Low unemployment rates and continued job growth make the Twin Cities Metro Area (TCMA) an appealing market for investors, and the multifamily sector has attracted substantial capital investment. According to the U.S. Bureau of Labor Statistics, the Twin Cities had the second lowest unemployment rate in the nation among large metropolitan areas, at 4.5% in June 2014.

Both downtown Minneapolis and St. Paul are experiencing significant new development and repurposing of existing buildings to meet the growing demand fueled by job growth and housing demand.

Robust market fundamentals and strong demand for new multifamily product have spurred greater levels of construction than seen in the last 20 years. The first half of 2014 saw 1,979 new units delivered throughout the metro area, which is nearly double the number of new units that came online during the same time frame last year. Furthermore, a total of nearly 5,000 multifamily units are expected to be delivered during all of 2014, up from 2,763 units delivered in 2013.

Absorption has kept pace with the supply of new units, and demand for new product remains strong despite the continued surge in construction. Overall vacancy rates remain extremely low, both historically speaking, and also as compared with similar metropolitan markets nationwide. The average TCMA vacancy rate decreased slightly, falling from 2.7% last quarter to 2.6% in Q2 2014. This represents the 13th consecutive quarter that Metro Area vacancy rates have remained below 3%. As might be anticipated, the low vacancy environment has fostered upward pressure on rental rates. The Metro Area posted rent growth of 2.6% year-over-year, with many submarkets experiencing even higher growth rates.

Downtown Minneapolis is the notable exception to the declining vacancy trend experienced throughout the Metro Area. This submarket has seen the greatest surge in new developments, and accounts for approximately 30% of the new construction and 22% of absorption in the TCMA. Consequently, vacancy rates have risen as new projects are incorporated into the overall rental market inventory. Q2 2014 saw a vacancy rate of 5.7% for Downtown Minneapolis, up from 5.0% last quarter, and up from 3.0% last year. Despite the increase in vacancy, the Downtown Minneapolis submarket is experiencing strong demand with rental rates increasing 4.5% year-over-year.

The majority of new developments are outperforming pro-forma rental rates and surpassing owner expectations for the velocity of initial lease-up. Some properties have offered limited concessions due to either a large number of units being delivered in a small geographic area, an inferior location, or design shortcomings. However, given the intensity of demand for multifamily product, it appears unlikely that vacancy rates will remain elevated for an extended period.
• Twin Cities Metro Area ranked as the 8th Best City for Job Seekers
• 23,100 jobs were added in past 12 months
• More than three years of multifamily vacancy rates below 3%
• 1,979 market rate units were delivered in first half of 2014
• Absorption in first half of 2014 was 1,754 units or 89% of units delivered
• Two submarkets had vacancy of 2.2% - the lowest in TCMA
• Highest average rents were in Downtown Minneapolis at $1,401
• Metro wide new projects are averaging 35% pre-leased occupancy at Certificate of Occupancy and 16 units/month during lease-up (these numbers are higher in urban areas)
• Twin Cities Shadow Markets (single family homes, townhomes, condo rentals, etc.) rental rates increased average of 4.7% year-over-year
• Unemployment rate for TCMA as of June 2014 was 4.5%, nearly 2% below the US unemployment rate of 6.3%
Twin Cities Metro Area (TCMA) vacancy rates averaged 2.6% in Q2 2014, adding yet another quarter to the now 13 consecutive quarters with sub 3.0% vacancy. This three year period of historically low vacancy has been a strong driver of rent growth throughout the TCMA. Average rental rates across the TCMA in Q2 2014 were $1,004/month, for an average increase of 2.5% year-over-year. Both Downtown Minneapolis and Downtown St. Paul exceeded the TCMA average, enjoying rental rate increases of 4.6% at $1,401/month and 6.1% at $1,273/month, respectively. Although Downtown Minneapolis and Downtown St. Paul were an exception to the historic low vacancy trend dominating the TCMA, with vacancy rates increasing by 2.7% and 4.5% respectively, this was due primarily to the number of units delivered during the first half of the year.

New apartment development is a continuing trend in the TCMA and Marquette Advisors reported that 1,979 multifamily units were delivered across the metro area during 2014, through August 1. Of these, 1,754 units, or 89%, have already been absorbed. The majority of new deliveries were concentrated in both urban cores, with 667 market rate units in Downtown Minneapolis, and 627 market rate units in Downtown Saint Paul. The trend of new construction shows no sign of slowing, and the Twin Cities Metro Area is expecting nearly 3,000 additional units by year end 2014.

