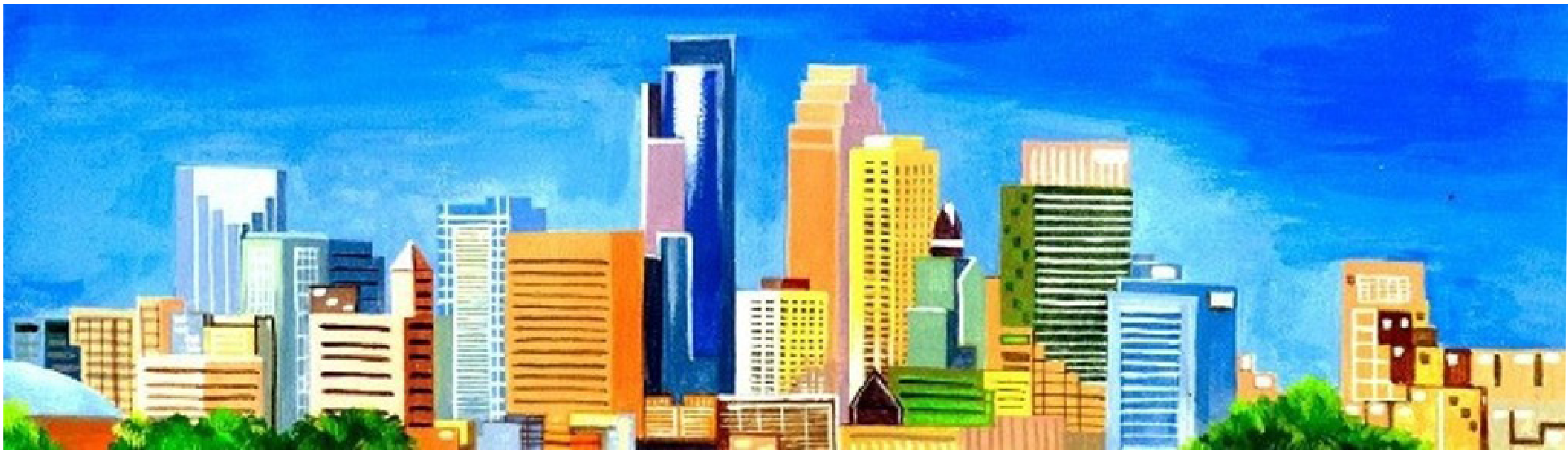


University of St. Thomas
Minnesota Commercial Real Estate Survey

Spring 2019

Commercial Real Estate Showing More Signs of Optimism

University of St. Thomas Minnesota

Real Estate UST Opus College of Business

Spring 2019 - Minnesota Commercial Real Estate Outlook Shows More Signs of Optimism for the Upcoming Two Years

The May 2019 University of St. Thomas / Minnesota Commercial Real Estate Survey is continuing to show to show changes in the sentiment of our panelists as they look out over the next two years. The biannual survey projects a two-year ahead outlook for Minnesota's commercial real estate industry and forecasts potential opportunities and challenges affecting all commercial real estate sectors.

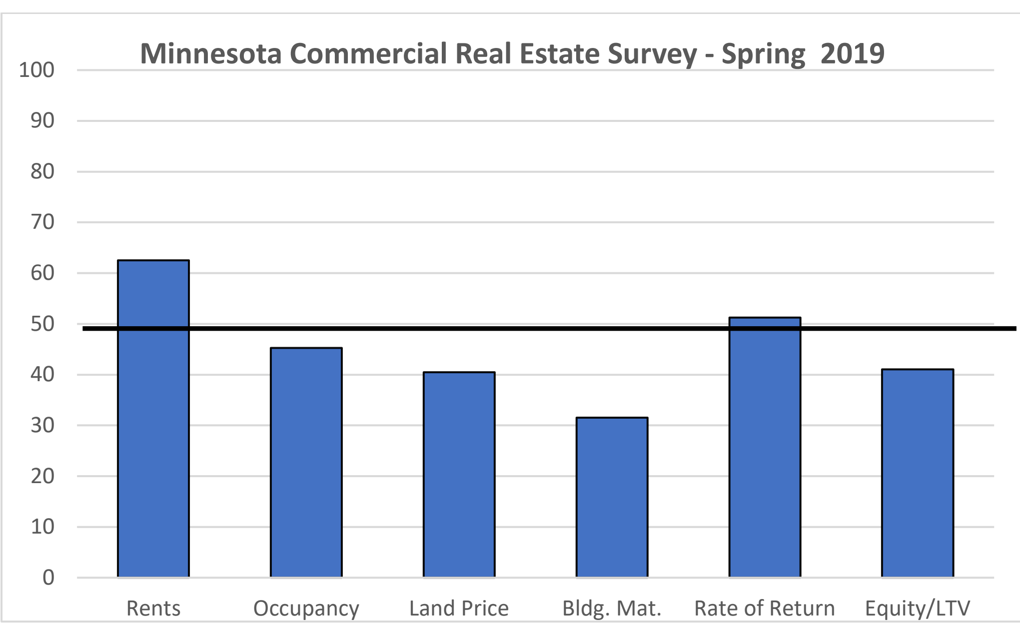
As was done with all sixteen of our previous surveys, the same group of 50 commercial real estate industry leaders involved in development, finance, and investment were polled regarding their expectations of near-term future commercial real estate activity. The decisions that these industry leaders are making today will determine what the CRE markets will look like two years from now.

