The commercial real estate markets recollect themselves after a tumultuous year in 2022 - by Webster Collins

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Webster Collins

The central theme of CBRE research year end summary reports is the need to adopt to hybrid work strategies, looming recession fears, and the importance of keeping a close watch on key trends used as indicators of market health. This article will address these issues across various Boston product lines.

Downtown Boston Office Market

In 2022, there was 1,367,050 s/f of negative absorption. To place this into perspective, this is 80% of the negative absorption seen in the 2009 recession and 43% of the negative absorption recorded in the 2001 recession.

Availability rose 60 basis points (bps), the highest level in the past 20 years and vacancy increased 70 bps to end the year at 12.5%.

The most significant trend is that 86% of the 4.8 million s/f of office space leased in 2022 was class A, with 41% of this space being in class A+ properties which are newly constructed or under construction office towers. The office product type carrying the highest level of risk is class B space. The decline in office asking rent does not reflect the true decline taking place in taking rents. The effective rent, after taking into account free rent and tenant improvements has decreased 66% more than the asking rent.

The post-pandemic trend of remote work strategies is evident in the CBD.

Cambridge Office Market

Cambridge is a “think tank” market. CBRE’s Q4 2022 review outlines the impact as tenants “right size” their footprint to adjust for more employees working from home. Cambridge ended 2022 with 787,500 s/f of negative absorption. The overall office availability is 18.3% which causes a decline in gross asking rent from $85.09 per s/f to $81.80 per s/f in 2022.

A surprisingly small, close to 300,000 s/f of office space was leased in 2022. 49,000 s/f of this space was leased to GE Vernova at 58 Charles St.

Suburban Boston Office Market

With a recession looming, large amounts of sublease space were listed in Q3 and Q4 of 2022. This has caused uncertainty to remain while office availability attended the year at 20.4%. As is the case with downtown Boston, the flight-to-quality trend is evident. Most transactions represented class A space.

Overall, the suburban office market finished 2022 with 209,475 s/f of positive absorption. Actual overall vacancy stood at 15.8% with the overall positive absorption, gross asking rents increased from $25.42 per s/f to $27.94 per s/f

Boston Metro Lab Market

CBRE’s lab summary for 2022 is titled “Fundamental Shift as Headwinds Persist”. Demand remains lower than the 2021 level while supply has continued to increase in both new construction and conversions.

Private venture capital funding propelled most growth in 2021. This funding has started to dip. Although year end 2022 statistics present 6.9 million s/f of leasing activity, sub-lease space coming on line has resulted in Q4 2022 recording, 137,808 s/f of negative absorption. There has been a slight dip in the asking NNN rent to $97.46 per s/f from $97.92 per s/f in 2021.

At the same time, there has been a very strong suburban and Cambridge sales market with Cambridge pricing in the $2,000 per s/f level and suburban transactions at the $828-$940 per s/f levels. The reason is that the buyer pool is low leveraged capital that does not need to price-in todays financing rates. NNN Cambridge asking rents are $115.96 per s/f, average Boston asking rent is $104.47 per s/f with average suburban asking rents of $88.09 per s/f.

The rate of annual growth is expected to look like pre-pandemic growth which is much more sustainable than the rate seen in the last several years.

Boston Metro Industrial Market

2022 was a record-breaking year. Total absorption was 7,547,390 s/f in a 270 million s/f marketplace.

The trend in the market is for construction of high bay 28’ height buildings for high tech manufacturing, logistics, wholesalers, and transportation uses. New leases accounted for 78% of all the leasing activity in Q4 2022.

CBRE’s leasing brokers report market hesitancy to enter into to long- term lease extensions as they evaluate potential headwinds and reassess their most efficient and cost-effective real estate footprint.

Conclusion

The Federal Reserve has raised Federal Fund rates dramatically through multiple increases in 2022 to combat inflation. Many expect the U.S. economy to enter a recession in the first half of 2023. The overall result has been that tighter financing and worsening economic conditions are causing commercial investment volumes to decline.

Experience shows that consumer and investor behavior can quickly change during heightened volatility.

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