CUSHMAN & WAKEFIELD

JANUARY 2019

COMPASS

Navigating the Minneapolis/St. Paul Commercial Real Estate Market

EXECUTIVE SUMMARY

OVERALL MARKET TRENDS

Absorption Exceeds Expectations in Dynamic, Competitive CRE Market

10.9%
VACANCY RATE

1,481,000 SF
NEW CONSTRUCTION

2.8 MSF
ABSORPTION

SECTOR HIGHLIGHTS

MULTIFAMILY: Bull Run Continues

INDUSTRIAL: Continues its Hot Streak

RETAIL: Adjusts to New Landscape, Closing Chains

HOTELS: Record Demand Outpaces New Supply

LAND: Dominated by Aggressive Single-Family Developers

INVESTMENT & CAPITAL MARKETS: New Capital Pours into Metro in Search of Higher Yields

MEDICAL OFFICE: 'Pauses' as it Adapts to Evolving Healthcare World

OFFICE: Twin Cities Market Redefines Itself

READ MORE INSIDE

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

> We've seen a lot of changes in the commercial real estate industry during this record-breaking economic cycle, but occupiers and investors remain active across all property types in our market. Our firm continues to project strong absorption in early 2019, and significant properties are under construction, signaling an encouraging start to this year.
>
> \- Mike Ohmes, Managing Principal, Minneapolis-St. Paul office of Cushman & Wakefield

MULTIFAMILY

Multifamily Bull Run Continues

2.3%

extremely tight vacancy rate

Despite the multifamily development boom, the Twin Cities maintains its position as one of the most resilient, in-demand apartment markets nationwide. Even accounting for new buildings undergoing lease-up, vacancies remain well below the national average at 3.3%. New supply has remained relatively in balance with market demand, even with an extremely active construction pipeline.

- Healthy occupancy continues to support rent growth, although there are some signs that the pace of rent growth is cooling.
- Absorption remained strong in 2018, with approximately 3,400 units absorbed through September. Developers, however, are relying on concessions to accelerate lease-up.
- All eyes are on Downtown Minneapolis to see how quickly it absorbs a big wave of new product as developers delivered 1,400 units in 2018 -- more than 2016 and 2017 combined.

INDUSTRIAL

Industrial Sector Continues its Hot Streak

1 MSF+

Industrial absorption in second half

The up-cycle for the Twin Cities industrial sector is hardly over, and in fact, picked up steam in 2018, and that momentum is expected to continue into early 2019. Leasing activity is particularly robust in the Northeast metro. The overall market's absorption for 2018 totaled 2.78 million square feet – its second-best performance since the 2008 financial crisis.

- It is time for the Northeast metro to shine, as the submarket has deals expected to close in early 2019 that could add another 600,000 sf of positive absorption.
- The average net rental rates for both office-warehouse and bulk warehouse product jumped to their highest levels in a decade.
- Following a frenzied 2017, developers tapped the brakes somewhat on new development as 2018 came to a close, with just 810,000 sf of multitenant space under construction.

RETAIL

Retail Market Adjusts to New Landscape, Closing Chains

9.4%

Retail vacancy rate highest since 2010

The Twin Cities retail sector continues to chip away at the inventory of big-box vacancies left behind by national bankruptcies and store closures. The majority of big-box vacancies have hit the market and most of the space is still available, offering expanding concepts and emerging new brands the opportunity to land in desirable locations. Prime space in the strongest trade markets is getting backfilled, while less attractive locations will take longer to absorb.

- Since few big-box retailers are in expansion mode, many of the boxes will be divided to house multiple, smaller users.
- Value-add retailers, service retailers, grocers, fitness brands, and fast-casual restaurants are driving much of the leasing activity, as they are considered "internet-resistant."
- Brick-and-mortar retail is impacted by the changing habits of consumers who demand in-store "experiences" and expect seamless shopping -- whether that is in-store, online, or through a mobile device.

HOTEL

Record Hotel Demand Outpaces New Supply

6,240

rooms delivered this cycle

Despite a surge in new rooms delivered, the Twin Cities hotel sector is resolute, posting record demand, which is absorbing most new product. The healthy economy is fueling demand from both business and leisure travelers, and as long as the economy remains strong, there are no significant signs of a downturn. Rates continue rising due to demand growth.

- Supply growth increased an average of 3.9% in 2018 while demand climbed an average of 5.0%.
- Supply growth will cool as overbuilding concerns and escalating construction and financing costs are deterring some developers. Still, another 6,700 rooms are in the pipeline.
- Due to rising construction costs and increased competition for guests, hotel brands are introducing lower-cost development options to make new developments and conversions feasible.

LAND

Land Market Dominated by Aggressive Single-Family Developers

SINGLE-FAMILY

low-density residential sector leads all activity

With an unprecedented appetite for suburban land positions, national homebuilders raced to build new single-family subdivisions to cope with rising interest rates and construction costs. This vigorous activity led to "low-density residential" becoming the hottest sector of the Twin Cities land market. However, homebuilders did not overpay for prime lots, as sellers seem to have mostly abandoned unrealistic pricing expectations.

Industrial land remained highly sought-after, but due to the scarcity of suitable sites in traditional industrial markets like Shakopee, speculative development slowed. That slack, however, was picked up by accelerated activity in the build-to-suit sector.

