



**AVISON
YOUNG**

Sacramento Office Insight Report

Q2 2021

AVANT
by AVISON YOUNG

Key takeaways



Economic conditions

- Reopening efforts and higher vaccination rates have allowed the Sacramento unemployment rate to drop from a high of 14.4 percent in April 2020 to **6.6 percent** now.
- Office-using job losses in this market have totaled **5.0 percent** during the pandemic. Employers are starting to expand their workforce with numerous job postings in the market, further solidifying the foothold of a recovery.



Recovery rate

- With the exception of Health Care, a general lack of velocity in the office market has led to very moderate leasing and negative absorption from the private sector.



Office demand

- Leasing activity has paused, decreasing by **60.6 percent** compared with the long-term historical average.
- Health Care continues to be the hottest sector with recent **University of California, Davis leases in excess of 250,000 sf** on the Highway 50 corridor.

Key takeaways



Office supply

- Direct and sublease vacancy have achieved levels approaching all-time highs, totaling **10.8 percent**.
- The sublease market grew during 2020 but that growth has been more tempered this year, accounting for only **536,867 sf** of vacant space.
- There is no speculative construction in the region. **New construction in excess of 2.2 msf** is largely in government owned projects that will add more vacancy as the State of California pulls agencies out of private sector office buildings to fill new State office projects. CalSTRS is currently under construction in West Sacramento with a 275,000-sf office expansion.



Pricing trends

- During most of 2020, landlords remained bullish on asking rents while adding more concessions. Recent lease deals reinforce this trend with asking rents flattening while concessions have trended upward.
- Demand has been tepid as the economy reopens. Tenants, that postponed their long-term occupancy strategies, are starting to re-enter the market slowly.



Capital markets

- Sales pricing has been trending downward since late 2019 as class B product made up nearly 62% of office sales.
- The largest sale during the quarter was 1625 & 1747 N Market Blvd. Nome Capital Partners purchased the class A buildings for \$21.7M or roughly \$207 psf.
- The Ziggurat, at 701-707 3rd Street in West Sacramento, is under contract. The class A, 373,725-sf office property, is 100% leased to the California Department of General Services (DGS).

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Economic and demographic trends

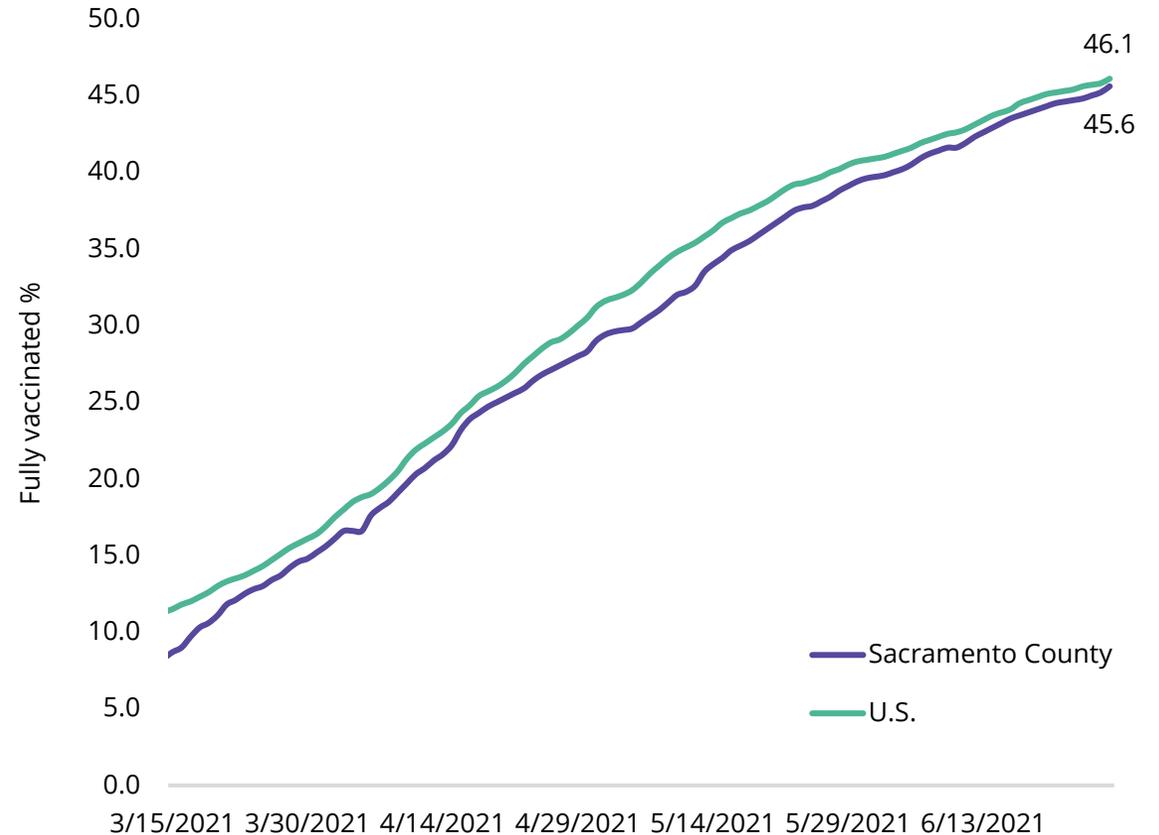
The pandemic initially shocked the Sacramento economy, though there have been incremental signs of a recovery as the region reopens.

Vaccination rates

45.6%

Share of total Sacramento County population that is fully vaccinated

Sacramento County proportionate vaccination rate closely mirrors, but lags compared to U.S. averages. This is an important metric that has allowed the county to loosen restrictions.



