

Downward Slide Continues as Twin Cities Commercial Real Estate Market Reaches Levels Not Seen in 20 Years

The Twin Cities commercial real estate market remained under duress in the first half of 2010 as vacancy and absorption numbers continued their downward slide amid ongoing uncertainty in the larger economy. However, the pace of decline has slowed and activity levels are starting to improve.

Vacancy rates in the office, industrial and retail markets are at their highest level in 20 years or more, and most segments of the market continue to report negative absorption.

Investment activity was muted as well, despite some loosening in the credit markets. Opportunistic investors are still waiting for a wave of distressed properties to manifest. Much of the distressed product coming to market is priced higher than what buyers are willing to pay.

Residential land began trading again late in the first half with strong

interest from national homebuilders in select metro communities.

ACTIVITY LEVELS IMPROVING

Increased activity among office and industrial space users has not yet resulted in any substantial increase in volume for direct space transactions. Many first-half office transactions were renewals, often for less space and/or at more favorable terms. More retailers are under pressure to change their footprint to help adapt to market conditions, forcing some to consider downsizing strategies.

Moving costs—always a barrier to relocation—are being offset by higher concessions and lower rental rates, making relocation more of an attractive option for office and industrial users.

ON THE HORIZON

The real estate markets will continue to face strong headwinds over the next six to 12 months, with rental rates

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- Transaction activity
- Investment sale activity
- Projections for the next 6-12 months

under downward pressure and more distressed property sales. Space users will be more opportunistic in their leasing decisions, which will keep the heat on landlords.

If this recovery follows the pattern established by previous major setbacks, a number of factors will soon come into play. First, rental rates will be under additional downward pressure—the office and industrial markets are already seeing that—for an extended period of time. Landlords can read that as today's deal will be better than tomorrow's.

Second, more distressed property selling will also contribute to negative rate pressure. New owners, buying at lower price points, will be better positioned to profit at lower rental rates than those owners who purchased properties—or built new ones—during the pre-recession boom.

And third, even as activity returns to the market, absorption rates will remain low as many tenants will continue to right-size their space needs to account for lower employee counts and slower economic growth. ■

