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What is the office sector experiencing as it moves out of COVID-19? - by Bill Pastuszek

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What is the office sector experiencing as it moves out of COVID? What is in store for landlords, tenants, and office occupiers going forward? The office market is an asset class that was affected very fundamentally by the lockdown: The house/apartment/loft became the office for many, and is likely to continue to be for some. And COVID-19 may have some lasting repercussions in terms of density in offices or on the streets.

What does the sector look like today, both nationally and locally? What does the future hold for the office sector in Boston, the urban core, and the suburbs? Nationally, a leading survey (PwC Investor Survey) notes that an investor states that “downtown areas have been flooded by sublease space.” This has negatively impacted lease pricing. Concessions, in particular, free rent, are on the rise. Vacancy hasn’t settled out, and may not until well into 2022, maybe 2023. Nationally, the survey says that the suburban market environment in “the near term is likely to present more challenges to landlords, remote-work trends and a shift away from CBDs could benefit suburban office locales in the future.”

In the Boston market, a broker survey notes: “Sublease surplus is negatively impacting leasing activity and our ability to increase rents.” While the Boston market’s average first-year rent change rate assumption stays at -0.50% this quarter, it represents the lowest average since 2010. The study goes on to say: “Little change is expected in the near term as more employers adopt permanent work-from-home formats, which will create favorable options for tenants searching for space.” A very informal anecdotal survey among real estate-related firms suggests that the in-office model is in the midst of transition as the pandemic required on the fly virtual/remote solutions, many of which will probably persist.

CoStar notes that “absorption turned negative in each quarter of 2020 for the first time in a decade and rent growth continued to decelerate. With 13.8 million s/f in the supply pipeline and lingering uncertainty regarding the economy, the Boston office market will likely face several quarters of rising vacancy rates, continuing the weakening seen in 2020.”

As firms delay space decisions to figure out what the new normal might end up being, landlords are in the position of offering free rent and other concessions. This type of activity will have the effect of obscuring what real rental rates are. Life-sciences and biotech firms have driven leasing demand during the past several years, with strong spillovers into other markets all the way out to Worcester. The good news is that Boston was in the forefront of vaccine development and will continue to enjoy a storied reputation in life sciences which will have magnet effect.

Short-term/flex space office providers of both local and national variety did well pre-pandemic. A notable example is WeWork, which ended up having a hard time generating enough flex space income to meet its rent payments in strong locations during pandemic (and probably leading up to it). COVID changed the dynamics of these types of space providers at least for a time.

CoStar notes that “construction levels in the Boston metro are the highest seen since early 2001.” Those projects with minimal current preleasing could struggle to secure tenants in the current leasing environment.” On the other hand, new buildings with state-of-the-art climate control systems and floor plans to meet post-pandemic tastes may gain an advantage. My purely anecdotal survey suggests that small office spaces in small buildings have gained an advantage in this market, as have office spaces in outlying markets.

In terms of sales, volume was down. However, prices held up reasonably well. So far. Another survey notes: “While overall sales volume remains low compared to pre-pandemic investment activity, recent transaction data continues to prove that buyers are not shying away from spending top dollar on high-quality, high-potential office assets. Consequently, sale prices in April reached an all-time high of \$304 per square foot, on average.” Investors are not shying away from high quality assets.

We should take another high-level look at these markets later this year or the beginning of the next. Many companies will likely refill their spaces with workers but will it be the same? It’s hard to overlook the effect of the innovative solutions for doing work during the pandemic that will continue to shape future work habits. The effects of COVID-19 no doubt will continue to influence the shape of office markets beyond this year. Let see what trends last. We can do a zoom call!

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