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MSCA news

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RETAIL DEVELOPMENT AND HOUSING STARTS: A DICEY RELATIONSHIP

Feature

by Christopher Naumann, KKE Architects, Inc.

How many times have we heard “follow the rooftops” when tracking retail markets? One might argue that a relationship between housing “starts” and retail development is obvious, with new residential developments spinning off retailing opportunities. It is logical that retailers want to be located conveniently to their customers and thus new residential projects drive new retail endeavors. Beyond concerns of location and accessibility, do housing starts really have direct impact on retail performance? Are new housing starts the best gauge to analyze the future of retail development, or are both housing and retail tied to larger development patterns and the economy as a whole?

According to a recent Bloomberg News Service article, sales at US retailers rose at a slower pace in September 2007, a downtrend that is likely to continue as the housing recession worsens.¹ This would suggest a direct relationship between housing and retail performance. The statement agrees with the theme of many articles published in recent months that relate stagnant housing numbers to flat retail performance. It is a common theme as unscrupulous sub-prime mortgage banking practices related to housing development has amplified the argument. Sub-prime lending activities of the past few years has allowed consumers to stretch their buying power as low

Retail and Housing on page 2

THE VILLAGE AT VADNAIS HEIGHTS

Snapshot

Location: SWQ of 35E and Co. Rd. E, Vadnais Heights

Month/Year Opened: New construction projected to open 2008

Owner/Managing Agent: Manley Commercial, Inc.

Center Manager: Carol Johnson

Leasing Agent: Jim Rock, Skip Melin, Brad Pfaff, Jennifer Colianni, Cushman & Wakefield of MN, Inc., (952) 465-3300

Architect: Architectural Consortium

Construction Contractor: TBD

GLA: Approximately 117,000 sf

Current Occupancy: 0

Number of Stores: TBD



Anchor Tenants: Super Wal-Mart shadow-anchored center

Market Area Served: Northeast

Construction Style: New construction

Additional Facts/Narrative: Exciting new center in an under-retailed trade area. Lifestyle center elements in place to embrace the cities vision for Vadnais Heights. Mid-box, inline and pad opportunities in what will be the 3rd largest retail development in the northeast quadrant.

RETAIL AND HOUSING *continued*

interest rates made borrowing for housing easy and cheap. Consumers were able to leverage themselves with debt, creating a cash windfall that was largely spent in the retailing sector. The market flourished under this premise and as quickly as you could find a new housing enclave under construction, you could find a busy shopping center being developed nearby.

Many consumers who borrowed using sub-prime debt now find themselves overextended with their finances, and bankruptcies and foreclosures have risen to historic levels. Consumers have less money to spend as interest rates move upward, fewer homes are constructed and retail performance has flattened. These events reinforce an implied direct relationship between retail performance and residential development.

According to regional data compiled by Cushman and Wakefield, the link between housing permits and completed retail development shows trending similarities, however no clear illustration of a cause and effect relationship can be drawn. In the years between 2000 and 2004, housing starts trended steadily upward from approximately 21,000 permits per year to a peak of approximately 28,000 permits in 2004. After 2004, residential permitting has declined, with only 5,000 housing permits being issued year-to-date. Retail square footage completion grew between 2000 and 2002, from 1 million sf to a peak of nearly 2.5 million. However, in 2003, the trend reversed as retail development in the region began a two-year slide ending in less than 1 million sf in 2004. 2005 saw a dramatic spike of completed retail development in the region to nearly 2.75 million sf of completed retail space, only to drop dramatically to a level of under 250,000 sf year-to-date. What is most interesting is the relationship of retail absorption in the same time periods. It shows a similar volatility as constructed space, indicating a stronger relationship with supply and demand which is related to, but not dependant on, new housing permits.² It is clear from this regional data, that a slowing of housing starts is not necessarily the cause of a stagnation of retail development.

