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Strong fundamentals do not suggest strong activity as financial service firms wad out the credit crisis

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The crystal ball forecasts that we all hope commercial real estate statistics will bring, are hard to find during a period of economic shakiness.

Three months into the 2008 cycle and total vacancy for Boston has dropped further to 6.3% after an impressive finish in 2007 of 6.5%. Even more impressive, in March 2007 Boston achieved a single digit percentage for total vacancy, falling to 9.4%, now the idea of reaching 5% appears almost certain. Although reflective of leasing activity that mostly occurred in the first half of 2007, the just over a quarter million s/f of net absorption year-to-date is on track to accomplishing a seven-digit year total absorption.

Yet, the all too familiar economic headlines have cast a shadow of doubt over the Boston office market's suburb performance. The most recent news being Bear Sterns' rescue by J.P. Morgan, unemployment rising, and the Fed's relentless hacking at the interest rate. The effect of such headlines has led to hesitations and inactivity on two fronts of commercial real estate: leasing and investment sales.

Therefore, what will the implications of the nation's economic performance be for Boston's downtown office market? It has well been established that the Massachusetts economy will be one of the more elastic economies during this downturn; with the ability to bounce back with ease due to the strong presence of the stable industries of education and medical/health care. These industries may continue to fuel job growth and capital growth in the state, but since their presence is largely felt outside of the downtown submarket, education and medical office space are by far the least likely to impact Boston's downtown market. With a combined presence of less than 5% of occupied space, the question is directed away from the later industries and towards the largest holder of downtown office space: financial institutions.

Although Boston has lost some major financial players to the Big Apple, almost 50% of its occupied downtown office space is of the Financial services, Insurance, and Real Estate (FIRE) industries. For Class A towers, this number inflates to 60%, and even greater when you examine floors 25 and above. Therefore, the current downtown office market finds itself heavily reliant on an industry that is ever closer to the pulse of a currently volatile Wall St. In addition, out of the four million s/f of tenant requirements for 2008, 35% of those are FIRE related firms.

It can always be expected that tenants are seeking the best possible deal, but FIRE firms that have been burned by the financial crisis will be even more willing to avoid the aggressive asking rents that have defined the current tower market. Mostly likely this will translate into some new trends for FIRE firms that require large floor plates. First, renewing could be more common for those offered attractive pricing. Secondly, lower floors will be more appealing, and towers may get the cold shoulder. Third, instead of committing to extra space for immediate firm growth, options to expand

will become more common or even downsizing space needs if required.
This is not to say that all FIRE firms will follow the above forecast. For example, Brown Brothers Harriman & Co. has recently experienced great employment growth and could soon be looking for a larger space other than their current lease at 50 Milk St. Other 100,000 s/f plus financial service firms looking to commit space in 2008 include Bank of America, Wellington Management, Bain Capital, KPMG, J.P. Morgan, Citizens Bank and Deutsche Bank. In the last few months, a majority of these firms have been reported by news publications to be committed to a particular building, the outstanding question ultimately will be is whether their new commitment is smaller or larger than their current requirement.
Although there is a placed emphasis on the success of Boston's financial institutions for a booming downtown office market, another industry continues to expand their presence in Beantown. Law firms have grown rapidly and now occupy 23% of tower market space. By becoming an internationally recognized hub, national firms have increasingly opened firms in Boston, absorbing a fair share of office space. According to the Boston Business Journal's 2008 Book of Lists, the top ten largest law firms on average employed an additional 57 employees over the past two years. Such growth can be seen this July when Bingham McCutchen moves from 150 Federal to One Federal adding an additional 90,000 s/f to their requirement.
Needless to say, the contagious condition of the nation's uncertainty of the economy has infected Boston's commercial real estate market for the time being. However, as long as vacancy remains low, asking rents will continue to climb (reported this quarter that some firms have recently committed to $100 per s/f). Financial firms may be experiencing some difficulties, but that is not to say they will not look beyond this cycle to the next when committing to space. 2008 might not hold the glitz and glamour of 2007, but nothing can change the fact that the fundamentals for the Boston market are holding stronger than ever before.
John Miller is the senior vice president/area director of Lincoln Property Co., Boston.