

# METRO BOSTON INDUSTRIAL MARKET

## Second Quarter 2001 Report

### Demand Growth Takes a Breather

After several years of very strong demand for industrial space by distributors, retailers, and manufacturing firms, net absorption fell to negative two million square feet during the first half of 2001. A tech sector-led decline in demand for manufacturing space was accompanied by continuing downsizing of regional discount retailing operations and a freeing-up of related warehouse space.

As a result, asking net rents remained flat in most submarkets, with a few properties rolling back expectations a bit. Asking net rents continued to climb, albeit at a much slower pace, in the Boston Central Core submarket (City of Boston and nearby suburbs) and a few other submarkets. This impressive stance in the face of a temporary slump in demand reflects the continuing upgrading of portions of industrial properties to office/R&D space uses.

As the chart below illustrates, new supply has remained limited in the



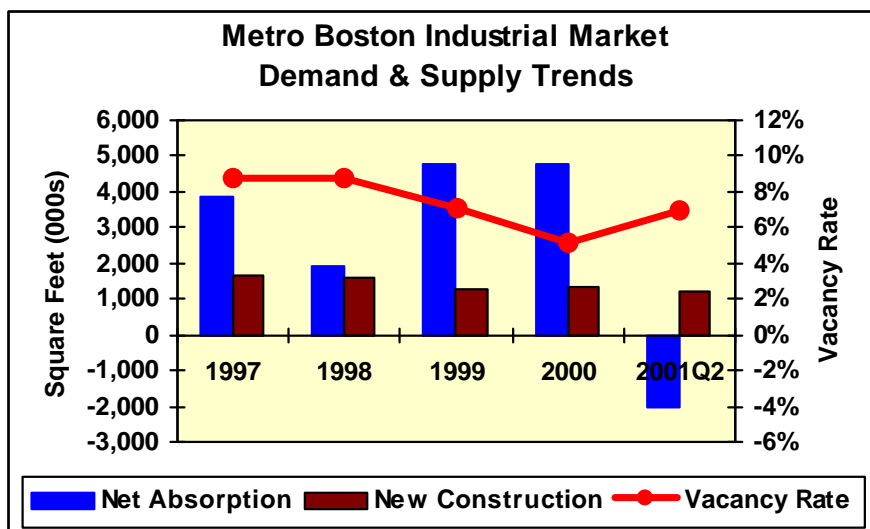
*With steel frame construction providing 30' high ceilings and 40' by 50' bays, Lincoln Property Co.'s speculatively-built 109 & 111 Constitution Boulevard in Franklin were leased quickly and sold this year to RREEF.*

1990s. Most new construction of industrial space has been of the build-to-suit variety. That conservative approach was relaxed last year with great results so far. Lincoln Property Co. successfully built and leased 384,000 SF at 109 & 111 Constitution Blvd. in Franklin and then sold

the new distribution facilities this year to RREEF for \$25,000,000.

Several new warehouse properties, either recently completed or scheduled for completion later this year, have yet to be leased. These state-of-the-art, high-cube distribution facilities are in very strategic locations along Route 128 or Interstate 495 and should lease up well as the year progresses. Asking rents tend to be very reasonable and little, if any, backsliding of rents is expected.

Where the temporary slump in demand is being felt most strongly is in less convenient locations and for older properties. These facilities can no longer count on a tight market to provide eager tenants. Achievable rents for these properties are likely to still be well above previous rent levels, but the jump owners enjoy is likely to be less than was the case a year ago.



# Boston Central Core Evolves with Industry Demand

There is nothing like a central location for many industrial firms and distribution companies in Metro Boston. When the regional economy was based on manufactures and international trade, proximity to the harbor was essential to reduce transportation costs. With the advent of air travel and shipping, proximity to Logan International Airport replaced the harbor as the attraction for some industries. In the brave new world of the New Economy and biotechnology, proximity to scientists, skilled technicians, research expertise, and world-class universities is attracting tomorrow's promising industries to the Boston Central Core submarket.

