



OFFICE MARKET REPORT

MARKET OVERVIEW Source: CoStar

The Sacramento region continues to show signs of economic resilience with stable metrics and various positive signs in the commercial office market. Net Absorption in Q3 2022 reported negative 108,603 square feet as compared to the negative absorption of 238,277 square feet in Q3 2021. Much of Sacramento's positive absorption is attributed to government lease transactions and not the private sector. Asking rents, typically the last indicator to react to market conditions, have been firm. The average lease rate remained unchanged from Q2 2022 at \$1.96/SF Full Service and a \$0.01/SF increase from Q1 2022. Vacancy Rates also remained essentially unchanged from the previous quarter from 14.6% to 14.5%, yet, a number of large office users have selected Sacramento as a location for relocation and expansion. At the end of the third quarter, Sacramento reported close to 1 million square feet of leasing activity for the first time since the first quarter of 2020.

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14.5%



Vacancy Rate

(±108,603) SF



Net Absorption

\$1.96



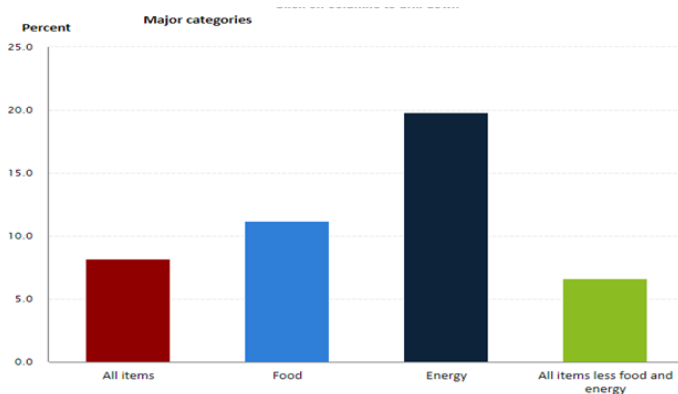
Average Asking Rate (FSG)

ECONOMIC OUTLOOK

While the long-term global economic outlook remains uncertain, there are clear indicators of recessionary pressures felt right now.

- The Federal Reserve has delivered five interest rate increases in 2022, putting pressure on borrower's ability to borrow.
- Consumer finances are stretched – if you've purchased groceries, gas, and other goods or services in the last few months, you have certainly noticed a higher bill.
- Households across the country are feeling the effects of inflation, brought on by supply chain disruptions paired with higher consumer demands.

12-MONTH PERCENTAGE CHANGE, CONSUMER PRICE INDEX, SELECTED CATEGORIES, SEPTEMBER 2022, NOT SEASONALLY ADJUSTED



Source: US Bureau of Labor Statistics

As Americans work on adjusting their budgets, the Federal Reserve, which serves as the U.S. central bank, is working to get inflation under control. This is meant to encourage savings and reduce consumer spending, which, in turn, decreases demand.

While raising rates can help the Fed address inflation, it can impact financing options, including mortgages. In September, with inflation still running stubbornly hot, the Federal Reserve increased the target for the federal funds rate still another 0.75% to a range of

3% – 3.25%. The Federal Reserve also released median projections showing that they anticipate the target rate to be 4.4% by the end of 2022. It is expected that the latest rate increases will continue to slow the growth and should stabilize in 2023.

LEASING

Demand is returning to pre-pandemic levels, however, the real growth observed comes from development in the biotech sector. Aggie Square recently had its groundbreaking ceremony, announcing two tenants: Cytvia and the Alice Waters Institute. Another example is Orca-Bio, which develops cell therapies for cancer blood disorders and autoimmune disorders and has come to terms with Buzz Oates on a 100,000-square-foot industrial manufacturing facility in Metro Air Park. The largest announcement has come from Solidigm, a subsidiary of SK Hynix and semiconductor producer, which will spend more than \$100 million to establish a new research and development campus and lab in Rancho Cordova. The firm has leased more than 300,000 square feet across several buildings and will be adding hundreds to tech sector jobs when occupancy begins in early 2023. Lease Rates have leveled off with an annual rent growth of 2.2%, close to the national figure of 1.2%. The highest reported rates were Downtown and Midtown submarkets at \$2.94/SF and \$2.31/SF, and in the suburbs, El Dorado Hills / Folsom reported at \$2.03/SF.

CONSTRUCTION

Sacramento has seen very little large-scale office construction over the past 10 years. Most of the construction that is taking place is build-to-suit with various state government agencies slated to occupy the majority of the 2.1 million SF under construction. The most extensive project underway is a four-building campus on the northern boundary of Downtown. Developed by the California Department of General Services, the project will bring another 1.3 million SF and will likely be filled with various state agencies located throughout the region.

