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New England SIOR Chapter holds Regional Market Review

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Boston, MA The New England SIOR Chapter held an invitation-only regional market review on May 18, with seven of the area's leading SIOR brokers with guests. The market review was conducted on Zoom with 82 registrants and Jeremy Freid, SIOR served as the moderator. The speakers and markets reviewed included:

• Chris Paszyc from The Boulos Co. on the Maine market;

• Tom Farrelly, SIOR from Cushman & Wakefield on the New Hampshire market;

• Bob Cleary, SIOR from Colliers International on Downtown Boston;

• Jeremy Freid, SIOR from 128 CRE as moderator and on the Rte. 128 market;

• Phil Desimone from Kelleher & Sadowsky on the Rte. 495/Metro West market; and

• Jim Grady from Synergy as the special guest principal speaker on his insight as a downtown Boston landlord.

Each speaker had 7 to 8 minutes to give an overview of the office, industrial and lab science markets in their prospective sub-market. Below is an overview.

Bob Cleary: Downtown Boston

Cleary commenced with his topic segregation of two issues to discuss: 1) the general office situation and 2) the landlord position with COVID. He also stated that in this environment he needs to discuss how the sublease market is impacting space demand, how the life science development is evolving into downtown Boston and the office venue of workers returning to the office.

The Office Landscape

Cleary sees today's landscape very different from a year ago and offices operating at a high capacity reduction. He is experiencing close to a 16% vacancy downtown with lingering uncertainty. But with the new vaccine he feels that the office market will come back to normal. The current vacancy is helping and allowing 20-30% of workers return to work. He sees Q3 as a return date. He sees momentum building in the market as Amazon exercised its Seaport option on a second office tower. Whoop committed to 121,000 s/f in the new Kenmore Sq. development and VC funding continues to pour into Boston at a record pace.

Landlord's Position

From the landlord's position, rents have decreased 2-2.5% from last year but still priced at pre-COVID levels and holding steady. However other types of concessions are being offered. There has not been a great deal of landlord pain; maybe a little more pain with the class B office buildings but overall class A and class B space held steady. Class B had a 4.8% dip in rents. Cleary does not see weakness in the market and only a slight lowering of rental rates. He thinks that we will see new construction and that pre-leasing will be tough on landlords as there will be competition with space inventory. New projects are being delivered in the next 24 months which will add stress on the market and specifically to Class A apace.

The State of the Sublet Market

On the sublet market status, he calculates that there is between 3 to 5 million s/f available and that is a lot of space in a short period of time since COVID. The asking rents are 15-18% less than direct office deals. He also sees that any space that is a good product has already been leased.

Life Sciences

East Cambridge was the home and focus of life science development. Now Cleary sees clusters of life science development in the Seaport, Fenway and Somerville and these locations are becoming very strong. 601 Congress was acquired by BioMed at the end of 2020 with plans for a conversion into lab space, BioMed has acquired the 321 Harrison construction project originally slated for office space and now repositioned for lab. Ginkgo Bioworks has leased 150,000 s/f at the Au Bon Pain site in the Seaport which is pending conversion approvals as is Related's design center plans to convert 250,000 s/f of office space. Any pre-built office wasn't designed for lab science use but these buildings are being converted anyway. Developments in the deep portion of the Seaport, 88 Black Falcon, Au Bon Pain conversion, old industrial conversion, marine facilities, etc. are now life science buildings. Outside of the Seaport epicenter, new lab projects are in the works in Fenway including a IQHQ's proposal for a 250,000 s/f development at 109 Brookline and 289,000 s/f lab building in Boynton Yards campus.

Back to the Office

Cleary is seeing that larger companies are talking about a return to the office in June/July or September. The office real estate industry is preparing to let everyone return to its offices within the city but he also believes that the office and city amenities may have disappeared due to COVID-19. He hopes that the support amenities will return. He also believes that we will see office workers that want to continue to work remotely from home but he doesn't think it will lead to downsizing on office space.