With the arrival and rapid expansion of new industries requiring a greater mix of attractive office and R&D/lab/manufacturing spaces, existing industrial properties are increasing being renovated for higher rent-paying mixed uses. Whereas zoning in some districts will not allow for an industrial property to be leveled and replaced with an office building, it



*Is this the future of industrial space in the Boston Central Core submarket? The former Simplex industrial tract in Cambridge, reborn two decades ago as University Park at M.I.T., is an urban oasis rapidly infilling with apartments, stores, and state-of-the-art office/R&D buildings housing biotech companies.*

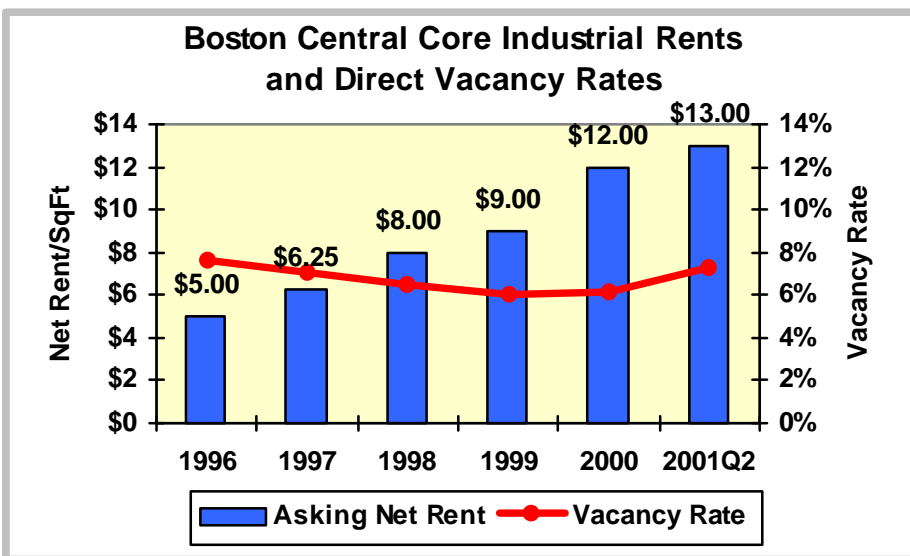
may be possible to upgrade portions of the property for office and/or R&D use. As a result, market rents for industrial space in the Boston Central Core submarket continue to rise as the nature of its use changes.

Also feeling the effects of this broader land use trend are districts that are still home to old economy manufacturing firms and distribution companies. Market rents may not be jumping to "New

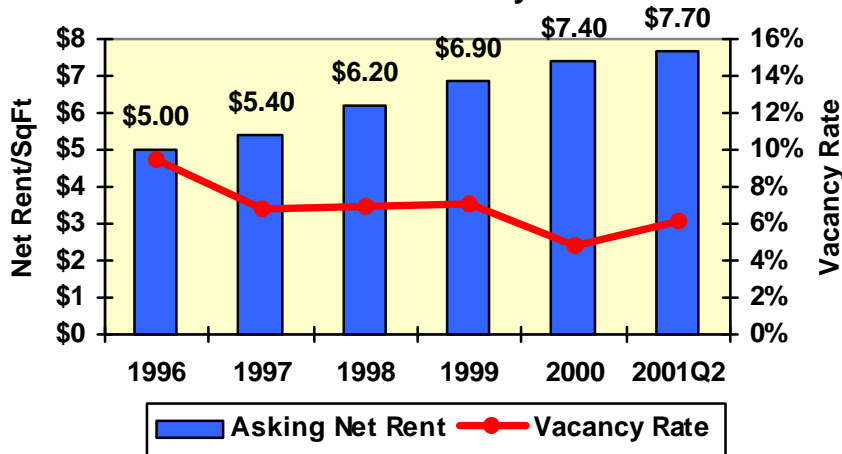
Economy" levels, but rents continue to climb at a pace greater than elsewhere in the metropolitan level. As old economy firms get squeezed out of the areas undergoing a change in use, they have to compete for a smaller remaining inventory of industrial properties.

