Rising sublease activity as users navigate workplace strategies and economic shifts

▲ **20.6%**
Vacancy Rate

▼ **(291,456)**
SF Net Absorption

◀ **350,000**
SF Under Construction

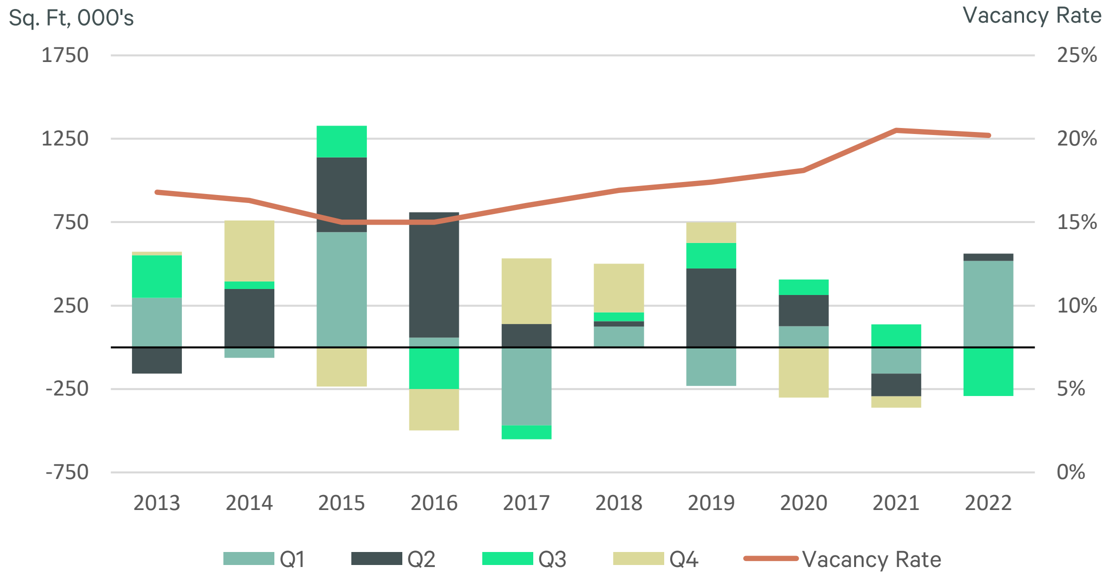
▲ **$16.93 PSF**
Average Asking Rate (NNN)

Note: Arrows indicate change from previous quarter.

MARKET OVERVIEW

- Q3 absorption in Minneapolis fell to (291,456) sq. ft. Most of the large move-in activity occurred within Class A spaces in the 394, BEA, Northeast, and St Paul CBD submarkets. Larger move-outs were seen predominantly from Class B properties in the 394, St Paul CBD, and Suburban St Paul submarkets, a continued signal towards flight to quality trends.
- The Minneapolis office market has seen an increase in available sublease space since 2020, with 2.8 million sq. ft. currently available. This represents 14% of the total available space in the market and accounts for an increase of over 400% from pre-pandemic rates.
- Vacancy rates remained steady at 20.6%, a 20 bps increase from the previous quarter. The lowest vacancy rates are seen in Class A buildings downtown at just 15% compared to 31% for Class B and 29% for Class C.
- Downtown asking rates have increased 5% year over year, averaging $17.33 per sq. ft. The highest asking lease rates were in the 394 submarket averaging $20.14 per sq. ft, 19% higher than the overall metro markets average

FIGURE 1: Quarterly and Annual Net Absorption vs. Vacancy



Source: CBRE Research, Q3 2022.

