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North suburban: Security software and defense industries looking to lease and buy

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It is well documented that nobody has ever before seen economic conditions like what we are experiencing currently. The constant drumbeat of poor earnings, bank failures, a capsized housing market, a free falling stock market and staggering layoffs has made us numb. What is less clear is how and when these factors will play out in the commercial real estate market.

We do know about the investment market it has for all intents and purposes stopped. Financing has become scarce and exacerbated by drastically conservative underwriting criteria. Many buildings are underwater and face refinancing hurdles over the next few years. So far in 2009, there were two investment sales in all of Massachusetts totaling $60 million. Conversely, 1Q 2006 saw 33 transaction totaling $1 billion; 1Q 2007 had 67 transactions at $2 billion; while 1Q 2008 was the last quarter before the sales hit the brakes with 33 transactions at $1.8 billion. Volume then fell apart with the remaining year seeing only $2.2 billion after 2007 saw $14 billion in sales.

Owner occupied activity has slowed considerably as well for both sales and leases of industrial and flex space. Sale prices have been reduced only slightly while lease rates have been reduced dramatically. Looking specifically at the northern suburbs, there have been few sales with the largest, and one of the only, being the $46 million sale of 10 Centennial Dr. (a 330,753 s/f 2-story class A office/flex building) to Children's Hospital in Peabody. Leasing activity has been more active but in much smaller transactions averaging 10,000 s/f. Renewals are the most active of leasing activity with the renewal rates sometimes 25-30% less than the last years rent. This is an indication that landlords' priority is to maintain occupancy, sometimes at almost any cost. Two examples of declining industrial lease rates are renewals that went from $7.25 to $4.75 NNN while another went from $4.75 to $3.10 NNN.

Office lease rates have dropped as well with some landlords willing to lead the market down. Edgewater Office Park peaked in the mid $30s and is now low to mid $20s. North Shore rates have gone from low $20s to high teens. Vacancy rates had hovered around 17% through 2007-2008 remain close to 16%, with signs that that number is rising. The only new construction is 138 Conant St. in Beverly, a 65,000 s/f first class office building built on spec that has seen a lot of activity. A major reason is the flight to quality as this building is the nicest building available in the area and very competitively priced.

While not much of this is particularly encouraging, there is activity and it goes beyond renewals. There are industries doing better than most security software, defense, medical device, some consumer goods and these companies have been looking to both buy and lease. This activity will generate volume that will be at best 65% of what the real estate community is accustomed to experiencing in a typical year. In addition, there is a very real sense that even though there are serious firms looking, the confidence that this activity will translate into deals is the lowest many have experienced in a long time.

We can only hope that we return to the market we knew; and that it happens sooner than later. Banks need to lend, jobs need to be created, and the housing market needs to absorb the inventory. This will all take time and then more time is necessary to affect our individual markets.

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