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Layoffs Create Glut of Space in Boston Area

By SUSAN DIESENHOUSE

BOSTON, Feb. 4 — The pressures weakening the commercial property market here were illustrated by the largest lease negotiated last year.

PricewaterhouseCoopers, the accounting concern, agreed to take 300,000 square feet at a prime downtown tower, 125 High Street. But starting in October, it will vacate 400,000 square feet in three nearby buildings. This leaves the office market with 100,000 square feet more space available than was occupied, a phenomenon called net negative ab sorption. This comes as 13 buildings, with a total of 3.7 million square feet of space, were completed in 2002 or are under construction.

This deal makes sense for the tenant, which recently sold parts of the company and trimmed staff to about 2,150 from 2,600, a 17 percent cut in its Boston jobs. The new quarters are walking distance from most clients and offer extensive services for rent in the range of $40 a square foot annually, compared with the mid-$80's for comparable space at the market peak two years ago.

"We're very happy to lock in these rents for the next 12 years," said Michael J. Costello, the PricewaterhouseCoopers managing partner here.

But for the Boston area's commercial real estate market, this deal adds to the combination of space returning to the market, historic high vacancies and falling rents that have created the fastest, most severe market contraction on record, according to industry professionals.

In the region's 146-million-square-foot office market, the availability of space to lease or sublease was 22.3 percent by the end of the fourth quarter of 2002 versus 5.5 percent at the end of 2000, according to figures from Spaulding & Slye Colliers, a real estate services concern based in Boston and Washington. In the suburbs, office availability is the highest on record, 27 percent, versus 6.4 percent in 2000, and has climbed above 30 percent in some submarkets.

In the prime suburban location at the intersection of Route 128 and the Massachusetts Turnpike, 27 percent of the office space and 43.7 percent of the research and development space is available. In the strongest urban markets, Boston and Cambridge, the office availability is 15.9 percent and 22.1 percent, respectively, versus 4.5 percent and 4.8 percent in 2000. In Cambridge, a haven for high technology and life science companies, availability for research and development space is 26.5 percent, up from zero in 2000. Across the region, annual office asking rents now average about $28 a square foot, compared with $46 two years ago.

More startling still, 2002 ended with the eighth consecutive quarter of net negative absorption, leaving the region with a net decline of three million square feet in occupancy during the year. That added to the total stock of available office space, now 32.6 million square feet, according to Spaulding & Slye Colliers.

The rising vacancies come amid layoffs by an array of businesses. By December, unemployment in Boston had doubled to 5.1 percent from 2.4 percent in December 2000, according to Elliot Winer, chief economist of the state Department of Employment and Training.

"We're in a real estate recession," said William F. McCall, president of McCall & Almy, real estate advisers. "Unlike any other downturn since the 1940's, this wasn't caused by an excess of office supply but by contracting demand among companies that leased space anticipating growth and have had layoffs instead."

During the wrenching recession of the early 1990's, the region was awash with property foreclosures and bank failures, and unemployment hit 9.6 percent. But the availability rate rose only to 16.9 percent over all, 16.2 percent in Boston, 12.6 percent in Cambridge and 18.5 percent in the suburbs. Furthermore, 1991 was the only year with net negative absorption.

Now after eight negative quarters here, there is about 25 million square feet of available Class A and B offices in the Boston region, said Mr. McCall, who predicts another 2.5 million square feet of net negative absorption in 2003.

To return to a healthy commercial property market, the region should have 10 million to 13 million square feet available. "Since the market normally absorbs about three million square feet a year, and by 2004 there will be about 14 million square feet to absorb, we won't see a real rebound until 2008 or 2009," Mr. McCall said.

Raymond G. Torto, managing director of Torto Wheaton Research, a unit of CB Richard Ellis, has a similar outlook. "The economic sectors that were engines of growth in the 1990's — law, finance, business services — are announcing layoffs and imploding," he said.

Statewide in 2002, financial services lost about 3,000 jobs; in 1993, the first year of the recovery, it gained 3,200 jobs. Also last year, jobs fell 6 percent in high-technology manufacturing and 7.9 percent in business services. Unfortunately, the growth sectors — health care at 1.4 percent and private education at 2.9 percent — lease only about 2 percent of Boston's offices. The contracting financial, law and professional service firms lease about 68 percent.

In stark contrast to the bleak rental market, investors leery of the securities markets and lured by low interest rates are buying owner-occupied Boston office buildings at high prices and at an accelerating pace, said Jeffrey B. Swartz, principal director of capital markets for Spaulding & Slye Colliers. Of the owner-occupied buildings valued at more than $10 million that he tracks, three million square feet were sold last year in transactions valued at $425 million versus 1.5 million square feet and $175 million in 2001. To catch this wave, John Hancock is marketing its entire Boston portfolio, valued about $1 billion.

But there can be a downside to such corporate sales. "The sellers will consolidate space, eliminate jobs or move them elsewhere," said Stephen D. Lynch, managing director of Insignia/ESG here. For instance, on Dec. 26, MetLife sold a 560,000-square-foot building at 501 Boylston Street in the Back Bay section that it had entirely occupied for $122 million to Beacon Capital Partners. Starting in 2004, MetLife will lease only 200,000 square feet for five years, a relatively short term.

In the suburbs, such sales since 2000 by hard-hit high-technology and telecommunications companies like Lucent Technologies and 3Com have been followed by job cuts, said William Barrack, a principal at Spaulding & Slye Colliers. Last month the military contractor Raytheon, which has cut 942 jobs since 2000, sold the 360,000-square-foot Lexington, Mass., headquarters it had occupied since 1961 to move to a new 150,000-square-foot headquarters in Waltham, Mass.

Especially in Boston, "investors are missing the real estate fundamentals," Mr. McCall said.

"The rents don't support the prices they're paying," he said. "Without demand, rents will fall further, and most companies have enough space they already lease but don't use to grow 10 percent without new leases.

Over all, rents are still sliding. In Boston, Fidelity Investments, a unit of FMR and a major owner and tenant, is subleasing for $17.50 a square foot space it had rented in the mid-$40's. In suburban Billerica, Bull HN Information Systems is subleasing 70,000 square feet for zero rent, asking only for operating expenses, estimated at $8 a square foot, according to Peter Stavropulos, a company spokesman.

But the Boston market has a bright side. Some longtime tenants are renewing leases at strong rents rather than bargain hunting, noted Mr. Lynch of Insignia.

In Cambridge last year, the life sciences company Novartis leased 800,000 square feet of lab space to relocate its world research headquarters here, an investment of approximately $1 billion.

"That's a great statement of faith in the long-term fundamentals of this economy," said Joseph W. Haley, a real estate specialist with the law firm of Goodwin Procter who describes himself as an optimist. "But real estate grows when business grows and business is depressed, state revenues are depressed and major firms are still cutting jobs. The best hope for real over the next year or two is stabilization."