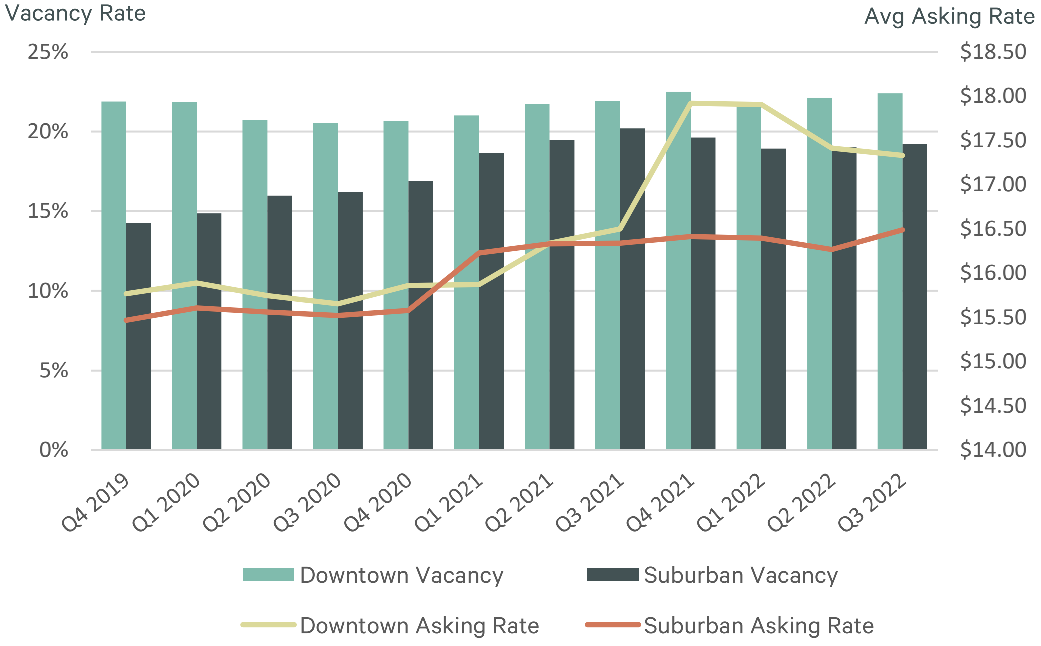
Absorption, Vacancy, and Lease Rates

In the Minneapolis office market, Q3 absorption fell negatively to (291,456) sq. ft. Most of the large move-in activity occurred within Class A spaces in the 394, BEA, Northeast, and St Paul CBD submarkets. Larger move-outs were seen predominantly from Class B properties in the 394, St Paul CBD, and Suburban St Paul submarkets.

Overall, vacancy rates remained steady this quarter at 20.6%. The lowest vacancy rates are seen in Class A buildings downtown at just 15% compared to 31% for Class B and 29% for Class C. The suburban vacancy rate remains relatively constant between class sizes near 20%.

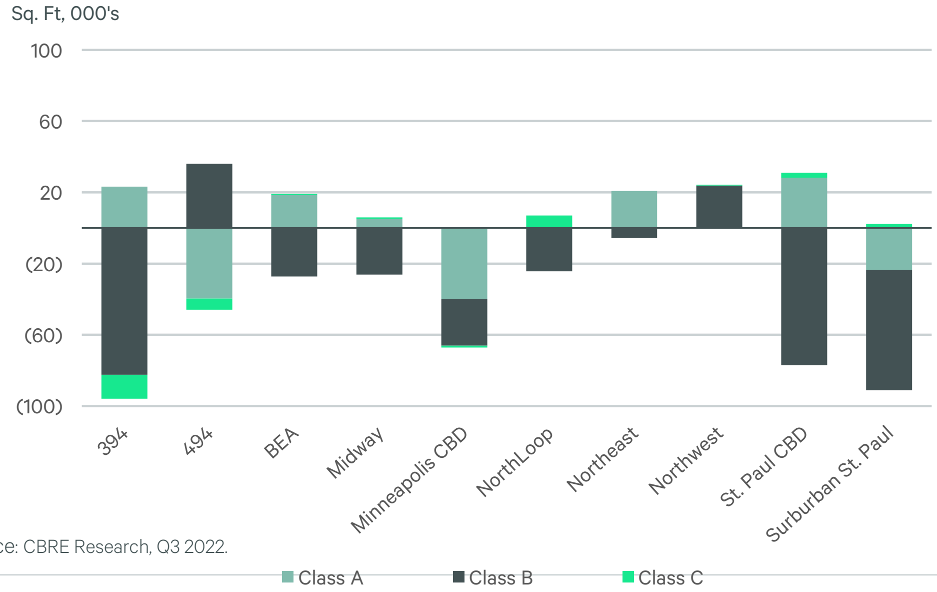
The highest asking lease rates in the market were in the 394 submarket with an average asking rate of $20.14 per sq. ft, 19% higher than the overall metro markets average of $16.92 per sq. ft. Downtown asking rates have increased 5% year over year, averaging $17.33 per sq. ft.

