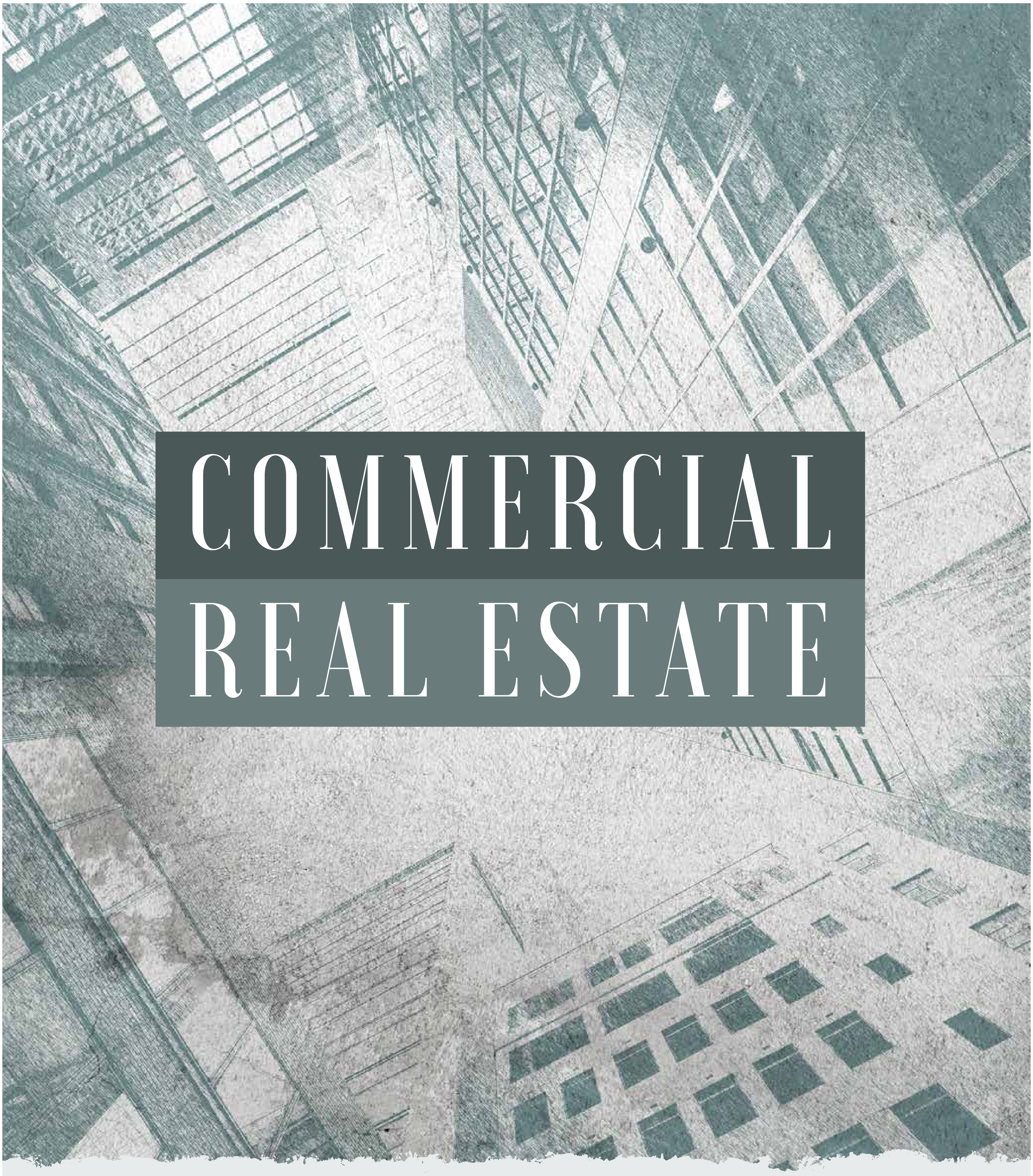

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MODERATOR

Diane Signorelli, MNCREW

Diane Signorelli is a senior associate at Apex Commercial Properties and a director of MNCREW. She has been in the real estate business since 2008 and brings years of sales, management, negotiation and relationship building experience to the table. Her focus is on office product, with a niche in medical office, working with private practice medical and dental clinics. Signorelli is a member of MNCAR and is an active member in a number of other industry networking groups.

