

BRIEF | Creating Resilience

Boston Occupiers Settling Only for the Best

A pandemic-accelerated “flight to quality” among office occupiers has rewarded the owners of Boston’s best buildings with healthy levels of leasing and steady positive absorption. Buildings with ‘Class A’ and ‘Class A+’ designations represent 64% of Boston’s commercial office market and dominate market activity.

Leasing in Class A and A+ buildings totals 3.37 million sq. ft. thus far in 2022, already exceeding the five-year annual average set before the pandemic (2015-2019). By comparison, leasing in Class B/C space is 74% below the pre-pandemic annual average as commodity buildings struggle to compete with the city’s sizable and growing inventory of premium office space.

The city of Boston’s substantial inventory of under-construction office space totals 5.2 million sq. ft. Sixty-three percent of this space has already been spoken for by occupiers, including nearly 80% of the space slated to be delivered in the next two years.

Share of YTD Leasing in Class A/A+ Buildings

92%

Class A Vacancy Rate

9.6%

Pandemic-Era Improvement in Class A Asking Rents

+4%

FIGURE 01: Top-Quality Office Space Claimed a Record 92% of Leasing in 2022
Square Footage and Percent of Leasing in Class A+, A, B, and C Buildings: 2015-2022 YTD

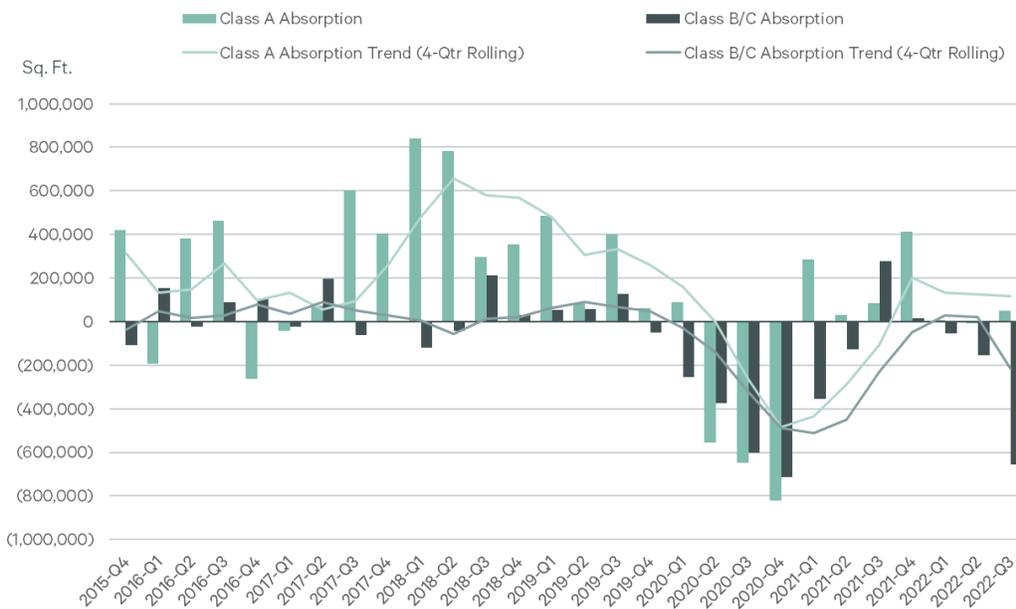


Source: CBRE Research, Q3 2022.

Resilient leasing in Boston’s top office properties helped the Class A absorption rate return to positive territory in late 2021, even as Class B/C space continued to struggle with negative absorption. Between Q1 2021 – when leasing began to recover in earnest – and Q3 2022, Class A space averaged monthly positive absorption of 123,000 sq. ft. while B/C space averaged monthly negative absorption of 151,000 sq. ft.

Even as leasing slowed and economic headwinds increased, Class A office properties have notched modest net positive absorption in 2022, contributing to a Class A vacancy rate of 9.6% compared to 15.6% for Class B/C at the close of Q3.