Metro Area vacancy rates may see a slight increase as supply and demand equalize. The large volume of units delivered within a short period of time has increased competition between multifamily projects. Concessions are most prevalent in the Uptown neighborhood of Minneapolis, where a total of 852 units were delivered during a six month period in late 2013, most of which are situated within an eight block area. An additional 388 units will be delivered in the same Uptown neighborhood in September of 2014, indicating that concessions will likely be present in this rental market into the foreseeable future.

Many new developments are exceeding owner expectations, both by achieving higher rents and leasing up faster than projected. Soo Line Building City Apartments, a 254 unit historic renovation high-rise tower in Downtown Minneapolis, opened in October 2013 and was 98% occupied in less than nine months. Be @ The Calhoun Greenway, a 185 unit development in the Uptown neighborhood, opened in December 2013 and was 85% occupied as of August 1, 2014. Victoria Park Apartments, a 215 unit development just outside of Downtown Saint Paul opened in February 2014 and was 88% occupied within six months. These examples of rapid absorption demonstrate the demand for well-designed and well-located projects, and should bode well for future similar developments.
### Submarket Conditions

<table>
<thead>
<tr>
<th>Submarket</th>
<th>Avg Rent</th>
<th>Vacancy</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Downtown Minneapolis</strong></td>
<td>$1,401</td>
<td>5.7%</td>
</tr>
<tr>
<td><strong>Minneapolis (Non-Downtown)</strong></td>
<td>$974</td>
<td>2.4%</td>
</tr>
<tr>
<td><strong>Downtown St. Paul</strong></td>
<td>$1,273</td>
<td>6.6%</td>
</tr>
<tr>
<td><strong>St. Paul (Non-Downtown)</strong></td>
<td>$886</td>
<td>2.5%</td>
</tr>
<tr>
<td><strong>North Central Suburban</strong></td>
<td>$894</td>
<td>2.4%</td>
</tr>
<tr>
<td><strong>Northeast Suburban</strong></td>
<td>$884</td>
<td>2.1%</td>
</tr>
<tr>
<td><strong>Northwest Suburban</strong></td>
<td>$914</td>
<td>2.7%</td>
</tr>
<tr>
<td><strong>South Central Suburban</strong></td>
<td>$966</td>
<td>2.3%</td>
</tr>
<tr>
<td><strong>Southeast Suburban</strong></td>
<td>$1,090</td>
<td>2.8%</td>
</tr>
<tr>
<td><strong>Southwest Suburban</strong></td>
<td>$1,111</td>
<td>2.2%</td>
</tr>
<tr>
<td><strong>Twin Cities Metro Area</strong></td>
<td>$1,004</td>
<td>2.6%</td>
</tr>
</tbody>
</table>

Source: Marquette Advisors
The substantial volume of apartment construction occurring in the Twin Cities shows no sign of slowing during the second half of 2014. Approximately 1,950 market rate units were delivered between January and August 2014. An additional 2,300 market rate units and 678 student housing units are expected to come online before year end.

Currently, there are 22 market rate developments under construction in the TCMA, with a total of 4,019 units expected for delivery in 2015 and 2016. Half of these projects are located in the urban cores of downtown Minneapolis and St. Paul, with the remaining developments underway in suburban locations. The south and west suburban submarkets are also experiencing substantial new development.

In addition to the projects currently under construction, there are 49 more developments in the planning or proposed stages across the TCMA, which together total 9,063 market rate units. Areas with the greatest concentration of planned/proposed market rate developments are the West Metro (eleven projects, 2,103 units), South Metro (nine projects, 2,166 units) and Uptown Minneapolis (six projects, 567 units).

Student housing construction near the University of Minnesota campus continues, although new starts have begun to taper off. There are currently 1,213 units under construction, 678 of which are expected to be delivered in 2014. Additionally, there are three student housing projects that are planned or proposed, totaling 564 units.

Construction costs in the TCMA continue to rise due to increases in the cost of certain construction materials and labor. Demand for skilled construction workers exceeds supply, and this scarcity has led to higher wages, some delays, and consequently higher construction costs. Average construction costs have increased 6% this year, continuing a trend that will likely persist for the next several years.

