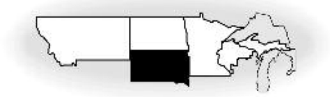
SOUTH DAKOTA



An udderly changing ag industry

South Dakota has carved another exception into the state's Family Farm Act for the dairy industry.

The law is intended to limit outside ownership of farms. But in February, the state House and Senate both approved a measure to allow corporate ownership of farmland for dairy purposes. Several other exemptions already exist, including for poultry, eggs and livestock feeding and breeding.

The measure is being pursued in part because of the state's interest in growing its dairy industry. But starting new dairy operations, or expanding existing ones, requires a lot of capital, and this law allows outside parties—in essence, nonfamily members—to invest in dairies.

Critics of the measure said it would accelerate the trend away from small dairy farms. With or without the law, that cow is already out of the barn. According to the U.S. Department of Agriculture, the number of dairy herds in the state dropped from about 1,000 in 2004 to 670 last year. At the same time, total head has risen about 6 percent, and total production is up 22 percent.

Tastes kind of oily

Two major proposals having to do with oil refining got recent approval to continue in (or through) South Dakota.

In Union County, in the southeastern corner of the state, county commissioners approved a request by Hyperion Resources to move forward on its plan to build a $10 billion oil refinery on a 3,300-acre site there. A unanimous 5-0 vote came despite an earlier hearing that saw 500 attendees and 100 or more people testify regarding the proposal. Opponents of the measure are expected to begin collecting signatures for a referendum vote by county residents. If built, the refinery would process 400,000 barrels a day of thick crude from Canada.

Over in Pierre, the state Public Utilities Commission held a public hearing on a separate pipeline proposal by TransCanada. The underground pipeline would transport 21 million gallons of Canadian crude through the state daily on its way to U.S. refineries. Though not formally related to the Hyperion refinery proposal, the pipeline runs due south along the eastern side of the state and exits through Yankton County, roughly 50 miles from the proposed site of the refinery.

—Ronald A. Wirtz

Store clearance

Retail vacancy rates are up in the district, especially for strip malls

By JOE MAHON
Staff Writer

You'd think that a slowdown in the retail real estate market would bother someone who makes a living selling shopping space. But not Ned Rukavina. The Minneapolis commercial real estate agent says that he welcomes a breather from the frenetic deal-making of recent years, when retail construction boomed and space in shopping centers was tight. "Yes, it has slowed down, but it has been crazy for so long," he said.

Other retail agents and brokers in the Ninth District may not be ready to take it easy. But they agree with Rukavina that the retail sector has cooled as available space has outstripped demand.

Both nationally and in the region, retail vacancies have been on the rise. From the end of 2005 to the end of last year, the vacancy rate among major cities nationwide grew by 1 percentage point, according to data compiled by REIS Inc., a real estate research firm based in New York City (see chart at top of page 15). Retail vacancy in Minneapolis-St. Paul at the end of 2007 was lower than the overall figure for large Midwest metropolitan areas, but the Twin Cities rate has increased faster than the national aggregate—from less than 6 percent in the fourth quarter of 2005 to 7.5 percent two years later.

Some observers worry that climbing retail vacancy rates are a harbinger of greater troubles to come. The concern is that retail space is going begging because consumers are spending less—raising the specter of closed stores, layoffs and deeper economic malaise.

But such fears are probably unjustified. For one thing, the overall rise in retail vacancy in the district isn't severe (although the trend is more pronounced in strip malls). For another, higher vacancies don't appear to be caused by a significant drop-off in demand for space from retailers. Instead, they're a predictable outcome from the surge of new retail construction that followed the last recession.

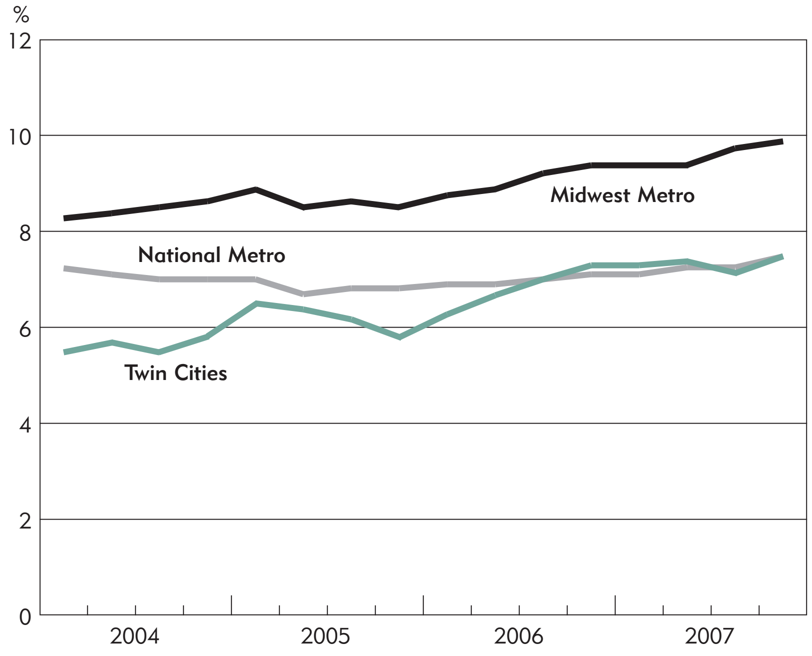
The outlook for the next few years suggests that vacancy rates will gradually decline as the market absorbs existing retail capacity.

