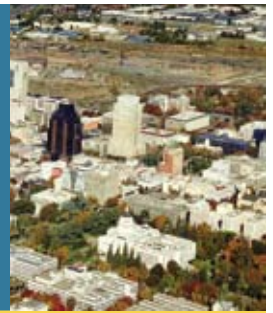




# Colliers International Sacramento Industrial Quarterly Report



First Quarter 2006

## Market Trends

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

## Is Bulk Back?

Overall vacancy within the Sacramento industrial market currently stands at 11.5 percent. This marks the lowest level of vacancy that the region has seen in five years. The last time that local vacancy stood below the twelve percent mark was the first quarter of 2001 when the market was at the peak of the last real estate cycle. By the close of 2001 vacancy had soared to the 14.4 percent mark as demand curtailed in the face of the economic downturn that began shortly before 9/11 and the country slipped into recession in the third quarter of that year. An additional factor that impacted the Sacramento market at that time was the construction of a number of bulk warehouse facilities that were delivered to the marketplace just as the real estate cycle turned. The combination of these factors resulted in overall vacancy increasing by over six percentage points that year.

Since 2001 tenant demand in the marketplace has gradually increased each year. But as we have reported to you in past quarters, local vacancy has largely been a tale of two product types. While smaller industrial properties and divisible multi-tenant facilities have fared well during this period, bulk warehouse properties have continued to face challenges throughout much of this time with vacancy exceeding 20 percent for most of the past five years. With a number of major bulk deals signed during the first quarter of this year it appears that bulk product may finally be experiencing the recovery that other industrial product has been experiencing in earnest since 2004.

FIGURE 1 Sacramento Industrial Market Inventory, Vacancy, Construction and Absorption

	2004		2005			2006
	4 <sup>th</sup> Qtr	1 <sup>st</sup> Qtr	2 <sup>nd</sup> Qtr	3 <sup>rd</sup> Qtr	4 <sup>th</sup> Qtr	1 <sup>st</sup> Qtr
Total Inventory	158,456,649	158,878,726	159,301,883	159,939,671	160,715,492	161,063,077
Total Vacancy	21,535,557	20,878,795	19,965,488	18,809,293	19,425,217	18,523,138
Total Vacancy Percent	13.6%	13.1%	12.5%	11.8%	12.1%	11.5%
Deliveries	532,457	477,692	401,367	624,618	771,896	514,923
Net Absorption (Growth)	1,051,777	1,078,839	1,336,464	1,793,983	159,897	1,249,664



www.colliers.com

Colliers International  
1610 Arden Way, Suite 240  
Sacramento, CA 95815-4028  
Tel: 916.929.5999  
Fax: 916.649.0001

1400 Rocky Ridge Drive, Suite 150  
Roseville, CA 95661  
Tel: 916.784.7550  
Fax: 916.784.7527

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### Vacancy Trends

This quarter marks the first quarter since 2001 in which overall industrial vacancy in the region has dipped beneath the twelve percent mark. At the height of the last economic downturn in late 2001 vacancy had peaked at the 14.4 percent mark and had stayed within a percentage point of that mark through the better part of 2004. However, since that time it has been on a general downward trend. Generally when a market records vacancy in the ten percent range it reflects equilibrium between supply and demand. Vacancy above that level generally ensures that competition among landlords for available tenants is heightened and rental growth is negatively impacted. Vacancy below that level generally means that tenants have limited options for local growth and the market runs the risk of inflated rents. With vacancy in the ten percent range, rental growth can generally occur while tenants still have reasonable options for expansion. Current vacancy totals paint a picture of a market nearing equilibrium. But they do not tell the whole story.

The product type that has experienced the highest levels of vacancy over the past five years has been bulk warehouse. In recent years bulk warehouse product has become the national industrial product of choice. Geared towards transportation/distribution uses with 100,000 square foot or more footprints, high ceilings for the warehousing of goods and generally considerable dock or cross-docking access, this product type has been the focus of most industrial development and most industrial occupancy growth nationally for the better part of the last decade. The Sacramento market came late to this product type and, as a result, local trends for bulk warehouse product have largely been a reverse image of national trends.

