

HOT TAKES
ON THE TWIN CITIES
COMMERCIAL REAL
ESTATE MARKET



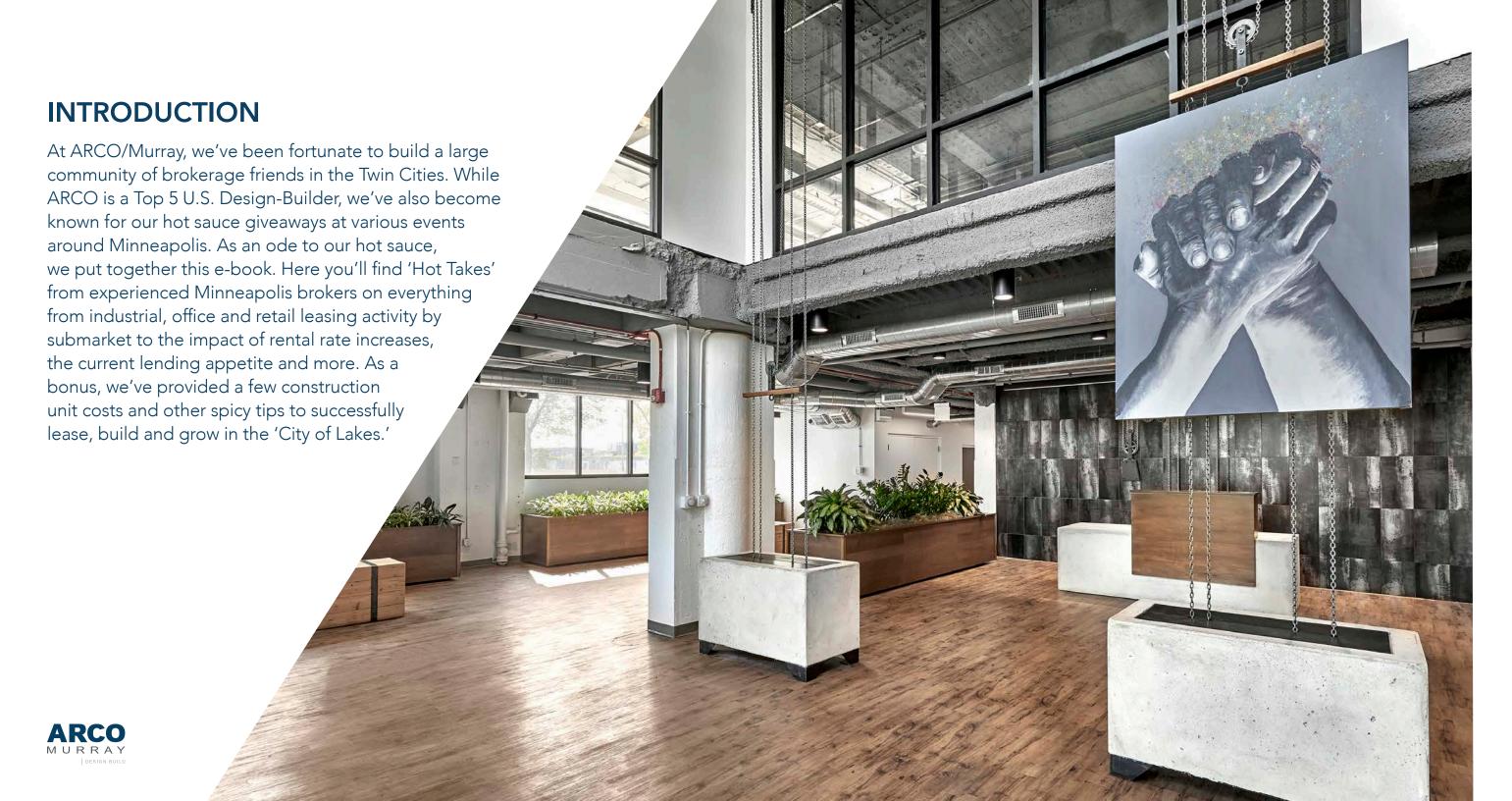


TABLE OF CONTENTS

02 | MEET THE BROKERS

04 | OFFICE MARKET OVERVIEW

Leasing Activity Ratings by Submarket
Hot Takes: Ripple Effects of Downtown Office Foreclosures
& Decreased Asset Values
Office Construction Unit Costs

