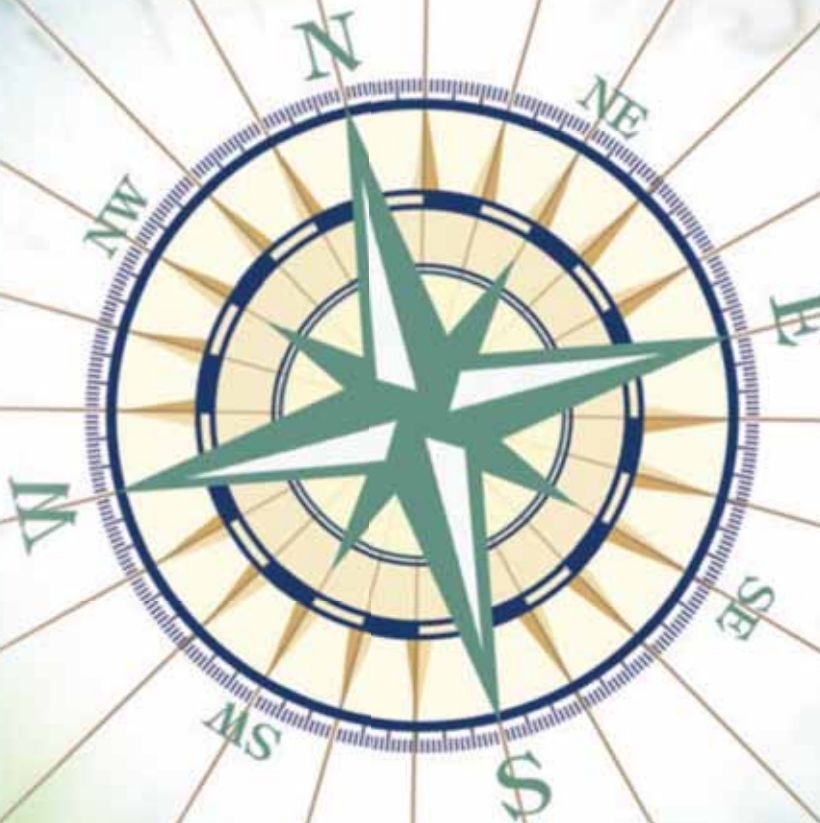


JULY 2008

THE COMPASS

Helping You Navigate Today's Commercial Real Estate Market

Minneapolis-St. Paul Edition



**NORTHMARQ**

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Flat vacancy, lighter absorption as tenants wait out economy

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CAPITAL MARKETS

Cost and availability of capital, pricing gap combine to significantly reduce transaction volume in first half

Quick Facts

Minneapolis • St. Paul



LOCATION

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.

Money magazine rated Plymouth, Minnesota, the top city in its 2008 list of the "100 Best Places to Live in America." Other Twin Cities metro communities included in the ranking were Eagan (17th), Apple Valley (24th), Lakeville (26th), Eden Prairie (40th), Maple Grove (41st), Burnsville (43rd) and Blaine (93rd).

POPULATION

According to AGS' (Applied Geographic Solutions) 2007 population estimates, the Minneapolis-St. Paul MSA (Metropolitan Statistical Area) ranks 16th in population in the United States with a population of 3,211,584.

INCOME

According to 2007 AGS estimates, the Twin Cities' median household income of \$67,181 is ranked fourth among the top 50 most populous MSAs.

The Bureau of Labor Statistics ranks the Twin Cities third-richest among the 24 metro areas it selected for comparison in a recent study and first in spending on entertainment and home furnishings.

BUSINESS STRENGTHS

Major business strengths in the Twin Cities include a highly educated work force, excellent transportation services, a diverse economic base and available capital. The Minneapolis/St. Paul MSA employment base does not rely on any single industry, which allows it to weather recessions and economic downturns in specific industries.

Marketwatch, the Dow Jones-owned online business information service, rated the Twin Cities as tops among large metropolitan areas in the nation for business opportunities. Among factors in the Twin Cities' favor: ranking second-highest in the concentration of both Fortune 1000 and S&P 500 companies in the nation and sixth in the nation in its concentration of Forbes 400 private companies, as well as a highly educated workforce well-prepared for the workplace by the University of Minnesota and other local higher education institutions.

EDUCATION

Minnesota has a highly educated workforce. In 2006, the state ranked first among states in the percentage of the population aged 25 years or older that have a high school diploma or equivalency (93%). Minnesota has the eighth-highest percentage of people with college degrees or higher (33.5%), according to the U.S. Bureau of the Census (2006), and the U.S. Chamber of Commerce's 2007 State-by-State Report Card places Minnesota second nationwide in academic effectiveness. The top three degree fields of all bachelor's degrees awarded in Minnesota are: Business Management (5,489), Education (3,306), and Social Sciences (2,805).

(Source: Minnesota Department of Employment and Economic Development)

HOUSING PRICES

Median housing prices in the Twin Cities plummeted to \$199,900 in the first quarter of 2008 from \$222,500 in first-quarter 2007, which is still very affordable in comparison to metropolitan areas such as San Francisco and its median home price of \$777,300.

(Source: National Association of Realtors)

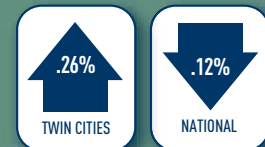
ECONOMIC OUTLOOK

- Minnesotans' personal incomes will grow by 4.6% on average over the next 18 months, although unemployment will increase by 1.1% state-wide during that same time period, according to the mid-year survey of regional business conditions conducted by the Federal Reserve Bank of Minneapolis (Minneapolis Fed) and the Minnesota Department of Employment and Economic Development (DEED). The Minneapolis Fed sees a 5.6% unemployment rate for Minnesota in the fourth quarter of 2008, just slightly higher than the 5.3% state unemployment number in June. The Twin Cities, as noted above, was below the state average in June at 5.1%.
- Economic activity throughout the Ninth District Federal Reserve Region was flat throughout the first half of the year. Profits were neither up nor down on average for professional services firms, and demand for commercial real estate space across the district was essentially flat as well. States with strong natural resource bases, such as Montana and North Dakota, are expected to see more employment growth during the next year. More industrialized states such as Minnesota will likely see flat to slightly lower economy activity, according to the Fed.
- Most companies in the Fed survey expect to see higher input costs during the next year; 40% expect to increase their selling prices.
- Ninth District wage growth, at 2.5%, will outpace a 2.2% increase in prices over the next year, according to the Fed survey.
- Something to cheer about this coming holiday season: the Fed sees housing bottoming in Minnesota by the end of the year, boosted by a 3.8% increase in new housing authorizations through year's end.
- Metro Transit expects to provide more than 80 million rides in 2008 through its network of 113 bus routes plus the Hiawatha Light Rail line. That's up from 77 million riders in 2007.
- Minneapolis ranks as the 19th most livable city in the world and is benefiting from an American "rust belt revival," according to London-based *Monocle* magazine as reported locally in *City Pages*.
- The Twin Cities area is in select company: *Site Selection* magazine ranked the Twin Cities as the fifth-most productive metropolitan area for new and expanded corporate facilities in its 2007 Governor's Cup count of new and expanded facilities. Minnesota took 15th place among the states as well. "Minnesota consistently places high in national rankings of business performance and quality of life," said Dan McElroy, commissioner of the Minnesota Department of Employment and Economic Development. "These rankings validate our state's competitiveness in targeting and landing new business opportunities, which in turn expand our economy."
- Boost for metro bioscience: the University of Minnesota obtained \$292 million in funding approval to launch its planned bioscience park in the East Gateway District of the Minneapolis campus. The funding will pay for four new research buildings, all set to open by 2013; the initiative will create jobs for about 120 researchers and 500 support personnel. The average wage in bioscience is \$26,000 higher than the average private sector wage in the U.S., according to the BioBusiness Alliance of Minnesota.
- Young and savvy: The median age for people in the Twin Cities market was 34.2 years in 2006, one year younger than the national median, according to Property and Portfolio Research of Boston. The firm attributes the area's youthfulness to the abundance of colleges and universities located in the area; it also notes that employment opportunities are good, since the metro area boasts 18 Fortune 500 company headquarters.

TWIN CITIES JOB GROWTH

June 2007 - June 2008

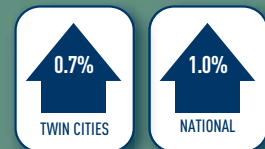
(Not Seasonally Adjusted)



TWIN CITIES UNEMPLOYMENT

June 2007 - June 2008

(Not Seasonally Adjusted)



JOBS

- Twin Cities employers added 4,800 jobs during the 12 months ending in June, a 0.3% gain. Employment numbers are firming up in both the metro area and state-wide. The state has seen job growth in three of the past four months and has added 1,900 jobs during the first half of the year. In contrast, the U.S. lost 438,000 jobs during that period.
- The state unemployment rate declined to 5.3% in June, down from 5.4% in May, on a seasonally adjusted basis. The June unemployment rate for the Twin Cities was 5.1% (on a non-seasonally adjusted basis). Nationally, the unemployment rate was 5.5% in June.
- Minnesota June job growth was powered by an increase of 1,300 manufacturing jobs. International sales growth of Minnesota's manufactured exports rose by nearly 10% during the first five months of 2008, according to preliminary data from the U.S. Department of Commerce.

Executive Summary



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

northmarqcompass.com

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.