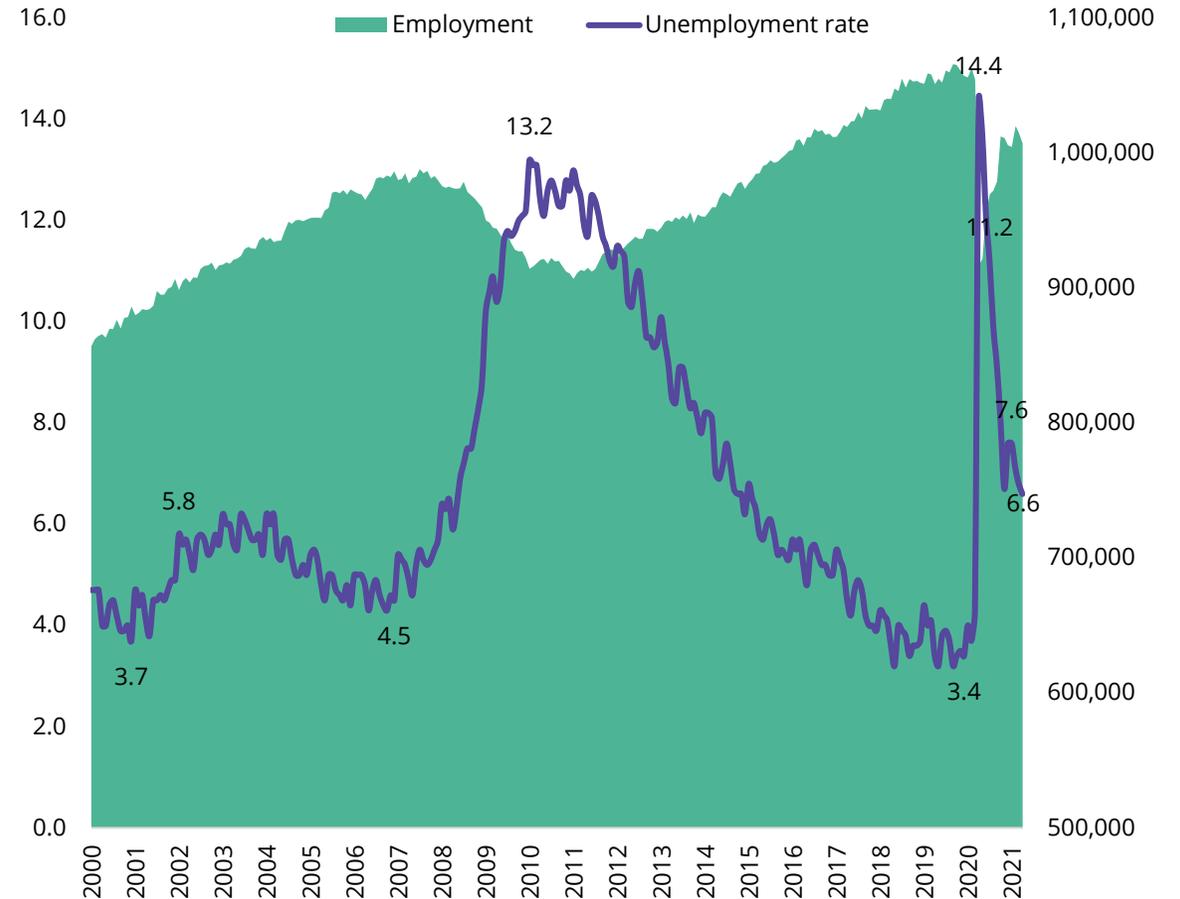
Source: CDC

Employment and unemployment rate

6.6%

Sacramento MSA unemployment rate as of April 2021, dramatically below the height of the financial crisis

Historically tightened labor market conditions were halted by the pandemic with 146,624 job losses between February and April 2020. However, reopening efforts enabled the economy to add 9.9% more jobs since April 2020.



Note: Not seasonally adjusted data.
Source: Bureau of Labor Statistics

Office-using job gains and losses

-5.0%

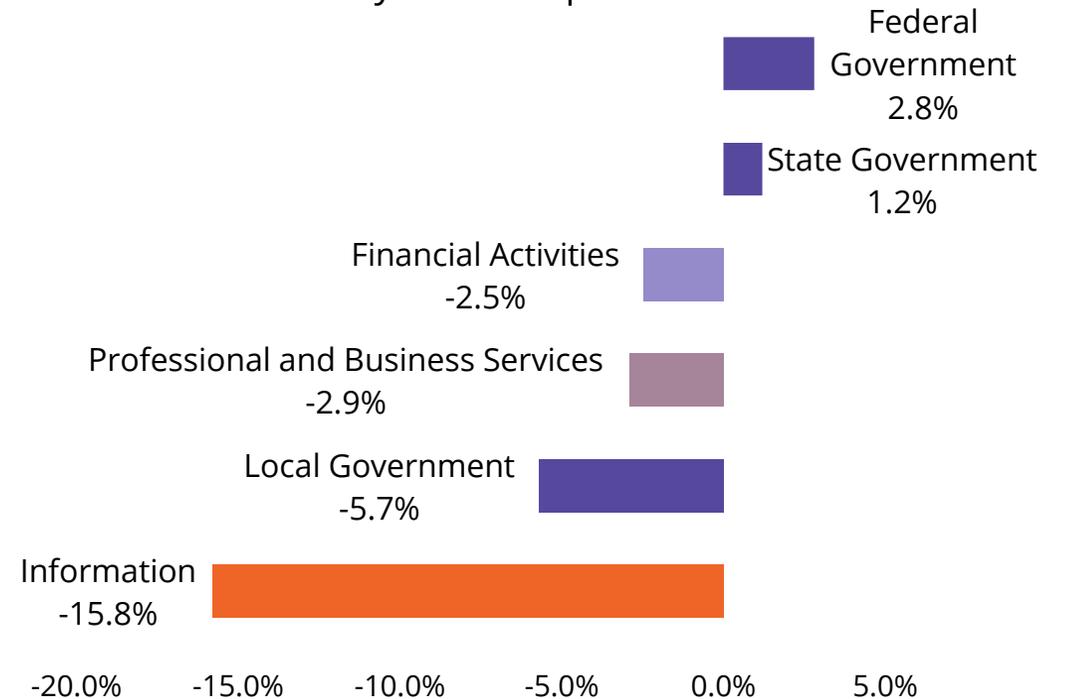
Change in office-using employment during the pandemic

