

LAND OUTLOOK



Slowing Housing Market Forces Correction in Land Prices and More Opportunities for Commercial Development

- Demand for residential land has plummeted
- Prices buyers are willing to pay for raw residential land are dropping from where they were 6-12 months ago
- Opportunities for buyers to take advantage of lower land prices are expected to be available
- The market has not yet hit bottom

The land market has undergone a drastic transformation in the past 8-12 months. Prior to this period, residential developers were aggressively competing for land positions in highly sought-after, high-growth markets like Maple Grove, Chanhassen, Chaska, Shakopee, Prior Lake, Blaine, Hugo, Rogers and St. Michael.

Residential developers, particularly large, publicly traded companies, aggressively competed for land control. These developers drove land prices up as they entered into contracts at extremely high prices to keep competitors out. Raw land in some Twin Cities submarkets more than doubled in price with rezoning and growth over three years.

The tides have turned, however. A glut of new homes on the market and slightly higher interest rates have resulted in a significant slowdown in new home construction. The Builders Association of the Twin Cities reports that Twin Cities-area homebuilders were issued 492 permits to construct 866 units in November 2006—a 38% drop in permits and a 40% drop in units from November 2005.

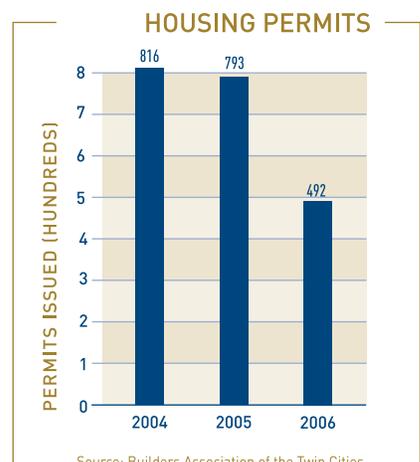
HOUSING DEVELOPERS UNLOAD LAND

During the land rush, residential developers struggled to keep a four-month supply of land. Today, some have an unprecedented 18- to 36-month supply, and demand has fallen from what it was 12-18 months ago. Many are taking a look at the prices they agreed to pay and have

become just as aggressive in unloading land and renegotiating contracts and purchase options. Some are walking away from options while others are refinancing, bringing in partners to help stabilize their hold, or trying to sell portions of their inventory to investors at substantial discounts. Prices for residential land have dropped at least 30%, meaning a price correction is well underway.

CORRECTION LEADS TO OPPORTUNITIES

Opportunistic commercial/industrial developers may soon be able to start new projects, taking advantage of lower land prices or buying land at adjusted prices as residential developers try to shake off one parcel in order to save another housing



project. Some prospective buyers may wait until pricing drops further, watching to see when the land market bottoms out.

INDUSTRIAL DEVELOPERS EYE MARKET

During the past two years, industrial land prices increased significantly—for example, key locations in sought-after markets doubled in price due to a tight supply of developable land and industrial developers being “priced out” as homebuilders’ frenzied land buyers pushed prices up.

With industrial vacancy at 13%, fewer large space options are available. However, lofty land prices are a barrier to speculative development because rental rates must increase to make deals work financially. Some companies are delaying relocation decisions and may be unwilling to pay the higher rates needed for new construction.

Opportunity exists in the next one to two years for industrial developers willing to take speculative land positions prior to approvals and leasing. There are opportunities for bullish developers willing to take land positions further out in the “next frontier”; however, this lies outside many developers’ comfort zones.

RETAIL PAUSES

Retail development follows rooftops, so the housing development slowdown in the outer rings is slowing “cornfield” retail development, and therefore, curbing demand for retail land. Retailers will look to penetrate the strong demographics of the first-ring suburbs and urban areas through redevelopment, although these deals are difficult due to high land prices, city reluctance to use eminent domain and environmental concerns.

Urban redevelopments that depend on a housing component to “buy-down” a developer’s land basis will be challenged due to the cooling housing market. It’s unlikely that the market will adjust efficiently. Landowners will be reluctant to lower prices, and municipalities will be slow on providing public subsidies until declining net operating income, vacancy and blight force cooperation.

Retailers will likely continue to pay the highest prices for land compared with other commercial uses. Sellers’ expectations for retail land will continue to be high due to the volume of development during the past few years and the “Walgreen’s Effect” (the belief by landowners that since Walgreen’s purchased a parcel somewhere at a record price, the value of all retail land is similar).

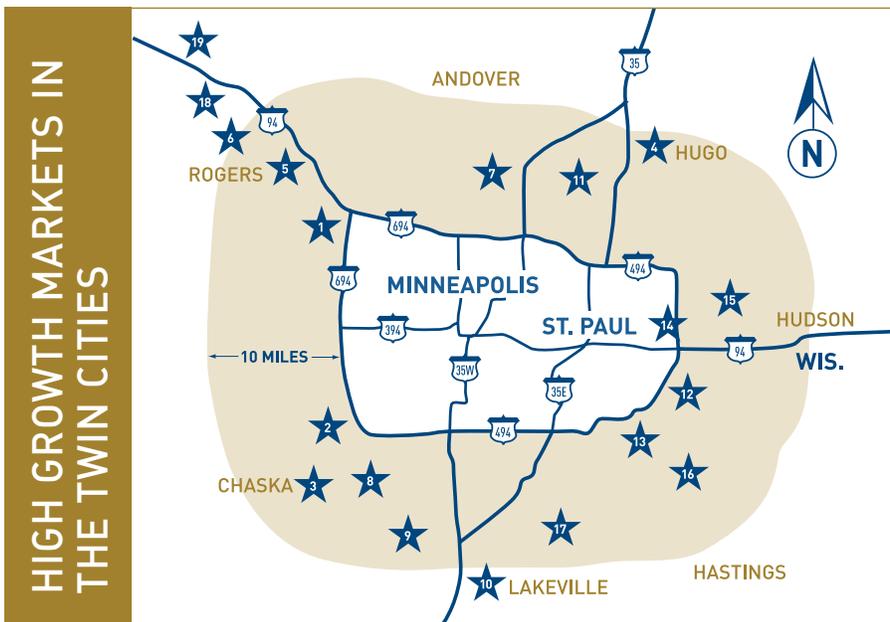
OFFICE DEVELOPERS RAMPING UP

It’s difficult to find good speculative office sites and land prices are up, which is forcing some developers to buy larger parcels of land than they need and offset costs with other types of development, such as retail, build-to-suit or senior housing.

Rental rates are increasing; however, there will need to be a significant jump in rates to offset higher land and construction costs. Recognizing the lack of options, some growing companies are committing to build-to-suits or mid-priced, single-story speculative buildings.

Redevelopment of inner-ring sites is occurring as office developers raze an obsolete building to obtain 10 acres in a desirable market. However, redevelopment can be expensive and time-consuming.

The market for land in the Twin Cities and its outer-ring suburbs has begun to shift away from residential development to more commercial uses. As this shift continues, land prices will likely return to more normalized levels, particularly as sellers adjust to the lower prices available on the market. ■



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|----------------|----------------|----------------|-------------------------|-----------------|
| 1. Maple Grove | 5. Rogers | 9. Prior Lake | 13. Inver Grove Heights | 17. Rosemount |
| 2. Chanhassen | 6. St. Michael | 10. Lakeville | 14. Oakdale | 18. Albertville |
| 3. Chaska | 7. Blaine | 11. Lino Lakes | 15. Lake Elmo | 19. Monticello |
| 4. Hugo | 8. Shakopee | 12. Woodbury | 16. Cottage Grove | |

