nerej
CELEBRATING 55 YEARS

An insider's view of the Boston commercial real estate market Q2 2017 - by Webster Collins

May 26, 2017 - Spotlights

Webster Collins,
CBRE/New England

This article represents a compendium of views that I have obtained from attending a variety of CBRE/New England's leasing and sales meetings, real estate conferences, a strategic planning session in Denver, CO and lastly, a speaking opportunity where I presented to a group of peers in Chicago for the Royal Institution of Chartered Surveyors (RICS) Americas Summit.

Real Estate Cycles
Starting in 2014, real estate pundits were saying that we were ±6 years into recovery, that typical cycles last 6-10 years and that a mild recession would begin at some time during Q3 2017-Q1 2018. On April 13, 2017, Belmont Savings Bank put on an exceptional program that was titled Bottom of the 7th or Top of the 10th. One speaker, with whom I concur, mentioned that Boston is considered as a part of the champion's league of marketplaces and that the city is currently 'at the top of the 4th and not the bottom of the 7th.'

"I don't find what economists say worth much," a program speaker added. This statement is consistent with a quote reiterated by Americas Head of Research for CBRE at a recent conference, stating that "some ideas are so preposterous that only intellectuals could believe it."

Consequently, real estate professionals are:

• Tracking tenants in the market

• Very concerned about interest rates

• Carefully tracking net absorption

• Following unemployment rates

While some think we are at the top of the 10th, I do not share the same perception. Unless the Fed acts to slow our economic growth, the Boston market will continue to persist until the market peaks. I do not foresee a recession on the horizon. We should continue to see momentum build up until 2020, further justified by a 50-60 basis point change in interest rates that is built into the capitalization rates of most properties.

Product Types

After the Downtown Boston Office market experienced a net positive absorption of 700,000 s/f in 2016, the market went relatively quiet. At 19% vacant, Class A space in the Back Bay was the primary contributor to elevated vacancy. There is a lot of discussion in the market over stipulations such as standard tenant improvement allowances. Most of the market activity is in low-rise office space. Prices for high-rise office space are ballparked at rents over $60 per s/f. The CBD experienced negative absorption of 175,844 s/f.

As for the suburban office markets at the beginning of 2017, substantial absorption took place in the Metro West submarket; 514,431 s/f was absorbed with 195,000 s/f leased to Insulet Corp. at Nagog Park. The Metro North and Metro South submarkets are both described as quiet. What is important to recognize here is that the large absorption taking place in the Metro West market has caused office market rents to rise by $0.30 per s/f, up to $25.25 per s/f. A big gap exists in the market with Metro North rents averaging $20.11 per s/f and Metro South rents clocking in at $20.83 per s/f.

On an overall basis, the strongest market is the Greater Boston Industrial market. In 2016, 3.4 million s/f of space was absorbed. The absorption that took place includes internal growth and out-of-market move-ins. California-based NEO Tech purchased a 198,000 s/f manufacturing building at 125 Fisher St. in Westborough. In Q1 2017, the strong absorption trend continued with 425,581 s/f absorbed. With an increase in absorption, average rental rates have now crossed over the $7.00 per s/f barrier to $7.18 per s/f NNN.

The third product type is in the Cambridge office/lab market. Cambridge office rents are above Boston's $56.15 per s/f average. The office market has appeared to peak at $65.67 per s/f. The lab market in Cambridge is on fire at an average asking rent of $76.00 per s/f. NNN. Overall, vacancy and availability have risen. East Cambridge lab spaces experienced 164,864 s/f of negative absorption. Cambridge lab space has now seen three consecutive quarters of similar activity, which has become a trend in this specific submarket.

The final product type to address is in the Boston retail market. Historically, retail stores have reinvented itself, adapting to the fluctuating economy. Retail power centers have run their cycle with the exception for the few locations where there are gaps existing in the market. Walmart has changed their ways and is now concentrating more on an e-commerce approach to increase their bottom line. The supermarket business as of late has created more prepared meal options for their customers to satisfy the needs of their busy customers. Retailers have used omni-channel marketing to expand their customer footprint. Physical store presence is still required, as the bricks and mortar store locations set a standard guideline for pricing online shopping inventory. Because of these market changes, percentage clauses in retail tenants' leases have been directly affected.

Conclusion

As is, the Boston market has a far stronger base than I have ever seen before. The city's basic economics are supported by a low unemployment number that have been reported at 3.7%, paired with the ability to create new jobs at an unprecedented rate.

CBRE is the world's largest real estate firm and has several companies under its umbrella. CBRE Econometric Advisors has studied all the major cities in the United States and published their study titled Best Metros for Investment in 2017. Boston is ranked #9 on this list, which is why I am convinced that Boston's market has a longer run rate before we experience another downturn.

Webster Collins is an executive vice president/partner within the valuation & advisory services group of CBRE/New England, Boston.