



Industrial Report

Q3 2017
GALLELLI REAL ESTATE MARKET REPORT

Overview

The Sacramento industrial market continued to tighten during Q3-2017, with the market recording the largest amount of positive net absorption in 17 years. Vacancy experienced another significant drop and overall leasing activity was significantly increased over Q2.

Market Trends

- Quarterly market vacancy dropped to its lowest level in nearly 20 years. Vacancy fell from 9.7% to 8.4% during the quarter, marking the lowest historical rate Sacramento has seen since the late 1990's, when regional vacancy fluctuated between 8% and 9%. Year-over-year vacancy has also seen a significant drop – one year ago, vacancy stood at 11.7%.
- The market recorded nearly 1.3 million square feet of positive net absorption during Q3, which is the largest amount of net absorption the Sacramento region has seen in 17 years. This number is significantly increased over the 480,000 square feet of positive net absorption recorded in Q2. Year-to-date, the market has seen over 2.7 million square feet of positive net absorption. As long as industrial market momentum keeps the same pace, 2017 is on track to see the highest amount of annual net absorption since 2006.
- Industrial leasing activity saw a significant increase during Q3, with the market recording over 2.4 million square feet of total deal volume, compared to 1.1 million in Q2. Larger blocks of



space remain a rare find in the region; as such, demand continues to focus on smaller spaces, typically 20,000 square feet or less.

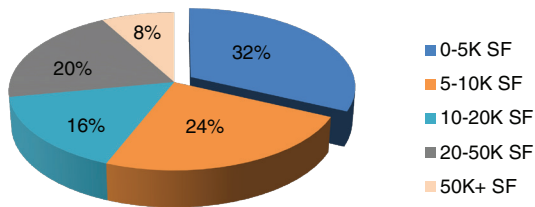
- Activity across the local submarkets was overwhelmingly positive, with only one out of sixteen submarkets recording negative net absorption. The Roseville/Rocklin submarket saw the largest occupancy gain of the quarter, recording 488,000 square feet of positive net absorption. ESL Technology, who occupied nearly 394,000 square feet at 10000 Alantown Drive, accounted for the majority of this absorption. The McClellan submarket also saw notable occupancy growth, recording 387,000 of positive net absorption. This is primarily attributable to Pine Mountain Brands occupying 90,000 square feet and RV Storage Depot occupying 181,000 square feet during Q3. The only occupancy loss of the quarter happened in the Sunrise submarket, which recorded 55,000 square feet of negative absorption.
- The average asking rent for industrial space increased from \$0.43 to \$0.45 per square foot, on a triple-net basis. This is the second consecutive quarter of incremental rent growth, and with vacancy currently at an all-time low, the pace of rent growth will start to increase in the coming months.

Industrial Q3 2017

The industrial market continues to tighten; however, the market has yet to see an increase in speculative construction.

<p>Vacancy</p> <h2 style="font-size: 2em;">8.4%</h2> <p>▼</p>	<p>Net Absorption</p> <h2 style="font-size: 2em;">1,284,646_{SF}</h2> <p>▲</p>	<p>Avg. Rent PSF</p> <h2 style="font-size: 2em;">\$0.45_{PSF}</h2> <p>▲</p>
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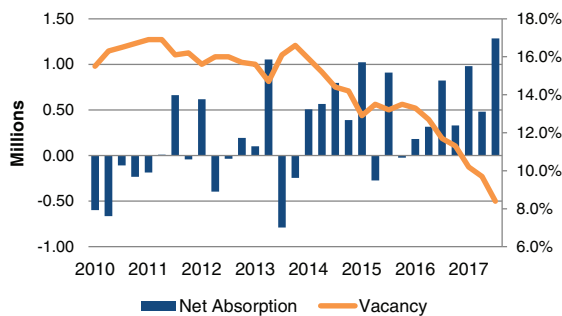
Q3-2017 Industrial Leasing Volume by SF



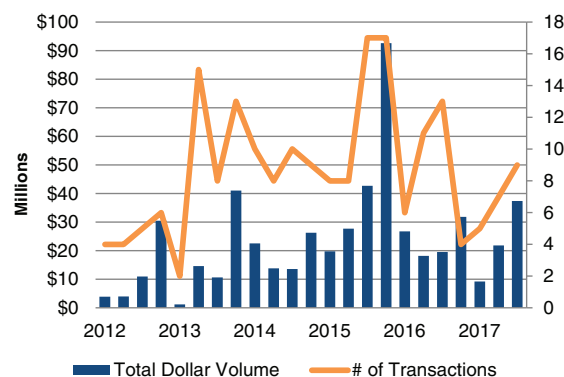
Investment Trends

- Industrial investment activity increased during Q3, with the market recording \$37.3 million in total sales volume over 9 transactions, compared to \$21.8 million over 7 transactions in Q2.
- The average price per square foot rose from \$64 per square foot to \$90 per square foot, primarily due to a number of Class B and C projects that sold for over \$100 per square foot. Marijuana users are primarily driving price per square foot increases, as they typically offer and pay more than the asking price for older industrial product.
- The average asking cap rate for industrial product currently stands at 6.8%. Cap rates for industrial product have hovered in the 6-7% range for the last 11 consecutive quarters.
- The largest investment sale of the quarter was the sale of 2959 Thomas Place within the Southport Business Park in West Sacramento. This 138,455-square-foot Class A warehouse building sold for \$12.3 million or \$88.92 per square foot.

