

Minneapolis/St. Paul Industrial, Q2 2015

Development and Absorption Strong Again in Q2 2015

 Vacancy Rate
5.0%

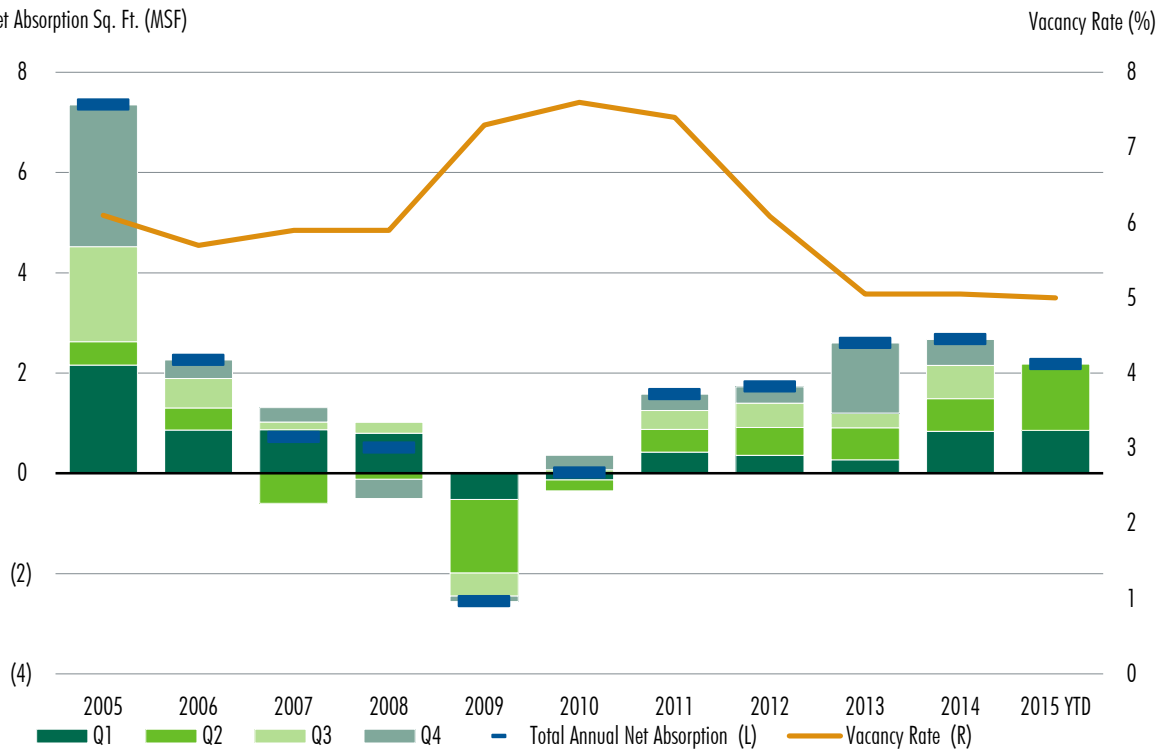
 Lease Rate
\$5.11 PSF

 Net Absorption
1,319,678 SF

 Under Construction
2,805,964 SF

Figure 1: Historical Net Absorption vs Vacancy Rate
Net Absorption Sq. Ft. (MSF)

*Arrows indicate change from previous quarter.



Source: CBRE Research, Q2 2015.

- The 1,319,678 sq. ft. of net absorption in Q2 2015 is the highest single quarter total since Q4 2013, 65% of the total resulted from one transaction.
- The largest deal in the past decade in the Minneapolis/St. Paul market occurred in Q2 2015 with Polaris occupying 870,000 sq. ft. of space in Shakopee, MN.
- According to CBRE Research, there is roughly 16.5 million sq. ft. of planned/scheduled construction being considered across the metro.