10 | INDUSTRIAL MARKET OVERVIEW

Leasing Activity Ratings by Submarket Hot Takes: Impact of Rental Rate Increases Industrial TI Construction Unit Costs

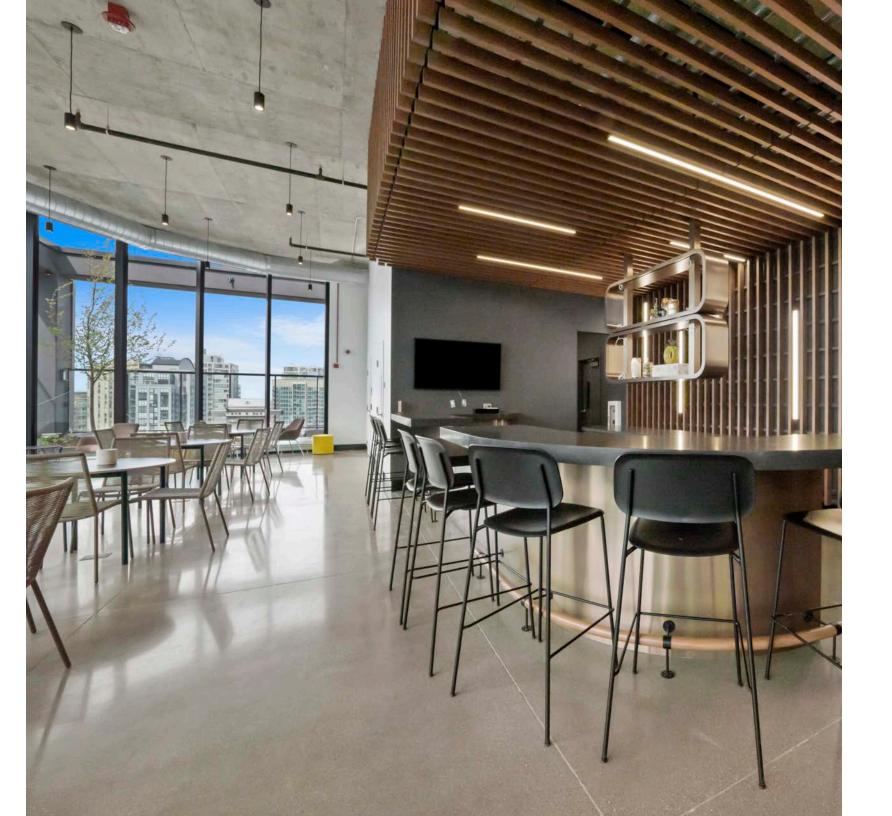
16 | CONVERSIONS & RETAIL

Hot Takes: Unique Local Conversions
Hot Takes: Successful Retail Types and New Concepts
Conversion Construction Unit Costs

22 GENERAL MARKET OVERVIEW

Hot Takes: Activity Trends Over the Next 1-3 Years Hot Takes: Lending & Creative Ways to Fund Deals How to Maximize Deal Efficiency

MEET THE **BROKERS**





MICHAEL BREHM, SIOR, CCIM Partner, Kenwood Commercial Years Experience: 16

Focus: Office & Industrial



ANDREW CHIRHART Commercial Real Estate Specialist,

TaTonka Real Estate Advisors Years Experience: 7 Focus: Office & Industrial Tenant and Buyer Representation