Bulk vacancy in the Sacramento region currently stands at 15 percent compared to

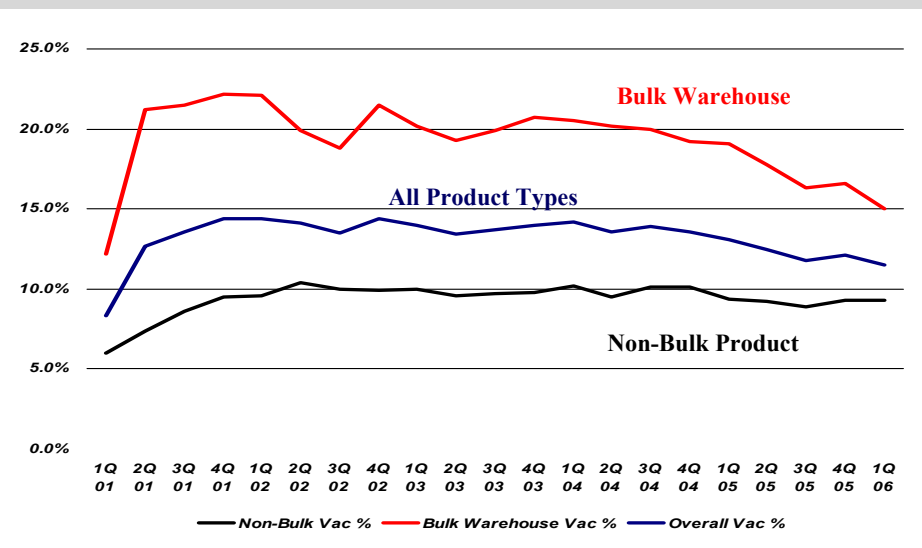
vacancy for all other product types which stands at 9.3 percent. Throughout the last three years of recovery, the Sacramento market has experienced distinctly different market dynamics for its bulk product versus all other industrial product types. The gap in vacancy between bulk warehouse space and other industrial product types has been as great as ten percentage points at times. While the market as a whole may be nearing equilibrium it is vital to note that non-bulk product in the region did not experience vacancy above the eleven percent mark throughout the past five years, even during the most recent economic downturn. This has translated into strong rental growth for smaller industrial buildings and for space in multi-tenant industrial properties—particularly those situated in Sacramento’s highest demand submarkets. Meanwhile, bulk ware-

house rents have remained relatively flat for the past five years.

Absorption trends have also been considerably different during this time with non-bulk product accounting for over seven million square feet of occupancy growth since 2001, or roughly 415,000 square feet per quarter. During this same period bulk warehouse space accounted for just over 5.5 million square feet of absorption—but nearly one million square feet of that total was recorded during the first quarter of this year. Bulk space has averaged approximately 325,000 square feet of occupancy growth per quarter since 2001. However, if you exclude the strong showing recorded during the first three months of 2006, that average drops to approximately 285,000 square feet per quarter. The good news for bulk landlords

FIGURE  
**2**

Sacramento Industrial Market  
 Vacancy: Bulk Warehouse, Overall and Non-Bulk Product





# Colliers International Sacramento Industrial Quarterly Report



Sub-Mkt.	Bldgs	Total Inventory Sq. Ft.	Existing Properties							Absorption		UC / Proposed		Rents
			Direct Vacant Sq. Ft.	Direct Vacancy Rate	Sublease Vacant Sq. Ft.	Sublease Vacancy Rate	Total Vacant Sq. Ft.	Vacancy Rate Current Period	Vacancy Rate Prior Period	Occupied Space Sq. Ft.	Net Absorption Current Sq. Ft.	Net Absorption YTD-Sq. Ft.	Completions Current Qtr SF	Under Construction Sq. Ft.