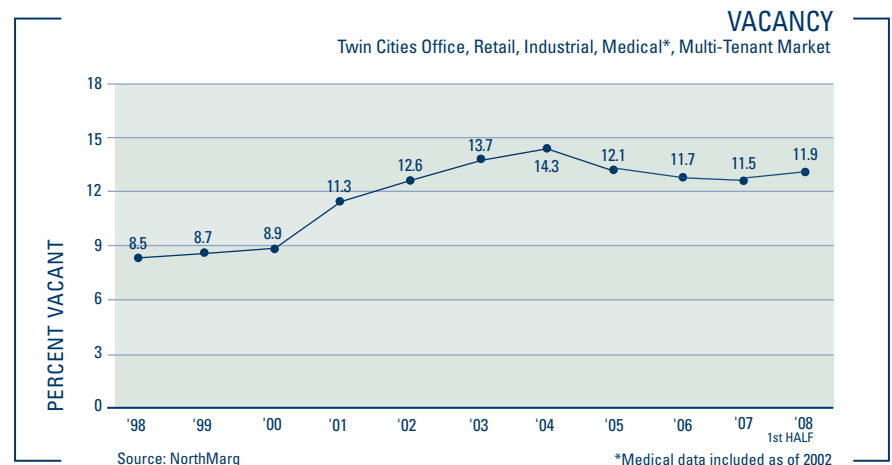
Most office submarkets are holding steady or improving slightly. The Minneapolis CBD absorbed 110,000

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-

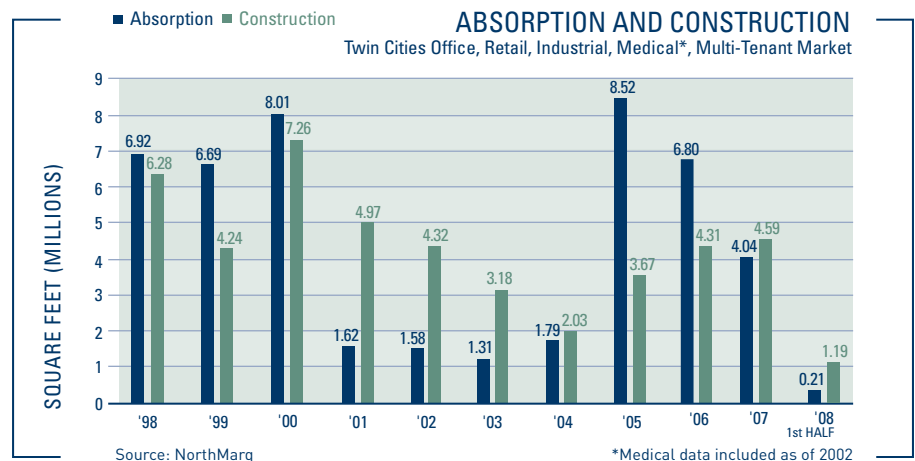
ous types of physician extenders is how many are attempting to address this shortage.

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. ■



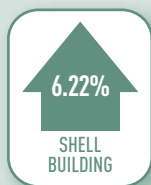
SNAPSHOT



- Many tenants holding off on expansion plans as they wait to see what the economy will do
- Minneapolis CBD continues to improve
- Growing Class A conundrum in the West submarket
- Southwest braces for more new product

OFFICE CONSTRUCTION COST INDEX

Per Sq. Ft. January - July 2008



Twin Cities Office Market Shows Some Improvement Despite Bumpy Economy

The Twin Cities multi-tenant office market faltered early but then regained stride to finish on a more positive note during the first half of 2008.

The Minneapolis Central Business District (CBD) gets credit for most of the absorption in today's very uncertain economy. Minneapolis posted 110,000 sq. ft. of positive first-half absorption, while the market as a whole recorded 158,000 sq. ft. of positive absorption.

Demand loped along at a slower, albeit still positive, pace throughout the market as tenants hunkered

down into a more wait-and-see stance with regard to expansion plans. Overall vacancy remained flat at 15.4%. Sublease space was slightly more available across the market. Continuing softness in the Southwest and St. Paul CBD submarkets in particular weighed on the overall vacancy numbers.

NEW DEVELOPMENT STILL ON HOLD IN WEST SUBMARKET

New development activity was slower as well, with just 96,000 sq. ft. of new product coming on line during the first half. That bodes well for landlords in submarkets such as the West and the Minneapolis CBD, where



Class A space options are limited. Vacancy in the Class A West submarket declined to 5.5%, leaving just 240,000 sq. ft. of direct space in inventory.

Although there are six major projects proposed for the West, developers may be reluctant to pull the trigger in light of growing softness in the adjacent Southwest submarket—a traditional crossover market for West submarket space users. With new construction bringing 600,000 sq. ft.

of new space to the Southwest, that submarket could see vacancy reach as high as 16% in the next 12 months.

CLASS STRUGGLE IN MINNEAPOLIS

A class struggle of sorts has broken out in the Minneapolis CBD, where demand for high-end, high-image space in the upper floors of Nicollet Mall corridor office towers has never been stronger. There was only one large block of space (larger than

50,000 sq. ft.) available at mid-year in the premium Class A market. Space users could find more options for large space in the lower-level Class A environs, but the prevailing mind-set of many tenants seems to be that if they're going to be downtown, their relocation will be a strategically driven statement.

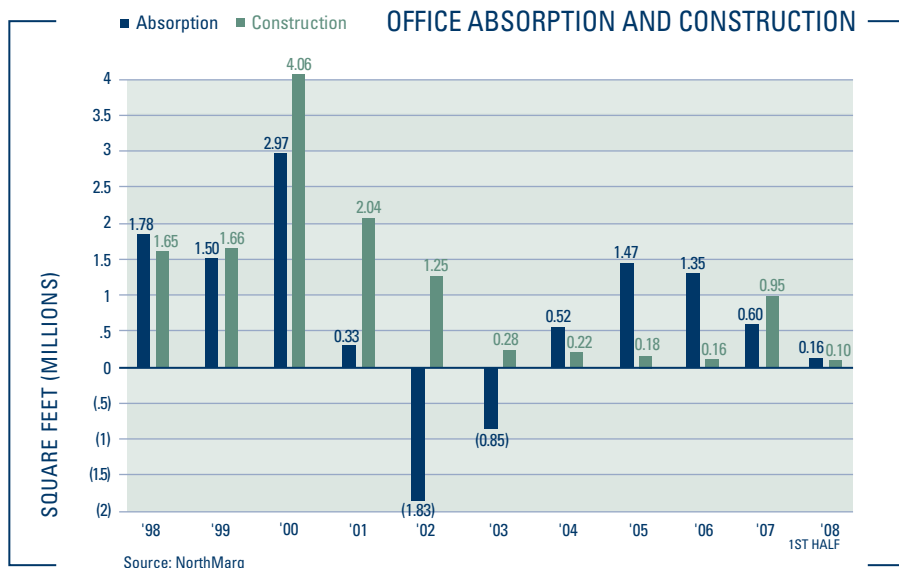
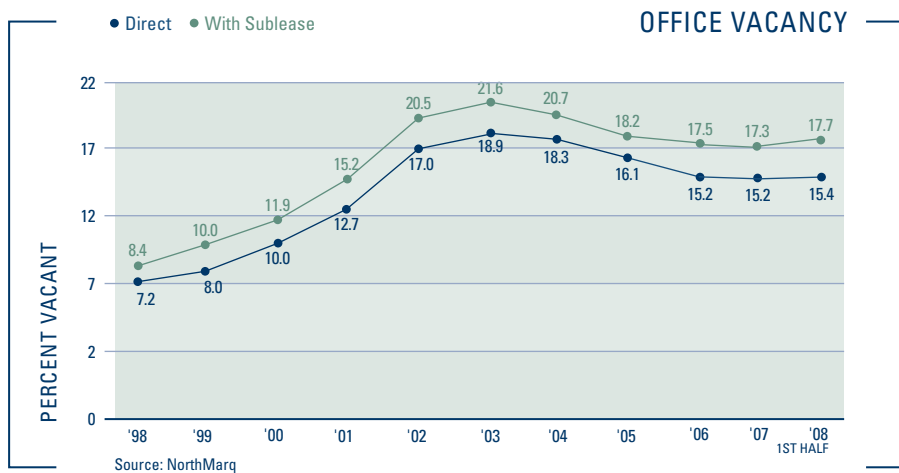
As a result, the less desirable Class A space is competing more fiercely with Class B properties for the same tenant base, putting downward pressure on rental rates for the less desirable Class A space. Even so, Class A rental rates in the Minneapolis CBD leaped 2.5% during the first half of 2008 to an average of \$15.44 per square foot.

NORTHEAST SHOWS CONTINUED STRENGTH

The Northeast submarket showed continued strength, reporting 49,000 sq. ft. of positive absorption, fueled by a number of smaller leases in various commercial pockets in Woodbury, Lake Elmo, the St. Paul Midway and the surprisingly rejuvenated Mid-City district located between the I-280 and I-35W corridors in Minneapolis and St. Paul. That area has added more than 3,000 living wage jobs during the past 10 years and is now competing to a certain extent with the Minneapolis CBD for tenants.