BRETT DRAXLER Associate - Tenant Advisory,

Transwestern Years Experience: 5 Focus: Office & Retail



JIM FREYTAG

Senior Vice President, CBRE Years Experience: 38 Focus: Office



JEREMY GRITTNER

Vice President, JLL Years Experience: 6 Focus: Retail & Land



ROSS HEDLUND

Partner, Tradition Commercial Real Estate

Years Experience: 14

Focus: Retail, Office & Industrial



BEN JENSEN

Co-Founder & Principal, Monarch Commercial Real Estate

Years Experience: 10+ Focus: Office & Industrial



LAUREN KESSLER

Associate Vice President, Colliers

Years Experience: 8 Focus: Retail



PETER LOEHRER

Senior Associate, Colliers Years Experience: 8

Focus: Office & Industrial



AUSTIN LOVIN

Vice President, CBRE Years Experience: 6 Focus: Industrial



KYLE RAFSHOL

Vice President, JLL Years Experience: 7 Focus: Industrial



STEVE SHEPHERD

Senior Managing Director, Newmark

Years Experience: 20 Focus: Office



BENTLEY SMITH

Senior Vice President, CBRE Years Experience: 10+ Focus: Industrial

BRADY WHALEN

Senior Leasing Specialist, Mid-America Real Estate MN, LLC

Years Experience: 8 Focus: Retail



ROBIN ZELLMER

Executive Vice President, Colliers

Years Experience: 30+ Focus: Office

ARCO/MURRAY HOT TAKES // 3







OFFICE LEASING ACTIVITY

Submarket 'Fire' Ratings

MINNEAPOLIS



ST. PAUL



SUBURBS











Yes, the Forum buildings in downtown Minneapolis recently sold at a discount of more than 90% relative to the previous sale. We've only seen the tip of the iceberg and expect to see more buildings in downtown Minneapolis and St. Paul revert to the lender and ultimately sell for substantial discounts.

Decreased property values will have a significant impact on property tax revenues and will place downward pressure on office rents which will benefit tenants while adding more stress to property owners. Lenders with significant exposure to downtown office properties may face significant losses as properties go into foreclosure."

Andrew Chirhart

Commercial Real Estate Specialist TaTonka Real Estate Advisors Yes, there will be a ripple effect through increased home property taxes and/ or decreased public services like police, parks, recreation, etc."

Ben Jensen

Co-Founder & Principal Monarch Commercial Real Estate A 50-90% pricing decline is underway."

Jim Freytag

Senior Vice President, CBRE

Office leasing rates will come down for tenants."

Mike Brehm, SIOR, CCIM

Partner, Kenwood Commercial







First movers acquiring deals that trade at the new 'reset' basis will have an advantage and will be able to provide very low cost space without much competition. One caveat here is this advantage will not last long."

Peter Loehrer

Senior Associate, Colliers

Tenants are concerned over landlord financial wherewithal. They want good terms but also want a landlord that has funds to invest in them and the property. It could mean more tenants look to the suburbs and/or move out of distressed assets."

Robin Zellmer

Executive Vice President, Colliers

I think we'll see some ripple effects as I don't believe we've seen the bottom of the office market yet. With that said, however, I think our downtown can greatly benefit from certain obsolete product being removed or converted in the market."

Brett Draxler

Associate – Tenant Advisory, Transwestern



ARCO'S UNIT COSTS OFFICE CONSTRUCTION

SPACE TYPE LAYOUT DENSITY 5K-10K SF 10K-25K SF 25K-50K SF 50K-75K SF 75K-100K 100K+ SF

Open-Open Space

- Fully Open Space
- No Private Offices
- 1:10 Conference Room/Employees
- Break Room
- Huddle Areas
- Collaboration Areas

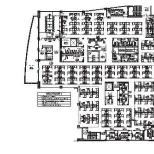


Cost Includes Design, Permit and Construction

\$60-75/SF	\$55-70/SF	\$50-65/SF	\$45-60/SF	\$40-55/SF	\$35-50/SF		
Construction Duration*							
9 weeks	10 weeks	12 weeks	14 weeks	15 weeks	16+ weeks		

Open-Private Space

- Large Semi-Open Office
- 1:10 Conference Room/Employees
- 1:10 Private
 Office/Employee
- Break Room
- Huddle Areas
- Collaboration Areas



\$65-80/SF	\$60-75/SF	\$55-70/SF	\$50-65/SF	\$45-60/SF	\$40-55/SF	
Construction Duration*						
11 weeks	12 weeks	14 weeks	16 weeks	18 weeks	20+ weeks	

Closed-Private Space

- Private Offices Only
- 1:10 Conference Room/ Employee
- 1:10 Workstation/ Employee
- Break Room
- Learning Center



\$70-95/SF	\$65-90/SF	\$60-85/SF	\$55-80/SF	\$50-75/SF	\$45-70/SF		
Construction Duration*							
11 weeks	12 weeks	14 weeks	16 weeks	18 weeks	20+ weeks		

^{*}Construction duration is from receipt of permit to substantial completion. Contact ARCO/Murray for permitting durations in specific jurisdictions. Please note: cost/SF does not include furniture, furnishings, AV, LV or security. Construction cost data is generalized and subject to change.





