

## SACRAMENTO'S OFFICE MARKET WEATHERS THE COVID-19 DOWNTURN FOR NOW

### REGIONAL SUMMARY

The COVID-19 pandemic has rattled office markets across the country. Companies are reevaluating their space needs as employees continue working from home. Sacramento is not immune from this economic disruption, however, its office market has not seen large amounts of new sublease space through the first half of 2020. Net absorption was negative in the second quarter (-104,724 SF), pushing vacancy up 20 basis points from the first quarter's 18-year low of 13.1%. That being said, vacancy is still down 50 basis points year over year. Second quarter leasing activity registered the lowest volume since Q4 2006. The State of California halted all new leases, affecting approximately 160,000 SF of total deal volume. Lower leasing volume has not impacted asking rents yet as the market average is holding and some submarkets recorded a slight increase. Sales activity similarly fell off compared to recent quarters. Second quarter sales volume was the lowest quarterly total in more than five years. While the full impact of the COVID-19 pandemic is still to be determined, for now, changes in Sacramento's office market rents and vacancy rates remain minimal. As companies look to cut costs during the current downturn, demand for office space will likely lessen through the remainder of the year.

### Net Absorption

- Market net absorption of -104,724 SF in the second quarter was largely driven by closures, downsizes, and relocations already in the works prior to COVID-19.
- Net absorption will likely post negative numbers through the rest of the year as the economic uncertainty will cause decision makers to pause in leasing new space. Sharply declining revenues since March will result in many companies cutting real estate costs where they can.

### Vacancy

- The market vacancy rate is 13.3% increased 20 basis point decline from last quarter and is still down 50 basis points year over year. The vacancy rate will likely continue increasing due to previously scheduled moves and upcoming downsizing.
- The Downtown Class A vacancy rate of 5.6% increased 40 basis points quarter over quarter, its first vacancy rate increase since Q3 2018.

### Rents

- Average market asking rates increased 1.9% year over year as Class A market rents held steady and Class B market rents increased 2.2% from last year.
- After nine straight record high asking rents, the Downtown's Class A asking rents decreased 0.9% from the first quarter to \$3.37/SF, its first drop since Q3 2016.

### Sales Activity

- Q2's sales volume was quite minimal, however, there are still investors looking for office assets. This was evidenced by four closed sales of \$17 million or more.



**-104,724 SF**  
Q2 2020  
Net Absorption



**+78,214 SF**  
2020 YTD  
Net Absorption



**13.3%**  
Q2 2020 Market  
Vacancy Rate  
(13.8% in Q2 2019)



**5.6%**  
Downtown Class A  
Vacancy Rate  
(7.0% in Q2 2019)



**\$2.04/SF**  
Market Average  
Asking Rate  
(+1.9% YOY)



**\$3.37/SF**  
Downtown Class A  
Average Asking Rate  
(+3.0% YOY)



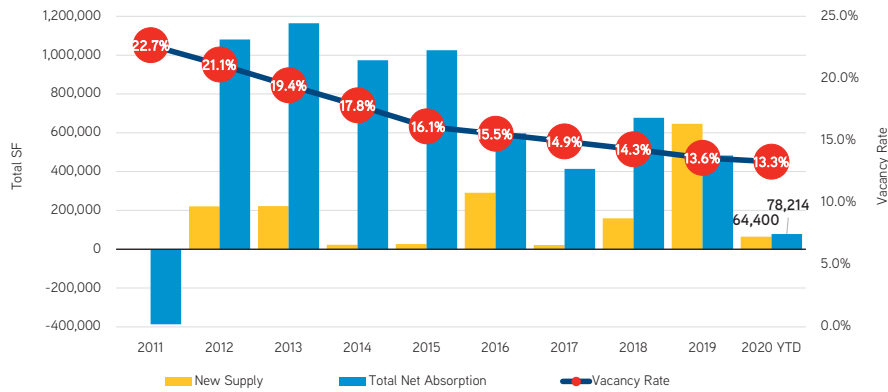
**\$120.6M**  
Q2 2020 Sales Volume  
((\$560.8M 2020 YTD Sales Volume))



