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Mass. NAIOP Chapter and New England SIOR team up June 15th

July 07, 2011 - Spotlights

The traditional Commercial Real Estate Mid-Year Forecast was held on Wednesday, June 15th from 8 a.m. to 10 a.m. at Westin Boston Waterfront. This event is jointly held by the New England SIOR Chapter and the Mass Chapter of NAIOP. Approximately 300 commercial real estate professionals attended this event. Tom Farrelly, the New England SIOR Chapter president, welcomed the attendees to the program and thanked the sponsors. He introduced the program. The event began with an economic overview by Harvard Kennedy School's Edward Glaeser who provided a snapshot of the economy and its impact on the local real estate market. Then some of Greater Boston's most senior real estate professionals gave sector reports with a special look at the office, multifamily and capital markets. Panelists explored the drivers and market fundamentals behind 2011 statistics, including emerging trends in specific markets, new growth areas, and a general outlook for the future.

Following is a summary of the event.

Economic Overview & Moderator: Edward Glaeser, Fred and Eleanor Glimp Professor of Economics, Harvard University, director of the Taubman Center for State and Local Government and director of the Rappaport Institute of Greater Boston.

Glaeser indicated that he is not a forecaster but that he would start with local events. He sees a housing malaise continuing but in the long run there is still a lot to like. The economy might be in a modest double-dip recession based on Boston's Case-Shiller report so the rise back to health has lagged. Glaeser stated however that there has never been a boom in real estate right after a bust. The industry has always been slow to recovery after a recession. The last 45 months has experienced a slow decrease in real estate since 2006.

Price Change

The larger perspective on Boston has experienced less of a housing decrease in price as compared to most cities in the U.S.

Housing Permitting Activity in Mass.

Glaeser has observed that there has been an incredible drop in housing permitting since 1986 and then it increased in 2006. In 2010, the permitting activity is much lower, in fact lower than the 1980 permitting volume.

National Levels of New Housing Units and Housing Formation

In 2001, the levels were peaking and then dropped to a low level in 2004. We need to work through this glut of housing inventory and that will take time.

Unemployment in Mass.

The unemployment rate in Mass. is 7.9% which is good as compared to the U.S. (over 9%). But still is shockingly high for Mass. The year 2000 was a low rate of unemployment in Mass.

Modest Declines in the Number of Unemployed

The unemployment rate is moving down modestly but the employment rate is slow in increasing. We have a high unemployment rate in the U.S. but the true unemployment is not 9.1% but 15% and is a more severe rate with unskilled workers. We need a private sector for employment solution output.

Mass. Population Growth

The larger population decrease is in western Mass. and the highest increase is in Worcester County. Boston is growing faster than the rest of the state which is good news and a real turn-around.

Density

We have been emptying the hinterlands as people are moving to cities and following the money where there is real growth. People are moving to Texas but not to areas such as the pan handle but to Dallas, Austin or Houston.

Glaeser went on to discuss the rebirth of U.S. cities going back over 100 years and discussed how cities are reinventing themselves by transitioning from a manufacturing base to hi-tech. His presentation was focused more about urban economics and planning and had some hints of Jane Jacobs. He promoted cities that would encourage human interaction in the work area. Even with the birth of the computer, people still found that they had to create active centers for collaboration where people could learn from each other. Cities needed to encourage a flow of information and activities.

He concluded with three final policy debates that need to be explored.

1. How bad would a reduction in Fannie/Freddie subsidy be?
2. There needs to be a debate over infrastructure
3. There are concerns over local government financial solutions.

Next Jack Kerrigan from Grubb & Ellis summarized the Suburban Market.

