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Investors Attracted to Highs and Lows of Twin Cities Commercial Real Estate Property Markets

- Capital remains abundant, but investors still selective on office and retail
- Multi-family remains hottest market
- High demand for contemporary industrial properties

Overview

Buyers are out in force for Twin Cities commercial real estate, albeit still on a more selective basis in certain segments. The multi-family market remains red-hot as an investor favorite, pulling strong interest from all types of investors.

Investment capital remains abundant, locally and nationally, from virtually all types of sources—lenders, institutional investors, private investors, REITs. It's still a tight strike zone for larger national investors, however.

In-Demand Product Types

- Contemporary industrial product—those with 32-foot clearances and low office finish are the most in-demand
- Grocery-anchored retail centers—still in demand, but investors are taking a harder look at each center's fundamentals as competition from non-traditional grocery retailers heats up
- Multi-family—institutional investors are vying to partner up on both the development of new high-end product and investment in existing class A properties
- Stabilized class A office product—especially in the Minneapolis CBD
- Retail power centers—gaining new traction with investors, who rate the survivors of the recession-era shakeout as likely to thrive in a rejuvenated retail environment.

Most of the significant first-half deals were in the office, multi-family and medical office sectors, with industrial trailing simply because there wasn't enough product for sale. The retail market saw two major transactions: a big-box-anchored retail center, which is a product that has been out-of-favor with investors, and a Cub Foods-anchored center.

Investors are coming to the Twin Cities in pursuit of higher yields. Cap rates on industrial properties average 50-100 basis points higher in the Twin Cities, compared with what's available in major distribution markets. Average-quality suburban office product is trading at 8-9% cap rates and is beginning to attract more investor interest following several years of being off the radar screen. Core class A properties in the Minneapolis CBD and select suburban submarket locations are in high demand and fetching more premium pricing with cap rates in the 6.2-7% range for the best product.

Among institutional investors, multi-family is the absolute sweet spot. The Twin Cities apartment market is ranked as one of the five best in the country with an average vacancy rate of 2.8%. Rental rate growth of 2-3% over the past year has sparked even more investor interest. Some observers anticipate a 4-5% rental rate growth in 2013, even as the market prepares to deliver another 2,600 apartment units in 2013 and 4,300 in 2014.

Big box-anchored retail centers are drawing renewed investor interest, as evidenced by the June sale of Oakdale Village Shopping Center, a 164,000-sf center anchored by Best Buy, Sports Authority and Home Goods.

Many non-core assets are considered “broken” by some investors. These are properties whose fundamentals are still soft—significant vacancies, above-market rental rates on the current rent roll, near-term rollovers or weak credit among existing tenants. In addition, continued economic uncertainty is giving investors pause when it comes to evaluating opportunities in the middle of the market. Owners of these properties—both the non-core and “middle market” properties—need to be cognizant of the concerns investors have about their potential to show positive growth over the next few years. Potential sellers may need to adjust pricing expectations accordingly. The market has seen a few examples of sellers reaching too hard for pricing; the gap in pricing expectations needs to narrow before this portion of the market will see significant transaction volume.

Outlook

The second half looks primed for plenty of new investment activity across all property types. Retail could see five or more significant transactions, which would make for a year’s worth of activity comparable to 2012.

Multi-family is expected to continue to be in strong demand in the second half and into 2014, which is when some of the recently constructed apartment properties may begin to come up for sale.

The capital markets are reacting to a 100-basis-point increase in Treasury prices since early May. As the Federal Reserve signaled its intention to begin winding down its economic stimulus and the economy showed positive signs, investors moved away from bonds, resulting in significant increase in Treasury yields. Fed moves will be important to the market during the next six months.