MOVING TOWARD THE "NEW NORMAL" New England and the effects of the recession

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When Boston's Hancock Tower, New England's tallest building, went into foreclosure earlier this year and sold at auction for about half its previous purchase price, a chill ran through the area's real estate community.

"The foreclosure of such an iconic building created a perception in New England that commercial real estate had really declined in value," said John Rattigan, a partner in the real estate development group at law firm DLA Piper. "And it's entirely true."

From what Rattigan sees, virtually all real estate development not already underway by 2008 is stalled, not only in Boston, but throughout New England.

"New England states are all behaving in pretty much the same manner," Rattigan said. "The liquidity crisis and the lack of demand for new spaces are both problems that are quite evident."

RECENT DEVELOPMENTS

The current recession has indeed taken its toll on New England. Job growth in the region is predicted to be flat over the next five years, with only New Hampshire (at 0.6 percent) expected to have any positive growth.

Meanwhile, landlords in New England are scrambling to maintain occupancy while tenants demand increasing concessions and lower rates. And lenders remain reluctant to free up credit to get new developments off the ground.

However, several major projects already in the pipeline before the recession hit continue to be developed. CB Richard Ellis, AMO®, lists several real estate projects in New England that have sufficient financing to continue until completion.

In the Boston area, One Marina Park Drive at Fan Pier and Two Financial Center are on track for completion in 2009. And the Commonwealth of Massachusetts relocated three state agencies, totaling about 138,000 square feet, from South Station to 1000 Washington Street.

In Connecticut, Hartford continues office expansion with one of its largest employers, Travelers, which leased 70,000 square feet at State House Square, One Financial Plaza and Connecticut River Plaza. CB Richard Ellis also reports Virtus Investments' 31,000-square-foot lease at 100 Pearl Street and UBS's 31,000-square-foot expansion at One State Street.

Meanwhile, conversion of a 70,000-square-foot freezer facility in Salem, N.H., to retail use is scheduled for completion before the end of 2009. Also in Salem, a 31,500-square-foot industrial facility at 12 Manor Parkway has been converted into office space.

Renaissance Downtowns, a real estate development firm specializing in downtown revitalization projects, recently signed a development agreement for a project in Nashua, N.H. Renaissance's president and CEO, Donald Monti, said he has similar projects in 16 additional cities throughout the Northeast.

"This is a paradigm-shifting recession," Monti said. "The days of 'you build it and they will come' are over. We feel very strongly that the new business model will be centered on revitalizing our suburban downtowns, and New England is a perfect region to focus these efforts."

DEALS AND STEALS

Although finding new acquisitions in the region can be tough, there is still a lot of activity going on in the real estate market, according to Todd Goldberg, a partner with law firm Bernkopf Goodman LLP.

"It's not that there's no money out there, but you have to know where to look," Goldberg said.

A lot of property owners in the region believe that commercial real estate will continue to fall in value, so they are waiting for prices to hit rock bottom before making any moves, Goldberg said.

"There's a lot of pent-up money on the side because no acquisitions are going on," he said.

But New England's local and regional lenders are still lending, particularly for refinancing deals.

"You see a lot of 'blend and extend' deals where tenants are asking for reductions in fees and property owners are choosing to reduce their rent for a short period of time in exchange for extending the lease terms," Goldberg said.

THE BOTTOM LINE

Not only are lenders trying to get tenants to extend lease terms, they are also trying to avoid taking foreclosed properties into inventory. These two pressing needs on the part of lenders, however, are creating opportunities for experienced property managers able to deal with delicate tenant situations.

"The characteristics people look for in property managers include not only an ability to keep the books, but also being skilled at dealing with defaults and tenants who want to shrink their terms," said Rattigan of DLA Piper.

According to Rattigan, tenants in this environment will come to property managers saying they need to shrink their leasing terms in order for their business to succeed. A good property manager has to evaluate that claim, see if it is true and deal creatively with the tenant.

There's pain all across the industry as far as property managers are concerned, Rattigan added. There are fewer leasing deals being done today, and because the property manager often gets paid as a percentage of revenue, the high vacancies in the region are hurting the bottom line.

On the positive side, those property managers with reputations of being skilled at the relationship aspect of the business continue to be viewed by property owners as valuable assets, particularly as lease extensions and term renegotiations become the primary focus for many owners.

"Some property managers are viewed as being better at dealing with tenant situations than others," Rattigan said. "Clearly, that's a skill in high demand these days." ■

TWO FINANCIAL CENTER IS A MAJOR PROJECT IN BOSTON, ON TRACK FOR COMPLETION IN 2009.

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