This space for rent

The fallout from an intense period of retail construction is evident in Minneapolis-St. Paul, the largest retail market by far in the Ninth District. When greater capacity isn't absorbed quickly enough, vacancy rates inevitably rise.

Retail inventory in the Twin Cities grew an average of nearly 4 percent annually over the past three years, the fastest metro growth rate in the nation, according to REIS. In the aftermath of this rapid development, as demand for new retail space leveled off, the metro vacancy rate has risen by a third since 2005.

Overall Retail Vacancy Rates



Source: REIS Inc.

All indications are that the same phenomenon—a spate of retail building followed by a market adjustment—has driven up vacancy rates in other district markets. "There's certainly more vacancy out there," said Neal Eriksmoen, a commercial appraiser in Fargo, N.D.

The commercial real estate franchise NAI Global tracks market trends in cities around the world, including the district communities of Fargo, Sioux Falls, S.D., and Billings and Missoula in Montana. The NAI data show that in the past year, retail vacancy has increased or stayed flat in all of these cities (see chart below).

In Sioux Falls, a regional retail hub, the vacancy rate for "neighborhood shopping centers" (strip malls) rose 1 percentage point between 2006 and 2007. Local commercial real estate broker Michael Bender said that the vacancy rate in the southwestern commercial corridor along Interstate 29 was even higher—about 14 percent for all types of retail properties.

A major factor contributing to the run-up in vacancy rates in Sioux Falls is robust expansion of retail space in the recent past. According to the city planning office, the value of retail construction surged about 60 percent between 2004 and 2005, and 20 percent in 2006. While the value of new construction fell last year, space was still added at a moderate pace in line with trends earlier in the decade.

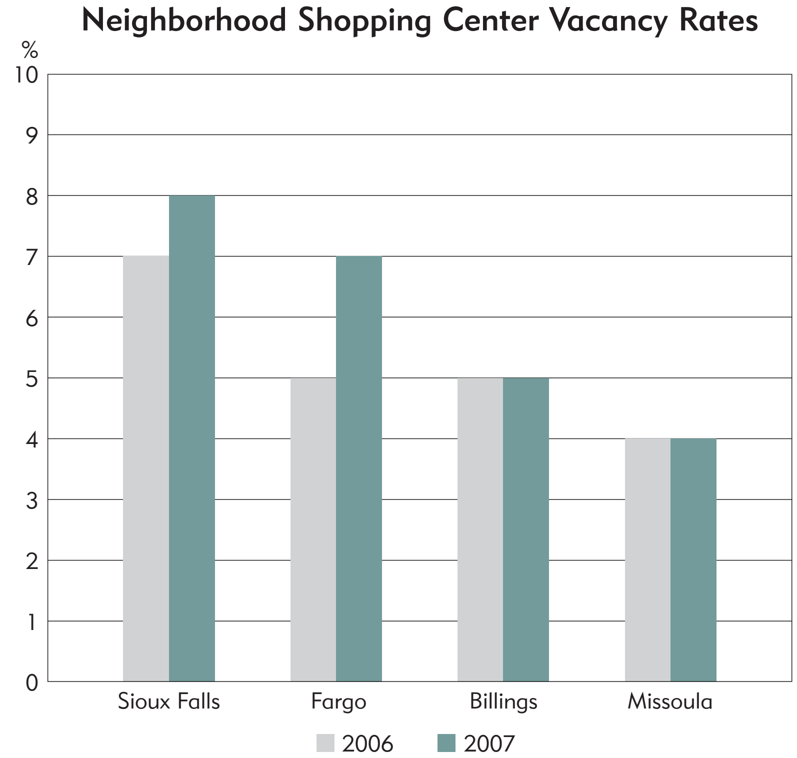
It's a similar story in Fargo, where neighborhood shopping center vacancy increased 2 percentage points in the past year, spurred largely by new development hitting the market.