What are other causes that may be contributing to a faltering retail development environment besides a lack of new rooftops? An argument can be made

that the current retail development slowdown being experienced in the metro might be the result of recent overdevelopment.

According to NuWire Investor, in an overbuilding situation, developers see an attractive market and build until the inventory of new construction combined with the inventory of current dwellings can't be absorbed, at which point the market stagnates.³ There are many markets across the country where construction booms have led to an oversupply of inventory, leading to market stagnation. Most severely overbuilt markets include Las Vegas, Phoenix, Orlando, Miami, and West Palm Beach. These markets represent the most extreme examples of the overbuilding trend, but have we breached a balance with oversupply of retail development in the Minneapolis market?

A breakdown of residential and retail growth statistics in the metro can be mapped to show geographic relationship of development densities. The strongest housing starts in the metro have occurred in the city of Minneapolis (est. households 167,317)⁴ which added 9,179 units of new housing over the past six years. Minneapolis also had 453,185 sf of retail development over the same period. By contrast, suburban cities of Maple Grove (est. households 21,575)⁵ and Blaine (est. households 19,752)⁶ combined for 10,059 units of new housing units over the same six years. The two outlying suburbs also developed an astonishing 2.5 million sf of retail development.⁷ This strong contrast suggests that when comparing residential unit growth with developed retail area, either Minneapolis has been underdeveloped from a retail standpoint, or the suburban counterparts of Maple Grove and Blaine have vastly been overdeveloped with retail during the past 6 years. Given the recent history of an extremely favorable development environment, and understanding the well-known struggles of many Minneapolis retail development endeavors, a simple assumption can lead to the belief that the remainder of the market may have been massively overdeveloped. The recent slowdown in housing starts only makes it much more apparent, as retail absorptions continue to decline. The housing slowdown did not cause the slowdown in retail development as much as the recent housing slowdown has magnified an existing oversupply of retail space.

There are many other factors that contribute to retail development stagnation. Shifting demographics, socio-economic conditions, inflated construction and land costs, rising energy costs, wearying consumer confidence, and geopolitical instability can all lead to market conditions that can stall market-wide retail activities. Through the analysis of development patterns in our own region, one can see that housing starts alone are not an accurate gauge of actual retail development opportunities. In fact, the simple analysis done for this article suggests that overdevelopment in rapidly growing areas may be a serious contributor to regional market retail stagnation.

To suggest that "following the rooftops" is a strong indicator of retail development patterns is an oversimplification. Although both residential development and retail development trend similarly in economic cycles, to assume that because new residential units are developed that a successful retail opportunity will appear is foolish. In fact, as our own regional market suggests, when there is overdevelopment in particular areas of a market, it may be hampering growth opportunities for other areas within the same market through market saturation.

As players in the retail development industry, it is imperative that we develop our retail centers with careful market analysis and study. It won't be enough to develop as much retail space as we can as close to every housing development conceived. Careful market integration and conscious management efforts must be made when times are good. By proactively managing our efforts, we will soften the blows when the eventual market slowdowns occur. ■

¹ "Retail Sales Probably Slowed in September: U.S. Economy Preview"; Shobhana Chandra; Oct 7th, 2007; <http://www.Bloomberg.com>

² "Residential Development and Retail Demand"; supplied by Deborah Carlson of Cushman and Wakefield published date unknown

³ "Top 5 Overbuilt US Markets in 2007"; Beth Anderson; September 10, 2007; <http://NuWireInvestor.com>

⁴ "Twin Cities Region Population and Household Estimates, 2006"; Met Council; <http://www.metrocouncil.org/metroarea/2006PopulationEstimates.pdf>

⁵ Ibid.

⁶ Ibid.

⁷ Ibid.

