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## **Are we bumping along the sandy bottom or are we walking toward another drop-off?**

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Has commercial real estate hit the bottom? In particular, is the office market at its nadir in terms of occupancy, rents, and absorption?

Is there some good news out there? Or, are we shuffling along the sandy bottom on the way to walk off another drop-off?

National unemployment is still hovering around 10% and Massachusetts somewhat less. The "true" unemployment rate is much higher once the discouraged and those that have just given up are considered. Not much is going to happen to most commercial markets until drivers of employment begin to manifest themselves.

In Boston and Cambridge, those traditional employment drivers - education, biotechnology, healthcare technology, etc - need to begin to create jobs. Until this happens, space is going to hang around and rents will continue to languish.

It's all about absorption. Absorption is a function of demand.

Depending upon whose metrics you choose to use, rents have moved down since early 2009. Probably conservatively, by 5%; maybe closer to 10%.

Good news. Rent levels aren't as low as they were during the dotcom bust. That's a relief.

More good news. This won't last forever. It just feels like it will.

In general, downtown Boston is clearly doing better than the suburbs. There is clearly a "flight to quality." Many tenants are taking this opportunity in the market to upgrade their space or renegotiate leases.

Several big transactions have hit the news recently. For example, occupancy in the Hancock Tower is looking better. These types of transactions make good press; where's the rest of the market?

Some less good news. There's plenty of "shadow" vacancy out there. Many firms banked space over the recent past, intent on expansion. That didn't happen: contraction did. When employment requirements bump up, that space will be absorbed first. This will obstruct absorption of space identified as vacant and available in the market. Also, the "plentiful" supply of vacant sublease space exists will also tend to impede natural absorption over the near term.

Absorption was negative at most levels of most markets in the first quarter, according to more than one source. The good news is that it was less negative than prior quarters. There are hopeful signs that absorption will begin to turnaround but stay tuned. There's the potential for plenty more unpleasantness out there.

Transaction activity should improve if things are really hitting bottom in the opinion of the market makers out there. Buyers with resource should be out there picking off the "good ones." But, financing is still challenging. And, how many really good deals are out there? When will some of these debt holders decide to take the plunge and release a lot of this distressed product into the

market place? Any set of statistics on CRE mortgages will tell the story that there is a lot of delinquent debt out there.

Whither capitalization rates? One quarterly survey (particularly good for institutional properties) indicates that investors observe that rates have "started to stabilize" in well-positioned markets. The survey notes recent decreasing velocity of increases in rates. Survey investors indicate rates should hold steady in most markets. But don't get too excited, just yet.

Part of this represents selectivity on the part of well-capitalized investors as well as renewed confidence in investment markets that in the recent past could only be politely termed as being "unreliable." It appears that the bid-ask divide between buyers and sellers may be resolving as markets have moved toward greater consensus in determining asset's. This was something that was:

a: not possible, or,

b: vexingly difficult to accomplish during the height of the crisis.

Shuffling along the bottom stirs up a lot of sand and reduces visibility. If you can't see, that steep drop-off is going to be all the more very surprising when it happens. Let's hope it's only a small dip and not a big step into another chasm. Look at shuffling along the bottom as a way to avoid stepping on sting rays and other nasty surprises.

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