

Executive Summary



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SNAPSHOT



- Small-shop space poses big problem for Twin Cities retail centers: new NorthMarq survey pinpoints the issue
- Housing to hit bottom by year end, says Fed survey
- Industrial users want to be near the loop, which is driving up industrial land prices
- Investment market stalls on pricing, cost of capital issues

Waiting for an Updraft: Mid-Year Caution on the Twin Cities Commercial Real Estate Front

There's a hint of summertime blues in the air for Twin Cities commercial real estate markets at mid-year. The economic slowdown and ongoing turmoil in the capital markets has made space users and developers alike more cautious in their approach to expansion.

OFFICE MARKET STILL SHOWING IMPROVEMENT OVERALL

Despite the challenging economy, the office market is showing resiliency, posting 158,000 sq. ft. of positive absorption, and is on track for 900,000 sq. ft. of positive absorption in the next 6-12 months.

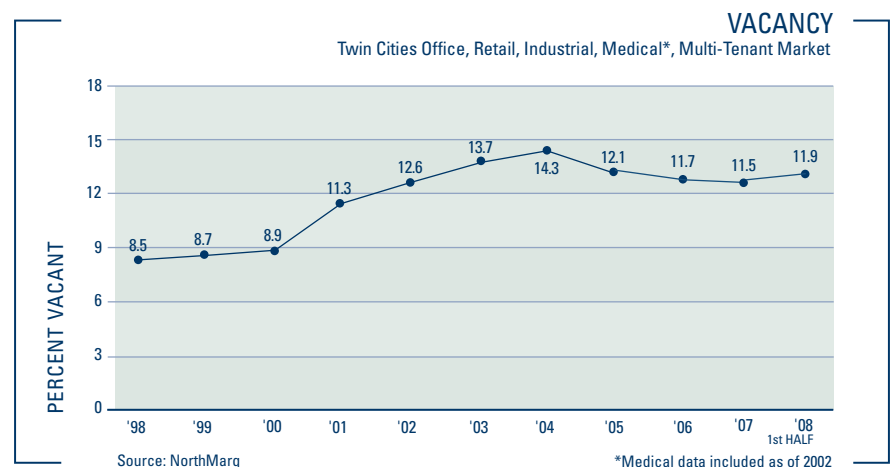
Most office submarkets are holding steady or improving slightly. The Minneapolis CBD absorbed 110,000

sq. ft. and lowered its vacancy rate to 15.4%, and the West submarket absorbed nearly 200,000 sq. ft. in the past 12 months and boasts a Class A vacancy rate of only 5.5%.

New development remains on hold in the West submarket due to the lack of activity and the over-building in the Southwest submarket. Vacancy in the Southwest may reach 16% and more than 900,000 sq. ft. with the delivery of five new projects next year.

RETAIL COOLS DOWN; SMALL-SHOP VACANCY SIGNIFICANT AND PROBLEMATIC

With consumer confidence waning, the Twin Cities retail market has taken a breather after several years of near-hyper new development activity.



Overall vacancy trended higher, at 7.6%, while the market posted 317,000 sq. ft. of negative absorption. Net retail rental rates declined to \$27.78, a six-year low.

Weighing heavily on the retail market is an abundance of vacant small-shop space. This vacancy amounts to 16.17% of a total of 9.3 million square feet of such space, according to the first-ever **NorthMarq Small Shop Retail Survey of the Twin Cities**.

STRONG BULK WAREHOUSE DEMAND POWERS INDUSTRIAL MARKET

Market fundamentals remain strong for industrial properties, but leasing activity is slowing as space users wait out the economy. Vacancy inched higher at 12.4%, as 797,000 sq. ft. of new space came on line.

Absorption numbers were mixed:

- 365,000 sq. ft. of positive absorption overall
- 897,000 sq. ft. of positive absorption in bulk warehouse properties
- 736,000 sq. ft. of negative absorption in office warehouse properties
- 203,000 sq. ft. of positive absorption in office showroom properties

PRICE FOR SPECULATIVE LAND DOWN 50-60%

Speculative land prices have declined by as much as 50-60% from their 2005-2006 peak across the Twin Cities. These lower prices reflect the need for increasing returns for those with available capital willing to take down land and wait for the market to improve. Many options are available today to invest in speculative land, but only the best-located sites are seeing any activity even at these lower price levels.

Prime industrial land in or near the I-494/I-694 loop is in high demand, and developers are paying record high prices for well-located industrial property.

Developers are quickly sizing up the potential for retail growth along the newly completed, 11.2-mile Highway 212 freeway corridor between the cities of Chaska and Carver in the Southwest submarket.

PHYSICIAN RECRUITMENT ISSUES CHALLENGING MEDICAL OFFICE MARKET GROWTH

Developers continue to press the “pause” button on new medical office space, allowing time for the market to absorb last year’s record amount of new construction.

Physician recruitment continues to be a significant challenge impacting future growth and expansion plans of Twin Cities healthcare organizations. Major healthcare organizations and clinical practices are increasingly reluctant to open new clinics, even in those areas of the Twin Cities where strong residential growth has created a market opportunity. The use of vari-

ous types of physician extenders is how many are attempting to address this shortage.

REAL ESTATE BUYERS, SELLERS SEEK COMMON PRICING GROUND

Commercial real estate investment market transaction activity is down 20% nationally, according to Real Capital Analytics, the first year-over-year decline in five years.

Buyers and sellers are looking for a middle ground on prices for office, industrial and retail properties. To get there, they need to see more transactions—and the uncertainty in the economy and especially in the capital markets has driven them further apart during the past six months.

The cost of capital has increased significantly for buyers, especially private, leveraged buyers. Institutional investors are also taking a more cautious approach, both as buyers and lenders. If there’s one bright investment spot, it’s the multi-family apartment market. Capital for investing is still relatively plentiful, apartment vacancy rates are falling, and there is still room for rental rate growth in the Twin Cities. ■