IS FIDO A RETAILER'S BEST FRIEND?



by Peter Berrie, Faegre & Benson, LLP

Pet-related retail is one of the fastest growing segments in retail and its scope is huge. In 2007, U.S. consumers will spend an estimated \$41 billion on their pets (compared to \$17 billion in 1994).¹ This amount is more than Americans spend on movies (\$10.8 billion), video games (\$11.6 billion) and listening to recorded music (\$10.6 billion) combined. Growing at 6% per year, pet care is the second fastest-growing retail category, lagging only consumer electronics.² Areas of spending include fresh, natural high-end pet foods; health care (including cosmetic surgery, anti-depression medication and counseling); hotel/spa services; nutritional supplements; poop-scooping services; end-of-life care and cremation services.

The rapid growth of this segment may be fueled by more people not having children or waiting until later in their lives to have children. According to sociologist Scott Coltrane, "the lack of presence of children leaves a gap, and some people fill that emotional gap with pets."³ The American Pet Products Manufacturers Association estimates that 63% of households in the U.S. have at least one pet. APPMA President, Bob Vetere, says that "people consider pets a part of the family and treat them accordingly. That has led to the evolution of

everything from new and improved services and travel accommodations to food and medicines, all of which make spending for pets more enjoyable and help fuel the continued rise in pet ownership."⁴

The challenge for retailers is learning how to take advantage of the trend. A recent survey of drugstores found that some had found shelf space for pet nutritional supplements and medicine, including hydrocortisone sprays, vitamins, joint treatments, cough syrups and digestive aids, while others had no pet-related offerings.⁵ Chuck & Don's Pet Food Outlet is a local independent retailer that has taken advantage of the trend. Since opening its first store in 1990, it has specialized in premium pet food but has witnessed more demand for raw diet, organic, and holistic pet food purchases, as well as nutritional supplements. This demand has resulted in double digit growth during the last few years, and in October it opened its 13th store in Minnesota.⁶

¹ Drug Store News, July 23, 2007; The Press-Enterprise, August 2, 2005

² Business Week, August 6, 2007

³ The Press-Enterprise, August 2, 2005

⁴ Drug Store News, July 23, 2007

⁵ Ibid.

⁶ Interview with Dana Andresen, Director of Operations, Chuck & Don's Pet Food Outlet

THE CARING TREE INITIATES VENDOR CAMPAIGN

Testimonial from Matthew Rieger, Park Midwest Commercial Real Estate

Over ten years ago while attending one of my first MSCA meetings, several young people were on hand who had been recipients of school supplies from The Caring Tree. The smile on their faces as they talked about the new school supplies told the whole story. As a father of five, living in the inner city and being active on an elementary school board, I really understand the difficulty so many parents/guardians have in making sure that their children start out the school year with the appropriate school supplies. It certainly made me realize how blessed so many of us are that we do not have that issue with our own children.

About five years ago, it became important for me to become more involved. I made a decision to send a letter to vendors, tenants and landlords that I work with to tell them more about The

Caring tree and to ask for their donation to this worthwhile cause. The response in general has already been very positive. I believe everyone knows how important the need is and that it is growing. This past year, as a member of The Caring Tree Board, I contacted a number of other real estate professionals and asked them to participate in what we called a "Vendor Campaign." The thought process was that if we could broaden the program, we could raise even more funds for The Caring Tree. This campaign raised over \$20,000 in one year! However, the need to help more children continues to grow and we have to enlist everyone's help.

~ Matthew Rieger

Please feel free to call Matthew Rieger at (763) 847-6675 or Martha Capps at (952) 746-1305 for more information as to how you can become more involved.



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MSCA STAFF

Executive Director - Karla Keller Torp
(P) 952-888-3490 (C) 952-292-2414
ktorp@msca-online.com

Associate Director - Stacey Bonine
(P) 952-888-3491 (C) 952-292-2416
sbonine@msca-online.com

8120 Penn Avenue South, Suite 114
Bloomington, MN 55431
(F) 952-888-0000

MINNESOTA

Marketplace

Press releases are printed based upon availability of space, and relevance to the local market and at the discretion of the newsletter committee.