\$492,825



Median Home Value in
Sacramento MSA
(Source: Zillow, September 2022)

3.7%



Sacramento
Unemployment

3.5%



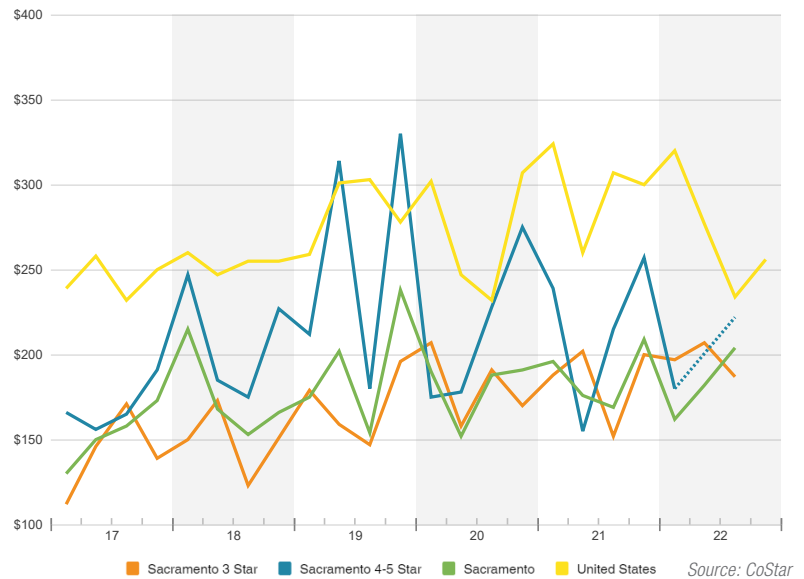
United States
Unemployment

SALES

Sacramento's office sales market reported a modest 2022 in terms of sales volume reaching \$866 million over the past 12 months, much of that figure comes from the second half of 2021, before the rapid increase in interest rates. Market sales prices have increased 2.68% year over year from \$224 to \$230 per square foot. Market cap rates have remained constant, increasing just 0.01% from 7.18% to 7.19%.

The largest sale of the year took place in September when San Rafael-based Seagate Properties, an owner of a number of office properties throughout Sacramento, purchased the 169,000 SF, 4 Star office building located at 925 L St for \$55.1 million (\$326/SF). The building was 99% leased at the time of sale. In Rocklin, a biotech company that has focused on office inventory is CPC Scientific which purchased 3880 Atherton Road for \$6 million. The 41,000-square-foot two-story office building, built in 2009, will also be used as a manufacturing facility.

SALE PRICE PER SF



EMPLOYMENT OUTLOOK

Overall employment has returned to healthy levels throughout Sacramento as the unemployment rate continues to fall, reaching 3.7%, on target with the national rate of 3.5%, which has decreased over 1.2% from Q3 2021. Job gains continue to be noted in hospitality and health care. Office employment recorded an increase of 4.1% year over year, bringing the number of office-using jobs to 190,000. Population growth witnessed during, and post-lockdown can be attributed to Sacramento's relative affordability. Bay Area and Southern California residents continue to show interest in Sacramento to escape exorbitant housing costs, and the pandemic has only accelerated that trend.

Gallelli Real Estate and Osborne Group Thoughts:

While the Global and National economy seems to be slowing, we believe our local Sacramento market still has near term opportunities in areas of biotechnology, medical, and industrial sectors. Interest rate adjustments have already begun to impact the residential market, however, commercial lending for owner-users is still strong and attainable. We anticipate seeing activity levelling in the near future but remain encouraged that with the Fed corrections and Bay Area transplants, enticed by a lower cost of living, will continue to drive our local economy through the end of the year and into 2023.

Office Market Statistics

(Criteria based on: 10,000 SF and above, does not include owner occupied, Existing, Under Construction, Proposed, Final Planning)

