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How the world sees Boston's booming real estate markets: An urban area moving forward

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With CBRE's worldwide reach, I never know what the next telephone call or email will bring. This article is the result of recent assignments with very far thinking real estate people, both within and outside of Boston. This article will address Boston from "the outside looking in" and conclude with the likely state of the market in 2014.

How The World Sees Boston

Beyond its well-known 24-hour city characteristics and the impacts of its educational institutions, what investors see is not a city made of 10 submarkets. They see the city of Boston as an urban area moving forward at a pace not seen in decades.

Investors see the city as having great vision in its setting of a forward-thinking urban fabric years ago. The city of Cambridge performed this changeover in the 1970s and 1980s with East Cambridge being the primary focus. The city of Boston had its changeover with the "Big Dig" in the 1990s-early 2000s.

East Cambridge and the Seaport are looked at as an integrated whole. They comprise some 2,125 acres, and an existing inventory of office/lab space of 31,600,000 s/f, which is expected to grow to over 50 million s/f of mixed-use space within 10 years. What Boston has is effectively a "city within a city." The combination of East Cambridge and the Seaport are an integrated whole.

The only other places in the world where you find "cities within cities" are Canary Wharf in London, Hong Kong and perhaps Playa Vista in Los Angeles.

An Interest Rate Structure Not Seen in 100 Years

The Federal Reserve's actions driving interest rates to record lows served to unlock the huge supply of real estate capital parked on the sidelines by The Great Recession. As reported during CBRE/New England's Boston Market Overview on January 15, 2014, 80 projects totaling over 15 million s/f have been unlocked.

In 2014, within the city of Boston, 6,000 new apartment/condominium units are expected to be built. Condominium sales in number increased 4.5% year-over-year and prices are up 9.5%.

Q3 2013 saw an increase in 10-year treasury rates from 1.62% to over 3% by end of year. Rates have slipped back to under 3%. The spreads to capitalization rates has narrowed resulting in Class

A multi-housing cap rates at $\hat{A} \pm 4.75\%$, with Class B product at the 5%+ level.

The overall result is that in 2013 over \$8.6 billion in commercial and multifamily sales took place within the Boston market, with \$3.5 billion in the city itself.

Changes in Real Estate Economics

What caused the growth in 2013, in part, was innovation. Much of the activity involved major tenant moves, the result of a changing workplace. Space is a "plug & play" with no assigned desks or offices. Space is designed to be more dynamic to encourage collaboration and interactions among professionals, unlike the type of space I work in, with a lot of files and work papers, known as the "Demilitarized Zone."

Outlook for 2014

A gradual creep up in 10-year treasury rates is expected to level the playing field. In terms of capital funding, CMBS lending, at \$40 billion in 2013, is expected to rise to \$80 billion for 2014. What must be remembered is that in the overheated days of 2007, CMBS lending totaled \$230 billion. Far more discipline in underwriting is evident in the financial markets.

In terms of rental rates for office and apartment building, the great increases seen over the past two years are leveling.

Discussions with our sales brokers indicate that the true vibrancy in the office markets has been in Class B space sales. What must be kept in mind is that over the past 15 years, except for the Blackstone portfolio, the city of Boston in terms of Class A office towers has averaged only 4.5 tower sales per year.

In terms of absorption, the major moves taking place are creating large blocks of availability. This includes the Brown Brothers Harriman's space at 50 Milk St., PricewaterhouseCooper's space at 125 High St., AIG's space at 100 Summer St. and the Goodwin Procter move from 53 State St.

The Back Bay will similarly be hit by State Street's move, first Marblehead and Met Life. What will happen is softening in lower-rise rents where most of the space is located.

Overall, Boston's urban market, while leveling in 2014, has a lot in its favor. Boston is dominant in terms of intellectual capital and it is this base that will provide a strong underpinning, despite vacancy concerns, for Boston's real estate markets in 2014.

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