

MARKET REPORT

OFFICE

Sacramento Metro Area

IPA
INSTITUTIONAL
PROPERTY
ADVISORS

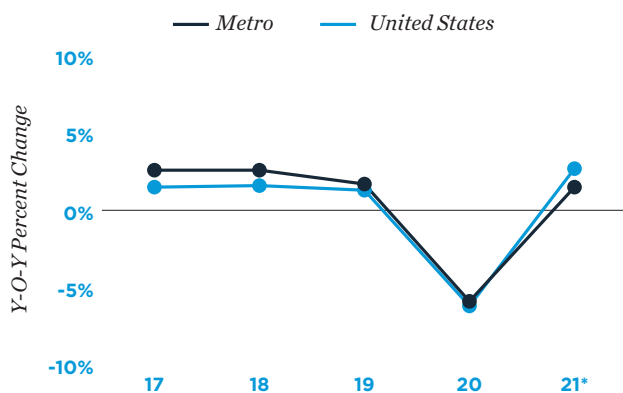
2Q/21

State Agencies' Uncertain Plans Cloud Near-Term Outlook; Redevelopment Potential Emerges

Performance hinges on government sector. Sacramento's office market is in a state of flux after recording a 200-basis-point-plus rise in vacancy last year that ended a span of declining availability. The increase can be partially attributed to a reliance on government agencies as primary office tenants, a factor that will weigh on fundamentals moving forward. California plans to fully reopen in mid-June, which would return private employees to offices, yet a percentage of state workers are expected to continue remote work or adhere to a hybrid schedule. As state agencies review their current footprints under these circumstances, those slated to occupy buildings currently underway or in planning stages may partially vacate or divest of aging buildings, placing upward pressure on vacancy, namely in the downtown area.

Future of aging offices altered by population growth. The volume of sublet space in the metro has reached a record level, inflated by Sutter Health placing two buildings totaling 200,000 square feet on the market in early 2021. The duration that these and similar spaces will remain available is uncertain; however, the sparse number of sublease executions during the pandemic suggests they may struggle to secure tenants. Slow leasing velocity could impact the trajectory of older privately held properties. Tight apartment vacancy and the metro's ability to attract new residents may position these assets as residential redevelopment candidates, removing them from vacant stock.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2021 Outlook



**15,000
JOBS**

will be created

EMPLOYMENT:

The rollback of business restrictions, aided by ongoing inoculations, will support job growth of 1.5 percent in 2021. The traditional office-using sector will expand at a stronger pace as the addition of 3,500 positions equates to 1.8 percent annual growth.



**626,000
SQ. FT.**

will be completed

CONSTRUCTION:

Deliveries increase the metro's office inventory by 0.7 percent for a second consecutive year. Nearly all the space slated for completion in 2021 is pre-leased by government agencies.



**100
BASIS POINT**

increase in vacancy

VACANCY:

State agencies and private firms evaluate their future office space needs, tempering leasing this year and potentially increasing the volume of available sublet space. These factors push vacancy up to 14.5 percent, the highest level since early 2016.



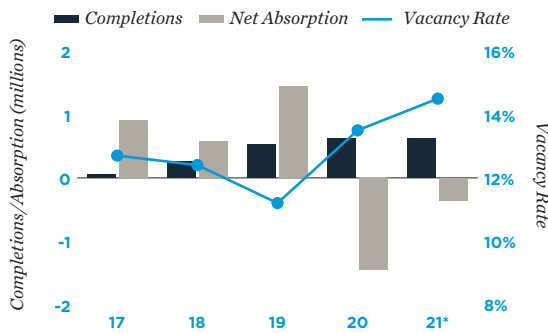
**0.4%
INCREASE**

in asking rent

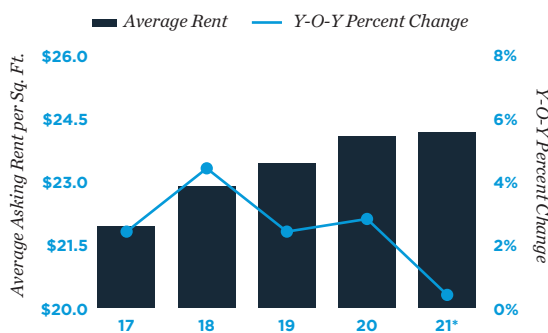
RENT:

A mix of older and higher-quality space rejoins the leasing market, allowing the average asking rent to rise nominally to \$24.17 per square foot. The slight uptick in marketed rate prolongs a stretch of positive growth that began in 2013.

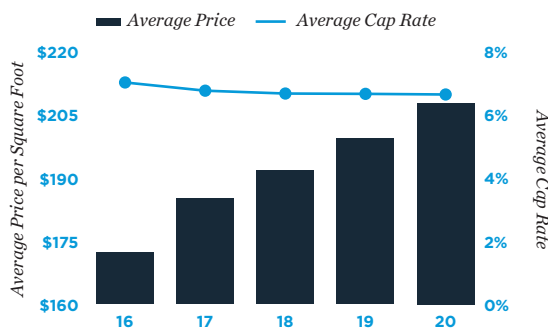
Supply and Demand



Rent Trends



Sales Trends



* Forecast
Sources: CoStar Group, Inc.; Real Capital Analytics

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2020

CONSTRUCTION

620,000 square feet completed

- Deliveries were concentrated in North Natomas during 2020, highlighted by completions at Centene’s new West Coast campus.
- Entering this year, construction was underway on nearly 2 million square feet of space with deliveries extending into 2022. Most of these properties are build-to-suit facilities for state agencies.

VACANCY

230 basis point increase in vacancy Y-O-Y

- Sacramento’s vacant stock expanded by nearly 2.1 million square feet in 2020, lifting availability to 13.5 percent. This increase ended an eight-year stretch of declining vacancy.
- Class A vacancy rose 480 basis points to 11.4 percent last year, while Class B/C availability expanded 140 basis points to 14.3 percent.

RENT

2.8% increase in the average asking rent Y-O-Y

- Average asking rent elevated to \$24.07 per square foot in 2020, supported by a more pronounced gain in Sacramento County, where 350,000 square feet of Class A space was vacated last year.
- Marketed rates climbed across all office segments, with average Class A and Class B/C rents rising 1.8 percent and 3.2 percent, respectively.

Investment Highlights

- Sales activity fell by 20 percent last year with a high percentage of transactions closing for less than \$3 million. This combination equated to a more than 50 percent drop in year-over-year sales volume.
- Sacramento remains California’s lowest-priced major market for office investment despite a 4 percent increase in pricing that boosted the metro’s average to \$208 per square foot. Amid the rise, the average cap rate was unchanged at 6.6 percent.
- Local and regional investors have placed a significant focus on suburban properties since the onset of the health crisis. Buildings along Interstate 80 are garnering notable attention, highlighted by a collection of recent Class A and B trades in Roseville. Class C trades are supporting sales activity in other office-heavy suburbs including Rancho Cordova, North Natomas and South Sacramento.
- In contrast to the overall office market, transaction velocity for medical offices has remained relatively stable, buoyed by a sizable healthcare sector that has maintained buyers’ confidence in future demand for this property type.

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. Note: 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: IPA Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Real Capital Analytics
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