



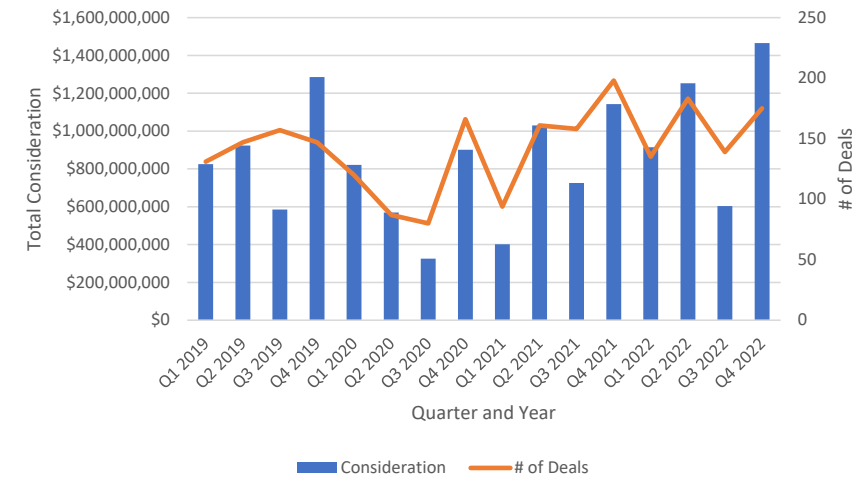
Transwestern
**CAPITAL
MARKETS
& ASSET
STRATEGIES**

2022 Annual Report - Minneapolis-St. Paul

Capital Markets & Asset Strategies - Midwest

Optimism was high at the beginning of 2022 – debt was historically cheap, the economy was bustling, and pricing for many asset classes were at historic highs – but inflation caused the Federal Reserve to issue a series of increases to the federal funds rate leading to wide reaching implications, including dampened expectations and continued re-pricing of real estate as the year progressed. By mid-year, institutional capital was effectively pencils down and, while middle-market private equity remained active through year-end, they too became more selective in their pursuits. Overall, transaction volume was significantly impacted in the second half of the year.

Deal Activity - Minneapolis-St. Paul by Quarter



CoStar Data: 10k SF+, Industrial, Retail, and Office



Investors found it difficult to keep up with the speed in which the market changed. With every rate hike, bad news on Wall Street or reports of high inflation, investor sentiment declined, deals were renegotiated, and transactions were thrown into a tailspin. Once the market had adjusted to the last adjustment and transactions were stabilizing, another rate hike would start the cycle over again. Overall, the second half of 2022 can best be characterized as a period of fits and starts. Despite continued price discovery, deals still got done thanks to strong market fundamentals, particularly in industrial and multifamily.

By year-end, most capital was on the sidelines, and capital that was active was primarily chasing value-add and opportunistic multifamily and industrial.

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We continue to see strong fundraising campaigns and private equity remains plentiful and motivated. Those that have been sitting on the sidelines in recent years find themselves in an advantageous cash position and are hopeful that attractive opportunities will present themselves. Investors that are nimble in terms of their acquisition criteria will likely find the most success.

Lenders and investors are currently reappraising their portfolio which will inform their investment and lending decisions going forward. Some investors, such as insurance companies, are finding their allocation of real estate is too high and they will need to rebalance going forward. Banks were the primary source of debt in 2022 but with some banks in a liquidity crunch and government bonds providing attractive returns, the ability for investors to secure financing is likely to be more difficult.

Positive movement in interest rates and the overall economy will have positive impacts in real estate. Overall, the market is looking for a prolonged period of stability – pricing certainty makes transactions more palatable for both sides of the transaction. Some are predicting this will occur in the second half of 2023. Until then, transaction volume will likely be subdued and more concentrated in middle market, private equity transactions or those that can find creative solutions for equity and debt. Look for properties with advantageous assumable debt or seller financing to trade as lower interest rates will help bridge the bid-ask spread.