With retail struggling, developers are not driving the retail land sector. Users themselves are leading the market, especially convenience store operators, daycare and pre-school providers, quick-service restaurant franchisers, and mini-storage developers.

The high-density residential land market remained active in the suburbs after most of the desirable sites in and around Downtown Minneapolis were snagged at high prices. Developers continue to look for A-plus sites.

MEDICAL OFFICE

Medical Office Sector 'Pauses' as it Adapts to Evolving Healthcare World

$19.20 PSF

stable average rental rates

Even with the changing healthcare environment -- including new delivery models and space requirements -- the Twin Cities medical office market has a healthy prognosis. Leasing and construction activity have slowed as demand catches up with the flurry of new space delivered in the first half of 2018. Meanwhile, the sector has "paused" as healthcare systems and private practice groups evaluate the shifting environment and seek to modify their strategies accordingly.

Impactful changes include uncertainty around healthcare policy, advances in medical technologies, growing healthcare needs of aging baby-boomers, and changes in how medical space is utilized.

As more patients demand healthcare closer to where they live, work, and play, more retail clinics, urgent-care centers, and ambulatory surgery centers are opening in convenient, high-visibility, retail-like settings.

Since the pace of development has slowed, absorption could pick up and offer some breathing room for some existing buildings facing vacancy.

INVESTMENT & CAPITAL MARKETS

Liquidity Continues to Drive Investment Sales Market

$7.3B

2018 combined Office, Industrial, Retail, Multifamily sales

More capital continues to flow into the Twin Cities, and in some cases, from capital sources that did not even have the metro on their radar a few years ago. The level of activity in downtown Minneapolis, both in terms of sales and on-the-market properties, is at its highest in recent memory. The office, industrial, and multifamily sectors in particular boasted significant jumps in 2018 transaction volume. One of the biggest trends, however, continues to be a lack of properties for sale.

Across all sectors, investors are attracted to the higher yields available in the Twin Cities relative to other primary and coastal cities, along with a strong and diverse macro-economy.

Multifamily sales continue to be white-hot, with investment sales approaching $2 billion in 2018, the fifth consecutive year with sales topping $1 billion.

More capital continues to be allocated to industrial properties across all product types, with investment sales activity in 2018 nearly twice the volume of 2017.

OFFICE

Twin Cities Office Market Redefines Itself

416,389 SF

positive absorption in past six months

Despite the continued right-sizing of tenants, office leasing activity remained solid in the second half, which pushed absorption to nearly 600,000 sf in 2018. Overall, market fundamentals are good – even great in some pockets – with both vacancies and rental rates continuing to show steady improvement.

At year-end, there was an estimated 2.2 million sf of active leasing requirements in the market. While not a big number for a 75 msf office market, it is typical of the new normal of more restrained growth that has become common during the current cycle.

Co-working providers continue to drive demand for space while the co-working trend is expected to accelerate, predominantly among corporate users.

CBD

Investors are pursuing office product, with the majority of capital intensely focused on purchasing assets in the Minneapolis CBD, along with suburban hot spots including the West End and I-494/ France Avenue.

COMPASS

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EXECUTIVE SUMMARY

PROJECTIONS FOR FIRST HALF 2019

CONTINUED INTEREST IN VACANT RETAIL BIG BOXES

2.2M

SQUARE FEET OF ABSORPTION

1.5M

MILLION SQUARE FEET OF NEW CONSTRUCTION

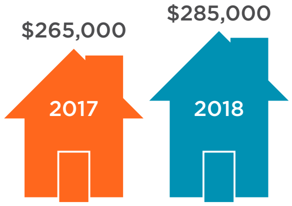
MARKET QUICK FACTS

Sources: MAAR, MNDEED 2018

TWIN CITIES METRO DEFINITION

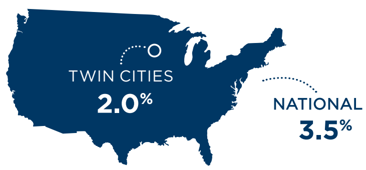
The "Twin Cities" of Minneapolis and St. Paul form the core of a metropolitan region encompassing 6,046 square miles and consisting of 13 counties: Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Washington, Isanti, Chisago, Sherburne and Wright in Minnesota, as well as Pierce and St. Croix counties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

HOUSING PRICES UP 7.5%

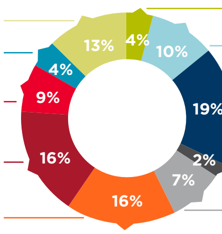


Median single-family home prices

UNEMPLOYMENT RATE REMAINS HISTORICALLY LOW



LABOR FORCE MIX CONSISTENTLY SOLID



TWIN CITIES BUSINESS STRENGTHS

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**

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

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

compass.cushwakemsp.com

ABOUT THE AUTHOR

THE COMPASS REPORT

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The report was created by experts using Twin Cities commercial property data from 2018. 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 (NYSE: CWK) is a leading global real estate services firm that delivers exceptional value for real estate occupiers and owners. Cushman & Wakefield is among the largest real estate services firms with 48,000 employees in approximately 400 offices and 70 countries. In 2017, the firm had revenue of $6.9 billion across core services of property, facilities and project management, leasing, capital markets, valuation and other services. 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*

More than $2.3 billion annual transactions

85 brokers

30MSF of assets under management

Employs nearly **500 professionals**

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