ON THE HORIZON

With the economic outlook as clouded as it is, overall absorption will likely fall below the 10-year average absorption of 800,000 sq. ft. Our absorption projection is 650,000 sq. ft. for 2008, which would mean that the market would absorb 500,000 sq. ft. in the next six months. This is a very positive sign considering the sluggish economic environment. ■



OFFICE VACANCY AND ABSORPTION

SUBMARKET	TOTAL # OF BUILDINGS	NRA	VACANT SPACE	PERCENT VACANT	PERCENT VACANT W/ SUBLEASE	2ND HALF 2007 ABSORPTION	1ST HALF 2008 ABSORPTION	LAST 12 MONTHS ABSORPTION
Minneapolis CBD	109	25,588,785	3,946,917	15.4%	17.4%	26,446	110,454	136,900
Northeast	123	7,898,964	1,132,830	14.3%	17.1%	113,556	48,605	162,161
Northwest	35	2,164,211	383,573	17.7%	18.7%	(52,893)	18,439	(34,454)
South/Airport	78	5,481,231	761,890	13.9%	15.6%	45,101	(34,784)	10,317
Southwest	144	13,487,991	1,882,371	14.0%	18.1%	17,456	(20,461)	(3,005)
St. Paul CBD	46	7,642,206	1,961,004	25.7%	27.0%	12,119	(8,606)	3,513
West	97	8,612,704	856,227	9.9%	11.7%	154,287	44,700	198,987
TOTAL MARKET	632	70,876,092	10,924,812	15.4%	17.7%	316,072	158,347	474,419

Source: NorthMarq

OFFICE PROJECTS UNDER CONSTRUCTION

NAME	DEVELOPER	LOCATION	SQ. FT.	COMPLETION
NORTHEAST				
Oakcrest Professional	MSP Commercial Management	Helmo Ave. & 12th, Oakdale	14,000	3rd Qtr., 2008
SOUTHWEST				
8200 Tower at Normandale	United Properties	West 83rd St. & Normandale Lake Blvd., Bloomington	274,000	2nd Qtr., 2009
MarketPointe II	Lutheran Brotherhood / Ryan Co.'s	78th Street, Bloomington	250,000	4th Qtr., 2008
Windsor Plaza	Solomon Real Estate Group	Hwy 212, Eden Prairie	100,000	4th Qtr., 2008
Excelsior Crossings Phase I	Opus Corporation	Hwy 169 & Excelsior Blvd., Hopkins	255,000	3rd Qtr., 2008
Excelsior Crossings Phase II	Opus Corporation	Hwy 169 & Excelsior Blvd., Hopkins	255,000	2nd Qtr., 2009
WEST				
Westwood Lake Office Building	Sand Companies	I-394 & General Mills Blvd., Golden Valley	25,242	4th Qtr., 2008
Crest Ridge Corporate Center I	Opus	I-394 & Hopkins Crossroads, Minnetonka	120,000	3rd Qtr., 2009
TOTAL OFFICE UNDER CONSTRUCTION			1,293,242	

Source: NorthMarq

SNAPSHOT

northmarqcompass.com



- Construction, absorption and leasing slowed as market settles and absorbs surplus capacity
- Presidential election is a factor as medical groups play "wait and see" on healthcare policies before committing to space
- Physician recruitment remains challenging, impacts future growth
- Hospital growth is funding-driven; presents opportunity for capital partners

Medical Office 'Pause' Continues as Market Absorbs Excess Space

DESPITE LACK OF ACTIVITY, MARKET REMAINS HEALTHY

Coming off a record-setting year of new construction and absorption, as expected, the Twin Cities medical office market experienced slowed activity in new construction, absorption and leasing. This is allowing the market to "settle" and absorb excess capacity.

Despite sluggish activity, the market remained strong; only 10.4% of the 5,468,947 sq. ft. was vacant. This market is significantly healthier than the general office market at 15.4% vacancy. Off-campus vacancy was 14.6%. The Southwest submarket was the tightest at 8.9%, followed by the Northwest at 10%, the Southeast at 16.1%, and the Northeast at 21.5%. On-campus vacancy remained low at 6.4%. Five hospital campuses reported zero vacancies in their multi-tenant office buildings.

The market experienced an unprecedented amount of new construction and absorption in 2007 and is "paus-

ing" to allow the market to catch up. Absorption dropped significantly to 7,515 sq. ft. This is due to the fact that the medical office market moves slower than the general office market. The upcoming election, which will influence future healthcare policies, is also playing a role. Many medical groups are gathering information about locations but waiting for the results of the election before committing to space.

RATES ARE HEALTHY

Average net rental rates were \$17.81 per square foot. Rates have steadily increased every year since 2003. The Southwest submarket boasted the highest average rate for off-campus space at \$18.29. Meanwhile, five hospital campuses listed rates higher than \$20. Woodwinds Health Campus in Woodbury listed the highest rate at \$23.50. Increased construction costs pushed up rates on existing buildings as landlords try to narrow the gap between new and existing space. Rates for off-campus new construction averaged \$18-19.

MEDICAL VACANCY AND ABSORPTION

	TOTAL BUILDINGS	NRA	VACANT SPACE	% VACANT	% VACANT W/ SUBLEASE	FIRST HALF 2008 ABSORPTION
ON CAMPUS	35	2,831,183	180,389	6.4%	6.8%	865
OFF CAMPUS	56	2,655,764	387,954	14.6%	15.1%	6,650
TOTAL MEDICAL	91	5,486,947	568,343	10.4%	10.8%	7,515

Source: NorthMarq

See www.northmarqcompass.com for historical vacancy and more submarket highlights

Rates for on-campus new construction averaged \$21-24.

PHYSICIAN RECRUITMENT IMPACTS GROWTH

Physician and staff recruitment remains challenging when staffing new facilities. The Twin Cities competes for physicians with other markets that offer higher pay scales, warmer climates and additional opportunities for growth. Recruitment even impacts when and where growth occurs. For example, medical groups relocating to the new Maple Grove hospital site didn't want to "miss the bus" in the burgeoning Northwest submarket. However, some are having difficulty staffing facilities. Medical staff recruitment is an ongoing challenge in staffing these clinics as well as expansions for any kind of sub-specialty.

HOSPITAL GROWTH IS FUNDING-DRIVEN

Future growth on hospital campuses is based on funding and how hospitals prioritize it. (There is constant reprioritization of funding by hospital administrators.) This creates an opportunity for capital partners to purchase or build new medical office buildings and form strategic partnerships with the hospitals.

URBAN HOSPITALS UNDERGO RENOVATIONS/EXPANSIONS

Several hospital campuses downtown or near downtown are undergoing expansions/renovations: St. Joseph's, Regions, Hennepin County Medical Center, University of Minnesota Children's Hospital – Fairview and both Children's Hospital and Clinics of Minnesota locations. The national trend to reinvestment in urban hospitals is to maximize these facilities by relocating outpatient functions to the suburbs and creating as much inpatient space as possible. It is a

"hub-and-spoke" strategy. Suburban facilities, in turn, are driving inpatient care back to the urban hospitals.

ON THE HORIZON

Other than hospital expansions currently underway, a pause will continue for the next 6 to 12 months as existing medical office space gets leased. Minimal new construction has been announced, and developers are finishing projects they have started. Unlike the recent medical office development cycle, which brought mostly specula-

tive space to the market, future development will likely be demand-driven.

Hospitals may begin to seek out capital partners to fund future growth. Physician and medical staff recruitment will remain a challenge when staffing new clinics. New construction costs have pushed up rates on all product; however, rates may be leveling off. ■



MORE ONLINE:

- *Minimal Construction Announced*

AVERAGE NET RENTAL RATES

	AVG. RATE	TOTAL OE & T*	AVG. RATE	TOTAL OE & T*
ON CAMPUS	SECOND HALF 2007		FIRST HALF 2008	
Abbott Northwestern	\$ 20.27	\$ 14.65	\$ 20.38	\$ 14.65
Fairview Ridges	\$ 18.00	\$ 13.32	\$ 18.00	\$ 13.32
Fairview Riverside	\$ 15.09	\$ 13.49	\$ 15.09	\$ 13.49
Fairview Southdale	\$ 19.74	\$ 12.51	\$ 16.89	\$ 13.78
HCMC	\$ 10.00	\$ 12.57	\$ 10.00	\$ 13.86
Mercy	\$ 17.50	\$ 14.69	\$ 18.00	\$ 11.04
Methodist	\$ 20.50	\$ 7.95	\$ 20.50	\$ 7.95
North Memorial	\$ 17.88	\$ 13.42	\$ 17.88	\$ 13.42
St. Francis	\$ 21.50	\$ 12.27	\$ 21.50	\$ 12.27
St. John's	\$ 21.70	\$ 13.51	\$ 21.46	\$ 14.34
St. Joseph's	\$ 17.00	\$ 11.13	\$ 17.00	\$ 12.06
United	\$ 19.56	\$ 13.88	\$ 19.64	\$ 15.24
Unity	\$ 17.00	\$ 11.82	\$ 17.00	\$ 11.82
West Health	\$ 19.50	\$ 17.39	\$ 19.50	\$ 17.39
Woodwinds	\$ 23.50	\$ 12.68	\$ 23.50	\$ 13.63
TOTAL ON CAMPUS	\$ 18.77	\$ 13.37	\$ 18.42	\$ 13.81
	AVG. RATE	TOTAL OE & T*	AVG. RATE	TOTAL OE & T*
OFF CAMPUS	SECOND HALF 2007		FIRST HALF 2008	
Northeast	\$ 18.07	\$ 9.73	\$ 17.96	\$ 10.68
Northwest	\$ 13.73	\$ 11.01	\$ 14.28	\$ 11.08
Southeast	\$ 17.18	\$ 9.33	\$ 17.73	\$ 9.67
Southwest	\$ 17.47	\$ 12.21	\$ 18.29	\$ 12.71
TOTAL OFF CAMPUS	\$ 16.79	\$ 10.51	\$ 17.15	\$ 11.02
	AVG. RATE	TOTAL OE & T*	AVG. RATE	TOTAL OE & T*
TOTAL MARKET	\$ 17.80	\$ 12.01	\$ 17.81	\$ 12.48

Source: NorthMarq

*OE & T: Operating Expenses and Taxes

SNAPSHOT



- Vacancies crept up; absorption dropped
- Tenants—unsure of the economy and its impact on their business—lack confidence and are in wait-and-see mode
- Increasing fuel costs spur developers to look at redeveloping inner-core sites near public transit, rail lines, employee base; second- and third-generation buildings seeing reuse for same reason

INDUSTRIAL CONSTRUCTION COST INDEX

Per Sq. Ft. January - July 2008



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Growth Slows in Industrial Markets as Companies Wait for “Better Days”

The Twin Cities industrial market is feeling the effects of the unstable economy, resulting in weak absorption, increasing vacancies, few user-building sales and lackluster speculative development.