Very little new industrial space is being constructed in the Boston Central Core submarket (biotech facilities tend to fall under office space or R&D space). This limits the amount of positive net absorption that can occur to vacant existing space. In recent years the amount of vacant space has gradually declined. So far this year, the direction has been reversed with moderate negative net absorption.

Asking rents continued to climb during the first half of 2001 reflecting the underlying long-term trend of land use change, but the rate of increase slowed considerably. Until the national economy starts to pick up momentum, rent growth is likely to be increasingly sluggish.



### Route 128 Corridor Industrial Rents and Direct Vacancy Rates



To the south, the Route 128 Southwest and Route 128 South submarkets experienced a significant amount of negative net absorption, nearly 900,000 sq.ft. combined.

Asking rents remained flat in Route 128 South, especially in the Quincy/Braintree area. This is where an older stock of industrial properties is located. In contrast, asking rents are noticeably higher near major highways in adjacent communities to the south, reflecting a more functional stock of manufacturing and distribution space.

Asking rents managed to increase in Route 128 Southwest, an increasingly popular alternative to congested Route 128 West. Strategically located between Boston, the western suburbs, and Providence, RI, the Route 128 Southwest submarket is well-positioned for long-term growth in rents and values. With a high 10.9% vacancy rate at present, however, the near-term outlook is for asking rents to stabilize at present levels.

## Route 128 Corridor Remains Tight

Industrial submarkets along the north to west arc of the Route 128 Corridor have experienced minimal negative net absorption this year, attesting to their popularity with manufacturing, R&D, and distribution firms. With very little new construction completed during the first half of 2001, vacancy rates remained low and asking rents have held steady or increased in these submarkets.

One new warehouse property is 42 Industrial Way, Building 2 in Wilmington, a 72,000 sq. ft. distribution facility leased to retailer Crate & Barrel. With a new I-93 interchange boosting the accessibility of the industrial/R&D/office district that straddles Woburn, Wilmington, and Reading just north of Route 128, properties such as 42 Industrial Way are well positioned for long-term growth in value. Even biotech firms such as ArQule have been attracted to this resurgent area.

The Route 128 Northwest and Route 128 West submarkets, in particular, have benefited from the strength of office and R&D demand in recent

years which has resulted in minimal new construction of industrial space and several conversions to office/R&D use (with more in the pipeline). Asking net rents have increased about 40% in five years, from \$5.75 per sq.ft. to \$8.00 per sq.ft. in Route 128 West, arguably the most strategically located warehouse/distribution submarket in Metropolitan Boston.



**42 Industrial Way, Building 2, in Wilmington is a new 24' ceiling height distribution facility that is leased to Crate & Barrel. The location is easily reached from two interchanges along Interstate 93.**

# Interstate 495 Loop Holds Steady

With negative net absorption of nearly 600,000 sq.ft. during the first half of 2001, industrial submarkets along the outer Interstate 495 Loop have cooled off some, but not much. Overall asking rents increased only slightly from \$6.90 per sq.ft. at the end of last year to \$7.00 per sq.ft. as of mid-year 2001. The 8.2% vacancy rate for the I-495 Loop is up significantly from 5.8% only six months ago, but is not much higher than the level 18 months ago and remains well below the double digit levels that characterized most of the 1990s.

The largest industrial submarket along the outer loop is the I-495 North submarket. Net absorption was a positive 342,000 sq.ft. during the first half of 2001. Asking net rents are among the lowest in Metropolitan Boston, primarily reflecting a considerable number of large, old industrial properties in or near Lawrence.