Sacramento MSA job losses have declined by 9.9% since the start of the pandemic, though office-using jobs contracted by just 5.0%. This recession's impact on the office-using labor market has been less severe than the global financial crisis, when Financial Activities job losses totaled 10.9%.

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Total change in Sacramento MSA job gains/(losses)

February 2020 to April 2021



Note: Not seasonally adjusted data. Metropolitan statistical area.
Source: Bureau of Labor Statistics

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Office occupier conditions

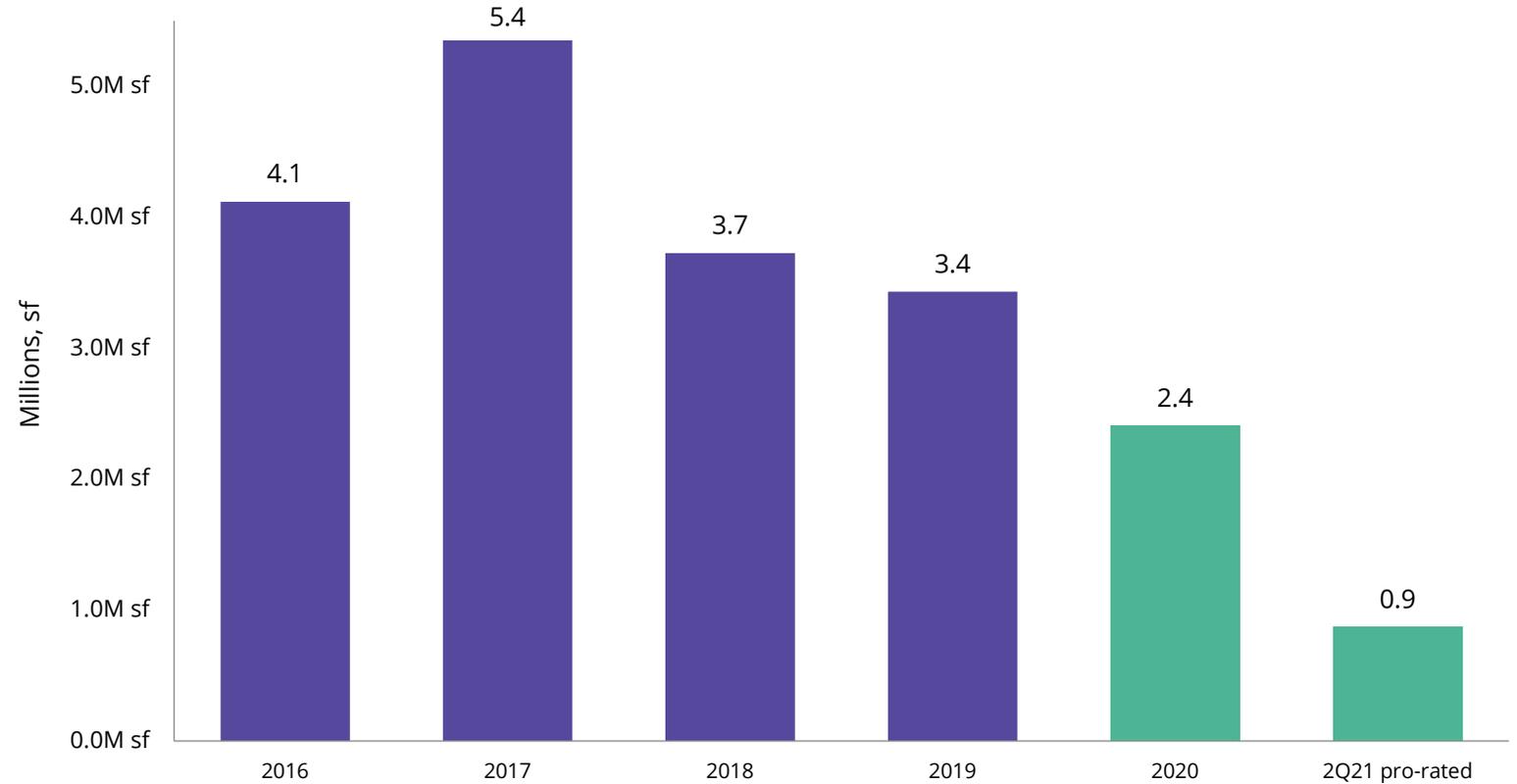
The office market has been slow to recover with government agencies and private sector companies still having substantial numbers of workers in a work from home environment.

Office leasing activity

-60.6%

**2020-2Q 2021 annual
average leasing activity**

There is no modern precedent for the post-COVID slowdown in leasing activity due to the sudden change in office occupiers' future workplace strategies and the 2020 recession.



