



# Q1 OFFICE

*market report*

2024 | GALLELLI REAL ESTATE

Gallelli Real Estate  
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Q1  
24

△  
**16.3%**

Direct  
Vacancy Rate

▽  
**(±369,000 SF)**

Net  
Absorption

—  
**\$2.08**

Average Asking Rate  
(FSG)

—  
**±22,000 SF**

Under  
Construction

△  
**5.3%**

Sacramento  
Unemployment

△  
**5.3%**

California  
Unemployment

—  
**3.8%**

United States  
Unemployment

*\*To provide the most accurate snapshot of market conditions, we revise our historical data in cases where new information is uncovered after the fact.*

## AFTER MODEST Q4 GROWTH, SETBACKS AND STATE SPACE GIVEBACKS LOOM

Office vacancy crept upwards across the Sacramento region during the first quarter of 2024. It now stands at 16.3%, up from the 15.7% rate that was recorded just three months ago at the close of 2023. The market recorded -369,000 square feet (SF) of negative net absorption in Q1, reflecting a significant reversal from last quarter's modest, but positive occupancy growth of 34,000 SF. There were no major corporate bankruptcies or failures resulting in large space givebacks in Q1. Sublease availability **declined** over the first three months of 2024 by nearly 100,000 SF—there is currently 1.3 million square feet (MSF) of office sublease availability across the Sacramento marketplace, down from the peak of 1.7 MSF recorded exactly one year ago. Most of this quarter's negative occupancy growth came from tenants simply not renewing existing leases at all or downsizing their space as leases expired. While we tracked plenty of tenant move outs in Q1, none included blocks of space larger than 35,000 SF in size.

## CLASS A REVIEW

This trend hit Class A space hardest; all told the Sacramento region is home to over 20.1 MSF of Class A office space (it accounts for 29.4% of the market's total inventory of 68.3 MSF). Class A occupancy fell by -294,000 SF in Q1 as vacancy climbed from 19.4% to 20.9%. One year ago, this metric stood at 16.6%.

Since the beginning of the pandemic, remote and hybrid work trends have disproportionately impacted



### Sacramento Office Market All Classes of Product Q1 2024

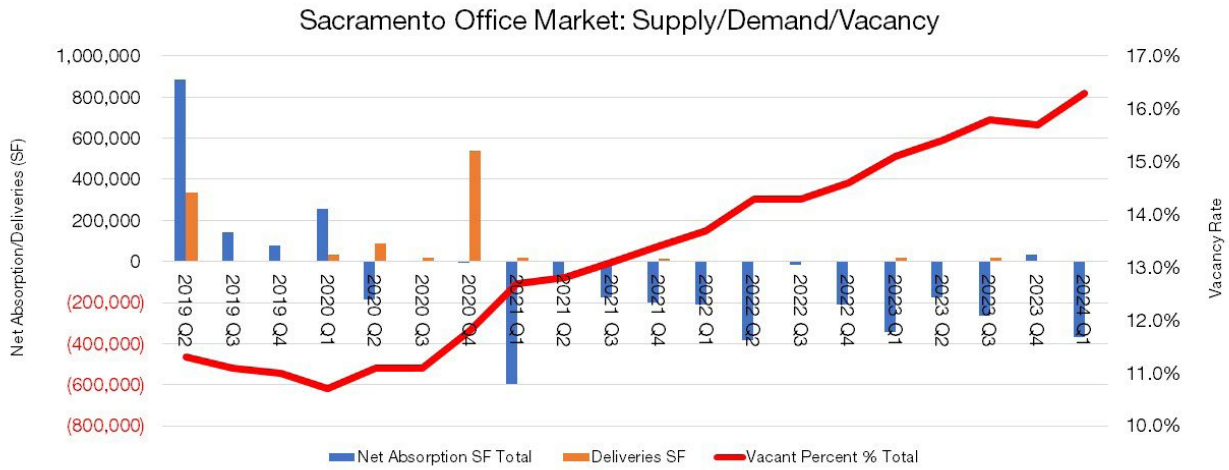


Source: Gallelli Real Estate, Costar Group





## Sacramento Office Market All Classes of Product Q1 2024



Source: Gallelli Real Estate; Costar Group

Downtown office projects nationally and locally. But Downtown is one of the few local submarkets where Class A space posted growth in Q1—to the tune of 27,000 SF. This quarter's negative net absorption was overwhelmingly a suburban phenomenon, with the Arden/Howe/Watt, Natomas, Roseville/Rocklin, and Yolo County submarkets all recording Class A occupancy declines of -20,000 SF or greater. In terms of Class A product, only the Downtown, and Midtown/East Sacramento trade areas recorded positive net absorption in Q1. This trend is likely to reverse itself over the next couple of quarters thanks to some looming moves by the State of California we will discuss later in this report.

