

MARKET HIGHLIGHT

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In 2011, the Boston commercial real estate market has shown some signs of life, with most movement attributed to small and medium-sized companies. 2012 appears to promise much of the same, with the greatest demand coming from the 5,000- to 25,000-square-foot users who are growing. Meanwhile, larger tenants are still active in the market but taking less space, effectively offsetting what smaller companies are growing into.

The largest users in the Financial District are law offices and financial services firms, and the downsizing in these industries has resulted in increased vacancies. In addition, major businesses have become more efficient users of office space (fewer administrative employees per attorney, more “hoteling,” equal sized offices for all, etc.) and more conservative in growth projections, resulting in less space demand for companies when they do grow.



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Over the last 12 to 18 months, Boston’s top commercial real estate markets have shifted. The Back Bay area has started to run away from the Financial District as the preferred submarket in Boston. Its appeal is shared between employers and employees alike, with a “24/7” neighborhood feel, new retail shops and restaurants and easy access from the Pike for commuters. These qualities have helped the Back Bay achieve higher rents and lower vacancy rates that have dropped into the single digits. (While vacancy rates have dropped slightly in the Financial District since last year, they are still hovering around 15 to 17 percent.)

2011 also saw the Seaport District rise in popularity, a trend we expect to see continue in 2012. Similar to the Back Bay, the vitality of Liberty Wharf has created a groundswell of interest in the entire Seaport District. Deals like the Vertex Pharmaceuticals move are also serving as a catalyst in the area. Vertex is

leaving Cambridge and building 1.1 million square feet in the Seaport. This is a big transition that will likely attract more development with it. In fact, a law firm recently decided to follow Vertex and leave Cambridge for the Seaport.

Of course, the seasons play a role in Boston's appeal. During the summer months, the walk across Fort Point Channel is far more bearable than between November and April, giving the Seaport an extra boost of popularity that won't play as much of a factor when the snow flies.

Current rental rates are trending from the \$50s to mid-\$70s in the Back Bay. In the B market, it's closer to \$30s and \$40s. The better space in the Financial District is paying up to the high \$50s, while low-rise spaces in Class A properties in the Financial District are priced from the high \$30s to mid-\$40s. For B market space in the Financial District, the range is from the high \$20s to low \$30s. The Seaport has now been dubbed the "Innovation District" and is commanding \$30 to \$40 per square foot.

While fundamentals have stabilized, the values established by recent sales are higher than one would expect. If you look at vacancy and rental rates, you have to question whether the current values are in line with the fundamentals. Do the rent growth model and assumptions about the property justify the price? The prices at which these buildings are selling is higher than the fundamentals will tell you they're worth. For example, TIAA-CREF recently purchased 33 Arch Street for \$365.8 million (more than \$600 per square foot). 53 State Street is on the market and is expected to command a similarly high price on the heels of the 33 Arch Street deal.

We have come a long way in the last two years, but if the stock market is any indication, we still have a long way to go. During the recent downturn, the industry expected a flood of sublease space that never materialized. This is due to the hard lessons of the boom and bust in the early 2000s that caused many companies to remain conservative with space needs in today's turbulent economy. Now that the cautious approach has been validated, I expect the conservative growth trend to continue in 2012. Firms that are growing aren't going overboard, and larger firms that are not growing will give some space back. There will continue to be excess supply, and developer-driven construction projects will remain scarce.