



# Minneapolis-St. Paul Office Market

## Occupancy Continues to Decrease as Tenants Downsize and Sublease Inventory Grows; Developers Show Confidence in Mixed-Use Projects.

The Minneapolis-St.Paul office market continued to exhibit signs of softening in the third quarter, noted by rising vacancy and negative net absorption of 343,676 square feet. This decline in occupancy brings market-wide vacancies to 15.3% up 30 basis points from the previous quarter. Average gross asking rents dipped slightly for the first time in 9 quarters. This modest decrease of \$.13 per square foot resulted in an average direct gross rate of \$29.77 per square foot metro-wide. The decline is due to a modest decrease in asking rates for Class B properties across the market. Gross class A asking rates continued to increase due in part to increasing tax and operating expenses. Class A asking rates stand at \$35.75 across all markets and have increased 220 basis points since the third quarter of 2021, while overall asking rates saw a 70-basis point increase in the same timeframe. This growth is due to high priced new availabilities, strong demand for premium spaces and landlord efforts to hold pricing. Despite overall face rents holding strong, effective rents are under downward pressure as concessions packages remain strong.

### Current Conditions

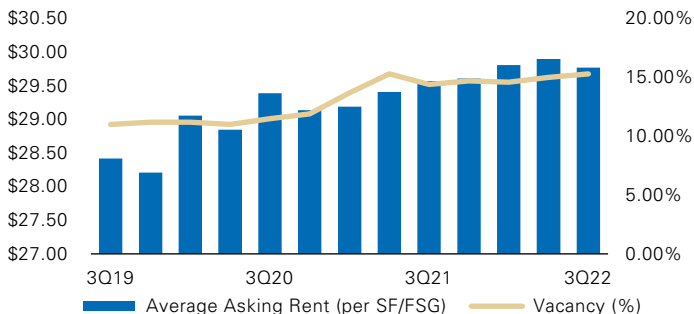
- Office net absorption of (343,676) square feet
- Overall vacancy rate at 15.3%
- Flight to quality continue as employers seek to lure employees back to the office.
- Tenants downsize as they implement hybrid work arrangements.
- Available sublease space continues to increase to 3 Million Square feet.
- Developers eye outdated office for conversion to live, work, play developments.

### Market Summary

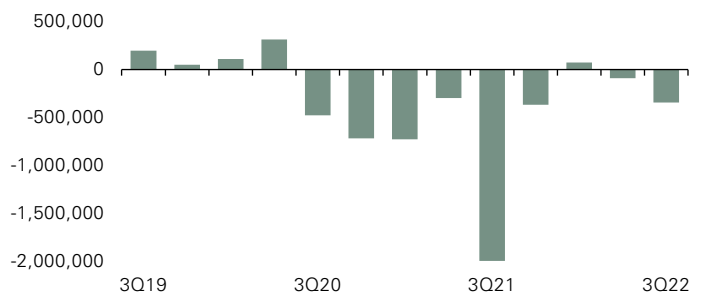
	Current Quarter	Prior Quarter	Year Ago Period	12-Month Forecast
Total Inventory (SF)	121.0 M	121.2M	120.5M	↑
Vacancy Rate	15.3%	15.0%	14.4%	↑
Quarterly Net Absorption (SF)	(343,676)	(103,620)	(296,404)	↓
Average Asking Rent/SF	\$29.77	\$29.81	\$29.44	↓
Under Construction (SF)	465,129	359,729	531,000	↑

### Market Analysis

#### ASKING RENT AND VACANCY RATE



#### NET ABSORPTION



### **Sublease & Return to Office**

The amount of sublease space continues to rise with over 3.0 million square feet available and 2.1 million square feet currently vacant. Total vacant sublease space increased by 167,756 square feet from the previous quarter. This vacant space represents 1.8% of the overall vacant space across the market.

Pent-up demand is yet to be realized in 2022 as tenants engaging in long term real estate planning are prioritizing driving innovation and attracting and retaining employees. Depending on the industry and individual company growth forecasts, many firms are expected to downsize modestly when their lease is up for renewal.

Many firms have steadily reoccupied office spaces following Labor Day. According to figures from BOMA Minneapolis, office occupancy within the Minneapolis CBD has grown to 54.5% of pre pandemic levels, rising 15.5% since the beginning of the year. Additional indicators such as public transportation data and road traffic indicators display similar growth. Market fundamentals like net absorption and vacancy are trailing indicators, while labor markets dynamics drive office occupancy. Overall, companies are accommodating employees' desire for a more flexible work week while balancing the benefits of in-person work and productivity.

### **West Submarket**

The West submarket recorded the most positive absorption with 80,198 square feet followed by the North Loop at 40,862 square feet. This continues the previous quarter's trend of positive absorption in the suburban corridors.

