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# Market Notes

Volume 2

## 2007 Market Recovery Differs From Those Of The Past

The office market recovery which is underway differs from all others in the past! Real estate development cycles typically take eight to ten years to run their course. Strong market conditions and economic growth fueled by available capital eventually leads to overbuilding, higher vacancies and declining rates. Once this occurs, development activity declines until gradually vacancies are absorbed, rates rise and new development activity again emerges. What makes the current cycle so different from historical standards is the rising costs of new construction. Over the past twenty years Class A net rental rates of \$15 to \$18 per square foot generally justified new construction throughout the market. In today's environment, net rental rates of \$18 to \$19 in the suburbs and \$22 to \$23 net in the Minneapolis CBD (Central Business District) are projected to support new construction. Rising costs for labor and materials, coupled with escalating land values, have made this cycle very different from those of the past.

For the most part, 14% to 16% vacancy levels throughout the market have maintained pressure on rates creating an average rate for Class A space that is \$3 to \$5 per foot less than necessary to support new construction in the suburban markets and as much as \$7 to \$10 per foot in the CBD's. In other words, unless you are a large user or are seeking the benefits of your own campus or ownership, new construction is a more costly solution.

Several additional factors which have softened the recovery include higher Class B and C vacancies. At 18% to 20% they have had a competitive impact on rates for Class A space as well. Absorption, although positive and steady, has also lost some of its punch due to the desire to own by the Twin Cities largest corporate users. Continued conversion of Class B and C office property to hotel or residential is also a recent trend which has impacted over 400,000 square feet of office property in the Minneapolis area in 2007. This will reduce vacancies in this segment slightly adding some pressure to increase rates.

Considering all of these factors we anticipate a 12-18 month pause before seeing significant new office development. We may also see less overbuilding during this next cycle which would result in a lower vacancy rate during the peak of the development cycle. This may mean that contiguous expansion space may be harder for tenants to obtain or may come at a higher price in the future. The record demand for institutional quality investment real estate also reflects this owner optimism and the outlook for future real estate values. Now more than ever securing flexibility for future growth or lease rate protection on renewals is critical.

Landlord motivation can vary significantly not only by building but also by floor. In considering high rise space, solutions are now becoming more limited in supply and rates may vary by as much as \$5 to \$6 per square foot over lower level alternatives in the same building.

As we have seen in other national markets which are enjoying low vacancy rates, the role of your real estate advisor may be to identify space opportunities prior to their availability in the market. Finding existing premises containing "residual value" to a particular tenant is also a value add element provided by an experienced advisor. Prudent input throughout space design, strategic long term planning and negotiation of the documents are also areas where the client/tenant/buyer deserve experienced representation to take advantage of market conditions and opportunities. Evaluating ownership opportunities versus leasing will also become more attractive as rental rates rise. Experienced, respected and trusted, TaTonka Real Estate Advisors provides value to our clients by offering innovative real estate solutions, designed with integrity.

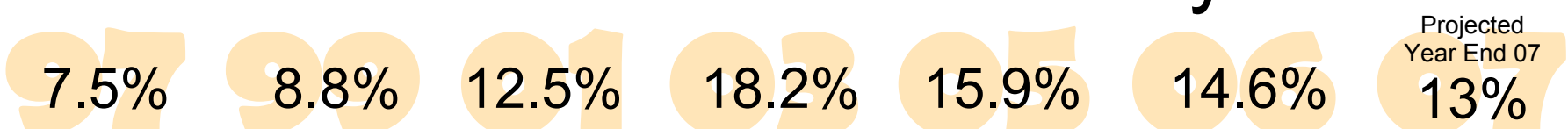
If you wish to discuss any requirement confidentially or have a market related question, please feel free to contact us at 612.466.7300. You may also visit our website at [www.TATONKAre.com](http://www.TATONKAre.com).

### TaTonka

TaTonka is a Dakota Indian term for the mighty American Buffalo. It is a symbol of strength, health, spirit and vitality. It is respected for its energy and integrity and thrives under adversity. It was chosen for our firm's name and incorporated into our logo to symbolize the values of our organization.



## Twin Cities Office Vacancy Rates



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## Sample Survey of Recent Transactions

### Office

**Associated Financial**  
36,759 sf expansion & renewal  
Minnetonka, MN  
**Bloomington Convention & Visitors Bureau**  
9,196 sf expansion & renewal  
Bloomington, MN  
**Fiserv Lending Solutions**  
21,781 sf lease  
St. Louis Park, MN  
**MWCIA**  
14,118 sf lease renewal  
Edina, MN  
**Siegel, Brill, Greupner, Duffy & Foster, P.A.**  
11,829 sf lease renewal  
Minneapolis, MN  
**Strother Communications Group**  
5,149 sf lease  
Minneapolis, MN  
**Wells Fargo Bank, N.A.**  
53,950 sf expansion & renewal  
St. Louis Park, MN

### Industrial

**Carbonair**  
13,289 sf lease  
Brooklyn Park, MN  
**Cardiovascular Systems, Inc.**  
34,556 sf lease  
New Brighton, MN  
**CMS Direct**  
19,500 sf sale  
New Brighton, MN

### Retail

**Signature Care for Hair Nails & Body, Inc.**  
3,530 sf lease  
Apple Valley, MN  
**Twin City Co-ops Federal Credit Union**  
1.5 acre land/building purchase  
Roseville, MN

### Services

- Advisory and Consulting Services
- Asset Disposition
- Build-to-Suit Client Representation
- Buyer Representation
- Lease Renewals
- National and International Network Connections
- Site Search and Selection
- Sublease Assignments
- Tenant Representation

### Investment

**900 W. American Blvd**  
18,500 sf Office Building  
Bloomington, MN  
**1513 West Lake Street**  
7,140 sf Retail Building  
Minneapolis, MN  
**3506 Bloomington Avenue S**  
4,040 sf Industrial Building  
Minneapolis, MN  
**9001 Business Center**  
23,897 sf Office Building  
Bloomington, MN

### Medical

**Dr. Michael Wolfe**  
2,648 sf lease renewal  
St. Anthony, MN  
**Physicians Neck & Back Clinics**  
11,861 sf lease  
Roseville, MN  
7,125 sf lease  
Maple Grove, MN

### Land

**Star Environmental**  
Purchase  
Fridley, MN  
**St. Paul Postal Credit Union**  
Purchase  
Hugo, MN  
**Twin City Co-ops Federal Credit Union**  
Purchase  
Eden Prairie, MN  
**Wells Fargo Bank, N.A.**  
Purchase  
Medina, MN

### National

**Nichols Kaster & Anderson, PLLP**  
Office - San Francisco, CA

### Areas of Specialization

- Office
- Industrial
- Medical
- Retail
- Land
- Investment

Market Notes Newsletter is published twice annually to highlight market trends and transactions, and to communicate helpful information to our clients and users of commercial space.



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