University of St. Thomas
Minnesota Commercial Real Estate Survey
May 2012
Welcome to the latest edition of the UST Minnesota Commercial Real Estate Survey.

The Minnesota Commercial Real Estate Survey has been developed by the University of St. Thomas Shenehon Center for Real Estate, and is designed to be a forecasting tool for the commercial real estate market in the Twin Cities. The semi-annual survey poses questions to local real estate market experts on their expectations for future vacancy rates and rental rate growth, on development costs and on new project financing structure. The questions are chosen to explore the various aspects of commercial real estate development and predict impact on new investment.

May Results

The semiannual Minnesota Commercial Real Estate Survey continues to show a less optimistic outlook for commercial real estate than the survey found last fall. This is a continuation of a downward trend that started with the fall 2011 survey. As was done with all four of the previous surveys, the same group of 50 commercial real estate industry leaders involved in development, finance, and investment were polled. The survey participants have now changed their two year outlook from slightly optimistic to slightly pessimistic.

The spring 2012 survey composite index recorded its first reading below 50. Index values greater than 50 represent a more optimistic view of the market over the next two years, with values of less than 50 indicating a more pessimistic view. The composite index was recorded at 49 falling from 51.2 last fall. This is a continuation of a trend that began in May 2011, when the composite index was 56. The continued decline of the overall index reflected many of the same concerns that drove the decline six months ago.

![Chart showing market conditions](chart.png)

Market conditions are best described by the price for space (rental rates) and the supply of space (occupancy levels). The index for rental rates increased slightly from 66.5 to 68. This indicates an optimistic outlook for rent growth that is somewhat more optimistic than the panel’s outlook last November. The index for occupancy levels was unchanged at 67. This sentiment seems to indicate optimism that the economy is going to continue to improve and that there will be a greater demand for space.

There was a definite change in the panel’s expectations about land prices. Last fall the expectation was that land prices would continue to increase. This spring the sentiment of our panel is more certain that land values will continue to increase. The land price index decreased...
from 38.1 last fall to 33 this spring. Increasing land prices are a hindrance to new development, making it more difficult to obtain financing and adequate returns for investors. We also continue to observe a very strong indication that the price of building materials will increase significantly over the next two years. The building material index went from a strongly negative 27.9 to an even more negative 26. Higher costs for building materials, much like higher land costs, are a hindrance to new development.

The index for investor’s return expectations remained unchanged for the third consecutive survey at 49. Although this index value is slightly pessimistic, it is essentially neutral. The panel responses continue to indicate that investors are trying to figure out the “new normal” in commercial real estate investment markets. Investors will continue to seek out quality investments but they are being much more diligent about how they evaluate risk and return when considering their investment options. The index for the amount of equity required by lenders was 62; this is a slight increase from the 60 recorded last fall. This indicates a continued belief that the credit markets will return to more normal loan to value requirements which will help to make financing more obtainable with better terms.

To summarize, our panel participants have changed their view from being slightly optimistic to slightly pessimistic about the prospects for the commercial real estate market in 2014. They continue to be confident that rents and occupancy will show solid growth in the next two years due to improving economic conditions. The expected increase in land prices and building materials will continue to have a negative impact on development activities. They expect that financing terms are going to continue to remain stable and there should be moderately increasing amounts of equity capital available. That being said, lenders and investors are going continue to be very selective in their underwriting criteria and evaluation of potential deals. The bottom line for the spring 2012 survey finds our panel showing increased concern about expected commercial real estate market conditions. The shift in the composite index from mildly optimistic to slightly pessimistic reflects the panels’ increasing uncertainty about general economic conditions in the next two years.
About the Survey

The Minnesota Commercial Real Estate Survey has been developed by the University of St. Thomas Shenehon Center for Real Estate, and is designed to be a forecasting tool for the commercial real estate market in the Twin Cities. The semi-annual survey poses questions to local real estate market experts on their expectations for future vacancy rates and rental rate growth, on development costs and on new project financing structure. The questions are chosen to explore the various aspects of commercial real estate development and predict impact on new investment.