MARKET OVERVIEW

The Minneapolis/St. Paul Industrial Market showed no signs of losing steam in Q2 2015 following a healthy first quarter. With the highest level of product completed in Q1 2015 since the first quarter of 2001, the construction and increased supply are keeping up with the demand for industrial product.

MARKET OVERVIEW CONT'D

The roughly 80% occupancy of the 1.7 million sq. ft. of space delivered in Q1 2015 points to a second phase of construction and development that should last through the end of the year. Other key drivers are the vacancy and availability rates which steadily continue to fall. The total vacancy after Q2 2015 was 5.0% with the total availability rate just under 7.0%. Newcomers, both developers and institutional investors alike, are entering into the market and echoing the notion that Minneapolis/St. Paul is more than a mid-market, middle of the pack economy where it has been historically categorized. The Minneapolis/St. Paul Industrial Market currently ranks 11th in the country in terms of sq. ft. (see figure 10).

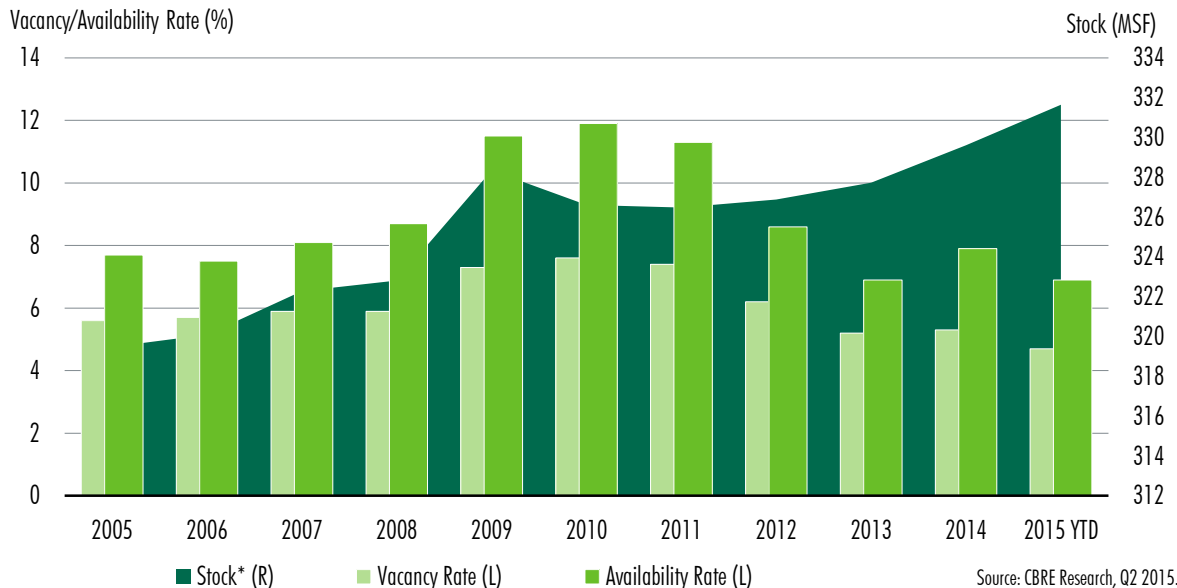
By far the largest deal of the quarter and in recent history was Polaris occupying Kmart's former 1.1 million-sq.-ft. facility in Shakopee. Vacant since 2013, Polaris occupied more than 870,000 sq. ft. of the former distribution center at 901 Canterbury Road. With this deal, overall net absorption was north of 1.3 million sq. ft. for the quarter. While institutional sales and increasing demand continues, particularly for flex product, available sites for development are being swept off the market. This has led to further

compression of cap rates and investor preferences such as clear height, becoming less significant. Investors are willing to buy lower quality product to simply get involved and be a player in the Minneapolis/St. Paul market.