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Banks were the primary sources of debt in 2022, and although term sheets were less appetizing as the year progressed, some lenders remained aggressive through the third quarter. Bank lending increased in 2022 compared with 2021 but witnessed a decline in the third and fourth quarters. As banks' liquidity dried up as the year progressed, it wasn't an uncommon requirement to have the borrower move their deposits to the bank to move forward with the loan.

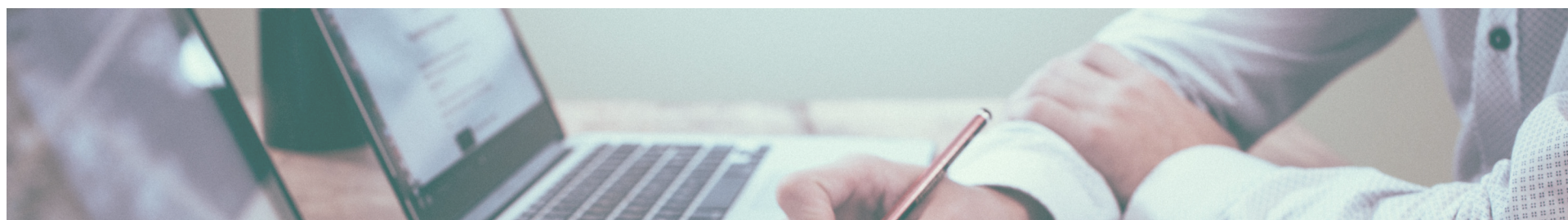
CMBS mirrored the sentiment of institutional investors as being on the sidelines the second half of the year with issuance declining 92% in Q4 year-over-year, and 63% for the year.

Healthcare witnessed the largest increase in originations compared with the previous year, whereas office saw the largest decline. Across all asset and lender types, originations were down 10% year-over-year, with a 54% decline occurring in the fourth quarter.

Commercial/Multifamily Mortgage Bankers Originations Index

	Origination Volume Index (2001 Avg Qtr = 100)				Percent Change, Year-over-year				Origination Volume Index (2001 Avg Qtr = 100)				Percent Change, Year-over-year		
	Q1	Q2	Q3	Q4	Q4	Q3-to-Q4	YTD-YTD		Q1	Q2	Q3	Q4	Q4	Q3-to-Q4	YTD-YTD
TOTAL								Multifamily							
2019	224	289	316	365	7%	15%	13%	2019	389	513	585	625	-4%	7%	8%
2020	219	151	169	298	-18%	76%	-30%	2020	446	388	403	712	14%	77%	-8%
2021	188	311	370	533	79%	44%	67%	2021	423	632	829	1,122	57%	35%	54%
2022	323	370	321	247	-54%	-23%	-10%	2022	665	786	696	536	-52%	-23%	-11%
CMBS/Conduits								Office							
2019	76	120	113	176	81%	56%	24%	2019	116	193	176	215	29%	22%	23%
2020	86	6	48	64	-64%	35%	-58%	2020	126	55	74	94	-56%	26%	-50%
2021	64	113	107	260	305%	144%	167%	2021	83	137	150	209	122%	39%	66%
2022	100	49	31	21	-92%	-35%	-63%	2022	108	123	85	92	-56%	9%	-30%
Depositories								Retail							
2019	344	466	514	589	13%	14%	20%	2019	111	128	144	185	13%	29%	-6%
2020	341	210	165	351	-40%	113%	-44%	2020	70	33	24	51	-72%	111%	-69%
2021	175	362	547	869	147%	59%	83%	2021	38	62	101	106	109%	6%	73%
2022	515	733	684	457	-47%	-33%	22%	2022	72	129	94	60	-44%	-37%	16%
Life Insurance Companies								Industrial							
2019	360	392	407	543	9%	33%	5%	2019	733	537	659	1,043	67%	58%	50%
2020	296	200	182	363	-33%	100%	-39%	2020	445	303	507	1,196	15%	136%	-18%
2021	252	487	501	593	63%	18%	76%	2021	736	1,296	1,300	2,545	113%	96%	140%
2022	456	465	292	278	-53%	-5%	-19%	2022	1,801	1,330	1,254	778	-69%	-38%	-12%
Fannie Mae/Freddie Mac								Hotel							
2019	497	692	739	615	-30%	-17%	-1%	2019	349	412	321	469	-25%	46%	-19%
2020	527	658	680	1,132	84%	67%	18%	2020	203	36	20	100	-79%	411%	-77%
2021	479	439	784	797	-30%	2%	-17%	2021	36	119	190	268	167%	42%	71%
2022	483	568	664	693	-13%	4%	-4%	2022	166	162	236	145	-46%	-39%	16%
Investor-Driven Lenders								Health Care							
2019	297	330	452	540	2%	20%	11%	2019	46	75	120	120	33%	0%	92%
2020	275	86	158	302	-44%	91%	-49%	2020	54	45	59	105	-12%	77%	-27%
2021	369	704	662	940	211%	42%	225%	2021	57	181	86	88	-17%	2%	56%
2022	654	788	611	380	-60%	-38%	-9%	2022	103	175	139	92	4%	-34%	23%

