EXECUTIVE SUMMARY

OVERALL MARKET TRENDS
Absorption Exceeds Expectations in Dynamic, Competitive CRE Market

10.6% VACANCY RATE
617,000 SF NEW CONSTRUCTION SO FAR
1.8 MSF ABSORPTION

SECTOR HIGHLIGHTS

HOTELS: Market ‘cooling its heels’ yet demand continues
LAND: Strong demand for mid-density housing, industrial uses fuels Land market
INVESTMENT & CAPITAL MARKETS: New capital pours into metro in search of higher yields
MEDICAL OFFICE: Pulse remains strong as Medical Office continues evolving

RETAIL: Expanding retailers backfill prime space as more stores close
INDUSTRIAL: Robust demand for space continues to drive industrial market
OFFICE: Office leasing remains active, but tenants continue downsizing
MULTIFAMILY: Insatiable renter appetite exceeds supply
The Minneapolis-St. Paul market remained stable amid a near-record economic recovery in the first half of 2018. The market is projected to continue tightening in the second half as investors and users become more conservative with their decision making, but activity remains stable and strong.

- Mike Ohmes, Managing Principal

### Hotel

**Hotel Market ‘Cooling its Heels’ Yet Demand Continues**

**7,000+** Hotel rooms still in some stage of development

After enjoying a very long, healthy cycle, the hotel market has finally leveled off and is flying at “cruising altitude.” While demand remains strong and rates continued to climb, growth slowed due to the surge in room supply. Average occupancy in the metro area was 70.1% in May. The market will have to play some catch-up until it can absorb new inventory.

- Approximately 4,450 rooms were delivered this cycle, and 7,000+ additional rooms are in some stage of planning or development.
- Developers continue to seek prime sites for the “right flag in the right market,” however, increasing construction and financing costs are barriers to new construction, and some developers have backed off.
- There is still a large pool of investors pursuing prime hotel properties in attractive submarkets, but transaction activity has slowed due to a bigger “bid-ask spread.”

### Land

**Strong Demand for Mid-Density Housing, Industrial Uses Fuels Land Market**

Following the year-end 2017 trend, the land market for both residential and industrial uses enjoyed the spotlight, drawing interest from developers, and with few signs of a slowdown. Prospective buyers showed confidence in their markets by aggressively staking out new land positions for future use.

- The suburban residential market was driven by an escalating demand for mid-density product, including single-level “active adult” or “villa homes” and for-sale townhomes targeting first-time homebuyers and downsizing Baby Boomers.
- Industrial developers continued to pursue larger land positions to accommodate the expanding e-commerce boom.
- Twin Cities-area municipalities updated their 10-year “comprehensive plans,” which serve as future land-use guides. More cities appeared to respond to the intense market demand for high-density residential and industrial land uses.

### Residential

**RESIDENTIAL land remained a hot commodity**

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### Investment & Capital Markets

**New Capital Pours into Metro in Search of Higher Yields**

$1B in Multifamily sales projected by year-end 2018

As of May, the U.S. economy had logged 107 straight months of growth, making it the second-longest economic expansion on record. For the Twin Cities, that means a steady stream of new capital flowing into the market. A trend typical of this mature stage of the cycle, investors priced out of gateway cities and other secondary markets are searching for opportunities that can deliver higher yields.

- The slew of new players is making it a very competitive bidding market. That competition — along with the continued pursuit of more generous returns — is pushing investors to broaden the scope of deals they are willing to consider in terms of location, property type, and asset quality.
- The biggest challenge remains that there is more capital chasing properties than available properties to acquire.

### Medical Office

**Pulse Remains Strong as Medical Office Continues Evolving**

$19.10 PSF represents an uptick in Medical Office rates

While the Twin Cities medical office market reported solid demand for new space and stable occupancies, healthcare continues changing, and the real estate must adapt. Changes include new technology, the aging population, uncertainty around healthcare policy, and a shift in how space is being used. Health systems are evolving to better meet patients’ needs and are locating facilities in easily accessible, retail areas.

- Absorption was flat as most activity is single-tenant and system-driven, rather than multi-tenant.
- Significant renovation and expansion activity is occurring on-campus as hospital systems reinvest in their core assets to gain a competitive edge.
- Investors are increasingly eyeing medical office as an attractive investment class. It has proven recession-resistant; however, there is far more capital pursuing product than available product.
Vacancy rate for Twin Cities Office space

16.6%

Office Leasing Remains Active, but Tenants Continue Downsizing

The Twin Cities office market could be described as a tale of two markets. Despite a healthy economy, high employment, and steady job growth, the market has had a tough time capitalizing on that robust business expansion, and therefore, has experienced lackluster growth. Although leasing activity remains active, tenants continue to give back space as they shrink footprints and squeeze more employees into smaller spaces. That densification, along with big users that have traded multi-tenant space for build-to-suits and corporate campuses, continues to offset positive absorption.