The Arrival of Amazon

With approvals and plans in place, we can expect to see construction of Amazon's 820,000-sq.-ft. distribution center in Shakopee take off on the 69.2-acre site. Sold by United Properties in late June, the company will take advantage of approximately \$5.8 million in tax revenue to improve roads and other infrastructure near the site. While initially asking for more tax-payers' dollars, the question remains regarding the impact of the arrival on the Minneapolis/St. Paul market and local economy. Amazon plans to create 1,000 full-time jobs, but many potential jobs will be fulfilled by machines in order to speed up their core operations. Now that this public financing is final, city and state officials will be scrutinizing the financial benefits of tax increment financing (TIF) for large corporations more than ever. Before the approval of the distribution center, Amazon leased a 162,000-sq.-ft. building in Shakopee as well.

Figure 2: Market Availability



Source: CBRE Research, Q2 2015.
*Represents Industrial buildings 10,000 sq. ft. and up.

CONSTRUCTION: PHASE II

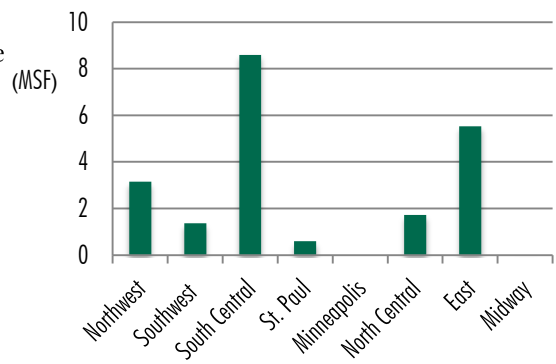
While only four projects were completed in Q2 2015 for a total of approximately 671,000 sq. ft., less than 40% of the space delivered during the previous quarter, the final two quarters are expected to produce numbers similar to the first quarter of 2015. This is largely attributable to developer and investor optimism regarding the market and strong absorption of recently completed product.

Highlighted by Amazon's plans to open an 820,000-sq.-ft. distribution center in Shakopee, the market can expect to see a large number of city approvals become public as the construction boom enters into the second phase of the cycle. This is a great indicator of sustainable growth in the near future.

BluDot occupied Gateway North Business Center III, their 150,000-sq.-ft. build-to-suit located in Otsego. The largest building completed was CSM's 271,000-sq.-ft. North Star Distribution Center in Rogers.

Three of the four completed projects were speculative, 32' clear facilities.

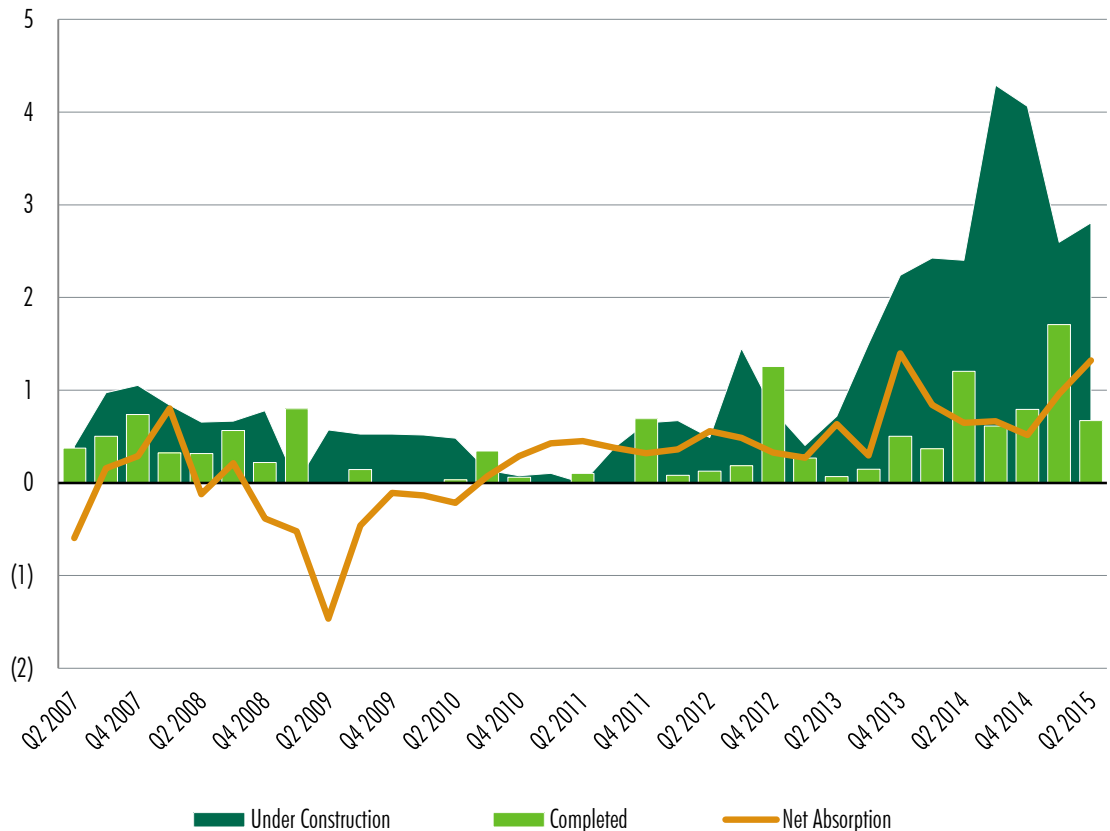
Figure 3: Planned/Scheduled Construction by Submarket



