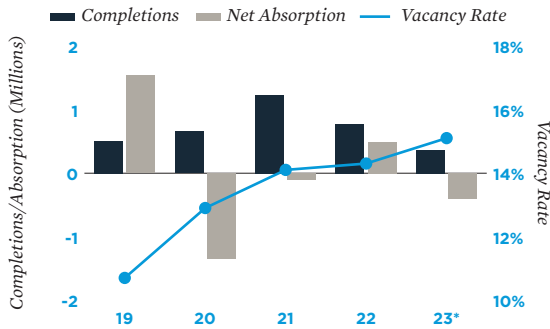
**0.9%
INCREASE**

in asking rent

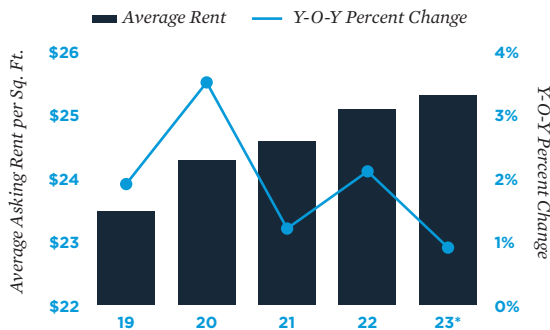
RENT:

Continued relinquishment of office space ebbs rent growth this year to its slowest pace since 2014. Still, this gain will allow the metro's average asking rate to reach its highest point on record at \$25.30 per square foot.

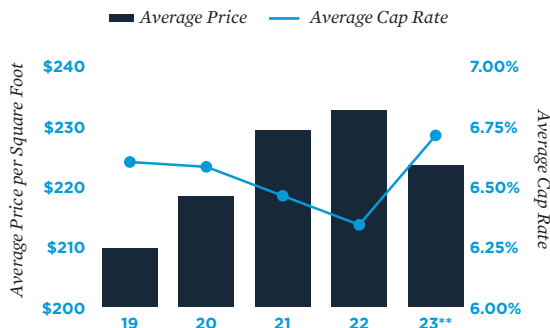
Supply and Demand



Rent Trends



Sales Trends



* Forecast ** Through 2Q

Sources: CoStar Group, Inc.; Real Capital Analytics

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Price: \$250

2Q 2023 - 12-Month Period

CONSTRUCTION

340,000 sq. ft. completed

- Few first half additions brought the year-over-year inventory growth rate down to 0.4 percent in June, matching its slowest pace since early 2019.
- The completion of the State of California's Military Headquarters near Mather Airport increased the Highway 50 Corridor's office stock by 1.7 percent over the year ended in June.

VACANCY

80 basis point increase in vacancy Y-O-Y

- Sacramento's three largest submarkets by stock each recorded vacancy increases of at least 90 basis points over the yearlong span ended in June. This elevated the marketwide rate to 15.0 percent entering July.
- Class B/C vacancy lowered 50 basis points during the previous annual period to 13.7 percent, which is 150 basis points below its historical average.

RENT

1.9% increase in the average asking rent Y-O-Y

- A considerable amount of Class A space returning to the market and demanding higher than metro average rents contributed to Sacramento's mean marketed rate lifting to \$25.19 per square foot.
- Among the metro's three largest submarkets, Sacramento County noted the largest average rental rate gain at 3.0 percent annually.

Investment Highlights

- Transaction velocity fell by roughly 30 percent over the four-quarter period ended in June relative to the 12 months preceding this span. Reduced deal flow was largely the result of muted trading activity within the \$15 million-plus tranche between October of last year and June 2023, amid elevated interest rates and conservative underwriting practices. Although preliminary data shows this trend continued in the third quarter, recent interest rate stabilization suggests some of this activity may return.
- Roughly 18 percent of properties traded in the first eight months of the year held a high vacancy designation, indicating some investors are seeking value-add and redevelopment opportunities. Local individuals and firms were most common among buy-side activity for these assets, typically acquiring properties below the \$5 million threshold.
- During the year ended in June, prices declined 3.2 percent against the same span in 2022 to \$223 per square foot. Nevertheless, long-term owners are realizing gains. The holding period on assets traded since the start of 2023 averaged 11 years, a stretch in which the measure appreciated more than 74 percent, likely encouraging improved sale volume moving forward.

The information contained in this report was obtained from sources deemed to be reliable. Every effort was made to obtain accurate and complete information; however, no representation, warranty or guarantee, express or implied, may be made as to the accuracy or reliability of the information contained herein. Metro-level employment growth is calculated based on the last month of the quarter/year. Sales data includes transactions sold for \$1 million or greater unless otherwise noted. This is not intended to be a forecast of future events and this is not a guaranty regarding a future event. This is not intended to provide specific investment advice and should not be considered as investment advice. Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Real Capital Analytics

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