PANELISTS

Patrick Seeb, Destination Medical Center

Patrick Seeb is director of economic development and placemaking for the Destination Medical Center Economic Development Agency in Rochester, Minn. In addition to supervising economic development and marketing initiatives, Seeb is responsible for managing relationships with investors, public and private businesses, and the community, as well as driving initiatives for attracting new business to the city of Rochester DMC Development District.

Steve Dorgan, Cresa Minneapolis

Steve Dorgan has a diverse background in real estate and development management with experience in site selection, governmental entitlement, project financing, budget management, programming, vendor selection, contract negotiation, design evaluation, development, construction and relocation management. He co-manages Cresa's Minneapolis office and has several leadership positions nationally with the company. He also oversees the project management group for Cresa Minneapolis.

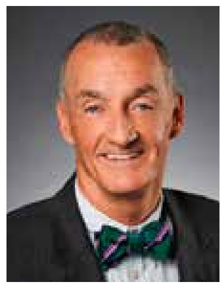
Matthew Rauenhorst, Opus Development Co.

As vice president, real estate development for Opus Development Co., Matthew Rauenhorst leads the day-to-day operations of the Minneapolis office and directs the development team, creating new multifamily, industrial, office and retail development opportunities. He has 13 years of real estate and development experience and has overseen the development of more than 2,000 residential units, 1 million square feet of industrial projects and 300,000 square feet of retail.

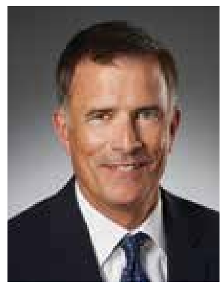
Peter Coyle, Larkin Hoffman

Peter Coyle is a shareholder at Larkin Hoffman and represents clients before the Minnesota Legislature and state agencies, as well as cities, counties and townships, on a wide variety of business licensing, permitting, regulatory compliance, environmental review and related matters. The main focus of his practice is advising developers and contractors who are seeking local and state regulatory approvals associated with new commercial, industrial and residential land development projects.

The "Go-To" Team in Real Estate, Land Use and Construction


Peter Coyle


Bill Griffith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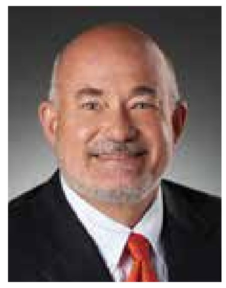
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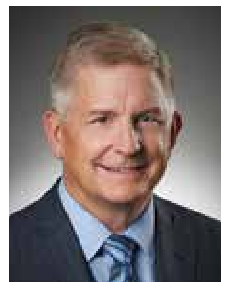
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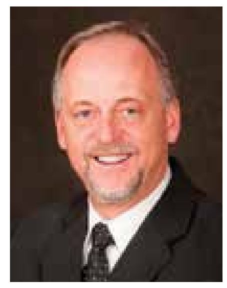
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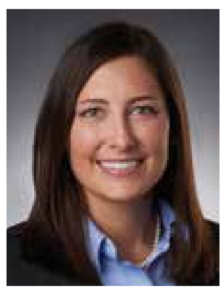
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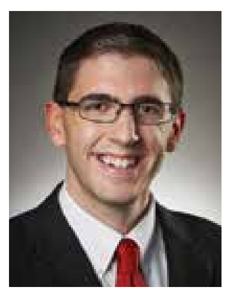
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From left:
Patrick Seeb, Destination Medical Center; Peter Coyle, Larkin Hoffman; Diane Signorelli, MNCREW; Steve Dorgan, Cresa Minneapolis; Matthew Rauenhorst, Opus Development Co.

NANCY KUEHN

By Holly Dolezalek, Contributing writer

The *Minneapolis-St. Paul Business Journal* held a panel discussion recently on the topic of commercial real estate. Panelists included Matthew Rauenhorst, vice president of real estate development at Opus Development Co.; Peter Coyle, shareholder at Larkin Hoffman; Steve Dorgan, principal at Cresa Minneapolis; and Patrick Seeb, director of economic development and placemaking at Destination Medical Center. Diane Signorelli, chapter director at MNCREW and senior associate at Apex Commercial Properties, served as moderator.

Diane Signorelli: Steve, where are you seeing the demand in the current market? What are the strong opportunities?

