As remote work takes hold, Boston's office market starts to wobble

Vacancy rates are at near-two-decade highs, and there are growing concerns that defaults and devaluations could ripple through the economy

By **Catherine Carlock** Globe Staff, Updated April 15, 2023, 4:14 p.m.

As companies shift more permanently to hybrid and remote work, many are paring back their office needs, which is having a variety of impacts on downtown Boston's commercial real estate market. MICHAEL DWYER/ASSOCIATED PRESS

or more than three years, people have been playing "wait and see" with regards to how the COVID-19 pandemic and remote work policies would impact Boston's office market.

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Now, we’re seeing. And the picture, while not as bad as in some cities, isn’t very pretty.

Office vacancy across Boston, Cambridge, and the suburbs has risen, with the regional vacancy rate hitting 19.1 percent at the start of this year, its highest in nearly two decades, according to real estate firm JLL. Companies such as Verizon, Cengage, and Duck Creek Technologies are putting blocks of underutilized space up for sublease. And even corporate tenants who are looking for new office space are looking for less of it, as hybrid work policies have become routine.

“Generally they’re saying: ‘I don’t need as much space as I have,’” said Matt Daniels, who leads JLL’s New England brokerage team.

Those impacts are rippling through the city’s office market. Just in the first three months of the year, companies in Greater Boston vacated more than 1.5 million square feet of office space — nearly a full Hancock Tower’s worth. And experts forecast more pain is ahead.

The squeeze is not being felt equally. Newer, Class A towers — think One Congress and One Post Office Square — are still drawing blue-chip tenants, while older Class B and C space increasingly looks less attractive. Of the 560,000 square feet in leases signed in Boston's central business district in the first quarter, nearly 95 percent were in Class A buildings, according to research from real estate firm CBRE.

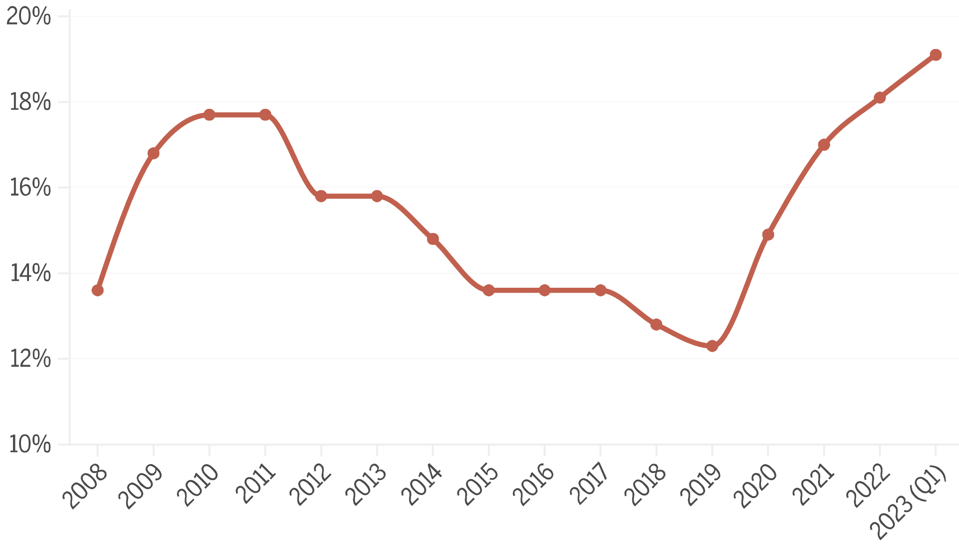
“A lot of tenants are saying: ‘if we want our employees to come back, even in a hybrid capacity, we want them to come to the best space available, the best in class, the best amenities,’” said Liz Berthelette, research director at brokerage firm Newmark.