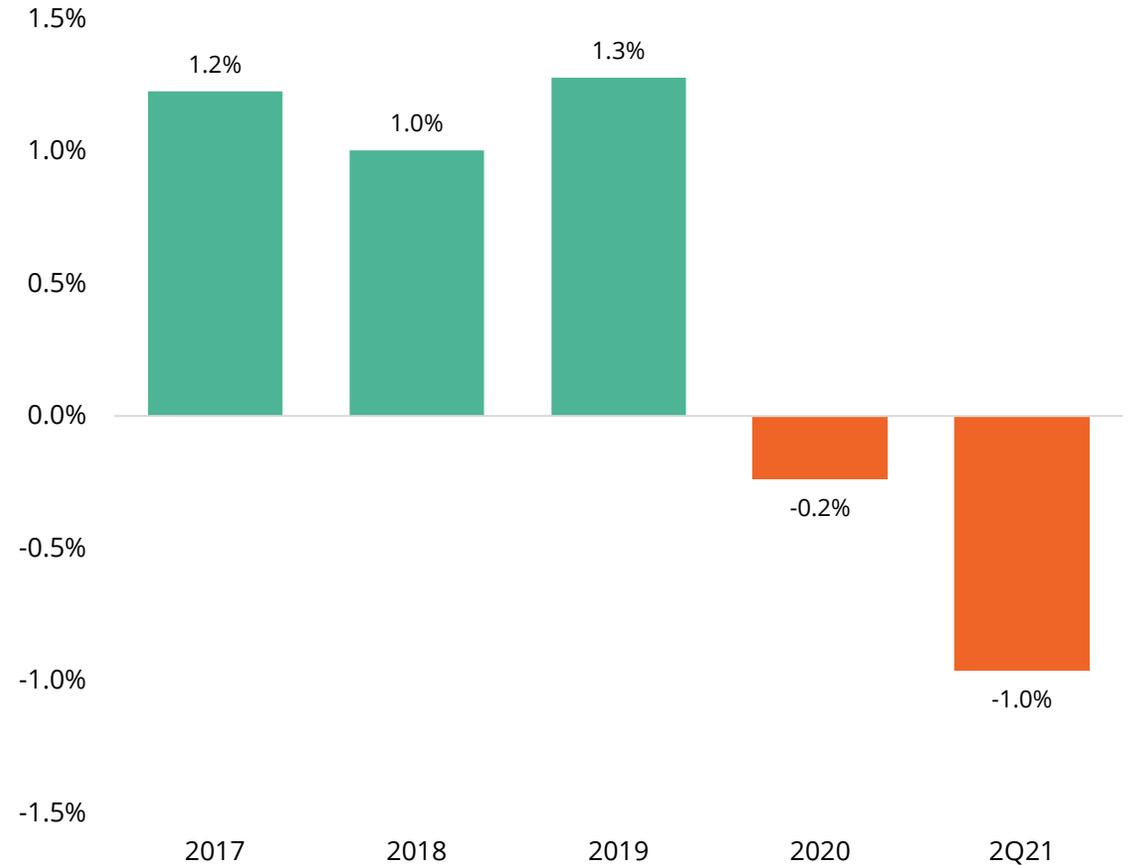
Source: AVANT by Avison Young

Absorption

-1.2%

Net absorption as a percentage of inventory, 2020 through Q2 2021

Negative absorption from 2020 to 2Q21 totaled 963,903 sf, equating to negative 1.2% of the existing stock. This negative absorption significantly surpasses the lows of the early 2000's recession and global financial crisis.



