CUSHMAN & WAKEFIELD

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COMPASS

Navigating the Minneapolis-St. Paul Commercial Real Estate Market

INVESTMENT & CAPITAL MARKETS

New Capital Continues to Enter Twin Cities in Search of Higher Yields

The current economic cycle is one for the record books. As of May, the U.S. economy had logged 107 straight months of growth, making it the second longest economic expansion in history. What that means for the Twin Cities is a steady flow of new capital coming into the market. Especially at this mature stage of the cycle, investors are searching for opportunities that can deliver higher yields than what they are finding in gateway markets and other secondaries that have experienced greater cap rate compression.

Investors across the board from private equity funds to institutions like the story of the Twin Cities market, featuring strong business expansion, low unemployment and job and population growth. Overall, real estate fundamentals are stable or improving across property types with positive absorption and rent growth.

The biggest challenge remains that there is more capital in the market than there are available properties to buy. Owners who have successfully executed on value-add strategies are bringing stabilized assets to the sale market to harvest gains, which is creating some buying opportunities in both single assets and portfolio deals. Value-add plays are still attractive, but those acquisitions are becoming harder to find. Competition, along with the ongoing quest for yield, is pushing buyers to broaden the scope of deals they are willing to consider in terms of location, property type and asset quality. However, there continues to be more capital seeking opportunities than there are properties for sale.

OFFICE CONTINUES TO WORK A BACKLOG OF 2017 DEALS

New for-sale listings have been slow to materialize in the first half following a surge of properties that came to market in Q3 and Q4 2017. However, buying opportunities are expected to pick up in the second half of the year.

Most of the deals trading are stabilized properties. That is not surprising given the fact that buyers have been focused on executing value-add strategies over the past few years and are now looking to capitalize on higher values.

Minneapolis CBD office properties are seeing the greatest demand, but a limited supply of for-sale assets is pushing investors to consider suburban acquisitions. Value-add deals are still highly sought after, but there are fewer and fewer such opportunities available.

TWIN CITIES INVESTMENT SALES — Source: Real Capital Analytics

PROPERTY TYPE	2017 SALES VOLUME	2018 SALES VOLUME	PSF/UNIT
	In Millions (Rolling 12 Month Total)		1ST HALF 2018
Multifamily	$1,357.56	$1,697.79	$147,867
Industrial	$785.21	$985.58	$65.00
Office	$1,297.90	$2,219.22	$190.00
Retail	$873.52	$558.74	$204.00
Hotels	$467.42	$297.19	$111.50
TOTAL	**$4,781.60**	**$5,758.50**	**$134.00 (off/ind/ret)**

FLEX PROPERTIES DOMINATE INDUSTRIAL SALES IN SUPPLY-CONSTRAINED MARKET

The biggest hurdle for industrial investors continues to be a supply-constrained market. Sales are highly competitive, with multiple bidders.

Multi-tenant bulk warehouse product remains in high demand with a new watermark for pricing being set in the first half. Flex/R&D properties have experienced a resurgence in interest and the product has been the most actively traded industrial property type in the first half of the year. Part of that is a supply story, as owners bring stabilized assets to market to capitalize on improved values. Flex/R&D is also benefitting from leasing momentum and rent growth.

As office rents rise, flex buildings are pulling more tenants away from Class C office buildings by offering a more affordable option along with the ability to provide open floorplans and creative/alternative office design.

DESPITE SLOW START, MULTIFAMILY IS POISED TO SURPASS $1B IN ANNUAL SALES

The $425 million in multifamily sales during the first half is down compared to 2017. However, velocity is expected to rally in the second half with total annual transactions likely to surpass $1 billion for the fifth consecutive year.

There continues to be significant dry powder in the market looking for investment opportunities across all classes. Class B and Class C suburban assets that fit value-add strategies remain the favorite, and value-add investors are casting a wider net to find those opportunities. Even 1960s-era properties in second- and third-ring suburbs are now considered viable value-add plays.