**2.45 MSF**  
Under Construction  
(64K SF 2020 YTD Deliveries)

### OFFICE MARKET FUNDAMENTALS

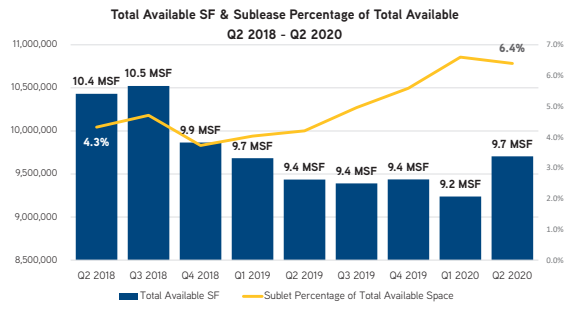
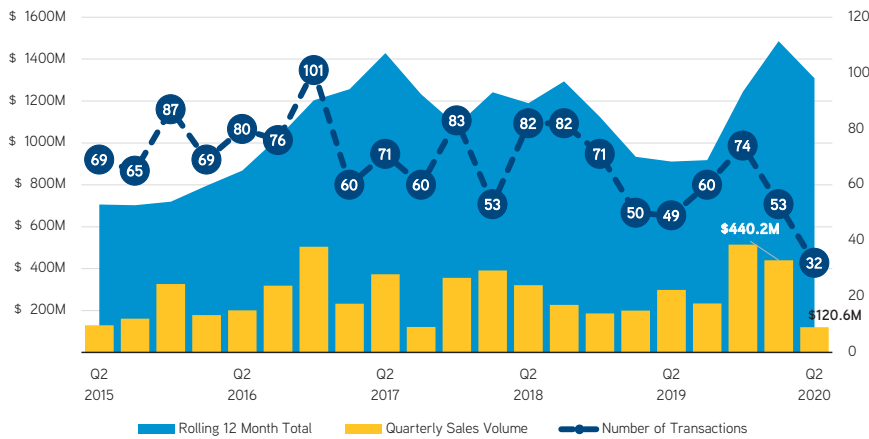
#### 10-Year Annual New Supply, Vacancy, and Absorption



Uncertainty in the marketplace due to COVID-19 greatly hampered sales activity in the second quarter, but there is still investor appetite for both stabilized and value-add assets. The Wonderful Company paid \$40.4M for two State of California-occupied buildings in Rancho Cordova this quarter and Cook Endeavors acquired an 80% occupied, 8-property, 166,000 SF portfolio from WHAL Properties for \$23 million.

The amount of new sublease space on the market in the second quarter was minimal with only four new subleases of more than 10,000 SF coming available since March 2020. However, in addition to some large vacancies looming in the second half of the year (Centene & State of CA), the total available space on the market increased 467,000 SF in the second quarter with the percentage of sublease space out all available space increasing from 4.3% in Q2 2018 to 6.4% in Q2 2020.

#### Quarterly Sales Volume & Rolling 12-Month Sales Volume



#### Q2 2020 Significant Leases Signed

| SIGNED DATE | ADDRESS             | SQ. FT. | CLASS        | SUBMARKET       | LANDLORD                | TENANT                               |
|-------------|---------------------|---------|--------------|-----------------|-------------------------|--------------------------------------|
| June 2020   | 9815 Goethe Rd *    | 80,000  | B            | Highway 50 East | The RMR Group           | CA Employment Development Department |
| April 2020  | 10940 White Rock Rd | 13,070  | B            | Highway 50 East | Toor Capital, LLC       | George Hills Insurance               |
| June 2020   | 100 Howe Ave        | 12,703  | B            | Campus Commons  | Fenway Properties       | Snowline Hospice of El Dorado County |
| April 2020  | 10877 White Rock Rd | 10,156  | A            | Highway 50 East | Basin Street Properties | Allstate Insurance                   |
| June 2020   | 401 I St            | 9,995   | Retail Bldg. | Downtown        | City of Sacramento      | CA Office of Digital Innovation      |

