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The U Word

Slowly But Surely, Uncertainty Taints Local CRE Market *Why Being Better Off Locally Than Nationally Still May Not Be Good Enough*

By **Jim Cronin**
Banker & Tradesman Staff Writer

While they don't like to admit it, "uncertainty" is a word on the tips of the tongues of many commercial real estate brokers and investors these days.

On the national level, there's uncertainty in the stock market and the economic policies being touted by the federal government. Locally, economists have expressed concerns over slow and uncertain near-term and future job growth, regardless of rosy recent media reports on the state outpacing the rest of the nation in job creation.

That uncertainty in employment prospects has made many firms hesitant to pull the trigger on hiring new employees or expanding, industry leaders say. And while there have been some big-ticket sales of core assets this year, investors have become more cautious on really large deals.

Storm Clouds Gathering

Take One Lincoln Street in Boston, for example.

Cushman & Wakefield started marketing the 36-story State Street Financial Center earlier this year with an asking price of about \$1.15 billion. It is owned by New York-based Fortis Properties, which bought the asset from American Financial Realty Trust for \$889 million in early 2007.

Ed Maher of Cushman's capital markets group declined to comment for the article. But according to several industry insiders, brokers and investors alike, that deal has been essentially stalled, at least temporarily, by volatility in the global financial markets.



Boston's One Lincoln Street, also known as the State Street Financial center, has been on the market since last year. But few investors are willing to pay the asking price given economic uncertainty, even though it has a stable tenant roster of one.

“That would be something, at this point, for sovereign funds or a behemoth pension fund,” said one industry executive. “But deals of that size, with the European crisis rattling Wall Street, just aren’t going to happen right now. A lot of people don’t want to make a billion dollar bet on Boston unless you’re someone like a Boston Properties. It will be more of a financial mechanism treated like a bond because it’s fully leased to [State Street], a credit-rated tenant, rather than a real estate investment.”

And while the commonwealth’s employment rate is holding pretty steady at just above 7 percent, comfortably below the national level of 9 percent, various economic factors at play have given many companies pause – even in our biotech- and life sciences-rich enclave.

“I think there are clearly storm clouds above us that are of real concern, and you can’t escape it,” said William Motley, managing director for Jones Lang LaSalle in Boston. “The way it translates as I see it, day in and day, out is a reluctance to make commitments related to new hires and taking new space and growth.”

And that doesn’t bode well for rent growth. For rents to grow, vacancy rates need to shrink. But there are large chunks of space still empty in the Financial District’s towers that need to be gobbled up before rents can really grow much more than they already have, Motley told Banker & Tradesman.

Silver Lining?

That doesn’t all mean there isn’t a silver lining to the darkness close at hand. There are many smaller companies choosing to relocate to Boston from Cambridge and the ’burbs, especially high-tech media and other technology firms that find relatively low rents downtown attractive.

Heartland Robotics recently roughly tripled its space requirement when it moved into 18,400 square feet at Tower Point along Wormwood Street in Boston’s Fort Point neighborhood. Woburn-based Lois Paul & Partners, a strategic communications firm for high-tech companies, is moving to One Beacon St. in mid-September, taking about 18,000 square feet.

Those are the kinds of transactions that Andrew Maher, managing director for Equity Office Properties Trust in Boston, said prove critics of the Boston market wrong. It helps that Equity has been getting rents in the low-\$70s per square-foot in the iconic Hancock Tower and 222 Berkeley and 500 Boylston streets, sister buildings that share a lobby and are 100 percent occupied, as Banker & Tradesman has reported.

As reasons that rents have nowhere to go but up, Maher pointed to what he called a strong Massachusetts unemployment rate, a supply of highly educated workers in the local business community and the fact that prices are already at the bottom. And with no new office construction not pre-leased besides the South Boston Vertex project, the laws of supply and demand will kick in sometime.

“All the major brokerage houses ... are [telling tenants] to lock in the deals you can get now,” Maher offered. “We have people trading up their spaces, up market, up location. They’re thinking, ‘It’s at the bottom, so let’s get the best we can for our money now.’”

Growth, Or Contraction?

In fact, some think rents will edge up another 5 percent in the next couple of years. The total Financial District market of 62 million square feet is averaging rents of \$39.27 a foot, with typical low-rise, Class B properties probably fetching between \$27 and \$33 per foot on a five-year deal, said Brian Smallman, vice president for Lincoln Property Co. And with vacancy in the Back Bay at “arguably” 4 percent, that market is bound to push out some tenants to be scooped up by Financial District landlords, Smallman said.

But others say that leasing activity has slowed considerably. A recent Jones Lang LaSalle third quarter office report said that despite one of the strongest economic recoveries in the country and job growth exceeding the national rate, Greater Boston experienced its first quarter of negative net absorption in a year and a half.

JLL attributed the lack of growth to economic uncertainty and a seasonal slowdown.

“Over the last couple of months things have started to retract again, and activity has started to slow a bit,” said **Joe Sciolla**, managing principal for **CresaPartners**. “Without job increases at a rapid rate and some positive absorption, I don’t see rents moving much, other than maybe in the Back Bay. I think a lot of companies are going to stall without any certainty of where the government’s going, and I think that well into 2012, rents will stay flat.”