FIGURE 3: Historical Vacancy Rates vs Asking Rates



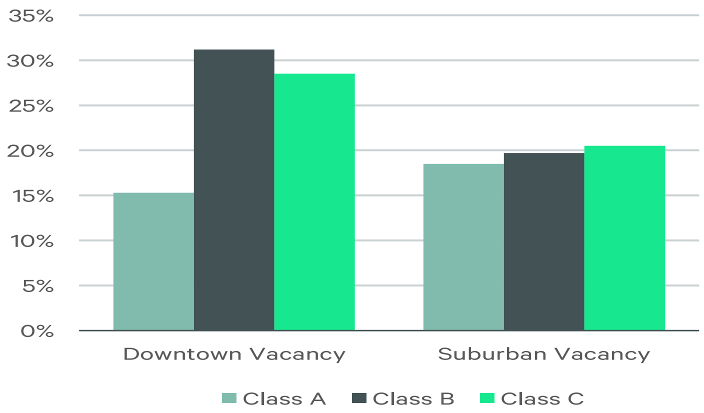
Source: CBRE Research, Q3 2022.

FIGURE 2: Q3 2022 Net Absorption by Submarket and Class



Source: CBRE Research, Q3 2022.

FIGURE 4: Q3 2022 Downtown vs Suburban Vacancy by Class



Source: CBRE Research, Q3 2022.

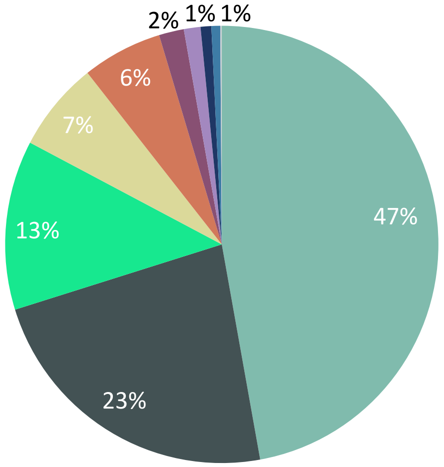
Subleasing

The Minneapolis office market has seen an increase in available sublease space since 2020, with 2.7 million sq. ft. currently available. This represents 14% of the total available space in the market and accounts for an increase of over 400% from pre-pandemic rates compared to 512,626 sq. ft. available in Q1 2020. Currently, 43% of the total availabilities on the market are large spaces 100,000 sq. ft. or more.

Nearly half of available sublease space is within the Minneapolis CBD submarket, including several of the largest listings at 33 South Sixth and Capella Tower. Several large suburban subleases are expected to come onto the market following with recent activity from Prime Therapeutics in Eagan.

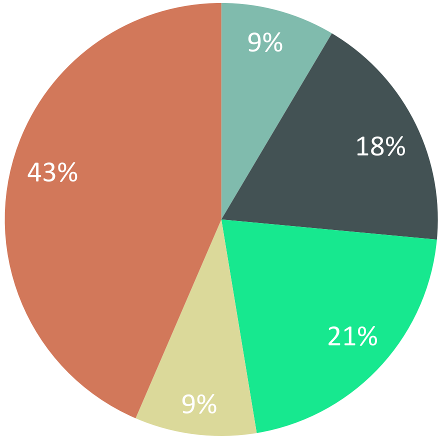
The average remaining term on sublease availabilities is 3.1 years with 46% of available space with terms seven years or greater. The top three largest sublease spaces currently available expire in at least six years.

FIGURE 5: Sublease Availability by Submarket



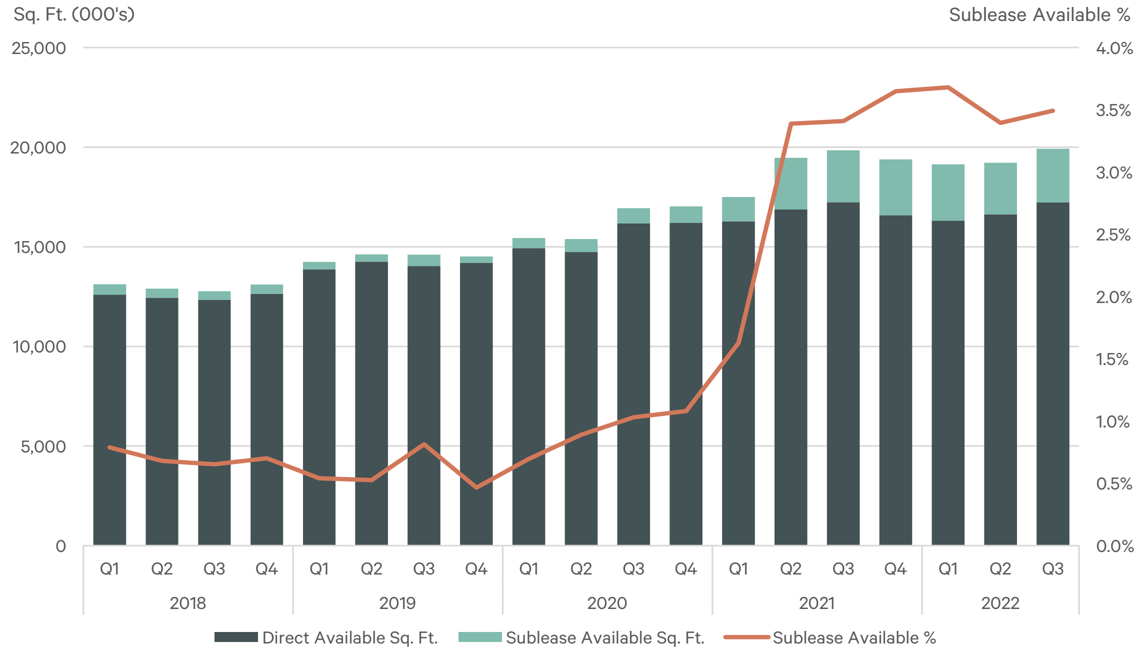
Source: CBRE Research, Q3 2022.