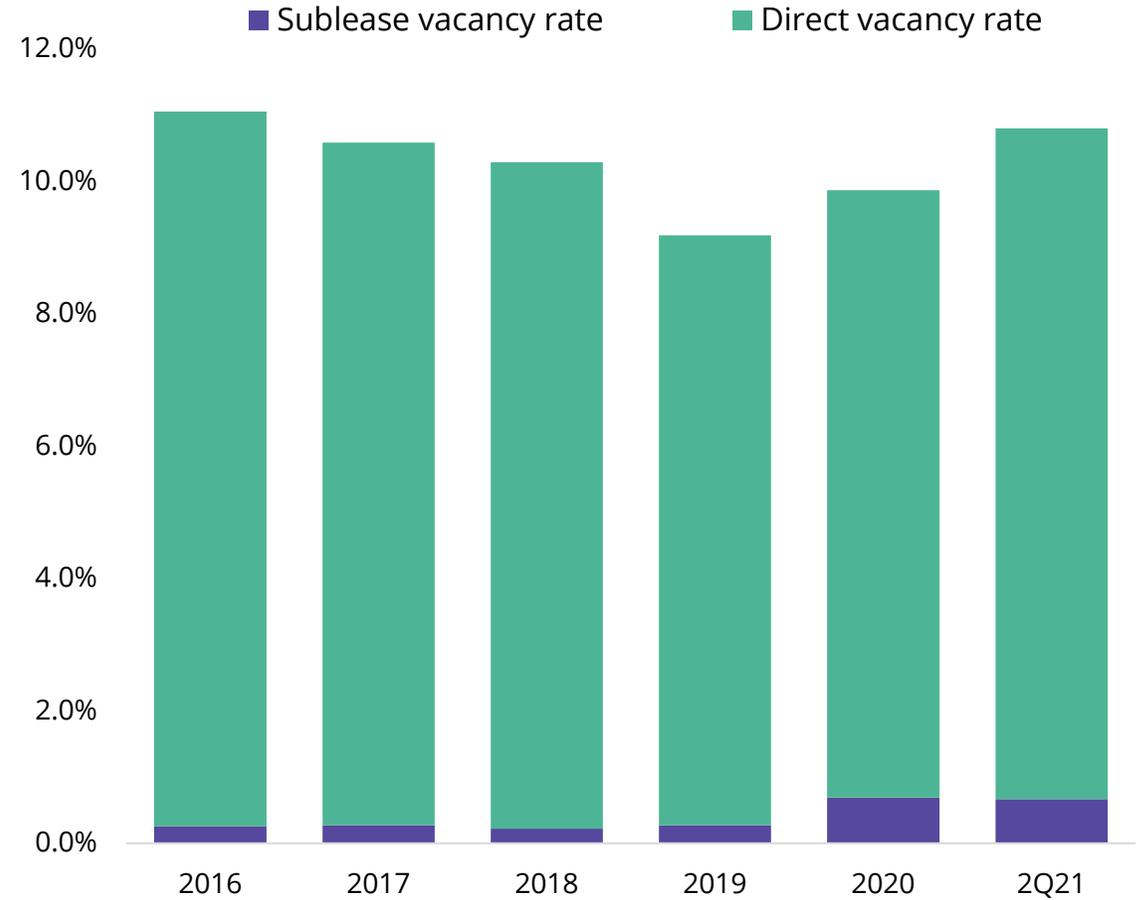
Source: AVANT by Avison Young

Vacancy rate

10.8%

Tempered Sacramento vacancy as of Q2 2021

The Q2 2021 vacancy rate has not experienced the formidable growth that other Northern California markets experienced during the pandemic. Current vacancy is only 160 basis point higher than the recent low of 9.2% in 2019 and only slightly higher than the previous 5-year average of 10.2%.



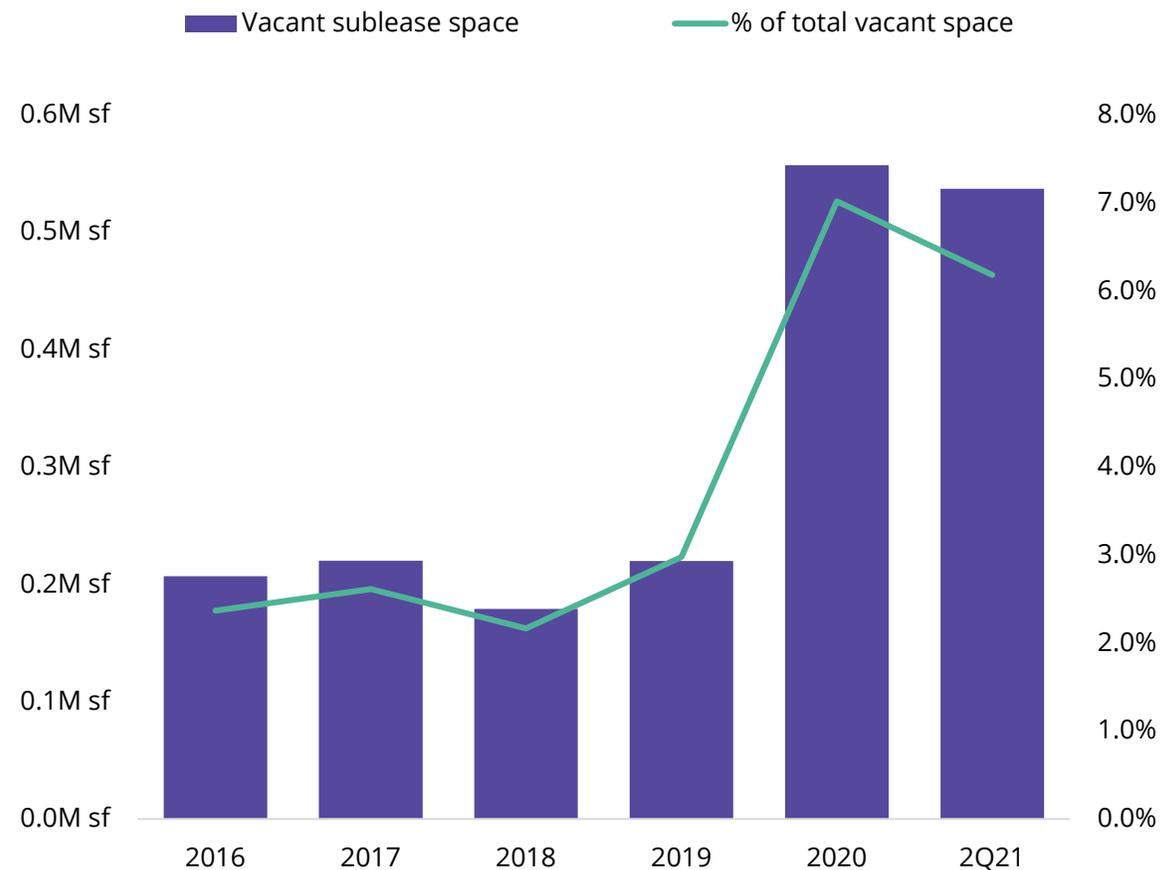
Source: AVANT by Avison Young

Vacant sublease space

536,867 sf

Elevated levels of sublease vacant space

The share of sublease-to-total vacant space was 6.2% for 2Q21. This market has not seen this level vacant sublease space since 3Q02 where nearly 700,000 sf dominated the market.