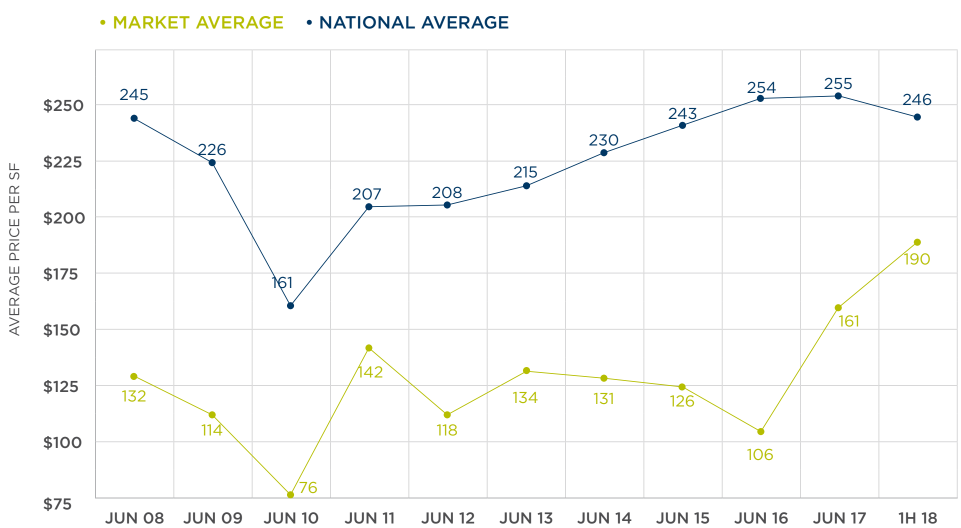
A number of Class A and stabilized new developments also hit the market, with $156 million in Class A properties that closed in the first half. Although the Twin Cities market is reporting one of the lowest vacancy rates in the country at 2.2% on stabilized assets, investors are keeping a close eye on new supply, with more than 5,500 units expected to be completed in 2018 and another 5,000-6,000 units in the pipeline for 2019.

$190 PSF
Office Avg
in 1H 2018

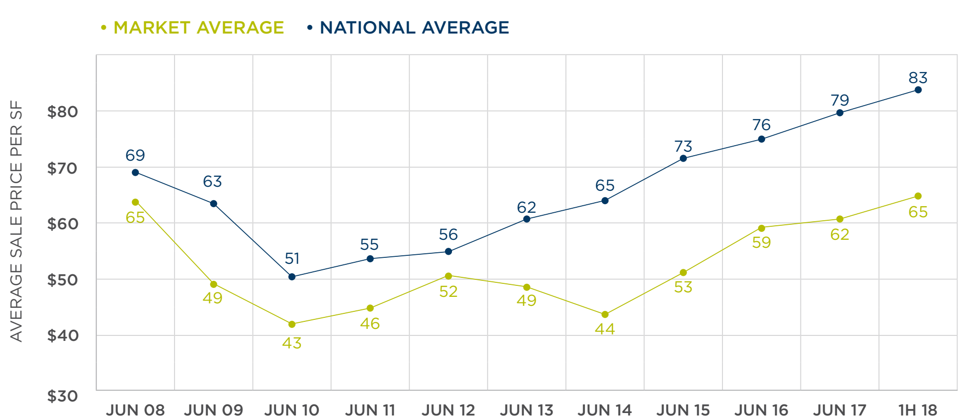
$65 PSF
Industrial Avg
in 1H 2018

$148 PSF
Multifamily Avg
in 1H 2018

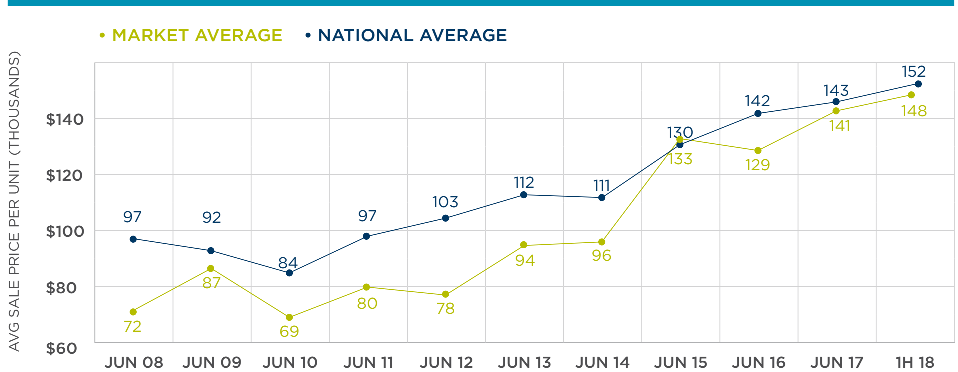
OFFICE SALE MARKET Source: Real Capital Analytics



INDUSTRIAL SALE MARKET Source: Real Capital Analytics



MULTIFAMILY SALE MARKET Source: Real Capital Analytics



LINGERING PRICE GAP SLOWS RETAIL SALES

Multi-tenant retail sales dropped significantly in the first half of the year, with $60 million in closed transactions as compared to $148 million during the same period in 2017. The decline is due to lingering effects of the pricing gap that surfaced last year with a sizable spread between buyer and seller expectations. The gap has largely sorted itself out as the market moved through a new pricing discovery phase.