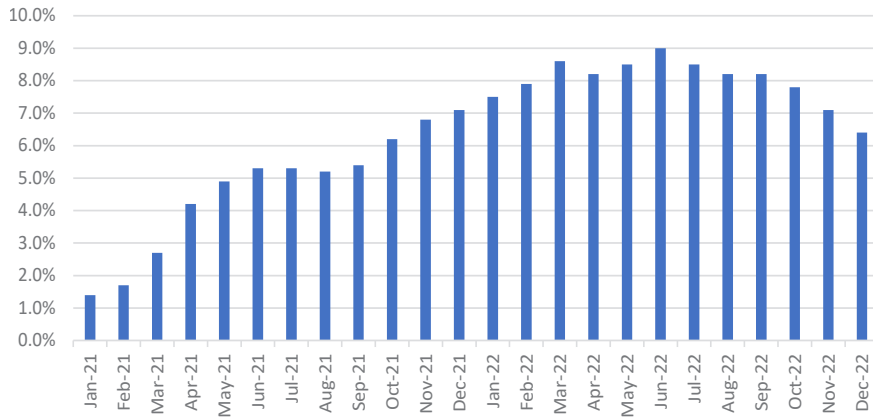
Source: Mortgage Bankers Association Quarterly Survey of Commercial / Multifamily Mortgage Bankers Originations | Q4 2022



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Inflation remained stubbornly high throughout 2022, peaking at 9.0% in June – a 40 year high. The Federal Reserve moved forcefully to reign in inflation with seven rate hikes throughout the year. The 425-basis point increase was the fastest rate increase in recent history and stoked fears of a recession. The federal funds rates ended the year at 4.5%, the highest in 15 years.

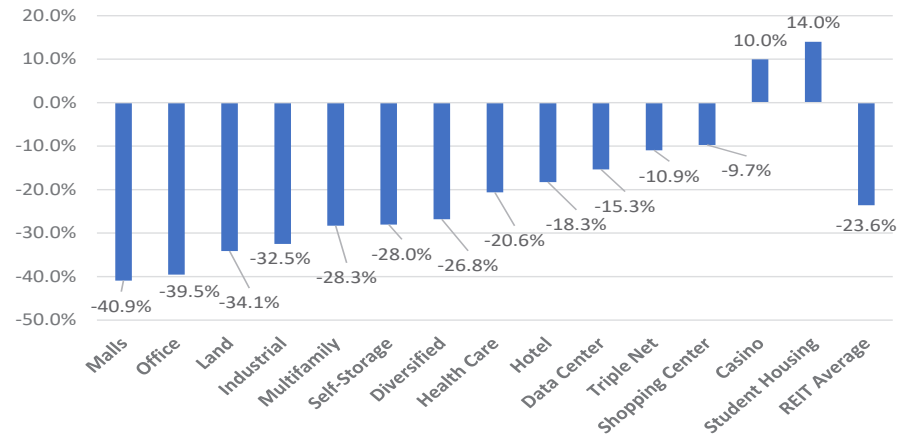
Monthly Inflation Rate Change 2021-2022



Source: Bureau of Labor Statistics

Despite the Federal Reserve’s actions, inflation only slowed slightly, and unemployment finished the year at 3.7% which is well below the widely accepted full employment rate of 5.0%, in which employment is at the lowest level without causing inflation.