FIGURE 6: Sublease Available Spaces by Size



Source: CBRE Research, Q3 2022.

FIGURE 7: Historical Sublease vs Direct Availability



Source: CBRE Research, Q3 2022.

FIGURE 8: Top Sublease Spaces

Available SF	Property Name	Submarket	Lease Expiration
825,776	33 South Sixth	Minneapolis CBD	12/13/2030
136,125	2815 Cleveland Ave N	Suburban St. Paul	12/31/2032
135,646	Capella Tower	Minneapolis CBD	10/31/2028
132,604	10380 Bren Rd	494	7/31/2026
76,573	3701 Wayzata Boulevard	394	7/24/2030
67,714	901 S 3rd Avenue	Minneapolis CBD	12/31/2024

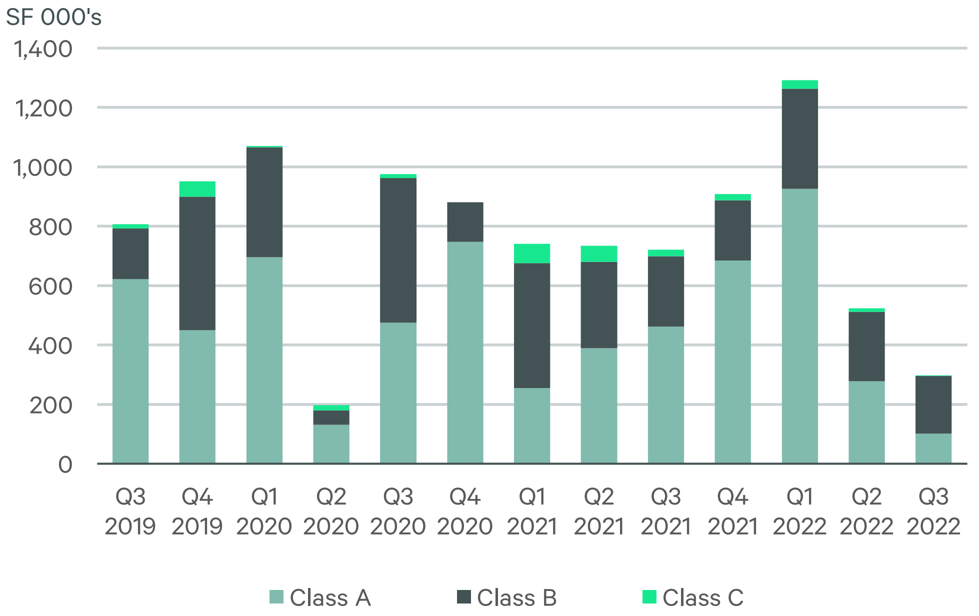
Source: CBRE Research, Q3 2022.

Leasing Velocity

In the Minneapolis market, Q3 leasing activity fell to 300,000 sq. ft. compared to a high of 524,000 sq. ft. the previous quarter. This 43% decrease is the lowest quarterly leasing velocity the office market has seen since early in the pandemic. The majority of activity in Q3 was focused primarily in the 394 market, which posted 141,000 sq. ft. of leases signed.