Absorption was 415,316 sq. ft. in the past 12 months, compared with 1.7 million square feet in 2007 and 2.2 million square feet in 2006. Vacancy edged upward to 12.4%—the highest since 2006. The Northwest submarket boasted the lowest vacancy at 9.4%, followed by the Southwest with 12.1%, the Northeast at 13.7% and the Southeast at 15.1%.

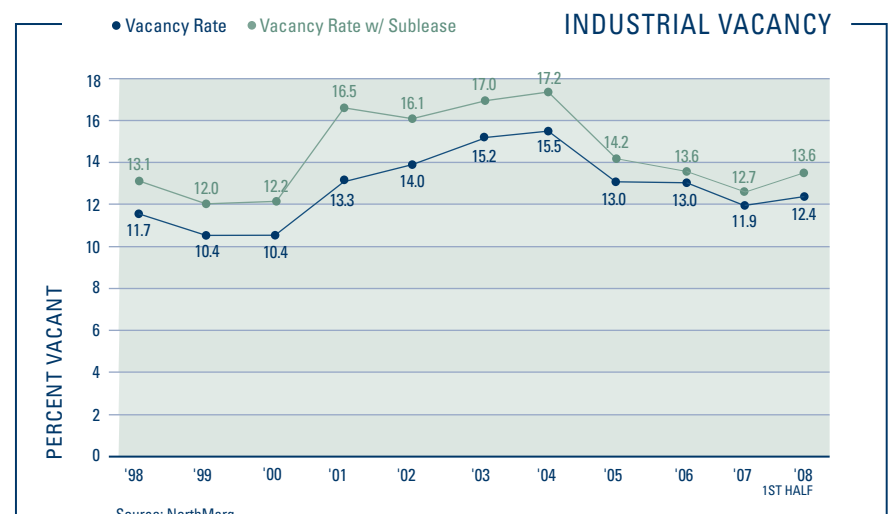
BULK LEADS ABSORPTION

Bulk warehouse performed best with nearly 1.1 million square feet of absorption—led by the Northeast—and vacancy of 10.4%. Showroom fared

well with 202,770 sq. ft. of absorption and 14.6% vacancy. The Northwest’s showroom market is tight at 11% and is on pace for 200,000 sq. ft. of absorption—the most since 1999. Office warehouse reported negative 735,758 sq. ft. of absorption and 14.6% vacancy. However, pockets are tight for functional, 24-foot clear space, including Shakopee, which could see speculative development for the first time since 2000-01.

USERS PROCEEDING CAUTIOUSLY

Tenants—uncertain of the economy and its impact on their business—lack confidence and are in wait-and-see mode when it comes to new space. Many are making due with space they have and renewing rather than relocating.



SPECULATIVE DEVELOPMENT SLOWED

Most speculative development is on hold, waiting to see how the market shakes out. Only 379,300 sq. ft. is under construction. Build-to-suit activity—less risky than spec—is relatively strong. Users wanting new, functional space and willing to pay new construction rates are choosing build-to-suits. Sportech and King Solutions in the Northwest and Cameron's Coffee and Snap Fitness in the Southwest are examples. Because there are few good, large blocks of space available, there's less sticker shock for users seeking newer, efficient space.

OUTER-RING SUBURBS HIT HARDEST

Due to rising transportation costs, some users view buildings in outer-ring suburbs as less desirable. Landlords with properties further out are struggling with vacancies and getting aggressive on deals, including concessions. One example is Powder Coating's 12 months of free rent when the company took space in Rogers.

Increased fuel costs also are spurring more developers to consider rede-

veloping inner-core sites if they can purchase buildings at a reasonable enough price for the project to make economic sense. Asking prices for industrial properties are dropping—due to tougher financing and lack of activity—but they need to drop further to be considered a redevelopment opportunity.

MANUFACTURING DECLINE IMPACTS INDUSTRIAL

Minnesota's manufacturing sector lost 1,600 jobs in April, according to DEED.¹ Approximately 55,000 manufacturing jobs disappeared since 2000. Some examples of consolidation in manufacturing include Cuno, Hi-Lex and Tempco Manufacturing, all in the Southeast submarket. DG Inventive and All-Pac vacated space in the Northeast.

RATES HOLDING STEADY

Rates on quality product were pushed by higher new construction rates during the past two years—on average 5%—and holding steady. One significant deal was Insignia Systems' lease at Park West Business Center. Opus is quoting \$12 for office space and \$6 for warehouse—a new high watermark for 24-foot clear—and achieved \$11.50.



ON THE HORIZON

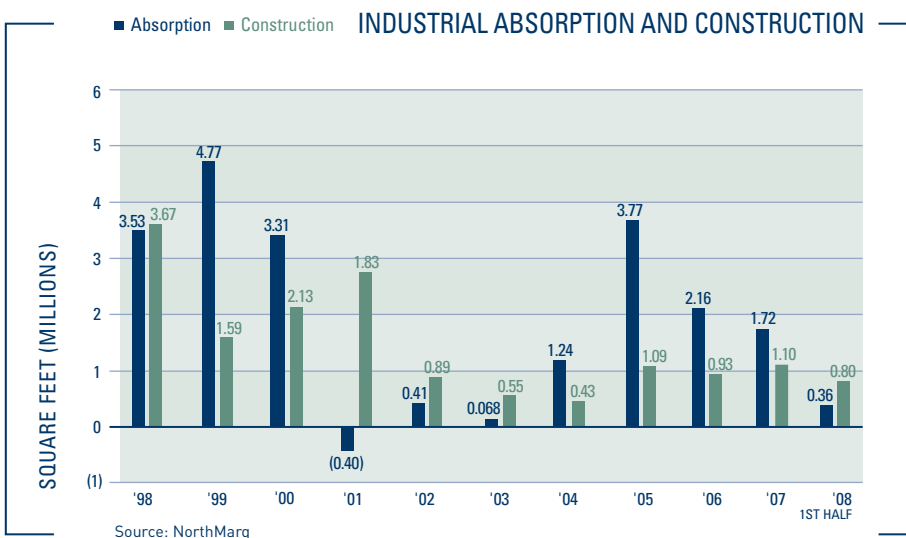
Absorption will be moderate during the next six months at 850,000-950,000 sq. ft.

Most speculative projects will be on hold or driven by unique submarket conditions. These developments will slowly return during the next 12-24 months due to the lack of larger blocks of functional space. Build-to-suit activity should continue throughout this timeframe. In Shakopee, there will probably be a 24-foot-clear bulk building developed.

Watch for redevelopment activity as developers look at inner-ring locations to mitigate high transportation costs. However, challenges exist, including high redevelopment costs and cities being more particular about what uses they allow.

Rates should hold steady. They were pushed closer to \$10 and \$5 for newer, efficient product due to new construction costs and should slowly increase as more new product gets delivered.

Tenants will continue looking for shorter-term renewals until the economy rebounds and they feel more confident. ■



INDUSTRIAL PROJECTS UNDER CONSTRUCTION

NAME	DEVELOPER	LOCATION	SQ. FT.	COMPLETION	NET RATE
NORTHEAST					
New Brighton Commons	Ryan Companies	Old Hwy 8 & 1st Street, New Brighton	54,300	3rd Qtr., 2008	\$12.00/\$6.00
NORTHWEST					
Rogers Corporate Center II	Cobalt Partners	Diamond Lake Rd. & Brockton Ave., Rogers	60,000	4th Qtr., 2008	NA
2200 Commerce Building	AMB	Commerce Blvd / George Weber, Rogers	150,000	2nd Qtr., 2008	\$9.50/\$4.75
SOUTHWEST					
Bloomington Industrial	Continental Property	94th & James, Bloomington	65,000	4th Qtr., 2008	NA
IDI	Marc Undestad	8301 Audobon Rd., Chanhassen	50,000	4th Qtr., 2008	NA
TOTAL INDUSTRIAL UNDER CONSTRUCTION			379,300		

Source: NorthMarq

INDUSTRIAL VACANCY AND ABSORPTION

	SUBMARKET	TOTAL # OF BUILDINGS	NRA	VACANT SPACE	PERCENT VACANT	PERCENT VACANT W/ SUBLEASE	2ND HALF 2007 ABSORPTION	1ST HALF 2008 ABSORPTION	LAST 12 MONTHS ABSORPTION
NORTHEAST	Bulk Warehouse	50	11,846,234	1,415,348	11.9%	12.1%	334,014	549,367	883,381
	Office Showroom	72	4,662,974	756,155	16.2%	16.8%	(111,667)	49,070	(62,597)
	Office Warehouse	245	17,456,548	2,472,149	14.2%	15.3%	75,168	(385,129)	(309,961)
	TOTAL	367	33,965,756	4,643,652	13.7%	14.4%	297,515	213,308	510,823
NORTHWEST	Bulk Warehouse	84	11,955,438	973,686	8.1%	9.2%	(141,913)	336,029	194,116
	Office Showroom	79	5,164,274	565,860	11.0%	12.2%	168,211	88,715	256,926
	Office Warehouse	136	9,301,654	957,254	10.3%	13.2%	(101,525)	(88,255)	(189,780)
	TOTAL	299	26,421,366	2,496,800	9.4%	11.2%	(75,227)	336,489	261,262
SOUTHEAST	Bulk Warehouse	35	5,592,990	833,453	14.9%	14.9%	(7,030)	89,569	82,539
	Office Showroom	52	3,147,388	508,617	16.2%	17.1%	(137,582)	138,036	454
	Office Warehouse	118	8,017,221	1,189,269	14.8%	17.3%	(88,221)	(246,193)	(334,414)
	TOTAL	205	16,757,599	2,531,339	15.1%	16.4%	(232,883)	(18,588)	(251,421)
SOUTHWEST	Bulk Warehouse	27	4,692,510	327,117	7.0%	7.0%	4,294	(77,525)	(73,231)
	Office Showroom	100	6,971,554	1,080,535	15.5%	17.5%	(16,354)	(73,051)	(89,405)
	Office Warehouse	165	12,081,893	1,472,419	12.2%	12.9%	73,469	(16,181)	57,288
	TOTAL	292	23,745,957	2,880,071	12.1%	13.1%	61,409	(166,757)	(105,348)
TOTAL MARKET	Bulk Warehouse	196	34,087,172	3,549,604	10.4%	10.8%	189,365	897,440	1,086,805
	Office Showroom	303	19,946,190	2,911,167	14.6%	15.9%	(97,392)	202,770	105,378
	Office Warehouse	664	46,857,316	6,091,091	13.0%	14.6%	(41,109)	(735,758)	(776,867)
	TOTAL	1,163	100,890,678	12,551,862	12.4%	13.6%	50,864	364,452	415,316

Source: NorthMarq

SNAPSHOT



- In-fill industrial land finding takers at higher prices
- More stress for stranded residential land owners
- Buy-and-hold opportunities abound

Demand for Industrial Space Within Metro's Core Sparks Speculative Development

Residential Land Prices Continue Sharp Decline in Some Areas

Twin Cities industrial land prices trended higher during the first half of 2008, fueled by demand for more quality development sites near the metropolitan core area (the Interstate 494/Interstate 694 loop).