The West's positive absorption mainly resulted from Epicor leasing 43,599 square feet at Jet 55 Corporate Center in Plymouth. Epicor downsized from 55,000 square feet at 600 Metropoint, and Prudential downsized by 2,267 square feet resulting in 57,267 square feet of negative absorption. In Minnetonka, Two Carlson Parkway gained 26,444 square feet with a move from Roers. 10 West End continued to benefit from flight to quality trends as Makwa Global, Aerotek and Two Harbors Investment absorbed 56,785 square feet of space.

### **Northwest Submarket**

Activity in the Northwest remained flat with total absorption of negative 8,478 square feet. In Brooklyn Park, Rasmussen University vacated 26,660 square feet as they consolidate into their new campus at 610 Crossing. In Osseo, Aerotek leased 10,764 square feet at Bell Tower Office Building. Expect a reduction in Northwest office inventory in the future as Prudential Campus is slated for redevelopment.

### **Northeast Submarket**

In the Northeast overall activity registered negative 207,183 square feet largely due to the 169,210-square-foot vacancy at Rosedale Commerce building by Principal Investment Services.

### **Southwest Submarket**

Total activity across all classes in the Southwest submarket registered 191,423 square feet of negative absorption. Accounting for the negative absorption was Prime Therapeutics vacating 180,344 square feet of Normandale Lake Office Park. Additional movement within Normandale Lake occurred when TripleTree expanded into 27,907 square feet. At The E in Edina, Relievent Medsystems occupied 12,754 square feet and Mitsubishi leased 17,641 square feet resulting in a gain of 30,395 square feet. TripleTree vacated 24,209 square feet of sublease space in Centennial Lakes Office Park. Additional negative absorption occurred as Cadance Mortgage left 17,620 square feet in 770 France, and Trimble vacated 26,449 square feet at Baker Road Corporate Center. Year-to-date absorption in the Southwest is negative 40,545 square feet.

### **Southeast Submarket**

In the Southeast total activity was slightly negative at 15,506 square feet in the third quarter and 104,000 square feet positive year to date. Accounting for the movement was positive activity among Class A properties. Primarily driven by a 27,656 square foot lease as Boeckerman Grafstrom and Mayer moved into International Plaza in Bloomington. A group of leases including Ameriprise, Campbell and Agave Therapy resulted in 8,416 square feet at Grand Oak Office in Eagan. Occupiers vacating space in the submarket include Loffler vacating 37,584 square feet of the Loffler Business Center and Hewlett Packard vacating 10,309 square feet of sublease space at the Offices at Mall of America.

### **Minneapolis CBD**

In the Minneapolis Core overall activity is positive with 15,912 square feet absorbed. Prudential Financial announced plans to relocate from Plymouth to 28,000 square feet in the Dayton's Project on Nicollet Mall. Flight to quality remains strong with Norwest Equity Partners signing a lease at RBC Gateway for 14,000 square feet. In the IDS Center Okabena, signed for 11,663. Additional activity in the IDS includes Taft expanding into 15,951 square feet and PNC Bank expanding to 14,000 square feet.

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### Investment Sales

Investment sale activity slowed in the third quarter as macroeconomic headwinds and the increasing cost of capital contributed to underwriting uncertainties. Despite this, Normandale Lake Office Park sold late in the second quarter as New York-based Opal Holdings purchased the 1.7 million square foot campus from a MetLife and Allstate Insurance partnership for a price of \$366 million, or \$215 per square foot.

An additional notable transaction occurred in the northeast submarket as Broadway Ridge was purchased by Singer Capital from Altus for \$30.0 million or \$161 per square foot.

Additional notable sales in the Northwest include the sale of Prudential Office Campus in Plymouth. This 466,900 square foot building was sold for \$20.4 million or \$43 per square foot. Scannell purchased the site and has plans to demolish the property and build a mixed-use development on the 75 acre site.

Within the CBD, Sherman and Associates purchased the former Wells Fargo Operations Center located at 255 2<sup>nd</sup> Ave S. This 561,000 square foot building was purchased for \$6.4 million or \$13 per square foot. Sherman has plans to demolish and redevelop the 2.4 acre block into mixed-income and market rate apartments, a hotel, and/or offices.

Totals sales volume in the metro stands at \$846 million year-to-date with \$142 million trading in the third quarter. Office investment sales volume remains significantly muted compared to previous years due in part to long term leasing concerns and rising rates slowing deal velocity. Investment sales will continue to face numerous headwinds as interest rates continue to increase and uncertainties regarding office utilization, future debt values, and The Fed's changing policies continue to put many office investors in a holding pattern.