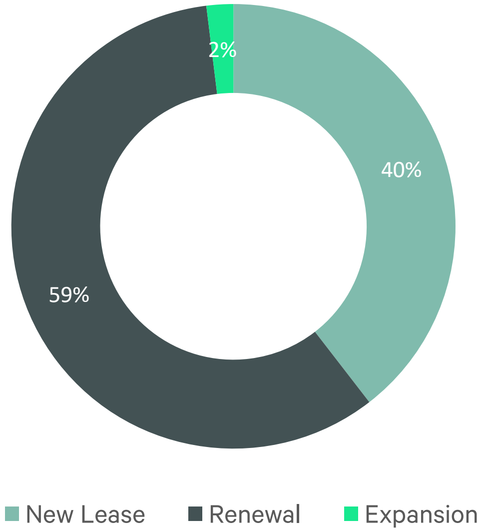
Renewals represented nearly 60% of total leasing volume in Q3 with new leases accounting for 40%. Among the most notable deals, Minnesota Medical Scanning Corp renewed for nearly 67k at Park Place East in the 394 submarket. Several new leases were signed for spaces above 20,000 sq. ft., demonstrating that tenants are continuing to stay active in the market amid the affects of hybrid and work-from-home operations.

FIGURE 11: Historical Leasing Velocity by Class



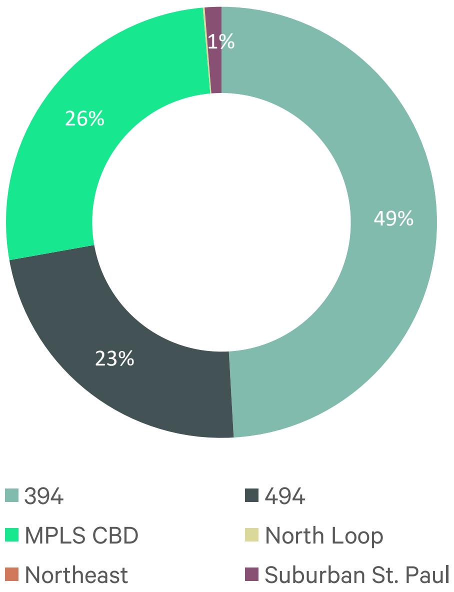
Source: CBRE Research, Q3 2022.

FIGURE 9: Lease Transaction Types



Source: CBRE Research, Q3 2022.

FIGURE 10: Lease Activity by Submarket



Source: CBRE Research, Q3 2022.

FIGURE 12: Key Transactions

Transaction Type	Size (SF)	Tenant	Property	Submarket
Renewal	66,911	MN Medical Scanning Corp	Park Place East	394
New Lease	33,100	GSA	Norman Pointe II	494
New Lease	27,478	Workbox	121 S 8th St	Minneapolis CBD
New Lease	22,060	Physician Reliance	Maple Grove Specialty Center	Northwest

Source: CBRE Research, Q3 2022.

Investment Sales

- **Volume:** Investment sales volume totaled $220 million in Q3, bringing the 2022 year-to-date total volume to $938 million. This is a 31% increase year-over-year.
- **Buyer Composition:** Private sales account for the largest percentage of 2022 YTD activity at 76% followed by institutional buyers with 11.5% and Listed/REITs with 7.5% of all sales.
- **Property Type:** Q3 sales were predominantly led by suburban sales with $214 million in total volume in contrast to $6 million for CBD sales.

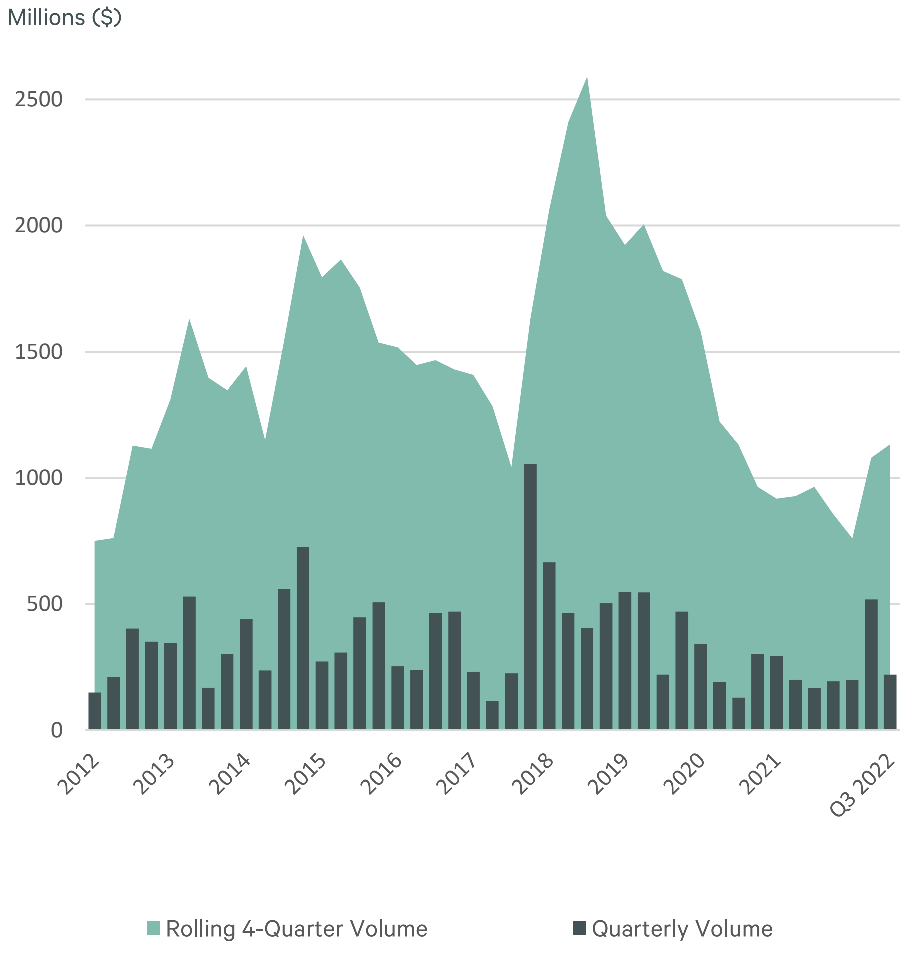
CBRE represented the seller in the sale of the New Brighton Office Center this quarter. In total, CBRE transacted $18.7M of total office sales this quarter, representing 8.4% of the market activity.

