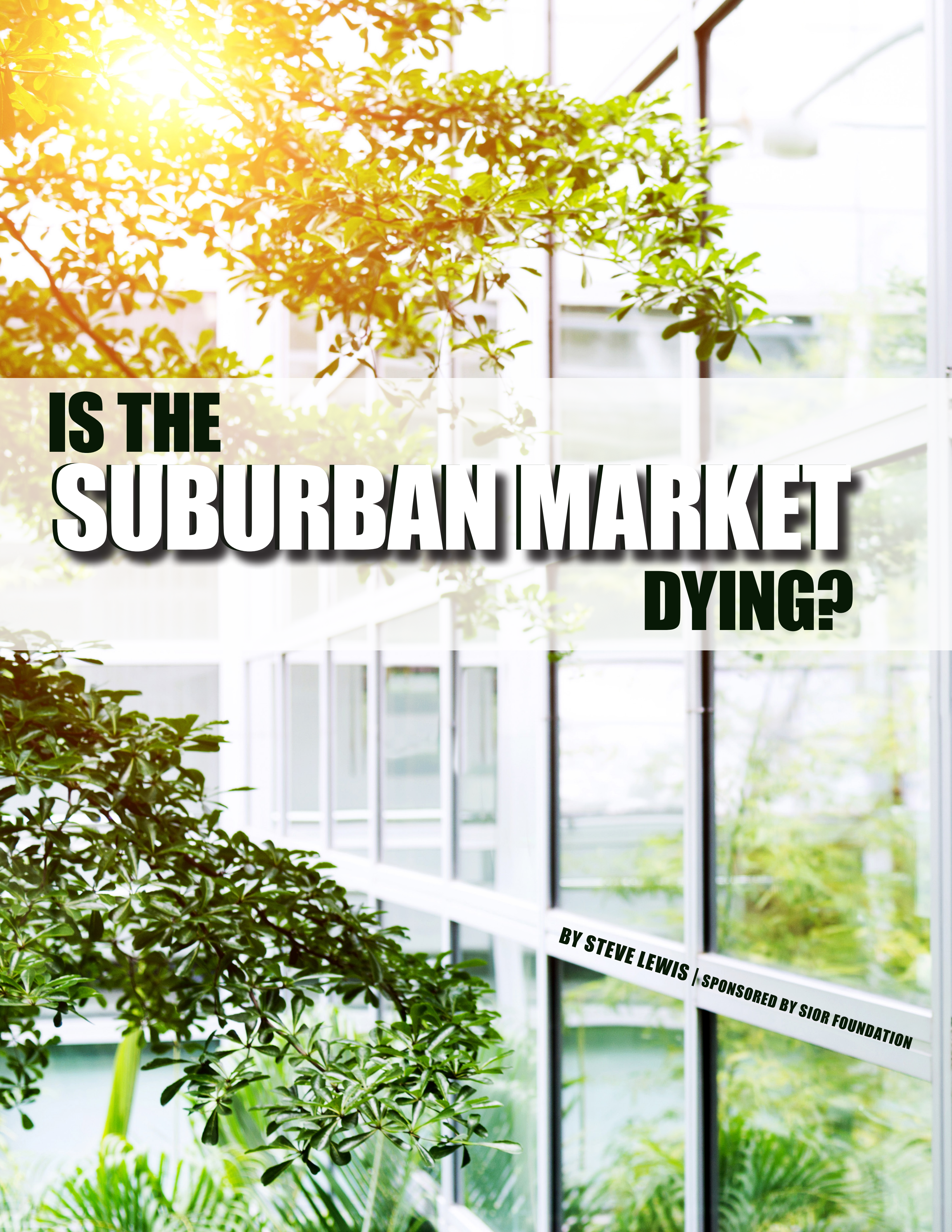

IS THE SUBURBAN MARKET DYING?

BY STEVE LEWIS | SPONSORED BY SIOR FOUNDATION

“The era of the suburban office parks is coming to an end,”

crows the *New York Times*. “Some of the office parks that are really outlying may just end up going back to seed,” Tim Evans, director of research for the smart-growth advocate New Jersey Future tells the *New Jersey Monthly* “It’s likely this problem is not going away, and may even get worse,” predicts the American Conservative. Pacific Standard reports that 14 percent to 22 percent of national suburban office inventory “has been assessed to be obsolete.”

As with most “national” trends, however, it really depends on your market. In Dallas-Fort Worth (DFW), for example, two SIORs do not see the magic lure of downtown that is often reported in national surveys. “We’ve had a bit of a resurgence in downtown, but it’s not the place to be,” says Colt Power, SIOR, executive vice president, NAI Robert Lynn. “The heavy demand and trend is NOT downtown – in Fort Worth in particular.”