\* Renewal

#### Q2 2020 Significant Sales Closed

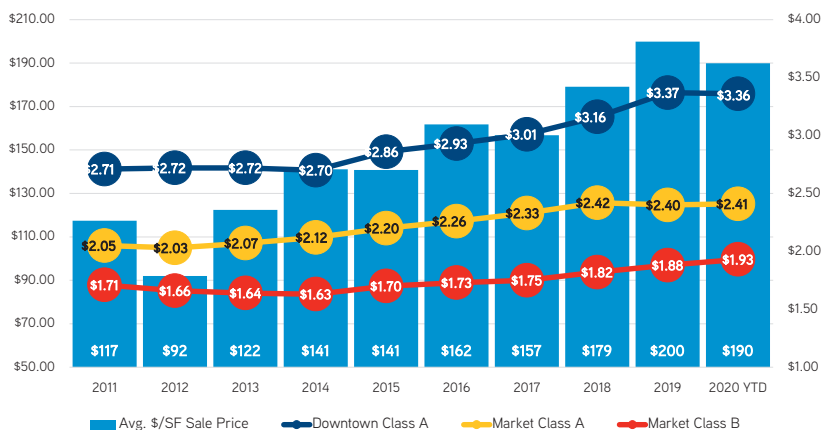
| SALE DATE | ADDRESS                                | SQ. FT./CLASS | PRICE/SF | SALE PRICE   | SELLER                       | BUYER                    |
|-----------|--|---------------|----------|--------------|------------------------------|--------------------------|
| 6/9/2020  | WHAL Office Portfolio (8 Properties) * | 166,000 / B   | \$139.00 | \$23,050,000 | WHAL Properties              | Cook Endeavors           |
| 5/12/2020 | 11150 International Dr                 | 90,111 / A    | \$240.26 | \$21,650,000 | Rohit Kumar & Nidhi Tull     | The Wonderful Company    |
| 5/13/2020 | 11000-11050 Olson Dr                   | 148,919 / B   | \$136.99 | \$20,400,000 | Real Capital Solutions, Inc. | Rohit Kumar & Nidhi Tull |
| 6/8/2020  | 11120 International Dr                 | 100,967 / A   | \$185.70 | \$18,750,000 | RREEF                        | The Wonderful Company    |
| 5/14/2020 | 3310 El Camino Ave                     | 128,285 / C   | \$137.97 | \$17,700,000 | Positive Investments, Inc.   | Rohit Kumar & Nidhi Tull |
| 4/8/2020  | 11702-11734 Enterprise Dr **           | 36,649 / C    | \$111.87 | \$4,100,000  | JTS Engineering              | Timothy & Michelle Bundy |

\* Colliers represented both buyer and seller, 8 property office portfolio included four properties in Gold River and four properties in Campus Commons, Howe/Watt/Fulton Ave submarkets, buyer was in a 1031 exchange

\*\* Colliers represented the seller, property in Auburn is 97% occupied by DMV and Placer County, buyer completed a 1031 exchange and the asset sold at an 8% cap rate

### MARKET RATES

Market Asking Rates & Sale Prices



Q2 2020 Asking Rates

| (Full Service, Per Month, Direct Available Space) | Avg. Asking Rate | YOY Change |
|---|------------------|------------|
| Market - OVERALL                                  | \$2.04/SF        | +1.9%      |
| Market - Class A                                  | \$2.41/SF        | Unchanged  |
| Market - Class B                                  | \$1.86/SF        | +2.2%      |
| Downtown - Class A                                | \$3.37/SF        | +3.0%      |
| Suburban - Class A                                | \$2.19/SF        | Unchanged  |
| Downtown - Class B                                | \$2.81/SF        | +10.2%     |
| Suburban - Class B                                | \$1.87/SF        | +1.6%      |