FIGURE 13: Notable Minneapolis Office Investment Sales, Q3 2022

Property	Location	Buyer	Sale Price	Size (SF)
Normandale Lake Office Park	Bloomington	Opal Holdings	365,900,000	1,700,000
Broadway Ridge	Minneapolis	Singer Capital	30,100,000	185,488
Prudential	Plymouth	Scannell	20,400,000	450,000
BLN Office Park	Bloomington	Hempel	18,700,000	372,545
New Brighton Office Center	New Brighton	Edgewood REIT	18,500,000	115,667
Carlson Center East II	Minnetonka	Dahl Real Estate	10,500,000	65,000

Source: CBRE Research, Q3 2022

FIGURE 14: Minneapolis Office Investment Sales Volume, 2012 – Q3 2022



Source: Real Capital Analytics

Market Summary Statistics

FIGURE 15: Minneapolis/St. Paul Office Market Statistics, Q3 2022 (cont. on next page)

Submarket	MT Renatble Area (Sq. Ft.)	MT Direct Availability Rate	MT Direct Vacancy Rate	Y-o-Y Vacancy Trend	Avg Dir Asking Ls Rate	Y-o-Y Asking Rate Trend	Q2 Net Absorption (Sq. Ft.)	Y-o-Y Quarterly Absorption Trend	Multi-Tenant and Single-Tenant Combined Stats	
									MT & ST Rentable Area (Sq. Ft.)	MT & ST Vacancy Rate
Metro Overall	76,651,422	22.0%	19.9%	↓	$16.92	↑	(291,456)	↓	96,159,227	16.5%
A	37,562,933	18.5%	16.1%	↓	$18.89	↑	(7,068)	↓	49,909,994	12.8%
B	31,988,104	25.8%	23.7%	↓	$15.52	↑	(277,267)	↓	37,990,236	20.5%
C	7,100,385	23.6%	22.4%	↑	$15.61	↑	(7,121)	↓	8,258,997	20.6%
Minneapolis CBD	22,975,415	23.7%	21.8%	↑	$18.31	↑	(67,188)	↓	28,890,626	17.9%
A	14,243,494	16.6%	14.4%	→	$20.46	↑	(39,773)	↓	19,531,901	10.9%
B	7,172,093	36.8%	35.3%	→	$16.69	↑	(26,251)	↓	7,275,368	35.3%
C	1,559,828	28.2%	27.3%	↑	$16.79	↑	(1,164)	↓	2,083,357	22.1%
394	11,651,502	20.0%	18.8%	↓	$20.14	↓	(72,601)	↓	12,908,891	18.6%
A	5,949,679	20.0%	18.7%	↓	$22.22	↑	23,242	↑	6,985,129	17.9%
B	4,686,491	22.6%	21.3%	↑	$17.92	↑	(82,443)	↓	4,875,430	21.3%
C	1,015,332	8.1%	7.7%	↓	$15.23	↓	(13,400)	↓	1,048,332	9.9%
494	16,962,381	20.0%	17.7%	↓	$16.28	↓	(9,902)	↓	19,685,885	15.6%
A	8,478,788	17.8%	15.2%	→	$17.99	→	(39,622)	↓	10,396,835	12.8%
B	7,017,416	22.3%	20.3%	↑	$14.68	↑	36,074	↑	7,822,873	18.5%
C	1,466,177	21.4%	19.8%	↓	$14.50	↓	(6,354)	↓	1,466,177	20.1%
North Loop	4,146,263	26.6%	24.5%	↓	$18.60	↓	(17,337)	↑	4,383,763	25.6%
A	877,775	12.6%	10.8%	↓	$23.02	↑	0	→	1,115,275	10.9%
B	2,244,628	31.3%	29.0%	↓	$18.79	↓	(24,361)	↓	2,244,628	30.7%
C	1,023,860	28.4%	26.5%	↑	$16.13	↑	7,024	↑	1,023,860	30.5%