INDUSTRIAL LEASING ACTIVITY

Submarket 'Fire' Ratings

NORTHWEST

00000

NORTHEAST

00000

SOUTHWEST

00000

SOUTHEAST











It's the consolidation of ownership and lack of available property for tenants to relocate to that is causing rent growth upon renewal. Private Equity (PE) has also largely impacted industrial rental rates relative to square footage. For example, say a company is purchased by a PE firm. The PE needs to increase bottom line, revenue, and customer base. The PE then goes into a larger facility to accommodate growth."

Austin LovinVice President, CBRE

The significant increase in institutional ownership coupled with increased tenant demand."

Bentley Smith

Senior Vice President, CBRE

Some developers timed it perfectly with COVID. Companies wanted to bring more of their operation in-house, thus increasing demand for space. This was happening at the same time developers and owners wanted to push rents. It was very cheap nationally for a long time."

Kyle Rafshol

Vice President, JLL

It's very simple. The Twin Cities have one of the lowest levels of industrial construction relative to our market size in the whole nation. Coupling that with steady and moderately growing demand will lead to tremendous rent growth. Colliers research is tracking 30%+ year-over-year rent growth as of Q3 2024."

Peter Loehrer

Senior Associate, Colliers

The limited supply in most markets has been driving up rental rates. You're also seeing +/- 3% vacancy rates with most of that vacancy being obsolete product."

Ben Jensen

Co-Founder & Principal Monarch Commercial Real Estate







It's lack of product."

Robin Zellmer

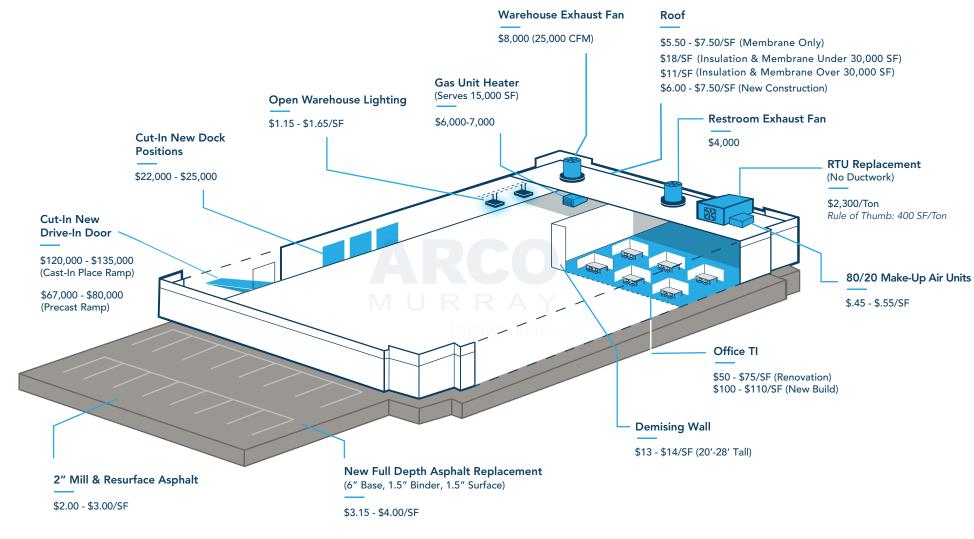
Executive Vice President, Colliers

There are two primary drivers behind the rise in industrial rental rates: 1) The consolidation of ownership – we've seen a trend of large institutional investors aggressively acquiring properties and pushing rental rates and annual rent increases. 2) The high cost of new construction."

Andrew Chirhart

Commercial Real Estate Specialist TaTonka Real Estate Advisors







CONVERSIONS & RETAIL OVERVIEW





CONVERSIONS & RETAIL

Will conversions continue to increase, especially office to multifamily? Any unique conversions you've seen in the market or would like to see if there was proper funding/legislative support?

What types of retail have been successful locally? What specific areas are seeing higher leasing activity and growth?

With the mass exodus of downtown office workers to the suburbs, suburban retail vacancy rates are as low as they have been since I started in commercial real estate. The lack of new development due to increased construction costs and higher interest rates have contributed to the low vacancy rates. Restaurants seem to be seeing the most growth due to increased customer spending and technologies like DoorDash and Uber Eats."

Brady Whalen

Senior Leasing Specialist Mid-America Real Estate - MN, LLC









A lot of retail still seems to work well. It's pretty easy for Starbucks to raise the cost of a cup of coffee from \$3.00 to \$4.00 to cover a 30% higher occupancy cost."

