



# Colliers International Sacramento Industrial Quarterly Report



First Quarter 2005

## Market Trends

	Change in Q1	Q2 Forecast
Lease Rates	↔	↑
Absorption	↑	↑
Direct Vacancy	↓	↓
Sublease Vacancy	↔	↔

## Vacancy Reaches Pre-Recession Levels

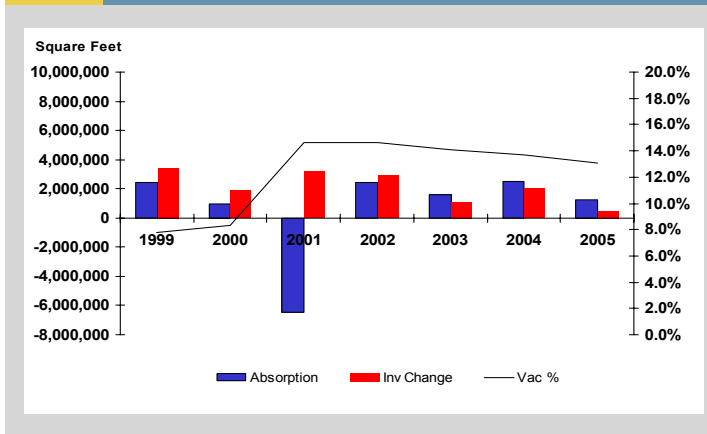
Following two consecutive quarters of strong occupancy growth vacancy in the Sacramento industrial market now stands at 13.1%. This is the lowest that it has been since the second quarter of 2001—before the events of 9-11 and before the economy slumped into recession during the third quarter of that year.

Positive net absorption continues to outpace new deliveries and this has resulted in the market moving further towards equilibrium between supply and demand.

Over 1.2 million square feet of space was absorbed during the first three months of 2005 compared to just under half a million square feet of new construction that came online during that same time. This is a repeat of trends that emerged at the end of 2004. During the fourth quarter of last year, over one million square feet of occupancy growth occurred—nearly double the amount of product that was delivered to the marketplace through new construction.

This all comes as welcome news to a market that has experienced vacancy in the 14% range for much of the last three years. While it is too soon to tell if this trend will continue there are a number of signs that seem to point towards the market moving closer to equilibrium between supply and demand heading into 2005.

FIGURE 1 Sacramento Office Market Inventory, Vacancy, and Absorption



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Roughly 780,000 square feet of space is currently under construction throughout the Sacramento area. Nearly all of that is scheduled for second and third quarter deliveries. This marks the lowest amount of new development to be in the pipeline in two years.

Meanwhile, we track tenant space requirements in the marketplace and are currently aware of over 3.8 million square feet of potential space needs. This total includes both tenants who are actively looking for space in the marketplace and space users who are facing pending lease expirations. This number is up significantly from the 2.7 million square feet in requirements we tracked exactly one year ago. With a slowly but surely improving economy we expect this number to continue to grow as tenants seek space for expansion and new businesses enter the marketplace. This combination of increased demand and diminished development will ensure that vacancy continues on a downward trend in Sacramento over the next six months.

While current vacancy of 13.1% is comparable to that being experienced in most major industrial markets, it is still a few percentage points above what is considered optimal. Vacancy levels within the ten percent range generally ensure enough available space for economic expansion, but not so much as to depress rental growth. Current trends indicate that vacancy in the 11% range may be attainable by the third quarter of this year. That being said, we are already experiencing a shortage of available buildings for some select property types.

**A Tale of Two Markets**

While our overall numbers indicate a market that is slowly but surely moving towards equilibrium, these statistics are a bit misleading on the micro level. Over the past four years the trends experienced by bulk warehouse product have been radically different from those experienced by smaller

**FIGURE 2** Sacramento Industrial Market Bulk vs. Non-bulk

	Total Inventory	Total Vacancy	Total Vacancy Percent	Deliveries (Qtr)	Deliveries (YTD)	Net Absorption (Qtr)	Net Absorption (YTD)
Bulk Warehouse	63,011,156	12,097,589	19.2%	106,504	106,504	172,170	172,170
Non-Bulk	93,333,337	8,421,972	9.0%	370,665	370,665	1,081,414	1,081,414
All Types	156,344,493	20,519,561	13.1%	780,444	780,444	1,253,584	1,253,584

industrial buildings as well as divisible mid-size product.

Bulk warehouse space is generally geared for distribution uses and is defined locally as buildings of 100,000 square feet or more with plentiful loading docks and easy truck access. Sacramento's central location, cheap land costs and easy access to major interstate arteries are all factors that would seem to dictate the success of this property type and Sacramento's emergence as a major distribution hub. However, strong competition from markets such as Stockton and tax-free Reno just two hours across the Sierras have prevented this trend from full realization in recent years.

One clear example of this is the fact that 2004 was a banner year for bulk warehouse product in Stockton. At least 16 bulk warehouse leases were signed accounting for just under three million square feet of absorption. By comparison, we are aware of only five bulk deals of 100,000 square feet or more being signed in Sacramento during that time.

