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Boston Properties Isn't Waiting for Recovery To Expand Bet on US Office Market

One of Nation's Largest Landlords Plans to Focus in 2024 on Investment, Leasing

Boston Properties bought its joint venture partner's interest in the office building at 901 New York Ave. NW in Washington, D.C. (CoStar)

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CoStar News

January 31, 2024 | 5:12 P.M.

Some of its investment partners may be scrambling to find the exit, but Boston Properties is willing to play the long game in terms of strengthening its stake in the national office market.

The Boston-based developer is looking beyond the depressed leasing environment and uncertain economic outlook to attract new tenants, expand its development pipeline and take advantage of what it expects to be a year full of "significant investment opportunities" that CEO Owen Thomas said will bolster the company's office portfolio through any short-term turmoil.

"Our overriding goal this year is to leverage our competitive advantages," he told analysts Wednesday on a call to discuss fourth-quarter earnings. "Many office owners are facing existential risks given the slow leasing and limited secured financing in the market. Many institutional owners want to diversify away from the office class, but the key advantage for [Boston Properties] is our commitment to the office asset class as many of our competitors disinvest in the sector."

Boston Properties, which touts itself as the largest publicly traded U.S. developer and office owner, reported more than 1.5 million square feet of leases across its portfolio in the quarter, substantially higher than the 1.1 million square feet reported over the same time last year despite an accelerating shift among tenants to sign deals for smaller spaces.

The developer inked about 4.2 million square feet of leases through all of 2023 with an average term of a little more than eight years, according to the earnings report.

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Despite what Thomas described as "withering negative market sentiment," the CEO said leasing activity across the office landlord's portfolio exceeded the company's initial expectations and has helped provide the stability it needs to pursue some of its capital deployment plans. Boston Properties at the start of this year bought out its joint venture partner at 901 New York Ave. NW in Washington, D.C., for $10 million, and other undisclosed partners have looked to do the same. Shortly after closing, the company extended law firm and anchor tenant Finnegan Henderson Farabow Garrett & Dunner's 214,000-square-foot lease on a deal that runs through 2042.

Moving forward, the firm is keeping a close eye on similar opportunities, echoing an offensive strategy Boston Properties adopted through the Great Recession to acquire premier office properties at steep discounts.

Playing Offense

To be clear, the developer is swimming upstream against a current of tenants shedding their spaces, widespread layoffs across myriad industries and a financial outlook that appears unlikely to be headed for a full recovery any time soon.

"The United States economy may not enter a technical recession, but no one should assume that the soft landing will result in a pickup in office-using employment," Boston Properties President Doug Linde told investors on the call. "Operating in this macro environment, it's hard to envision any dramatic pickup in office-market leasing for 2024, and maintaining our portfolio occupancy in the current environment is an accomplishment in its own right."

In other words, "2024 will not be the year for space absorption," Linde said of companies taking on more space than they offload.

Those sentiments underscore a challenged office environment as stakeholders such as Boston Properties contend with a sector that has experienced a shaky and uneven recovery since the pandemic. The crisis has unleashed seismic shifts that are expected to have dramatic, long-term effects on the office market, helping to drive vacancy rates beyond an unprecedented peak of 13.7%, according to CoStar data.

The developer's office portfolio is concentrated in high-end markets including New York, Boston, San Francisco and Seattle in addition to Washington, all of which have faced some of the steepest declines in leasing activity as well as an even slower return among employees getting back to physical workspaces. Its development pipeline, which currently includes 10 projects, spans roughly 2.7 million square feet and is valued at roughly $2.4 billion.

While the company was able to surpass its earlier leasing projections, Linde said average deal size has shrunk considerably in recent years. Late last year it finalized a lease extension agreement with tech giant Snap for space in Santa Monica Business Park, a Southern California office campus in which it bought out a stake formerly owned by the Canada Pension Plan. The 467,000-square-foot deal, however, was only one of two leases the landlord signed last year that exceeded 130,000 square feet.

"We can't require clients to lease more space, but we can meet their workplace needs," Linde said. "All demand is good demand if it translates into absorption."

The company is tempering its lease expectations for the year ahead and forecasting it can sign about 3.5 million square feet of deals before the end of 2024.

Boston Properties reported revenue rose to nearly $829 million for the final quarter of 2023, up 5% from the same time in 2022. It reported net income of roughly $120 million, a healthy boost from the $112 million loss it reported in the prior three-month period last year.