

BUSINESS

Twin Cities industrial real estate sector is on the rise

Growth of e-commerce, manufacturing is turning the ugly duckling of commercial real estate into its strongest, most profitable sector.

By Nicole Norfleet (<http://www.startribune.com/nicole-norfleet/101685423/>) Star Tribune |

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Scott Tankenoff of Hillcrest Development doesn't usually just buy land — at least not without a building on it.

But when he was approached about an undeveloped, 39-acre property in Cottage Grove zoned for industrial use, he took a chance and, last month, started building an industrial park.

Tankenoff's leap shows just how far the strong economy has taken the Twin Cities industrial real estate scene. It's attracting not just developers, but end customers and investors from far away. And across the country, the business long thought of as the ugly duckling of commercial real estate, is now "the strongest and most profitable sector," an industry trade group [said recently \(https://www.naiop.org/en/Magazine/2018/Spring-2018/Development-Ownership/What-Lies-Ahead-for-Commercial-Real-Estate-Sectors\)](https://www.naiop.org/en/Magazine/2018/Spring-2018/Development-Ownership/What-Lies-Ahead-for-Commercial-Real-Estate-Sectors).

"I think industrial gets a bad name," said Casey Hankinson, who leads custom, build-to-suit office and industrial projects at Minneapolis-based Ryan Cos. "Some people think of smokestacks and industrial uses, but these are great places to do business."

About 4.5 percent of single and multitenant bulk warehouse, office showroom and office warehouse space in the Twin Cities was vacant in the first quarter of the year, real estate firm CBRE said. That's significantly below the nearly 8 percent level seen in 2010 as the region and country were pulling out of the recession.

Today, many new industrial buildings are being custom-built for companies as well. In September, packaging manufacturer North Star Sheets is expected move into the 161,000-square-foot building that is being constructed at Hillcrest's Southeast Industrial Park in Cottage Grove. Tankenoff said the deal was possible because of a partnership with the Opus Group, which is handling the build; cooperation with the city; existing infrastructure at the site and access to rail.

Hillcrest also recently solidified an agreement to purchase and renovate a 300,000-square-foot older industrial building in the Midway area of St. Paul that is being used by Living Word Church. As part of the purchase, Hillcrest would provide the church with a new home in Minneapolis.

"I think that the marketplace is robust and we have some room to grow," Tankenoff said.

This month, construction started on a large industrial facility in Maple Grove close to the Arbor Lakes retail center. The building will allow local candlemaker Illume to consolidate six buildings in Bloomington into one modern headquarters space complete with offices, a manufacturing facility and warehouse.

"It was very much for us about the location," said Kim Mokosso, president of Illume. "There's basically no land available for the size of almost a 300,000-square-foot facility that we are looking for. Your choices are limited."

Industrial capitalization, or cap rates, which show the potential rate of return on real estate investments, continue to be low in bigger cities on the coast where land is at a premium. But they are higher in places like the Twin Cities, increasing their appeal to real estate investors, including those from overseas.



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Recently grown in Southeast packaging manufacturer North Star Sheets is expected to lease rate increased \$5.75 per square foot move into the 161,000-square-foot building

Net absorption decreased to 617,310 square feet but still the 31st consecutive quarter of positive absorption

Construction completions added 772,959 square feet

Source: CBRE Research, Quarter 1 2018 (Includes single tenant and multi tenant space)

“There is more and more capital trying to come to the Twin Cities,” said Colin Ryan, senior vice president of Colliers local investment services division.

For example, the recent sale of the Plymouth headquarters of women’s apparel retailer Christopher & Banks Corp. attracted about 15 offers from interested parties from around the country, said Ryan, who helped with the sale.

“Multifamily has been a darling for investors because if somebody is moving out of an apartment, there is a good chance that somebody else is going to move in,” Hankinson said. “It is the same now I would say for well-located industrial.”

Industrial real estate hasn’t always been popular. Industrial inventory garners lower rental rates than other real estate sectors. The jobs that fill industrial warehouses and manufacturing plants can be lower paying than typical white-collar jobs. Even the appearance of industrial buildings, usually large boxy structures with numerous loading docks, can generally be unappealing.

There is currently a trend of more manufacturing reshoring in the United States which is giving the local market a push, said Dan Swartz, a senior vice president at CBRE who specializes in industrial properties.

“With the tax cuts and the threat of tariffs, it’s just more attractive for companies to locate their manufacturing within the U.S.,” he said.

The biggest current driver of industrial demand has been the popularity of e-commerce which has resulted in what is being called “the Amazon effect.” Retailers are now racing to build distribution facilities close to population centers to quickly deliver their products to customers.

“Because of people and households wanting more things delivered on a quicker time basis, there is more of a need to have that last mile and last 20-mile distribution,” Ryan said.

Even in the Twin Cities, which has never ranked high as a distribution hub due to its geographic location, distribution centers such as the nearly million-square-foot Amazon facility in Shakopee will continue to expand in the market for the next five years or so, real estate experts predict.

E-commerce companies tend to need more space in their distribution centers, leading developers to build warehouses with 32-foot ceilings as opposed to the 24-foot-tall heights that were previously common. More loading docks and higher finishes are also being incorporated into newer buildings.

But new buildings require land. Buildable infill sites close to customers, workers and amenities are becoming harder to find, and it can be expensive to retrofit existing industrial complexes, said Mark Evenson, principal and managing director of real estate firm Avison Young’s local office.

To try to draw more jobs to their areas, some cities have been more proactive with providing viable industrial sites. Rogers and Shakopee have welcomed many industrial projects. Late last year, the Brooklyn Park City Council approved a plan to rezone a 62-acre business park that was once supposed to be the site of offices, apartments and retail to allow light manufacturing and industrial. The Arbor Lakes Business Park where Illume is moving was originally planned to be retail stores, but the city of Maple Grove decided more daytime jobs were needed so it allowed for the industrial park.

Despite efforts by cities and developers, one of the major concerns of industrial tenants has been the shortage of workers. Minnesota has an unemployment rate of 3.2 percent, and Amazon, General Mills and other companies have paid to bus workers to their facilities. Labor has quickly become the main focus of industrial users as they select where their facilities will be.

“It’s not any different in the industrial world than the office sector,” Evenson said. “You want good talent and you want dependable employees and you want to be located where it is convenient for them.”

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