CUSHMAN & WAKEFIELD

JULY 2017

COMPASS

Navigating the Minneapolis/St. Paul Commercial Real Estate Market

EXECUTIVE SUMMARY

OVERALL MARKET TRENDS

Twin Cities Real Estate Market Sees Continued Steady Demand

VACANCY RATE
10.8%
Slight uptick but still healthy

ABSORPTION
332,339 square feet
Expected to pick up significantly in next six months

NEW CONSTRUCTION
836,000 square feet
Driven by industrial; most is preleased or quickly filling

SECTOR HIGHLIGHTS

- **INDUSTRIAL:** Industrial sector takes a breather from its record pace
- **INVESTMENT & CAPITAL MARKETS:** Strong investor demand continues; buyers becoming more discerning
- **OFFICE:** Office market comeback continues as tenants continue trading spaces
- **RETAIL:** Store closures continue as retailers navigate challenging environment
- **MEDICAL OFFICE:** Healthy medical office market but some uncertainty lingers
- **MULTIFAMILY:** Multifamily sector is firing on all cylinders
- **LAND:** Insatiable appetite for industrial and single-family residential land
- **HOTELS:** Hotel market cycle peaking, 'soft landing' projected

Photo Credit: Meet Minneapolis

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> The Twin Cities multi-tenant market isn't moving with the urgency or intensity of recent years, but demand and activity have remained remarkably strong throughout the first half of this year, a more careful approach by developers and end-users has caused our transaction volume to be lower than expected, but we project a much more active second half of the year.
>
> — Mike Ohmes, Managing Principal

INDUSTRIAL

Takes a Breather From Its Record Pace

273,728 SF

positive absorption

While activity in the industrial market took a short break, it is expected to get its groove back in the second half of 2017. The market reported a dip in absorption due to some economic uncertainties—prompting users to proceed more cautiously when signing leases—and a discernible lack of large, high-quality multi-tenant space available. This supply shortage resulted in some users choosing single-tenant or build-to-suit options.

1 million square feet (msf) of absorption is projected by year end as several big, multi-tenant deals are completed.

E-commerce is driving many industrial projects as users need distribution facilities.

Demand is solid for product near the urban core as evidenced by robust activity in the Northwest and Northeast submarkets.

INVESTMENT & CAPITAL MARKETS

Strong Demand Continues, Although Buyers Becoming More Discerning

$4B

in commercial and multifamily sales

Investor demand continues to outweigh properties for sale. Particularly, private investors are well-capitalized and highly motivated to complete deals. However, mirroring the national trend, transaction volume dropped, and the lack of inventory is a primary reason.

While a pickup in sales activity is anticipated for the second half of the year and the investment market should remain solid, there are fewer buyers for most property types and bids are less aggressive. Investors are taking their time and being selective in acquiring properties that meet their specific investment criteria.

Multifamily sales reached nearly $800 million, far above historic levels.

Smaller deals dominated office investment sales, while industrial and retail buyers pursued the few available properties.

LAND

Insatiable Appetite For Industrial And Single-Family Residential Land

TORRID DEMAND

for single-family residential land

Developers' hot pursuit continues for industrial land including huge tracts for massive distribution centers for e-commerce retailing. Suitable sites near the coveted urban core—for the "last mile" of the distribution chain—are limited, which is pushing land prices to peak pre-recession levels.

Homebuilders are scrambling to find land to meet the growing needs of the housing market renaissance. Homebuilders are cautious about overpaying for land as escalating construction costs take a bite out of profit margins. This has kept residential land prices in check.

Multifamily land interest shifted from urban to underserved suburban submarkets.

HOTELS

Cycle Peaking, 'Soft Landing' Projected

ADR Climbs to $110.27

The Twin Cities hotel market is reaching it cyclical peak and a cooling pace is anticipated. Occupancy plateaued due to the delivery of new rooms and the outlook for key performance metrics suggests more modest growth and an upcoming "soft landing."

Development remains robust with 3,400 new rooms completed and another 5,000 rooms in various stages of planning/development.

Overbuilding concerns and rising construction costs are prompting some developers to curb plans.

It remains a seller's market, and values have likely peaked.

EXECUTIVE SUMMARY

OFFICE

Comeback Continues As Tenants Continue Trading Spaces

82,265 SF
positive absorption

The office market continued its road to recovery. After struggling with negative absorption recently, it posted 82,000 sf of positive absorption and a vacancy rate that improved 30 basis points to 16.7%. The market is adapting to a changing environment as tenants lease less space and use it more efficiently. Companies that are trading spaces, consolidating, and downsizing, are fueling activity.

Leasing momentum is expected to pick up in the second half as a growing list of users have space requirements. Also, larger firms have returned to drive some deals.

AMENITIES

Quality building amenities are a big driver as firms look for properties that offer newly renovated and creative space in an effort to retain and attract talent. The cost of replacing employees is high, and users are willing to pay for the right space—even though they require less of it. Users are also signing longer-term leases.

CBD

The Minneapolis CBD continues to attract large tenants

RETAIL

Store Closures Continue as Retailers Navigate Challenging Environment

8.2% vacancy
despite several major closings

More than 300 retailers nationally have filed bankruptcy in 2017, leaving large blocks of vacant space and likely more to come. Store closings, downsizings, and few new concepts entering the market resulted in negative absorption and an uptick in vacancy.