But the good news is that fierce competition among bulk properties in Sacramento has resulted in bargain rents that are increasingly attracting space users. Asking rates for bulk space in Sacramento have dropped to the \$.30 per square foot range and the market has become more competitive with Stockton and other markets. Just over

1.1 million square feet of space was absorbed in 2004, and bulk space continued to record occupancy growth over the first three months of the year with an additional 172,000 square feet of positive absorption. Yet, vacancy for bulk warehouse space still stands at a whopping 19.2%. The health of all other industrial building types stand in sharp contrast to that of bulk warehouse with vacancy currently at a low 9.0%.

Vacancy has held steady in the ten percent range for the last three years, despite the fact that over four million square feet of product has come online since the beginning of 2002. Smaller space and medium-sized buildings offering divisibility have dominated activity in the Sacramento area for much of the past two years. Leasing, sales and development activity has all increasingly focused on this product type. Most striking is the fact that all of the 780,000 square feet of product currently under construction in the Sacramento region is in the form of either smaller or divisible structures.

**Looking Ahead**

Ultimately, the Sacramento industrial market remains two separate and distinct markets at this point in time. The market for smaller buildings or space within divisible buildings



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Existing Properties											Absorption		New Supply		UC / Proposed		Avg Rent
Sub-Mkt.	Bldgs	Total Inventory Sq. Ft.	Direct Vacant Sq. Ft.	Direct Vacancy Rate	Sublease Vacant Sq. Ft.	Sublease Vacancy Rate	Total Vacant Sq. Ft.	Occupied Space Sq. Ft.	Vacancy Rate Q1-05	Vacancy Rate Q4-04	Net Absorption Current Sq. Ft.	Net Absorption YTD-Sq. Ft.	New Supply CurrentSq. Ft.	New Supply YTD Sq. Ft.	Under Construction Sq. Ft.	Proposed Sq. Ft.	Avg Rental Rate
<b>SACRAMENTO METRO</b>																	
Auburn/Lincoln/Newcastle	113	2,074,364	73,424	3.5%	-	0.0%	2,000,940	73,424	3.5%	4.1%	11,000	11,000	-	-	6,356	20,000	\$0.78
Davis/Woodland	244	17,111,224	2,795,292	16.3%	109,800	0.6%	14,206,132	2,905,092	17.0%	17.4%	73,243	73,243	-	-	61,000	653,166	\$0.27
Downtown/Midtown	190	5,021,484	117,094	2.3%	-	0.0%	4,904,390	117,094	2.3%	2.6%	14,310	14,310	-	-	-	-	\$0.47
East Sacramento	42	847,149	25,000	3.0%	-	0.0%	822,149	25,000	3.0%	3.0%	-	-	-	-	-	-	\$0.65
Elk Grove/Laguna	103	3,818,782	697,583	18.3%	-	0.0%	3,121,199	697,583	18.3%	19.6%	49,122	49,122	-	-	-	743,291	\$0.40
Folsom/El Dorado	190	4,429,886	238,975	5.4%	-	0.0%	4,190,911	238,975	5.4%	5.6%	7,572	7,572	-	-	-	192,882	\$1.10
Marysville/Yuba City	138	5,096,540	314,398	6.2%	-	0.0%	4,782,142	314,398	6.2%	6.3%	4,920	4,920	-	-	-	6,600	\$0.45
McClellan/North Highlands	420	14,679,261	3,847,207	26.2%	102,461	0.7%	10,729,593	3,949,668	26.9%	27.3%	59,551	59,551	-	-	257,640	593,095	\$0.50
Northeast	347	6,832,380	436,523	6.4%	99,596	1.5%	6,296,261	536,119	7.8%	7.6%	(16,116)	(16,116)	-	-	-	13,000	\$0.58
Northgate/Natomas	268	11,324,838	953,131	8.4%	58,040	0.5%	10,313,667	1,011,171	8.9%	9.6%	455,259	455,259	415,504	415,504	247,056	1,003,634	\$0.46
Power Inn	738	24,757,487	3,610,805	14.6%	8,100	0.0%	21,138,582	3,618,905	14.6%	15.5%	212,393	212,393	-	-	113,000	273,125	\$0.53
Richards	123	5,497,222	442,873	8.1%	31,000	0.6%	5,023,349	473,873	8.6%	8.9%	14,760	14,760	-	-	-	-	\$0.35
Roseville/Rocklin	438	17,024,990	3,206,246	18.8%	23,900	0.1%	13,794,844	3,230,146	19.0%	19.6%	146,681	146,681	56,565	56,565	-	956,723	\$0.59
South Sacramento	172	4,327,464	91,789	2.1%	-	0.0%	4,235,675	91,789	2.1%	1.3%	(30,879)	(30,879)	5,100	5,100	-	-	\$1.10
Sunrise/Highway 50	720	16,415,408	1,444,115	8.8%	106,657	0.6%	14,864,636	1,550,772	9.4%	10.3%	136,890	136,890	-	-	-	1,003,201	\$0.58
West Sacramento	457	17,086,014	1,643,096	9.6%	42,456	0.2%	15,400,462	1,685,552	9.9%	10.5%	114,878	114,878	-	-	95,392	535,635	\$0.38
<b>GRAND TOTAL</b>																	
	<b>4,703</b>	<b>156,344,493</b>	<b>19,937,551</b>	<b>12.8%</b>	<b>582,010</b>	<b>0.4%</b>	<b>135,824,932</b>	<b>20,519,561</b>	<b>13.1%</b>	<b>13.7%</b>	<b>1,253,584</b>	<b>1,253,584</b>	<b>477,169</b>	<b>477,169</b>	<b>780,444</b>	<b>5,994,352</b>	<b>\$0.55</b>