During Cleary's Q&A, he was asked if the office tenants will come back to the office on the opening day of MA, May 29th? Cleary concluded that tenants and employees need to be comfortable with the use of mass transit when returning to work. Tenants will need to coordinate how companies will bring back its employees. Some people still want to work remotely from home and some are still concerned about COVID. We are social animals however and are in a "contact sport". Company cultures demand face-to-face contact. July could be the "come back" date or it will be Labor Day in which tenants will aggressively return to the offices. Cleary summarized by saying that it took 40 years to build Boston to what it is today and that growth was lost in 14 months. It will take time to rebuild the city but without office workers, retailers downtown can’t exist.

Jeremy Freid: Rte. 128 Market
Freid started the discussion by stating that Rte. 128 is a release valve for downtown Boston. Lab and life science is new to Rte. 128 and is exceeding multi-family development on a cost per s/f basis. Watertown, Weston, and Waltham are at $60-70 per s/f rental rates with very high land sales. Lab and life science is coming to the suburbs, but the question is when will demand come to a bubble? Freid asks in 2023-24 will lab demand exceed lab supply. This is the number one argument.

Industrial on Rte. 128 does not exist anymore. You just cannot find industrial. What you can find for industrial on Rte. 128 is also costing $18-19 per s/f and at that rent, it is difficult for an industrial company to afford. There is competition as well from cannabis users who are leasing flex space, paying higher rents and removing available space from industrial users.

Jeremy offered other short observations on real estate. Housing costs are pushing people out to Rte. 495. When it comes to “return to work” every company speaks about flexibility for its employees. The financial industry is less flexible, but tech wants employee flexibility. People still want to collaborate, go out after work with friends and still want the office environment.

Phil Desimone: Rte. 495/Worcester Market
Desimone stated that Worcester is hot and really poised for a solid rebound due to colleges. Students are now staying after the semester is completed in Worcester and not go home to Boston. That was not the case in the past. Today Worcester has more to offer and more housing for students. The Red Sox minor league team, The WooSox is a plus. And Phil is seeing more bio-medical companies move out to Worcester. There is no R&D space in Worcester as a tenant has to travel to Marlboro or Westboro for that type of space.

Generally speaking, Desimone is not experiencing any big dip in rents. It is more about tenants playing musical chairs with buildings.

He believes that Worcester will experience a big rebound in space demand and the economy.

Rte. 495 MetroWest
There is a tale of two cities, Framingham and then the “boroughs”. There are two different issues with both areas. Phil thought at one time that he would see more companies migrate out of Boston to MetroWest but that did not happen. What about post COVID-19 occupancy issues? Desimone says that leases are happening at a 15% rent reduction which is far less than the anticipated 30-40%. We are in a better rent environment.

Natick-Framingham Market
In the past, large corporate users drove the Framingham office market but now these corporate users are not transacting. TJ Maxx and others are at a standstill. Once they expand office demand

then you can expect other smaller tenants to expand. The office market has been slow and there is not a great deal of indicators for expansion. The Staples HQ is on the market for sale and when it does sell, it will be an indicator what investors think of value in today’s market.

The 'Boroughs

Phil started with Westboro and 44 Computer Dr. and its demolition. Amazon will lease the replacement warehouse building of 220,000 s/f. At another Westboro site Amazon leased another site for robotics and that move will create new jobs.

In Marlboro, there was a new lease for 220,000 s/f for a life science building. Amazon also took another 600,000 s/f. In general, in the boroughs rent dipped a little but in the last 60 days, activity has picked up.

Jim Grady, Synergy on the Landlord Market

Grady has been in front of his tenants since the beginning of COVID. Now his discussions are about coming back to work and he is finding that his tenants want to come back to their Boston offices. They want to collaborate. We need collaborative space for college brains but tenants want their teams back in the office to have in-house team competition. In-house competition drives company production and that competition is now missing which is the reason to the question “why go back to the office”?

Grady must also answer the question “when?” Through his discussions with his tenants, he is finding that some will return in July, but it is not universally accepted. There needs to be an agreement within company employees. Traffic has picked up and we need to figure out the use of mass transit and the health issues of crowding and sneezing on subways and trains. People are not ready for the crowded mass transit yet and the danger of COVID. The landlord must figure out how to deal with crowds coming into a building and the density at all the same time. Maybe social distancing remains or maybe companies stagger shifts. Grady continued that rents are still strong, and construction is way up in activity. Costs have risen as well. Plywood was $90 and now $600-650 as prices are becoming “crazy.” With costs rising, the today’s landlord needs pre-COVID rents.