Developers are still pursuing speculative industrial projects, especially on premium infill sites near the I-494/694 loop. Space users are accepting the higher lease rates required to justify such development as the price to be paid for locating near the loop, which has a limited supply of readily developable industrial land.

MARKET ACCEPTING HIGHER INDUSTRIAL RENTAL RATES

Asking rental rates are as high as \$12/\$6 for new office showroom and tech/flex space near the loop (\$10.25/\$5.25 for office warehouse), significantly above the market average of \$10/\$5. If developers can find sites, more such development is on the way on the heels of successful projects such as developer OPUS Northwest LLC's first-phase Park West Business Center in Brooklyn Park.

CLOSER IS BETTER, INDUSTRIAL USERS SAY

Industrial space users are starved for development in or near the

I-494/694 loop. High-demand infill industrial sites are what the market wants right now, and the land prices are rising accordingly. OPUS paid more than \$5 per square foot for its speculative industrial development in Brooklyn Park, for example. More commonly, industrial land has traded in the neighborhood of \$2.50 per square foot to \$4 per square foot in the metro area, but as OPUS has demonstrated, the market may now be more willing to accept the higher lease rates that new development in premium locations requires.

LENDERS TAKING STEPS TO MARKET FORECLOSED LAND

Lender foreclosures are also creating buyer opportunities for industrial land in the Twin Cities. One such opportunity is a 38-acre industrial site in Maple Grove, the last large pure industrial site remaining in the city. Originally intended as a 500,000-sq.-ft. industrial development, the site is in such a premier location that it will likely be sold again in the second half of the year.

Prices for speculative land continued to decline, particularly in third-ring suburban municipalities such as Lakeville, Farmington and Otsego, where the inventory of investor-owned speculative land is high.

A number of land owners have had their properties foreclosed on by lenders, a trend that seems to be gathering momentum.

RETAIL ANCHORS WANTED FOR NEW DEVELOPMENT

While there is still some activity in grocery-anchored retail development (Cub Foods is building a new concept grocery store in Eagan with 45,000 sq. ft.—its average store is 68,000 sq. ft.) interest in unanchored, speculative retail development has fallen dramatically.

Retail land pricing is weakening, although not quite as dramatically as residential land. A few properties have traded hands recently at prices 30% lower than what they commanded two to three years ago.

SENIOR SECTOR SIZZLING

Demand for new senior housing developments intensified, however, as many cities continued to welcome the addition of senior cooperative centers and 55+ transitional housing projects. Seniors, particularly those living in inner-ring suburbs, are often in older homes that no longer accommodate their needs, but they don't want to leave their communities. Senior cooperatives fill the need to remain within the same community and also provide one-level living with less maintenance.

NEW HIGHWAY 212 CORRIDOR BECKONS DEVELOPERS

High on the new development radar screen is the future of the new Highway 212 corridor, an 11.8-mile stretch of four-lane freeway that's just been completed from Eden Prairie to

Carver. It heralds a promising new vista for retail, residential and office/industrial development in the growing Southwest submarket. Commuter times will be shortened by as much as 15 minutes between the Interstate 494 and Eden Prairie Center Drive interchange in Eden Prairie and Highway 212 and County Road 147 in Carver. Local industry observers believe the area will also serve as a barometer for new retail development in the Twin Cities.

ON THE HORIZON

Watch for more pressure on municipalities to allow developers to tap their land bases for more industrial development to meet space user needs near the I-494/694 loop.

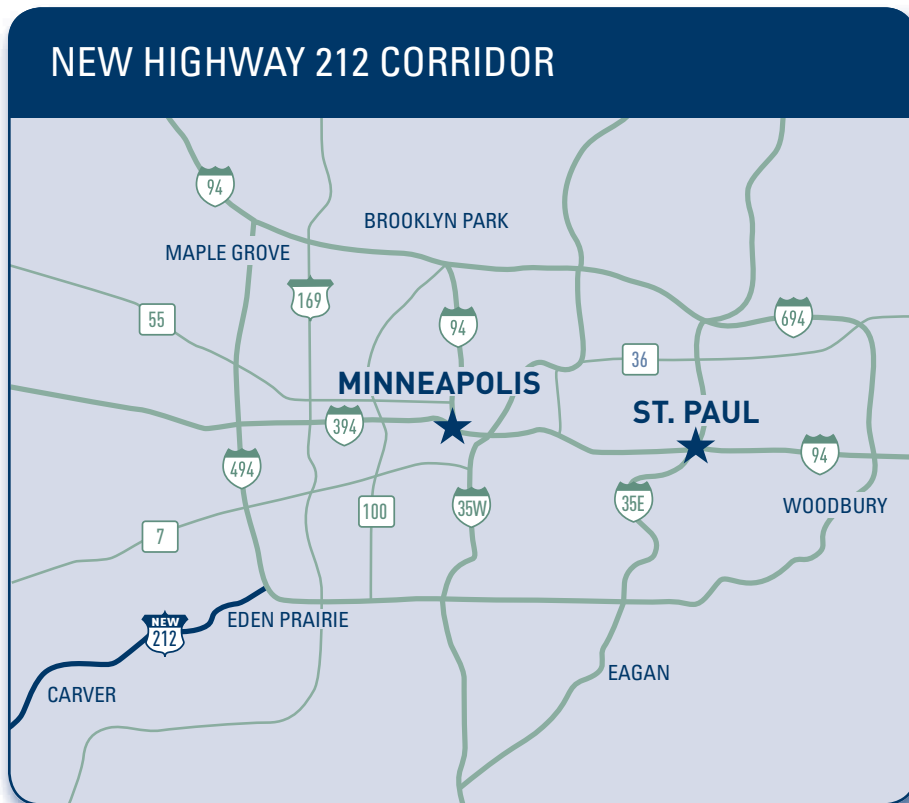
Financial stress will continue to plague under-capitalized landowners, leading to more highly motivated sellers and foreclosures, especially for residential and retail land. More opportunities will unfold for land buyers with available capital and a willingness to buy and hold until the market turns around.

Expectations are that the housing market will bottom out in 2009 in the Twin Cities and may begin to recover in late 2010 or 2011.

Senior housing development may be near an overall peak in the Twin Cities, although there is still a need for such development on a city-by-city basis. ■

MORE ONLINE:

- Residential Growth Remains Stalled
- Landowners Face Reverse Sticker Shock
- Bumper Prices for Corn Belt Landowners
- State Projects Strong Suburban Labor
- Force Population Growth



SNAPSHOT

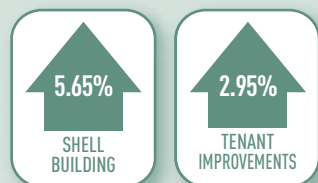
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- The housing mortgage crisis and decreasing consumer spending are slowing retail leasing, development
- Small-shop space, particularly in outer-ring suburbs, is struggling; landlords are offering concessions
- With more options, retailers are looking for “cream-of-the-crop” locations

RETAIL CONSTRUCTION COST INDEX

Per Sq. Ft. January - July 2008



Retail Struggles With Falling Consumer Confidence, Residential Mortgage Crisis

The Twin Cities retail market was red-hot for years. Retailers followed fast-paced residential development, resulting in record-setting construction and absorption. However, the housing and mortgage crisis, rising fuel and food costs, and weakened consumer spending are taking their toll. Vacancy is 7.6%, up from 6.9% at year end.

Absorption plummeted to negative 317,521 sq. ft. from positive 1.3 million square feet. Primary reasons included weak leasing in small-shop space, more discerning retailers, store closings and a lack of new concepts coming to the market. (Only 224,800 sq. ft. opened so far this year, but 1.84 million square feet is under construction.) Net rental rates dropped to \$27.78 from \$28.39.

SMALL-SHOP SPACE STRUGGLES

Small-shop activity is particularly quiet in outer-ring suburbs because retail development was based on continuing residential development in markets like Chanhassen, Chaska, Woodbury and Lakeville. Struggling to fill space around anchors, landlords are offering concessions, including free rent and increased tenant improvement allowances. NorthMarq's “small-shop retail survey” tracked 341 community and neighborhood centers and reported 16.17% vacancy in small-shop space.

HOUSING WOES IMPACT HOME RETAILERS

The housing downturn has hit home-improvement and home-furnishings retailers the hardest. Linens ‘n Things is closing up to 200 stores across the nation, including Woodbury and Rochester. Home Depot closed 15 stores nationally, including Cottage Grove locally. Ethan Allen closed its Eagan and Minnetonka stores. Cost Plus is shuttering 18 stores nationally, including one in Minnesota. Wickes closed all five metro stores.