Grant Pruitt, SIOR, president and managing director of Whitebox in Dallas, concurs. “To say that as a blanket statement would be incorrect,” he asserts. “I am in Dallas-Fort Worth, and our suburban markets outperform our central business district (CBD). If you take our Class A product, there is 163,000 square feet of new construction underway in the CBD. There is 7.6 million square feet of new Class A construction underway in the suburban markets. Suburban Class A vacancy rates are 16.3 percent, compared to 24.5 percent for the CBD. There is also a 12 percent rent premium for Suburban Class A product vs. CBD Class A Product.”

However, he adds that this trend may be changing. “The market leaders in rent are literally across a park from the CBD in Uptown (Klyde Warren Park that goes over the Woodall Rogers Freeway and connects Uptown and Downtown),” he reports. “The Park, which opened in 2012, is changing the perception of downtown, and the desirability of ‘Uptown’ is bleeding into downtown.”

“Nationally, companies are largely dictating downtown offices due to labor force needs; however, in Louisville, Ky., we are seeing a different story,” says Tony Fluhr, SIOR, vice president of NTS Development Co. “The stats in Louisville show that the CBD (~16.7 percent vacant) is lagging the suburban market overall (~11.0 percent vacant). More importantly, when you look at office development occurring in the overall Louisville market, a significant amount of development has occurred in the suburban market, with very little new office development activity in the CBD. The CBD has been left with an older product and is lacking the rental rate growth and absorption required to entice new speculative office development. However, the suburban market continues to experience rent growth and the positive absorption required for speculative office development to occur.”

“Suburban office is alive and well in Phoenix, Ariz., as well as other parts of the country,” echoes Andrew Cheney, SIOR, principal of The Coppola-Cheney Group/ Lee & Associates Arizona. “Phoenix is unique in that instead of one massive CBD surrounded by suburbs, we have a significant downtown market surrounded by nine other core employment areas. Our downtown has improved noticeably over the past several years, and most suburbs are doing well. The only suburbs not doing well are the ones not central to several labor pools.”

In Canada, favorability of downtown locations is a clear trend, according to Rob Renaud, SIOR, managing principal/ broker of record with Devencore Realties Corporation in Vancouver. “While major Canadian cities across the country have grown through suburban sprawl in the last 50 years, there has definitely been a significant movement towards urbanization and away from the suburbs in general in recent years,” he says. “The development and urbanization of our downtowns has created a larger stock of available office and residential space for both companies and residents, which has made it possible for companies located in the suburbs to relocate downtown, commensurately reducing their footprint due to higher rent costs. We have also seen a shift towards infill redevelopment, densification (more residents and more workers in less space), and a gradual move away from everyone owning a car and driving to work, which has added fuel to the fire.”

What Makes the Difference

The Times article makes it seem like the demise of the office park is inevitable, stating “Suburban office parks have lost their luster for a variety of reasons, including a growing preference among younger workers for life in more dynamic urban centers than in sometimes staid and sleepy suburbs. And the rapid pace of technological advancement has made the need for many clerical and processing jobs and the real estate to house those workers increasingly obsolete.”

“The smart property owners have created a ‘cool factor’ within their buildings to make them feel like downtown buildings.”

Renaud sees similar trends in Canada. “The suppression of suburban office space demand has been facilitated to a great degree by technology innovations that have allowed for mobile work, freelancing, and an appetite by younger generations (like the millennials) to simplify their lives by being able to live, work, learn, and play in walkable urban settings and not have dedicated desks – thereby allowing their employers to compress office space footprints,” he says. “This put the brakes on major suburban office building development in the last few years as tens of millions of square feet of modern office space have been built around transit-accessible and condo-centric locales in major Canadian cities.”

So what is it that enables these other markets to buck those trends? “I’m bullish on the Louisville suburban office market, as it compares to the Louisville CBD office market, for reasons that may not coincide with larger office markets and national trends,” says Fluhr. “Our labor market is very strong across the board; however, we see a growing trend in our market for companies wanting a ‘suburban campus’ environment, close to easily accessible retail amenities, and shorter commutes home.”

“If you’re not a law firm that’s always been there, you can’t really justify [the cost of] downtown,” Power asserts. “And living, working, and playing in the suburbs is the trend.”

Pruitt agrees. “I really see it continuing to grow outside of downtown,” he says. “In Fort Worth, for example, rents are 30 percent higher than the market, but if you want to be in that new building, you will do it. In general, I see people understanding and appreciating the quality they can get and the easy accessibility.”