2022 Average REIT Return By Property Type



Source: Seeking Alpha

A combination of interest rates, attractive government bond yields, and macro-economic concerns placed downward pressure on real estate pricing. REITs were especially volatile in 2022, partially due to redemptions that were driven by financially distressed investors and those concerned with the economy. In some instances, there was a large dislocation between fund performance and price.

Recovery was swift:

- Jobs are back to pre-pandemic levels
- Job market remains resilient
- Industrial-using job growth has been very strong
- Interest rates rose very quickly

Signs of slowing & concern:

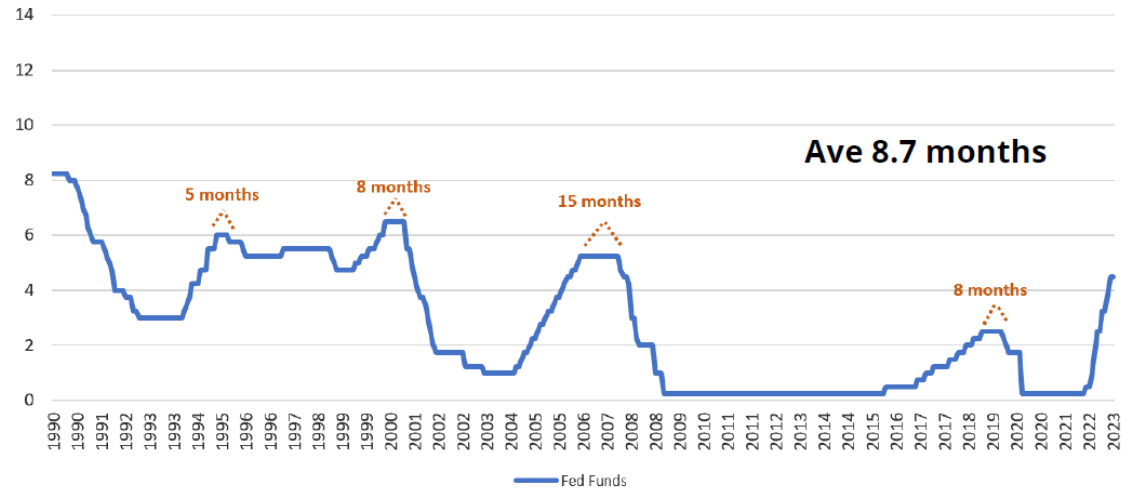
- Inflation remains high despite rate hikes
- Falling home sales volumes
- Retail sales beginning to decline and shift from goods to services
- Low consumer confidence
- Inverted yield curves

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The Federal Reserve appears committed to fighting inflation through continued rate hikes. Some investors are anticipating rate hikes will cease by mid-year and we could see a softening by year-end. However, we urge caution with these predictions as inflation has shown little signs of slowing down and recent history shows a timeline of anywhere from five months to 15 months between the last rate hike and first cut.

Loan originations are likely to continue to remain depressed for much of 2023 with CMBS and life insurance companies largely on the sidelines. Banks, the largest source of debt in 2022, are faced with declining deposits and relatively attractive government bonds, are likely to pullback in 2023. However, the availability of financing will largely be asset dependent.

FED Rate: Last Hike to First Cut



Sources: Federal Reserve Bank of St. Louis, Board of Governors of the Federal Reserve System