In addition to multifamily construction activity, numerous other large scale projects are currently underway. Minneapolis’ Downtown East Redevelopment Project is a five block, $400,000,000, mixed use development including 1.1 million square feet of office space in two 17 story office towers owned by Wells Fargo, about 24,000 square feet of retail, 193 market-rate apartments, a six level parking ramp with 1,610 spaces, and a nearly two block urban park connecting the new NFL Vikings football stadium to the core of downtown Minneapolis. Additional Minneapolis construction includes new company headquarter buildings for both Xcel Energy and Kraus Anderson Construction Company. A new baseball stadium for the St. Paul Saints is under construction in downtown St. Paul.

For more information or a copy of the complete pipeline and maps, contact Erin Hartwig at ehartwig@naieverest.com.
The TCMA saw 17 transactions totaling $211.5 million dollars during the first half of 2014, several of which are highlighted below. The average sale price per unit was $88,847 in Q2 2014. The largest transaction in the TCMA was The VUE Apartments, a 119 unit luxury apartment building located in the Loring Park neighborhood of Minneapolis, which sold in May 2014 at a sub 4.5% cap rate for $30,750,000, or $258,403 per unit.

The TCMA is experiencing a historically low cap rate environment, which is fostered by the convergence of a variety of factors including robust demand for multifamily assets (especially well-located Class A properties), historically low interest rates, and outstanding market fundamentals. Due to Increased capital demand, investors have broadened acquisition criteria to encompass value-add and suburban assets. These market forces will push cap rates of Class A assets to the mid 4% to low 5% range, well located Class B assets to the high 5% to low 6% range, and suburban Class B and Class C assets to a low 6% to mid-7% range, with variability depending on the location and condition of the asset.

### Notable Sales Transactions, January - June 2014

<table>
<thead>
<tr>
<th>Property</th>
<th>City</th>
<th>Units</th>
<th>Age</th>
<th>Sale Price</th>
<th>$/Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>VUE</td>
<td>Minneapolis</td>
<td>119</td>
<td>2013</td>
<td>$30,750,000</td>
<td>$258,403</td>
</tr>
<tr>
<td>Gallery Flats</td>
<td>Hopkins</td>
<td>73</td>
<td>2014</td>
<td>$11,352,117</td>
<td>$155,508</td>
</tr>
<tr>
<td>Madison Trailway</td>
<td>Burnsville</td>
<td>240</td>
<td>1988</td>
<td>$24,800,000</td>
<td>$103,333</td>
</tr>
<tr>
<td>Madison Atrium</td>
<td>Burnsville</td>
<td>348</td>
<td>1986</td>
<td>$33,000,000</td>
<td>$94,828</td>
</tr>
<tr>
<td>Raven Hill</td>
<td>Burnsville</td>
<td>304</td>
<td>1971</td>
<td>$26,925,000</td>
<td>$88,569</td>
</tr>
<tr>
<td>Lexington Hills</td>
<td>St. Paul</td>
<td>168</td>
<td>1987</td>
<td>$13,500,000</td>
<td>$80,357</td>
</tr>
<tr>
<td>Grand Pre East</td>
<td>Roseville</td>
<td>250</td>
<td>1972</td>
<td>$19,450,000</td>
<td>$77,800</td>
</tr>
<tr>
<td>Westwood Gardens</td>
<td>St. Louis Park</td>
<td>152</td>
<td>1962</td>
<td>$11,430,000</td>
<td>$75,197</td>
</tr>
<tr>
<td>Fairway Flats</td>
<td>Anoka</td>
<td>36</td>
<td>1968</td>
<td>$2,560,000</td>
<td>$71,111</td>
</tr>
<tr>
<td>Hillside East</td>
<td>New Brighton</td>
<td>108</td>
<td>1964</td>
<td>$7,250,000</td>
<td>$67,130</td>
</tr>
</tbody>
</table>

Source: Real Capital Analytics
NAI Everest brings industry-leading resources to its disposition and acquisition services. Speed, agility, and keen insight are hallmarks of our services. The result is connecting properties with our exclusive list of investors and institutions. NAI Everest disposition services rely upon the skills and insight of our experienced team of brokerage, marketing and data resource management professionals. Our process begins with an internal launch meeting that unifies clients’ objectives with marketing and sales strategies. This launch is the beginning of a process that involves the following phases:

Comprehensive Property Profile - market analysis, competitive review, capital market summary

Marketing Promotional Strategy Development - advertising, direct mail, e-mail, web listings, and public relations tactical outline

Sales Planning & Execution - database profile analysis, identification of network connections, direct contact with exclusive list of buyers

Client Communication - communication of progress through activity reports and updates

Maximum Price - the result is the capitalization of market dynamics in achieving a competitive bid environment and the maximum sales price

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