CUSHMAN & WAKEFIELD

JULY 2019

COMPASS

Navigating the Minneapolis/St. Paul Commercial Real Estate Market

EXECUTIVE SUMMARY

OVERALL MARKET TRENDS

Twin Cities Multitenant Market Holds Steady Course of Slow Improvement

VACANCY RATE
10.8%
Landlords repositioning assets, offering more attractive options

ABSORPTION
2.0 million square feet
Boosted by strong demand for Industrial space

NEW CONSTRUCTION
1.5 million square feet
Activity remains high even as costs rise

SECTOR HIGHLIGHTS

- **INDUSTRIAL:** Industrial Market Up-Cycle Continues
- **INVESTMENT & CAPITAL MARKETS:** Deep Investor Pool Eager for Twin Cities Assets
- **OFFICE:** Office Move Decisions Impacted by Tight Labor Market
- **RETAIL:** Big-Box Vacancies Slowed as Retail Transforms
- **MEDICAL OFFICE:** Metro Has Right Prescription for Healthy Medical Office
- **MULTIFAMILY:** Robust Demand for Apartments Pushes Rents Up
- **LAND:** Industrial, Multifamily Land Remain Hot
- **HOTELS:** Hotel Supply Finally Catching up to Demand

READ MORE INSIDE

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

JULY 2019
EXECUTIVE SUMMARY

"The industrial market has remained a strength during this real estate development cycle, and in the first half of the year, we saw office and retail start to show their strength as well. We're projecting an even stronger second half of 2019, particularly in the retail and investment sectors, and as of now we're expecting one of the best absorption years we've seen during this economic expansion."

- Mike Ohmes, Managing Principal, Minneapolis-St. Paul office of Cushman & Wakefield

MULTIFAMILY
Robust Demand for Apartments Pushes Rents Up

4.1%
Rate rent growth is tracking year-over-year

The Twin Cities continues to rank among the country's most in-demand apartment markets. Despite a flood of new development, the metro boasts healthy absorption, a 2.6% vacancy rate, and solid rent growth. Business expansion, job growth, and in-migration are bolstering renter demand, while the shortage of available, affordable starter homes is keeping more millennials in the rental pool.

- Approximately 25,000 units came online during the red-hot 2012-18 development cycle with another 5,500 units slated to open in 2019.
- CONCESSIONS — Downtown Minneapolis has been dominating the development pipeline, with 1,300 units delivered in 2018. That boost in pushed vacancies higher, and concessions have emerged in pockets where competition is greatest.
- CBD — Downtown Minneapolis landlords are preparing for another surge of new units to be delivered in 2019 and more in 2020. However, more stringent inclusionary zoning requirements for new development may curtail the pipeline and create more barriers to entry.

HOTEL
Hotel Supply Finally Catching up to Demand

$117.17
Average Daily Rates fell 5.3%

Following a record-setting run - thanks to robust business and leisure travel - the Twin Cities burgeoning supply of hotel rooms is finally starting to catch up to demand. After several peak-performance years, a downturn is inevitable, but when and how deep is unclear. As long as the economy remains healthy and there is no "black swan" event, the hotel industry could merely experience a "hiccup" in activity.

- While hotel developers continue pursuing attractive sites, some have curbed plans due to overbuilding concerns and increasing costs, which will rein in future supply growth.
- Nontraditional players like Airbnb and Sonder -- which turns apartments into short-term hotel rooms -- remain a disruptor, and their future impact on the hospitality sector remains uncertain.
- Investor appetite is healthy for well-located, strong-branded metro-area hotels, and the value of these assets is expected to remain strong. However, there are also more buyers than sellers.

LAND
Industrial, Multifamily Land Remain Hot

Homebuilders are pivoting towards
AFFORDABILITY

Vigorous demand for industrial, multifamily, and single-family residential land positions persisted in the Twin Cities. Buoyed by the ongoing industrial and residential development booms, land prices in general have increased over the past few years, particularly in 2018. However, that upward momentum took a break in the first half, and prices stabilized.

- The hunt for desirable industrial land located as close to the urban core as possible continued, with suitable sites snagging peak prices.
- Appetite for multifamily land, particularly in suburban areas, was insatiable for both apartments and senior housing.
- Single-family residential land demand remained strong, but homebuilders shifted their focus even more toward smaller and more affordable products.

INDUSTRIAL
Industrial Market Up-Cycle Continues

7.8%
Vacancy rates have dropped

With a healthy local economy creating unremitting demand for space, the Twin Cities' industrial vacancies remain well below historical averages. 1.42 msf was absorbed during the first half, led by the thriving Northwest and Northeast submarkets, while the historically strong Southwest submarket was held back only by the lack of sufficient bulk warehouse product to satisfy strong demand.

- The development pipeline remains dynamic, boasting 1.8 msf of new construction underway and another 711,000 sf planned to start later in the year.
- Pricing is up for all types of industrial real estate, but infill properties with outdoor storage capability lead the pack. Retailers and e-commerce suppliers for "last-mile" locations near core, urban markets are driving much of that demand.

RETAIL
Big-Box Vacancies Slowed as Retail Transforms

9.7%
Retail vacancy rate highest in nine years

The Twin Cities continues to feel the impact of national retail bankruptcies and store closings; however, that impact has slowed with significantly fewer big boxes coming back to the market. Expanding retailers and new concepts are snagging smartly located big boxes and junior boxes in vibrant trade markets while less attractive locations will take longer to fill. With few big-box retailers expanding, many boxes are being split up for multiple tenants. Despite progress, more shakeout is expected with a "watch list" of possible retail closings.