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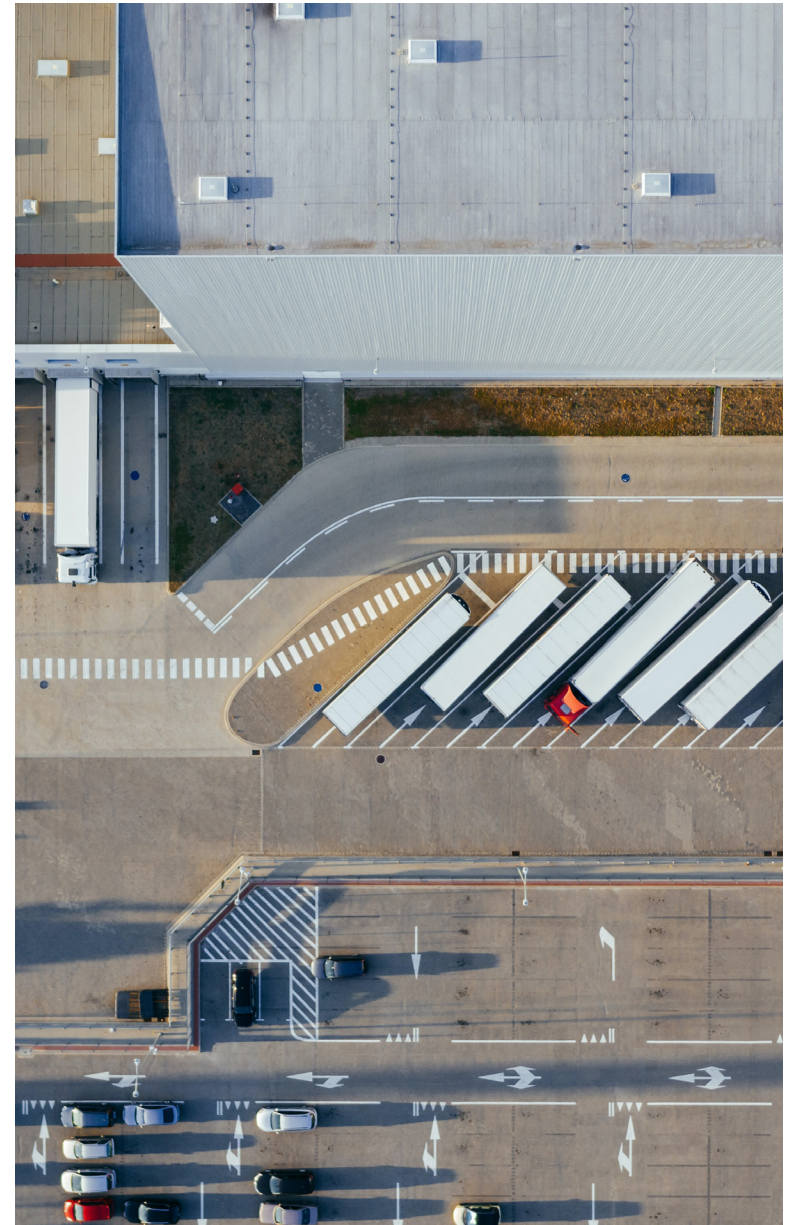
Supply-demand dynamics continue to be out of sync with tenant demand greatly outpacing supply. Despite concerns about the economy, tenants showed little signs of slowing down and landlords continued to find themselves in an advantageous negotiating position. This led to a 15.5% rental rate increase in the Minneapolis market year-over-year with many owners witnessing significantly higher releasing spreads. As a result of the strong market fundamentals, industrial remained the primary acquisition target among investors.

At the beginning of 2022, assets with low-weighted average lease terms were selling at premiums compared to those with long-term leases. Investors were bullish on mark-to-market strategies, but worries over the economy changed this trend and investors returned to historical norms by seeking properties with longer leases in exchange for lower returns. That said, mark-to-market remains the core strategy of many investors and value-add industrial real estate pricing was strong compared to all historical measures.

Beginning mid-year, developers reevaluated their risk threshold for speculative development as construction costs, interest rates, and exit cap rates took their toll and equity dried up. Confidence was high that speculative developments would lease quickly and at high rates, but the financial feasibility, especially with leases less than ten years, was questionable and many developers decided to part ways with sites they had under contract. Speculative developments under construction at year-end were likely fully committed to many months earlier.