This survey is general in nature in that it takes into account office, retail and industrial properties in the Twin Cities market as a whole. The survey focuses on the supply side of commercial real estate, meaning people that develop, invest in and finance commercial real estate. Our participant panel consists of 50 individuals who are industry leaders in their respective fields. These people are actively engaged in studying both the demand and supply side of the commercial real estate market in order to analyze and evaluate potential investments. Since they are involved in leasing space and adjusting supply to demand conditions, these individuals are close to the actual changes taking place in the market. They have informed opinions on changes in supply and demand conditions looking forward two to three years into the future and they will be making investment decisions based on their opinions. These actions will, in turn, affect the demand for new construction and, consequently, the stock of commercial space in the market. Understanding the current and future views of the participants will help us better understand the evolution of the commercial real estate market.

The UST Minnesota Commercial Real Estate Survey is a forward looking survey. This type of survey seeks to elicit information about decisions being made today which will affect economic events in the future. The survey is conducted twice a year, in the spring and fall, and is patterned after the UCLA Anderson California Commercial Real Estate Survey initiated in 2006. As the years pass and more surveys are completed, the survey becomes a useful forecasting tool.

The survey consists of six questions around future markets and participants’ expectations. The participants give their views of market conditions between now and two years from now. Each question has a value from 0 to 100, with higher values corresponding to answers consistent with a more favorable outlook for commercial real estate. Lower values indicate a more pessimistic view of what will happen in the market over the next two years. The midpoint of 50 is neutral, indicating that no change is expected. Survey responses are summarized in the next section and provide some interesting insights into the market.

About the Authors

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November 2011
Survey

The UST Minnesota Commercial Real Estate Survey consists of six questions. Each question asks participants to give their expectations of real estate conditions in 2014.

Compared to today, what do you think that rental rates will be in 2014?
- Significantly Lower
- Somewhat Lower
- The Same
- Somewhat Higher
- Significantly Higher

Compared to today, what do you think that occupancy will be in 2014?
- Significantly Lower
- Somewhat Lower
- The Same
- Somewhat Higher
- Significantly Higher

Compared to today, what do you think that land prices will be in 2014?
- Significantly Lower
- Somewhat Lower
- The Same
- Somewhat Higher
- Significantly Higher

Compared to today, what do you think that the price of building materials will be in 2014?
- Significantly Lower
- Somewhat Lower
- The Same
- Somewhat Higher
- Significantly Higher

Compared to today, what do you think that the threshold rate of return on equity will be in 2014?
- Significantly Lower
- Somewhat Lower
- The Same
- Somewhat Higher
- Significantly Higher

Compared to today, what do you think that the amount of equity required by lenders will be in 2014?
- Significantly Lower
- Somewhat Lower
- The Same
- Somewhat Higher
- Significantly Higher

Real Estate at the Opus College of Business

Shenehon Center for Real Estate  www.StThomas.edu/Shenehon
The Shenehon Center for Real Estate serves as a resource to the commercial, industrial, residential and corporate segments of the real estate industry and the community to advance the public interest in real estate issues. For more than 15 years, the center has supported improvement in real estate leadership and management by creating and developing real estate leadership and management programs for undergraduate and graduate degree programs and professional development, providing a neutral forum to convene real estate professionals to share best practices, supporting and working with local real estate industry organizations, conducting real estate research, and developing mechanisms to transfer leading edge business practices to the real estate industry.

Master of Science Degree in Real Estate  www.StThomas.edu/RealEstate
The Master of Science Degree in Real Estate is one of seven graduate business degree programs offered through the Opus College of Business. This part-time, evening program provides students with a comprehensive understanding of real estate financial and quantitative decision making processes, and advanced issues in valuation and land economics, knowledge of critical legal issues, and techniques for market and feasibility studies and real estate investment analysis. Students in the UST MSRE program come from a variety of different backgrounds including appraisal, brokerage, property management, finance, development, engineering, design, facilities management and corporate real estate. The program produces alumni with strong leadership abilities, aptitude for sound decision making, focus on ethics and social responsibility, and a solid network of real estate professionals.

Bachelor of Science Degree in Real Estate www.StThomas.edu/business/BSRealEstate
The Bachelor of Science Degree in Real Estate is one of 13 undergraduate concentration areas in the Opus College of Business. This four-year degree program provides students with a background in general business and real estate theory and practice. Students study the many factors involved in property assessment and sales, how they change and how these changes affect real estate and individuals. Recent graduates hold positions in the government, nonprofit, construction and private business sectors, including leadership positions in real estate brokerage, investment management, property management, appraisal, construction management, land-use planning and land development.