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Increased demand for Boston office space will continue into 2008, causing little need to worry

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The downtown Boston office market achieved stratospheric results in 2007. The year finished with direct vacancy at 5.4%, one million s/f of net absorption and average asking rents for Class A space consistently hitting the $60-$80 mark. Such statistics have kept wide smiles on landlord's faces throughout the downtown market. The streamlined growth has been greatly attributed to the so-called "Blackstone effect," but in actuality, limited supply is the rightful instigator of the market's current state.

The total rentable s/f of the downtown market currently stands at 59 million s/f. Within the last ten years, newly built office space has expanded the market by approximately 15%, significantly smaller compared to the three previous development cycles: 25% (1987-1996), 30% (1977-1986) and 75% (1967-1976). Government regulation (the BRA) and limited population growth in Massachusetts are factors of organic economic growth and directly accounted for the minimal expansion of supply. However, deep-rooted Boston businesses that chose to sign a new lease recently are dramatically expanding their operations: Eaton Vance added an additional 65,000 s/f (230,000 s/f) at the end of 2006; Ropes & Gray (the largest downtown lease of 2007 with 410,000 s/f committed at 800 Boylston St.) expanded by 55,000 s/f; and Bingham McCutchen leased an additional 93,400 s/f (320,000 s/f) at One Beacon. With a rapid expansion trend defining Boston tenants, it would be no surprise that fresh supply wades in its wake.

A majority of new office development is concentrated in the ever expanding Financial District, particularly within the South Station hub. 2 Financial Center is expected to be delivered in early 2009 (220,000 s/f of office space), Joseph Fallon's Fan Pier (504,000 s/f) is also anticipated to be delivered within the same year; and with Russia Wharf (517,000 s/f) along with South Station Air Rights (1.4 million s/f) soon to follow if construction gains momentum for the two projects. Furthermore, the combination of One Franklin St. (572,000 s/f) and the 19 story office tower at 888 Boylston St., could also add over a million sf of office before the close of the decade.

As outlined above, 2008 stands dormant in the coming development pipeline, leaving the next four quarters with a destiny to produce even lower vacancy levels and average asking rents that continue to rise, especially for Class B space. In 2007, 81% of the combined absorption from the Financial District and Back Bay was Class B office space. Such dominance over new tenants can be attributed to the successful trend of renovating Class B space. This has attracted Class A tenants that wish to save a buck, but not sacrifice the quality of their work space. Overall, the average Class B tenant's rent has increased by $6.66 per s/f ($31.68/s/f), influenced by the recent state of high asking rents that range between $37-$45 per s/f.

The Class A tower market may lose some top clients in the coming months due to aggressive rents that average between $65-$85 per s/f for floors 20 up, furthered by the limited availability of contiguous blocks of space. The number of 100,000 s/f or more blocks of contiguous space has dwindled to ten plausible options. Hence, the new development option once again comes to play. As recently reported, Wellington Management Co. currently is pursuing the Russia Wharf option and Vertex, a Cambridge-based corporation, has weighted the Fan Pier site as an opportunity to consolidate their scattered operations. Furthermore, the Suburbs have also proved a viable option for large tenants with First Marblehead opting to ditch the Back Bay to expand their space out near Wellington Station in Medford.

Investment sales for downtown Boston this year topped the $6 billion mark achieved in 2006, but this was largely accomplished in the first two quarters of 2007. European investors flush with capital, primarily Irish backed institutions, were a major presence in 2007. Due to the Euros strength against the U.S. dollar, the sound investment of the Boston office market has become a very attractive option. 30 Winter St. and the Thompson portfolio in the Seaport submarket were both acquired by Anglo-Irish ($150 million plus combined), a company originated in Ireland. As the credit market tightens, there will be more hesitation to lend to private investors, and sellers will favor those that can easily procure capital. Pension funds and REITs will have a better opportunity to compete for sites in 2008 than they had in the past two years.

The success of 2007 has catapulted the downtown Boston office market into a position of strength as the U.S. economy heads for a period of economic turbulence. With employment, gross state product, and capital availability all on the rise in Massachusetts, increased demand for Boston office space will continue into 2008, causing little need to worry.

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