### MARKET STATISTICS

| Submarket                               | Existing Buildings | Total Inventory SF | Q2 Direct Vacant SF | Q2 Sublease Vacant SF | Q2 Direct Vacancy Rate | Q2 Total Vacancy Rate | Q1 Total Vacancy Rate | Q2 Net Absorption | 2020 YTD Net Absorption | Average Asking Rate |
|---|--------------------|--------------------|---------------------|-----------------------|------------------------|-----------------------|-----------------------|-------------------|-------------------------|---------------------|
| Downtown Sacramento                     | 137                | 10,184,697         | 1,230,510           | 7,101                 | 12.1%                  | 12.2%                 | 11.9%                 | -25,050           | 4,229                   | \$2.87              |
| Downtown Sacramento *                   | 215                | 20,288,761         | 1,347,757           | 7,551                 | 6.6%                   | 6.7%                  | 6.6%                  | -24,049           | 13,943                  | \$2.85              |
| Highway 50 Corridor - East              | 182                | 9,310,230          | 1,424,775           | 53,299                | 15.3%                  | 15.9%                 | 16.2%                 | 34,756            | 27,362                  | \$1.85              |
| Roseville                               | 133                | 6,578,980          | 722,037             | 27,253                | 11.0%                  | 11.4%                 | 11.0%                 | -25,752           | 203,205                 | \$1.97              |
| South Natomas                           | 50                 | 3,273,709          | 419,165             | 4,047                 | 12.8%                  | 12.9%                 | 12.8%                 | -4,971            | -21,241                 | \$2.29              |
| Folsom                                  | 68                 | 2,835,724          | 147,665             | 8,249                 | 5.2%                   | 5.5%                  | 6.0%                  | 13,015            | 13,474                  | \$2.13              |
| Midtown Sacramento                      | 65                 | 2,268,334          | 280,945             | 0                     | 12.4%                  | 12.4%                 | 12.2%                 | -4,798            | 1,562                   | \$2.48              |
| North Natomas                           | 46                 | 2,375,183          | 392,439             | 2,281                 | 16.5%                  | 16.6%                 | 16.8%                 | 4,739             | -11,355                 | \$1.65              |
| Rocklin                                 | 58                 | 1,499,304          | 187,632             | 0                     | 12.5%                  | 12.5%                 | 11.1%                 | -20,557           | -38,789                 | \$1.99              |
| <b>PRIMARY SUBMARKETS</b>               | <b>739</b>         | <b>38,326,161</b>  | <b>4,805,168</b>    | <b>102,230</b>        | <b>12.5%</b>           | <b>12.8%</b>          | <b>12.7%</b>          | <b>-28,618</b>    | <b>178,447</b>          | <b>\$2.20</b>       |
| Highway 50 Corridor - West              | 39                 | 2,250,893          | 378,736             | 8,735                 | 16.8%                  | 17.2%                 | 17.1%                 | -2,502            | -68,247                 | \$1.69              |
| Point West                              | 38                 | 2,391,592          | 326,819             | 40,111                | 13.7%                  | 15.3%                 | 15.1%                 | -6,058            | -1,346                  | \$2.06              |
| South Sacramento                        | 54                 | 1,266,129          | 122,180             | 0                     | 9.6%                   | 9.6%                  | 10.2%                 | 6,435             | 4,185                   | \$1.49              |
| Davis/Woodland                          | 54                 | 1,372,065          | 87,328              | 12,088                | 6.4%                   | 7.2%                  | 7.0%                  | -3,989            | -21,181                 | \$1.93              |
| El Dorado                               | 55                 | 1,334,780          | 158,932             | 0                     | 11.9%                  | 11.9%                 | 12.3%                 | 5,232             | 14,243                  | \$1.86              |
| Elk Grove                               | 35                 | 1,165,182          | 58,707              | 5,684                 | 5.0%                   | 5.5%                  | 5.2%                  | -3,282            | 3,446                   | \$2.41              |