## TOTAL MARKET

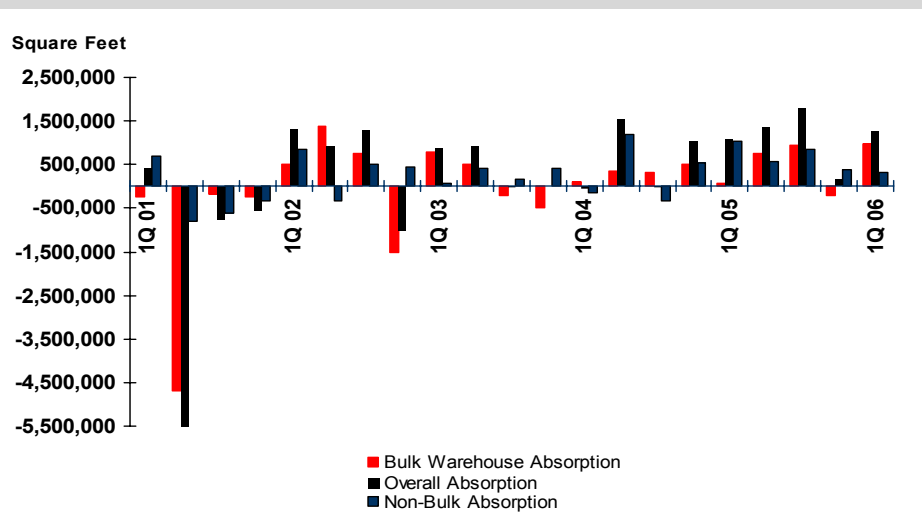
Auburn/Newcastle	119	2,448,922	223,032	9.1%	16,100	0.7%	239,132	9.8%	4.1%	2,209,790	-139,426	-139,426	0	0	\$9.65
Davis/Woodland	256	17,159,660	2,404,012	14.0%	0	0.0%	2,404,012	14.0%	13.6%	14,755,648	-63,942	-63,942	0	0	\$3.65
Downtown	190	5,095,962	153,003	3.0%	0	0.0%	153,003	3.0%	3.1%	4,942,959	2,922	2,922	0	0	\$3.85
East Sacramento	45	897,278	35,200	3.9%	0	0.0%	35,200	3.9%	6.5%	862,078	23,275	23,275	0	0	\$5.91
Elk Grove/Laguna	120	4,634,935	718,922	15.5%	16,052	0.3%	734,974	15.9%	14.6%	3,899,961	75,791	75,791	157,184	83,216	\$8.10
Folsom/El Dorado Hills	189	4,376,991	179,640	4.1%	3,000	0.1%	182,640	4.2%	3.5%	4,194,351	-27,900	-27,900	0	118,240	\$11.04
Marysville/Yuba City	136	5,043,193	220,821	4.4%	0	0.0%	220,821	4.4%	4.4%	4,822,372	1,660	1,660	0	0	\$5.90
McClellan	441	15,231,387	3,417,291	22.4%	20,407	0.1%	3,437,698	22.6%	27.6%	11,793,689	772,971	772,971	0	100,366	\$4.80
Natomas/Northgate	314	12,056,369	1,703,767	14.1%	25,288	0.2%	1,729,055	14.3%	14.4%	10,327,314	75,539	75,539	78,984	499,506	\$6.30
Northeast	354	7,000,706	429,632	6.1%	62,325	0.9%	491,957	7.0%	8.1%	6,508,749	76,605	76,605	0	0	\$6.11
Power Inn	770	25,050,484	2,975,274	11.9%	8,400	0.0%	2,983,674	11.9%	13.7%	22,066,810	442,981	442,981	76,575	178,234	\$5.55
Richards Boulevard	123	5,630,603	592,592	10.5%	31,000	0.6%	623,592	11.1%	11.0%	5,007,011	-3,840	-3,840	0	0	\$4.27
Roseville/Rocklin	459	17,836,039	2,220,968	12.5%	17,141	0.1%	2,238,109	12.5%	11.4%	15,597,930	-112,293	-112,293	135,780	294,825	\$8.31
South Sacramento	181	4,548,166	93,021	2.0%	2,000	0.0%	95,021	2.1%	1.9%	4,453,145	-6,808	-6,808	0	0	\$7.92
Sunrise/Hwy 50/Mather	723	16,460,352	1,400,462	8.5%	32,409	0.2%	1,432,871	8.7%	8.4%	15,027,481	-39,218	-39,218	66,400	349,516	\$6.90
West Sacramento	471	17,592,030	1,511,379	8.6%	10,000	0.1%	1,521,379	8.6%	9.6%	16,070,651	168,372	168,372	0	0	\$4.96
<b>TOTAL</b>	<b>4,891</b>	<b>161,063,077</b>	<b>18,279,016</b>	<b>11.3%</b>	<b>244,122</b>	<b>0.2%</b>	<b>18,523,138</b>	<b>11.5%</b>	<b>12.1%</b>	<b>142,539,939</b>	<b>1,246,689</b>	<b>1,246,689</b>	<b>514,923</b>	<b>1,623,903</b>	<b>\$6.00</b>

## QUARTERLY COMPARISON AND TOTALS

Q1-06	4,891	161,063,077	18,279,016	11.3%	244,122	0.2%	18,523,138	11.5%	12.1%	142,539,939	1,246,689	1,246,689	514,923	1,623,903	\$6.00
Q4-05	4,868	160,715,492	19,032,459	11.8%	392,758	0.2%	19,425,217	12.1%	11.8%	141,290,275	159,897	4,369,183	771,896	1,754,732	\$5.76
Q3-05	4,829	159,939,671	18,374,407	11.5%	434,886	0.3%	18,809,293	11.8%	12.5%	141,130,378	1,793,983	4,209,286	624,618	2,049,334	\$5.66
Q2-05	4,803	159,301,883	19,397,469	12.2%	568,019	0.4%	19,965,488	12.5%	13.1%	139,336,395	1,336,464	2,415,303	401,637	1,891,335	\$5.46
Q1-05	4,773	158,878,726	20,296,785	12.8%	582,010	0.4%	20,878,795	13.1%	13.6%	137,999,931	1,078,839	1,078,839	477,692	1,294,179	\$5.46



