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Grubb & Ellis' Boston office market trends study for the second quarter of 2008

July 23, 2008 - Spotlights

Activity in the Greater Boston office market slowed significantly in the second quarter of the year. Total net absorption dropped to a positive 124,000 s/f down from an average of 715,000 s/f gained over the previous four quarters. The CBD reversed some of its recent additions by losing 117,000 s/f, while a modest tenancy inflow in the suburbs was responsible for the overall net quarterly gain. Despite the downturn in overall absorption, the escalation of asking rents continued unabated in the second quarter. Average Class A asking rents for the entire Greater Boston market rose to $41.55 per s/f, up $0.50 per s/f from the beginning of the year. In the CBD, despite a net outflow in tenancy, the rent increase was even more dramatic, rising $2.73 for Class A space up to $63.57 per s/f.

The office investment market once again posted an unremarkable quarter, with just 14 transactions of $5 million in value or greater conducted in the second quarter. The total value of transactions summed to $489 million in the second quarter. This is a significant departure from the nearly $2 billion in total quarterly transaction volume averaged throughout 2007. Though credit issues are still lingering, a few suburban office buildings did trade in the second quarter of 2008.

Overview

By focusing solely on the recent quarterly absorption figures, one may have overlooked the dip in leasing activity in the Greater Boston office market over the past few quarters. The flurry of deals signed in 2006 and 2007 helped to keep absorption numbers inflated in the beginning of 2008 despite outward signs of a weakening market. The slowdown finally manifested itself in terms of absorption in the second quarter. The CBD market, home to the region's financial service sector, was especially susceptible to the economic downturn and posted a net negative absorption tally. The suburbs contributed positive gain, but not to the same extent of quarters past.

Despite the downturn in overall market leasing activity, there are still areas of growth to be found. The biotech sector appears to be weathering the economic storm quite nicely and has provided some stability to the Cambridge and suburban lab markets. There are a host of new and existing lab development projects in the works primed to capitalize on this trend and increase the inventory of lab space available. In addition to the recently completed 301 Binney St. and 320 Bent St. properties in Cambridge, the pipeline of new inventory includes a new Alexandria Real Estate Equities park in Kendall Square and a repurposing of 3 Preston Court in Bedford, Boylston Properties' 121 Brookline Ave.in Boston and BioRealty's planned 700,000 s/f biotech park in Grafton. Furthermore, EMD Serono plans to add a 125,000 s/f annex to its facility in Billerica.

A trend to watch in the investment market is the pickup in suburban portfolio sales. Three notable transactions from the second quarter included Colony Realty Partners taking both The Meadows on Rte. 9 and Framingham Corporate Center for a combined $82 million, MIT picking up a portfolio in Cambridge for $90.5 million and New Boston Fund acquiring the Granite Woods Corporate Center in

Braintree for $27 million.

Boston Central Business District Overview

The second quarter produced a net outflow of 117,000 s/f of tenancy from the CBD. The bulk of the loss occurred in the Financial and Back Bay Districts, while the peripheral North Station, South Station and Fort Point Channel submarkets all netted modest gains. One factor contributing to the tenancy loss is the rising cost of occupancy in Boston. Average asking rents rose $2.73 for Class A space up to $63.57 per s/f while Class B asking rents increased $1.27 to $33.96 per s/f. Despite the rate increases and the tenancy loss, vacancy in the CBD remains at a landlord friendly 8.6%.

The largest downtown deal of the quarter was signed at Boston Properties' Russia Wharf office tower development, where Wellington Management leased 450,000 s/f for 15 years. Other new construction projects in the CBD have been garnering attention from prospective tenants. Vertex Pharmaceuticals has shown interest in taking a block of space at The Fallon Company's Fan Pier, while KPMG is rumored to be interested in 125,000 s/f at Lincoln Property Company's Two Financial Center.

Additionally, announcements were made during the quarter that could open up more space for development. First Church of Christ, Scientist plans to place 200,000 s/f of space at the Christian Science Plaza up for lease and The Postal Service is nearing a deal to sell off a 16-acre parcel adjacent to Fort Point Channel for future development.

Investment activity in the CBD during the second quarter was almost non-existent. Very few transactions greater than $5 million in value were recorded in the past three months. Ponte Gadea finally closed on its purchase of 50 Milk St. for $170 million, or $619 per s/f. Synergy Real Estate Services picked up another asset, 100 North Washington St., for $11.7 million.

The CBD Submarkets

The Back Bay again recorded the highest rates in the market, with Class A asking rents at $64.55 per s/f. Vacancy rose 70 basis points in this submarket to 6.1%. The Financial District averaged $63.49 per s/f for Class A space and submarket vacancy finished the quarter up 120 basis points to 10%. The Fort Point Channel submarket recorded the highest absorption in the CBD, a positive 218,000 s/f, dropping vacancy to 8.1%. Vacancy in the North Station and South Station submarkets ended the quarter at 5.6 and 9.3%, respectively.

The CBD hosted a considerable volume of movement in the second quarter, with one prominent tenant changing locations within the downtown market. Bingham McCutcheon increased its footprint in the market by moving into 321,000 s/f at 1 Federal St. and vacating 227,000 s/f at 150 Federal St. Hill Holiday changed submarkets as it commenced occupancy of 165,000 s/f at 53 State St. after leaving 133,000 s/f at 200 Clarendon St. in the Back Bay. SunLife Financial also went from the Financial District to the Back Bay, leaving 131 Oliver St. to occupy 28,000 s/f at 2 Copley Place. Ropes & Gray will be following the same path in 2010, as it signed a 20-year deal for 413,000 s/f at the Prudential Center. Aberdeen Group also vacated the Financial District, leaving 260 Franklin St. to move into 25,000 s/f at 451 D St. in Fort Point Channel.

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