NAI doesn't track retail vacancy in Eau Claire, Wis., and Rochester and Duluth in Minnesota, but commercial real estate agents in those cities have also seen a rise in vacancies. Eau Claire's downtown retail vacancy rate increased almost 10 percent in 2007, and a massive new mixed retail/office development is expected to drive that rate still higher. Mac Hamilton, a commercial broker in Rochester, said that the city's retail base "has become overbuilt, and I think we're seeing an increasing number of vacant storefronts."

There are exceptions to the general rise in vacancies. According to NAI, vacancy rates for strip malls in Missoula stayed locked from 2006 to 2007, despite a considerable amount of retail development. Dennis Hardin, a commercial real estate agent in Bozeman who handles store leasing and sales throughout western Montana, said the region's strong economic growth has insulated it from the national rise in vacancy. "It's like we're in a different universe out here," he said.

Official vacancy statistics are not available for Grand Forks, N.D., and Rapid City, S.D. But vacancy rates there are also low and fairly stable, according to sources who credit a moderate pace of retail development in those communities in recent years. "People here generally don't overbuild," said Grand Forks City Assessor Mel Carsen.

Neighborhood Shopping Center Vacancy Rates



Source: NAI Global

No room at the big box

Developers who specialize in building shopping centers anchored by "big box" stores like Wal-Mart and Home Depot probably aren't too worried about rising vacancy rates in the region. That's because vacancies haven't been as pronounced in that market segment. Around the district, commercial agents and brokers are saying that the properties hurting for tenants are strip malls, not big box stores. "We clearly have an overabundance of supply and not enough demand in that sector," Bender said.

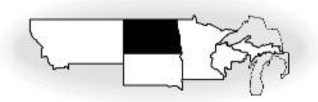
The data clearly show this vacancy gap between strip malls and big box stores. According to REIS, the vacancy rate for strip malls in the Twin Cities was running almost 3 percentage points higher than the rate for "community shopping centers" (big box stores) in 2007, and it has grown much faster. In fact, the big box vacancy rate actually fell slightly from 2006 to 2007, so the overall increase in retail vacancy was entirely due to escalating strip mall vacancy.

The same gap shows up elsewhere in the district. Strip mall vacancy rates in Fargo rose 2 percentage points in 2007, and were flat in Billings. But vacancy at big box centers remained extremely low in both cities. NAI reported virtually zero vacancy at Billings community shopping centers over the past two years, and in Fargo the story was the same (see charts on page 16).

Missoula again bucks the district

Continued on page 16

NORTH DAKOTA



Wind power: Huffing and puffing

It looks like North Dakota is attempting to live up to its billing as the Saudi Arabia of wind power, because it's hard to keep track of all the new proposals.

In the fall of 2007, the state was producing about 170 megawatts of wind energy. According to local newspapers and other reports, a handful of major proposals would push that figure up dramatically: In January, a 159-megawatt wind farm near Langdon started producing power and promptly sought a 40-megawatt expansion. Other proposals on the drawing board this year include a 150-megawatt project near Finley, which reportedly could grow to 500 megawatts; a 200-megawatt farm near Valley City (at a reported cost of $350 million); and a 115-megawatt project south of Minot ($240 million).

The activity stems in part from the scheduled elimination of a federal tax break for wind power at the end of this year. Transmission has been repeatedly identified as a potential kink in the development of more wind power. So in February, two utility companies announced a new 400-megawatt power line that will move new wind power to a substation near West Fargo.

Working hard at working hard

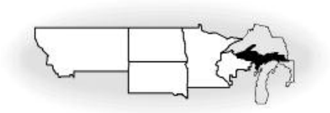
While much of the country is slumping, North Dakota is humming a tune while it goes to work.

According to the Bureau of Labor Statistics, the state has the highest labor force participation rate in the country. Among its civilian, noninstitutionalized population, 71.8 percent were employed in January of this year. That rate beat second-place Nebraska by more than half a percentage point and outpaced 90 percent of states by at least two percentage points.

From January 2007 to January 2008, the state logged the fifth-highest rate of job growth, at just over 2 percent. The state's unemployment rate—at 3.2 percent—puts it among the 10 lowest in the country. Fewer workers are also taking on multiple jobs. As recently as 2005, the state led the nation at nearly 10 percent. The most recent data on multiple jobs showed it slipped to 8.4 percent in 2006, dropping the state to eighth place.

