CUSHMAN & WAKEFIELD

JANUARY 2018

COMPASS

Navigating the Minneapolis-St. Paul Commercial Real Estate Market

EXECUTIVE SUMMARY

SUPER SIZED EDITION!

OVERALL MARKET TRENDS

Twin Cities Absorption Surges in Second Half of 2017; Demand Drives Competition in Sales and Leasing

ABSORPTION
2.3 million square feet
Highest absorption we have seen in four years

VACANCY RATE
10.8%
Steady across office, industrial, and retail

NEW CONSTRUCTION
2.58 million square feet
Second-highest recorded since end of last recession

SECTOR HIGHLIGHTS

INDUSTRIAL: Strong demand fuels industrial market; Rogers poised for recovery

INVESTMENT & CAPITAL MARKETS: Multifamily sales hit record high

OFFICE: Office market stays the course

RETAIL: Expanding retailers seize prime vacancies as store closures continue

MEDICAL OFFICE: Vital signs are strong, despite uncertainties

MULTIFAMILY: Apartment market 'defies gravity' as rental boom continues

LAND: Residential, industrial remain hottest Land Markets

HOTELS: Hot hotel market cools down

Photo Credit: Meet Minneapolis

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FOR PROPERTY TYPE & SUBMARKET REPORTS AND MORE, PLEASE VISIT COMPASS.CUSHWAKEMSP.COM

"The second half of 2017 saw a flurry of activity across all product types, and absorption across the board exceeded our projections from earlier in the year," said Mike Ohmes, Managing Principal in the Minneapolis-St. Paul office of Cushman & Wakefield. "Market activity continues apace, and our team is already projecting a number of significant transactions to occur in early 2018."

HOTELS

Hot Hotel Market Cools Down

69.2%

Occupancy

Following seven years of unprecedented growth in occupancy and average daily rates, the hotel market's hot streak is finally cooling. The slowdown is primarily due to the flood of new rooms as supply growth is outpacing demand. The market will experience slower growth until it absorbs the new product.

Approximately 3,900 new rooms were delivered this cycle, and another 3,000 rooms are in various stages of development.

Amid overbuilding concerns and increasing construction costs, some developers pulled plans.

Hotels are still trading, but there is a widening buy-sell gap slowing transaction activity as investors haggle to push prices down. However, investors are still pursuing prime properties in desirable submarkets.

LAND

Residential, Industrial Remain Hottest Land Markets

SINGLE-FAMILY

market dominates activity

The Twin Cities land market remains extremely active, with values in many cases hitting post-recession highs and deals closing swiftly, particularly in the residential and industrial markets. Dominating activity is the single-family residential market, where homebuilders are aggressively staking out large positions in suburban cities known for their excellent school districts. Builders are willing to compete and bid up prices to seize the best parcels.

In the multi-family market, demand and pricing are particularly solid for sought-after urban infill apartment sites within walking distance of popular amenities such as grocery stores.

Unabated demand for industrial land continues with pricing holding strong. Industrial users are seeking bigger sites to accommodate the rapidly increasing space requirements of e-commerce distribution and fulfillment businesses.

MEDICAL OFFICE

Vital Signs Are Strong, Despite Uncertainties

710,950 SF

under construction

The medical office market appears unwavering as the vacancy rate dropped more than a point, absorption increased, rental rates held firm, and 178,710 sf of multi-tenant space was delivered. However, healthcare delivery continues evolving to meet patients' needs, and facilities must continually adapt to meet new requirements. Other factors impacting real estate requirements include continuing consolidations, uncertainty surrounding the Affordable Care Act, physician shortages, and changing technology including telemedicine.

Healthcare systems continue building facilities away from hospital campuses to convenient, easily accessible office-campus sites, including high-visibility retail areas.

Single-tenant, system-driven projects lead development, resulting in vacancy in traditional medical office buildings (MOBs).

Systems are requiring buildings with bigger, more flexible floor plates for more operational efficiency, leaving older MOBs vulnerable. Some are being repositioned.

MULTI-FAMILY

Apartment Market 'Defies Gravity' as Rental Boom Continues

2.5% VACANCY

for apartments in the Twin Cities metro

The Twin Cities continues to rank among the nation's strongest apartment markets. Robust renter demand can be attributed to several factors, including healthy job growth, in-migration of new residents, desirable demographics, and a lack of good starter home options.

Absorption outpaced new construction in 2017, even as 3,500 new units were delivered (this follows approximately 15,000 new units between 2013 and 2016). Landlords will face a bigger test in 2018 when development increases to more than 5,000 new units.

Annual rent growth, which experienced a steady pace of 3 to 3.5% in recent years, jumped to 5.1%.

One wild card is how the aging Millennial population will impact future rental demand, as many consider starter homes. The question becomes whether demand by Baby Boomers and Empty Nesters can fill the void left by Millennials transitioning to homeownership.

OFFICE

Office Market Stays the Course

550,171 SF

positive absorption in second half 2017

Activity surged in 2017, but absorption finished the year at a modest level. While companies are relocating, expanding, and trading into more efficient space, this positive momentum has been offset by space coming back to the market due to downsizing and consolidation, resulting in modest net absorption.

Despite vacancies, landlords have pushed rental rates steadily higher since 2011. Rents are now showing signs of slower growth, except for buildings with character that are highly amenitized, and in desirable locations.

As a result, landlords are spending significant dollars to renovate and reposition properties and upgrade amenities. Meanwhile, companies are willing to invest more in their office space environment in order to attract and retain top talent in a competitive hiring environment.

Development is occurring in some pockets, including four new speculative buildings underway in Minneapolis.