- Savvy landlords are reinventing shopping centers as they seek experiential tenants including gyms, entertainment, food halls, grocers, and even CBD shops to fill vacancies, and drive foot traffic.
- Internet-resistant, "daily-needs" retailers like grocers, fitness concepts, value-add retailers, dollar stores, and fast-casual restaurants dominate leasing activity in community and neighborhood centers.
- Development has slowed to its lowest levels in nine years and there are no significant large-scale, greenfield retail developments in the pipeline.

INVESTMENT & CAPITAL MARKETS
Deep Investor Pool Eager for Twin Cities Assets

$5.8B
Estimated sales in commercial/multifamily

New and abundant sources of capital continue to target the Twin Cities in search of higher yields. Both domestic and foreign capital is drawn to the metro's strong fundamentals and demand drivers. However, there continues to be more investors than buying opportunities.

- The apartment market is performing at peak levels, with investors attracted to the robust fundamentals that are producing some of the best risk-adjusted returns in the U.S.
- Portfolio sales fueled industrial transaction velocity with Blackstone closing two deals and becoming the metro's largest industrial owner. Office sales started off slow, but are projected to increase in the second half with several large Minneapolis CBD and suburban properties set to hit the market.
- 20% — Investors are getting more comfortable with the retail transformation underway, and year-to-date sales are up approximately 20% over last year.

MEDICAL OFFICE
Metro Has Right Prescription for Healthy Medical Office

$19.27 PSF
Rental rates ticked up

Undeviating demand for space, stable occupancy rates, steadily increasing rental rates, and an uptick in construction all bode well for the Twin Cities medical office market. However, unrest continues as the sector faces uncertainty around healthcare policy, new medical technologies, the aging population's mounting medical needs, changes in reimbursement, and new healthcare delivery models. Medical office real estate continues to evolve to keep up with these changes.

- The pivot continues away from on-campus to off-campus properties as well as from multi-tenant medical buildings to single-tenant and system-driven facilities that can deliver all-inclusive healthcare services.
- In order to make deals work, elongated lease terms and higher rental rates have become the norm, particularly for new, Class A build-to-suit construction. In turn, developers/landlords are offering up hefty tenant improvement packages.
- "Retail-ization" of healthcare continues as systems aspire to deliver healthcare when and where patients need it, rather than only on hospital campuses. However, a bifurcation may be occurring as more destination-driven medical providers may not need to be in the "retail path."

OFFICE
Office Move Decisions Impacted by Tight Labor Market

557,601 SF
Positive absorption in the first half

Relocations are fueling office activity as companies continue to right-size footprints, boost density, and enhance workspaces to meet the fastidious demands of today's workplace. Companies want highly amenitized space to attract and retain talent in a tight labor market. When considering location, companies are weighing both the cost per square foot of leasing space and cost of employee turnover. In some cases, difficulty finding qualified candidates to fill positions is hampering expansion.

- CBD — Capital continues chasing office investments with the sales of Wells Fargo Center and Oracle International in downtown Minneapolis closing in the first half.
- Many buildings are getting in on the "spec suites" action, as landlords recognize a healthy appetite by tenants for modern, turnkey space and flexible leases.
- Rents are expected to remain relatively flat, although there is an increasing gap between the "haves and have-nots" of top-performing, Class A assets vs. buildings struggling with vacancies.

PROJECTIONS FOR SECOND HALF 2019

INCREASED SALES ACTIVITYY

2.44M
SQUARE FEET OF ABSORPTION

1.5M
MILLION SQUARE FEET OF NEW CONSTRUCTION

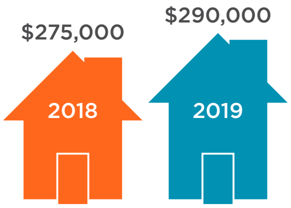
MARKET QUICK FACTS

Sources: MAAR, MNDEED 2018

TWIN CITIES METRO DEFINITION

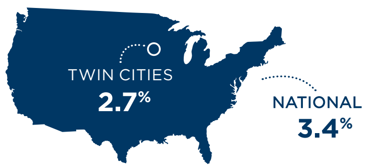
The "Twin Cities" of Minneapolis and St. Paul form the core of a metropolitan region encompassing 6,046 square miles and consisting of 13 counties: Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Washington, Isanti, Chisago, Sherburne and Wright in Minnesota, as well as Pierce and St. Croix counties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

HOUSING PRICES UP 5.5%

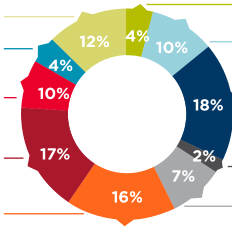


Median single-family home prices

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 2019*

Minnesota ranks **#3** in Best States in America - *U.S. News 2019*

Minneapolis-St. Paul is the birthplace of gamechangers like the **pacemaker** and **supercomputer**

- Highly educated workforce
- Excellent transportation services
- A diverse economic base
- 17 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

The report was created by experts using Twin Cities commercial property data from 2019. 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 approximately 51,000 employees in 400 offices and 70 countries. In 2018, the firm had revenue of $8.2 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 by *Minneapolis/St Paul Business Journal*

More than $4 billion in annual transaction value

80+ Brokers

300+ Properties managed

30MSF of assets under management

Employs nearly **500 professionals**

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