Attractive Leasing Environment Sparked Tenant Upgrades in '04

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Last year was a great year to be a commercial landlord in greater Boston – if you were looking to sell a well-leased building, or you were able to attract life sciences companies to your properties. More generally speaking, it was an even better year to be a tenant looking for space, as tenants in the market found an ample supply of potential options and very aggressive landlords who were faced with a challenging leasing environment and strong sales opportunities.

It is counterintuitive that a difficult leasing market would coincide with a strong sales market, but it did. The two seemingly divergent patterns do have some overlap, as it was typically the exceptionally well-leased properties that were selling. This in turn increased the competition for the companies that were out looking to lease space since solid leases help increase a building's value.

In contrast to the tough leasing environment, commercial sales in 2004 were well above past years' amounts both in total dollars and dollars per square foot, as Joe Clements noted in a recent year-end wrap-up in *Banker and Tradesman*. Most experts agree that a combination of historically low interest rates, potential returns that exceed stock market returns, an abundance of capital in competition for properties, limited supply of trophy properties for sale, and the existing barriers to entry to the market forced sales prices higher, even though rents were flat or trending slightly downward.

In addition to lower rent, those tenants who were in the right place to be either a "marquee" tenant, the final piece to fill a building, or in the midst of lease renewal found that some landlords preparing to sell were especially willing to negotiate liberally with certain other deal points. Free rent was one of these, since once the rent-free period passed, the building's monthly income was higher than if the same discount were applied evenly over the term. Higher monthly income helps justify a higher sales price.

Additionally, tenant improvement allowances were more lucrative for some tenants when the landlord was planning to sell a building. In those instances, if the landlord expected a quick return on the investment, the landlord was more willing to offer a significant tenant improvement allowance.

The continued surplus of both direct and sublease space, and competitive rental rates meant tenants in the market had more options. The trend in 2004 of tenants pursuing those options and some making a "flight to quality" has been well documented. The causes have been less evident, but the "flights" were due, in part, to a reversal from the conditions of 1999 and 2000, when there were fewer options for tenants. As occupancy rates escalated in the late 1990's, so did rental rates. Many firms paid more for their space to remain in place, simply because it was still less expensive than moving, and their choices were constrained due to limited availability.

As five-year leases signed in 1999 began to expire in 2004, tenants had more options to trade up to. Lower rates and more supply also allowed some firms that signed leases in 2000 - 2002 to take advantage of "blend and extend" programs and reduce their rental rates by making longer-term commitments. Cummings Properties, like many suburban landlords, has proactively worked with clients to extend leases early, and also seen some client firms upgrade their space for the same or less rent than they paid in 1999. According to Steve Drohosky, Cummings' director of Operations, one recent client expanded by 30% and had a 1% reduction in total rent expense.

As another example, Vaisala, an international measurement systems and equipment manufacturer recently relocated to one of Cummings Properties' Woburn buildings after spending several years in a nearby property. Vaisala was able to lease a brand new, custom-built facility for less than they had paid for space in 1999. Company officials reported a significant upgrade in space.

Another trend that helped fill buildings in 2004 was the continued growth in the life sciences sector. While the pace slowed somewhat from 2003, life sciences reflected one of the more active market segments. Those firms were able to take advantage of the same factors afforded all clients, though they were typically driven more by scientific advances than five-year lease renewal cycles.

Several, like U.S. Genomics, Biotrove and BioProcessors, who collectively occupy nearly 100,000 square feet, all expanded in 2004 with Cummings Properties. They were all in the midst of growth, and seized the chance to take advantage of market conditions. While each of the firms had specific business and scientific reasons for expanding when they did, they all decided to remain in the suburbs for similar reasons, such as ease of commute, lower rental expenses, available expansion space and free parking.

When the market was overheated several years ago, they found great lab space for less in the suburbs. When the market cooled, they were able to very economically expand into more space. The money they saved was then available to invest in their science.

Many firms migrated to suburban locations when space in Cambridge was difficult to find. While more space is available in the city than several years ago, comparable space is typically half the cost in the suburbs. As an example, Drohosky noted that more than 100 life science firms now occupy more than 1.4 million square feet of space with Cummings Properties, and that 13 of the largest biotech employers in Massachusetts are in its buildings.

In summary, 2004 was a great year to be a tenant looking for space.