RESEARCH **3Q 2020**

Newmark Knight Frank

MINNEAPOLIS – ST. PAUL OFFICE MARKET

Unprecedented rate of subleases becoming available in the Twin Cities office market

The Minneapolis-St. Paul office market continues to soften into the third quarter of 2020 due to curtailed demand from the Covid-19 pandemic. Office net absorption in the Twin Cities was negative 456,000 square feet, an absorption drop-off not seen since the 2008 financial crisis. The sharp turn to negative absorption increased the vacancy rate by half-a-point, from 11.2% in the previous quarter, to currently 11.5% vacancy in the third quarter.

A rise in vacancy was not the only factor leading to increased space availability, the amount of sublet space has climbed drastically in recent months. Sublet availabilities rose nearly 25% in the third quarter, pushing the metro-wide sublet total close to 2 million square-feet. This trend is amplified in the Minneapolis CBD, where rent is most expensive, and limited mobility has subdued downtown's atmosphere and work culture. The amount of sublet space in the Minneapolis CBD will soon equate to 3% of the submarket's inventory.

Initial tenant exits and downsizing seen

The Southeast submarket recorded the most negative absorption with a total of 246,000 square feet put back on the market. Unrelated to the pandemic, the consolidation of Prime Therapeutics into their headquarters occurred when a combined 135,000 square-feet was vacated at 2655 Eagan Woods Dr and Crosswind Centre. However, other tenant move-outs were more correlated to the uncertain state of the market. Corelogic, a data analytics firm, opened a sublease opportunity in the Southeast when they left 42,000 square-feet at Riverview Office Tower.

Another notable shakeup transpired in the West submarket when the affordable housing developer Dominium elected to forgo a move into their Crest Ridge headquarters. Dominium purchased the property in early January and is now marketing the 56,000 square-foot space for lease. A short distance from Crest Ridge, Fortune 500 company General Mills vacated the last 48,000 square-feet from their Bassett Creek Building, a property located on their office campus.

The Minneapolis CBD observed negative absorption in the third quarter, totaling 88,000 square feet. ERM downsized from 34,000 square-feet of space in the IDS Center to 22,000 square feet in their new Two22 office. AT&T gave back 30,000 square-feet at AT&T Tower and Epsilon vacated 28,000 square-feet on a sublease at PwC Plaza. The only submarket to record positive absorption was the St. Paul CBD, where Kindeva Drug took an available sublease of 32,000 square-feet at Infor Commons.

CURRENT CONDITIONS

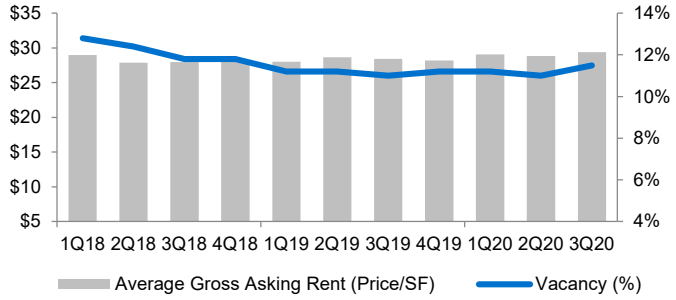
Quarterly net absorption of (456,038) square feet

Overall vacancy rate of 11.5%

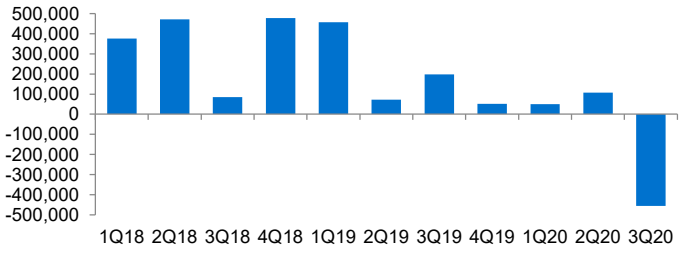
2,122,300 square feet under construction

MARKET ANALYSIS

Gross Asking Rent and Vacancy



Net Absorption (SF)