“HOURGLASS EFFECT”

Deep discounters and upscale retailers appear to be performing better than retailers catering to the middle class. Dubbed the “hourglass effect,” economists explain that luxury retail tends to feel less pressure from consumer spending slowdowns, and discounters benefit as middle-class consumers “trade down” to retailers with lower prices.

RESTAURANTS FEEL IMPACT

Restaurants are also affected by declining consumer spending. Baker's Square closed seven metro locations. Don Pablo's closed five. Starbucks announced 600 store closings nationwide. Escalating gas and housing prices are decreasing consumers' disposable income, and therefore, cutting into restaurant revenues. Restaurants are raising prices, cutting

portion sizes and/or substituting less expensive ingredients to help weather the storm. Also, Minnesota does not allow a tip credit to offset wages paid to servers, making it difficult to romance new restaurants to Minnesota.

COMMUNITY CENTERS

Community centers, where big-box and junior-box retailers slowed expansions, saw vacancy jump to 6.1% from 5.5%. Absorption dropped to negative 122,514 sq. ft.—the first negative absorption since 1998. Big boxes continue to look for top-notch sites but are more selective. SuperTarget, for example, opened in Apple Valley and will open in fall 2008 in Otsego. A new Target format will open in Waconia later this year.

Since big-box retailers have slowed expansion, developers are working with non-traditional tenants to backfill space. Some of these non-traditional tenants include health clubs like L.A. Fitness and family entertainment concepts like Dave & Buster's, Brunswick Fun Zone and Amazing Jake's.

NEIGHBORHOOD CENTERS

Typically anchored by a grocer or drugstore, neighborhood centers reported 9.5% vacancy, up from 8.6%. Grocers, however, are active. Two Cub Foods stores are underway (Eagan and St. Paul). Trader Joe's is underway in St. Paul, as is Kowalski's in Eagan. Aldi continues to look for additional sites. Roundy's is investing in its Rainbow Foods stores to better position itself. Roundy's is opening a new concept at West End—a higher-end/fresh concept. Nash Finch is opening a new concept just across the border in Hudson, Wisconsin.

SPECIALTY CENTERS

Specialty centers reported 7.2% vacancy, up from 6.2%. Many spe-

cialty retail centers report little or no vacancy, including Grand Avenue, 50th & France and the Galleria. However, Calhoun Square reported 45% vacancy and is beginning a long-awaited redevelopment.

Lifestyle centers continue to be developed. The Shops at West End is underway in St. Louis Park. Lifestyle centers will continue to work to identify themselves to consumers and try to find the right balance between fashion, retail and entertainment.

REGIONAL CENTERS

Regional malls reported negative 58,893 sq. ft. of absorption, pushing up vacancy to 6.3% from 5.8%. Southdale and Ridgedale are working on renovation plans. Southdale announced plans that include a lifestyle center component and new department store, rumored to be Neiman Marcus. Ridgedale announced a letter of intent with Nordstrom, and Trader Joe's committed to a freestanding store. At Mall of America, Best Buy, American Girl and Cantina No. 1 Corona Mexican Restaurant are under construction.

MINNEAPOLIS CBD

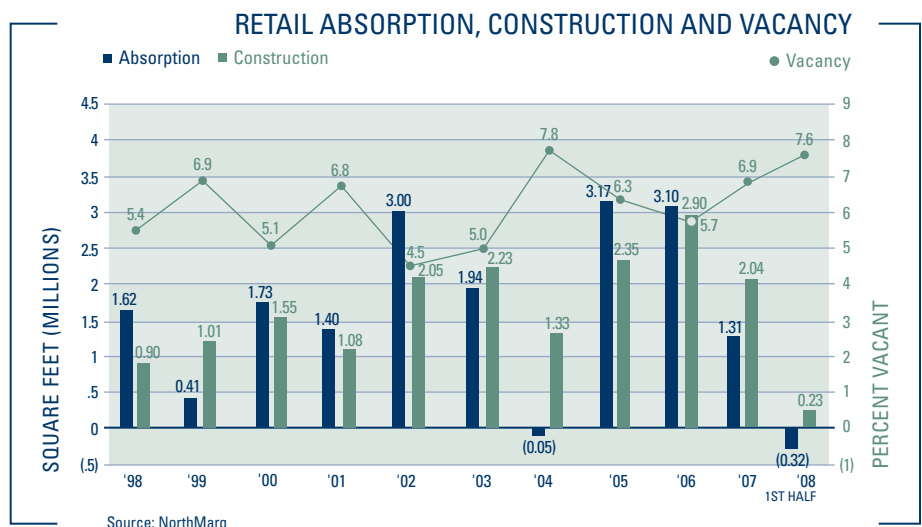
Downtown Minneapolis reported 19.1% vacancy. The condominium population helped boost retail development, but it has slowed now that the residential growth has mostly stopped. However, there are still some retailers looking at downtown. For example, CVS opened at 12th Street and Hennepin Avenue, and there's talk of a Lund's across the street.

ON THE HORIZON

Vacancy and rents will stay flat through 2008. Improvement will follow a recovering economy. Demand for retail space will likely remain slow for the next 12 months.

Retailers will continue to be more selective and deals will take longer. Landlords will continue offering concessions to fill space.

With slow big-box expansion, landlords will continue negotiating with non-traditional tenants like fitness and entertainment. With high gas prices, more consumers will likely shop closer to home, benefiting neighborhood centers. ■



RETAIL VACANCY AND ABSORPTION

SUBMARKET	TOTAL # OF BUILDINGS	NRA	VACANT SPACE	PERCENT VACANT	PERCENT VACANT W/ SUBLEASE	2ND HALF 2007 ABSORPTION	1ST HALF 2008 ABSORPTION	LAST 12 MONTHS ABSORPTION
Community	114	28,884,624	1,835,775	6.1%	7.3%	581,230	(122,514)	458,716
Minneapolis CBD	17	1,574,001	300,406	19.1%	20.6%	4,776	4,194	8,970
Neighborhood	297	19,348,026	1,835,157	9.5%	11.0%	(132,138)	(126,484)	(258,622)
Outlet Mall	3	788,440	29,250	3.7%	3.7%	(7,000)	(10,250)	(17,250)
Regional	9	11,808,064	742,694	6.3%	6.3%	115,000	(58,983)	56,017
Specialty	14	1,629,567	117,303	7.2%	7.2%	(3,397)	(16,450)	(19,847)
St. Paul CBD	9	341,810	81,690	23.9%	23.9%	(11,600)	12,966	1,366
TOTAL MARKET	463	65,374,532	4,942,275	7.6%	8.6%	546,871	(317,521)	229,350

Source: NorthMarq

RETAIL PROJECTS UNDER CONSTRUCTION

NAME	DEVELOPER	LOCATION	SQ. FT.	COMPLETION	TENANTS
COMMUNITY					
Chanhassen Development	Kraus-Anderson	Chanhassen	60,000	2nd Qtr., 2009	Kwik Trip
Hazeltine Plaza	Aurora Investments	Chaska	175,000	3rd Qtr., 2008	Kohl's w/ Jr. Boxes & Small Shop
Maplewood Development	NA	Maplewood	200,000	4th Qtr., 2008	Carmax, Costco
North Branch Retail Center	Solomon Real Estate Group	North Branch	150,000	3rd Qtr., 2008	County Market, Shopko
Great River Centre	Ryan Companies	Otsego	200,000	4th Qtr., 2008	Super Target
Interlachen	Avalon Group	Waconia	175,000	4th Qtr., 2008	Super Target
TOTAL COMMUNITY UNDER CONSTRUCTION			960,000		
NEIGHBORHOOD					
Diffley Marketplace	Reliance	Eagan	72,000	4th Qtr., 2008	Cub Foods
Village of Mendota Phase II	Ross Pfeffercorn	Mendota Heights	20,000	4th Qtr., 2008	Snyders
New Brighton Village	Kraus-Anderson	New Brighton	125,000	3rd Qtr., 2008	NA
Boardwalk Center (Former Ford Site)	PBK	St. Louis Park	50,000	1st Qtr., 2009	LA Fitness
Cub Foods	Oppidan	St. Paul	75,000	4th Qtr., 2008	Cub
Woodbury Marketplace Phase III	Hawkins Company	Woodbury	45,000	2nd Qtr., 2009	Staples
TOTAL NEIGHBORHOOD UNDER CONSTRUCTION			387,000		
SPECIALTY					
Windsor Plaza	Solomon Real Estate Group	Eden Prairie	60,000	2nd Qtr., 2009	NA
Centennial Shops	Cypress Equities	Edina	80,000	4th Qtr., 2008	West Elm, Container Store, Potbelly, Verizon
West End	Jeffrey Anderson/Duke	St. Louis Park	350,000	4th Qtr., 2009	Kerasotas, Roundy's Fresh
TOTAL SPECIALTY UNDER CONSTRUCTION			490,000		
TOTAL RETAIL UNDER CONSTRUCTION			1,837,000		

Source: NorthMarq

SNAPSHOT



- Vacancy hovers around a healthy 4%
- Average market rent increased 3.7% over one year ago
- Favorable market conditions are prompting developers to gear up; approximately 2,500 units are in various stages of development
- Uncertainty looms regarding how the post-condo period will settle and impact apartments

STRONGEST MARKETS

(Reporting vacancies below 2%)

Brooklyn Center
 Crystal
 Falcon Heights/Lauderdale
 Golden Valley
 Vadnais Heights
 Mounds View/Spring Lake Park
 U of M/Southeast Minneapolis
 Northeast Minneapolis

northmarqcompass.com

Apartment Vacancy Is Down, Rents Are Up, Developers are Ramping Up

The Twin Cities apartment market continued its impressive comeback, resulting in near-record low vacancy rates and continuing rent growth. Vacancy decreased to 3.9% from 4.2% at year end and a high of 7.6% in 2003.

