SACRAMENTO

AVISON YOUNG

KEY MARKET METRICS – 2020 EXPECTATIONS

Annual growth rates, estimated for year-end 2020 vs year-end 2019.

	OFFICE	RETAIL	INDUSTRIAL
Rental Growth	↑	↑	↑↑
Vacant Space	↓↓	→	→
Construction Levels	↑	↓	↓
Leasing Volume	↑	→	↑
Investment Volume	↑	↑	↑↑

EXECUTIVE SUMMARY

- Strong tenant demand continues to put pressure on available inventory, pushing vacancy rates in the Sacramento Valley to dip below 10% for all product types.
- With historically low vacancy rates, tight occupancy levels provide little room for expansion opportunities, igniting demand for new construction in the region.
- After years of relatively flat rental growth, average asking rates have increased exponentially year-over-year.
- Demand for distribution centers by e-commerce companies is a rising trend in the Sacramento Valley and driving activity within the industrial sector.
- Sacramento continues to be an attractive cost alternative to the Bay Area for occupiers and investors alike.

The Sacramento Valley continues to prove its strength within the Bay Area. Vacancy rates have dropped below 10% while average asking rates have skyrocketed. Government, medical, and technology tenants continue to fuel the office market, while an increasing demand for distribution space by e-commerce tenants are driving the industrial market. Over the next year, expect tenant and investor activity in the Sacramento Valley to remain strong.

Over the past couple of years, vacancy rates for office and industrial product have been on the decline, all falling below 10%. Due to the limited inventory and construction, office vacancy should continue to decline, with potential to descend below the 8.0% rate measured towards the end of 2019. The amount of available industrial space in Sacramento has also been remarkably low this year with vacancy rates hitting an all-time low of 4.5% in the first quarter of 2019.

Average asking rates have been on the rise as a result of the declining vacancies. Office rents have increased by about 1.0% year over year with premium Class A space in downtown increasing by about 9.5%. Industrial and flex landlords have also been pushing rents upward due to the lack of available inventory throwing off the supply-demand balance over the past couple of quarters. Year-over-year, pure industrial rents have increased by a whopping 7.8%. Tight occupancy levels amongst all product in Sacramento has allowed for unprecedented rent growth that doesn't appear to be slowing down any time soon.

A rising trend within Sacramento Valley is the growing demand by e-commerce companies for distribution facilities. Many landlords are realizing that if they build speculative construction focused on distribution, then tenants, like Amazon and Walmart, will occupy. Amazon already has an 855,000 square foot (sf) distribution center near the Sacramento Airport and has plans for an additional 41,000 sf center in Roseville. Similarly, there is a building permit application under review for a brand new 1.13 million square foot (msf) distribution center in Metro Air Park that is rumored to belong to Walmart. Nevertheless, these types of developments typically require larger footprints, numerous dock high doors, and extensive open areas which are hard to come by within most of the Sacramento metro.

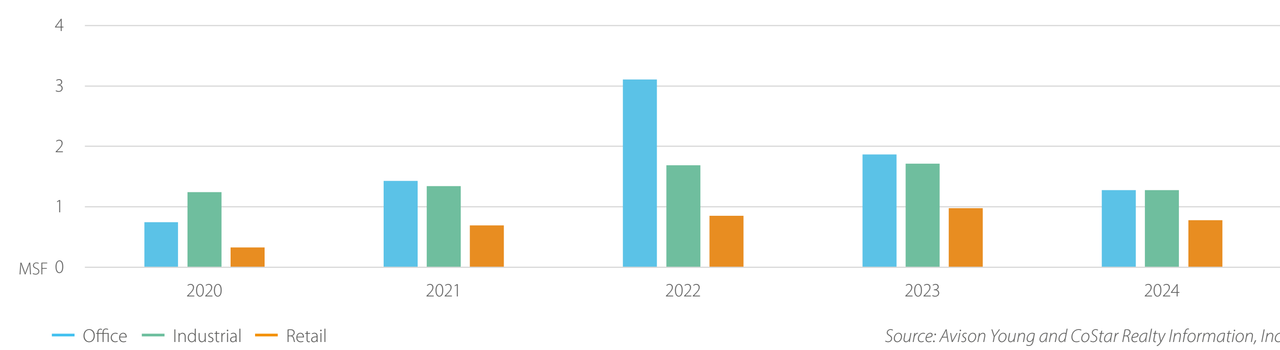
But things may be looking up for the industrial sector in the near future since there is roughly 2.5 msf of development currently under construction with only 44% of that space preleased. Due to the modest increase in demand over the past year, industrial developers have been choosing to build more speculative projects generally in the form of warehouse centers. So far, these projects have been performing well in the Sacramento market which will only pave the way for future developments.

The office market, however, has a slightly different story to tell. High demand from office tenants will continue to put pressure on asking rates and vacancy as there is little construction in the pipeline that is not already spoken for. The market should only see a marginal change in inventory with just 700,000 sf of new office product being delivered next year with 87% already preleased. However, the office market should expect roughly 6.4 msf of new product over the next few years, which should include more opportunities for relocating companies.

Overall, Sacramento should see enough development in the coming years to attract more tenants and residents to the Sacramento area. As more tech workers relocate to the Sacramento Valley due to housing costs, the metro should see a notable increase on tech demand in the area. Despite the minimal increases in job growth over the past couple of years, Sacramento continues to hold a 5.0% record of population growth each year. Over the next few years, Sacramento should continue to be a viable option for the relocation of new businesses due to its' relative affordability and thriving lifestyle.

Despite the high construction costs in the Bay Area, Sacramento Valley's development pipeline is quite strong. There is a high number of projects currently under construction and entitled that are expected to be completed over the next couple of years across all product types.

DEVELOPMENT DELIVERY TIMELINE



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