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Major office rent increases predicted in core Boston downtown locations

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Between July and September 2014, Boston has seen in excess of 5.5 million s/f of office towers either sell or go under contract for sale. As much as 4 million s/f of additional core office space is in process of being placed on the market. A turnover of space of these proportions has not been seen since The Blackstone Group acquired the Equity Office Properties Trust portfolio in 2007. The Blackstone portfolio size exceeded 7 million s/f.

This article will address what became known as "The Blackstone Effect", how conditions differ today, and the implications of increased capital markets activity on asking rents in downtown Boston, today and in the near future.

"The Blackstone Effect"

When Blackstone acquired the Equity Office's portfolio in Q1 2007, the Class A central business district and Back Bay market contained 32 million s/f. Blackstone purchased close to 25% of the core market. Blackstone brought in their own leasing team and raised rents essentially overnight. A significant increase in rent in Boston occurred.

Other property owners followed suit. Rent adjustments occurred across the board during 2007. The following exhibit is indicative of rent change from Q4 2006 through the end of 2007 when impacts of the great recession took hold (see chart above):

From Q4 2006 to Q4 2007, average asking rents in Boston's core market areas rose 44% from $41.76 per s/f to $60.15 per s/f; vacancy was very tight, hovering between 5.9% and 8.3%.

The Blackstone Effect Core Market Office Rents:

Quarter	Absorption	Vacancy %	Average Rent
Q4 2006	228,055	8.30%	$41.76
Q1 2007	238,587	7.80%	$45.97
Q2 2007	-52,976	7.20%	$51.57
Q2 2007	137,224	6.00%	$55.67
Q4 2007	31,995	5.90%	$60.15

*Source: CBRE

Conditions Today

Blackstone, which led core market buying, now leads the core market in sales. Blackstone sold 3 millioin s/f of space to Oxford Properties for $2.1 billion who in turn, sold 546,000 s/f at 100 High St. to CBRE Global Investors. Blackstone then turned around and purchased 399 Boylston St. Beacon Capital Partners, another major player, sold one Beacon St. for $561 million. All of the above transactions took place in September 2014.

A number of other major transactions are expected to take place by year end. These include Boston Properties selling interest in 280-290 Congress St. (780,000 s/f) and 100 Federal St. (1,305,000 s/f), as well as Broadway Partners selling 116 Huntington Ave. (274,000 s/f).

The difference between 2007 and 2014 is that there are a far larger number of players in the market and a far larger number of square feet at issue. Between March 2014 and September 2014, by CBRE's count, 14 major players have sold properties with an average transaction size of $306 million and close to $5 billion in sales.

Predictions of Office Rent Patterns for the Next Two Years

All signs are in place for another major rent move rivaling The Blackstone Effect of 2007. As of Q2 2014 when everything started, vacancy for class A and B buildings in core downtown Boston (defined as Back Bay, Seaport and CBD) was at 8.4%. In Q4 2006, vacancy was at 8.3%. In Q2 2014 average rent for Boston's core downtown market was $50.32 per s/f; this is $8.56 per s/f higher than Q4 2006.

The momentum in the market is similar to 2007. Based on 2007 actual experience, and a move similar to 2007, it would be reasonable to see a "rent pop" up to the $70 per s/f level for core assets. 2007 peaked at $60.15 per s/f. 2015-2016 should add another $10 per s/f, which would result in average rent of $70.15 per s/f during the next 2 years.

Conclusion

Capital Markets activity has created an entirely different new set of owners in the Boston office market. Ownership represents worldwide capital with their own views of Boston.

Just as Blackstone pushed rents following their 2007 purchase, history is expected to repeat itself with Boston's new players. The key question is, "are rents into the $60 to low $70 per s/f range sustainable?" The great recession of 2008-2010 suggest that the answer is "no." It is all about the demand size of the equation, and if employment growth ceases and then counteracts, rents will begin to decline.

In both instances of heightened capital markets activity, first in 2007 and again in 2014, increased sales occurred when markets were particularly "tight" - at times of low vacancy. In order for capital markets activity to have a significant, lasting effect on rents, a tight market is a prerequisite. In markets with high vacancy, tenants will seek alternative buildings rather than paying increased rent.

At this point in time with Boston being a 24 hour city with growing demand, rents projected herein are expected to be sustainable for a far longer period of time than that experienced in the past.

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