MARKET SUMMARY

	Current Quarter	Prior Quarter	12 Month Forecast
Total Inventory	118.9M	118.9M	↑
Vacancy Rate	11.5%	11.2%	↑
Quarterly Net Absorption	(456,038)	274,934	↓
Average Gross Asking Rent	$29.39	$28.85	↓
Under Construction	2,122,000	2,122,000	↓
Deliveries	0	0	↑

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Construction moves forward

A new medical office development called the Xchange is schedule to break ground in the months ahead after two deals were signed in the third quarter. Committed tenants were needed to kick-off construction for the 78,000 square-foot office that will soon replace three properties, one consisting of 34,000 square feet. First to enter into the West submarket's Xchange will be Surgical Care Affiliates for 26,500 square-feet and Ear, Nose & Throat Specialty for 19,000 square-feet. One mile east of the Xchange site, Ten West End's construction is nearing completion. Ten West End notably had engineering firm HDR sign a deal during the third quarter. HDR will move into the sixth and partial fifth floor for 46,600 square-feet, when the property is scheduled to deliver in the first quarter of 2021.

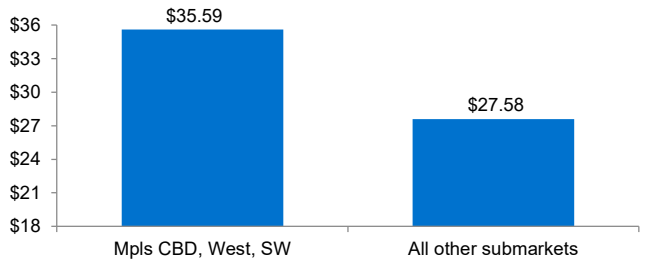
In the Minneapolis CBD, RBC Gateway continues to move forward for a Q2 2020 delivery. The pandemic caused no regulatory interference or delays with the project's construction. However, on Nicollet Mall, the Dayton's Project struggle to find an office tenants to lease due to high asking rent and low demand. The planned food hall slated in the retail area of the Dayton's Project is also of concern, with regards to large gatherings in the Coronavirus era.

Rent climbs across the metro

Average asking rent continued to rise in all building classes of the Twin Cities office market due to landlords' hesitancy to adjust rates while assessing the current slowdown's variables. Rent growth in the Core neighborhood of the Minneapolis CBD, topped at $34.47 full-service gross (fsg), and grew 4.24% from last quarter's rent of $33.01. Record high rents and larger rent growth percentages occurred in the suburban submarkets too. The Northeast submarket grew 4.32% and reached $22.04 and the West submarket gained 2.22% rent growth at a high of $31.67 full-service gross. All the submarkets experienced an increase in rents except for the Southeast submarket and CBD's North Loop.

The disparity in Class A rent between submarkets continues to grow. Lower asking rent in Class A product that's located in less desired submarkets could lead to more leases in the future as companies seek bargains.

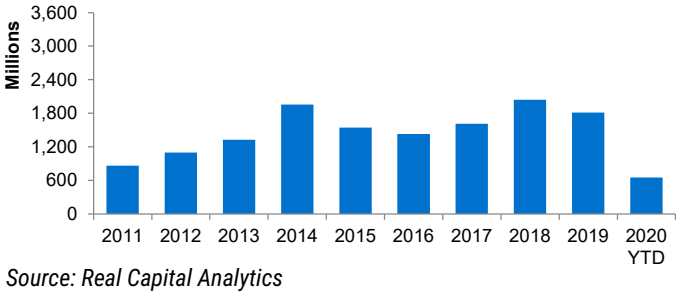
Class A Average Gross Asking Rate



Sale activity slides further in 2020

The simultaneous slowdown in office space leasing and consumer spending led to a slump in capital markets activity across the country. At the end of the third quarter, Minneapolis St. Paul total office sales stand at $649 million, which is a decrease of 53% compared to office product sold at this point in 2019. Transactions are difficult to appraise as there are little to no comparable sales.