Source: CBRE Research, Q2 2015.

Figure 4: Under Construction/Completed/Net Absorption

(MSF)



Source: CBRE Research, Q2 2015.

Investors

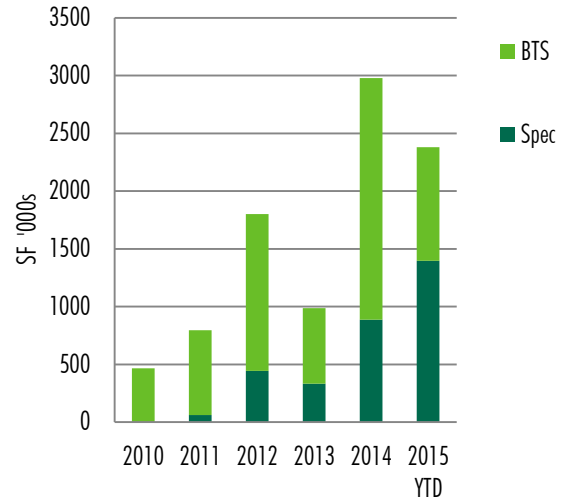
Return of Capital to Minneapolis High Finish

Spreads between low finish industrial properties and high finish remain attractive providing encouragement to new capital showing there is room for additional cap rate compression remaining in flex product. 2013 and 2014 flex sale volume totaled nearly \$300 million – the highest volumes since 2005. CBRE expects another \$200 million in flex sales to close in 2015. Assets and portfolios acquired in 2013 and 2014 experienced near term leasing success with better than expected renewal rates and robust activity on vacancies. The largest portfolio sale in Q2 2015 was the acquisition of two flex buildings for \$19.2 million by Eagle Ridge Partners in Bloomington. Expect multiple high finishing offering in the 2nd half of 2015.

Increased Demand for Infill Locations

Investment demand has increased for Class B industrial properties with clear heights ranging from 14’ to 20’. Even as cap rates have continued to compress, investors have been attracted to limited amounts of supply, increasing user demand, and pricing below replacement costs.

Figure 5: Spec vs. Built-to-Suit



Source: CBRE Research, Q2 2015.

New Construction Pricing

As spec development becomes stabilized, CBRE expects several core industrial offering coming to the market. Most of the core buyers for the Minneapolis market will need more education on the cost of new construction and the resulting rents. CBRE expects core industrial offering to surpass \$100 per sq. ft. in the next 6 months.