### Future Outlook

Expect tenant activity to continue to be driven by the flight to quality as firms seek to right size and upgrade space, creating competition among the best properties. While expectations for a rapid recovery in leasing demand remains low, longer-term commitments from firms renewing are encouraging. Overall leasing activity is expected to continue to decrease modestly as firms adopt long term work from home arrangements. Expect some level of continued contraction as occupiers downsize to modernized workspaces with more efficiencies. The very best Class A space will continue to experience rent growth and high demand. Employee preferences for remote work, coupled with a tight labor market and the lowest unemployment rate in the nation has given workers leverage and further constrained return to office momentum. This labor balance will likely dampen demand in the Minneapolis office market for the time being. Increasing vacancy downtown has presented numerous opportunities for firms to negotiate attractive economic terms. This shift has accelerated an amenities arms race as building owners upgrade building amenities with a focus on health and safety features. Premium HVAC with faster air exchange rates will ensure a healthy environment and company cultures that focus on the value of in-person work within a larger hybrid structure will play a part in the continued recovery.

The Minneapolis metro construction pipeline has risen slightly compared to last quarter with 375,129 square feet under construction, representing less than .03% of all inventory. This will help to keep supply in check as sublease space decreases and market fundamentals stabilize. Additional Class B and C office buildings have been targeted for redevelopment which will aid in reducing inventory.

### Notable Lease Transactions

Tenant	Submarket	Building	Type	Square Feet
Channel Partners	West	Crescent Ridge II	New	34,654 SF
Prudential Financial	Minneapolis CBD	Dayton's Project	New	28,000 SF
Roers	West	Two Carlson Parkway	New	26,444 SF
Snap Install	West	Northland Corporate Center	New	22,000 SF
Stantec	West	One Carlson Parkway	New	20,242 SF
Taft Stettinius & Hollister	Minneapolis CBD	IDS Center	Expansion	15,951 SF

### Notable Sales Transactions

Building	Submarket	Sale Price	Price/SF	Square Feet
Normandale Lakes Office Park	Southeast	\$366,000,000	\$193	1,700,000
Broadway Ridge	Northeast	\$30,250,000	\$157	191,610
Prudential Campus	Northwest	\$20,400,000	\$43	466,900
Centennial Crossings	Southwest	\$15,320,000	\$149	102,448
Carlson Center East II	West	\$10,475,000	\$155	67,346
Wells Fargo Operation Center	Minneapolis CBD	\$6,400,000	\$11	560,698

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Submarket Statistics								
	Total Inventory (SF)	Direct Vacant	Sublease Vacant	Vacancy Percentage (w/ Sublease)	Q3 Absorption (SF)	YTD Absorption (SF)	Total Asking Rent (Price/SF)	Under Construction (SF)
<b>Minneapolis CBD Total</b>	<b>37,260,527</b>	<b>6,600,659</b>	<b>1,471,806</b>	<b>21.78%</b>	<b>43,878</b>	<b>-338,192</b>	<b>\$33.65</b>	<b>359,729</b>
Core - CBD	26,513,423	5,269,406	1,242,321	24.60%	15,912	-152,972	\$35.03	359,729
East - CBD	2,224,853	160,854	0	7.20%	-14,819	-49,380	\$29.07	0
Loring - CBD	227,360	24,875	14,640	17.40%	0	6,942	\$25.15	0
Northeast - CBD	3,244,403	305,703	2,476	9.50%	17,298	-46,214	\$23.98	0
Northloop - CBD	2,739,701	465,305	131,338	21.80%	40,862	-39,502	\$34.75	0
Warehouse - CBD	2,310,787	374,516	81,031	19.70%	-15,375	-57,066	\$27.06	0
<b>Suburban Total</b>	<b>83,699,880</b>	<b>9,728,193</b>	<b>703,828</b>	<b>12.55%</b>	<b>-387,554</b>	<b>-73,915</b>	<b>\$25.54</b>	<b>15,400</b>
Northeast	17,938,212	1,728,937	68,519	10.00%	-207,183	-94,456	\$21.71	0
Northwest	5,571,218	479,192	33,772	9.20%	-8,478	-3,277	\$21.70	0
Southeast	15,989,766	1,954,307	24,440	12.40%	-15,506	104,821	\$23.04	0
Southwest	23,746,975	2,529,635	410,667	12.40%	-191,423	-40,545	\$30.72	15,400
West	11,990,745	1,725,951	147,869	15.60%	80,198	112,261	\$32.19	0
<b>St.Paul CBD</b>	<b>8,462,964</b>	<b>1,310,171</b>	<b>18,561</b>	<b>15.70%</b>	<b>-45,162</b>	<b>-152,719</b>	<b>\$23.89</b>	<b>0</b>
<b>Overall Total</b>	<b>121,051,428</b>	<b>16,342,352</b>	<b>2,175,634</b>	<b>15.30%</b>	<b>-343,676</b>	<b>-412,107</b>	<b>\$29.77</b>	<b>465,129</b>