Nationally, he notes that there is no question that the CBD markets command a premium to the suburban office buildings (over 30 percent for all classes and roughly 20 percent for Class A product), but, as he says, “we buck that trend in DFW.”

Marketing Strategies

Cheney concedes that in some of the weaker suburban areas there are significant marketing challenges. “Lack of walkable amenities, tired buildings, or poor access to labor are suppressing tenant activity in the weak suburban markets,” he notes. “The best thing an owner can do is renovate the building, build out incredible cool spec suites and front stage space, and make sure you have a great leasing team on it.”

“Many property owners in the suburbs have started supporting transit-oriented and amenity-rich development, thereby ‘urbanizing’ the suburbs as much as possible,” says Renaud. “The smart property owners have created a ‘cool factor’ within their buildings to make them feel like downtown buildings.” Some of these strategies, he notes, include opening up the ceiling to show exposed lighting and ductwork (reminiscent of loft-style downtown space), creating bike racks, fitness facilities, transit shuttles, eateries, ride-sharing programs, etc.

“For the suburban markets that are struggling in DFW, we see older products that need updating and that lack amenities; it is the opposite of the live-work-play,” says Pruitt. “There is little to no public transportation. There are no walkable amenities or restaurants. It is a very sterile environment.”

He says that most workers in those projects are driving 30 minutes from where they live to work, and as soon as work is over, they drive back to where they live as fast as they can to meet friends, go out, etc., “because there is nothing around.”

In an effort to overcome these drawbacks, “we’ve seen owners work together with the city to bring amenities (example: Las Colinas with Water Street and the Music Factory),” Pruitt says. “We have seen owners try to engage the street level with lobby renovations to create a more inviting environment. We have even seen owners literally tear down fences to make the place more inviting. We have seen restaurants, walking trails, putting greens, wine bars, golf simulators, pubs, food delivery, and expanded fitness centers to draw tenants and create a stickier rent roll.”

In Holmdel, N.J., one creative developer seems to have overcome the odds, as reported in *New Jersey Monthly*. In a former Bell building, the project, called “Labs Bell Works,” is a 2 million square foot glass-encased development that contains coffee shops and restaurants, with plans for a wine bar and food hall on the first floor that will be open to the public. The businesses in the development fill space range from 350 square feet to 350,000 square feet and demand has been high in the project, which opened in 2013. “We coined a term for this: Metroburb,” said Ralph Zucker, the developer. “They said it’s an insane idea, we wish it could work, it’s great, it’s what we need, but you’ll never pull it off. Once we started pulling it off, everybody jumped on board.”

In that same article, one observer was even more creative. “If New Jersey legalized cannabis,” says Evans, “we could start growing pot in some of these defunct office parks.” In fact, the

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publication *Real Estate NJ* recently floated the same idea, according to the article.

The Cycle 'Wins'

Whatever the current status of their markets, SIORs maintain a firm belief in the recurrent nature of real estate. "Nationally, this trend will likely be cyclical," says Fluhr. "We've seen it before; as prices for both real estate and parking rise in downtown office markets, more companies will consider relocating to suburban office markets to reduce occupancy costs."

"It's just my personal opinion, but real estate is cyclical, and if I pick one way, demand could drive it another way," says Pruitt. "Fortunately for me, I am on the tenant side, so I go where my clients want to go. I do see value opportunities opening up, though, in the suburban markets, and we have been able to take advantage of that with our clients."

"I believe this is a short- to medium-term trend, especially as developers start to employ some of the strategies available to make their properties more attractive to workers," Renaud predicts. "I also believe that with vacancy rates in many of North America's largest cities (e.g. in downtown Toronto, there's currently a 2 percent office vacancy rate) and with rental rates being at all-time heights, many companies will not be able to afford to just locate in urban locations."

Long-term, he says, there are opportunities to redevelop suburbs from the 1960s and 1970s that are on the edge of Canadian cities, where manufacturing and old office space is being converted to the kind of "cool" loft-style space seen downtown. "I also believe that many of the millennials will eventually want to own or rent detached houses with backyards for their kids. The notion that families will all live in two-bedroom condos is not a one-size fits all," says Renaud. "Finally, with Canada's flexible immigration policy, we see continued demand for houses – and with prices being as expensive as they are in the downtown areas, they will have no choice but to look in the suburbs. These factors all point to the gradual resurgence we are already seeing in the suburbs for both office and industrial 'maker-space.'"

"I think it's a short-term trend; I'm more concerned with quality," says Cheney. "Give me a quality building and a strong owner, and I will get it leased regardless of the trends at the time." ∇

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