Rising interest rates had the largest impact on Class A industrial – reigning in pricing and upending offerings in the market and bringing the forward phenomenon to a complete halt. Portfolios that were brought to market experienced mixed results. Cash buyers, particularly Nuveen, were king as they were not as sensitive to movements in the debt markets and could push pricing. Class B remained liquid throughout the year as the larger spread between interest rates and cap rates at the beginning of the year allowed for more movement in pricing as interest rates ticked up. Private equity, middle market transactions continued through Q3, but slowed in Q4.

¹Source: MNCAR, Transwestern



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BUILDING	ADDRESS	CITY	SIZE	BUYER	SELLER	SALE PRICE	\$/SF
NorthPark Biz Ctr. & Park 81 Portfolio	Multiple	Brooklyn Park	871,855	Nuveen	Scannell Properties	\$137,100,000	\$157.25
Best Buy Distribution Center	6201 W 111th St	Bloomington	580,733	Orton Development Group	First Industrial Realty Trust	\$54,000,000	\$92.99
Kindeva Drug Delivery	11200 Hudson Rd	Woodbury	137,897	Creative Manufacturing Properties	Virtus Real Estate Capital	\$48,200,000	\$349.54
Eagan Innovation Center	1000 Blue Gentian Rd	Eagan	300,000	Water Street Partners, LLC	Spectrum Group	\$35,500,000	\$118.33
Minnesota Industrial Portfolio I	Multiple	Multiple Cities	2,609,735	Capital Partners Management, LLC	Artis REIT	\$248,850,000	\$95.35
7075 Flying Cloud Dr	7075 Flying Cloud Dr	Eden Prairie	345,000	Aldevron	Eagle Ridge Partners LLC	\$27,000,000	\$78.26
Golden Triangle Industrial	7350 Golden Triangle Dr	Eden Prairie	130,100	Principal Real Estate Investors LLC	The Opus Group	\$26,000,000	\$199.85
610 Junction Portfolio	9400 Decatur Ave	Brooklyn Park/ Burnsville	407,500	Nuveen	United Properties	\$54,350,000	\$133.37
White Bear Parkway Business Center	4835 White Bear Pkwy	White Bear Lake	117,518	Norman Properties, Inc.	CSM Corporation	\$21,500,000	\$182.95
Partners Group Portfolio	Multiple	Multiple Cities	1,415,349	Partners Group	Onward Investors	\$143,000,000	\$101.04
2080 Woodwinds	2080 Woodwinds Dr	Woodbury	42467	Davis Real Estate	MFC Properties Corporation	\$18,000,000	\$423.86



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Investors remain bullish on the near-term and long-term fundamentals of industrial real estate and, as a result, industrial will remain the favored acquisition target. Investors are keeping a close eye on key metrics and trends – consumer consumption and e-commerce sales, on-shoring and re-shoring, tenant demand and rent growth, container volume at key ports, supply chain dynamics, etc. – to guide their underwriting and investment strategies.

Developers that over-extended themselves may be forced to sell land in pioneering areas and newly delivered product at losses for liquidity purposes. Overall, these opportunities are anticipated to be few and far between. New development will primarily be limited to developers that secured financing and equity in 2022 or build-to-suit projects.

Overall, the big winners will be investors with existing product and favorable debt. With tenant demand continuing to surge and speculative development slowing, rental rates are anticipated to grow at a rapid pace. Overall, this asset class will continue to outperform.



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Workers continued to return to the office in 2022, but the growth was modest and office usage is well below pre-pandemic levels. According to the Minneapolis Downtown Council, 62% of downtown office workers returned to their office at least once a week in 2022, up from 56% the year before. The hybrid work model is no longer a trend – most believe it is here to stay – which is reflected in increased office occupancy Tuesday-Thursday compared to Monday and Friday.

Vacancy increased to 19.4% at year end, with a notable uptick of large blocks of vacant space, especially suburban corporate campuses. Of the 21-million SF total that was vacant, 2.63-million SF was sublease space- more than double the amount from 2021 (1.16-million SF), indicating direct vacancy may continue to increase in the near term as tenants downsize.