**FIGURE 3** Sacramento Industrial Market  
 Net Absorption: Bulk Warehouse, Overall & Non-Bulk Product



is that it appears that after a long drought, recovery is finally happening in earnest. We are aware of over one million square feet of deals inked in the first quarter (not all of them assuming occupancy and thus impacting current statistics) as well as nearly two million square feet in tenant requirements that are currently searching for bulk warehouse space in the marketplace.

One number that shows just how strongly these trends have impacted the market is the amount of new construction that has been delivered to the marketplace since 2001. Just over 1.4 million square feet of bulk product has been delivered in the past five years with no new projects completed since the third quarter of 2004. All other industrial product types accounted for over 7.6 million square feet of new construction during this period or nearly 85 percent of all new development. The lack of new bulk warehouse construction in recent years has played a major role in stabilizing the market.

With the bulk warehouse market accounting for over 987,000 square feet of occupancy

growth during the first quarter alone, and as much as an additional two million square feet of bulk warehouse requirements currently in the marketplace developers may be asking whether it is time to consider building bulk product in the Sacramento region again. But while there is one 150,000 square foot building currently under construction in the region, we do not expect any significant return of bulk warehouse development in the immediate future.

Bulk warehouse rents in the Sacramento region remain largely in the \$.30 to \$.35 per square foot range (based upon a monthly triple net lease). The region continues to face stiff competition from the Stockton and Modesto markets where rents have averaged as much as 25 percent lower. The Reno industrial market remains competitive with Sacramento as well. Despite the fact that bulk warehouse rents there have increased significantly in recent years, Nevada's tax advantages remain a draw. Meanwhile, construction costs in the Sacramento area have increased by as much as 17 percent for each of the past two years. Most importantly

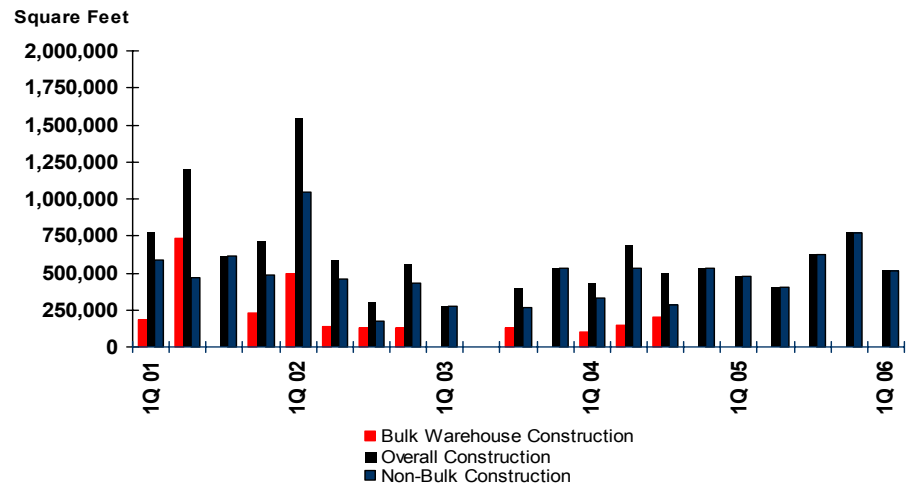
is the issue of industrially zoned land. The Sacramento region is currently experiencing a shortage of industrially zoned dirt and this has sent land prices skyrocketing. The net effect is that until real rental growth can occur for bulk warehouse space, it is unlikely that new construction of this product type will be economically feasible in most cases. And those developers who already own land and may be able to make their numbers work will still have to face stiff competition from cheaper rent markers in the Central Valley. In the meantime this should all come as welcome news for landlords of existing bulk product. Vacancy should continue to decline with demand finally on the rise. With little chance of new development in the immediate future, owners of bulk warehouse buildings may be looking at the very real possibility of rental growth for the first time in five years.

### Absorption Trends

With just over 1.2 million square feet of positive net absorption during the first quarter of this year, the market recorded one of its strongest quarters in terms of occupancy growth since 2001. Since 2001 the market has averaged approximately 725,000 square feet of occupancy growth per quarter. The market outpaced this by roughly seventy percent during the first three months of 2006. Bulk warehouse deals are back and our brokers report tenant interest and activity for smaller industrial and multi-tenant buildings to be on the rise as well. All of these factors bode well for landlords who are beginning to record rental rate growth for select product types in the region's high demand submarkets.