Dorgan: We at Cresa represent a wide variety of users of space: industrial, office, health care, some government and nonprofit. We're seeing a tight industrial market that's been competitive for a while and will continue to be. Where we think there's opportunity, and where the market's heading, is office space in downtown Minneapolis and certain sub-suburban markets; we are seeing a lot of office space coming into the market. There's the TCF space, and now Macy's. There's an opportunity to find some better deals. A lot of the valuation on these buildings has gone up, because there have been a lot of investor buildings change hands in the past five years, but we believe lease rates will start coming down.

Signorelli: According to MNCAR, in the third and fourth quarter of 2017, there is 716,000 square feet of future occupancy in the Minneapolis CBD, and Amazon and Select Comfort have taken up almost half of that. So you're saying there's still additional demand in downtown Minneapolis?

Dorgan: In some of the niche areas like the Warehouse District, there's still a lot of demand, but in the downtown core we've had TCF leave, Wells Fargo build a new building, and the conversion of Macy's. There's some absorption, but there are some large-tract spaces that we haven't seen for a while. When you look at when the next office high-rise might be built in downtown, it may be a while. It's been a long time, and that window to build appears to be closing.

Signorelli: Matt, what do you see?

Rauenhorst: I agree with regard to office space downtown. In the downtown core, there are some larger spaces; Wells Fargo has gone from being a tenant to an owner. As to the next downtown high-rise building, we are seeing them, it's just that they're multifamily. The demand in that space is strong, but when it comes to office, the net rents are very close to where they've been for 25 years. Perhaps the best way to make a downtown high-rise work for new office development today is if you could somehow build on stilts and start at floor 20. To be successful in today's market, a downtown office high-rise would have to be a user-driven build-to-suit with some limited speculative space on the top floors.

Dorgan: In the niche markets, like the Warehouse District, you have seen new builds such as the Be The Match space, and T3, an investor building that is really replicating that warehouse look. Financially, downtown can draw a lot of the workforce from broader areas, but if you look at the cost of office space downtown, it's significantly more per square foot than the suburbs, and you have to throw parking on top of that analysis. Parking per square foot can be $5 to $10, so when you're looking at $20 in the suburbs compared to $25 to $30, plus the parking downtown, that's a much larger increment. We might start seeing more demand in the suburbs given the expenses downtown.

Rauenhorst: I think beyond being user-driven, what will make speculative office work is the floor plan being the right layout for the workplace of the future, this includes an open floor plan that maximizes the efficiency and creates spaces where people want to work. The cost of new space may be more, but we believe that added real estate cost is offset by productivity gains and efficient use of space. There are several credible studies highlighting the relation between quality workspace with increased productivity. The economic benefits of productivity gains greatly outweigh the costs of marginally more expense real estate. As a result of this, we've been having discussions with some of our clients who would be great candidates to benefit from this approach, asking them, "Is rent the sole driver of your real estate solution driver, or can we help you quantify the impact of improved productivity and retention of your employees?"

Dorgan: Yes, we talk about the importance of space with our clients, that it's not just an office space; every user has a different need. In downtown we're seeing that it's those amenities in buildings, such as bike storage and fitness centers, make the difference. Not every building has bike storage, but the buildings being retrofitted or converted are making a point to provide this amenity. Having those amenities, and a flexible workspace, productivity can go up depending on the space and how it's designed and built.

Signorelli: Do you see the suburbs still being a draw for good-sized office users?

Dorgan: Absolutely. We're working with a client now in the south metro, and their workforce is generally south. They do not have to move downtown and take on those extra costs to attract employees. A lot of the employee base live in the suburbs. It's amazing how mobile the workforce is in the Twin Cities. As you get into manufacturing jobs or lower paid workers, they're a lot less mobile, but by and large our workforce is very mobile and will move to where the job is and chose based on the company and culture.

Signorelli: Different locations have different tax ramifications. Peter, Minnesota has high property taxes on commercial properties compared to our peer states. If property taxes aren't going to change, what else can be done to improve the financial viability of commercial development?