Positive net absorption was also the case in the adjacent I-495 Northwest submarket, at 195,000 sq.ft. The va-

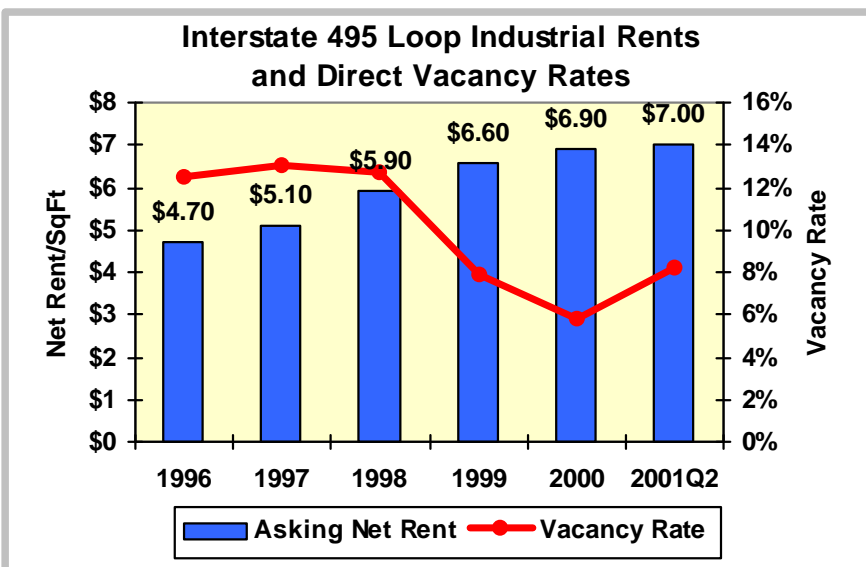


*Tambone Corporation recently completed 14 Aegean Drive in Methuen Industrial Center, just south of the New Hampshire state line. This 232,950 square foot distribution facility has a 30' ceiling height and excellent interstate highway access.*

cancy in this submarket is very low at present, at 3% (versus 21% in 1996). With continued expansion of the high-tech sector along the Route 3 Northwest Corridor well up into southern New Hampshire, the I-495 Northwest submarket remains a pivotal location for many firms.

The second largest outer loop submarket, I-495 West, experienced negative

net absorption of nearly 390,000 sq. ft. during the first half of 2001. With the vacancy rate now at 10.1%, asking rents remained flat at an average of \$7.00 per sq.ft. NNN. The strategic central location of this submarket in eastern New England accounts for its popularity with distributors and its proximity to high-tech employees and relatively affordable housing for new recruits attracts industrial firms.



Perhaps the most strategically-located warehouse/distribution submarket in eastern New England, however, is the I-495 Southwest submarket. With outstanding highway access to Boston, its suburbs, Providence, and Worcester, the I-495 Southwest submarket commands some of the highest rents along the outer loop. Negative net absorption of 439,000 sq.ft. kept asking rents stable at \$7.25 per sq.ft.

Quickly catching up in popularity is the adjacent I-495 South submarket. Skilled industrial workers, affordable housing, and proximity to Cape Cod makes this an attractive choice.

## Near-Term Market Outlook

With only 1,050,000 square feet of industrial space under construction and scheduled for completion during the second half of this year, the supply side of the market will not be a source of trouble. Unfortunately, demand for industrial space is expected to remain weak in the near term. Numerous layoffs have been already

announced and their impact will also be felt during the second half.

More disappointing are decisions to close plants in the region, some very new, and to halt construction on new facilities (e.g., Corning's new Nashua, NH manufacturing facility). With these trends in mind, our forecast of manufacturing employment as of the end of 2001 is 288,000, down another 4,700 employees from May 2001 levels. Wholesale trade employment is expected to remain

about the same. By the end of 2001, total employment in these two industry sectors (which serve as good proxies for industrial demand) is expected to be nearly 10,000 workers less than at the start of the year. This translates into negative net absorption of 3,400,000 sq.ft. for the year, about 70% of last year's positive net absorption. The overall vacancy rate for Metro Boston is expected to increase to 8.2% and asking net rents should stabilize near \$8.25 per sq.ft.

