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## **R.E. economics are expected to be strong and to serve as an offset to slowing in economic growth**

January 23, 2008 - Spotlights

The opening words for Massachusetts in this fall's 2007-2011 Economic Outlook are:

"Economic growth is projected to slow in 2008, and then rebound moderately."

This article will intertwine market change with August's sub prime financial sector hiccup and present my view of the market going forward in 2008. To begin, I will start by giving legs to the Economic Outlook.

### WHAT DOES A SLOWING IN 2008 MEAN?

In the commercial real estate field absorption and vacancy are key indicators. Absorption is driven by office or industrially related job growth. The number of new jobs can be converted into demand for space.

When I analyze market statistics for 2008, I calculate a demand for office space of 3,890,000 s/f. In 2007, actual market absorption was 2,651,901 s/f. Thus, I do not believe the "slowing" to be in market demand for office space.

For industrial space, the market was already slow. This market of 133,690,000 s/f had flat market conditions in 2007. Absorption was (81,805) s/f. Asking rents which had blipped up to \$7.09 per s/f in third quarter 2007, slipped back to \$6.94 per s/f in fourth quarter 2007.

Where I believe the "slowing" will occur is in other areas of the market; namely the pushing of market rent.

### MARKET RENT

In 2007 we saw a major push by property owners in asking rents. Record high prices paid demanded rent growth to justify investments.

The following are increases in office asking rents from the third quarter 2006:

Downtown: 39.2%

Cambridge: 46.0%

Suburbs: 17.6%

The suburban rents were driven primarily by the Rte. 128 West Market at 25.4%, primarily due to Waltham.

With the financial sector pull back, the mega deal pressures are off the market. While there is plenty of capital for real estate, that capital is on the sidelines.

The only place rents have to go is in a flat line. The upward pressures on rents have in many respects been artificial. They have only taken place where demand for a specific space

quality/size/location has exceeded supply. These areas are pockets in downtown, Cambridge, and Waltham.

Average asking rents as of fourth quarter 2007 are:

Downtown: \$53.87 per s/f

Cambridge: \$48.48 per s/f

Suburbs: \$22.14 per s/f

What must be kept in mind is that there is still plenty of office space and industrial space availability in the market:

Overall office space

availability: 15.5%

Overall industrial space

availability: 15.7%

While there will be pockets where individual deals "work" and new construction can take place, this is not the market overall.

## OVERVIEW

The market in 2008 will have its twists and turns. Those who over levered portfolios will find their equity position challenged by lenders who may choose to shift from a debt to an equity position. With limited large deal financing available, to refinance short term debt, foreclosure looms for those who violated one basic principal; you never borrow short to invest long.

Deals will be done which will result in positive absorption of office space in 2008. For industrial space, I believe we will shift to 2009 for market movement.

The key issue is rents. But for the few exceptional deals, I believe rents will be flat. What must be kept in mind is the huge delta between Downtown at average asking rents of \$53.87 per s/f and the suburbs where nicely renovated space or in one or more instances, new space can be acquired at rents starting at \$27.50 per s/f and scaling to the low to mid \$30.00 per s/f.

In summary, I believe real estate is still a good anchor to windward in "slowing" market conditions. I reach this conclusion in part due to another "Economic Outlook" - Quote: "In terms of the proportion of its' population over 25 with a bachelor's degree, Massachusetts rose in rank from the 13th in the nation among states in 1960 to first by 2000."

Office oriented job growth is taking place. Education and health alone are expected to add 7,000 jobs. Smaller rates of employment are projected for FIRE, business services and information. The point is that our education dominance, and Massachusetts #1 rank, real estate economics are expected to be strong and to serve as an offset to "slowing" in economic growth projected for 2008. Webster Collins, MAI, CRE, FRICS is executive vice president/partner in the Valuation and Advisory Services Group, CB Richard Ellis|New England, Boston.