* The Suburban Office Market totals 108 million s/f and is similar in size to Atlanta and Houston.
* In terms of absorption, in 2010, 436,488 s/f was absorbed, 2010 = 1,077,082 s/f and 2011 YTD = 470,393 s/f
* Boston suburbs have a 16% vacancy and is the lowest vacancy of the top 10 markets. However, 8% of the properties represent 50% of the vacancies and that is good news.
* The Suburban Rte. 128 vacancy is 16.7% and the average rent is $29.76 per s/f, gross for Class A properties; while West Rte. 495 has a 21% vacancy and is rising. The average rent for Class A properties is $20.75 per s/f, gross.
* The office market is heating up as the door is starting to close on office tenants.
* The best office values for purchase in the market include Manning Rd., Billerica that sold for $31.88 per s/f and last sold in 1998 at $56 per s/f. Nagog Park in Acton sold at $45.35 per s/f.
* Eight buildings in 2007 were available for lease along Rte. 128 between Rte. 20 and Rte. 2 in Waltham/Lexington which was a good economy. Now in this worst economy, all eight buildings are leased and/or were sold and that is incredible. These eight buildings represent over two million s/f of space. 200,000 s/f on Rte. 128 no longer exists due to the recent leasing in 2011.
* There are very limited options of large blocks of space available which begs the question who will be the first to develop a new office building? Kerrigan cites four possible companies that could break ground first, Normandy Partners, Boston Properties, Equity, or Guitierrez Co.

Curtis Cole of CBRE then reviewed the Cambridge Market

* Preliminary 2Q 2011 the office market had a 12.6% availability; an average asking rent of $37.33 per s/f, gross and absorption YTD of 62,169 s/f . The 2Q absorption however was 30,452 s/f.
* The preliminary 2Q 2011 Lab Market had a 17.5% availability; an average asking rent of $54.89

per s/f; a YTD absorption of 9,043 s/f and 2Q '11 absorption of 41,770 s/f.
* In terms of current activity, Curtis cited a gross demand of 1.191 million s/f with a net demand of 450,000 s/f.
* The 2011 YTD vacancy is 10.5% which translates to 210,000 s/f. The availability is 305,000 s/f and the peak rents for this market were completed in 2000-01.
* Curtis discussed the differences of East and West Cambridge and stated that Alewife is 50% less in rent than East Cambridge and serves as an affordable alternative to East Cambridge.
* Curtis stated that there was Lab Gross Demand of 1,815,000 s/f and a net demand of 602,000 s/f.
* In terms of new development in the pipeline, he felt that the time was close for both new office and lab development. Rent pricing is getting close to support new construction.
* He concluded by stating the Cambridge market was moving very fast. During April and May 2011 in a 33 day span, the market experienced 1.2 million s/f of transactions into and out of Cambridge from Vertex and Biogen.
Downtown Boston: Bill Motley of JLL
* Motley stated that the Boston downtown market is comprised of 60 million s/f.
* The vacancy during the 1Q of 2001 = 12.5% and the availability rate = 17.5% and there was positive absorption.
* The lowest vacancies are in Boston's BackBay at 5.5% and the highest vacancy is at the waterfront with 20%.
* 2009 was the lowest net decline since JLL's record keeping at 2 million s/f.
* There is positive movement now as compared from 2008-09.
* The 1Q'11 replacement cost rent needed = $72 per s/f. But right now tower office rent is ranging from $40-60 s/f with TI average of $55-65 per s/f with a 10-year deal; that includes $18-24 per s/f in operating expenses.
* Boston is a volatile market with rental savings. Markets have declined 50% in this last down cycle due to inconsistent job growth and the high cost of living.
Boston Fairs Better During the Recession
Motley moved on to discuss how Boston has faired better in this recession as compared to past recessions. The deepest recession for Boston was in the late 1980s. We lost 250,000 jobs and it took 10 years to regain those jobs. We lost 180,000 jobs in the dot.com bubble and 110,000 jobs in this recession. It is not as bad but still a tough economy for Boston. It took from April 1988 to December 1997 to regain lost jobs from the late 1980s recession. In May 2011, Boston had 4.3 million s/f of tenant demand.
Tenant Demand
* About Â¾ of the demand is under 15,000 s/f and the medium size is 7,000 s/f so Boston is a small tenant town.
* Only six tenants have over 100,000 s/f of need with the financial and legal sectors driving this demand.
* The financial sector is not as great as in the past down markets but many out-of-state law firms want to be in Boston.
Supply Side
* Hi rise availability is 13.4%; the vacancy is 6.5% and the average asking rent is $49.10 per s/f gross.
* Low rise office space has 18.9% availability; 11.7% vacancy and an average asking rent of $42.14

