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Climbing up and down the ladder of fair market rent in today's dramatic and dynamic office market

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CBRE's Q4 2014 Boston office snapshot shows the highest asking rent for Class A space in Boston to be \$63.56 per s/f with that space located in the Seaport! The Seaport is a dramatic and dynamic market. While the Seaport is known for its new construction, what is often overlooked is its Class B/C office market. While this market has been lifted by the Seaport's up draft, it is far different. Most of the office buildings in a B/C Class are warehouse Boston Army Base or Marine Industrial Park conversions. In the Army Base conversions there are certain requirements for other uses such as manufacturing or as a design center.

Many of the B/C office buildings were leased for 10 years with renewal options. Sometimes these buildings were leased on a gross basis; in other times on a NNN basis with tenant pay for all costs to upgrade space. Renewal options are now being exercised and are creating complex real estate problems requiring fair market rent arbitration.

This article will address the wide gaps that exist in fair market rent in the B/C office market and present an adjustment grid as a bridge for reaching solutions when involved in arbitration. Lease arbitration clauses can be broad and can use such words as determination of market rent in a "customary manner", "comparable space", and "tenant improvements" and then leave everything else up to the appointed "arbitrators."

The B/C Office Market

The market for this class of space has four parts. The first step is the market itself. In the Seaport the B/C office market on a gross rent basis as of Q4, 2014 had average asking rents of \$41.12 per s/f up from \$34.09 per s/f Q4, 2012. This is a 20.6% increase in two years and over a 40% increase in four years. These rents are for first class space.

The next three parts address terms found in the market. Free rent is very much part of any negotiation. Free rent of 1-3 months on a 3-5 year lease and 10-17 months on a 10+-year lease are in place.

The levels of tenant improvements are a key ingredient. Tenant improvements paid by the landlord are \$55-\$67 per s/f reached \$75 per s/f in the case of LogMeIn.

The final part is the property itself. No two properties are alike and adjustments are required. Many of the older buildings in the Seaport have different calculations of rentable area. An adjustment to building standard measurement is part of the process. In arbitration cases, inspection of comparables is critical. Calls to open doors must take place.

Adjustment grids are helpful tools to summarize findings. The first step in the grid starts with the market and then looks inward at basic fundamentals within the property. The second step involves property operation:

Property Operations

The age of internal infrastructure can impact property operations. Class B/C office buildings in the Seaport district may contain original radiators mixed and matched with package air conditioning systems. Excessive utility costs by themselves can be the result and require an adjustment.

With modern space planning, open ceilings and clustering of employees around workstations, the term developed is "B Cool" space. The problem with "B Cool" space is that what was "cool" 5 years ago is not "cool" today. When inspecting space, a checklist is required to distinguish between what is "cool" and what is not.

Within the Seaport, ground leases involving Massport or EDIC are widespread. The ground leases can contain clauses that require payments to cover road and utility maintenance and payments of real estate taxes under PILOT programs. A typical PILOT program real estate tax would be 20% of net income.

The final operation issue involves the division of maintenance and repairs between landlord and tenant. The mix and match of capital improvements and true maintenance and repairs requires unbundling.

Obstacles within the Fair Market Rent Process

After the rungs of the ladder are addressed, parking becomes a key issue. For spaces with limitation on parking, employees often take the "T" to South Station and "rent a bike" under the Hubway program to peddle to their office. Parking is an important component to be considered. Parking is typically \$150 to \$175 per car per month as part of building leases within the Seaport. Bentall Kennedy just purchased 300 A St. because they also could acquire the Necco garage.

Summary

When speaking before real estate groups, I like to provide "take-aways" and in this case the adjustment grid is presented for that purpose. To truly be "fair" in arbitration, at times it is necessary to climb up or down the rungs on the ladder between gross and net rents to truly shake out the right answer.

The dramatic and dynamic market we are experiencing today presents opportunities for those with brokerage, valuation, advisory and consulting experience to assist in solving real estate problems as they might arise.

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