—Ronald A. Wirtz

UPPER PENINSULA



U.P. tribes gambling on expansion

Two Upper Peninsula tribes are hoping to bring a little more Vegas to lower Michigan near Detroit.

The Sault Ste. Marie Tribe of Chippewa Indians and the Bay Mills Indian Community are hoping to open off-reservation casinos in the cities of Romulus and Port Huron, both on the eastern side of lower Michigan—one north and one south of Detroit—and some 350 miles away from the tribes' reservation.

In exchange for off-reservation sites for the two new casinos, the tribes are willing to settle claims for 110 acres of land around Charlotte Beach in the U.P., a dispute with the federal government that dates back 120 years.

Detroit Mayor Kwame Kilpatrick has been a strong critic of the plan, noting that the new casinos are a short drive from Detroit's three downtown casinos (all of which are state licensed) and will siphon players, jobs and other positive economic effects that have been important to that city's revitalization, particularly in light of the downturn in the automotive sector. Detroit casinos reportedly took in $1.3 billion in revenue last year.

With 17 other tribally owned casinos in the state, other tribes are not particularly thrilled either; a majority of the state's 12 tribes reportedly oppose the measure.

As of late March, a U.S. House panel had approved the land-rights-for-casinos swap, and advocates are hoping for prompt attention by the full House. The measure has considerable bipartisan support, in part because it is promising 3,000 new jobs and a $300 million investment. Residents of the two cities involved have also officially voted their support.

But a number of legal and political matters stand in the way. In 2004, state voters approved a referendum outlawing any gaming expansion without voter approval. Tribal gaming compacts with the state also outlaw any off-reservation gambling unless tribes agree to share revenue proceeds from those particular casinos.

The matter also has to pass the Senate, where Nevada Democrat and majority leader Harry Reid reportedly opposes the measure. And if the matter is not passed during this congressional session, the entire affair has to start over next year, according to news reports.

—Ronald A. Wirtz

Retail vacancy rates from page 15

norm; last year the vacancy rate for the city's big box stores was much higher than the rate for strip malls.

It's unclear why vacancies have climbed higher at strip malls than at community shopping centers, although brokers offer their own theories. Rukavina said that recent big box developments offer fewer opportunities for vacancies, because they're often standalone stores such as Wal-Mart and Menards. Hamilton pointed to a shift in grocery sales from traditional super markets that often anchor strip malls to big box "super centers" selling both food and merchandise.

Vacancy rates at indoor shopping malls—"power centers" in retail parlance—don't follow a discernible pattern in the district. Nationally and in the Twin Cities, mall vacancy has trended upward, but that doesn't appear to be the case elsewhere in the district.

Has the tide turned?

The decline in retail occupancy has some investors worried that housing woes are spreading to the retail sector. But the evidence suggests that higher vacancies in district markets have more to do with an abundant supply of retail space than weakening demand.

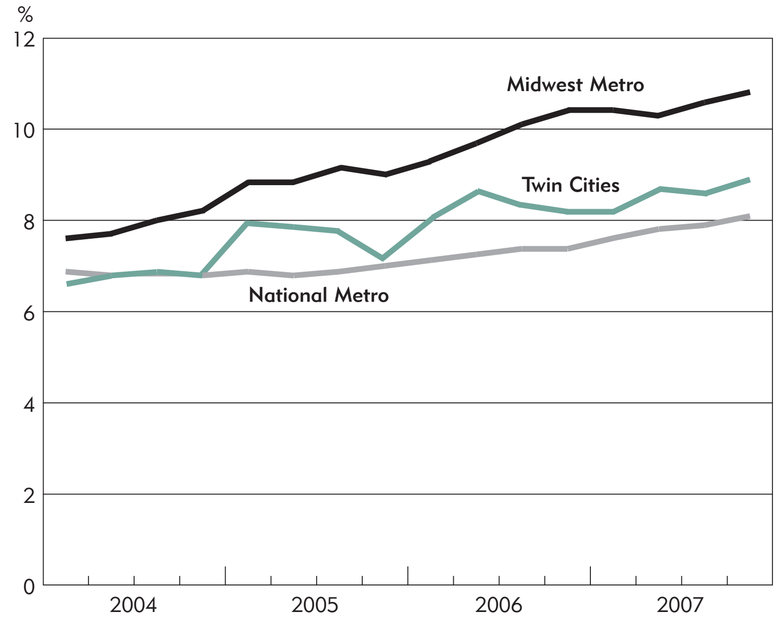
Today the tide of construction that swept over the market a few years ago has mostly receded, allowing existing retail space to be absorbed. In the Twin Cities, inventory grew by less than 2 percent during 2007, and REIS anticipates modest growth for the foreseeable future.