Office Sales Volume



Source: Real Capital Analytics

The largest investment sale of the third quarter was the East neighborhood's Millwright Building, which transacted for $51,200,000. The 168,296 square-foot, four story building was 97% leased when it sold in early September for $295.14 per-square-foot. CBRE Global Investors was the buyer of the property, which is also their first purchase in the Minneapolis-St. Paul market; the seller was Artis REIT. The second largest investment sale transaction occurred at Optum Technology buildings A & B, located in the southwest metro city of Eden Prairie. Virtus Real Estate Capital paid $32 million to Angelo, Gordon & Co for the two properties totaling for 279,502 square-feet. In addition to the Millwright Building, an office property at 200 12th Avenue S. sold in the East neighborhood of the Minneapolis CBD. Reuter Walton Development purchased the 18,842 square-foot property for $6,185,000, which equates to $326.28 per-square-foot.

Future outlook in the office market

Leasing velocity and sale activity were in a dismal state in the third quarter. One indicator illuminating the state of today's office market is the large negative absorption total and spike in vacancy. Office market figures similar to this quarter were last seen during the 2008-2009 financial crash. Tenant activity is focused on increasing sublease availability as a wide variety of users, regardless of size, class, or location, seek to downsize.

In Minnesota, the coronavirus hasn't exposed the economy as profound as other state economies that rely more on tourism and entertainment. Minnesota workers will be put to test as winter is approaches and alarmed scientists warn of a challenging season with coronavirus and the seasonal flu. Significant changes will have to be made in order to bring back workers into the office and boost consumer confidence.

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SELECT LEASE TRANSACTIONS

Tenant	Property	Address	City	Submarket	Type	Size (SF)
Deluxe Corp	801 Marquette	801 Marquette Ave	Minneapolis	Minneapolis CBD	New	94,300
Wells Fargo	Wells Fargo Plaza	7900 Xerxes Ave	Bloomington	Southwest	Renewal	80,000
U.S. Army Corps	First National Bank Building	332 Minnesota St	Saint Paul	Saint Paul CBD	New	80,000
Principal	Two22	222 S 9th St	Minneapolis	Minneapolis CBD	New	45,480
HDR	Ten West End	10 West End Blvd	Saint Louis Park	Southwest	New	44,622
Activision	Edenvale Corporate Crossing Park	7693-7699 Anagram Dr	Eden Prairie	Southwest	New	39,390
Kindeva Drug	Infor Commons	380 Saint Peter St	Saint Paul	Saint Paul CBD	Sublease	34,129
Edmentum	Normandale Lakes - 8200 Tower	5600 83rd St W	Bloomington	Southwest	Renewal	27,447
Site Improve	Normandale Lakes - 8200 Tower	5600 83rd St W	Bloomington	Southwest	New	27,447
Surgical Care Affiliates	Xchange	6099 Wayzata Blvd	Saint Louis Park	West	New	26,500
Ear, Nose & Throat Specialty	Xchange	6099 Wayzata Blvd	Saint Louis Park	West	New	19,000
State of MN, Board of Public Defenders	Town Square Concourse	445 Minnesota St	Saint Paul	Saint Paul CBD	New	18,018
People Incorporated	Boulder Lakes III	3000 Ames Crossing	Eagan	Southeast	New	18,016
Clear Capital	Southpoint Tower	1650 82nd St W	Bloomington	Southeast	New	17,294
Brooklyn Park School District	Shingle Creek Plaza	5910 Shingle Creek Pkwy	Brooklyn Center	Northwest	New	15,000
Ivanti	New Brighton Office Center	119 14th St NW	New Brighton	Northeast	Expansion	14,022
CNA	Normandale Lakes – 8500 Tower	5800 84th St W	Bloomington	Southwest	New	12,058
Home Service Insurance	Northpark Corporate Center	119 14th St NW	New Brighton	Northeast	New	10,899
Wayside Recovery	New Brighton Office Center	1600 W University Ave	Saint Paul	Northeast	Expansion	10,827
ReMax Results	7373 N Kirkwood Ct Office	7373 N Kirkwood Ct	Maple Grove	Northwest	New	9,901

