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Real estate in recession - Discovering the bottom for office market rents

February 12, 2009 - Appraisal & Consulting

A typical real estate professional will experience four recessions in their career.

This article will address the three most current, and based on the analysis from these recessions, predict where the city of Boston office rents will end up in our current market decline.

In 1990, decline started in July; was sharp, sudden, and deep with the bottom hit in January 1991. Recovery did not begin for a long time. Remember, Wang Tower sold for $525,000 at auction February 15th, 1994. We were not in recovery until 1998.

Recovery was short in that we peaked December 2000. The market slowly declined beginning January 2001 and hit bottom December 2003. Recovery did not take place until January 2006 and we peaked two years later in January 2008.

Let's begin by review of market statistics during these time periods.

*Office Market Rents are from CBRE statistics.

Market Statistics:

As of January 1991, the city of Boston average asking rents had not moved. They averaged $31.41 per s/f. During that slow after crash period, they slipped 31.4% to $21.54/Sf. Rents hit bottom in mid-1993.

In December 2000 average asking office rents peaked at $59.65 per s/f and declined 44.2% to $33.29 per s/f as of December 2003. Rents remained flat for two years between $33.92 per s/f and $34.38 per s/f.

Recovery began in January 2006 and average city of Boston asking office rents peaked in January 2008 at $56.31 per s/f.

Of significance is that gross rents did not exceed the level of 7 years earlier. This is despite inflation of over 20% during the time period.

The only reason for increase in value was capitalization rate compression brought about by reduction in Federal Fund rates; reducing capitalization rates.

To summarize:

* After 1991-1993: A 5-year recovery period was required.
* After 2001-2003: A 2-year recovery period was required.
* In both instances, the recovery itself was a short 2 years before contraction again began.
* Office rent declines were 31.4% and 44.2% during respective recessionary periods.

How does 1991-2008 history apply to the present?

An Anti-Gravity Period

Recession began in January 2008, yet the market refused to accept its presence. Real estate professionals could talk until they were "blue in the face" but those listening just did not believe. Average city of Boston asking rents held flat at $56.00Â± per s/f.

Sudden shocks were required to awaken the industry:

* The forced sale of Merrill Lynch to Bank of America - September 14th, 2008.
* Lehman Brothers failure - September 15th, 2008.
* $700 billion TARP - October 3rd, 2008.

As of January 2009, city of Boston office rents were averaging $52.82 per s/f for a 6% decline in six months. This is 12% per year in terms of rate of decline. If the same rate of decline continues, and I see no reason to the contrary, average asking office rents in the city of Boston would become:

*January 2010 - $46.48 per s/f

*January 2011- $40.90 per s/f

Conclusion

One only has to study market rents from the bottom of prior recessions:

*Mid 1993 $21.54 per s/f

*December 2003 $33.29 per s/f

*January 2011 $40.90 per s/f (Projected)

What this study tells me is that at market bottoms, there is a pattern for rents bottoming some $10 per s/f higher than the prior bottom.

Clearly, we are now through the anti-gravity period of 2008. How we walk through 2009 and 2010 is directly dependent on the revitalization of our banking system and re-creation of a secondary market source to replace CMBS. These are tall orders by themselves.

Credit availability and financing are two cornerstones in our industry. It is their uncertainty that creates clouds. No matter how much we stimulate our economy, if it has no substance and does not lead to a 21st Century Industrial Revolution, the current 24 month to 36 month recession projection will seem short.

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