COMPASS

Navigating the Minneapolis-St. Paul Commercial Real Estate Market

INDUSTRIAL MARKET

Strong Northeast Metro Deal Flow Highlights Another Solid Half for Industrial Market

First-half leasing activity was especially strong in northeastern metro hubs such as Roseville, northeast Minneapolis and Fridley – with a continued bump predicted for early 2019 – leading the way in what was another solid half-year for the Twin Cities market. The overall market met its expectations for the six-month period, logging over 1 msf of positive absorption.

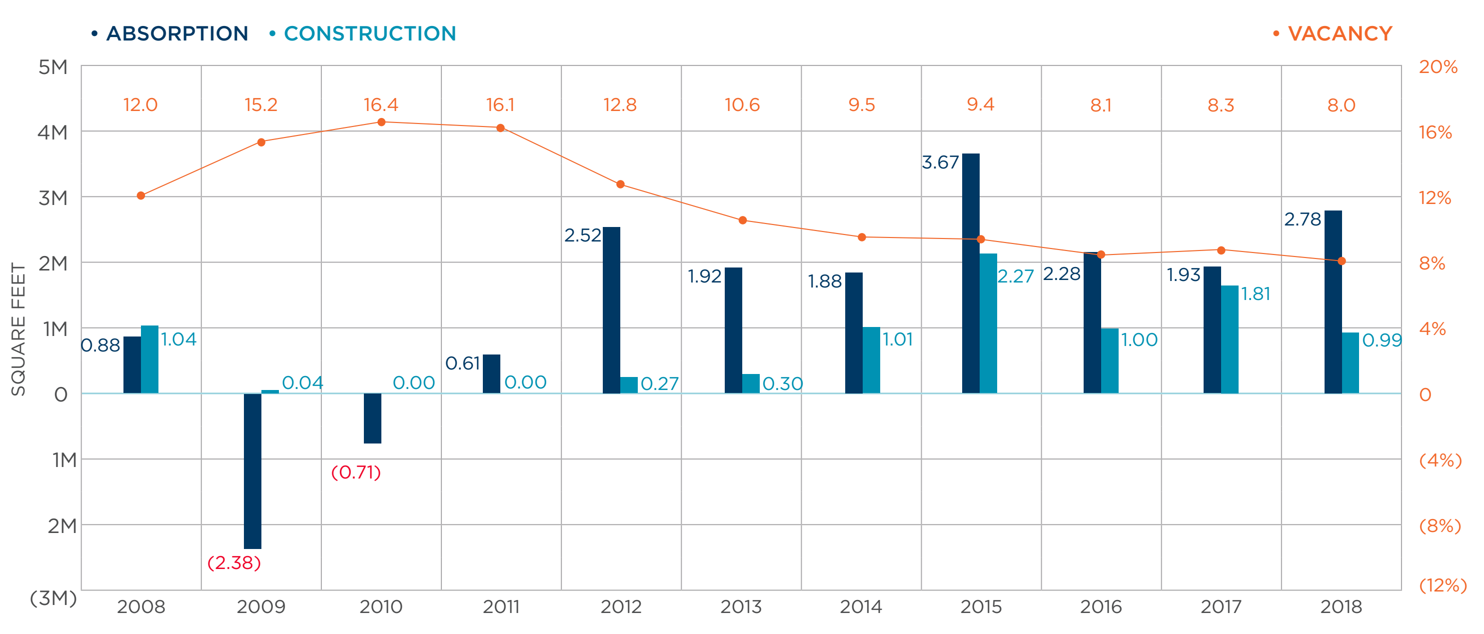
The latest numbers suggest the long-standing up-cycle for the Twin Cities industrial market is hardly over, and in fact gained steam in 2018. The market's full-year absorption total of 2.78 msf was its second-best yearly performance since the 2008 financial crisis, exceeded only by 2015's total of 3.7 msf. It also represented a 43% jump over the absorption totals of 2017. Overall industrial vacancies, meanwhile, ticked down from 8.3% in the fourth quarter of 2017 to 8.0% during this year's period.

