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Tenants seeking value in Boston market: Lucrative incentives and generous concessions

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In the Financial District, fundamentals continued to soften in the third quarter albeit at a slower pace than the first half of 2009. The submarket recorded several leases this quarter. However, its high concentration of financial services companies continued to impact demand.

In the third quarter, the Financial District recorded an additional 80,049 s/f of negative net absorption bringing the year-to-date total to negative 970,119 s/f. Two thirds of Boston's occupancy declines this year have been recorded in the Financial District, and the submarket is on pace for back-to-back years of occupancy decline for the first time since 2001-2002.

The perception that the market may be nearing bottom has encouraged companies seeking value to begin to act. Two large renewals led leasing activity over the quarter. Bank of New York Mellon executed the submarket's largest transaction when it renewed a 362,293 s/f lease at One Boston Place. Sullivan & Worcester also renewed for 105,840 s/f at One Post Office Sq.

Renewals have become more common as firms remain sensitive to the capital expenses associated with relocations. However, savvy tenants are seizing the opportunity created by current market conditions, taking advantage of lucrative incentives and generous concessions. ITG's relocation from the South Boston Waterfront to the Financial District was an example of this trend. The company will relocate into 72,000 s/f in two phases beginning in May 2010 and June 2011.

Demand remains suppressed as tenants seek to limit capital expenses and reduce financial exposure. This has caused the average asking rent to drop 26.8% year-over-year to $46.45 per s/f gross. While this decline is steep, the average asking rent was still above the 10-year average of $46.85 per s/f gross.

The Back Bay remained stable during the third quarter after deteriorating market fundamentals during the first half of the year. While the submarket has suffered during the past year, it did not record any additional large sublease or future available space options appear in the third quarter. Occupancy in the Back Bay has not suffered as greatly as the Financial District due to its diversified tenant base allowing different sectors to spur activity, albeit at a very weak pace. The Back Bay has recorded 198,914 s/f of negative net absorption year-to-date verse 970,119 s/f of negative net absorption in the Financial District.

The Back Bay recorded 59,750 s/f of positive net absorption during the third quarter. Occupancy gains this quarter were due to strong leasing activity in the Class B market. Leasing activity was particularly strong at 177 Huntington Ave. where four tenants combined to sign for 71,595 s/f. The largest of these tenants was CSN Stores, which agreed to relocate into 47,730 s/f from 800 Boylston St. This also represented the largest lease transaction in the Back Bay this quarter. Other tenants that have signed in the building this year include: Altus Marketing and Management, Charity Partners, One Pica, and Carbonite.

The average asking rent in the Back Bay declined by 33.9% year-over-year to $42.93 per s/f gross. This decline brings the average asking rent back to a level last recorded in 2006, and below the Back Bay's ten-year average of $45.36 per s/f gross. A lack of demand has caused the average asking rent to decline sharply, particularly in premium towers. The average asking rent in the Class A market has declined 39.3% in the past 12 months to $45.00 per s/f gross, the largest decline of any submarket in Boston.

Investment sales activity was limited once again this quarter due to a lack of available credit, but there were a few transactions to report. In the Financial District, Credit Suisse acquired 470 Atlantic Ave. from GE Real Estate and One Winthrop Sq. was sold by RREEF to GLL Real Estate Partners. In the Back Bay, there was just one major sale to report. The Salvation Army disposed its headquarters at 147 Berkeley St., along with a land parcel at 155 Columbus Ave., to Liberty Mutual Insurance Co. The turmoil in the investment sales market has hit the Back Bay particularly hard this year with two distressed asset sales at 441 Stuart St. and the John Hancock Tower. Limited investment sales activity will persist in the short term, as stringent underwriting and falling assets values continue.

Landlords in Boston's premier tower space will continue to struggle as weak tenant demand and increased concessions drive the market. The delta between effective rents and asking rents will continue to grow as landlords compete for a limited number of tenants looking to either relocate or renew. The perception that the economy is nearing bottom has encouraged cost conscious companies to begin to act.

While the Back Bay in particular saw an uptick in activity during the third quarter, market conditions are not expected to improve over the near term. Though tenants are re-entering the market with a renewed sense of purpose, landlords will face challenges to maintain occupancy. Vacancies in the premier office towers will weigh heavily on the overall average asking rents, and significant job losses in the financial and professional service sectors will keep demand limited.

Fortunately, new development will not add significant new vacancy downtown. Two Financial Center delivered this quarter 43% leased to KPMG. Russia Wharf is now the only development under construction in the Financial District. Wellington Management is the building's anchor tenant which is scheduled to be delivered in early 2011. The other major development in the Financial District, One Franklin St., remains on hold. In the South Boston Waterfront, Fan Pier is scheduled to be delivered in early 2010. Fish & Richardson recently completed a lease agreement in the building. The company plans to occupy 124,000 s/f.

Barring any major setbacks in the economy, it appears that office-using employment declines abated in June. Greater Boston shed 41,684 office-using jobs over a period of 16 months beginning in March 2008 through June 2009 for a 6.1% loss peak to trough.

By comparison, the previous downturn from 2001 to 2003 was far worse on the local economy. During that downturn Greater Boston lost 96,288 office-using jobs over the span of 32 months for a 13.3% loss.

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