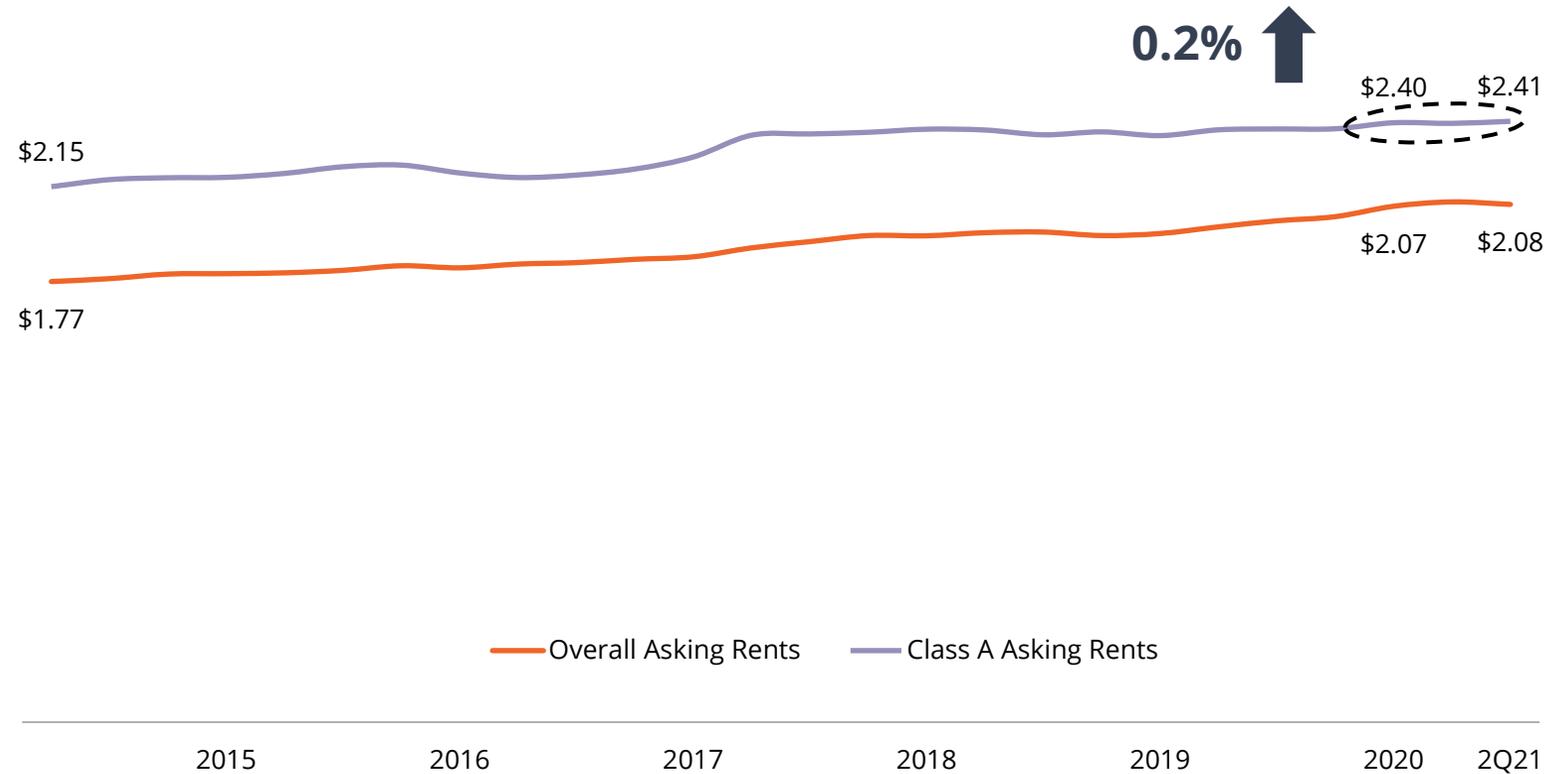
Source: AVANT by Avison Young

Asking rents

0.2%

Year-to-date change in Sacramento class A asking rents

Landlords held firm on asking rents through the pandemic. Average class A asking rents remained relatively flat with only a 0.2% increase during the first half of 2021.