Source: CBRE Research, Q2 2022.

FIGURE 15: Minneapolis/St. Paul Office Market Statistics, Q3 2022 (cont. from previous page)

Submarket	MT Renatble Area (Sq. Ft.)	MT Direct Availability Rate	MT Direct Vacancy Rate	Y-o-Y Vacancy Trend	Avg Dir Asking Ls Rate	Y-o-Y Asking Rate Trend	Q2 Net Absorption (Sq. Ft.)	Y-o-Y Quarterly Absorption Trend	Multi-Tenant and Single-Tenant Combined Stats	
									MT & ST Rentable Area (Sq. Ft.)	MT & ST Vacancy Rate
Midway	2,534,180	14.5%	14.2%	↓	$16.12	↓	(20,330)	↓	3,608,522	10.7%
A	603,984	24.2%	24.2%	↑	$16.50	↑	5,227	↑	603,984	24.7%
B	1,531,962	11.7%	11.5%	↓	$15.21	↓	(26,249)	↓	2,325,917	8.6%
C	398,234	10.5%	9.3%	↑	$18.73	↑	692	↓	678,621	5.4%
Northeast	2,424,556	9.5%	8.6%	↓	$14.74	↑	15,025	↓	2,709,710	7.9%
A	465,813	21.8%	18.6%	↓	$15.44	↓	20,791	↑	465,813	18.6%
B	1,819,117	5.7%	5.4%	↓	$14.61	↓	(5,766)	↓	2,104,271	5.0%
C	139,626	17.5%	15.7%	↓	$12.47	↓	0	→	139,626	15.7%
BEA	3,644,915	25.5%	22.5%	↓	$12.45	↓	(8,249)	↓	5,145,417	16.0%
A	1,806,727	21.8%	18.2%	↓	$13.89	↓	18,460	↑	2,345,765	14.0%
B	1,709,176	30.7%	28.1%	↓	$11.88	↓	(27,335)	↓	2,670,640	18.0%
C	129,012	10.3%	8.5%	↓	$11.23	↑	626	↑	129,012	8.5%
Northwest	1,374,588	22.6%	19.7%	↓	$12.98	↑	24,313	↑	2,564,191	10.6%
A	244,850	6.5%	5.5%	↓	$13.28	↑	0	→	1,245,981	1.1%
B	851,663	26.7%	22.4%	↑	$13.12	↑	23,881	↑	1,040,135	18.3%
C	278,075	24.1%	24.1%	↑	$12.45	↑	432	↑	278,075	24.1%
St. Paul CBD	6,042,576	23.7%	19.5%	↓	$12.94	↑	(46,165)	↓	8,707,661	13.8%
A	2,685,792	20.0%	17.8%	↓	$13.06	↓	28,181	↑	3,240,792	15.0%
B	3,047,791	26.8%	20.6%	↓	$12.57	↑	(77,143)	↓	5,157,876	12.4%
C	308,993	25.3%	23.5%	↓	$16.06	↓	2,797	↑	308,993	23.5%
Suburban St. Paul	4,863,145	27.6%	24.4%	↓	$13.66	↑	(89,022)	↓	7,522,660	16.3%
A	2,120,799	28.2%	21.2%	↓	$14.03	→	(23,574)	↓	3,893,287	12.6%
B	1,956,199	21.6%	21.2%	↓	$13.74	↑	(67,674)	↑	2,521,530	16.4%
C	786,147	41.0%	41.0%	↑	$10.85	↓	2,226	↑	1,107,843	28.9%