Despite challenges, the average asking rent for Class A space has remained stable at \$2.53 per square foot (PSF) on a monthly, full-service basis over the past year, with the Downtown Class A average currently standing at \$3.38 PSF.

Local office rents have changed little since 2021, which is a phenomenon that we are seeing nationally. From 2017 through 2019, local rents were climbing consistently in the 3% to 4% range annually as local vacancy levels fell from the mid-teens to approach single-digit levels. That trend ended abruptly with the pandemic and though it appears rents have remained stable over the past year at \$2.08 PSF, the impact of inflation over the past 30 months has impacted them negatively in terms of real dollars. But given the challenges of the post-pandemic era, they've held their own better than most analysts have forecast. A big reason for this is significantly increased concession packages in the form of additional free rent and increased tenant improvement allowances.

### CLASS B AND C REVIEW

Class B space accounts for roughly half (50.2%) of the region's office inventory, or 34.3 MSF out of Sacramento's total of 68.3 MSF. It fared far better during the first three months of 2024, though overall occupancy

growth was also in the red. As of the close of Q1, Class B vacancy stood at 16.1%, up slightly from the 16.0% rate that had been in place over the final two quarters of 2023. One year ago, Class B vacancy peaked at 16.5%.

Class B recorded -31,000 SF of negative net absorption in Q1, but most submarkets posted modest occupancy gains over the past three months. Class B product in the Arden/Howe/Watt, Downtown, and Highway 50 trade areas all recorded growth of 20,000 SF or more over the last three months. But those gains were not enough to mitigate losses in the Auburn/Lincoln, El Dorado Hills, Midtown/East Sacramento submarkets, which all saw occupancy declines of -20,000 SF or more.

Asking rents for Class B space across the region have fallen slightly over the past year. The current average rate of \$1.88 PSF is down -1.6% from where it stood one year ago (\$1.91 PSF).

Accounting for 13.9 MSF, or roughly 20.4%, of Sacramento's inventory is the Class C office sector. Class C vacancy currently stands at 9.9%, up from last quarter's reading of 9.6%. Tenants gave back approximately -43,000 SF of space in Q1 2024. The Arden/Howe/Watt and Downtown submarkets both recorded negative net absorption of -20,000 SF or more, with nearly all the region's other trade areas posting flat or extremely modest occupancy gains—but not enough to lift this asset class out of the red.

The average asking rent for Class C space across the Sacramento region now stands at \$1.69 PSF, up 1.8% over the \$1.66 PSF reading of a year ago.

### NEW STATE BUILDINGS TO HAVE INDIRECT IMPACT AHEAD

Heading deeper into 2024, multi-tenant construction is expected to remain flat. We are currently tracking just one leased project in the development pipeline—a speculative 22,000 SF creative office building in the Downtown



Office For Lease  
2110 Professional Dr, Roseville, CA



## Sacramento Office Market All Product Types Q1 2024

Sacramento Office Market: Median Price PSF/Average Cap Rate



\*The impact of interest rate hikes with uncertainty over leasing fundamentals has resulted in near record low levels of office investment activity in the first half of 2023. There have not been enough sale transactions to serve as truly reliable indicators.

Source: Gallelli Real Estate; Costar Group

submarket (1800 24th Street) that is not expected to be delivered until early 2025. However, since 2019 the State of California has been pursuing a transition plan to bring a significant portion of their leased inventory into state-owned buildings (which our statistics do not include) and they have been far from inactive.

Multiple state departments are anticipated to relocate into the four buildings of the Richards Boulevard Office Complex at 344 N. 7th Street that is currently under construction and expected to be complete by June 2024. This project alone accounts for more than 1.5 MSF of new space. Additionally, the completion of CalSTRS ongoing 275,000 SF expansion at 100 Waterfront Place in West Sacramento is expected to be completed in Q2 as well.