**FIGURE 4** Sacramento Industrial Market  
 New Construction: Bulk Warehouse, Overall & Non-Bulk Product



**Construction Trends**

Over 9.1 million square feet of space has been delivered to the marketplace since 2001. Since that time the market has averaged over 535,000 square feet of new construction per quarter. First quarter totals fell just below this average with just under 515,000 square feet of new deliveries. That is not to say that industrial development is on the decline in the Sacramento region. The fifth wettest winter on record has delayed many projects. We are aware of over 1.6 million square feet of industrial product currently under construction throughout the Sacramento region. Since 2001, the amount of industrial space in the construction pipeline at any given time has averaged 1.2 million square feet. We expect most of this space to be completed by the close of 2006, with a few projects slated for early 2007 delivery. Based upon these numbers, 2006 should see above average construction levels—although the totals will come nothing near the records set between 2000 and 2002.

The region’s continued shortage of developable, industrially-zoned land remains a factor impacting construction trends. Industrially-zoned parcels in the region that would have sold for \$3 to \$4 per square foot in 2003 are now fetching prices double that amount. Available parcels above 50 acres in size are few and far between, meaning that industrial development continues to push outward to markets not traditionally known as industrial hotspots such as Galt or, in the case of the new Metro Air Park, the formerly agricultural area near Sacramento International Airport. Land zoned for manufacturing uses is in even scarcer supply and those few remaining infill parcels that remain are commanding top dollar.

The shortage of large industrially-zoned land has been a factor that has negatively impacted the bulk warehouse market as well and has been cited as a reason for a number of distribution center build-to-suit requirements opting for other nearby markets. Build-to-suit distribution centers for Wal-Mart, Lowe’s and Kohl’s could have

added as much as three million square feet of occupancy growth over the past two years, but never happened due to land issues.

But the good news for landlords is that the shortage of developable land has had a beneficial impact on rents. The cost of land and rising costs for materials have increased rents in new projects by as much as 20 percent over market averages. Meanwhile, owners of existing buildings in many of Sacramento’s stronger submarkets have found that they can ride this wave and have recorded rental growth as well.

**Looking Ahead**

Expect vacancy within the Sacramento industrial to continue to diminish in the near future. The return of bulk warehouse requirements as well as continued strong demand from smaller space users should ensure positive occupancy growth heading into the second and third quarters of this year. Meanwhile, though we expect deliveries of new product to be up throughout the remainder of 2006, we do not believe that construction will outpace demand. Development of industrial product will continue to push further away from Sacramento’s traditional industrial centers as new areas with available land come onto the radar screen. Look for strong upward pressure on rents for most property types and the possibility of rental growth for the first time in years for bulk warehouse product as it continues to record increased demand and decreased vacancy.



## 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	

FIGURE  
**5**

Sacramento Industrial Market  
 2006 Select Leasing Activity (YTD)

	Building Name Building Address	Submarket	SF Leased	Tenant
1.	Depot Park	Power Inn	104,000	Continental Warehouse
2.	Interstate Business Park	Natomas/Northgate	75,000	US Postal Service
3.	260 N. Pioneer Avenue	Davis/Woodland	60,000	Interpac Technologies
4.	440 N. Pioneer Avenue	Davis/Woodland	45,000	Special Distributions California
5.	8372 Tiogawoods Drive	Power Inn	44,000	Pacific Fulfillment
6.	1021 Striker Avenue	Natomas/Northgate	43,700	Lennox Industries
7.	Norwood Business Park	Natomas/Northgate	30,000	Scofield's Furniture
8.	Laguna Creek Ranch	Elk Grove/Laguna	25,679	Armstrong Cabinets
9.	2701 Academy Way	Northeast	21,400	Mercedes Benz of Sacramento
10.	5071 Kelton Way	Natomas/Northgate	20,520	Sierra Valley Moving Company

*For more information, contact:*

**Dennis Shorrock, SIOR**

Garrick Brown  
 David Liu

**Managing Director**

Research Director  
 Research Analyst

### Industrial Specialists

Bud Applegate  
 Gay Moss  
 Michael Callahan  
 Doug Solinsky  
 John Barney  
 Benjamin Caputo

Steve Cippa, SIOR  
 Jim Dennis  
 Mark Demetre, SIOR  
 Jennifer Laugesen  
 Mark Naves  
 John Knight, SIOR

Dave Leatherby  
 Matt Lofrano  
 Bill Niethammer, SIOR  
 Irv Rios, SIOR  
 Tom Tyler, SIOR  
 Zac Sweet