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Boston's life science and technology industries are seeing growth due to venture capital funding

November 27, 2007 - Spotlights

The Boston office market has had a dynamic couple of years, highlighted by a red hot investment sales environment and strong leasing demand. Changes in ownership and corporate growth led to escalating rents, tight market conditions, and new development opportunities.

Now that disruptions on Wall Street have curtailed access to debt, and many financial institutions are dealing with losses related to mortgage backed securities, the Boston market has slowed as it heads toward 2008.

There are, however, major areas of growth in Greater Boston's real estate market and leasing activity remains healthy. The life science and technology industries are seeing robust growth due to a steady stream of venture capital funding.

Another bright spot is the up-tick in global demand for local exports including medical devices, biopharmaceuticals, and aerospace/defense products due to the weakening dollar. Expansion in these industries should help offset any potential downsizing by the region's financial institutions.

While the investment sales market is taking a pause, it is also clearing the way for traditional institutional investors to capitalize on positive market fundamentals. The sales market may return to more traditional and sustainable growth levels over the next few quarters.

Landlords continue to maintain the upper hand in downtown Boston, driven by 500,000 s/f of positive net absorption through the third quarter of this year. The vacancy rate stands at a historically low 7%, and the average asking rent at $53 per s/f gross is 41% higher than last year. Premium space options are even more limited, and are achieving rental rates in the $75 to $85 per s/f gross range.

As a result the class B market has gained traction, drafting under class A product and capturing tenants priced out of Boston's towers. Considering rents for first-class high rise space can run as high as $85 per s/f gross or more, it's easy to see why well located class B space at $40 per s/f is an attractive option.

As of Q3 2007, the vacancy rate in Boston's class B market was 11%, nearly two basis points less than 2006. I expect the number of available space options will continue to dwindle in 2008, particularly in those class B assets under new ownership and scheduled for capital improvement programs.

Large tenants with lease expirations in 2010 and beyond are gaining negotiating power, as nearly five developers compete for anchor tenants. With projects such as 2 Financial Center, Russia

Wharf, and Fan Pier all under construction, Boston's skyline is poised for a change. With new development comes much needed large blocks of available space.

Considering that combined these projects promise to deliver only 1.2 million s/f of office space, a 2% increase in supply, there should be plenty of tenant demand to fill the second wave of new developments including South Station Tower and One Franklin St. However, Boston's historical market trends underscore the importance of winning the development race, and raise questions about those development projects further down the pipeline.

Despite changes in the economic climate, demand for commercial real estate in Boston should remain positive. Expect to see positive absorption and steady but moderate rental growth, albeit below 2006 and early 2007 levels.

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