INVESTMENT FORECAST

Office

Minneapolis-St. Paul

IPA INSTITUTIONAL PROPERTY ADVISORS

2022

Challenges Arise in the Minneapolis CBD, Obscuring the Near-Term Outlook and Repositioning Buyer Demand

Hurdles surface in Minneapolis' urban core after initial resilience. The central business district in Minneapolis, which contains roughly one-fourth of the entire metro's office stock, witnessed fundamental fluctuation during the pandemic. Office performance downtown bucked national trends in 2020, when vacancy tapered by 30 basis points compared to a national CBD rise exceeding 300 basis points. Nonetheless, the tides shifted last year when pandemic-induced challenges caught up with the market. Availability in the Minneapolis urban core soared 360 basis points in just the first three quarters of last year, with vacant stock growing by 1.7 million square feet over that frame. Moving into 2022, headwinds persist as the omicron variant led firms to push back return-to-office plans in dense corridors at the start of the year. The outlook is more favorable in the suburbs, however, as vacancy late last year was only 200 basis points above the pre-pandemic level and average asking rents grew on an annual basis. Suburban areas with the tightest availability entering 2022 include Anoka, Scott and Washington counties.

Suburbs grab a larger share of deal flow as the office landscape changes. During the health crisis, some firms chose to escape density by leasing floorplans in the suburbs, where bringing workers into offices is operationally easier relative to crowded downtown districts. Many investors are cognizant of this demand shift and have responded by focusing on the suburbs, particularly the Interstate 394 and Interstate 494 corridors as well as Burnsville-Eagan-Apple Valley. Here, mid-tier properties change hands with entry costs near $150 per square foot and first-year returns in the 6 percent to mid-7 percent band. Lower-tier buildings transact with an average per-square-foot price about 20 percent below Class B, and cap rates can reach into the 8 percent area. In 2022, buyers will likely continue to favor suburban locations as the recovery downtown is slower-moving, though more investors could pursue redevelopment opportunities in the urban core.

2022 Market Forecast

Employment up 2.8% — In 2022, the traditional office-using headcount grows by 9,000 positions as the overall job tally increases by 55,000 roles.

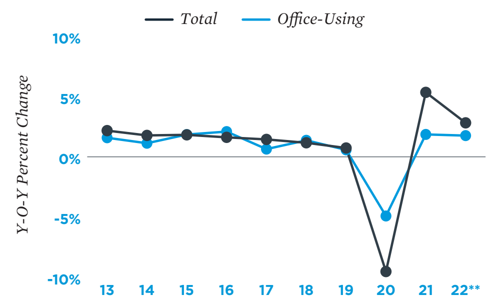
Construction 900,000 sq. ft. — Builders match last year's pace of inventory growth at 0.5 percent. The 511,000-square-foot RBC Gateway building in Downtown Minneapolis will be the largest completion.

Vacancy up 20 bps — Vacancy rises for a third straight year, though the 2022 uptick will be the smallest over that span. Availability reaches 13.3 percent at year-end, up 220 basis points from 2019.

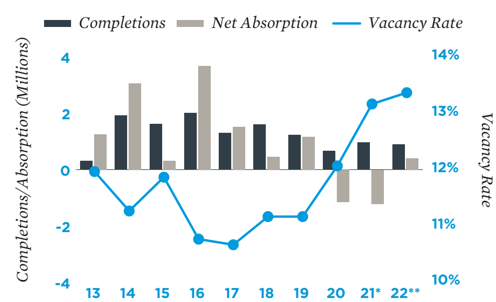
Rent up 1.8% — Despite the upward vacancy trajectory, the metrowide average asking rent climbs for the 11th consecutive year. The mean marketed rate will move up to $17.30 per square foot in 2022.

Investment — Investors with a desire for urban properties may be inclined to target the St. Paul CBD. Vacancy here is more than 700 basis points below the Downtown Minneapolis rate.

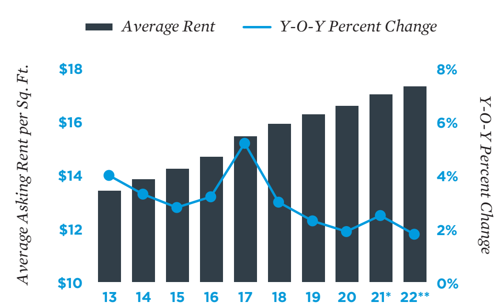
Employment Trends



Supply and Demand



Rent Trends



* Estimate; ** Forecast
Sources: CoStar Group, Inc.; Real Capital Analytics; RealPage, Inc.

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Metro-level employment, vacancy and effective rents are year-end figures and are based on the most up-to-date information available as of December 2021. Effective rent is equal to asking rent less concessions. Average prices and cap rates are a function of the age, class and geographic area of the properties trading and therefore may not be representative of the market as a whole. Sales data includes transactions valued at $1,000,000 and greater unless otherwise noted. Forecasts for employment and apartment data are made during the fourth quarter and represent estimates of future performance. No representation, warranty or guarantee, express or implied may be made as to the accuracy or reliability of the information contained herein. This is not intended to be a forecast of future events and this is not a guaranty regarding a future event. This is not intended to provide specific investment advice and should not be considered as investment advice.