| West Sacramento                         | 26                 | 1,366,735          | 112,242             | 0                     | 8.2%                   | 8.2%                  | 8.2%                  | 0                 | 74,744                  | \$1.83              |
| Campus Commons                          | 31                 | 994,035            | 154,367             | 1,699                 | 15.5%                  | 15.7%                 | 15.2%                 | -4,617            | -34                     | \$2.19              |
| <b>SECONDARY SUBMARKETS</b>             | <b>332</b>         | <b>12,141,411</b>  | <b>1,399,311</b>    | <b>68,317</b>         | <b>11.5%</b>           | <b>12.1%</b>          | <b>12.0%</b>          | <b>-8,781</b>     | <b>5,810</b>            | <b>\$1.89</b>       |
| Howe/Fulton/Watt Ave                    | 98                 | 3,539,755          | 739,308             | 19,311                | 20.9%                  | 21.4%                 | 21.2%                 | -8,923            | -21,445                 | \$1.60              |
| Citrus Heights/Orangevale               | 31                 | 856,108            | 91,332              | 0                     | 10.7%                  | 10.7%                 | 11.2%                 | 4,291             | 5,804                   | \$1.39              |
| East Sacramento                         | 6                  | 748,736            | 11,891              | 0                     | 1.6%                   | 1.6%                  | 0.6%                  | -7,311            | -5,426                  | \$2.95              |
| Rio Linda/North Highlands               | 25                 | 965,071            | 252,883             | 0                     | 26.2%                  | 26.2%                 | 22.6%                 | -34,318           | -42,446                 | \$1.70              |
| Auburn/Lincoln                          | 39                 | 761,073            | 47,053              | 0                     | 6.2%                   | 6.2%                  | 4.5%                  | -13,052           | -31,348                 | \$2.12              |
| Carmichael/Fair Oaks                    | 33                 | 681,814            | 170,750             | 1,099                 | 25.0%                  | 25.2%                 | 24.0%                 | -8,012            | -11,182                 | \$1.31              |
| <b>OTHER SUBMARKETS</b>                 | <b>232</b>         | <b>7,552,557</b>   | <b>1,313,217</b>    | <b>20,410</b>         | <b>17.4%</b>           | <b>17.7%</b>          | <b>16.8%</b>          | <b>-67,325</b>    | <b>-106,043</b>         | <b>\$1.60</b>       |
| <b>SACRAMENTO OFFICE MARKET SUMMARY</b> |                    |                    |                     |                       |                        |                       |                       |                   |                         |                     |
| CLASS A TOTAL                           | 162                | 18,865,763         | 2,056,681           | 79,344                | 10.9%                  | 11.3%                 | 11.4%                 | 18,256            | 107,110                 | \$2.41              |
| CLASS B TOTAL                           | 660                | 27,549,510         | 3,809,747           | 94,348                | 13.8%                  | 14.2%                 | 13.8%                 | -99,064           | 51,510                  | \$1.92              |
| CLASS C TOTAL                           | 481                | 11,604,856         | 1,651,268           | 17,256                | 14.2%                  | 14.4%                 | 14.1%                 | -31,989           | -72,241                 | \$1.62              |
| SUBURBAN TOTAL                          | 1,166              | 47,835,432         | 6,287,186           | 183,856               | 13.1%                  | 13.5%                 | 13.3%                 | -87,747           | -41,826                 | \$1.90              |
| MARKET TOTAL                            | 1,303              | 58,020,129         | 7,517,696           | 190,957               | 13.0%                  | 13.3%                 | 13.1%                 | -104,724          | 78,214                  | \$2.04              |
| MARKET TOTAL *                          | 1,866              | 87,940,854         | 7,691,495           | 233,308               | 8.7%                   | 9.0%                  | 8.9%                  | -37,731           | 266,738                 | \$1.97              |