## QUARTERLY COMPARISON AND TOTALS

Q4-04	4,684	155,867,324	20,865,142	13.4%	430,834	0.3%	134,571,348	21,295,976	13.7%	14.1%	1,055,459	2,539,445	504,150	2,016,353	860,557	5,994,352	\$0.54
Q3-04	4,651	155,363,174	21,361,701	13.7%	485,584	0.3%	133,515,889	21,847,285	14.1%	13.8%	33,089	1,483,986	534,931	1,512,203	1,082,213	6,120,452	0.54
Q2-04	4,627	154,813,243	20,796,870	13.4%	533,573	0.3%	133,482,800	21,330,443	13.8%	14.4%	1,526,433	1,450,897	686,019	977,272	1,212,914	6,235,448	0.51
Q1-04	4,595	154,127,224	21,668,352	14.1%	502,505	0.3%	131,956,367	22,170,857	14.4%	14.1%	-75,536	-75,536	291,253	291,253	1,442,017	6,582,664	0.51
Q4-03	4,586	153,785,971	21,230,936	13.8%	523,132	0.3%	132,031,903	21,754,068	14.1%	13.8%	-76,777	1,628,756	472,051	1,110,811	1,227,742	7,105,663	0.48



## United States

Akron, OH	Minneapolis, MN
Allentown, PA	Nashville, TN
Atlanta, GA	New Haven, CT
Austin, TX	New Jersey, NJ
Bakersfield, CA	New York, NY
Baltimore, MD	Oakland, CA
Beachwood, OH	Ogden, UT
Bellevue, WA	Orlando, FL
Boca Raton, FL	Palo Alto, CA
Boise, ID	Park City, UT
Boston, MA	Philadelphia, PA
Carlsbad, CA	Phoenix, AZ
Charleston, SC	Pittsburgh, PA
Charlotte, NC	Pleasanton, CA
Chicago, IL	Plymouth Meeting, PA
Cincinnati, OH	Portland, OR
Clearwater, FL	Provo, UT
Cleveland, OH	Raleigh, NC
Columbia, SC	Reno, NV
Dallas/Ft. Worth, TX	Roseville, CA
Dayton, OH	Sacramento, CA
Denver, CO	Salt Lake City, UT
Detroit, MI	San Diego, CA
Fairfield, CA	San Francisco, CA
Fort Myers, FL	San Jose, CA
Fresno, CA	San Mateo, CA
Ft. Lauderdale, FL	Scottsdale, AZ
Gilroy, CA	Seattle, WA
Greenville, SC	St. Charles, MO
Hartford, CT	St. George, UT
Honolulu, HI	St. Louis, MO
Houston, TX	St. Paul, MN
Indianapolis, IN	Stamford, CT
Jacksonville, FL	Stockton, CA
Kansas City, MO	Sun Valley, ID
Las Vegas, NV	Tacoma, WA
Los Angeles, CA	Tampa, FL
Louisville, KY	Walnut Creek, CA
Memphis, TN	Washington, DC
Miami, FL	Wilmington, DE
Milwaukee, WI	

remains extremely strong and favors the landlord. Meanwhile, it is definitely a tenants market when it comes to bulk warehouse/distribution space. Bulk space will need to keep extremely competitive in order to rebound. Expect deal activity to continue to primarily be focused on smaller spaces.

Landlords of smaller or divisible properties—particularly landlords of new high-end buildings—are in the drivers seat and have recorded some rental growth. The gradually improving economy will ensure that this trend continues so long as this product type is not overbuilt. With the construction time of an industrial building ranging anywhere from six months to a year, industrial developers have the advantage of being able to generally respond to market conditions

more quickly than their office or retail counterparts. With current vacancy rates for smaller and divisible properties dipping beneath the 10% mark it is entirely possible that we may see a surge in the development of these types of buildings sometime in the near future. However, rising construction costs will likely play a strong role in keeping development levels down, despite the fact that we are nearing shortage levels in some submarkets. So long as demand continues to increase and construction stays at moderate levels these properties will continue to be strong and rental growth is likely.

In the meantime, look for overall vacancy to continue to decrease throughout the metropolitan area for all property types—including bulk warehouse space.

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