Figure 6: Top Sale Transactions

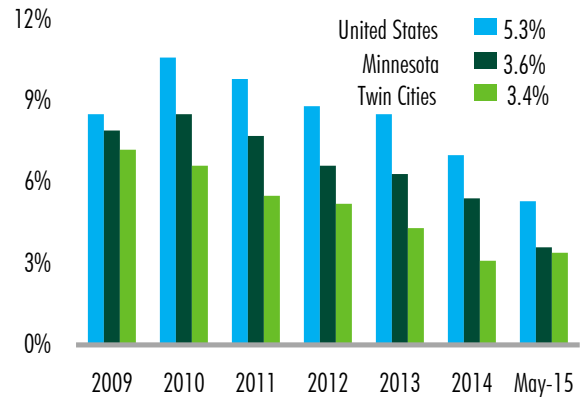
Property	Buyer	Sale Price / Size (Sq. Ft.)	City	Transaction Type
9401 & 9555 James Ave S	Eagle Ridge Partners LLC	\$19.2 M / 230,000	Bloomington	Investment Sale
2685 Long Lake Rd	LSREF4 Rebound LLC	\$18.4 M / 128,443	Roseville	Investment Sale
9464-9496 Hemlock Ln N 11701-11741 95th Ave N 11751-11787 95th Ave N	Interstate Partners LLC	\$9.1 M / 163,336	Maple Grove	Investment Sale
121 S 12 th Ave	Shamrock Development	\$8.3 M / 121,780	Minneapolis	Investment Sale
11611 Business Park Blvd	Eagles Partners IV LLC	\$7 M / 188,828	Champlin	User Sale

Source: CBRE Research, Q2 2015.

LOCAL ECONOMIC CONDITIONS

Despite Minnesota's unemployment rate ticking up 10 bps to 3.8% in May, the figure has decreased from 4.6% in the previous quarter to 3.6% in Q2 2015. With the participation rate reaching its fifth consecutive month of improvement despite baby boomers departing the workforce, the statistic is a positive sign for the economy. More relative to the industrial side of the market are the adverse effects of the spreading bird flu. Millions of chickens and turkeys have contracted the virus. This epidemic has wiped out entire farms across the state. The manufacturing industry is feeling the majority of the blow with infected farms decreasing activity.

Figure 7: Unemployment



Source: BLS and MN DEED, May 2015
*Non-seasonally adjusted figures

Figure 8: Top Lease Transactions

Tenant	Size (Sq. Ft.)	Address	Transaction Type
Polaris	870,128	901 Canterbury Rd	New Lease
Amazon	162,000	5825 E 11 th Ave	Expansion
The Bernard Group	156,333	19011 Lake Dr E	New Lease
Flint Hills Resources	87,481	3747 117 th St	New Lease
Koch Logistics	77,063	429-475 Prior Ave N	New Lease
Best Warehousing and Transportation	68,051	807 Hampden Ave	Expansion

Source: CBRE Research, Q2 2015.