It is currently unclear as to how much currently leased space that the State of California will be vacating or on what timelines, as the State remains unsure about its long-term remote work strategies. However, this will likely result in large blocks of space being returned to the market over the next six to 36 months as different governmental agencies relocate as existing leases expire. The longer this process is, the greater the likelihood that the market will be absorb these space givebacks with less of an impact on vacancy levels—though this will clearly present many local landlords with another set of headwinds with which to contend.

If there is some good news here it is that new multitenant development has been virtually non-existent since the pandemic. While 2020 saw the

delivery of more than 674,000 SF of space—all those projects were under construction before the pandemic hit. Only two buildings totaling 32,000 SF of space were delivered in 2021, none in 2022 and just 40,000 SF of space came online last year. Nearly all of this was medical office space. The lack of speculative product in the development pipeline currently and over the last few years starkly contrasts what happened in Sacramento in the last cycle when vacancy stood at 17.0% as of Q4 2008 when the Great Financial Crisis hit and sent vacancy upward as high as 20.3% before it started to fall again in Q3 2012. Sacramento's vacancy stood at 10.7% in Q1 2020 as the pandemic arrived, and though it may continue to creep upward for now, organic tenant demand is likely to grow heading deeper into the year, while private sector space givebacks are expected to slow considerably.

## SALES ACTIVITY REMAINS STAGNANT

Investment activity remains relatively stagnant in the region. Through the first three months of 2024, we are aware of less than 20 total office sales in the region. While this is on par with averages we have seen since the Federal Reserve began its rate hike program in late 2021 to combat inflation, the Sacramento region typically recorded an average of 30 investment sales or more per quarter from 2014 through 2020. Roughly \$32 million in transactions closed in Q1, currently putting the market on the same track experienced last year when sales volume for the year reached \$121 million—the lowest amount recorded in Sacramento in a decade. According to the Costar Group, private investors and

Office For Sale or Lease  
4160 Douglas Blvd, Granite Bay, CA



users have accounted for 90% of all acquisitions in the Sacramento market over the past two years.

Uncertainty surrounding the long-term position of office space has kept buyers and lenders on the sidelines throughout the past two years and we anticipate this to remain the case through at least the first half of 2024, if not longer. The Federal Reserve has stated multiple times since November 2023 that their goal is to be able to lower interest rates two to three times by the end of 2024, however, inflation has remained stubbornly in the 3% range throughout the first three months of the year and crept upward from 3.2% to 3.5% in March. While we don't anticipate a return to rate hikes, this trend could derail the central bank's plans should it continue much longer. At the least, it makes the likelihood of three cuts by the end of 2024 less likely, though it certainly does not rule out the possibility of one or two. We are not anticipating a significant uptick in deal activity until this happens. In the meantime, significant headwinds will remain in place thanks both to current leasing fundamentals and the price of debt.

## LOOKING AHEAD

Entering 2024, we were cautiously optimistic that the modest growth recorded at the close of 2023 might potentially indicate the market nearing bottom. But we also warned that one quarter does not a trend make. The trend of tenant consolidations is not yet completely over, and we may see these gains reversed in the months ahead *even if* the greater economy continues to remain in positive territory.

The good news is that much of the economic hand wringing of the past two years appears to be behind us. A year ago economists from Wells Fargo, Chase, and the National Association of Business Economists were pegging the chances of an economic downturn in the following six months at 75%. That did not happen. Now, those same groups are placing the risk of a downturn in the next six months at 25% to 33%, depending on the forecast (though increased geopolitical tensions remain a significant risk).

We still see a compelling case for the coming year to be one of overall economic stabilization and even potential private sector growth for Sacramento's office market—though it would assuredly be tepid, at best. However, potential moves from the public sector now cast some shadows on this. We should note that most of the State of California's current office usage is in the Downtown, Midtown, West Sacramento, South Sacramento, and Highway 50 markets. Placer and El Dorado County markets would see little impact. But it remains a given that the worst of pandemic-related private sector space givebacks is behind us.

While the recent minor uptick in inflation is a concern, it appears that the Federal Reserve has managed to do something most economists felt they would not be able to do just one year ago and that is engineer a soft economic landing... or possibly, a "softish" one. All these factors bode well for the office sector, but the market still has not yet begun to fully stabilize. We suspect that until we see at least two consecutive quarters of occupancy growth, that the phrase, "Survive until '25," is one we will continue to hear from brokers and landlords alike.