per s/f, gross.
* There are options for 10-20,000 s/f users but to see a real estate recovery we need to see space absorption.
Simon Butler, Cushman & Wakefield on Multifamily
* Butler sees cap rates for Class A suburban MF between 4.75-5.25%; Class B suburban is 5.75-6.75% and core urban infill at 4.25-4.75%
The Apartment Overview
* The 1Q'11 inventory totaled 197,641 units; the average vacancy was 4.6% with an average asking rent of $1,742 per month and an effective average rent of $1,653 per month.
* In terms of rental market trends, Butler felt that the strength of the market was its proximity to trains, subways and limited new development.
Development Trends in Mass.
* 2010 has unit deliveries fall by 82% as compared to 2009 at a total less than 1,000 units for the entire 2010 year.
* From 2011-2013, Butler sees a three year average of 3,778 units per year to be delivered. The peak was 2008 at 6,000 units for the year. 2009 had 3,500 units; 2011 is estimated at 1,100 units; 2012 estimated at 4,500 units; 2013 at 5,400 units.
* In the last five years from 2004-'09, the average annual delivery was 4,423 units.
Mass. MF Cap Rates
* In 2011, the cap rates declined to 211 bps spread over 10-year T-Notes. As an example, Back Bay Manor sold February 2011 at 4.7% cap rate or $321 per s/f or $310,811 per unit. Reservoir at Marina Bay sold January 2011 at 4.93% cap rate or $256,383 per unit. Battle Green in Lexington sold June 2011 at a 5.35% cap rate or $235 per s/f or $208,333 per unit.
Frank Petz of RBJ & Partners on the Capital Markets
Petz concluded the program by stating that the capital markets have had a great time in the last 12 months and that Boston is in the top three markets in the U.S. for investors. It has been fun and he welcomed the other panelists to join the party but it was time to get back to basics. His sector is not trading as much in volume but still attracting big prices. He said that as a comparison, 2007 was a ridiculously high year of volume but now he is experiencing in 2011 the same low volume that he had in 2001. There is ample (a ton) of capital. Cap rates are down and the volume of transactions is increasing.
Greater Boston
* The 2011 YTD volume breakdown = 10.3% of sales are greater than $50 million; 3.4% are in the $25-50 million range and 86.2% are less than $25 million.
* He is seeing more activity along Rte. 495 because there is too much demand inside Rte. 128 and very little or no product to buy inside Rte. 128. There are smaller deals along Rte. 495 and not as much large portfolios to purchase.
* Core trophy sales are also back as the Hancock Tower traded at $490 per s/f.
Distressed Sales
Petz stated there were still distressed opportunities in the market but not much movement on pricing. The distressed properties have 50% or more in vacancies and the core trophy assets are back. He is not seeing as much distressed sales in Boston and therefore does not see any tsunami occurring. Lenders are looking to place capital to work and there is debt available which is driving deals.

Cap Rates

Petz is experiencing extreme compression. Boston cap rates are in the 4.5-5.0 % range. Recently Bay Colony sold at 6.9% cap; Landmark Center at 5.7% but it's unusual to see cap rates below 5% unless it's multi-family but it is happening.

* The 10-year T-Note is hovering below 3% so the spreads are widening. For instance, from 2001-2011 the 10-year average = 342 bps over the 10-year T-Note.
* Jan. 2005 the spread was 265 bps over the 10 year; Jan. 2007 it was 182 bps spread and now April 2011 it is 361 bps over the 10-year note.

Mortgage Spreads are Narrowing

In terms of lender's interest rates, Petz stated the spreads are getting narrow for lenders.

* In June 2001 mortgage rates were 230 bps over 10-year T-Notes; March '07 = 109 bps; April '09 = 272 bps; May '11 = 192 bps and June '11 = 225 bps. We still have positive leverage.
* Petz concluded that the CMBS market is finally back. In 2009, there was $0.9 billion of volume and the estimate 2011 volume is $50 billion.

We would like to thank Garry Holmes, SIOR for organizing this event and to the following sponsors:

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