Given the uncertainty of the future of office, underwriting remains challenging, especially for assets with foot-traffic dependent revenue streams such as parking ramps and retail. The pool of buyers for office product has thinned considerably, but investors remain active on both ends of the spectrum - core offerings and deep value-add/opportunistic assets. With a sparse buyer pool for stabilized non-core offerings, these assets are only attractive to investors at value-add pricing. Sellers' unwillingness to meet the market has led to buyer fatigue. Offerings must be appropriately priced to get buyers' attention and compel investors to focus on the acquisition opportunity. Most owners of core-plus assets are choosing to hold, assuming no near-term debt maturities, or offering assumable debt or seller financing to bridge the bid-ask spread.

Office performance has declined since the beginning of the pandemic, but investors have largely been able to service their loans and refinance upon maturity thanks to lower interest rates, but that changed in late third quarter as higher interest rates began to take their toll and the first signs of distress in the office sector are beginning to show.

Not all is negative in office- companies are flocking to best-in-class properties such as 10 West End, RBC Gateway, and Hines' North Loop Green project (which doesn't deliver until 2025 and has already secured a 113,000 SF anchor tenant). Spec suites are seeing strong leasing velocity as they fit the needs of tenants looking for short and moderate term solutions. Many landlords have been able to keep, or even push rental rates. Some are predicting that economic headwinds could give employers more leverage regarding return-to-office policies. Medical and life science buildings are witnessing healthy occupancy and tenant retention.



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BUILDING	ADDRESS	CITY	SIZE	BUYER	SELLER	SALE PRICE	\$/SF
10 West End	1601 Utica Ave S	St. Louis Park	343,000	Bridge Investment Group	Ryan Companies	\$117,315,435	\$342.03
Normandale Lake Portfolio	Multiple	Bloomington	1,756,167	Prana Equities	MetLife Investment Management	\$366,000,000	\$208.41
The Colonnade	5500 Wayzata Blvd	Golden Valley	412,736	Eagle Ridge Partners LLC	AEW Capital Management L P	\$79,000,000	\$191.41
Excelsior Crossings	9350-9380 Excelsior Blvd	Hopkins	486,215	Bridge Investment Group	DigitalBridge Group, Inc.	\$82,500,000	\$169.68
Broadway Ridge	3001 NE Broadway St	Minneapolis	187,903	The Sovereign Group	Altus Properties	\$30,250,000	\$160.99
Jet 55 Corporate Center	12755 Highway 55	Plymouth	229,142	Brefrank, Inc.	Falcon Ridge Partners	\$26,247,186	\$114.55
Shutterfly	11000 Viking Dr	Eden Prairie	258,850	Tempus Realty Partners	Shutterfly, Inc.	\$23,460,000	\$90.63
The Andrus	500-520 Nicollet Mall	Minneapolis	141,381	Richard Cargill	The Davis Companies	\$23,000,000	\$162.68
Flagship Corporate Center	775 Prairie Center Dr	Eden Prairie	139,353	Altus Properties	LNR Partners	\$21,525,000	\$154.46
The New Brighton Office Center	119 14th St NW	New Brighton	116,011	Edgewood Real Estate Investment Trust	Artis REIT	\$18,500,000	\$159.47
2080 Woodwinds	2080 Woodwinds Dr	Woodbury	42,467	Davis Real Estate	MFC Properties Corporation	\$18,000,000	\$423.86



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A tumultuous mix of decreased pricing, bleak near-term underwriting projections and increasing interest rates will likely have the following impacts:

- **Owners forced to sell or give keys back upon loan maturity**
- **Creation of opportunistic funds**
- **Significant increase in distressed sales, which won't be limited to lower Class B product or downtown; expect notable Class A, cash-flowing properties to enter special servicing, foreclosure, and/or sell at sizeable discounts**
- **Special servicers and banks will be active in this asset class**
- **Non-performing office note sales**
- **Opportunistic buyers will find themselves in favorable positions for acquisitions**

Offices selling at discounts will be healthy for the long-term utilization of the office sector as they will enable owners to reposition the assets and increase property performance. That said, tenant demand, notably in downtown, needs to increase for this to be a compelling long-term solution for office as a whole.

