Real estate trends, not real estate cycles, dictate the direction of the Boston market

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So much has been written about real estate cycles that people have forgotten that it is trends that truly count. Trends have been misdefined and are often paired with statistical analysis. Trends are caused by truly cataclysmic events that change direction of a market.

This article will first discuss cataclysmic events over the past 60 years, quantify market impacts and then address the most important trends in place in the Boston market.

60 Years of Change

After World War II, Boston was a passed-over city. Numerous mill buildings sat vacant after industries moved to lower cost southern states. Office vacancies were high and real estate taxes paid were as much as 25% of a building's collected rent.

And then what happened? Out in an old mill complex in Maynard, Ken Olsen set up Digital Equipment Co. (DEC) with an entirely new product which ultimately morphed into personal computers. Boston's suburbs took off with the industrial park being the direct result. Technology became the trend of the 1950s-1970s.

In the 1980s, the Boston technology market hiccupped and was replaced by the biotech/life science field. What was missed was that the capital surge attracted to real estate built buildings in the wrong locations. Rte. 495 became a target for investment with numerous speculative office/flex buildings constructed. Just look at the availability rate in these markets today.

The life science market that took technology's place is a good market but small market that is still emerging today. CBRE reports a total rental lab market size in the greater Boston area of approximately 17.5 million s/f, not including institutional owners.

Market Impacts

One of the principal trends that is now taking place involves quiet times. As we study Boston today, core assets have all traded in the 2011 surge coming out of the Great Recession. Such prominent sales at 53 State St., 33 Arch St., and One Exeter Plaza have taken place, with 100 Federal St. committed to Boston Properties. There are no core properties available for sale as the market recharges.

The B-grade products referenced above are looked at as "commodity space" and are not seen as an attractive opportunity. Carrying costs of vacancy are a huge stumbling block. Money is far more cautious today and buyers stung in the past are far more selective.

What is clear is that markets have windows that open and close quickly. As an example, Class B malls had a year-end opportunity when CMBS funds existed and that market is closed today. This is a real estate cycle impact; not a trend.

The most interesting trend in place is the third re-tooling of the Boston market. Boston has become the true innovation center of the world.

The Innovation Market

CBRE in its January 2012 Real Estate Market Outlook presented astonishing statistics:

Innovation is a direct result of spin-offs from Boston's major universities and the results are astonishing:

* In 2011 across all markets, there was 857,000 s/f of absorption created by innovation tenants alone.
* As the total 2011 office absorption for the entire Boston market was 833,118 s/f, innovation was what drove our economy.
* If the innovation trend had not taken hold, our markets would have been negative.

The innovation market has spawned growth:

* The location of that growth is primarily Boston's Seaport and East Cambridge.
* 7,822 residential units are proposed in the Seaport area alone.
* 1.5 million s/f of retail is expected to be added in the Seaport District.
* Pfizer has entered into a lease with MIT for 80% of 610 Main St., a 230,000 s/f research building.
* Novartis has obtained approval for a three-building, 500,000 s/f campus on MIT owned land at 177 Main St.

Conclusion

The growth that is taking place is caused by trends. Trends are long term. They last for decades. Cycles are short. They can be as short as 3 years as shown by the Great Recession starting 3 years after recovery began in 2004. Cycles can be as long as 10 to 13 years.

When I look at investors who invest based on trends, a very interesting and small group exists. Names like Boston Properties, Beal, and the Bulfinch Companies quickly emerge. They buy only in Waltham to Needham, Cambridge and Boston.

Those who invest based on cycles carry far higher risks. While profits have been made, it is those properties that have been "trend" investments
that have had the best performance.

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