NORTHEAST SECTOR GETS ITS TURN IN THE SPOTLIGHT

A combination of positive factors came together in the northeast submarket as 2018 drew to a close. While its second-half absorption total of 376,730 sf was relatively modest, it previewed an expected surge into early 2019 which could result in an additional 600,000 sf of absorption there. Those expected deals include a pair of leases in the 200,000-sf range (Curtis 1000

INDUSTRIAL ABSORPTION, CONSTRUCTION & VACANCY

Source: Cushman & Wakefield



INDUSTRIAL VACANCY & ABSORPTION

Source: Cushman & Wakefield

SUBMARKET	TOTAL # OF BLDGS	NRA	VACANT SPACE	% VACANT	% VACANT W/SUBLEASE	1ST HALF 18 ABSORPTION	2ND HALF 18 ABSORPTION	2018 ABSORPTION
Northeast	411	35,620,636	3,131,954	8.8%	9.8%	413,293	376,730	790,023
Northwest	336	31,210,959	3,184,834	10.2%	11.1%	607,347	410,199	1,017,546
Southeast	230	18,458,352	1,115,118	6.0%	6.7%	170,062	138,201	308,263
Southwest	315	27,308,401	1,579,761	5.8%	6.6%	402,049	264,736	666,785
Total Market	**1,292**	**112,598,348**	**9,011,667**	**8.0%**	**8.9%**	**1,592,751**	**1,189,866**	**2,782,617**

Inc. and LKQ Corp.). The stepped-up activity means the northeast's unsightly bulk warehouse vacancy rate of 15.6 percent could be halved by summer 2019.

Developers keep going on new construction

After a frenzied 2017, industrial kept the pedal to the metal on building new industrial space as 2018 came to an end. Some 2.0 msf was under construction in the fourth quarter, more than the 1.8 msf total then ongoing during the year-earlier quarter. "Spec" development in the ultra-tight southwest metro was once again hampered by a lack of suitable close-in sites, although limited new construction from United Properties, Eden Trace Development and Scannell Properties was on the way there as the year closed. About 856,000 sf of the under-construction total is speculative space.

Streaky northwest metro evens out a bit after big first half

The northwest submarket posted huge gains in absorption during the first half of 2018 as users fled the higher rates and tight conditions of the southwest metro. While still solid, the submarket came back down to Earth a bit in the second half with an absorption total of 410,199 sf, which, though reduced, was still large enough to lead the Twin Cities market. The slower pace seemed to be due to reduced demand for "spec" space.

Industrial rental rates reach highest levels in a decade

As the industrial up-cycle has lengthened, it has slowly but surely pulled up the average net rental rates of both office-warehouse and bulk warehouse product. The average office-warehouse rate in the fourth quarter was $8.61 per sf -- the highest level since the 2008 recession and up from a 2011 low of $7.98 per sf. Meanwhile, lengthier leases are becoming more common, with seven-year deals overtaking the traditional five-year leases.

OUTLOOK

With a strong pipeline of pending and expected deals, yet another robust six-month period is predicted for early 2019. Some 1.5 msf of absorption is likely to be recorded in the first half, led by 600,000 sf in the northeast submarket. Demand is such that absorption totals could be significantly higher if there existed sufficient desirable space.

An ongoing boom in new built-to-suit industrial space will continue in the first half, with expected delivery of 1.1 msf of such product. Some 810,632 sf of speculative multitenant construction is also set to be completed in early 2019.

Tight market conditions will continue to prop up healthy lease rates for bulk warehouse and office-warehouse products, as well as sales prices for building owners looking to sell. Many of the new lease deals seen in 2018 were expansions of existing businesses, which bodes well for the strength of the economy overall heading into the new year.

ABOUT THE AUTHOR

THE COMPASS REPORT

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