Industrial Vacancy vs. Net Absorption



Industrial Investment Sales Volume by Quarter





Construction

1,603,179^{SF}

Sacramento Unemployment

4.5%



US Unemployment

4.1%



Spotlight On: Speculative Industrial Construction

The industrial market continues to tighten; however, the market has yet to see an increase in speculative construction. While some developers have begun to test the market with new speculative projects, primarily in the Southport area of West Sacramento, the majority of new industrial construction has been made up of built-to-suit projects. Of the 1.9 million square feet of new industrial that has been delivered since 2015, build-to-suit construction makes up nearly 1.1 million square feet of this total. The remaining product is speculative construction, the majority of which has been made up of smaller warehouses that have been immediately leased or sold upon completion.

With industrial market vacancy currently at its lowest level in 17 years, the pace of rental rate growth will soon increase, and as a result, the market will likely see the return of speculative construction. The short supply of existing large box spaces has created demand for larger industrial buildings; however, the market will likely see more mid-size to smaller speculative projects get underway first, as there are limited areas in the region that can accommodate larger buildings.

Outlook

The Sacramento industrial market performed outstandingly during Q3, and momentum is showing no signs of slowing down. The market continues to tighten and with vacancy now in the 8% range, we anticipate that the pace of rental rate growth will begin to increase over the coming months. Though there is currently ± 1.6 million square feet of new industrial space under construction throughout the region, ± 1.2 million square feet of this space is made up of build-to-suit projects that will be fully occupied upon completion. With the exception of Amazon, all of these build-to-suits are for existing tenants within the region. The remaining $\pm 345,000$ square feet are speculative projects that may temporarily help alleviate local demand. With little available space and minimal speculative space coming onto the market, we anticipate industrial vacancy will edge closer to the low 8% or high 7% range by year's end, and that current momentum will continue through the rest of the year and into 2018.

Research

Our team focuses on providing high quality, data driven, accurate market information to our clients. We provide in-depth commercial real estate market analysis and insight into market trends in order to help optimize our clients' real estate decisions.



Industrial Q32017

Market Statistics

Submarket	Inventory	Direct	Available Space Sublease	Total	Vacancy Q3-17	Net Absorption		SF Under Construction	Avg. Asking Rate (NNN)
						Q3-17	Q3-16		
Auburn	1,186,745	4,730	0	4,730	0.4%	0	22,963	0	\$0.49
Davis/Woodland	8,019,330	1,117,378	32,000	1,149,378	14.3%	177,643	(53,675)	12,024	\$0.29
Downtown	768,518	112,000	0	112,000	14.6%	0	0	0	-
East Sacramento	175,668	0	0	0	0.0%	0	0	0	-
Elk Grove/Laguna	3,031,098	179,464	0	179,464	5.9%	16,514	9,459	0	\$0.46
Folsom/El Dorado Hills	1,478,657	120,856	0	120,856	8.2%	20,120	0	75,000	\$0.65
Mather	2,570,865	212,317	6,400	218,717	8.5%	74,299	(3,309)	0	\$0.47
McClellan	9,901,308	839,111	0	839,111	8.5%	386,980	128,674	0	\$0.41
Northgate/Natomas	8,791,009	397,901	0	397,901	4.5%	37,836	105,815	855,000	\$0.43
Northeast Sacramento	2,797,736	139,109	0	139,109	5.0%	16,326	(10,716)	0	\$0.46
Power Inn	16,259,618	707,596	0	707,596	4.4%	81,751	157,396	240,255	\$0.51
Richards	2,826,050	229,980	0	229,980	8.1%	0	(3,505)	0	\$0.38
Roseville/Rocklin	8,964,203	1,182,591	0	1,182,591	13.2%	488,049	245,792	316,100	\$0.38
South Sacramento	2,489,269	993,386	0	993,386	39.9%	0	13,980	0	\$0.50
Sunrise	5,842,252	223,516	81,452	304,968	5.2%	(55,311)	80,639	0	\$0.46
West Sacramento	14,316,905	752,041	152,000	904,041	6.3%	40,439	98,587	104,800	\$0.41
Totals	89,419,231	7,211,976	271,852	7,483,828	8.4%	1,284,646	792,100	1,603,179	\$0.45

About Gallelli Real Estate

Gallelli Real Estate is a private firm that specializes in commercial estate services and property management. We believe that as a boutique firm whose understanding of the business runs as deep as our core values, our advantage is large. We take pride in our unique approach to offer more individual solutions that address the ever changing needs of our clients and the industry. After all, our success is measured by the success of our clients and the strength and longevity of our relationships. For the latest news from Gallelli Real Estate, visit GallelliRE.com, or follow us on Twitter: @Gallelli_RE and LinkedIn.

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