Source: AVANT by Avison Young, CoStar

Sacramento's inventory makeup

54 properties

proposed, under construction

8.2 msf

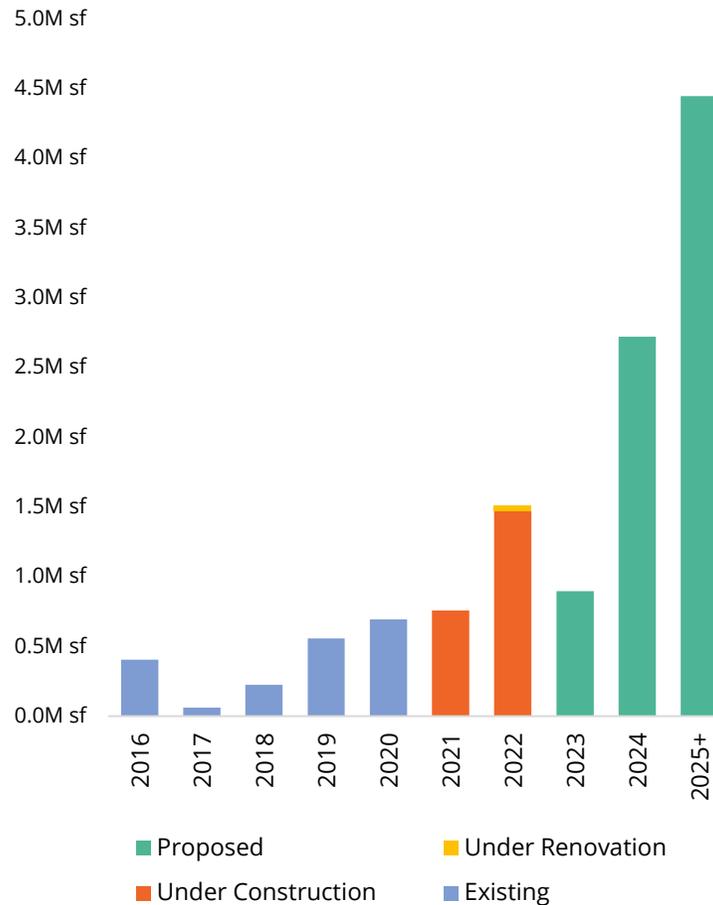
proposed or under construction

11.0%

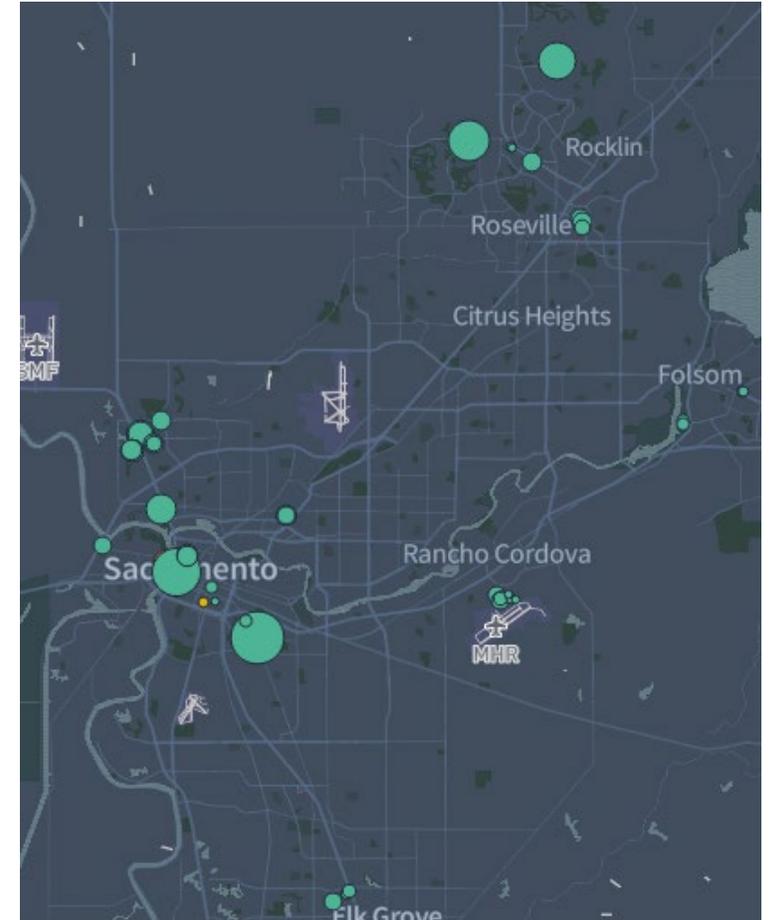
share of office inventory

1988

average delivery date of existing Sacramento area offices



Source: AVANT by Avison Young



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Capital market conditions

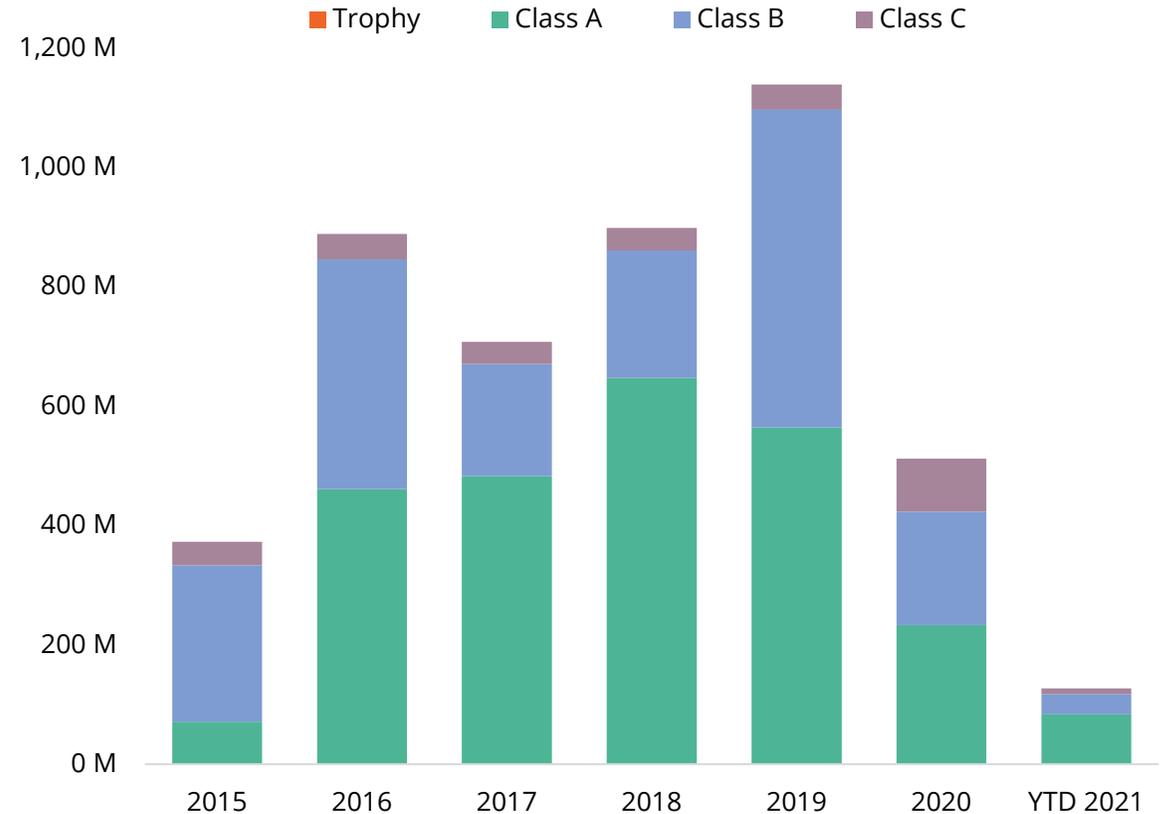
Capital market activity has been slow during the first half of 2021 but the Sacramento office market continues to hold the interest of investors.