Looking at the future, Grady expects a busy summer. It is back to business for his tenants and planning for efficient floor plates post COVID. He sees an end of COVID in sight by his tenant’s feedback.

During Grady’s Q&A, he was asked about underwriting office rents. Grady is using his best guesses on the future of rental rates. He looks at the rising cost of construction and occupancy. It is about his 2019 budget that is at a record high level and no one was expecting COVID-19. But he is dialing back his rental expectations by 15-20% and he will have to take the situation from there. Office sale values were at an all-time high during COVID in Boston while the suburbs did not experience as many building sales. He feels that the lack of suburban sales could be due to the fact that building ownerships consolidated in the last 10 years with institutional owners.

On the question of returning to offices this summer, Grady said that we need more critical mass of office workers returning to the office before retail downtown can reopen. Restaurants will need 60 days to recruit workers and train staff and that has not happened yet. With the government unemployment benefits, it is hurting the ability to attract workers to fill jobs. We may need to re-evaluate retail space as an amenity to office space or repurpose retail in downtown office buildings. In the end, his primary goal is to fill his office buildings.

Chris Paszyc on the Maine Market

Paszyc stated that the office market in downtown Portland is 12 million s/f The pre-COVID class A vacancy was 6.6% in 2020 which was up from 0.4% with new construction planned that came to a halt. The overall Downtown Portland vacancy was 4% and now is 10%. He is experiencing a comeback in the office market to some normalcy. There has not been much for dips in rental rates. Suburban class A vacancy dropped in 2020 from 17% to 9.8% and overall suburban 12.6% to 8.6%. Overall office vacancy for the entire market is up from 6.6% in 2019 to 8.7% in 2020.

Recently they surveyed tenants on space needs and 75-80% stated that they will keep or increase their office s/fage.

Downtown Portland will have large lab sciences space. Rioux Institute, an affiliate of Northeastern University focused on Artificial Intelligence, computer and data sciences, digital engineering, advanced life sciences and medicine started in Maine in 2020. The new facility will hold 500,000 s/f of lab, classroom, offices, and housing. The Maine Law School is taking over 55,000 s/f downtown. There is 77,000 s/f SunLife at 58 Fore St. that is under construction. There was also a delayed Covetrus project of 163,000 s/f now back on construction but with a one-year delivery delay with other sublet space available.

The suburbs experienced a declining vacancy as there was a great deal of leasing activity in 2020. Berry Dunn signed 88,000 s/f 12 year lease at the Unum complex in Portland. Other notable deals in the suburbs included Stantec and Abbott Labs. Waterstone is developing a 200,000 s/f Cross-Laminated Timber Office Tower at Rock Row which is 110 acres of $600 million development of office, medical and retail development. New England Cancer Specialists will be the anchor in a two building 200,000 s/f medical complex. University of New England is also expanding with a new $70 million school of medicine as educational schools took advantage of COVID. Commerce Center is under agreement to be sold as 311,000 s/f and the former MBNA 314,000 s/f facility in Belfast is under contract to be sold.

Industrial Overview

There is over 19 million s/f in the market with the 2020 vacancy at 2%. Now rents are approaching office rents for the first time. The Scarborough Racetrack is being redeveloped in September 2019 into 54 lots. Of the 54 lots, 50 house lots have been sold. Also 340,000 s/f of development over 12 buildings have been completed. Abbott Labs is expanding taking 250,000 s/f. Tambrands started a $15 million, 116,000 s/f expansion in Auburn. Amazon looking to make entry in the market. There is also a great deal of retail converting into warehouse and the space is quickly leasing. Spec development rents are $12-14 per s/f NNN for industrial.