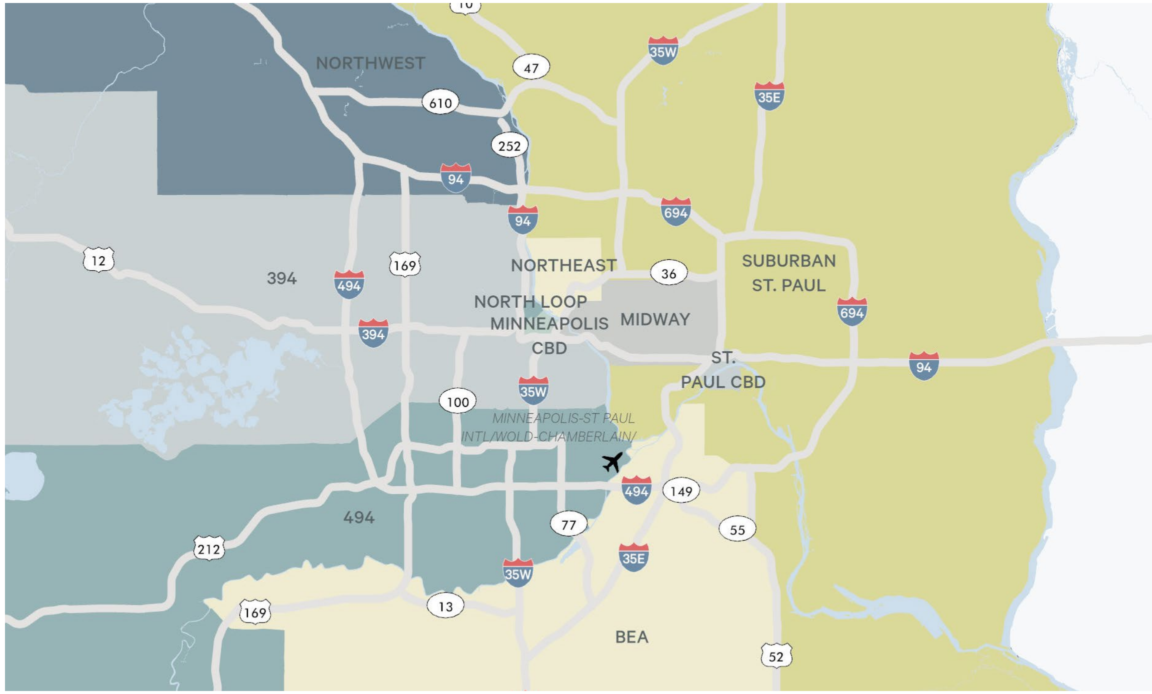
Source: CBRE Research, Q2 2022.

Economic Overview

The problems associated with inflation continue to run their course. Although the pace of inflation may have started to plateau, the Federal Reserve's hawkish response has been unequivocal in a way that caught markets by surprise. Aggressive rate hikes and Fed balance sheet reductions have successfully resulted in a strong dollar and higher mortgage rates, and the beginning of a slowdown in the U.S. economy.

Higher rates are not just impeding household decisions; a higher corporate cost of capital is forcing firms to rethink hiring plans. So far resilient consumers have driven further economic growth but now the realities of lower savings rates and chronically poor sentiment suggest excess spending is coming to an end. Consequently, we expect the economy to contract early next year, and unemployment to rise. This should push inflation down toward 3% by year-end 2023. It is possible the Fed may be able to reduce inflation and maintain the unemployment rate below 5%, but we should not bank on that. Once inflation is tamed, both capital and real estate markets will become more predictable again

Market Area Overview



Definitions

Available Sq. Ft.: Space in a building, ready for occupancy within six months; can be occupied or vacant. Availability Rate: Total Available Sq. Ft. divided by the total building Area. Average Asking Lease Rate: A calculated average that includes net and gross lease rate, weighted by their corresponding available square footage. Building Area: The total floor area sq. ft. of the building, typically taken at the "drip line" of the building. Gross Activity: All sale and lease transactions completed within a specified time period. Excludes investment sale transactions. Gross Lease Rate: Rent typically includes real property taxes, building insurance, and major maintenance. Net Absorption: The change in Occupied Sq. Ft. from one period to the next. Net Lease Rate: Rent excludes one or more of the "net" costs (real property taxes, building insurance, and major maintenance) typically included in a Gross Lease Rate. Occupied Sq. Ft.: Building Area not considered vacant. Vacancy Rate: Total Vacant Sq. Ft. divided by the total Building Area. Vacant Sq. Ft.: Space that can be occupied within 30 days.

Survey Criteria

Includes multitenant office buildings 10,000 sq. ft. and greater in size in the Minneapolis/St. Paul market, excluding single-tenant owner-occupied buildings, government-owned and –occupied buildings, and medical buildings. Buildings which have begun construction as evidenced by site excavation or foundation work.

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