\* Lines in red above include owner-occupied buildings, government-occupied buildings, and medical office buildings, in addition, the vacancy rate and net absorption totals are not verified

For additional statistics, analytics, and insights into the Sacramento office market's 22 submarkets, please reach out to Bob Shanahan at [bob.shanahan@colliers.com](mailto:bob.shanahan@colliers.com)

## NEW CONSTRUCTION & FORECAST

In addition to the current economic downturn and uncertainty office owners, developers, and tenants are dealing with, the State of California is currently on a building spree. This will further increase the upward pressure on the vacancy rate over the next two to three years. The New Natural Resources Building (700K SF) will deliver by the end of 2021. The Department of Conservation and Department of Parks and Recreation will be vacating large blocks of leased space in Downtown to move into this new tower. The California Military Department's new headquarters building under construction along Highway 50 will deliver by Q4 2020. This new building will consolidate operations from multiple locations, including 110,000 SF at 9800 Goethe Road. Also impacting Highway 50, Centene will start relocating from five leased locations to its new 540,000 SF Natomas campus next quarter. To date, there is 334,000 SF of space being vacated by Centene currently on the market for lease.

Interestingly enough, all new office construction delivered in 2020 to date has been in Davis. This includes: Nugget Market's new 32,000 SF headquarters which opened in the first quarter; and Buzz Oates' two 16,200 square foot office buildings delivered 50% leased at the Offices @ Mace Ranch this quarter. In November 2020, Davis voters will decide the fate of the 187-acre, 2.7 MSF proposed research park now called the Davis Innovation and Sustainability Campus.

Sacramento's office market is facing multiple headwinds at the moment. Through the first half of 2020, the market appears to have weathered the storm but there are more dark clouds on the horizon. As companies and public agencies struggle with reopening efforts, uncertainty and confusion will continue to impact the market. With an increasing number of companies downsizing and many employees working from home through the rest of the year, demand for office space will likely decline for the foreseeable future. For the near term, we see increased upward pressure on market vacancy resulting in a downward movement of rents. In the long term, the COVID-19 pandemic will have lasting effects on office space that remain to be fully realized.

| Projects Currently Under Construction |       |  |                 |          |                  |                     |
|---------------------------------------|-------|--|-----------------|----------|------------------|---------------------|
| Submarket                             | Bldgs | Project                                      | Est. Completion | % Leased | Office SF        | Developer/Owner     |
| Downtown                              | 1     | Natural Resources Building*                  | Q4 2021         | 100%     | 700,000          | State of California |
| North Natomas                         | 2     | Centene Natomas Campus - Phase I             | Q3 2020         | 100%     | 539,960          | Hines               |
| Downtown                              | 1     | Capitol Annex Swing Space - 1021 O Street*   | Q4 2021         | 100%     | 400,000          | State of California |
| Highway 50 East                       | 1     | California Military Department Headquarters* | Q4 2020         | 100%     | 285,000          | State of California |
| West Sacramento                       | 1     | CalSTRS HQ Expansion*                        | Q2 2022         | 100%     | 275,000          | Ridge Capital       |
| Downtown                              | 1     | 1215 O Street*                               | Q3 2021         | 100%     | 255,000          | State of California |
|                                       |       |  |                 |          | <b>2,454,960</b> | <b>TOTAL SF U/C</b> |

*\*Single tenant, government owned/occupied building, won't be included in inventory after completion*



The California Military Department Headquarters building (pictured above on May 20, 2020) is under construction at 10601 Bear Hollow Drive next to Mather Airport. The 285,000 SF building on 31 acres will house the California Army National Guard, California Air National Guard, California State Military Reserve, and California Youth and Community Programs. The design-build team of Walsh Construction and Stantec will deliver the new \$135 million building for the State of California by Q4 2020.

In the midst of the COVID-19 outbreak, information and data is emerging at a quick and uneven rate. The information contained herein has been obtained from sources deemed reliable at the time the report was written. While every reasonable effort has been made to ensure its accuracy, we cannot guarantee it. No responsibility is assumed for any inaccuracies. Readers are encouraged to consult their professional advisors prior to acting on any of the material contained in this report. This publication is the copyrighted property of Colliers International and/or its licensor(s). Real estate officer license number 01908588. © 2020. All rights reserved.

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