- **Best Buy** is reaching out to environmentally conscious CE consumers with an exclusive, upscale, three-piece collection of home media furniture from designer Maria Yee.
- **Park Midway Bank** located on Como Avenue in St. Paul is the first to have a coffee bar in its bank. Proceeds raised from the coffee bar will help local youth groups and small nonprofits.
- Keep your eyes open for a number of upcoming Minneapolis restaurant openings. **Red Stag Supper Club** on First Avenue, **Heidi's Minneapolis** on 50th Street West, **Nick and Eddie** on Harmon Place and **Meritage** at Peter Street.
- **Leeann Chin**, acquired in March by Lorne Goldberg, has introduced new entrees, and stores will be getting makeovers over the next several months. The company plans to open 10-15 new stores in the Twin Cities in the next three years.
- **Movie Gallery** will be closing more than 500 stores.

RESEARCH

Committee Chat

Co-Chairs: Jen Helm, United Properties and Gregg Erickson, United Properties

The MSCA Research Committee has finished the 2007 Retail Report. The committee has met with all of the presenters for the Retail Report that will be delivered on November 7 at the Doubletree Hotel Minneapolis Park Place. We are excited about the program and its presenters...we look forward to an informative and enjoyable afternoon. Please join us for the 2007 Retail Report program with registration starting at 3:00 pm and the program at 3:30 pm. To register, visit www.msca-online.com.

It is the goal of this committee to provide a recap of the year in terms of retail real estate. We review market/retail trends, data, legislative issues, new retail concepts, and development/redevelopment issues, to name just a few.

Please consider joining our committee for 2008. Not only is it a great opportunity to contribute to an important industry report, but you can learn a lot about the Twin Cities market while doing it. ■

ALEXANDRIA, MINNESOTA

Hot Spots/Cold Snaps

by Ross Dahlin, Itasca Funding Group, Inc.

Much attention has been paid in recent years to the tremendous growth and development along I-94 between the Twin Cities and St. Cloud. However, 60 miles further up the interstate, Alexandria is also undergoing a major development boom. The town of 11,000 swells to thousands more during the summer as people flock to the lakes and woods in surrounding Douglas County (pop. 35,000). Alexandria has grown by 37% since 1990 due to its major industries of tourism, healthcare and manufacturing. Commercial developers and retailers have started to take notice of the area's potential.

Job growth in Alexandria is strong with the following recent announcements:

- 3M – adding 50 jobs at its expanded manufacturing facility
- Brenton Engineering – 100 new jobs
- Douglas Machine – expanding facility and adding jobs next year.

In August the school district passed a major bond referendum adding a new grade school, new administrative offices, and the purchase of 167 acres of land for a new high school.

Retail development is concentrated north of I-94 along Highway 29. Last year Wal-Mart razed its existing building and constructed a SuperCenter next door. Mills Fleet Farm entered the market two years ago across the street from Wal-Mart. Two new multi-tenant retail centers are under construction near Wal-Mart and Mills Fleet Farm. Other recent developments include a Hampton Inn Hotel, a Holiday Service Station, a 32-lane bowling alley and conference center, and a Whiskey Creek Steak House. Whiskey Creek, based in Kearney, NE, has fourteen locations in five states, this one being the first in Minnesota. The restaurant features grilled menu items cooked over a hardwood fire of oak and ash.¹ In addition, Bennigan's Restaurant will break ground this fall on a \$1.4 million dollar restaurant.

Near downtown, Alexandria's first Walgreens is under construction at 10th and Broadway (MN 29). The State Bank of Fargo is under construction across the street from Walgreens. Down the road, a branch of Glenwood State Bank is being built at 22nd and Broadway. Thrifty White Drug is vacating the Viking Plaza Mall and is moving to a location on 3rd and Broadway.

The thirty-year old Viking Plaza Mall was recently sold to an equity group out of New York and will be managed by United Properties. The new ownership will "bring some good things to the area," according to Randy Fischer of Counselor Realty in Alexandria. JCPenney and Herbergers anchor the 40+ store indoor shopping mall.