**Select Sacramento Region Office Leases  
Past Six Months (Q4 2023/Q1 2024)**

<b>Address</b>	<b>Project Name</b>	<b>Submarket</b>	<b>SF Footage</b>	<b>Tenant</b>
3707 Kings Way	3707 Kings Way	Arden/Howe/Watt	57,368	County of Sacramento
2349 Gateway Oaks Drive	Gateway Oaks Corporate Campus	South Natomas	30,465	Western Health Advantage
One Capitol Mall	One Capitol Mall	Downtown	26,929	California State Division of Boating & Waterways
3130 Kilgore Road	3130 Kilgore Road	Highway 50	17,146	Kleinfelder
2800 Nicolaus Road	Lincoln Air Center	Roseville/Rocklin	13,450	Tamraloo Studios
9323 & 9333 Tech Center Drive	9323 & 9333 Tech Center Drive	Highway 50	13,313	Empyrean Logistics
300 University Drive	University Office Park	Arden/Howe/Watt	13,624	Health Plan Alliance
3721 Douglas Boulevard	Summit at Douglas Ridge	Roseville/Rocklin	11,958	TRC Trading Corporation
1771 Tribute Road	Point West Executive Center	Arden/Howe/Watt	11,900	BeanStalk
1401 El Camino Avenue	El Camino Tower	Arden/Howe/Watt	9,508	Agency on Aging
111 Woodmere Road	Woodmere Pointe	Folsom	8,264	Opeeka
925 Highland Pointe Drive	Highland Pointe II	Roseville/Rocklin	8,148	Booz Allen Hamilton
915 Highland Pointe Drive	Highland Pointe	Roseville/Rocklin	7,214	Regus
7806 Uplands Way	7806 Uplands Way	Northeast	6,734	Behavior Frontiers
2237 Douglas Boulevard	2237 Douglas Boulevard	Roseville/Rocklin	6,668	AP Mortgage
2240 Douglas Boulevard	Johnson Ranch	Roseville/Rocklin	6,448	Five Star Bank
110 Woodmere Road	Lake Forest Tech Center	Folsom	6,175	California Walnut Board
2151 Professional Drive	Johnson Ranch	Roseville/Rocklin	3,892	WSE
3730 Atherton Road	Sunset Medical & Professional Plaza	Roseville/Rocklin	3,806	Recovery Specialists
920 Reserve Drive	Vintage Oaks Office Park	Roseville/Rocklin	3,368	California Recovery Center
2200 Douglas Boulevard	Capital Professional Center	Roseville/Rocklin	3,281	Coldwell Banker Residential