And while this trend has been underway downtown for some time, these pressures are building in the suburbs too, where there are now about 4.5 million square feet of sublease space — space which a company has under lease but is offering to other tenants — on the market, Colliers data show. Many suburban companies have not required employees to return to the office, and as a result, a growing number are looking to downsize their footprint within their existing buildings, Newmark research states.

The slowdown is also increasingly spreading into the once-lucrative business of buying and selling buildings, which has been sluggish since the start of COVID. In the first quarter of this year, less than $900 million worth of office and lab buildings changed hands in Greater Boston, the smallest quarterly amount in a decade, Newmark research shows.

Vacancies on the rise

More than 19 percent of office space in Greater Boston sat empty in the first three months of 2023, the highest rate in at least 15 years.



Source: JLL

A Flourish chart

And some buildings that are going up for sale face a tough market, buffeted by both lower demand and higher interest rates, which make crucial financing more expensive.

An arm of private equity giant Blackstone bought 179 Lincoln St., a five-story, brick-and-beam office building near South Station, in January 2020 for just under $156 million. Now they're putting it back up for sale, and while there's no formal list price, industry sources tell the Globe they expect it to fetch between $80 million and $90 million.

A spokesperson said Blackstone has long been paring back its office holdings — which today comprise just 2 percent of Blackstone's portfolio — and investing in "sectors with exceptionally strong fundamentals including industrial, rental housing, hotels, lab office, and data centers."

Another looming risk: loan defaults. One Back Bay office building — 116 Huntington Ave. — was part of a seven-building portfolio owned by Columbia Property Trust, which defaulted on its $1.7 billion loan in February, according to multiple media reports. Industry-watchers warn that loans on many more buildings will come due by the end of this year, and that selling or refinancing could be harder amid regional banking challenges, ballooning vacancy, and sharp interest rate hikes.

Amid struggles in Boston's office market, 179 Lincoln Street, in the Leather District, is on the market for a price far below what it sold for a little more than three years ago. BUSINESS WIRE VIA AP

All of this could have big implications for Boston's tax base, which has surged in the past two decades on the strength of city's hot commercial real estate market.

Ashley Groffenberger, the city's chief financial officer, this week said she's keeping a close eye on the office and commercial real estate market. There's good reason for that. Some 72.4 percent of the city's $4.28 billion in budgeted revenue is slated to come from property taxes. Groffenberger touted the strength of Boston's property-tax base this week at a breakfast unveiling the city's budget, where she noted that Boston has maintained a triple-A bond rating from two credit agencies — an important marker indicating the city's overall financial strength, and one that allows Boston to borrow at a lower interest rates than it would with a lesser grade.

"The property tax structure that we have here in Boston and in Massachusetts is stable in such a way that we do not anticipate that we will see revenues fall off a cliff in any dramatic fashion," Groffenberger told reporters last week. For companies that found downtown too expensive pre-COVID, the downturn may offer something of an opportunity, she said: "We're hopeful that, if there is any softening in the commercial space, it will allow for additional employers to come into the city who normally wouldn't be able to afford to come into that space."

And there have been some bright spots. The Lego Group in January announced it would relocate its headquarters to Boston from Enfield, Conn., while law firm Goulston & Storrs plans to lease 100,000 square feet at One Post Office Square next year. Portal Innovations, a biotech venture capital firm, leased 22,000 square feet of wet lab and office space at the former Globe headquarters in Dorchester — now called Southline Boston — with plans to expand to 58,000 square feet by next year.

“There are new companies that are still looking to Boston as a place to come to take advantage of the talent that we have here,” said Jeffrey Myers, research director at Colliers. “Those are things that also keep the market moving forward.”

Indeed, Boston’s talented workforce has long been the bedrock of the city’s economic success, said JLL’s Daniels. Officials at both the city and state levels are focused on maintaining that competitive edge.

“In a downturn, people tend to return to where it works, and where they can get great employees,” Daniels said. “While we’re certainly having a different time than we had two or three years ago, and it’s not all rainbows and lollipops here, there’s reason to be optimistic.”

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