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SELECT SALES TRANSACTIONS

Property	Address	City	Submarket	Buyer	Seller	Price	SF	Price PSF
Millwright Building	533 3rd St S	Minneapolis	Minneapolis CBD	CBRE Global Investors	Ryan Cos	$51,200,000	168,296	$294.25
Optum Technologies Buildings A & B	13675 Technology Dr	Eden Prairie	Southwest	Virtus Real Estate Capital	Angelo, Gordon & Co	$32,049,556	279,502	$114.67
Optum Technologies Building C	13675 Technology Dr	Eden Prairie	Southwest	Virtus Real Estate Capital	Angelo, Gordon & Co	$20,550,444	193,823	$106.03
-	200 12th Avenue S	Minneapolis	Minneapolis CBD	Reuter Walton Development	Private Owner	$6,185,000	18,842	$328.26
Crosstown Woods Office Center	10125 Crosstown Circle	Eden Prairie	Southwest	Sandman Structural Engineers	George Zeller	$3,175,000	47,591	$66.71
-	5516 S Lyndale Ave	Minneapolis	Southwest	South Lyndale Liquor	Borton Volvo, Inc	$2,523,987	10,000	$252.39
DaVita Wyoming Dialysis	5657 257th St	Wyoming	Northeast	Manwerk Corp	DV Wyoming, LLC	$2,490,000	5,500	$452.73
Office Ridge Center	7500 Office Ridge Center	Eden Prairie	Southwest	Private Owner	Kraus-Anderson	$2,009,000	38,586	$52.07
-	1340 Corporate Center Curve	Eagan	Southeast	Gemco International	EFI, Inc	$2,000,000	44,000	$45.45
Valley Crossing Professional Building	9950 Valley Creek Rd	Woodbury	Southeast	Private Owner	Private Owner	$2,000,000	9,000	$222.22
-	2722 Park Avenue	Minneapolis	Southeast	Diamond Lake Properties	Ebenezer Society	$1,830,000	12,671	$144.42
-	7601 Wayzata Blvd	Saint Louis Park	Southwest	Private Owner	Private Owner	$1,300,000	8,403	$154,71
-	11375 Robinson Dr NW	Coon Rapids	Northeast	TNT Property Partners	Private Owner	$1,250,000	11,020	$113.43
Cenex Building	201 Concord Exchange Street N	South St. Paul	Southeast	Beard Group	Private Owner	$1,150,000	63,365	$18.15
-	6001 N 78th Ave	Brooklyn Park	Northwest	Private Owner	Private Owner	$800,000	8,884	$90.05
Douglas Office Center	3501 Douglas Dr N	Crystal	Northwest	Hampton Companies	FTK Properties, Inc	$758,333	9,500	$79.82
Foster Building	200 W Broadway St	Monticello	Northwest	Private Owner	Private Owner	$390,000	7,252	$53.78
-	2534 7th Ave E	North St. Paul	Northeast	Berwald Investment Company	Koller Properties	$250,000	4,158	$60.13

ECONOMIC CONDITIONS

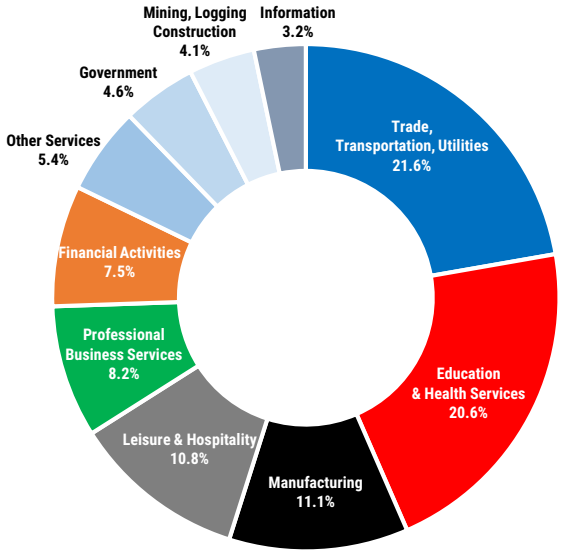
The Minneapolis-St. Paul metropolitan area has a highly educated workforce and a diverse economy that is home to 16 Fortune 500 companies, more than anywhere else in the world. Additionally, more than 320 Fortune 500 companies have a local presence. This concentration of corporate heavyweights supports a median income of $81,000 per year, more than 25.0% above the national average.