Well amenitized buildings in peripheral, non-core, locations will continue to perform well as tenants seek safety combined with centralized locations. Owners with well-performing assets are preparing to hold for the long-term so we can expect to see limited non-distressed office transactions in 2023. Medical office and life sciences will be the standout stabilized office product due to the resiliency of its tenancy while vacant suburban office headquarters will present repositioning and redevelopment opportunities.



LaSalle Plaza, Minneapolis

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It seems like a lifetime ago retail discussions revolved around deferred rent, government shutdowns, and business closures. Retail's bounce back from the initial stages of the pandemic proves once again that retail is resilient; constantly evolving to a changing environment and meeting the demand of consumers.

Retail wasn't insulated from interest rate hikes or pricing decreases, but remained relatively liquid throughout 2022 due to its high concentration of high net wealth individuals and private equity investors. Compared with 2021, retail middle market transactions² only witnessed a slight decrease in transaction volume (136 vs. 143) and transaction consideration (\$500.9 million vs \$523.7 million).

Single-tenant NNN sales declined due to movements in cap rates, but largely due to a smaller 1031 buyer pool. That said, high-demand net assets regularly traded at negative leverage, with Chick-Fil-A ground leases being the poster child. Neighborhood retail centers were the primary acquisition target for investors as market fundamentals favor this subtype.

Grocery-anchored shopping centers continued to attract sizeable investments from deep-pocketed private equity and institutional investors and remains easily financeable. Grocery has remained internet-resilient as customers still favor an in-store experience. During recessions, grocery has outperformed retail meaning this sub-type is well positioned going forward.

² Defined as transactions between \$2 million and \$8 million. Source: CoStar, Transwestern



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BUILDING	ADDRESS	CITY	SIZE	BUYER	SELLER	SALE PRICE	\$/SF
Galleria	3510 W 70th St	Edina	380,312	Maslon	Hines	\$150,000,000	\$394.41
Har-Mar Mall	2100 Snelling Ave N	Roseville	446,268	Fidelis Realty Partners	Clarion Partners	\$50,250,000	\$112.60
Hy-Vee Portfolio	Multiple		296,140	Inland Private Capital Corporation	Hy-Vee, Inc.	\$92,760,931	\$313.23
Centennial Lakes	7401-7595 France Ave S	Edina	191,246	Phillips Edison & Company	PGIM, Inc.	\$68,750,000	\$359.48
Maplewood Mall	3001 White Bear Ave N	Maplewood	321,217	Brookwood Capital Advisors	Washington Prime Group Inc.	\$27,500,000	\$85.61
Walgreens	2099 Ford Pkwy	Saint Paul	15,632	Charles Karp	Center Investors Group LLC	\$19,000,000	\$1,215.46
Country Village Shopping Center	11303-11400 Highway 7	Minnetonka	127,022	HJ Development	Janus Henderson Group plc	\$18,460,000	\$145.33
Lake Plaza	755-795 & 812-864 Lake St E	Wayzata	57,592	Asana Partners	Leisure Lane Partners, LLP	\$20,050,000	\$348.14
Floor & Decor	12575 Elm Creek Blvd N	Osseo	71,161	Agree Realty	Launch Properties	\$13,021,000	\$182.98
The Village at Mendota Heights	720-750 Main St	Mendota Heights	88,766	FBTW Asset Advisors	Oxford Square Associates Ltd	\$21,500,000	\$242.21
Birch Run Station	1715-1749 Beam Ave	Maplewood	279,343	Arizona Partners Retail Investment Group	Voya Investment Management	\$11,300,000	\$40.45

What to expect in 2023

Investors will keep a close eye on unemployment, discretionary income, potential recession, and business closures as benchmarks to guide their investment strategy. We anticipate retail will remain the favored asset class for high-net wealth individuals and expect a bounce back in transaction volume in single-tenant net lease assets as investors seek safety. Distress in retail will be highly concentrated to indoor malls, especially those in secondary locations and tertiary markets with maturing debt.



THINKING BEYOND THE OBVIOUS

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