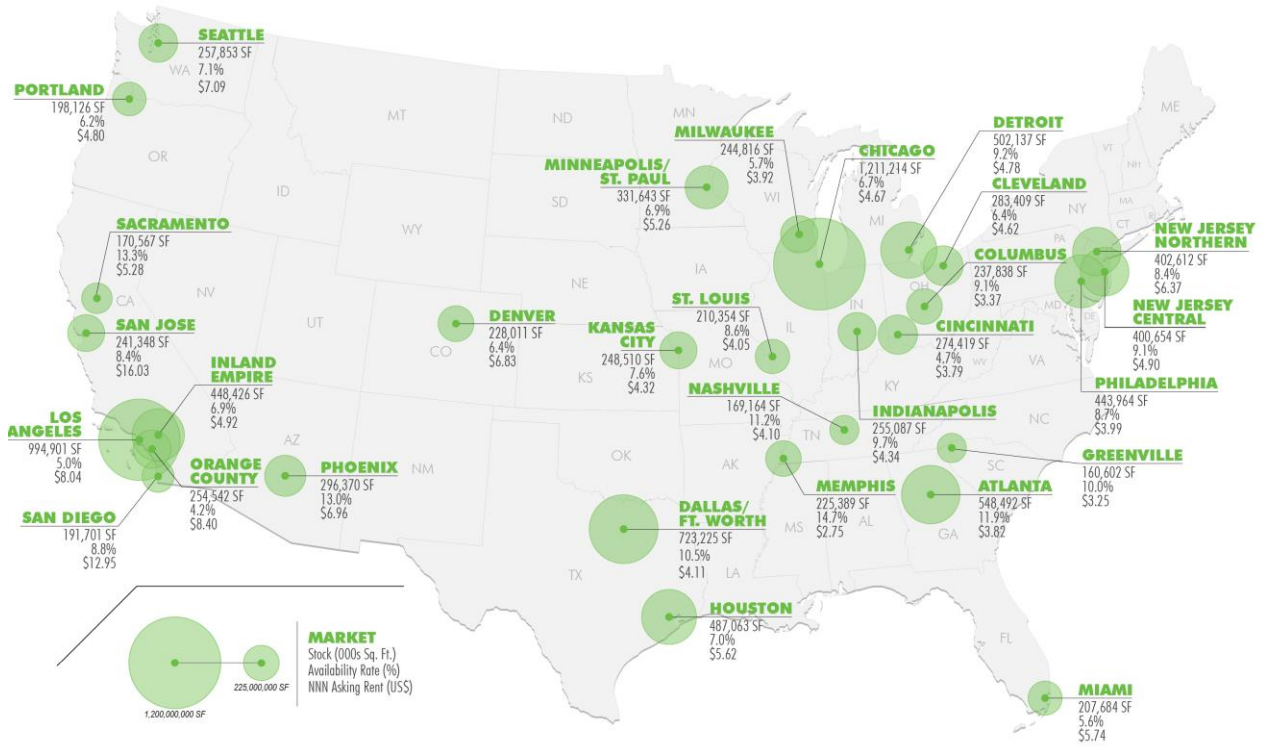
Figure 9: Minneapolis/St. Paul Submarket Map

