



Industrial Report

Q2 2017
GALLELLI REAL ESTATE MARKET REPORT

Overview

The Sacramento industrial market continued its growth streak during Q2 2017, with the market recording notable occupancy growth and another significant drop in vacancy. Despite a slowdown in overall leasing activity, the industrial market still experienced leasing volume in excess of 1 million square feet. Local investment activity saw an uptick during the quarter; however, local investment volumes remain flat due to the lack of quality assets on the market.

Market Trends

- Quarterly vacancy fell from 10.2% to 9.9%, which is the lowest vacancy rate the industrial market has seen in 17 years. Year-over-year vacancy has also declined – one year ago, vacancy stood at 12.7%.
- The market recorded over 295,000 square feet of positive net absorption during Q2. While this number declined from the 980,000 square feet that was recorded in Q1, this marks the sixth consecutive quarter of positive industrial absorption in excess of 100,000 square feet. Year-to-date, the industrial market has seen over 1.2 million square feet of positive net absorption.
- Industrial leasing activity remained strong, despite a decline in deal volume. The market recorded over 1.1 million square feet of industrial leases during Q2 compared to 1.8 million in Q1. Though the market has seen a few larger leases signed, the majority of demand continues to be focused on smaller spaces, as larger blocks of space have become rare in the marketplace.



- Activity across the local submarkets was mostly positive, with the Power Inn and McClellan submarkets posting the largest occupancy gains. Power Inn saw nearly 265,000 square feet of positive net absorption, while McClellan recorded 136,000 square feet. The largest occupancy losses were seen in the Davis Woodland and Sunrise submarkets, which recorded 69,000 and 47,000 square feet of negative net absorption, respectively.
- The average asking rent for industrial space increased from \$0.41 per square foot to \$0.43 per square foot. This marks the first movement in the average rental rate the market has seen since Q4 2015. Though the industrial market has tightened, rents have remained flat; however, with local vacancy now under 10%, the market may begin to see more incremental movement in rental rates.

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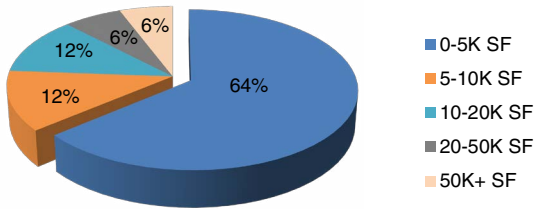
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Industrial Q2 2017

The Sacramento industrial market continues to tighten, with vacancy falling to its lowest rate in 17 years.

<p>Vacancy</p> <h2 style="font-size: 2em;">9.9%</h2> <p>▼</p>	<p>Net Absorption</p> <h2 style="font-size: 2em;">295,464^{SF}</h2> <p>▼</p>	<p>Avg. Rent PSF</p> <h2 style="font-size: 2em;">\$0.43^{PSF}</h2> <p>▲</p>
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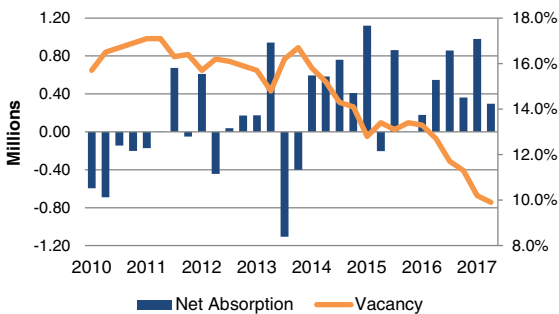
Q1-2017 Industrial Leasing Volume by SF



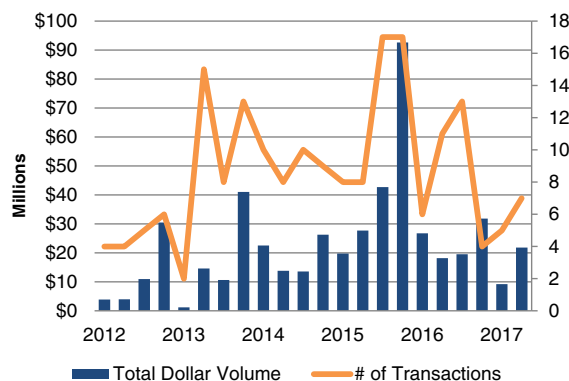
Investment Trends

- Industrial investment activity increased during Q2, with the market recording \$21.8 million in total volume over 7 transactions, compared to just \$9.2 million over 5 transactions in Q1.
- The average price per square foot also increased during Q1, rising from \$57 per square foot in Q1 to \$64 per square foot in Q2.
- The average asking cap rate for industrial product currently stands at 6.0%. Cap rates for industrial space have remained flat for the last 10 consecutive quarters, hovering within the 6-7% range.
- The largest investment sale of the quarter was the sale of 4350 Pell Drive within the Norwood Industrial Park. This 156,373-square-foot, Class B distribution building sold for \$6,200,000 or \$39.65 per square foot.