Average market rent was \$908, up 3.7% over one year ago, and concessions continued disappearing. The tumultuous housing market is resulting in more people renting. Studios and one-bedroom units performed best, reporting rent growth of 5% and 3.8%, respectively.

AFTER LONG DROUGHT, DEVELOPMENT RETURNS

Developers are seriously pursuing apartment projects, and the metro is at the beginning stages of a development cycle. Approximately 2,500 units are in various stages of development. Many developers are appealing to the higher-income, renter-by-choice market. Projects near light rail transit, the new Twins ballpark, the Guthrie Theater and the Lake and Hennepin area account for the majority of activity.

Approximately 860 units should be delivered this year, and it is anticipated that the metro will absorb 1,700-2,000 units in 2008. Vacancy should drop further because absorption is outpacing new supply. Developers are ramping up for future projects; it's expected that 1,300-1,600 units will be delivered in 2009 and another 4,000 units are being considered for 2010-2011.

ON THE HORIZON

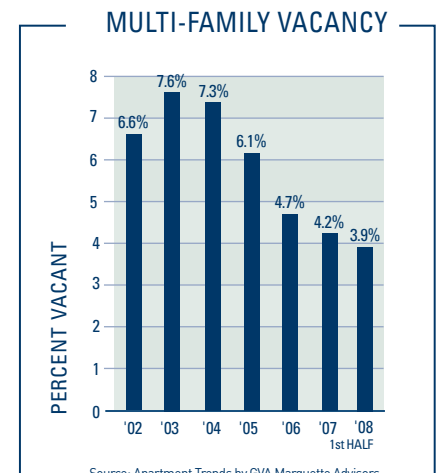
Vacancy should remain stable, and rent growth will continue, although slowly. Development will pick up, especially as developers convert former for-sale housing sites to rental.

There is potential for an increase in the supply side, but questions remain whether the overall economy will have an impact and whether the mortgage fallout is over. The tough housing market could lead to continued declining vacancies and increased demand for new apartments.

Lease-up time and increased shadow space from condo, townhouse and single-family rentals may prevent some projects from starting. ■

MORE ONLINE

- *Tough Housing Market, Job Growth Are Key to Recovery*
- *"Shadow Effect" Has Impact*
- *Projects Underway*



Source: Apartment Trends by GVA Marquette Advisors

SNAPSHOT

northmarqcompass.com

Buyers, Sellers at Loggerheads Over Pricing Gap

Following a national trend, buyers and sellers in the Twin Cities are playing a game of “you go first,” with neither side willing to make the first move. It makes for a slow market for commercial real estate investing. Real Capital Analytics reports that transaction volume nationwide is down 20% compared with 2007, marking the first time in five years that a decline in year-over-year comparative sales volume has emerged. In the Twin Cities, the pace of 2008 transaction activity is comparable to 2007, but the overall dollar volume is down 34% in a year-to-year comparison.

Institutional investors are seeking security in quality, selectively investing in only the most stabilized assets such as A+ office buildings in the Minneapolis CBD, premier grocery-anchored retail centers, Class A multi-family properties and well-

leased, low-office-finish industrial properties.

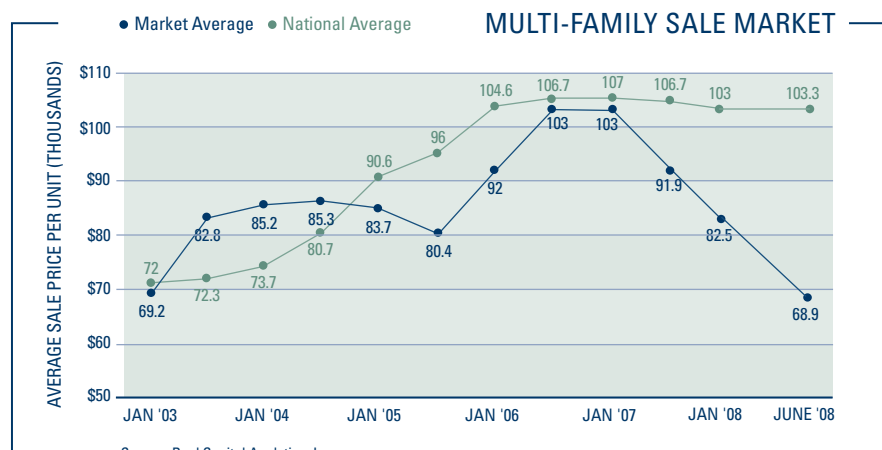
MULTI-FAMILY RULES INVESTMENT ROOST

There are exceptions to the trend in transaction volume. Multi-family properties of all types and sizes remain in favor as investors foresee continued improvement in market fundamentals. During the first half of 2008, agency financing flowed into the market from entities like Freddie Mac and Fannie Mae. However, this picture appears more uncertain in the second half of the year.

INCREASED COST OF CAPITAL REDUCES LEVERAGED BUYER PRICING

Compounding the challenges of higher interest rates, reduced loan-to-value ratios and amortization terms, the cost of equity capital has

- Buyers, sellers squared off over current market pricing
- Multi-family market rolling along on the back of strong market fundamentals
- Leveraged buyers squeezed by increased cost of debt and equity
- Market needs a clear signal on pricing



increased fairly dramatically, causing leveraged buyers to significantly increase their capitalization rates. It's more difficult for them to compete against institutional buyers for premium quality properties. In effect, private equity buyers are becoming more heavily weighted to the value plays and/or lower-priced properties—buildings priced in the \$15 million and less range—that are outside the interest of institutional players.

Sellers are slow to test the waters. But they are quick to pull back when the water proves chillier than expected, as is often the case today.

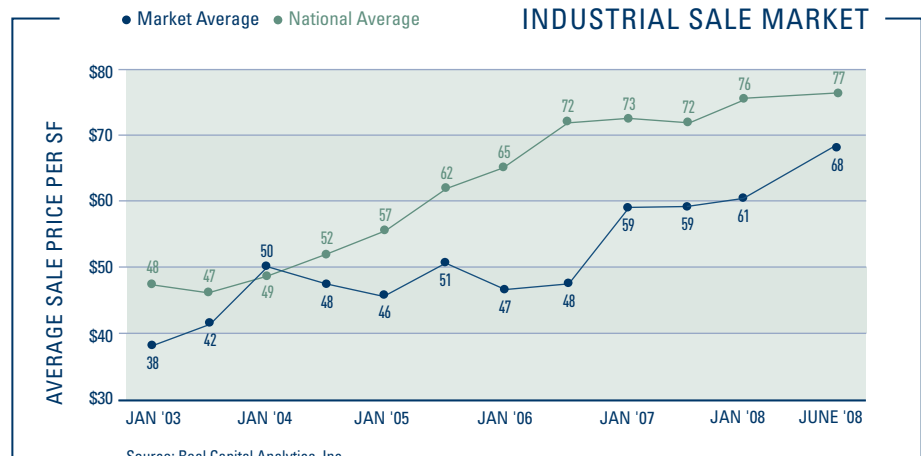
PRICING PICTURE IS MURKY

With so few transactions taking place, it's difficult for investors to effectively gauge pricing for office, industrial and retail properties in general.

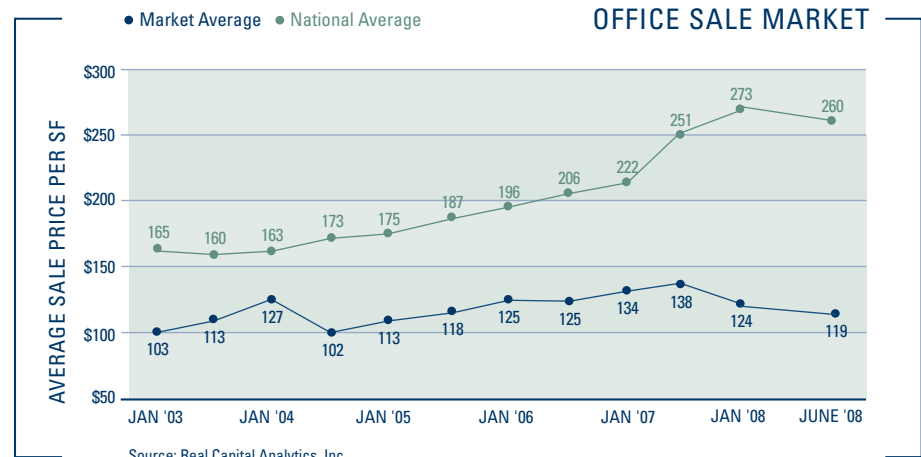
What has changed is that sellers are experiencing a bit of reverse sticker shock. Private equity buyers have increased their yields by 5-10%, reflecting the higher cost of debt and equity. At the same time, sellers are reluctant to meet the current market pricing, creating a wide valuation gap in the market.

OFFICE MARKET TRANSACTIONS

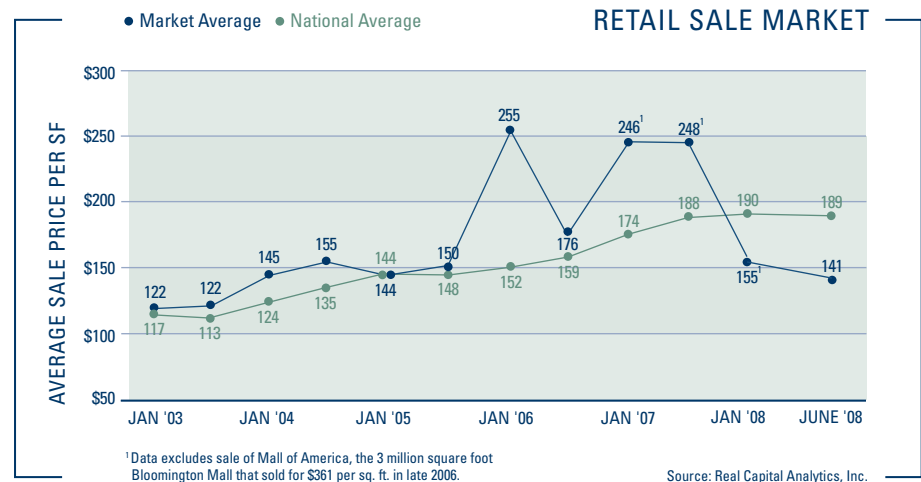
Two significant first-half transactions occurred in the Office market. Ted Glasrud Associates purchased the 84,000-sq.-ft. Rosedale Towers in Roseville from Meridian Management Inc., and Dougherty Commercial Properties purchased the 57,191-sq.-ft. City West Financial Center in Eden Prairie and the 51,144-sq.-ft. 55 West Financial Center in Plymouth in a joint venture with JRK Birchmont Advisors. These buildings were part



Source: Real Capital Analytics, Inc.