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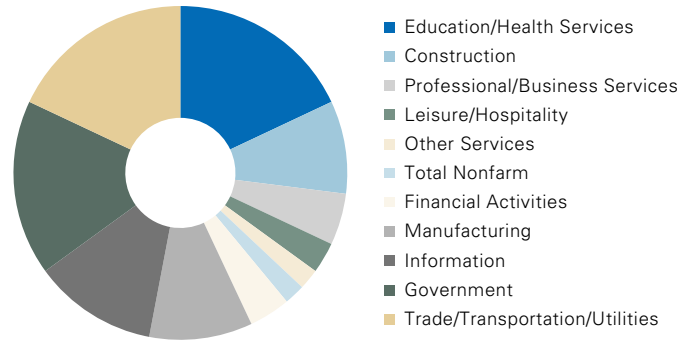
Economic Conditions

The Minneapolis-St. Paul metropolitan area has a highly educated workforce and a diverse economy that is home to 15 Fortune 500 companies, the most per capita in the United States. 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 remains 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

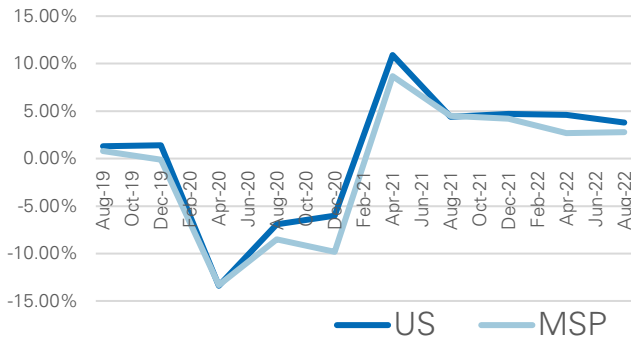
EMPLOYMENT BY INDUSTRY | MINNEAPOLIS-ST. PAUL



Source: US Bureau of Labor

Payroll Employment

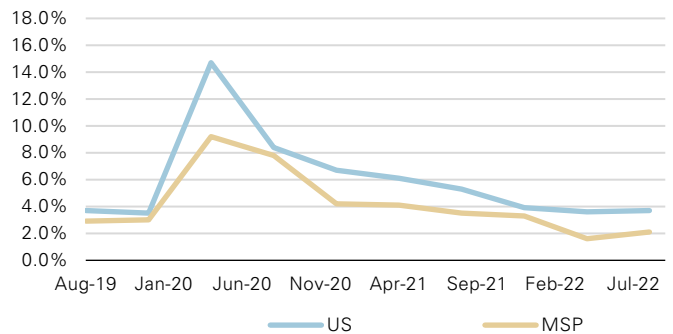
TOTAL NONFARM, NOT SEASONALLY ADJUSTED, 12-MONTH % CHANGE



Source: US Bureau of Labor

Unemployment Rate

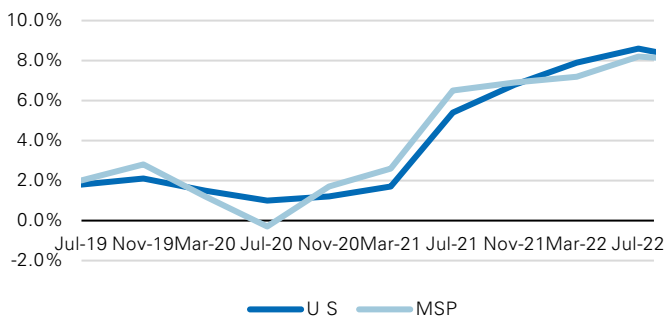
SEASONALLY ADJUSTED, AUGUST 2022



Source: US Bureau of Labor

Consumer Price Index (CPI)

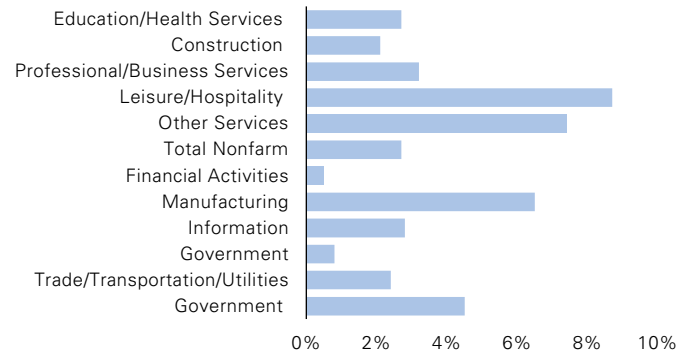
ALL ITEMS, 12-MONTH % CHANGE, NOT SEASONALLY ADJUSTED



Source: US Bureau of Labor

Employment Growth By Industry

MINNEAPOLIS, AUGUST 2022, 12-MONTH % CHANGE, SEASONALLY ADJ



Source: US Bureau of Labor

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