Another positive sign: The price of retail space has continued to increase in metro areas nationwide. In the Twin Cities, lease rates have risen more than 3 percent in the past year. If landlords anticipated lower demand for retail space, they would likely be dropping their rates.

For these reasons, the outlook for the retail sector in the district isn't as dour as some observers fear. While the rapid development of a few years ago is unlikely to return anytime soon, it's also unlikely that vacancies will soar. In fact, vacancy rates may have already peaked. The REIS forecast calls for vacancies in the Twin Cities, the Midwest and the nation to drop slowly over the next four years.

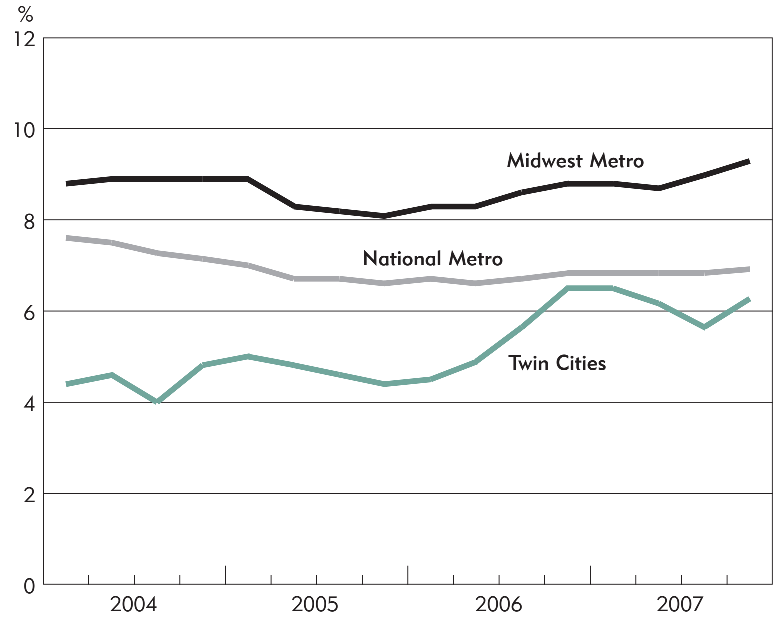
In the meantime, some people see vacant storefronts not as wasted space, but as a chance to make a deal. "There are opportunities for new people to move in," Rukavina said. "As a broker, change is good." f

Neighborhood Shopping Center Vacancy Rates



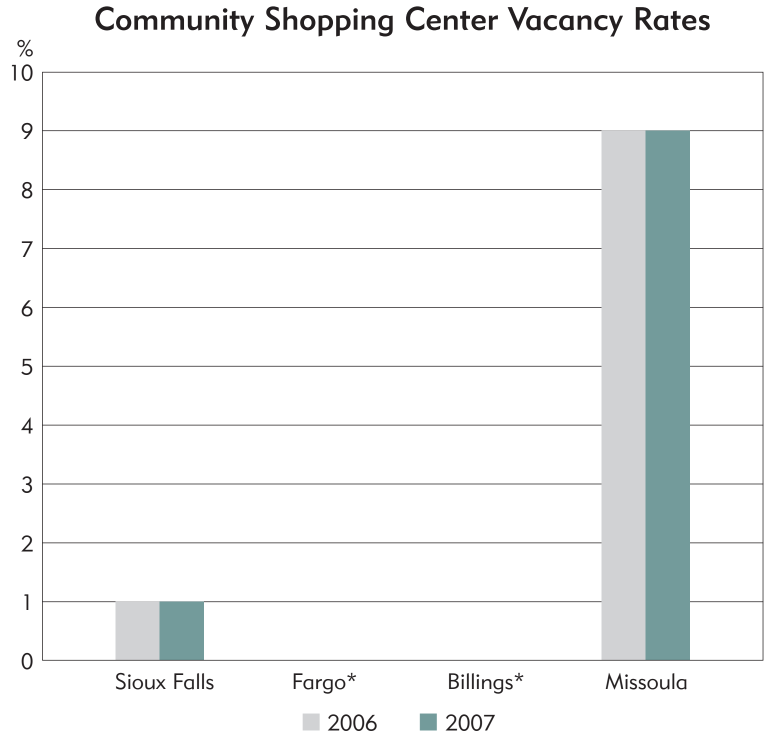
Source: REIS Inc.

Community Shopping Center Vacancy Rates



Source: REIS Inc.

Community Shopping Center Vacancy Rates



*Vacancy rates are zero.
Source: NAI Global