Ross Hedlund

Partner, Tradition Commercial Real Estate

The regional malls have done a nice job of repositioning and adding new uses to bring activity to them."

Jim Freytag

Senior Vice President, CBRE

I believe we'll see more conversions, especially if the basis for these office buildings is low enough. We're seeing legislation being introduced and passed that will allow and entice developers to continue to explore conversion products. Our market will benefit from this taking place, particularly with obsolete product in the market."

Brett Draxler

Associate – Tenant Advisory, Transwestern

Office conversions to multifamily are often difficult because of the floor plates, but I expect we'll continue to see teardowns of functionally obsolete Class C office buildings with the sites redeveloped as multi-unit housing."

Steve Shepherd

Senior Managing Director, Newmark

It's expensive to move. The idea of renewing in-place with more space than you might need gives comfort for the unknown and is typically cheaper than trying to get space in a new building."

Mike Brehm, SIOR, CCIM

Partner, Kenwood Commercial

Conversions can be difficult. If we see more office buildings trading for 91% discounts, maybe it could pencil."

Ben Jensen

Co-Founder & Principal
Monarch Commercial Real Estate







We've seen a lot of retail activity in the North Loop and France Avenue."

Ben Jensen

Co-Founder & Principal
Monarch Commercial Real Estate

The Twin Cities retail market overall has a low vacancy rate. Good space is hard to find and typically leased before it even hits the market. Downtown hasn't been doing well for retail with a lot of the workforce being removed. However, North Loop Minneapolis has still been doing really well, especially with restaurants.

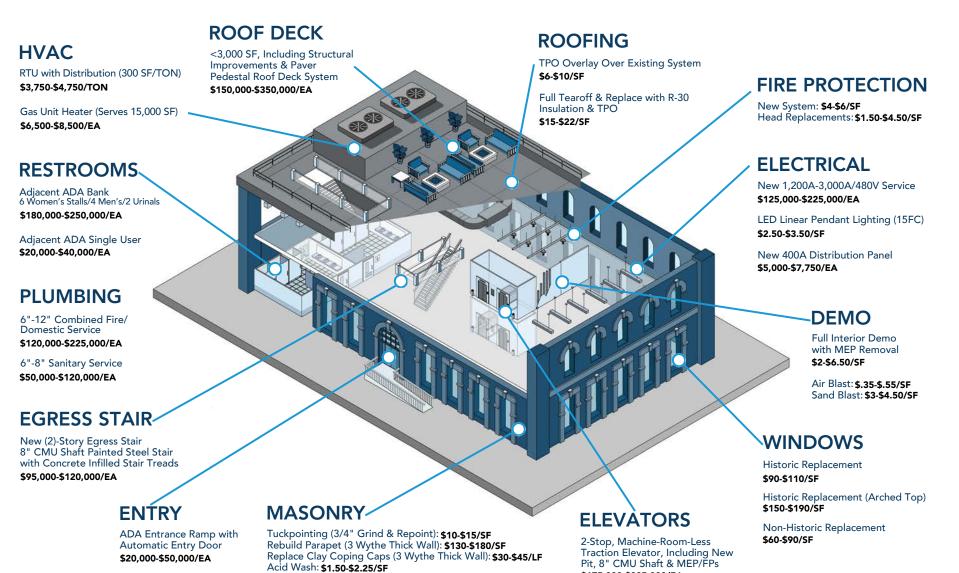
First ring suburbs, and even the smaller out of metro areas, are becoming more active since retailers have seen the cost to enter the market become lower, as well as a lack of competition.

Restaurants are an active category, especially quick service ones. Everyone is looking for second generation restaurant space. Coffee & auto shops, car washes, and credit unions are all active pad users. You also have some junior box users like T.J. Maxx, Ross, Burlington, and Ulta that are still active. Yemenese coffee concepts are a new trend which has been interesting to learn about."

Lauren Kessler

Associate Vice President, Colliers

ARCO'S UNIT COSTS CONVERSIONS



\$175.000-\$225.000/EA



Please note: construction cost data is generalized and subject to change. Existing building conditions and conversion type will significantly impact unit costs.

Power Wash: \$2.50-\$3.25/SF Clear Sealer: \$1-\$1.50/SF

GENERAL MARKET OVERVIEW



HOT TAKES LENDING & FUTURE ACTIVITY

Where do you see activity picking up in the next 1-3 years?