Spring 2019 Results

Observations from May 2019 have recorded several notable changes in the panel's expectations when compared to the previous survey conducted in Fall 2018. "There is still some concern that we are near the top of the cycle and that overbuilding and increased vacancies may occur in some product types and submarkets." says Herb Tousley, Director of the Real Estate Programs at the University of St Thomas. "While our composite index for late 2021 remains slightly pessimistic, there are some bright spots worth noting. There is no expectation of a major downturn in the commercial real estate market in the Twin Cities within the next two years. The increase in online shopping, low interest rates, changes in housing trends and the continued redefinition of the office environment will remain major factors in the performance of commercial real estate in the coming two years."

The panelists are very concerned about the expected increase in the cost of land and building materials and its expected impact on values and expected returns for developers and investors. There was a big change in the index for investor's return expectations. It increased 9 points moving from a pessimistic level moving to slightly optimistic territory. This is a big change in sentiment since our last survey. It appears that our panel now expects interest rates to remain stable at current low rates. While our respondents are not expecting a major downturn, they are more somewhat concerned about where we are in the market cycle.

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. More detailed information about each of the individual indices may be found below.



The individual indexes are detailed below:

Rent Expectations
The outlook for rental rates is essentially unchanged from our last survey. Market conditions expected in early 2021 are best described by the price for space (rental rates) and the supply of space (occupancy levels). The index for rental rates was 63 compared to 62 six months ago. This means the panel continues to be strongly optimistic in its expection of continued rent growth. The panel's sentiment is that the economy will continue to grow and that business conditions will continue improve creating more competition for commercial space.