## 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			Net Absorption		Current Avg Asking Rent PSF	Avg Asking Rent PSF One Year Ago	Average Asking Rent % Change Annually
			Vacancy SF	Vacancy %	Vacancy One Year Ago	Total Quarterly	Total Last Four Quarters			
Arden/Howe Watt										
Class A	188	7,305,199	1,221,375	16.7%	16.9%	(8,168)	226,777	\$1.83	\$1.86	(1.6%)
Class B	7	812,303	134,466	16.6%	27.3%	(26,661)	87,658	\$2.05	\$2.06	(0.5%)
Class C	86	3,860,109	759,979	19.7%	23.2%	62,911	134,189	\$1.78	\$1.82	(2.2%)
<b>Total</b>	<b>95</b>	<b>2,632,787</b>	<b>326,930</b>	<b>12.4%</b>	<b>12.6%</b>	<b>(44,418)</b>	<b>4,930</b>	<b>\$1.86</b>	<b>\$1.83</b>	<b>1.6%</b>
Auburn/Lincoln										
Class A	47	888,000	61,593	6.9%	5.9%	(19,131)	(9,588)	\$1.51	\$1.59	(5.0%)
Class B	-	-	-	-	-	-	-	-	-	-
Class C	22	444,938	27,690	6.2%	4.1%	(20,216)	(9,269)	\$1.47	\$1.72	(14.5%)
<b>Total</b>	<b>25</b>	<b>443,062</b>	<b>33,903</b>	<b>7.7%</b>	<b>7.6%</b>	<b>1,085</b>	<b>(319)</b>	<b>\$1.55</b>	<b>\$1.53</b>	<b>1.3%</b>
Downtown Sacramento										
Class A	171	12,295,038	1,913,621	15.6%	15.8%	29,129	34,370	\$3.05	\$3.01	1.3%
Class B	21	5,742,230	1,035,529	18.0%	16.8%	27,116	(70,676)	\$3.38	\$3.41	(0.9%)
Class C	64	3,996,399	732,820	18.3%	20.2%	22,359	74,913	\$2.69	\$2.73	(1.5%)
<b>Total</b>	<b>86</b>	<b>2,556,409</b>	<b>145,272</b>	<b>5.7%</b>	<b>6.9%</b>	<b>(20,346)</b>	<b>30,133</b>	<b>\$2.28</b>	<b>\$2.19</b>	<b>4.1%</b>
El Dorado Hills										
Class A	59	1,355,968	232,183	17.1%	10.0%	(74,084)	(96,642)	\$2.05	\$2.16	(5.1%)
Class B	5	218,179	62,924	28.8%	17.7%	(6,971)	(24,286)	\$2.48	\$3.12	(20.5%)
Class C	29	683,683	125,601	18.4%	10.4%	(67,663)	(54,465)	\$2.01	\$1.94	3.6%
<b>Total</b>	<b>25</b>	<b>454,106</b>	<b>43,658</b>	<b>9.6%</b>	<b>5.7%</b>	<b>550</b>	<b>(17,891)</b>	<b>\$1.49</b>	<b>\$1.39</b>	<b>7.2%</b>
Elk Grove/South Sacramento										
Class A	120	3,561,377	173,718	4.9%	5.4%	(15,300)	19,023	\$2.19	\$2.00	9.5%
Class B	6	477,418	4,827	1.0%	1.1%	(1,577)	383	\$2.75	\$2.28	20.6%
Class C	69	2,007,579	139,561	7.0%	7.8%	(16,924)	16,812	\$2.44	\$2.23	9.4%
<b>Total</b>	<b>45</b>	<b>1,076,380</b>	<b>29,330</b>	<b>2.7%</b>	<b>2.9%</b>	<b>3,201</b>	<b>1,828</b>	<b>\$1.74</b>	<b>\$1.41</b>	<b>23.4%</b>
Folsom										
Class A	83	3,303,809	459,888	13.9%	13.3%	(3,403)	(2,095)	\$2.33	\$2.29	1.7%
Class B	9	724,339	81,021	11.2%	12.0%	-	5,811	\$2.37	\$2.43	(2.5%)
Class C	63	2,287,799	371,525	16.2%	15.2%	(3,403)	(7,906)	\$2.33	\$2.26	3.1%
<b>Total</b>	<b>11</b>	<b>291,671</b>	<b>7,342</b>	<b>2.5%</b>	<b>2.5%</b>	<b>-</b>	<b>-</b>	<b>\$1.95</b>	<b>\$1.95</b>	<b>-</b>
Highway 50/Rancho Cordova										
Class A	243	12,645,334	3,154,253	24.9%	21.1%	28,200	(491,377)	\$1.68	\$1.73	(2.9%)
Class B	31	2,974,688	1,216,122	40.9%	25.3%	(23,590)	(463,106)	\$1.91	\$1.86	2.7%
Class C	142	7,808,811	1,788,637	22.9%	22.4%	56,176	(41,614)	\$1.63	\$1.75	(6.9%)