As proof that retailers have discovered Alexandria, Caribou Coffee now has two locations in town, one near the interstate and another at a new retail center on the north side along Highway 29. The area's natural beauty, quality of life, and growing job base will keep commercial real estate activity strong. As the main interchange of I-94 and Highway 29 becomes fully developed, focus will soon shift to I-94 and Highway 27 two miles to the northwest. Randy Fischer currently lists a large 90+ acre commercial parcel on the southeast quadrant of I-94 and Highway 27.² Taking the 150-mile trek up to Alexandria will surely yield a wealth of recreational activities, and perhaps some potential business as well. ■

¹ www.whiskeycreek.com

² www.randyfischer.net

Press releases are printed based upon availability of space and relevance to the local market.

Meyer Recognized

Kim Meyer has been recognized as an honoree in the 7th Annual Top Women in Finance.

Tousley Joins Griffin

Herb Tousley has joined Griffin Companies as the Senior Vice President Acquisitions. Tousley, who has 12 years of experience in financial management, brings a wealth of knowledge and expertise in the operations and financing of investment properties.

WELCOME

New Members

Erik Moe, Bank of the West
Joseph Unger, The Lawn
 Ranger, Inc.
Terry O'Brien, Shamrock
 Companies
Kara Simons, Jones Lang
 LaSalle/Rosedale Center

David Edquist, Holiday
 Companies
Laura Jossart, LandCor
 Companies
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 Frank Roos Associates

2007 HOLIDAY FORECAST: COLD SHOULDER FROM SHOPPERS

As shoppers get ready to start the annual frenzy over holiday shopping, retailers are strapping in for what is likely to be a bumpy ride. Warm weather, high gasoline prices with the barrel topping \$90.00 a gallon, less consumer spending and credit concerns all will influence how retailers do this holiday season.

Holiday retail sales are expected to increase 3% in 2007, barely keeping pace with the projected inflation rate of 2%. This reflects the slowest growth rate in retail holiday sales over the last five years. Gift card sales are anticipated to exceed \$35 billion this holiday season. Driving this trend is the fact that retailers are becoming more innovative in their marketing efforts. For instance, gift cards can now be found outside of the location where they are to be redeemed. A consumer can walk into the neighborhood drug store and buy a pre-paid Visa card or gift cards for Target or iTunes.

A lot is at stake for the nation's retailers, who typically make 50% of their annual sales and profits in November and December alone. The year-end spending spree is also vital to the economy, because consumer spending fuels two-thirds of the nation's economy.

Sources: CNN Money, Retail Traffic Magazine

MOLLY R. CARSON



Company: Ryan Companies US, Inc.

Primary Career Focus: Retail Development

Education: BA Psychology Saint Mary's College, Notre Dame, IN

Family: Husband, Mike; 2 Daughters: Trinity (4), Marley (2)

Hobbies: Running, skiing, snowboarding, traveling

Dream Job: There's a job dreamier than retail development?

Secret Talent: Can still do a back flip

Favorite Food: Good cheese plate

SEAN CULLEN



Company: McCombs Frank Roos Associates

Primary Career Focus: Commercial/Retail Development

Family: Wife, Marta; Kids: Savannah, Nathaniel, Laura, Mateus

Hobbies: Martial Arts, Skiing

Dream Job: Adventure Travel Guide

Secret Talent: Back flips off the pontoon boat

Favorite Food: Grilled Chicken Hearts, Brazilian style

MSCA Involvement: Technology Committee

2007/2008

Events Schedule

Our monthly program meeting date is the first Wednesday of every month. All meetings will be held at 8:00 a.m. (registration at 7:30 a.m.) at the **Doubletree Hotel Minneapolis Park Place** unless otherwise noted or publicized before the program. Program topics and location are subject to change.

