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By Garry Holmes, SIOR, and Craig Johnston, R.W. Holmes Realty Tenant activity begins to pick up: Is 2004 the turn around year for the Boston office market?

After watching the Boston Suburban office market struggle through 10 consecutive quarters of negative absorption we are now seeing a glimmer of hope as tenant activity is picking up. For the first time in 2 1/2 years we witnessed positive quarterly absorption of just over 800,000 s/f for the fourth quarter of 2003. The Suburban office market totals 76.5 million s/f with a combined vacancy rate of 28.5% through the end of 2003.

Other positive trends in the market place are companies starting to hire a few people which will lead to possible expansion. One of the key factors we have been missing in this recovery is job growth, although in the late third and fourth quarter a historic rise in gross domestic product (which is a measure of the value of all goods and services) grew at an 8.2% annualized rate in the third quarter.

It was the best showing for quarterly growth in the U.S. economy since the third quarter of 1984, according to the U.S. Department of Commerce. Furthermore, approximately two-thirds of the firms tracked by the Standard & Poor's 500 Stock Index topped



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earnings expectation, which should lay the groundwork for a long term recovery.

As we start to see signs of economic prosperity some of the different sectors that are fueling this recovery are Health Care, Biotech, and Technology. These growth sectors are also being developed from top talent leaving larger companies and starting new businesses, which are now run much more conservatively. These start ups are taking less space, demanding higher tenant improvements, lower security deposits, furniture, and free rent from landlords.

Some of these companies are absorbing the limited number of "quality" low priced sublease space, which should ease the downward pressure on direct rental rates within the next 12 months as this trend continues. Given the vast amount of sublease space, it should be noted that most of these options now have less

than two years of term remaining and are not true "plug and play" opportunities.

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We do not expect a huge rush on demand and with rental rates not expected to stabilize until the end of 2004 landlords will continue to focus on tenant retention, making themselves personally available for showings, offering broker incentives to show their properties, and paying higher than normal brokerage fees. Landlords are starting to reevaluate the pricing of their office space with an asking rate of "negotiable". What does this mean? If a tenant is in the Waltham market for 10,000 s/f of office space they have approximately 126 options in 48 buildings to choose from. Many of these properties with an asking rate of "negotiable" are not even making the tour list. As a result, it is critical that landlords establish a competitive rental rate.

Even though we are in a slow leasing recovery campaign the appetite for high

quality grade investment product is still strong with pent up demand from local investors to Wall Street Capital. Driving this trend is increased competition among debt capital sources who are pricing long term fix rate mortgages at near historic lows. Investors now more than ever believe that real estate in the New England area is a good long term play. Furthermore, there is tremendous interest from companies that are looking to purchase real estate for their own use.

In summary, we are seeing less space returned to the market and tenants are making decisions about relocating and signing longer term leases. It is only a matter of time before we see stabilization in the Boston Suburban office market as a result of improved job growth, stronger corporate earnings, and the continued upward momentum in the stock market which shall lead us to a recovery.

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