Minneapolis-St. Paul's unemployment rate jumped to 9.2% in April of 2020 due to the coronavirus. The United States unemployment rate spiked to 14.7% in March and has since dropped to 11.1% with the injection of government stimulus. The Twin Cities boasted a strong work ethic: Its labor force participation rate in June 2020 tied for the second best in the nation at 68.1%, compared with 61.5% nationally.

Minneapolis-St. Paul is a global leader in biotechnology and biomedical research with deep roots in agriculture, food exports and water technology, and it has one of the highest concentrations of banks and financial talent of any major metropolitan area. Six of the world's 10 leading medical device manufacturers have operations in the area. The area ranks high in quality of life and enjoys a great education system, low cost of living and high-quality, low-cost housing options.

EMPLOYMENT BY INDUSTRY

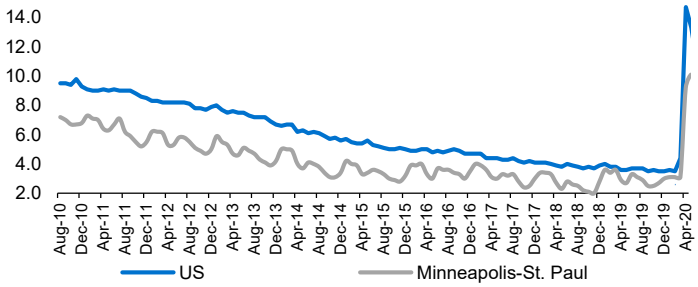
Employment by Industry Minneapolis-St. Paul



Source: U.S. Bureau of Labor Statistics

UNEMPLOYMENT RATE

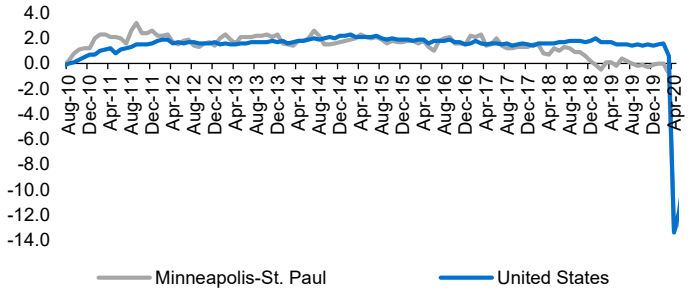
Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

PAYROLL EMPLOYMENT

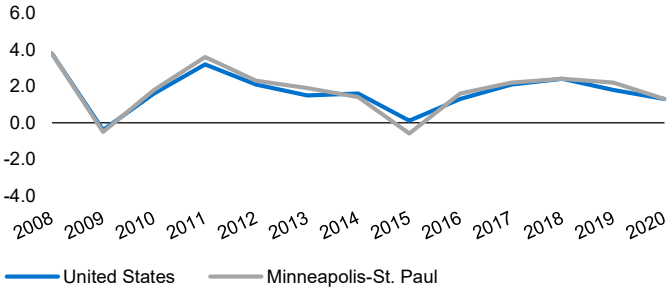
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

CONSUMER PRICE INDEX (CPI)

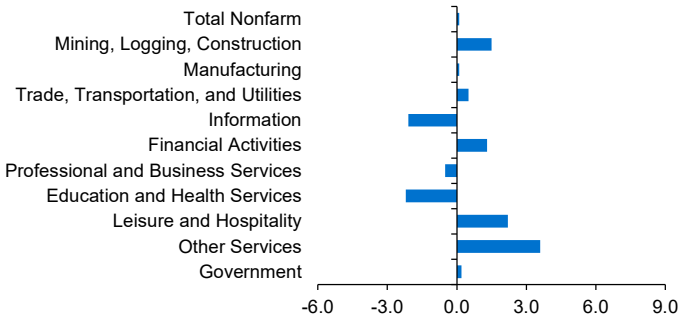
All Items, annual % Change, Not Seasonally Adjusted, 1982-84=100