INVESTMENT & CAPITAL MARKETS

Deep Investor Pool Continues Chasing Assets

$4.54B

in commercial and multifamily sales

Plenty of capital continues to pursue real estate. However, with the last economic downturn still fresh in their minds, investors are sticking to their criteria. Many are focused on steady cash flow while others are looking to add value. Meanwhile, the investor pool for best-in-class assets is deep and well-balanced across private equity funds, institutions, and foreign capital.

Investors are willing to aggressively bid on assets that check all of the boxes matching their investment strategies.

MF $1.8B

Multifamily sales reached nearly $1.8 billion in 2017—far above historic levels. Office sales reached $1.36 billion in 2017, while a shortage of inventory of industrial and retail properties held transaction volume down.

With the recently passed Tax Cuts and Jobs Bill, the looming question is how much tax savings could be generated for commercial real estate investors. Cushman & Wakefield expects a moderate positive impact on multifamily, retail, and industrial properties, and a minimal impact on office.

RETAIL

Expanding Retailers Seize Prime Vacancies as Store Closures Continue

8.3% VACANCY

holding steady despite closings

Retailers, developers, and landlords continue to grapple with changing consumer shopping behaviors, mounting e-commerce competition, and store closings/downsizings, but demand for new space remains competitive. Rental rates remain high, although they are leveling off.

Store closures and bankruptcies are opening up 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 approved, 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.

INDUSTRIAL

Strong Demand Fuels Industrial Market; Rogers Poised for Recovery

1.66M SF

positive absorption

Despite the delivery of approximately two million square feet (msf) of new multi-tenant space in 2017, the industrial market held firm with an 8.3% vacancy rate. This construction delivery marked the highest level of new competitive industrial space in the Twin Cities in the last decade.

Driven by demand for high-ceilinged bulk warehouse space, the market surpassed expectations with 1.66 msf of absorption in the second half of 2017 - two-thirds higher than forecasted.

A constricted supply of contemporary bulk warehouse space in the tightest markets is motivating users to reassess the long-overbuilt Rogers market. Rogers contributed nearly 100,000 sf of positive absorption during the past six months, and more absorption is projected in early 2018.

Tight market conditions are supporting healthy lease rates for bulk warehouse and office-warehouse product, as well as strong user-building sales prices.

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Check out our special **SUPER STATS** supplement on how the Big Game impacts Twin Cities CRE **#CWSuperStats**

CLICK HERE

PROJECTIONS FOR FIRST HALF 2018

1.5 MSF Absorption projected

1.34 MSF Construction to be delivered

$ Significant sales transactions projected in first half, especially in office

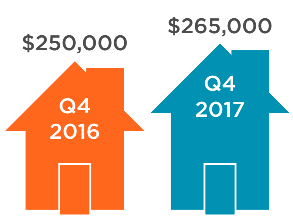
MARKET QUICK FACTS

Sources: MAAR, MNDEED

TWIN CITIES METRO DEFINITION

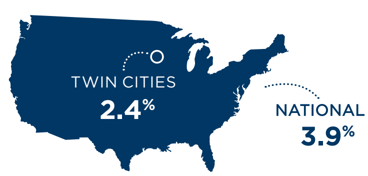
The “Twin Cities” of Minneapolis and St. Paul form the core of a metropolitan region encompassing 6,046 square miles and consisting of 13 counties: Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Washington, Isanti, Chisago, Sherburne and Wright in Minnesota, as well as Pierce and St. Croix counties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

HOUSING PRICES UP 6.0%

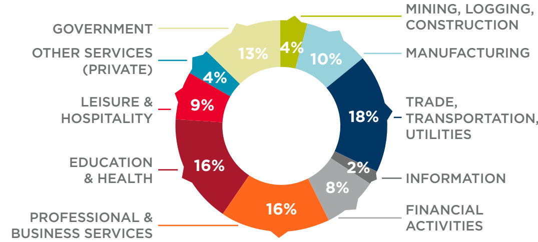


Median single-family home prices

UNEMPLOYMENT RATE REMAINS HISTORICALLY LOW



LABOR FORCE MIX CONSISTENTLY SOLID



MN is the **#3 state** for business - *CNBC*

More per capita **Fortune 500 companies** than any other U.S. metro - *Forbes, 2016*

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

Minneapolis a **Top 10 destination** to visit in 2018 - *Wall Street Journal, 2017*

TWIN CITIES BUSINESS STRENGTHS

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

For more information, read our **Minneapolis-St. Paul Market Overview**

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ABOUT THE AUTHOR

THE COMPASS REPORT

 The information contained within this report is gathered from multiple sources considered to be reliable. The information may contain errors or omissions and is presented without any warranty or representations as to its accuracy. It is our intent to provide the best possible information while leaving the reader the responsibility of further verification before using this report for business and/or financial decisions. The report was created by experts using Twin Cities commercial property data from the first six months of 2017. 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 issue.

ABOUT CUSHMAN & WAKEFIELD

Cushman & Wakefield is a leading global real estate services firm with 45,000 employees in more than 70 countries helping occupiers and investors optimize the value of their real estate. Cushman & Wakefield is among the largest commercial real estate services firms with revenue of $6 billion across core services of agency leasing, asset services, capital markets, facility services (C&W Services), global occupier services, investment & asset management (DTZ Investors), project & development services, tenant representation, and valuation & advisory. To learn more, visit www.cushmanwakefield.com or follow @CushWake on Twitter.

ABOUT THE MINNEAPOLIS-ST. PAUL OFFICE

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

Winner - Best of Business, *Twin Cities Business*

Winner - Reader Rankings, *Finance & Commerce*

More than $2.3 billion annual transactions

30MSF of assets under management

Employs nearly **500 professionals**

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