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The dynamics of the Boston market pave the way for a 2021-2022 recovery with a redefinition of the term supply and demand - by Webster Collins

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Webster Collins

The overall economy for the United States and its near 7% GDP growth present signal flags for positive forward movement in key sections within the Boston market. It was not until the United States market opened on May 29, 2021 that we could see what is now taking place.

Instant Change
The market over the past six weeks has moved sharply and quickly.

In terms of multifamily rental units, within the city of Boston and Cambridge, as of May 2021, occupancy levels were at the 50% to 70% level.

In one portfolio which we monitor on a regular basis involving over 5,000 units, the average occupancy moved to over 96%. This sudden change was brought about by strong demand for student housing.

In terms of office towers, at the bottom of the market in December 2020, only 4-5% of office space was physically occupied. As of June 30, 2021, this occupancy had tripled to 15%.

To place this change in perspective, the entire 2020 year saw negative office absorption of -3,837,650 s/f, CBRE's market statistics through Q2, 2021 show nominal negative absorption of 169,178 s/f.

Long Term Trends
Over the past 45 years, there have been four identified market bottoms in the Boston office markets–1974-1976, 1990-1999, 2007-2009, and 2020-2021. In each recovery period which followed, the market increase exceeded its prior peak.

Where we are today is a total office market size for both the city of Boston and its suburbs of $206.7

million s/f. In addition, there is another 43 million s/f in lab/life science space that did not exist some 20 years ago.

In terms of long-term trends, the lab market has grown exponentially. As of Q1, 2020 the Boston/Cambridge suburban market contained 34.2 million s/f. As of Q2, 2021, 18 months later, these were 28% more lab space. In contrast, the office market has slipped.

This article will also address what is potentially a complete redefinition of supply and demand for office space.

Office Supply and Demand

The post COVID-19 market will have two types of occupiers. One is the Facebook, Apple, Google and Amazon's of the world who will lease very large space in new buildings. Amazon in the Seaport and Google in Kenmore Sq. are two prime examples. Another is Facebook leasing at 50 and 100 Binney St. in Cambridge. The rents that are paid are top of the market. The CBRE Q2 2021 average asking rent for office space in East Cambridge is $89.65 per rentable s/f. Turnkey office rents in Kenmore Sq. are as high as $90 per s/f NNN.

There definition of supply and demand will separate big tech from everyone else. Everyone else is the typical older Class B and Class C of office space.

Remote office use by individuals who now rarely use office space is likely to continue for some time. There will be a large impact on the Boston market. Downtown and Back Bay Boston have some 14 million s/f of Class B/C space. This space is typically occupied by the small tenant user of 3,500 s/f to under 10,000 s/f.

From appraisal of a number of office buildings in downtown and Back Bay, I have learned that many tenants have not renewed their leases. The overall result is that the spin off of COVID-19 is the increase of vacancy within Class B and C properties. As of Q1 2020, the vacancy level was 8.3% in the Central Business District. 18 months later, the vacancy rate is 18.6% for an increase of over one million s/f in vacant space.

Within the Central Business District, the average office Class B/C size is 70,000 s/f. The average vacancy has increased by 10% and in certain instances for smaller buildings by as much as 20-30%. The occupier market will contain less than prime quality tenants who will drive hard bargains. Interview of market participants indicates office rents will slip from the mid $50s to $60 per s/f down into the $40 per s/f or less. Lease terms of 5 years to 7 years or more will also slip. The redefinition of the market will mean more landlord paid tenant improvement allowances and the need to gut space and speculate on tenant use just to attract tenants to space. Absorption periods will be longer.

Conclusion

The shining star continues to be lab space with no signs of space contraction on the horizon. The lab market is driven by venture capital and VC Funding. The long-term prospects for lab space remain strong.

As pointed out above, the Class B/C office space is of real concern and will likely continue far longer with owners anticipating a 3 to 4-year time horizon for this part of the office market to shakeout.

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