Submarket	Rentable Area (Sq. Ft.)	Total Vacancy Rate (%)	Y-o-Y Vacancy Trend	Average Net Asking Rate (\$/Sq. Ft./Yr)	Q2 Net Absorption (Sq. Ft.)	Y-o-Y Net Absorption Trend	YTD Net Absorption (Sq. Ft.)	Under Construction Spec (Sq. Ft.)	Under Construction BTS (Sq. Ft.)
Metro Overall	331,642,774	5.0	→	5.11	1,319,678	↑	2,177,977	1,505,764	1,300,200
Bulk Warehouse	68,105,656	4.8	→	4.31	1,136,362	↑	1,942,649	742,000	-
Office Warehouse	141,016,517	4.7	→	4.99	(12,342)	↓	73,703	733,540	363,600
Office Showroom	36,445,020	8.9	↑	7.03**	191,415	↓	4,078	30,224	-
Northwest	64,458,225	5.6	↓	5.59	191,115	↑	690,904	1,475,540	295,600
Bulk Warehouse	16,694,406	7.2	↑	4.86	176,012	↑	556,276	742,000	-
Office Warehouse	29,733,640	5.0	↓	5.37	(1,795)	↓	(27,342)	733,540	195,600
Office Showroom	7,829,871	9.2	↑	6.94**	30,698	↓	69,710	-	-
Southwest	70,742,779	5.9	↑	5.56	965,017	↑	1,323,793	30,224	216,000
Bulk Warehouse	13,270,774	4.2	↓	3.88	858,506	↑	1,174,529	-	216,000
Office Warehouse	31,675,450	5.6	↑	5.24	(104,331)	↓	68,263	-	-
Office Showroom	13,134,095	11.1	↑	7.10**	131,469	↓	(52,372)	30,224	-
South Central	51,402,167	5.0	↓	5.02	173,693	↑	239,326	-	504,600
Bulk Warehouse	11,478,071	2.9	↓	3.87	60,152	↑	170,152	-	-
Office Warehouse	23,673,082	5.4	↓	5.23	70,419	↑	44,398	-	93,600
Office Showroom	6,893,998	8.2	→	5.17**	43,122	↑	27,113	-	-
St. Paul	17,575,197	3.8	↓	4.02	35,985	↑	103,711	-	-
Bulk Warehouse	3,934,253	3.1	↓	4.11	22,963	↑	22,963	-	-
Office Warehouse	5,866,398	3.3	→	4.89	(10,275)	↑	47,325	-	-
Office Showroom	1,194,488	5.2	↓	6.06**	13,297	↑	13,297	-	-
Minneapolis	29,305,990	1.9	↓	5.43	(129,482)	↓	(247,543)	-	-
Bulk Warehouse	2,145,464	6.1	↓	3.73	(37,956)	↓	(37,956)	-	-
Office Warehouse	11,544,075	2.6	↓	4.21	4,263	↑	(98,368)	-	-
Office Showroom	158,266	0	↓	-	(20,221)	↓	(20,221)	-	-
North Central	49,900,348	4.3	↓	5.30	7,837	↓	36,699	-	42,000
Bulk Warehouse	10,786,596	6.0	↑	5.24	(20,378)	↓	(20,378)	-	-
Office Warehouse	22,855,393	3.9	↓	4.82	28,165	↑	(3,519)	-	42,000
Office Showroom	4,815,769	5.9	↓	6.98**	50	↑	538	-	-
East	14,745,735	3.5	↑	5.30	1,212	↑	(61,025)	-	242,000
Bulk Warehouse	2,374,518	1.7	↑	5.24	-	→	-	-	-
Office Warehouse	5,619,911	5.0	↓	4.82	1,212	↑	(14,705)	-	66,000
Office Showroom	1,500,977	7.6	↑	6.98**	-	→	(26,987)	-	-
Midway	33,512,333	3.8	↓	4.75	74,301	↑	92,112	-	-
Bulk Warehouse	7,421,574	3.4	↓	4.50	77,063	↑	77,063	-	-
Office Warehouse	10,048,568	4.8	↓	4.93	-	↑	57,651	-	-
Office Showroom	917,556	5.4	↓	7.22**	(7,000)	↑	(7,000)	-	-

Source: CBRE Research, Q2 2015.

* Single Tenant & Multi Tenant. ** Represents a blended rate of 50% office and 50% warehouse. Total Vacancy Rate May Not Add Up Due To Rounding.

Figure 10: Largest 30 U.S. Industrial Markets



Source: CBRE Research, Q2 2015.

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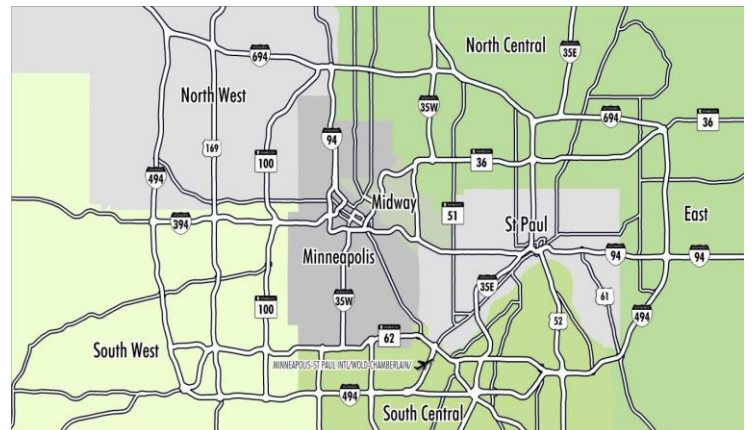
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