Buyers are more cautious on potential risks, which has pushed cap rates higher in some categories, while strong demand for core retail assets has resulted in some additional cap rate compression for best-in-class properties. Despite national news of store closings, the Twin Cities retail market remains solid with retailers that are continuing to enter and expand in the local market.

Sales activity is expected to pick up in the second half of the year, with about $200 million in for-sale properties on the market at mid-year. Class B grocery-anchored centers in particular are likely to drive second half activity.

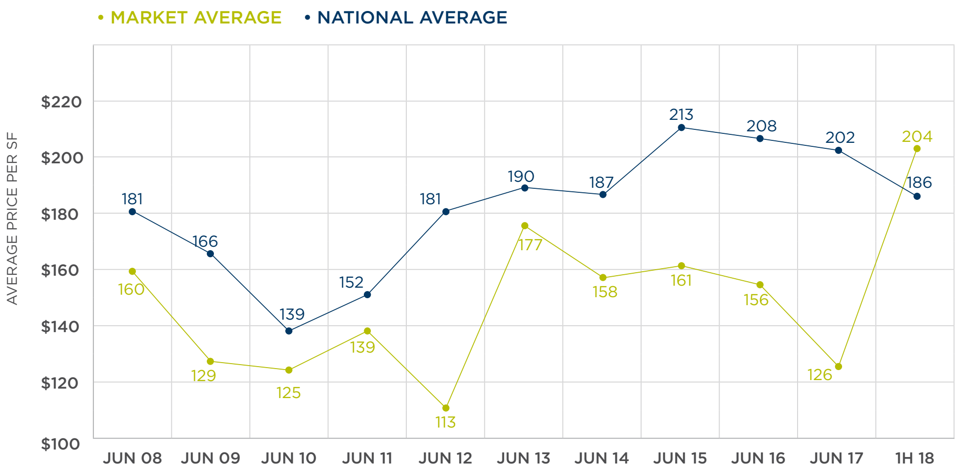
FOR HOTELS, IT REMAINS A SELLER'S MARKET BUT VALUES MAY BE TOPPING OUT

Also, investors are more selective and cautious. There is still a large pool of buyers seeking prime hotel assets in desirable submarkets -- if they can find the right asset at the right price. However, there is a widening buy-sell gap that has slowed transaction activity.

$186 PSF
Retail Avg
in 1H 2018

$163.7M
Hotels Sales
in 1H 2018

RETAIL SALE MARKET Source: Real Capital Analytics



Notable hotel sales

- Hospitality Properties Trust purchased the Radisson Blu in downtown Minneapolis from Chartres Lodging Group for $75 million.
- AIG Global Real Estate Corp. acquired the DoubleTree by Hilton near the University of Minnesota from Huron Investors LLC for $38.3 million.
- A private investor purchased the Four Points by Sheraton in Richfield from GM Richfield LLC for $12.8 million.

OUTLOOK

The trend of new players coming into the Twin Cities in search of higher yields will continue to contribute to a highly competitive bidding market. Liquidity remains strong on both the equity and debt side, and barring a big leap in interest rates, it appears that debt will remain affordable. Local operators also are finding institutional capital partners to help finance acquisitions.

One wildcard is the impact from potentially higher interest rates. However, the impact of those higher capital costs on pricing and cap rates will vary based on the sector and product type.

ABOUT THE AUTHOR

THE COMPASS REPORT

The report was created by experts using Twin Cities commercial property data from the first six months of 2018. 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 is a leading global real estate services firm that delivers exceptional value by putting ideas into action for real estate occupiers and owners. Cushman & Wakefield is among the largest real estate services firms with 48,000 employees in approximately 400 offices and 70 countries. In 2017, the firm had revenue of $6.9 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.

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