Source: Real Capital Analytics, Inc.



¹ Data excludes sale of Mall of America, the 3 million square foot Bloomington Mall that sold for \$361 per sq. ft. in late 2006.

Source: Real Capital Analytics, Inc.

of a five-building portfolio sold by Principal Financial Group.

INDUSTRIAL MARKET TRANSACTIONS

A significant first-half transaction was the sale of the 107,000-sq.-ft. Eagle Creek East property in Savage, purchased by TRT Eagle Creek East LLC of Colorado from Dividend Capital Total Realty Trust, a joint venture with JP Morgan Chase Co.

Also in the first half, Dougherty Commercial Properties purchased

three metro-area industrial properties as part of a five-building portfolio sold by Principal Financial Group. The industrial properties included were the 166,322-sq.-ft. Eden Woods Business Center in Eden Prairie (92% leased), the 119,242-sq.-ft. Cedar Business Center in Bloomington (93% leased), and the 54,355-sq.-ft. Olympia Business Center (75% leased), also in Bloomington.

RETAIL MARKET TRANSACTIONS

Just a handful of multi-tenant retail properties changed hands in the first

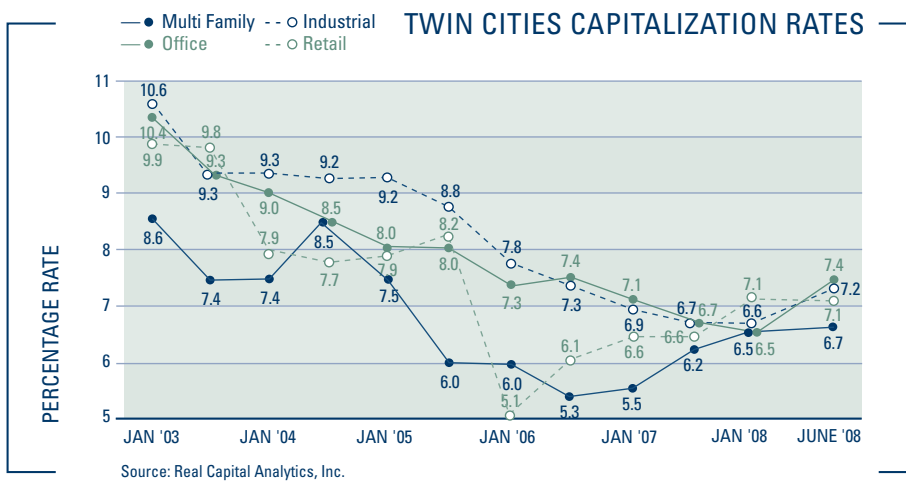
half; most were deals in progress from 2007. Key trades included the sale of the 70,000-sq.-ft., Festival Foods-anchored Victor Marketplace in Hugo and the 87,000-sq.-ft., Cub Foods-anchored Savage Town Square property in Savage.

ON THE HORIZON

2008 has already proven to be a watershed year for the capital markets, as evidenced by the slowdown in transaction volume. The effect has been chilling on the commercial real estate investment market, as seen so far this year, and will likely continue to tamp down activity in the second half of the year.

Buyers and sellers are too far apart on pricing to make for an active market; both sides need to find a way to give some ground in order to make the wheels turn faster.

Clearly there is a large amount of investment capital sitting on the sidelines, waiting for the dust to settle. Many institutional investors have not filled their allocation of investment dollars for commercial real estate this year. The money is there, but the willingness to invest depends on buyers and sellers drawing closer on their understanding of building valuations in this new, more conservative era of risk underwriting. ■



ABOUT NORTHMARQ: NorthMarq offers a full range of commercial real estate solutions. NorthMarq Real Estate Services works nationally with mid-sized corporate users to manage their real estate needs through its corporate solutions division and provides brokerage, property management and healthcare real estate services to investors and space users throughout the Upper Midwest. The NorthMarq Capital group offers commercial real estate investment banking, investment sales, real estate debt and equity financing, and commercial loan servicing in 29 offices coast-to-coast.

REGISTER FOR OUR COMPLETE ONLINE REPORT: Visit www.northmarqcompass.com. Additional charts and complete submarket reports are available online. In addition to our complete research report in January and July, we also provide members of our mailing list a quick update and discussion of market trends after the first and third quarter of each year.

Definitions

EXECUTIVE SUMMARY

Absorption: The difference in occupied space from one time frame to another.

Vacancy: The percent of space that is not leased.

OFFICE

Class A: Generally 200,000 sq. ft. or larger, constructed after 1980, offering a host of business/support amenities and providing a strong and identifiable location and/or access. Class A properties in either of the CBDs are skyway-connected. In the smaller submarkets in our report, Class A buildings may be defined as such simply because they are the highest-quality buildings in the area in terms of finish, location and amenities, although they may not fit the standard definition of Class A as far as square footage and age, for example.

Class B: Older Class B buildings are sometimes renovated and in a good location. Newer Class B buildings are smaller in size and in a non-prime location. May include skyway linkage if located in a CBD.

Class C: Older, unrenovated building of any size in average to poor condition. May include skyway linkage.

MEDICAL OFFICE

Medical: A property where 50% or more of the tenants are medical-oriented in a multi-tenant building greater than 20,000 sq. ft. Generally marketed to medical tenants and have the electrical and plumbing infrastructure capable of accommodating medical tenants.

On Campus: Connected by a tunnel or skyway to a hospital or major ambulatory surgery center.

Off Campus: Not connected or immediately adjacent to a hospital or major ambulatory surgery center.

INDUSTRIAL

Bulk Warehouse: These facilities have 21' or more clear height ceilings and are generally located near major transportation corridors.

Office Warehouse: Facilities with 16'-20' clear height ceilings.

Office Showroom: Buildings typically offer smaller bay sizes and heavier than normal finishes and landscaping. Typical clear height ceilings are less than 16'.

RETAIL

Community Centers: These centers are greater than approximately 100,000 sq. ft. and have at least two anchor tenants, which may include a general merchandise store (as a major tenant) in addition to a supermarket or drug store. Limited small shop space is occupied by a mix of service-oriented tenants and soft-goods retailers. This classification also includes power centers, which are built around large format category killers such as electronic, home improvement and sporting goods stores.

Neighborhood Centers: Usually anchored by a grocery store and/or a drug store. This type of center fulfills the day-to-day needs of the surrounding neighborhood, is located at major street intersections and is approximately 30,000 to 100,000 sq. ft.

Regional Centers: A major shopping area generally with two or more anchor department stores and a variety of additional shops. These centers draw customers from a broad geographical area.

Specialty Centers: These centers are un-anchored and have a theme or specialty tenants with a different character than the other center types. These centers are not located in CBDs. These centers may be a part of a larger Community Center development.

Minneapolis or St. Paul CBDs: Centers located in the Central Business District (CBD) of Minneapolis or St. Paul. This includes space located on the skyway or street fronts. To properly reflect the status of these submarkets, some of these centers may be smaller than 20,000 sq. ft. due to the smaller size and scope of this market.

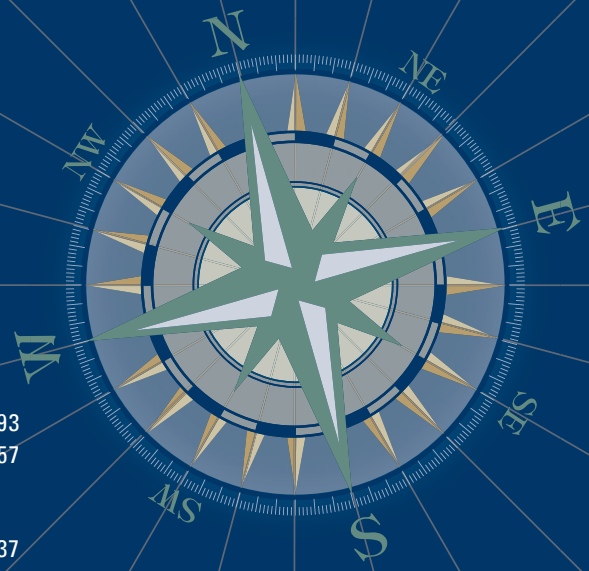
SPECIAL THANKS TO: Toby Madden at the Federal Reserve Bank of Minneapolis for contributing to the content of this report.

DISCLAIMER: This report was created by NorthMarq Real Estate Services and Capital Markets experts using Twin Cities commercial property data from the first six months of 2008. The data used for this report has been obtained from sources which we deem reliable. While every effort has been made to report accurate data, NorthMarq cannot guarantee the accuracy of this market report. Furthermore, we cannot assume responsibility for any omission of data which may occur. It is our intent to provide the best possible information regarding the office, industrial, land, retail, multi-family and investment markets while leaving the reader the responsibility of further verification before using this report for business and/or financial decisions.

This report includes information for multi-tenant office, industrial and retail projects greater than 20,000 sq. ft. and multi-family 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 volume.

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