METRO BOSTON REAL ESTATE MARKET UPDATE

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Biotech, health care and defense provide some relief

In the suburbs and Cambridge, Q1 vacancy rates for office space also increased but, in some cases, at more modest rates than previous quarters. On Rte. 128, Class A vacancy was estimated at 17.2%, up slightly from 16.6% at the end of 2001. On the other hand, in the Rte. 495 submarket, Class A vacancies climbed to 18.3% in March of 2002 from 14.6% in December 2001. These submarkets thrived on venture capital backed technology enterprises, so the fall from economic grace has been predictably hard. So far this year, these markets continue to be tenant-driven with landlords offering concessions such as larger tenant improvement allowances, flexible terms, stepped rental rates, furniture, fixtures and equipment.

Demand from biotechnology, healthcare, and security sectors is the one bright spot for these submarkets. Cambridge Class A office vacancy rates did rise

**Vacancy rates rise, but more slowly**

While national economic indicators point to the promise of recovery, commercial real estate in metropolitan Boston continues to cope with weak demand and increased vacancies. On an aggregate level, the number of office deals done in the region, as tracked by CoStar, shows an upward spike in the first quarter of 2002. Total square footage of done deals also shows a slight upward trend. But other data reminds us of how far away the Halcyon days of economic “summer” may really be.

**Vacancy rates rise, but more slowly**

Vacancies increased in almost all submarkets for both Class A and Class B space during the first quarter of 2002. Downtown Boston showed a relatively large increase, registering 9.4% for Class A space, up from 8.5% the previous quarter. Vacancy for Class B space remained unchanged at 9.7%. For most of last year, the Downtown market was somewhat insulated from this recession by a relatively healthy Research Park in late 2001 when such companies as State Street and Fidelity placed large amounts of sublease space on the market.

**Early 2002 Trends: a Glimmer of Hope?**

NAI Hunneman brokers recognized at CBA awards banquet

Several NAI Hunneman brokers were recognized at the Commercial Brokers Association awards banquet held on March 21 at the Four Seasons Hotel in Boston. Executive Vice President and Principal Cathy Minnery was honored as one of the top five producers in industrial brokerage in the Greater Boston market. Cathy’s 484,000 square foot United Liquids deal was also in contention for Industrial Deal of the Year. Cathy and David Ross, Senior Vice President, were recognized as members of the CBA’s Multi-Million Dollar Club at the Platinum level for sales in excess of $25 million. Executive Vice President and Principal Steve James achieved Gold Club level with sales of $15 to $25 million. Senior Vice President Robert Tito, and Vice Presidents Chris Curley, Carl Christie, Tom Arken and Jim Grady were recognized as members of the Silver Club with sales of $5 million to $15 million.
Declining demand in the technology industry has been somewhat buffered by the strong demand in the biotech, security and healthcare sectors. These sectors should be able to absorb some of the space made available by the technology firms.

Speculative construction will be limited as there is no current financing on any speculative properties in the suburbs. Essentially, no new construction projects will break ground in 2002 without prior tenant commitment. Current office supply in the suburbs should remain steady for the next two years.

Suburban rents could fall another 5% to 10% in the first half of 2002 before stabilizing in the second-half of the year. Recovery will depend heavily on strong tenant demand and absorption of sublease space, both of which are currently weak. Speculative construction is almost non-existent, and transaction activity is expected to pick up in the latter half of 2002 as many high-tech and financial services companies will need to expand again as the economy recovers.

The market has essentially remained stagnant, but stable. Most of the submarkets are experiencing low supply and soft demand. However, space has recently started to open up, especially in the suburbs.

The industrial inventory in the Boston and Inner Suburban area is mainly comprised of owner-occupied buildings; thus, there has been little activity lately as tenants are staying put due to the uncertainty in the economy. Supply has remained tight, especially on a sale basis. Rental rates have slightly decreased to $6.25 p.s.f. from $6.75 p.s.f. triple net for prime space and $5.25 p.s.f. from $5.75 p.s.f. for secondary space. Sale prices still remain $60 p.s.f. to $65 p.s.f. for prime space and $40 p.s.f. to $45 p.s.f. for secondary buildings.

The space that is available is small with most transactions taking place in the 15,000 to 20,000 square foot range. Rents range from $5.00 p.s.f. to $6.50 p.s.f.

The New Hampshire submarket also remains flat with very little vacant space. Rents are being quoted at $5.50 p.s.f. to $5.75 p.s.f. but landlords may only get $4.75 p.s.f. to $5.00 p.s.f. Unlike the past, there is now very little differential in labor supply and costs between New Hampshire and Massachusetts, so there is less incentive for companies to relocate to New Hampshire.

For the overall Boston industrial market, construction has been driven by owner-user and build-to-suits, ensuring that supply does not surpass demand. Demand for space has been moderate, keeping speculative construction limited in all industrial product types. There is currently only 500,000 square feet under construction.

The market costs remain higher than national averages, making small affordable parcels for 20,000 – 50,000 s.f. hard to find.

Due to stable demand, the industrial market should experience an increase in activity by late 2002. Rental rates should remain steady in 2002.

Manufacturing may be the only industrial product type that could face a decrease in demand and rental rates. Industrial leases will focus more on smaller properties and shorter lease terms.

Despite the recent economic slump, Boston is still regarded as one of the strongest multi-family markets in the nation. Boston is very tight as demand continues to outpace supply as home prices reach the $300,000 range. The multi-family vacancy rate remains around 2%.

Rental rates slipped downward for one year until approximately the start of 2002 but remain relatively high compared to other markets.

Supply has been extremely constrained due to the high cost barriers to entry for new construction. It is difficult to build market rate housing because it is hard to make the financing work. High cost of land and affordable housing requirements limit multi-family development in the area.

Boston should maintain its standing as one of the strongest markets in the nation as rents continue to be among the highest in the U.S., and vacancy rates should remain below 5%.

Investment Properties Market in 2002

Going-in capitalization rates (the ratio of net operating income to sale price) on office properties trended upward through 2002 as the economy slowed and market rents gradually declined.

Falling interest rates, however, kept valuations fairly generous in 2001. The option of refinancing rather than selling properties provided owners with negotiating leverage.

With office building sales activity sluggish in Metro Boston in 2002, it is difficult to accurately assess the full impact of 9/11 on property values. It is likely that cap rates will trend up 25 bp (0.25%) to 50 bp (0.5%) during the second quarter of 2002 and stabilize once economic growth returns later in the year.