NAIOP/SIOR 2009 Forecast held Dec. 4th at Hyatt Regency, Boston

January 07, 2009 - Spotlights

The annual NAIOP/SIOR 2009 Forecast was held at the Hyatt Regency on Thursday morning Dec. 4th to over 450 commercial real estate professionals. David Begelfer of NAIOP and Greg Klemmer, SIOR Chapter president introduced the panel of Barry Bluestone, director of the Center for Urban and Regional Policy at Northeastern University; Glenn Verrette, DTZ FHO Partners on the Boston Market; Robert Richards of RBJ & Partners on the Cambridge Market; Alex Dauria of JLL on the Suburban Market; Austin Smith of Newmark Knight Frank on the Industrial Market and Frank Petz of Eastdil Secured on the Debt and Investment Market.

This is a bullet summary of each of the speaker's presentations:
Dr. Barry Bluestone, Economist
Bluestone started the program by stating that this was a great time for economists as everyone is seeking answers to this recession. He gave a snapshot of what is happening by stating that this recent downturn was not a new event. The economy has been falling for awhile. The U.S. may be half-way through the recession if economists agree that this cycle started last December '07. The U.S. GDP has been sliding for the last 4 years and probably will hit a 0.00% GDP for '08 if we are lucky. He estimated 2009 GDP at -0.5%. He noted again that this down cycle with the GDP has been going on for sometime from 2004 and now unemployment is rising. He concluded that you really need 3% GDP real growth for any sizable employment and that hasn't happened.
* In 2004, there were 5.7 million unemployed in the U.S. and in 2008 it is 10 million.
* The CPI index has exploded from 2001-09 from 1.65% in '01 to 4.7% in '08. Deflation is now a bigger issue. Bluestone estimated that the CPI '09 could be 0.5%.
* The federal debt as a percent of GDP has increased with the spending in the Iraq war. In 1970, the federal debt was 37.6% of GDP, 1980, 33.3%; 1992 64.1% and 2009 79.4%. His best guess for 2010 was $1 trillion per year in U.S. debt. The last 12 years has seen a quadrupling of the debt level.
* Real median family income stopped growing in 2000. In 1993 it was $50,782 and in 2007 it is $57,648. We have been flat with family income due to credit cards and other borrowing while corporate debt has increased to 11.3% of GDP in '08 from 8.4% in '98.
* The value of residential housing construction in 2008 was $231 billion, the same as in 1998 ($224 billion).
* Commercial and office construction will see a recovery cycle. It peaked in 2000 with 1.19% of GDP and a low in 2003 of .80%. So we should see improvements.
Bluestone concluded with his 2009 predictions:
1. We will see a federal recovery stimulus in 2009 look like the 1933-34 federal works programs as

we rebuild our infrastructure.
2. We will see a large dose of money coming to states. Massachusetts is running a $1.5 billion deficit in '08.
3. We will see more bail-outs.
4. There will be no change in the tax policy for awhile. Tax refunds are not as helpful and probably will not happen.
5. Bernanke will liquify the economy and probably push down interest rates close to zero.
6. U.S. dollar is getting stronger but is still weak compared to years ago. Re-emerging manufacturing sector will occur and probably here in Massachusetts first. Massachusetts has seen manufacturing and jobs plummet but it will come back stronger.
7. We will see good news in the second half of '09. 2010 will be better for commercial real estate construction.

Glenn Verrette on the Boston Market
* The downtown Boston vacancy is 7.2% overall and that's healthy but absorption was only 150,000 s/f through 3Q '08 and that is flat. He expects negative absorption in '09.
* There were some '08 deals that showed some tenant growth and there are a few tenants now seeking over 50,000 s/f.
* Boston has a different economy from 15 years ago as we now have more diversified tenants such as consulting, money management, government and education. In the early 1990s it was all about the mutual fund industry.
* In terms of the sublet market, Boston peaked in 2002 with 2.6 million s/f of available sublet and has averaged over 2 million sf in the last few years. It will grow slightly but not as bad as 2000.
* There is 868,000 s/f of available sublet space in '08 so it is better.
* Verrette noted that there were 3 downtown projects that totaled 1.3 million s/f to be delivered in 2009, 2010 and 2011 and are 45% pre-leased. So we are in good shape with the on-coming space. In 1994-1999 period, Boston had 1.2 million s/f available so we have not had this much supply coming on board but we are in good shape with pre-leasing.
* There is another 9.9 million s/f in the planning stages that better serves as a "relief valve" for tenants at a later time and won't start without pre-leasing.
Verrette then gave his 2009 predictions:
1. Tenants are pausing on leasing space waiting for rents to decrease further. The average quoted rent is now $57.52 per s/f.
2. The second half of '09 will be a challenge as rents will decrease, concessions will rise and fringe core locations will suffer with longer lease-up.
3. Landlords have to re-examine their strategies on holding rents. They need to understand the cycle and stay ahead of the vacancies.
4. A final thought; things will get better and be optimistic but it will "not be so fine in '09"

Bob Richards on the Cambridge Market
Richards summarized that the last market correction was in '01 and now the tenant roster has really changed with new stronger credit tenants today.
1. It took from 4Q '01 to 3Q '05 to "burn off" the sublet space.
2. New development today has focused on more lab space. So the office supply has only grown by

4% from '01 to '09 and that is good. No overbuilding.
3. There is little sublet space in the 50-100,000 s/f range and that will drive new development.
4. Rent levels have dropped from $45 per s/f to $34-$36 per s/f in the last 30-60 days on direct space.
5. Suburban lab space are 66% of Cambridge rent costs and are attracting 79% of the greater Boston lab demand for life sciences.
6. Boston has more lab jobs than anywhere in the U.S. and that is good news.
Richards then gave his 2009 predictions:
1. 50% of R&D users have cash to last less than one year. They need to be replenished or could be the catalyst for more company mergers or acquisitions in '09 and '10. There are little choices if they seek 20,000 s/f or more and it will be interesting to see where they land.
2. Richards speculated the key for '09 by asking if venture capital money or IPO's grow?
3. What will happen to cash-strapped companies in '09?
4. And will we see spec lab development in the suburbs?