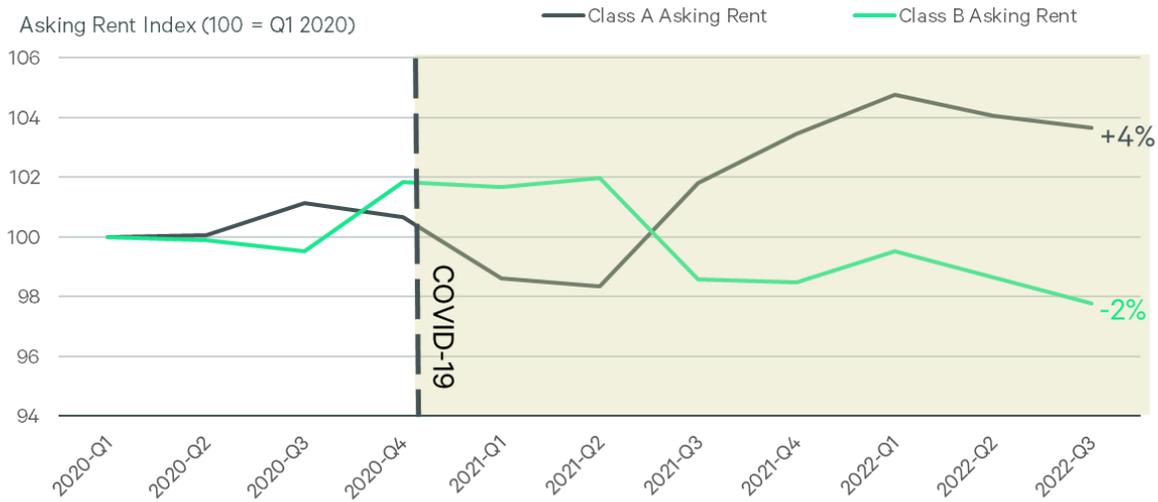
FIGURE 02: Class A Absorption Stable as Class B/C Falters
 Quarterly Absorption for Class A and Class B/C Office and 4-Quarter Rolling Averages



Source: CBRE Research, Q3 2022.

Boston’s Class A properties, buoyed by an active leasing market, raised their asking rents through the pandemic era. With occupancy tight for the city’s stock of premium office space and much of the pipeline pre-leased, Class A asking rents remain 4% above the level where they stood in Q1 2020 at \$75.44. Meanwhile, Class B/C buildings have dropped asking rents slightly below their pre-pandemic level to \$55.16.

FIGURE 03: Class A Asking Rents Grow Amid Market Turmoil While Class B/C Falter
 Asking Rents Indexed to the Q1 2020 Level



Source: CBRE Research, Q3 2022.

A Decision Point for Office Owners

Owners of Class B and C buildings are confronting a rapidly changing office market. Hybrid and remote work adoption have resulted in diminished demand with higher quality office space commanding nearly all deal volume in Boston.

Boston’s older office properties face the near certainty of significant capital expenditure in the years to come, whether it be for rehabilitation into a Class A property, making the necessary upgrades to comply with Boston’s increasingly stringent Building Emissions Reduction and Disclosure Ordinance (BERDO), or embarking on a residential conversion.

With a volatile debt market, rising interest rates and uncertainty regarding return-to-office plans, the recent introduction of a zero net carbon building zoning initiative from the Mayor’s Office draws into question the economic feasibility of securing financing for new development. Residential conversions pose a greater challenge with Gensler finding that only 10 of 84 properties examined in downtown Boston had the right balance of location, cost, and vacancy to support a conversion.

Regardless of the challenges facing office developers and owners, the drivers of demand for Class A+ office space are clear. The properties tend to use less energy and boast higher Energy Star scores, reducing exposure to BERDO fines for carbon emission overages, in addition to attracting blue chip tenants and environmentally conscious corporations, while supporting premium asking rents in an office market facing an assortment of headwinds.

As the pandemic subsides and companies put into action a variety of hybrid work options, Class A/A+ properties are poised to rebound quickly, supported by demand on the part of occupiers and investors for office space that is modern, tenant-friendly, and sustainable.

Contacts

Suzanne Duca

Director of Research
New England
suzanne.duca@cbre.com

Connor Channell

Field Research Manager
New England
connor.channell@cbre.com

Ben Wurtzel

Senior Research Analyst
Northeast
ben.wurtzel@cbre.com

Jake Smith

Field Research Analyst
New England
jake.smith@cbre.com

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