What groups have become the most aggressive for lending and what are some creative ways that deals can still get done?

Activity will pick-up for niche product types like lab, cold storage, data centers and high-tech manufacturing.

Life Co. lenders have taken a huge portion of market share on acquisition financing for industrial investment sales. Since LP equity or JV partnership dollars are harder to find for the time-being, some sponsors have had luck with participation loan programs from these Life Co lenders."

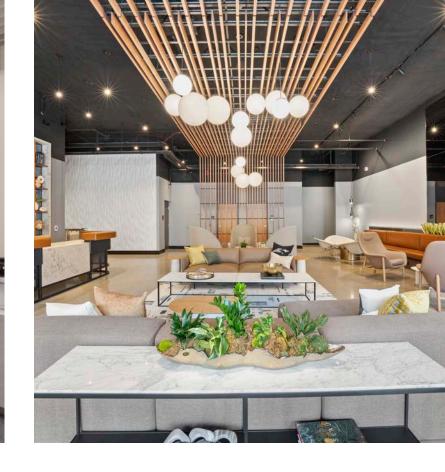
Peter Loehrer

Senior Associate, Colliers











Industrial. Currently, we're seeing life insurance companies and a few banks starting to come back to the table to get deals done."

Bentley Smith

Senior Vice President, CBRE

Well-located urban suburban Class A office with walkable retail amenities will continue to attract considerable activity with landlords gaining the ability to push rates and curb concessions."

Steve Shepherd

Senior Managing Director, Newmark

I see healthcare continuing to remain strong as practices start evaluating their current locations and growth markets/ submarkets. We should see more capital become available and deployed. Additionally, the Twin Cities market will continue to see an increase in the life science space with new product being delivered."

Brett Draxler

Associate - Tenant Advisory, Transwestern

Industrial leasing should remain strong over the next 24 months as supply dwindles. Spec industrial construction will have to pick up due to such low supply and high demand for space."

Kyle Rafshol

Vice President, JLL

Industrial will continue to stay strong, but supply will be low."

Robin Zellmer

Executive Vice President, Colliers

Retail continues to do well as retailers are able to adjust pricing to reflect increases in occupancy costs."

Ross Hedlund

Partner, Tradition Commercial Real Estate

I see office activity increasing; however, no one has really been aggressive when it comes to lending for that sector."