Alex Dauria of JLL gave the Suburban Market Stats:
Dauria summarized that there is a total of 83.8 million s/f in the suburbs. The suburbs are growing with more space but the 3Q absorption is negative at (338,817). The available 3Q overall vacancy is 20.3% and rising but direct space continues to fall to a 13.6% vacancy. Rents for Class A & B office is averaging $24.17 per s/f, gross and only slightly down from 2Q at $24.57 per s/f.
So how is the economy different? Dauria stated some points as follows:
* In 2001, tech drove the market and tenants starting up with 30,000 s/f needs had good financing. Then the downturn threw off sublet space.
* In 2008, the financial market is driving tenant needs. Getting pre-commitment from these tenants however is difficult. Landlords should have a jaundice eye with today's tenant demands. Tenants need flexibility in leases to expand or terminate.
* In 2001: Boston has the BRA for development approval and makes the supply side predictable. But in the suburbs, anyone can build at any time and now it's constrained either due to lack of financing or a need to pre-lease.
* Right now, it is a "watch and wait" attitude for tenants and landlords.
* In 2001 alone, we had 5.7 million s/f being built which is outstanding. From '05-'07 we had a total of 1.6 million s/f built.
Dauria then asked, "What is on the minds of tenants today?"
1. Visibility beyond 1Q and 2Q of '09. The executive suite is having a tough time figuring out where their business will be.
2. We have intellectual talent and it will drive tenant demand to gravitate and stay here. In '01 west coast companies drove the culture here with LEED and sustainability thinking and today's companies want the same.
3. Younger people are competing for jobs and interviewing if employers are located in "green" buildings.
4. We are a very global economy today. We telephone or communicate in countries we never knew of a few years ago.
So, what is the 2009 market going to be like? Dauria gave 3 predictions.
1.Rental rates will drop due to velocity. Landlords think that they need to drop their rents by $1 per

s/f to attract tenants and that really isn't going to matter.
2. The lab sector will stabilize the market but it is not the panacea.
3. People have 80% debt on buildings and equities are now wiped out. During tenant tours, landlords highlight, not the building features, but that they are well capitalized and are financially strong for TI build-out. It is a different approach in marketing.

Austin Smith on the Industrial Market
Smith concluded that he was quite bullish on industrial and the cost to do business is lower than other real estate sectors. With past downturns, there has been a flight to quality. In the past, large deals were in the $3.75 to $4.50 per s/f range but in '08 tenants are vying for functionality, value and not necessarily lower rent.
Today's high end industrial space has good high ceilings over 40 ft., dimensions that are not too deep (not over 300 ft. in depth from the front door), one dock per 5,000 s/f, etc. Functionality is now selling in the market.
The demand right now is about 2.1 million s/f which is a little off in the last few months. It should increase in '09. Demand is coming from companies with real growth. Strong demand seems to be from the food, liquor and construction service companies.
Class A rent is $5.50-$6.25 per s/f for 30 ft. clear, fundamentally sound buildings but down from the $6s. Class B space is in the $4.25-$5 per s/f range and that has decreased, while the Class C space has really dropped the most in the $3.50-$4.50 per s/f range.
Smith then gave his 2009 predictions:
1. Telco tenant needs are now in vogue from the late 1990s. Supply power needs currently are 200-300 watts per s/f and we do not have enough power since it was built at 75 watts per s/f.
2. Users want cheap transportation and that means "rail" service is in demand.
3. Land in distress or available with infrastructure in place will be cheap to buy for future development.

Frank Petz on the Debt and Capital Markets
Betz quoted Sam Zell as "keep it clean until 2013" for a comeback in the economy. Debt drove the capital markets up and cap rates down. And it is debt that is driving the financing markets down and cap rates up. Betz sees Bernanke continuing to lower interest rates. The Fed Funds are currently at 1.9% and that is good news. We will have flat but low interest rates.
The CMBS market is gone and the national banks have slowed down as they do not have the balance sheet capacity to lend. There is a lot of de-leveraging now occurring. People will take any debt now because it is difficult to find. Big deals can't secure financing. Any future debt will be on a recourse basis to get any good pricing. Betz sees 50-60% LTV at this point but the new source of financing has been from private equity and it is seeking yields. Foreign investors were the prime source for most of '08. The DCR is all about cash flow for everyone.
The 2009 Outlook
1. There will be less debt available
2. There will be more buying opportunities
3. Equity is great but on the sidelines but less money once values drop
4. Boston is better in balance with rental space supply and demand.
5. Asking prices will be re-priced for sales and there will be discounting. Once investors see

discounts, sales will increase.

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