Industrial Vacancy vs. Net Absorption



Industrial Investment Sales Volume by Quarter





Construction

1,337,023^{SF}

Sacramento Unemployment

4.1%



US Unemployment

4.1%



Spotlight On: Recreational Marijuana's Effect on Industrial

The passage of proposition 64, which legalized recreational marijuana in California, has been having a noticeable impact on industrial real estate. The City of Sacramento currently allows dispensaries, cultivation, manufacturing and testing within specific zones of the city, primarily within light and heavy industrial zoned properties. The Power Inn and Northgate/Natomas submarkets have the highest concentration of these industrial zonings, and as such, they have attracted the most attention from marijuana cultivators and dispensaries. Buildings in these areas also typically fit within the guidelines set by state and city policy, which include being 600 feet from schools, and not being visible from the public right-of-way.

Vacancies in the Power Inn and Northgate/Natomas submarkets have declined by well over half in the last three years, and currently have some of the lowest vacancy rates in the region at 5.2% and 4.9%, respectively. Sale prices per-square-foot for industrial properties in these areas have also increased over the last two years, with Power Inn seeing the average sale price per square foot jump from \$40 to \$76, and Northgate/Natomas seeing prices rise from \$50 to \$82 per square foot. Asking sale prices have also increased, with the majority of buildings on the market in Power Inn asking over \$100 per square foot. While there has been a noticeable increase in the number of prospective commercial marijuana businesses applying for permits in the City of Sacramento, the City's process for permitting is both rigid and expensive, with applicants having to appear at multiple public meetings and pay fees ranging from \$16,000 to over \$30,000 for multiple permits. It is unlikely that all of the current pending conditional use permit applications will make it through the entire process. However, with the County of Sacramento and other outlying regions still figuring out their policies on recreational marijuana business, the City of Sacramento's industrial submarkets will likely continue to see more and more activity from marijuana businesses.

Outlook

The Sacramento industrial market continues to tighten, with vacancy falling to its lowest rate in 17 years. With vacancy now under 10%, we anticipate that rental rate growth is not much further off, and the market will begin to see increases in rental rates as vacancy continues to decline. New industrial construction remains limited – though there are currently 1.3 million square feet of new space under construction, nearly 886,000 square feet are build-to-suit construction, the majority of which is the new 885,000-square-foot Amazon facility at Metro Air Park. The remaining 442,000 square feet under construction are speculative projects, which may help alleviate some demand and will likely lease up quickly upon completion. Leasing activity and demand remain strong, and with little speculative space on the horizon, we anticipate this momentum will continue throughout the rest of the year, as vacancy edges closer to the mid 9% range.

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.

Market Statistics

Submarket	Inventory	Direct	Available Space Sublease	Total	Vacancy Q1-17	Net Absorption		SF Under Construction	Avg. Asking Rate (NNN)
						Q1-17	Q1-16		
Auburn	1,186,745	4,730	0	4,730	0.4%	1,270	7,825	0	\$0.49
Davis/Woodland	7,976,089	1,377,021	0	1,377,021	17.3%	(68,922)	(13,162)	12,024	\$0.29
Downtown	830,518	112,000	0	112,000	13.5%	0	0	0	-
East Sacramento	175,668	0	0	0	0.0%	0	0	0	-
Elk Grove/Laguna	3,029,467	195,978	0	195,978	6.5%	(8,274)	19,005	0	\$0.42
Folsom/El Dorado Hills	1,478,657	140,976	0	140,976	9.5%	(18,646)	11,000	75,000	\$0.65
Mather	2,570,865	286,616	6,400	293,016	11.4%	11,134	41,230	0	\$0.45
McClellan	9,901,308	1,226,091	0	1,226,091	12.4%	136,260	167,861	0	\$0.41
Northgate/Natomas	8,821,044	435,737	0	435,737	4.9%	27,547	110,487	855,000	\$0.42
Northeast Sacramento	2,772,656	155,435	0	155,435	5.6%	(5,100)	(6,120)	0	\$0.33
Power Inn	16,107,554	830,893	0	830,893	5.2%	264,702	(60,552)	240,255	\$0.44
Richards	2,973,008	229,980	0	229,980	7.7%	(28,302)	150,282	0	\$0.39
Roseville/Rocklin	9,043,915	1,648,140	0	1,648,140	18.2%	11,878	(5,205)	22,500	\$0.38
South Sacramento	2,489,269	993,386	0	993,386	39.9%	2,400	11,482	0	\$0.50
Sunrise	5,842,252	164,030	89,227	253,257	4.3%	(46,773)	31,390	18,944	\$0.46
West Sacramento	14,316,085	959,480	0	959,480	6.7%	16,290	126,888	104,800	\$0.40
Totals	89,515,100	8,760,493	95,627	8,856,120	9.9%	295,464	592,411	1,328,523	\$0.43

About Gallelli Real Estate

Gallelli Real Estate is a boutique 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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