About the Survey

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The Minnesota Commercial Real Estate Survey has been developed by the University of St. Thomas Master of Science degree in Real Estate and 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 will be 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 2013. 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. This is the third survey and there have been some changes in the results from our previous survey last fall. Survey responses are summarized in the next section and provide some interesting insights into the market.
Results

According to the most recent Minnesota Commercial Real Estate Survey, the commercial real estate landscape looks somewhat brighter than it did in our previous survey last fall. This is a continuation of a trend that we have observed since our initial survey was conducted one year ago in May of 2010. For all three of our surveys, we polled the same group of 50 commercial real estate industry leaders who are involved in development, finance, and investment. While our panel of participants continues to feel that the worst is behind us for most commercial real estate in the Twin Cities, there are still some reasons to be concerned. While we expect the markets to continue to be sluggish in some areas for the near term, our panel still sees reasons for optimism in 2012 and 2013.

Overall, the survey shows that the panel continues to feel more optimistic about commercial real estate’s prospects over the next two years. The composite index has continued to increase from 54.1 last fall to 55.6 for the May 2011 survey. This is a continuation of the upward trend that began with our first survey in May of 2010. Index values greater than 50 represent a more optimistic view of the market over the next two years. Although there was a modest increase in the composite index, there were notable differences in some of the responses to specific survey questions. Again, we found that the panel’s answers to our survey continue to be grouped much tighter than the original survey, showing that there was much stronger agreement among panel members around their responses.

Since market conditions are best described by the price for space (rental rates) and the supply of space (occupancy levels), we looked at those two components of the survey and found that our participants were significantly more optimistic that rents and occupancy would continue to increase. The index for rental rates increased from 56.4 to 70.8. This is one of the single biggest changes we have observed in any of the components of the index since its inception. The index for occupancy levels recorded a similar increase, moving from 64.9 to 71.4. This sentiment seems to come from a general expectation that the economy is going to continue to improve and that there will be a greater demand for space.

There was a definite reversal in the panel’s expectations about land prices. Last fall there was a slightly favorable expectation that land prices would continue to moderate. In the current survey, that sentiment changed dramatically as the land price index fell from 50.5 last fall to 37.5 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 observed 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 moderately negative 37.2 to a decidedly negative 25.

The index for investor’s return expectations at 51.6 is essentially neutral. This indicates that the panel feels that investors are continuing to try and figure out what the “new normal” is in the commercial real estate investment markets. Investors are going to 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 62.5; this is an increase from the 56.4 recorded last fall. This increase reinforces 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.
Results (continued)

To summarize, our panel participants are becoming somewhat more optimistic about the prospects for the commercial real estate market between now and 2013. They expect rents and occupancy to show solid growth in the next two years; however, the expected increase in land prices and building materials are going to be somewhat of a drag on the market. Financing terms are expected to continue to improve and there should be increasing amounts of equity capital available. That being said, lenders and investors are going to be very selective in their underwriting criteria and evaluation of potential deals. The bottom line for the Spring 2011 survey finds our panel showing more optimism about expected commercial real estate market conditions in the next two years. In spite of their concerns about the rising prices of land and building materials, the commercial real estate markets in the Twin Cities should continue to show modest improvement.

Real Estate Programs 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.
The UST Minnesota Commercial Real Estate Survey consists of six questions. Each question asks participants to give their expectations of real estate conditions in 2013.

Question 1
Compared to today, what do you think that **rental rates** will be in 2013?

- Significantly Lower
- Somewhat Lower
- The Same
- Somewhat Higher
- Significantly Higher

Question 2
Compared to today, what do you think that **occupancy** will be in 2013?

- Significantly Lower
- Somewhat Lower
- The Same
- Somewhat Higher
- Significantly Higher

Question 3
Compared to today, what do you think that **land prices** will be in 2013?

- Significantly Lower
- Somewhat Lower
- The Same
- Somewhat Higher
- Significantly Higher

Question 4
Compared to today, what do you think that the **price of building materials** will be in 2013?

- Significantly Lower
- Somewhat Lower
- The Same
- Somewhat Higher
- Significantly Higher

Question 5
Compared to today, what do you think that the **threshold rate of return on equity** will be in 2013?

- Significantly Lower
- Somewhat Lower
- The Same
- Somewhat Higher
- Significantly Higher

Question 6
Compared to today, what do you think that the **amount of equity required by lenders** will be in 2013?

- Significantly Lower
- Somewhat Lower
- The Same
- Somewhat Higher
- Significantly Higher