Office investment dollar volume

\$639M

Sacramento office dollar volume 2020 to present

Office sales activity was dramatically affected during the risk-pricing crisis, decreasing by an annualized rate of 46.8% compared with the prior five-year average dollar volume.



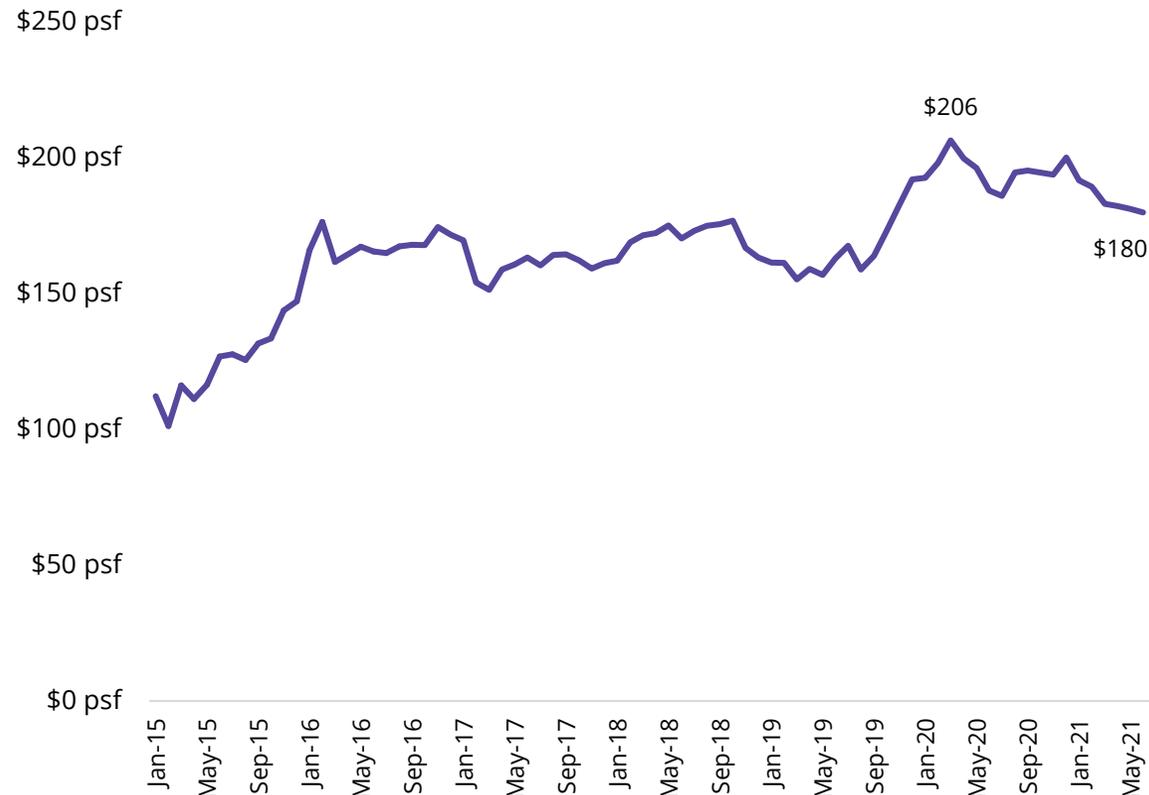
Source: AVANT by Avison Young, RCA

Office asset pricing

-1.5%

Sacramento office pricing from November 2019 to present

Pricing decreased during the pandemic as investors adopting more conservative underwriting approaches, decreasing from \$206 psf in March 2020 to \$180 psf. Expect pricing to rebound as investors explore options in tertiary market.



Source: AVANT by Avison Young (12-month moving average)

Looking forward



Here's what we can expect

- The State of California has long been a stabilizing factor in downtown leasing. More recently, **the State has been trending away from leased space and moving in the direction of more State-owned properties.** This will continue as State-owned construction projects complete over the near term, leaving a surplus of vacancy in its wake.
- Demand for office space has lightened. It is early in the return to office process and companies have yet to make decisive real estate decisions. The **shakeout may lead to more subleases coming to the market** during the second half of 2021.
- Renewals and short-term extensions grew during the pandemic. This trend should continue as **today's market favors tenants and flexibility.** Longer-term leases will have more concessions as landlords look to keep asking rents stable.
- **Asset pricing is poised for a rebound** but the overall lack of quality product for sale could hamper this. As occupancy climbs with employees returning to the office, interest in well-leased assets will grow.
- Despite 2021 YTD vacancy increases resulting in negative absorption, the Sacramento office market sits in relatively good shape compared to other Northern California markets.



Get in touch



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Let's talk

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