Source: U.S. Bureau of Labor Statistics

EMPLOYMENT GROWTH BY INDUSTRY

12-Month % Change



Source: Bureau of Labor Statistics

MINNEAPOLIS CBD STATISTICS

	Total Inventory (SF)	Total Vacant	With Sublease Vacant	Q1 2020 Absorption	Q2 2020 Absorption	Q3 2020 Absorption	YTD Absorption	Weighted Avg. Rental Rate (FSG)	Under Construction
Core									
Class A	17,577,963	1,957,952	11.1%	(68,449)	41,405	(85,336)	(112,380)	$36.23	1,731,000
Class B	6,989,659	1,641,592	23.5%	60,965	(10,034)	34,076	85,007	$28.83	0
Class C	148,201	31,734	21.4%	0	0	(2,234)	(2,234)	$18.10	0
Totals	**24,691,973**	**3,631,278**	**14.7%**	**(7,484)**	**31,371**	**(53,494)**	**(29,607)**	**$34.47**	**1,731,000**
East									
Class A	1,407,443	5,225	00.3%	5,225	56,824	0	62,049	$34.97	0
Class B	879,568	61,218	7.0%	(18,333)	10,043	4,845	(3,445)	$27.82	0
Class C	175,842	15,000	8.5%	(10,609)	1,400	2,841	(6,368)	$22.94	0
Totals	**2,462,853**	**81,443**	**3.3%**	**(23,717)**	**68,267**	**7,686**	**52,236**	**$30.64**	**0**
Loring									
Class A	0	0	-	0	0	0	0	-	0
Class B	58,312	18,178	31.2%	(3,538)	0	0	(3,538)	$29.28	0
Class C	165,797	0	-	0	0	0	0	$16.16	0
Totals	**224,109**	**18,178**	**8.1%**	**(3,538)**	**0**	**0**	**(3,538)**	**$24.90**	**0**
Northeast									
Class A	200,739	2,791	1.4%	0	0	0	0	$34.51	0
Class B	1,791,478	195,209	10.9%	66,280	1,344	(33,892)	33,732	$25.49	0
Class C	1,187,464	55,849	4.7%	4,696	(4,941)	990	745	$20.72	0
Totals	**3,274,036**	**253,849**	**7.8%**	**70,976**	**(3,597)**	**(32,902)**	**34,477**	**$26.31**	**0**
Northloop									
Class A	1,036,475	114,751	11.1%	24,982	41,592	(13,212)	53,362	$39.35	0
Class B	1,173,777	335,004	28.5%	(52,914)	(65,795)	(9,258)	(127,967)	$31.47	0
Class C	329,449	76,981	23.4%	(16,776)	(1,372)	23,496	5,348	$24.90	0
Totals	**2,539,701**	**526,736**	**20.7%**	**(43,988)**	**(25,575)**	**1,026**	**(68,537)**	**$33.35**	**0**
Warehouse									
Class A	434,333	0	-	0	0	0	0	$37.58	0
Class B	1,565,289	356,848	22.8%	(62,761)	(21,030)	(11,300)	(95,091)	$30.18	0
Class C	311,165	8,146	2.6%	0	0	0	0	$26.75	0
Totals	**2,310,787**	**364,994**	**15.8%**	**(62,761)**	**(21,030)**	**(11,300)**	**(95,091)**	**$30.07**	**0**
Overall									
Class A	20,656,953	2,080,719	10.1%	(38,242)	139,821	(98,548)	3,031	$36.20	1,731,000
Class B	12,458,083	2,608,049	20.9%	(10,301)	(85,472)	(15,529)	(111,302)	$28.95	0
Class C	2,317,918	187,710	8.1%	(22,689)	(4,913)	25,093	(2,509)	$22.45	0
Totals	**35,432,954**	**4,876,478**	**13.8%**	**(71,232)**	**49,436**	**(88,984)**	**(110,780)**	**$33.35**	**1,731,000**

Data includes single and multi-tenant office buildings; does not include owner-occupied properties (75% or more occupied by owner)