Wednesday, November 7 – Retail Report, *Afternoon Program*

Tuesday, December 4 – Year End Ceremonies / STARRSM Awards / Holiday Party, *Golden Valley Country Club*

Wednesday, January 9 – Geographic Focus

Wednesday, February 6 – Retail Focus

THE FUTURE OF RETAIL

Program Recap

by Josh Krsnak, Hempel Properties

Who: Kelly Doran, Doran Companies
David Larsen, U.S. Bank
Whitney Peyton, CB Richard Ellis

What: Future of Retail

When: Wednesday, October 3

Where: Doubletree Hotel Minneapolis
Park Place

Synopsis: It is no secret that the struggling housing market has had adverse effects on various industries nationwide. The development of retail properties has become one of these affected industries. Developers are currently seeing increased expenses in their hard costs (land) and soft costs (finance-related expenses).

The demand for residential property over the past several years has inflated land prices throughout the country. Higher land prices have made it difficult for retail developers to acquire land. In fact, land prices are reaching a price point that makes development only feasible for the large anchors and the owner/user tenants. These types of tenants are generally willing to pay more to be in a specific trade area compared to a typical retail developer.

In addition, the sub-prime lending market has had a negative impact on the financing of new retail developments. Generally speaking, banks are tightening their purse strings and letting less money out the door. Compared to six months ago, a lender today is going to have greater preleasing requirements and larger initial equity requirements from developers. The housing market turmoil is not only affecting landlords and developers; tenants are also beginning to feel the squeeze.

The softening housing market is influencing consumer spending. Homeowners' perceived wealth is being shaken. The result is a decrease in consumer spending which is impacting retailers' bottom line. In addition, banks are also tightening the credit facilities available to tenants. Thus these retailers have fewer dollars available to them for growth and expansion. As a result, tenants are now turning to landlords/developers to assist in the funding of their tenant improvements and furnishings. Needless to say, this is creating a riskier

and more capital intensive development for developers.

With regard to the future, the general consensus is that rough and choppy waters lie ahead. The overall local real estate market is perceived to be flat with no one product type (office, retail, industrial, etc.) excelling. The tightening of the lending market is requiring developers and buyers to put more equity into projects. This is resulting in fewer buyers and a decrease in demand. As the demand continues to decrease, the capitalization rates may start to increase pushing project values down. However, the settling of the financial markets and downward pressure on land



October presenters: Left to right

Kelly Doran, *Doran Companies*
Whitney Peyton, *CB Richard Ellis*
David Larsen, *U.S. Bank*
Stephen Dombrowski, *Suntide Commercial Realty, Inc.*

owners will hopefully offset any longer term negative impacts. ■

OCTOBER Professional Showcase



Pictured left to right: Aaron Hemquist, John Dietrich

RLK is a full service firm, specializing in the areas of civil engineering, transportation, land survey and landscape architecture. The company's expertise is in the development and restoration of retail and commercial properties throughout the Midwest and the Minneapolis/St. Paul region in particular. RLK recently expanded into the Tampa, Florida area to further its goal of "creating extraordinary communities."

SMART TAX TIP FOR DECEMBER

If you're looking for a last minute deduction, consider giving a donation to The Caring Tree. Visit www.caringtree.org to make a donation.



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TECHNOLOGY

Tip

Do you know someone looking to become a MSCA member? Send in a referral through the MSCA website. From the home page, go to the “resources” bar on the left and click on “referrals” on the bottom of the drop-down menu. Fill in the prospective members’ contact information and the prospective member will be contacted with additional information. Another option is to send the prospective member directly to the website. From the MSCA home page, click on the “membership” bar on the left. Click on “Join MSCA”. That will take you to the secure online membership form. Fill it out and submit and they too can start to enjoy the benefits of MSCA membership. Any questions please call Sean Cullen at (763) 476-6010.

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Join us for the release of the 2007
Retail Report on November 7th.

RETAIL REPORT

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