The Class B market has been hit particularly hard, and the surplus of space is forcing landlords to be more creative and elevate their game to better position their buildings to attract tenants.

Class A buildings continue to perform well, which is evident in the uptick in rents during the first half of 2018.

Co-working now represents just over 1% of the local office market with both local and national firms, including WeWork, growing operations. Also, Chanhassen-based Life Time Fitness plans to open three new locations for its new Life Time Work model.

Expanding Retailers Backfill Prime Space as More Stores Close

8.3%

Retail vacancy rate amid continued closings

Despite ongoing turmoil in a rapidly changing retail environment, the Twin Cities retail market experienced positive absorption and competitive demand for new space. Challenges include bankruptcies/store closures, changing consumer habits, e-commerce competition, and increasing demand for experiential retail. Rates were stable although they are expected to dip as more space comes back on the market.

Store closures and bankruptcies are opening desirable space in prime trade markets, and attractive big boxes are being snapped up quickly. Value-add retailers, fitness concepts, quick-serve restaurants, coffee shops, and medical users are driving demand.

No large-scale construction projects are in the pipeline, which will make it challenging for retailers to find good space in the future.

The metro will be impacted by continuing national store openings and closings; however, the mood here is of less uncertainty, with activity expected to continue at a steady pace.

Robust Demand for Space Continues to Drive Industrial Market

1.59 MSF

positive Industrial absorption

Led by the revived NW submarket — particularly the comeback of Rogers — the Twin Cities Industrial market continued its positive momentum posting a tightening 7.9% vacancy rate. A steady pace of new construction continues and is anticipated to result in more than 1 msf of new space by year-end 2018.

The office-warehouse market remains extremely tight with a 5.8% vacancy rate, which will likely push rental rates higher, especially in the most sought-after submarkets.

User-building sales activity remained red-hot, with even poorly located and obsolete properties trading and, in some cases, fetching staggering prices. Self-storage users remained aggressive.

Buoyed by robust user demand and a healthy economy, the long industrial up-cycle is expected to continue with 1.1 msf of absorption projected in the second half of 2018. That would be a 25% boost over 2017.

Insatiable Renter Appetite Exceeds Supply

5,500+

new Multifamily units anticipated by year-end 2018

Even with thousands of new units delivered over the past five years and new properties still undergoing lease-up, the Twin Cities multifamily vacancy rate hovers at a remarkably low 2.8%. It is a perfect storm for the apartment sector as it benefits from a healthy economy, job and population growth, strong renter demand by both Millennials and Empty Nesters, and a limited inventory of for-sale homes. Construction is on pace for a record year with more than 5,500 new units projected.

Vacancies will likely edge upward in the short term as the market works to absorb the flood of new supply, and concessions could creep up in pockets where bigger concentrations of new properties are being added.

Another 6,000 units could be delivered in 2019, which would bring the total expansion of the apartment inventory during this development cycle to 8.5% since 2013.

Developers are starting to see return on cost sliding due to high land and construction costs, which have jumped nearly 35%.

Multifamily sales are expected to surpass $1 billion for the fifth consecutive year.
**TWIN CITIES BUSINESS STRENGTHS**

- Highly educated workforce
- Excellent transportation services
- A diverse economic base
- 19 Fortune 500 companies
- Available capital
- Diverse labor force

**UNEMPLOYMENT RATE REMAINS HISTORICALLY LOW**

- Twin Cities: 2.3%
- National: 3.6%

**HOUSING PRICES UP 7.8%**

- Q2 2017: $255,000
- Q2 2018: $275,000

**LABOR FORCE MIX CONSISTENTLY SOLID**

- Government: 16%
- Education & Health: 16%
- Professional & Business Services: 13%
- Trade, Transportation, Utilities: 10%
- Mining, Logging, Construction: 9%
- Manufacturing: 8%
- Other Services: 8%
- Information: 8%
- Financial Activities: 4%

**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.

**MORE PER CAPITA FORTUNE 500 COMPANIES THAN ANY OTHER U.S. METRO - FORTUNE 2018**

**MINNESOTA RANKS #2 IN BEST STATES IN AMERICA - U.S. NEWS 2018**

**MINNEAPOLIS-ST. PAUL IS THE BIRTHPLACE OF GAMECHANGERS LIKE THE PACEMAKER AND SUPERCOMPUTER**

**200,000 SQUARE FEET OF ABSORPTION**

**2.3 MILLION SQUARE FEET OF NEW CONSTRUCTION**

**$1B MULTIFAMILY SALES FOR FIFTH CONSECUTIVE YEAR**

**PROJECTIONS FOR SECOND HALF 2018**

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More than $2.3 billion annual transactions

85 brokers

30MSF of assets under management

Employs nearly 500 professionals

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