Retailers, landlords, and developers are grappling to find ways to operate in an environment with increasing e-commerce competition and changing shopping habits.

CLOSED

Store closures are creating opportunities in tight, prime trade markets. Value retailers, quick-serve restaurants, coffee shops, fitness concepts, and grocers are hot categories filling space.

WHOLE FOODS MARKET

Amazon's announced $13.7 billion deal to acquire Whole Foods could forever change the supermarket business.

MEDICAL OFFICE

Healthy With Some Lingering Uncertainty

430,000 SF
under construction

Healthcare delivery is changing, and facilities continue to adapt. Healthcare systems are pushing development away from hospital campuses to accessible off-campus locations.

RATE PRESSURE

Single-user, system-driven projects dominate new development, which is creating more vacancy in traditional medical office buildings (MOBs), resulting in downward rate pressure.

Systems want buildings with larger floor plates and more operational efficiency, leaving older, off-campus MOBs at risk.

Additional issues impacting real estate requirements include continuing consolidation, physician shortages, and the uncertainty surrounding the Affordable Care Act.

MULTIFAMILY

Firing on All Cylinders

$1,110
average market rents

The multifamily sector continued its hot streak with near-record-low vacancy and new projects that are meeting both lease-up and projected rent expectations. Higher-end development is helping drive rent growth.

The construction pipeline is robust with 4,000 units scheduled for delivery in 2017 and another 4,000 in 2018.

New construction is shifting to the suburbs as some pockets approach a saturation point, including downtown Minneapolis, Uptown, and St. Paul. Some properties are offering rent concessions.

New deliveries continue to be well-received with Millennials and empty-nesters fueling renter demand. Developers are working to balance unit size, design, and amenity features that cater to both groups.

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PROJECTIONS FOR SECOND HALF 2017

2.1 MSF
new construction projected by year end

1.625 MSF
absorption projected by year end

TRANSACTION VOLUME
increase in second half

MARKET QUICK FACTS

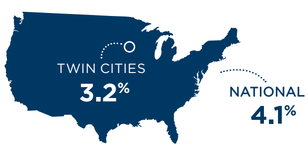
TWIN CITIES METRO DEFINITION

The "Twin Cities" of Minneapolis and St. Paul form the core of a metropolitan region encompassing 6,046 square miles and consisting of 13 counties: Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Washington, Isanti, Chisago, Sherburne and Wright in Minnesota, as well as Pierce and St. Croix counties in Wisconsin.

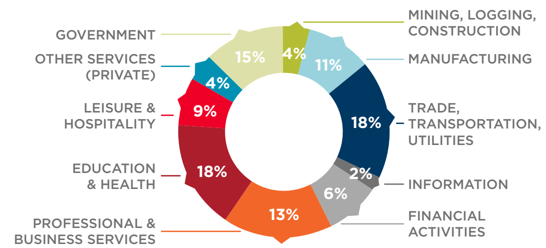
HOUSING PRICES ARE UP

The Twin Cities median single-family home price is $250,000, up 5.5% compared with $237,000 in second-quarter 2016.
Source: MAAR

UNEMPLOYMENT RATE REMAINS HISTORICALLY LOW



LABOR FORCE MIX IS CONSISTENTLY SOLID



BUSINESS STRENGTHS

Major business strengths in the Twin Cities include a highly educated workforce, excellent transportation services, a diverse economic base and available capital. The metro area is home to 17 Fortune 500 companies representing a broad spectrum of industries. The Minneapolis-St. Paul area's employment base does not rely on any single industry, which allows it to weather recessions and economic downturns in specific industries.

More per capita **Fortune 500** companies than any other US metro region *Forbes, 2016*

Minnesota is the **#3 state** for business *CNBC*

The **6th** most inventive city worldwide *Bloomberg Businessweek*

North Loop ranks a **Top 25** Destination in the World *Fodors, 2016*

ABOUT THE AUTHOR

THE COMPASS REPORT

The report was created by experts using Twin Cities commercial property data from the first six months of 2017. The data used for this report has been obtained from sources which we deem reliable. While every effort has been made to report accurate data, Cushman & Wakefield cannot guarantee the accuracy of this market report. Furthermore, we cannot assume responsibility for any omission of data which may occur. It is our intent to provide the best possible information regarding the office, industrial, land, retail, multifamily and investment markets while leaving the reader the responsibility of further verification before using this report for business and/or financial decisions. The Compass report includes information for multi-tenant office, industrial and retail projects greater than 20,000 SF and multifamily for-rent properties. Not included are owner occupied, government or single-tenant buildings. Not all information and insights we've collected can be published in any given volume.

CUSHMAN & WAKEFIELD

Cushman & Wakefield is a leading global real estate services firm that helps clients transform the way people work, shop, and live. The firm offers innovative solutions to its occupier and investor clients around the world. A recognized leader in real estate research, the firm publishes a broad array of proprietary reports.

#1 Commercial Real Estate Brokerage Firm & Commercial Property Management Firm
by Minneapolis/St Paul Business Journal

Best of Business by *Twin Cities Business*

More than $2.3 billion annual transactions

40 MSF of assets under management

Employs nearly 500 professionals

CUSHMAN & WAKEFIELD

3500 American Blvd W Suite 200
Minneapolis, MN 55431
952 831 1000
cushmanwakefield.com