Submarket	Total Number of Buildings	Inventory	Vacant Space			Vacancy Rate Q3-22	Availability Rate Q3-22	Net Absorption		Avg. Asking Rate (FSG) Weighted
			Direct	Sublease	Total			Q3-22	Q3-21	
Arden/Arcade										
Class A	8	872,773	176,982	7,893	184,875	21.2%	23.6%	30,096	15,751	\$2.14
Class B	88	3,868,722	863,508	26,228	889,736	23.0%	26.4%	(85,942)	(69,080)	\$1.82
Class C	96	2,693,368	369,743	965	370,708	13.8%	15.4%	1,907	(29,619)	\$1.77
Total	192	7,434,863	1,410,233	35,086	1,445,319	19.4%	22.1%	(53,939)	(82,948)	\$1.84
Auburn/Lincoln										
Class A	-	-	-	-	-	-	-	-	-	-
Class B	21	408,275	17,982	11,718	29,700	7.3%	7.7%	(11,107)	(9,885)	\$1.70
Class C	28	518,721	41,793	-	41,793	8.1%	8.4%	(5,578)	(2,213)	\$1.40
Total	49	926,996	59,775	11,718	71,493	7.7%	8.1%	(16,685)	(12,098)	\$1.53
Downtown Sacramento										
Class A	20	5,540,320	748,568	19,963	768,531	13.9%	18.1%	(29,890)	15,223	\$3.40
Class B	62	3,940,366	724,519	2,347	726,866	18.4%	19.3%	(6,340)	8,320	\$2.78
Class C	84	2,517,003	177,811	-	177,811	7.1%	11.5%	17,835	(11,073)	\$2.16
Total	166	11,997,689	1,650,898	22,310	1,673,208	13.9%	17.1%	(18,395)	12,470	\$2.94
El Dorado Hills/Folsom										
Class A	11	925,911	106,333	17,321	123,654	13.4%	22.7%	(33,357)	(3,408)	\$2.30
Class B	93	3,033,805	318,615	63,993	382,608	12.6%	26.8%	(84,126)	5,725	\$2.07
Class C	37	760,437	36,617	-	36,617	4.8%	4.4%	4,298	1,216	\$1.55
Total	141	4,720,153	461,565	81,314	542,879	11.5%	22.4%	(113,185)	3,533	\$2.03
Highway 50/Rancho Cordova										
Class A	31	2,958,603	505,847	132,699	638,546	21.6%	36.7%	(24,492)	(116,431)	\$1.92
Class B	146	7,848,559	1,482,373	24,193	1,506,566	19.2%	24.1%	274,291	65,126	\$1.75
Class C	70	1,883,631	203,177	-	203,177	10.8%	12.8%	4,139	13,178	\$1.30
Total	247	12,690,793	2,191,397	156,892	2,348,289	18.5%	25.3%	253,938	(38,127)	\$1.72
Midtown/East Sacramento										
Class A	4	465,701	7,930	-	7,930	1.7%	3.3%	5,194	5,363	\$2.93
Class B	55	3,393,116	346,195	-	346,195	3.7%	10.8%	(26,923)	(777)	\$2.34
Class C	43	876,735	98,986	-	98,986	11.3%	15.8%	(5,267)	(22,771)	\$1.87
Total	102	4,735,552	453,111	-	453,111	9.6%	11.0%	(26,996)	(18,185)	\$2.31
Natomas										
Class A	36	3,659,233	585,778	35,508	621,286	17.0%	20.8%	(37,936)	(21,849)	\$2.22
Class B	51	2,177,970	271,472	10,871	282,343	13.0%	19.5%	580	(52,136)	\$1.84
Class C	16	569,884	48,238	-	48,238	8.5%	24.5%	7,228	5,119	\$1.15
Total	103	6,407,087	905,488	46,379	951,867	14.9%	20.7%	(30,128)	(68,866)	\$2.00
Northeast Sacramento										
Class A	1	79,163	-	-	-	-	-	-	-	-
Class B	40	1,306,066	218,749	2,083	220,832	16.9%	17.3%	33	9,260	\$1.66
Class C	67	1,545,781	273,270	-	273,270	17.7%	24.2%	(24,553)	(21,144)	\$1.40
Total	108	2,931,010	492,019	2,083	494,102	16.9%	20.5%	(24,520)	(11,884)	\$1.48
Roseville/Rocklin										
Class A	38	3,210,554	526,196	11,419	537,615	16.7%	24.9%	27,867	(16,020)	\$2.30
Class B	147	5,148,700	483,223	230,910	714,133	13.9%	19.9%	(46,516)	(7,174)	\$1.73
Class C	48	1,030,755	157,588	10,203	167,791	16.3%	18.4%	(174)	(41,010)	\$1.43
Total	233	9,390,009	1,167,007	252,532	1,419,539	15.1%	21.5%	(18,823)	(64,204)	\$1.89
South Sacramento/Elk Grove										
Class A	6	481,431	1,128	-	1,128	0.2%	0.9%	5,377	22,476	\$2.55
Class B	69	2,123,084	128,321	29,604	157,925	7.4%	9.4%	(1,539)	11,751	\$2.20
Class C	51	1,177,192	48,468	-	48,468	8.1%	13.8%	(6,726)	(2,410)	\$1.40
Total	126	3,781,707	177,917	29,604	207,521	5.5%	9.6%	(2,888)	31,817	\$2.00
Yolo County										
Class A	7	706,467	84,601	3,464	88,065	13.9%	13.1%	(63,178)	(3,608)	\$2.30
Class B	47	1,707,942	175,339	5,996	181,335	18.4%	11.7%	(9,353)	13,248	\$2.08
Class C	39	803,455	28,825	1,903	30,728	7.1%	3.7%	15,549	575	\$1.80
Total	93	3,217,864	288,765	11,363	300,128	9.3%	10.0%	(56,982)	10,215	\$2.06
Totals	1560	68,233,723	9,258,175	649,281	9,907,456	14.5%	19.3%	(108,893)	(238,277)	\$1.96
Class A	162	18,900,156	2,743,363	228,267	2,971,630	15.7%	22.1%	(129,319)	(102,509)	\$2.56
Class B	819	34,956,605	5,030,296	407,943	5,438,239	15.6%	19.9%	3,058	(25,622)	\$1.77
Class C	579	14,376,962	1,484,516	13,071	1,497,587	10.4%	14.3%	8,658	(110,152)	\$1.64
Downtown	166	11,997,689	1,650,898	22,310	1,673,208	13.9%	17.1%	(18,395)	12,470	\$2.94
Suburban	1,394	56,236,034	7,607,277	626,971	8,234,248	14.6%	19.8%	(90,498)	(250,747)	\$1.90