Jim Freytag

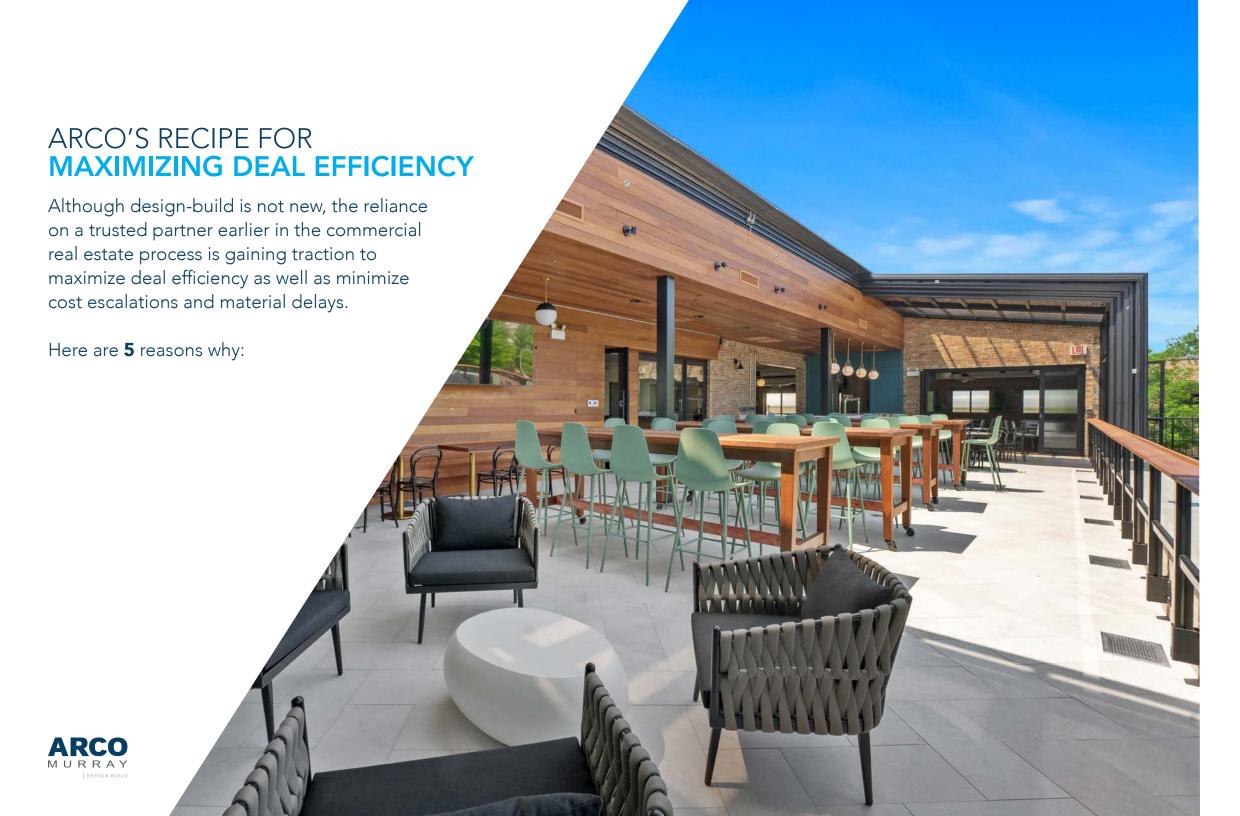
Senior Vice President, CBRE

Restaurants/coffee shops are the most active businesses in retail leasing. I expect there to be some casualties within the next few years and a new wave of restaurant franchises to emerge. For lending, credit unions and smaller banks."

Brady Whalen

Senior Leasing Specialist Mid-America Real Estate - MN, LLC





1 | DOLLARIZING DECISIONS BASED ON A CLIENT'S DREAM FLOOR PLAN

When designing a floor plan, MEP is often overlooked, but it accounts for a significant portion of the overall construction cost. A design-builder will analyze these systems much earlier in the process and can find creative solutions to maximize dollars while ensuring it's properly accounted for in initial pricing exercises. Tenant brokers can then provide space options that will more readily suit a client's budget, vision and ideal lease terms. Landlord brokers are better equipped to propose solutions centered on the TI allowance and how the floor plan can easily fit in that space.

2 | PROVIDING A COMPREHENSIVE BUILDING AND/OR SPACE ANALYSIS FOR EACH OPTION

Now that the tenant's dream floor plan is solidified, a design-builder can also provide a cost for the floor plan in each building option. This is an important next step as each building's unique parameters can have a drastic impact. For example, existing MEP infrastructure and location of these systems will weigh heavily on overall cost, especially if needing to run underground plumbing, move electrical rooms, or tie to an existing HVAC system. Brokers can provide clients with an apples-to-apples comparison, reviewing the dream floor plan and how it sits in each building compared with the overall benefits of that location.

3 | MINIMIZING DRAWING CHANGES

Once a building is chosen, a design-builder can take it a step further and provide good/better/best options. Their in-house architecture team can finish designing to a budget versus value engineer once the design is complete. In the plan & spec approach, an estimate is given based on finished drawings. Oftentimes, the cost of construction is higher than the budget allocated, forcing the client to go back to the architect and remove certain design aspects. This slows down the process, adds to overall cost for drawing changes and delays occupancy.

4 | MANAGING A CLIENT'S RISK EARLY IN THE PROCESS

Next, the design-builder will create a detailed scope letter explaining what each party is receiving, which can be used in lease negotiations. Once the scope is agreed upon, the construction contract can be signed prior to design drawings being completed. At that point, the design-builder helps manage 100% of the overall cost and schedule risk. This eliminates finger-pointing between the owner, broker, architect, project manager and engineers. Committing to a budget upfront also puts both the broker and client at ease.

5 | REDUCING THE OVERALL PROJECT SCHEDULE

Having a design-builder involved earlier in the process eliminates the need to have fully complete drawings before fully bidding out to general contractors. The entire project team is assembled and construction can commence to meet the proposed schedule. Another benefit of early involvement is the design-builder can assist with tenant and landlord coordination by communicating the entire scope of work to the building engineer, vendors and team while design is being completed. Faster occupancy means quicker revenue and a happier tenant. Simple as that.

THE ARCO/ MURRAY TEAM





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