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Boston office market is on fire, but suburban office market has become the “brown banana” - by Webster Collins

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Webster Collins,
CBRE/New England

At the start of each year CBRE/New England presents in Boston its predictions and projections for the year ahead. 25 years ago in 1993, our presentation was at the Harvard Club with 28 attendees. The 1990s were a time of recession, and doom and gloom was everywhere.

This year, over 700 attendees learned of numerous insightful takeaways from CBRE’s Americas head of research, Spencer Levy, and from six of CBRE/NE’s best and brightest. To start the program, Levy presented CBRE’s office market report placing Boston as the #9 city in the U.S. for tech talent, an increasingly dominant driver of office demand. The Boston office market is on fire.

A Landlord’s Market
What is going on in the Boston office market is huge growth in the co-working sector. These are the spaces within Regus, the Cambridge Innovation Center and a number of other operators where Boston’s start-ups are located. Over 1.5 million s/f of the city’s 80 million s/f of office space is occupied by co-working operators. With Cambridge lab vacancy at 2.1% and office at 3.6%, and with only eight availabilities in Boston over 100,000 s/f, “spec success” is taking place. Significant large e-commerce companies are predicted to take sizeable chunks out of our limited supply.

A major change is occurring. The tenants, not the landlords, are at risk. Tenants are expected to invest capital up front. Landlords are “going spec” on new builds as they know that leasing activity will follow. Tenants are showing up at landlords’ doors with near immediate timing. There is high competition for limited space. The market is moving at a frantic pace.

Commercial Sales Market Spin-Offs
Colleague David Pergola Jr. said, “if you have tried to purchase an office building in Boston or Cambridge, then you know what real estate combat feels like.”

Speed is everything. Investors in the market are fast and agile. Owners are equally fast and prepare due diligence in advance. We are seeing closings that take place from award to deed in 20-25 days. This healthy investment market is strengthening leasing fundamentals, as the leasing market must follow suit.

The Suburban Office/Lab Market

The unfortunate part of our market is that the classic 1980s suburban office building has become the “brown banana” most investors will not touch. As Alison Powers pointed out, the ingredients that make the suburban market appetizing are “big, new and nice.” There is a structural change in our industry where players like Boston Props. are finding organic growth when buildings are renovated, expanded or built with state-of-the-art concepts.

A guaranteed suburban market driver for 2018 is lab demand. Lab rents are up 10% year-over-year and over 1.2 million s/f was absorbed over 12 months. The drag on the suburban office market is functionally obsolete buildings, which caused a misleading 920,000 s/f of negative office absorption.

The Industrial Market

As Rachel Marks pointed out, for the first time in over a decade, industrial real estate is the preferred class for global investors. It was the top choice for more than a third of CBRE’s global investors recently surveyed. Class A warehouses are in huge demand. Buildings with high ceilings (at least 20’), ample dock doors and trailer parking are being gobbled up by direct retailers where delivery speed is a factor.

One of the key trends in industrial real estate is that properties close to urban centers, with the ability to act as way-points to clients, have seen rents more than double in the past few years.

So, where do we go from here? There is a lack of available land on which to build new industrial facilities. With little new construction on the horizon, demand far exceeds supply and will not change anytime soon.

The Retail Market

One of our key retail gurus is Matt Curtin, who takes issue with the bad press about the retail market over the past 12 months. While certainly e-commerce is having an effect, brick-and-mortar retail is certainly not dead and, in many cases, it is changing for the better.

Today’s consumers expect retail to become a lifestyle experience, and landlords must adapt to consumer behavior and step up their game. The best examples are L.L.Bean and lululemon. Do not be surprised to see kayaking and paddle boarding in the Fort Point Channel this summer from L.L.Bean’s first urban store in the country. Entertainment concepts in Seaport Sq. are at the leading edge with luxury theaters, live music and bowling.

A very active segment in the retail market is craft beer brewing. Technology is the new word in retail, with mobile devices becoming an integral part of the strategy of retail operators like Capital One and sweetgreen, the fast-casual restaurant and “ultimate millennial brand.” Retail has shifted to an experience-based “postable” activity as consumers want to share their experiences on social media and touch, feel and try on merchandise.

Conclusion

As we move forward into 2018, those in the commercial real estate profession in Boston are absorbed with head-spinning experiences such as those outlined herein. When I entered the business years ago, the markets were set by the greatest training grounds in the U.S.: life insurance companies' real estate departments. The recessionary years of 25 years ago crushed these training grounds, shifting more influence to academia, whose "scholarly research" approach has not worked. What has now taken over is the new thought process outlined herein, where professionals themselves become students of the game and their actions create the road ahead. 2017 was CBRE/New England's best year in its 110-year history!

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