<b>Total</b>	<b>70</b>	<b>1,861,835</b>	<b>149,494</b>	<b>8.0%</b>	<b>8.7%</b>	<b>(4,386)</b>	<b>13,343</b>	<b>\$1.26</b>	<b>\$1.27</b>	<b>(0.8%)</b>
Midtown/East Sacramento										
Class A	96	4,429,961	373,931	8.4%	7.1%	(15,880)	(61,363)	\$2.52	\$2.45	2.9%
Class B	4	465,701	8,414	1.8%	1.2%	10,843	(2,603)	\$3.22	\$2.89	11.4%
Class C	54	3,259,940	229,750	7.0%	6.4%	(29,470)	(20,205)	\$2.48	\$2.48	-
<b>Total</b>	<b>38</b>	<b>704,320</b>	<b>135,767</b>	<b>19.3%</b>	<b>13.8%</b>	<b>2,747</b>	<b>(38,555)</b>	<b>\$1.92</b>	<b>\$1.98</b>	<b>(3.0%)</b>
Natomas										
Class A	104	6,497,561	1,198,193	18.4%	17.2%	(51,631)	(82,445)	\$2.00	\$2.04	(2.0%)
Class B	37	3,937,097	677,297	17.2%	16.2%	(33,333)	(37,562)	\$2.23	\$2.23	-
Class C	50	1,974,425	435,966	22.1%	20.1%	(16,144)	(38,146)	\$1.81	\$1.87	(3.2%)
<b>Total</b>	<b>17</b>	<b>586,039</b>	<b>84,930</b>	<b>14.5%</b>	<b>13.3%</b>	<b>(2,154)</b>	<b>(6,737)</b>	<b>\$1.43</b>	<b>\$1.44</b>	<b>(0.7%)</b>
Northeast Sacramento										
Class A	105	2,840,099	377,727	13.3%	14.0%	12,167	21,197	\$1.46	\$1.43	2.1%
Class B	1	90,909	-	-	-	-	-	N/A	N/A	-
Class C	40	1,262,888	192,784	15.3%	15.3%	(3,362)	577	\$1.62	\$1.50	8.0%
<b>Total</b>	<b>64</b>	<b>1,486,302</b>	<b>184,943</b>	<b>12.4%</b>	<b>13.8%</b>	<b>15,529</b>	<b>20,620</b>	<b>\$1.35</b>	<b>\$1.39</b>	<b>(2.9%)</b>
Roseville/Rocklin										
Class A	234	9,597,544	1,602,590	16.7%	14.1%	(208,187)	(252,098)	\$1.90	\$1.88	1.1%
Class B	41	3,559,965	873,248	24.5%	15.4%	(212,948)	(324,059)	\$2.31	\$2.25	2.7%
Class C	144	4,990,765	552,943	11.1%	13.0%	1,584	97,010	\$1.65	\$1.71	(3.5%)
<b>Total</b>	<b>49</b>	<b>1,046,814</b>	<b>176,399</b>	<b>16.9%</b>	<b>14.5%</b>	<b>3,177</b>	<b>(25,049)</b>	<b>\$1.43</b>	<b>\$1.40</b>	<b>2.1%</b>
Yolo County										
Class A	88	3,577,409	345,027	9.6%	7.4%	(42,284)	(79,798)	\$2.58	\$2.66	(3.0%)
Class B	8	1,142,767	110,866	9.7%	7.5%	(27,315)	(24,666)	\$3.08	\$3.22	(4.3%)
Class C	44	1,676,836	170,954	10.2%	9.1%	(16,519)	(18,142)	\$2.10	\$2.11	(0.5%)
<b>Total</b>	<b>36</b>	<b>757,806</b>	<b>63,207</b>	<b>8.3%</b>	<b>3.5%</b>	<b>1,550</b>	<b>(36,990)</b>	<b>\$2.06</b>	<b>\$1.66</b>	<b>24.1%</b>
<b>Totals</b>	<b>1,538</b>	<b>68,297,299</b>	<b>11,114,099</b>	<b>16.3%</b>	<b>15.1%</b>	<b>(368,572)</b>	<b>(774,039)</b>	<b>\$2.08</b>	<b>\$2.08</b>	<b>-</b>
<b>Class A</b>	<b>170</b>	<b>20,145,596</b>	<b>4,204,714</b>	<b>20.9%</b>	<b>16.6%</b>	<b>(294,436)</b>	<b>(853,106)</b>	<b>\$2.53</b>	<b>\$2.54</b>	<b>(0.4%)</b>
<b>Class B</b>	<b>807</b>	<b>34,254,172</b>	<b>5,528,210</b>	<b>16.1%</b>	<b>16.5%</b>	<b>(30,671)</b>	<b>133,754</b>	<b>\$1.88</b>	<b>\$1.91</b>	<b>(1.6%)</b>
<b>Class C</b>	<b>561</b>	<b>13,897,531</b>	<b>1,381,175</b>	<b>9.9%</b>	<b>9.5%</b>	<b>(43,465)</b>	<b>(54,687)</b>	<b>\$1.69</b>	<b>\$1.66</b>	<b>1.8%</b>

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