Coyle: The challenge is for cities and the development community to realize they're in a partnership. Too often I get a call from a client who wants to do X, and wants to know which cities are offering whatever package. But any city with a sophisticated development office, whether suburban or the core, is going to be working with the same tools, and the truth is they're pretty limited. Tax increment financing is probably the most prevalent. Beyond that, the city has look within its resources if it's trying to help make a project viable beyond what the property tax system will provide. So companies have to decide, in the scheme of things, where's the most value going to come from? Is it getting employees to the location, which suggests transit corridors that are accessible? Is it the cost of land? What is City X going to charge me to put this project together? It's disappointing to me that cities haven't recognized that responsibility more clearly. It's like they're still back in the early 2000s, in terms of how they look at development projects and cost them out. If I had to rank the top 10 things clients complain about, the first, second and third might be the cost of getting a project approved in a given community. Now that's not uniformly true, but the communities people want to be in have the most aggressive fee structure — because they can. Cities have to see it as a partnership and be more willing to re-assess how they're responding to development. If they're only looking at the short term, can they get a half million dollars in extra revenue, or do they want the company and property to be there for the next 25 years, which will generate property taxes, the employment base, hopefully the activity in the community, investment in the schools and the rest. That conversation doesn't happen except with more sophisticated developers and cities, and I think that's what DMC is trying to set up and facilitate. Most communities don't have the infrastructure to manage that, and they may have to go back to the Legislature and say, "We need some help here. We're trying to compete with Wisconsin and Iowa and the Dakotas, because of our high property tax system, we used to have generous authority to do TIF, and you need to give that back if you're not going to give us general fund support."

Signorelli: The [Destination Medical Center] development plan [in Rochester] is a huge project, there's a fair amount of public investment, and it's working to attract up to $5 billion in private investment. How's the DMC working?

Seeb: Well, Rochester is a very healthy city, and a great place to begin any initiative. It also has an extraordinary engine and asset called the Mayo Clinic. I've spent 25 years in the Twin Cities, and I have a background in urban development and health care, and even I underestimated how powerful a brand it is. I was at a bioscience conference with people from around the world recently and we were there to introduce the opportunity of locating a business in Rochester, and to a person — people from Japan, Thailand, Australia, London — they all knew of Mayo and the value of being associated with it. The fact that it's 75 miles from downtown Minneapolis didn't matter to them; what mattered was that it's a global brand and asset. The Legislature committed to investing in Rochester to help it succeed and grow and attract patients and talent from around the world. All of us should understand that that's the great shared interest we have, which is attracting talent to Minnesota. That's what we're competing for with other states. Property taxes matter, but creating an environment that attracts and retains young talent is equally important. That should be our shared goal, whether we're in Minneapolis or St. Paul or Shakopee or Rochester.

Signorelli: Matt, what do you see as the future of development here in the Twin Cities?

Rauenhorst: At this time we see the most activity in two sectors. First is industrial, not only in the Twin Cities, and the state of Minnesota, but around the country. Nationally there has been and continues to be a lot of growth in that space. The other is multifamily, where we're seeing strong demand in cities with jobs growth. Particular to this market, we have either under construction or completed in the past 90 days, 950 units of multifamily across Minneapolis, St. Paul and Edina. Multifamily has been driven by a new and growing group of renters: those who rent by choice — which is a trend we see continuing. We're optimistic for well-located properties that have the amenities, proximity to transit and access to local employers. An apartment provides a level of flexibility that doesn't come with homeownership. Across Minnesota, homeownership rates fell through the recession, and while they have increased some, they haven't gone back up to pre-recession levels because there isn't the same desire to own among millennials and empty nesters. As the quality and amenities of multifamily increase, it makes the decision to choose renting versus ownership even easier.

Seeb: Something Peter said was really germane: How do we make it efficient for developers for entitlements? In Rochester's case, a group of local developers has advanced Rochester, but as we look ahead into the 21st century we know we need to attract people who will likely partner with local developers. They're new to the Rochester market, and they don't know all the nuances of how to get through the process, the local customs and historical patterns. So, how do we make it more efficient for people who want to do projects? There is a cost of doing business in delays or process. That's one of the obligations for people like me, organizations like ours, and cities: to figure out how you make that process efficient for the developer.

Coyle: I think Rochester and DMC are an interesting case study. From my vantage point, it's the first holistic approach to remaking a city. The challenge is going to be giving developers enough confidence about what that process will take them through: "I know what the rules are; now what are the other rules that aren't written down and the politics of the city?"

Seeb: I said earlier that Rochester is a very healthy city; the crime rate is low, people are graduating from high school, unemployment is nearly zero. It's been said that it is harder to go from good to great than from bad to good, so it's an opportunity that Rochester is so strong and healthy, but it's also a challenge. If things are going well, how do you break up the system to get to the next level?