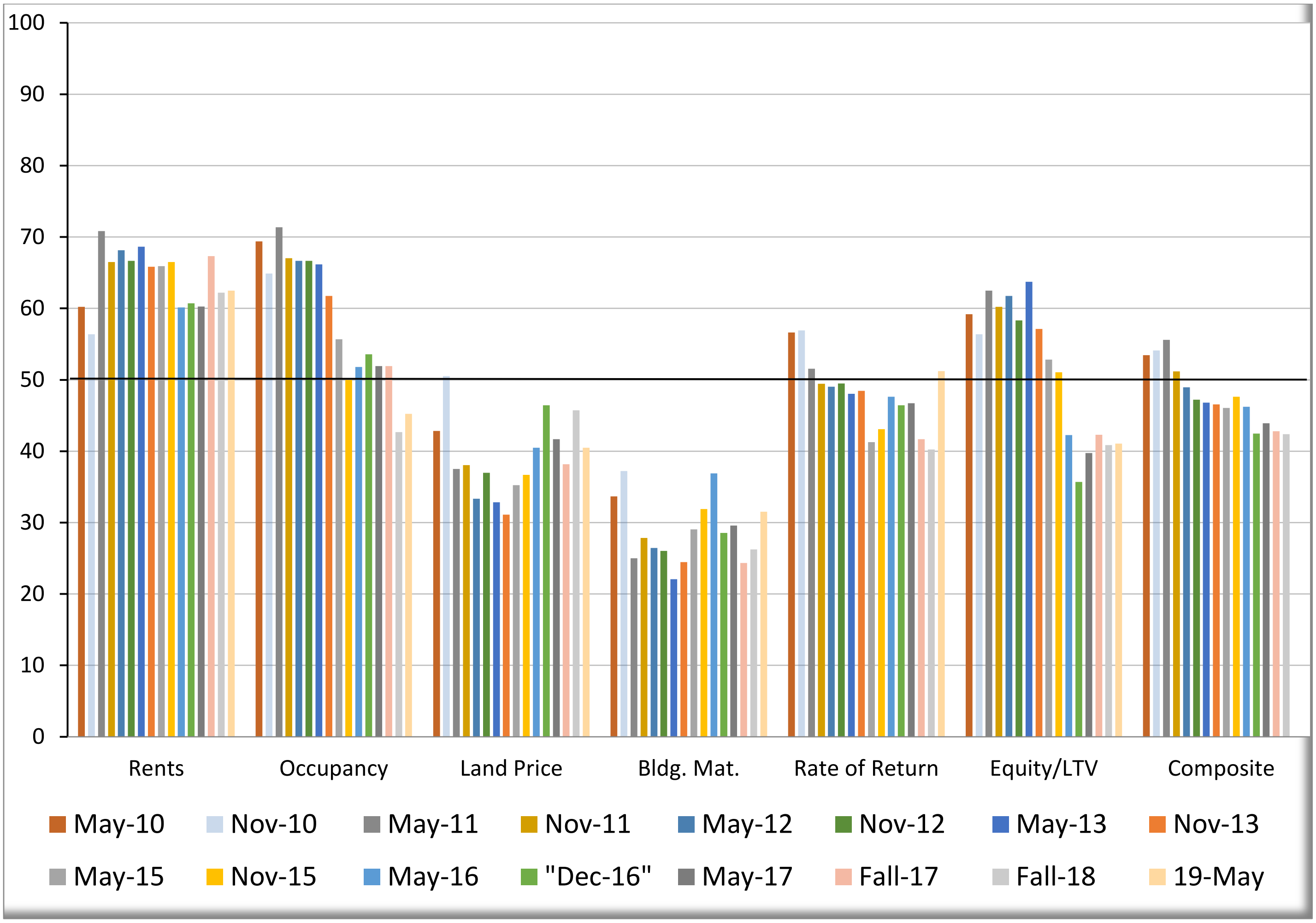
Occupancy
The outlook for occupancy levels continues to be moderately pessimistic moving from 43 to a slightly less pessimistic 45. This indicates the panelist's belief that occupancy levels and space absorption may not remain at current levels during the next two years. As a great deal of new product continues to be delivered, the panel is beginning to be concerned about the market's ability to absorb the new space. This is especially noticeable in the multi-family and certain office and industrial segments. It is a continuation of a general trend that began 4 ½ years ago. Businesses expect to continue to grow but they are concentrating on reducing their cost of occupancy by doing more with less space.

Land Price Expectations
The rate of increase in land prices is expected to accelerate. The land price index has decreased (become more pessimistic) in the current survey moving from 46 last December to 40 this spring. Although, the lowest point for the index was recorded at 31 in the fall 2013 survey, a score of 40 for this index indicates increasing concern about the rapid rise of land prices. Since land prices are a major component of project costs, any increase has a great deal of impact. Higher land prices are a hindrance to new development, making it more difficult to obtain financing and adequate returns for investors.

Building Material Price Expectations
There is a continued expectation that increases in the price of building materials will continue to increase. The index for the price of building supplies remains strongly negative, moving from 26 in December 2018 to 32 in May 2019. The panel believes that commodity prices for lumber, concrete, steel and many of the other materials used in construction will continue to increase due to shortages and newly imposed tariffs. Since building materials are a major cost component of any development project any increases in prices will make it difficult to provide adequate returns on future developments.

Return on Investment Expectations
Our panel expects that investors return on investment expectations will remain constant. The index for investor's return expectations made a big move, increasing from a pessimistic 42 to a slightly optimistic 51. This indicates that investors will be expecting to maintain their expected returns. The consensus among survey respondents indicates that investors will not be seeking higher returns in the next two years due to their expectation of stable interest rates. The panel's concern remains about market fundamentals over the next two years. Investors will continue to seek out quality investments, but they will be much more diligent about how they price risk, evaluate projects and developer/sponsors when they evaluate potential return when considering their investment options.

Lending Expectations
Equity and loan to value requirements are not expected to increase. The index for the amount of equity required by lenders remained unchanged from our last survey at 41. That recorded level is somewhat pessimistic but, now that appears interest rates have moderated and are expected to stay that way, the panel's belief that is even if interest rates were to increase moderately credit will still be available for good projects. However, they expect lenders will continue be more risk adverse by tightening their underwriting criteria in the coming two years.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Rents
Occupancy
Land Price
Bldg. Mat.
Rate of Return
Equity/LTV
Composite
May-10
Nov-10
May-11
Nov-11
May-12
Nov-12
May-13
Nov-13
May-15
Nov-15
May-16
"Dec-16"
May-17
Fall-17
Fall-18
19-May