Industrial Market Indicators	Dec-96	Dec-97	Dec-98	Dec-99	Dec-00	May-01	Forecast Dec-01
	<b>Metro Boston *</b>						
Manufacturing Employment (000s)	297.6	305.4	296.1	294.7	298.9	292.7	288
Wholesale Trade Employment (000s)	130.8	132.7	134.6	135.0	136.8	137.3	137
<b>Industrial Employment Total</b>	<b>428.4</b>	<b>438.1</b>	<b>430.7</b>	<b>429.7</b>	<b>435.7</b>	<b>430.0</b>	<b>425.0</b>
<b>Space Demand (Sq.Ft.) Per Employee **</b>							
Manufacturing Sector	252	252	252	252	252	252	252
Wholesale Trade Sector	745	750	770	805	820	815	815
<b>Employment-Based Demand (Sq.Ft.)</b>	<b>172,441</b>	<b>176,486</b>	<b>178,259</b>	<b>182,939</b>	<b>187,499</b>	<b>185,660</b>	<b>184,231</b>
<b>Actual Occupied Space (Sq.Ft.)</b>	<b>172,351</b>	<b>176,185</b>	<b>178,103</b>	<b>182,842</b>	<b>187,623</b>	<b>185,592</b>	<b>184,200</b>
<b>Vacancy Rate</b>	<b>10.3%</b>	<b>8.8%</b>	<b>8.8%</b>	<b>7.1%</b>	<b>5.2%</b>	<b>7.0%</b>	<b>8.2%</b>
<b>Asking Net Rent (Per Sq.Ft.)</b>	<b>\$4.90</b>	<b>\$5.40</b>	<b>\$6.40</b>	<b>\$7.10</b>	<b>\$8.00</b>	<b>\$8.30</b>	<b>\$8.25</b>

\* Metro Boston employment numbers include the Boston, Brockton, Lawrence, and Lowell PMSAs.

\*\* Space demand parameters are calibrated at the metro level to fit observed relationship between employment and actual occupied space. The parameters should be interpreted merely as estimators, not as marginal or average space consumption measures.

This report was researched and authored by Daniel P. Guenther, SrVP / Director of Research, and Amy Szeto, Market Analyst, in collaboration with NAI Hunneman Commercial Company industrial brokers, property managers, and project consultants as well as using property-level data provided by CoStar Realty Information Group. The views and opinions expressed are solely those of the authors and are not necessarily those of NAI Hunneman Commercial Company nor its employees. For additional copies of this report, please call your NAI Hunneman industrial broker or Amy Szeto at (617) 457-3400. If you have questions regarding the data or analysis contained in this report, please call Dan Guenther at (617) 457-3369 or send an e-mail to [dan\\_guenther@naihunneman.com](mailto:dan_guenther@naihunneman.com).

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## Conditions as of 2001Q2

Industrial Submarket	Space Inventory	Vacant Space	Vacancy Rate	Average Net Rent
<b>Boston Central Core</b>	<b>32,400,878</b>	<b>2,374,984</b>	<b>7.3%</b>	<b>\$13.00</b>
Route 128 North	30,567,191	1,821,805	6.0%	\$8.00
Route 128 Northwest	6,145,925	192,367	3.1%	\$7.50
Route 128 West	14,454,974	396,066	2.7%	\$8.00
Route 128 Southwest	15,371,644	1,680,121	10.9%	\$8.00
Route 128 South	28,253,122	1,655,633	5.9%	\$7.00
<b>Route 128 Loop</b>	<b>94,792,856</b>	<b>5,745,992</b>	<b>6.1%</b>	<b>\$7.70</b>
I-495 North	19,461,176	1,858,542	9.6%	\$6.75
I-495 Northwest	11,345,430	335,825	3.0%	\$6.75
I-495 West	16,200,481	1,639,489	10.1%	\$7.00
I-495 Southwest	13,731,048	976,278	7.1%	\$7.25
I-495 South	11,692,991	1,101,480	9.4%	\$7.25
<b>I-495 Loop</b>	<b>72,431,126</b>	<b>5,911,613</b>	<b>8.2%</b>	<b>\$7.00</b>
<b>Metropolitan Boston</b>	<b>199,624,860</b>	<b>14,032,589</b>	<b>7.0%</b>	<b>\$8.30</b>

Source: Co-Star, NAI Hunneman.

Prepared: June 28, 2001

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