Dorgan: If there is no desperation for development from the community, they are less likely to streamline their process. You have to have political leadership that really wants development to come into their community.

"I think the evidence of the population returning to the core cities is more relevant than what's happening immediately adjacent to the transit line."

PATRICK SEEB, Destination Medical Center

"Where I engage is when someone is trying to put a deal together and they're frustrated because it's not lining up, they've got community opposition or it's not coming at the pace they assumed based on all the public commentary."

PETER COYLE, LARKIN HOFFMAN

NANCY KUEHN

Seeb: I remember when Gov. Jesse Ventura and Metropolitan Council Chairman Ted Mondale were championing the idea of transit and light rail. They decided to take the media on a traffic congestion tour. They were driving around a packed busload and they couldn't find any congestion that day. The governor's staff was calling a traffic helicopter to help them find congestion. Well, today, there's no Wednesday when you could drive around the Twin Cities and not face congestion. What they were doing then was helping people to see around a corner. They were trying to help people understand that if we don't work to address issues today they will become big problems 10 or 15 years from now. This is true for Rochester, as well.

Signorelli: On that topic: The Southwest light rail line is continually getting delayed, so what is it looking like for light rail and other types of transit?

Coyle: Well, the pace of development along transit corridors has probably not been what anyone wanted. Some of it is because the cities were trying to make a market where none existed. The market realities have had to adjust over time, and we're beginning to see the Hiawatha Corridor get some more traction after almost 10 years. Southwest is a little different because it's such a well-established commercial corridor already, as opposed to Hiawatha. The line through St. Paul has been a challenge; the city is trying to remake that corridor, but it's having to replace what's there, so the business owners, property owners and residents that are already there, have to accept that vision or be prepared to move. So the tension is still playing out more dramatically and more visibly there than we are seeing along in the Southwest line.

Seeb: When I'm in town on the Green Line, I see a lot of development happening, so I'm trying to reconcile that with what you're saying. But beyond that, the Star Tribune reported that the core cities had their fastest population growth in the last decade and actually outpaced the suburbs. I think the evidence of the population returning to the core cities is more relevant than what's happening immediately adjacent to the transit line.

Coyle: That's fair, and I'm not denigrating the core cities, I think they're doing what they have to to make transit viable for the long term. Where I engage is when someone is trying to put a deal together and they're frustrated because it's not lining up. They've got community opposition or it's not coming at the pace they assumed based on all the public commentary.

Signorelli: If you're a betting man, what do you see is the Southwest light rail timeline?

Coyle: I'd be astounded if it wasn't completed in three years, assuming they get going in the next 12 months. They're acquiring properties, so something is going on.

Signorelli: Matt, obviously Opus has a lot of experience in development. What are you seeing? What products are expanding? What's the big push?

Rauenhorst: Historically, Opus's primary product types are office and industrial, and these are still significant pieces of business today. In the past five years, multifamily and student housing have been a growing component of our business. Looking forward we are focused on growing two categories: senior living and health care. There is a wave of baby boomers who will age into senior living over the next two decades in the Twin Cities market and nationally. And expectations and needs in this segment are evolving, so these residences will need to be fully amenitized and offer a continuum of care to meet the diverse needs of prospective residents — from independent living to assisted living and memory care facilities — so we are designing and building with all that in mind. We look forward to kicking off our first senior living project this fall in Minnetonka at Interstate 394 and Hopkins Crossroad. Likewise, a growing aging population, consumer expectations for service delivery and other trends in health care are driving toward a greater need for outpatient services and smaller clinics and away from hospital campus-centered delivery. Collectively, these trends are shifting the health care real estate landscape significantly to more of a retail model. That said, leveraging our extensive experience in the retail sector, we've recently developed a unique modular approach to scalable clinic design to support health care clients in addressing shifting market demand effectively and efficiently.

Coyle: Do you see the condo market coming back anytime soon?

Rauenhorst: Growth in the condo market is and always has been a function of risk and reward. The Minnesota Legislature passed a bill modifying components of the long-term liability requirements that have stalled condo development over the past decade. These changes will help owners, designers and builders get more comfortable with developing condos again. The bigger impact on future development is supply and demand metrics. The lack of new supply of units in downtown Minneapolis, St. Paul and the premier first-ring suburbs has caused prices to climb. When that pricing gets to where the developer is comfortable with the risk and corresponding reward, we will see condo towers again and we're getting much closer. At Opus we're starting to evaluate condo underwriting for the first time in many years. And again, it all comes down to the ROI equation for developers and their stakeholders.