Tom Farrelly: New Hampshire Market

Farrelly started by saying that Chris just gave his update on New Hampshire. The story is basically the same. New Hampshire has moved forward on COVID and no masks are required for meetings. He is now shaking people's hands. He congratulated New Hampshire for handling the COVID health issue and said it deserved accolades. These positive policies have helped real estate. Concord and Manchester are the two hottest residential markets in the U.S. Houses are selling at prices exceeding pre-COVID-19 levels. Farrelly is extremely busy, but the office market is flat. He is busier with industrial space as there is not a great deal of "dumpy" space. Much of the space is owner occupied as well leaving little for tenants. There has not been any increase in sublet inventory and in fact he cannot find any sublet space. Portsmouth and the Seacoast are on "fire" with its high quality of residential real estate. There has been an office development in Portsmouth for lease, but it is now almost fully leased with rents in the high $30s per s/f. It is almost at record-breaking rents. There are also large tenants in the market. In 2020, he sold 200,000 s/f on 120 acres to Lincoln Financial. One day prior to St. Patrick's Day, the firm sent everyone home. Oracle took 110,000 s/f in Manchester last year and then sent everyone home.

Industrial Market

This sector of the market is also "on fire." Farrelly researched past rents and 35 years ago rental rates were high $ 3.00 per s/f to high $4.00 per s/f. Now the same buildings are leasing in the $6-8 per s/f. Some are higher at $10 per s/f. There is now zero inventory. Tenants looking for 300,000 to 500,000 s/f and 40' clear ceilings from Boston to NH in the logistics/supply chain industry are not finding space. There are two tenants looking for 1.1 million s/f and 1 million s/f in NH and they cannot find it. Construction costs are out of control. What once were estimated costs of $14 million are now at $19 million. Site work costs are "killing" a great deal of the cost details. Retail is being repurposed into industrial.

Life Science in NH has finally made an appearance. Integra leased 100,000 s/f, another tenant took 70,000 s/f and another at 100,000 s/f. Overall industrial property rents are approaching or eclipsing some of the office buildings. It is very difficult for regional industrial companies to afford the current industrial rents. As an alternative, to buy and retrofit industrial is also much too expensive. End-users are paying the highest broker suggested selling prices.

George Paskalis: Rhode Island Market

Paskalis stated that there was a great deal of parallel between RI and NH but he will focus on the industrial market overview as its an anomaly in RI. Demand is weak for office leasing and downtown Providence is non-existent. There is some activity in the 3,000 to 4,000 s/f range in the suburbs so at some level there is activity. Office rents are "flat," and the vacancy rate is 15%. Large companies are still working remotely and still analyzing its future with office space. Smaller companies have trans/formed to hybrid while others are full time. RI is somewhat behind with the vaccines which is not helping.

Retail was damaged during COVID. With Amazon accumulating e-commerce sales, it has impacted RI retail. Recently there has been a slight pick up in demand but that demand has been from small start-up retailers rather than from large retailers. It will take time to adjust.

The Amazon effect has been positive for RI with industrial vacancies below 2% and industrial high-quality space now too difficult to find. RI companies prefer to purchase and not lease. Companies are bidding on industrial buildings at asking prices or above asking prices. In the past anything in the 15,000 to 55,000 s/f range was the “bread & butter” market in RI. In 2020-21, RI then experienced large institutional industrial investors coming from the Boston market and other national industrial developers. These players were securing land for logistics-supply chain users for 100,000 s/f, 175,000 s/f and 500,000 s/f. George has not experiencing that level of demand in RI for the last two decades. He has institutional buyers looking to purchase industrial buildings and the demand is overwhelming with multiple offers on industrial buildings. He is experiencing three institutional buyers bidding for vacant industrial buildings in East Providence and that type of activity has never happened in two decades. The state has also helped to accelerate the industrial demand with tax programs for job creation and income tax programs. The newest story in RI is Amazon as it is building 3.5 million s/f.

Overall, the industrial side will impact the demand and there is not quality space in RI. He cannot fulfill demand due to the lack of inventory. There is a need for industrial sites to be built on spec to create a balance.

Paskalis was asked in his Q&A about RI industrial companies moving to Rte. 146 between the RI state line and Worcester as there were ample industrial parks. Paskalis answered that RI companies are fickle. They will not leave RI for space in Central or southeastern Mass., but that could change.