SUBMARKET STATISTICS

	Total Inventory (SF)	Total Vacant	w/Sublease Vacant	Q1 2020 Absorption	Q2 2020 Absorption	Q3 2020 Absorption	YTD Absorption	Weighted Avg. Rental Rate (FSG)	Under Construction
St. Paul CBD									
Class A	3,111,558	293,575	9.4%	(28,816)	(2,502)	57,069	25,751	$27.82	0
Class B	4,940,322	967,912	19.6%	15,692	(1,753)	3,679	17,618	$24.38	0
Class C	411,084	28,860	7.0%	(587)	870	139	422	$16.81	0
Totals	**8,462,964**	**1,290,167**	**15.2%**	**(13,711)**	**(3,385)**	**60,887**	**43,791**	**$25.13**	**0**
Northeast									
Class A	1,245,396	114,684	9.2%	14,136	17,581	2,710	34,427	$25.53	0
Class B	12,998,812	1,196,264	9.2%	1,855	34,627	(34,767)	1,715	$22.17	0
Class C	3,740,967	146,628	3.9%	31,914	33,108	16,595	81,617	$18.14	0
Totals	**18,090,175**	**1,457,576**	**8.1%**	**47,905**	**85,316**	**(15,462)**	**117,759**	**$22.04**	**0**
Northwest									
Class A	971,953	12,026	1.2%	15,878	(739)	3,426	18,565	$23.12	0
Class B	3,580,367	342,450	9.6%	(30,547)	13,744	(13,888)	(30,691)	$22.83	0
Class C	1,072,052	24,438	2.8%	(5,876)	(847)	700	(6,023)	$16.48	0
Totals	**5,618,457**	**378,889**	**6.7%**	**(20,545)**	**12,158**	**(9,762)**	**(18,149)**	**$22.41**	**0**
Southeast									
Class A	2,611,888	416,785	16.0%	25,430	1,919	(115,957)	(88,608)	$29.38	0
Class B	9,815,573	1,007,029	10.3%	(38,820)	54,853	(115,884)	(99,851)	$22.41	0
Class C	3,647,290	208,980	5.7%	556	3,920	(14,403)	(9,927)	$20.28	0
Totals	**16,074,751**	**1,632,794**	**10.2%**	**(12,834)**	**60,692**	**(246,244)**	**(198,386)**	**$23.66**	**0**
Southwest									
Class A	8,016,986	894,429	11.2%	10,053	57,709	(7,271)	60,491	$33.42	0
Class B	10,399,270	1,365,918	13.1%	16,204	78,559	(55,626)	39,137	$26.59	0
Class C	5,330,719	464,530	8.7%	41,392	(137,443)	(57,892)	(153,943)	$22.94	0
Totals	**23,746,975**	**2,724,877**	**11.5%**	**67,649**	**(1,175)**	**(120,789)**	**(54,315)**	**$29.29**	**0**
West									
Class A	3,568,631	541,628	15.2%	15,146	42,952	(42,904)	15,194	$36.76	391,300
Class B	6,091,438	678,774	11.1%	81,380	10,378	20,718	112,476	$29.62	0
Class C	2,070,111	109,714	5.3%	(3,671)	18,562	(13,498)	1,393	$24.55	0
Totals	**11,713,044**	**1,330,116**	**11.4%**	**92,855**	**71,892**	**(35,684)**	**129,063**	**$31.67**	**391,000**
Total Market									
Class A	40,377,365	4,353,846	10.8%	13,585	256,741	(201,475)	68,851	$34.28	2,122,300
Class B	60,089,950	8,166,396	13.6%	35,463	104,936	(211,297)	(70,898)	$26.21	0
Class C	18,527,005	1,170,860	6.3%	41,039	(86,743)	(43,266)	(88,970)	$21.32	0
Totals	**118,994,320**	**13,691,102**	**11.5%**	**90,087**	**274,934**	**(456,038)**	**(91,017)**	**$29.39**	**2,122,300**

Data includes single and multi-tenant office buildings; does not include owner-occupied properties (75% or more occupied by owner)