Signorelli: The legislative changes are probably the biggest driver.

Rauenhorst: Well, liability is one component, but there are many others that need to be considered, including financing. In order to begin construction, many lenders will require significant pre-sales. Also, putting together and executing a condo project takes about three times the staff hours as multifamily. These and other factors need to be addressed when considering for-sale condos.

Coyle: Can we talk about what Amazon means to the market? I'd love to know how you think this is going to reshape our market?

Dorgan: It's three areas of the market it's impacting. It now has a million square feet of distribution in Shakopee, offices in the Warehouse District, and it plans to buy the Whole Foods chain. You have the logistics and distribution component, as well as the client interface. It's a change in retail, and in fact, I think it's going to change distribution. We're also going to see changes in warehouse jobs. Automation of distribution is going to take away traditional warehouse jobs. The newly created jobs will be more sophisticated and require technical training; it's going to be someone maintaining robotic equipment, not a high school kid running a forklift.

Rauenhorst: One of the big questions is, how do we provide the opportunities to get the right skills on our team? Opus is a developer but we have a lot of associates who are construction workers, and the tenure of our men and women in the field continues to grow while we see the numbers of new associates entering the trades declining. So how are we providing opportunities to get into that skilled trade? These are good jobs for a good wage that aren't going to go away. We have a strong focus at Opus, culturally and through the Opus Foundation, on providing opportunities for skills training. It's something contractors in the Twin Cities need to get together on, because the shortage of labor in that space is real.

Dorgan: We feel it directly. Historically, when the recessions hit, construction gets hit really hard. Because it's a union town, seniority stays; people who were 35 and older stayed, while others found new jobs. But as construction has progressed in the past five or six years, those folks are now reaching retirement age, and there's no backfill. You had the master plumber and the journeyman and the apprentice, where you skipped a generation. That's how that workforce works. There's vocational training, but really they learn on the job with a master teaching them the trade, and there's a gap there. So I think the labor rates are going to go up in that industry dramatically, because the unions will have the upper hand. Which is fine. It's a cycle.

Rauenhorst: How do you get folks in to those trades? They want to grow their base as much as they want to grow their rate, so looking at a pipeline, how do you talk about, "Here's the workforce we need, how do you move that apprentice faster to journeyman?" That's the partnership we need to be in right now across the Minneapolis market.

Coyle: You've got to convince mom and dad to let junior be in the trades.

Seeb: That's a larger question: What are the disruptive technologies on the horizon, and how do they affect how we build our cities? Autonomous vehicles? If the amount of public infrastructure for single-occupancy vehicles changes, that $5 to $10 per square foot for parking, that equation could change a lot. The other disruptor is the cost of fuel, and as battery costs are falling exponentially, in the not too distant future it will be cheaper to have an electric car than gasoline. That may change the locational needs that distribution companies have.

Dorgan: You talked about the automation of transportation, and we're seeing that in trucking with our clients. Right now, they can't find drivers to go into the business, because there are better jobs out there. Also, drivers are required to only drive eight to 10 hours before they have to stop and break. If you have automated trucks, the hours you can drive go from eight to 12 to 16 because drivers are not actually driving, they are monitoring the vehicle. With our manufacturing and logistical clients distributing all over the U.S., where's the best location to optimize transportation? That criteria sometimes trumps the cost of labor. It definitely trumps taxes in a community, because if you take a big portion of that transport cost out — whether it's fuel, or labor costs for the driver, or time speed to market, that's a disruptor and it just cascades through the entire process.

Seeb: The other disruptor is the cost of fuel, and as battery costs are falling in the not too distant future it will be cheaper to have an electric car. So from a distribution perspective, if labor changes because of autonomous vehicles and the fuel costs go down, is that going to change the locational needs that distribution companies have?

Dorgan: We haven't talked about energy and how that impacts real estate. We just leased a client's rooftop in California to a solar developer, and they now have 200,000 square feet of solar on their roof, which will provide them with $6 million in energy savings over the next 15 years. The cost of photovoltaic panels is decreasing and becoming much more efficient, making them a more affordable investment with shorter returns. Rooftops, windows and many other building materials will become one big energy producer in the future. Those opportunities to reduce energy costs will revolutionize competition in real estate.