Clarion Partners

Beyond the CBD: Sweet spots in the urban fringe and suburbs

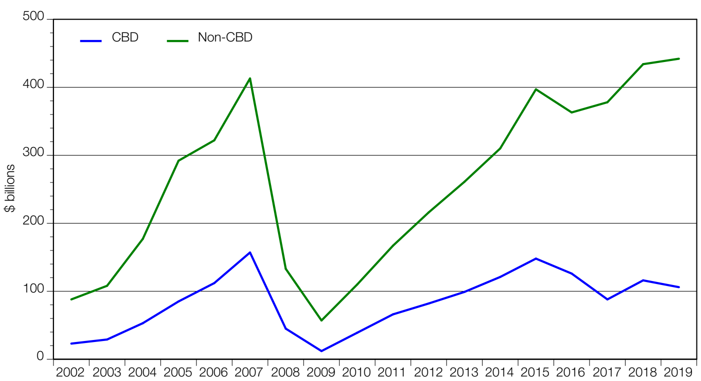
Note: The COVID-19 pandemic is unexpected and still rapidly developing globally, which will impact the U.S. economy and commercial real estate investments. This report was drafted before the event and **does not address** the potential impact of the coronavirus.

The comeback of U.S. suburbs

Much of live-work-play occurs beyond the central business districts (CBDs) and downtowns of the biggest U.S. cities. Over 75 percent of those residing in the largest metropolitan areas live and work in the suburbs or exurbs.[1] In recent years, the boom in urban fringes and suburbs that lie outside of major U.S. cities has accelerated. These areas are generally an easy commute away from thriving cities or corporate outposts and appeal to young and old alike for greater quality of life.

More high-performing, mixed-use commercial real estate is now located beyond the CBD, along with a healthier and more diversified economy and housing market. Urbanization trends are occurring rapidly in areas outside of downtowns in a broader set of markets. At the same time, there has been a greater dispersion of institutional capital investment over the past decade (Figure 1).

Figure 1: U.S. commercial property investment volume: CBD vs. Non-CBD



Source: Real Capital Analytics, Q4 2019. Note: CBD represents 77 of the largest U.S. cities.

The suburbanization of America has been a multi-decade-long trend, except for a few years after the global financial crisis. The "return to the city" trend seen at the beginning of the decade has now reversed. Since 2015, suburbs have reported more rapid population growth than some of the largest CBDs. Sprawling, low-rise cities, such as Los Angeles and Seattle, are more of the American "norm" than a few dense, high-rise metropolitan areas, such as New York City.[2]

Notable metropolitan areas with recently fast-growing suburbs include: Austin; San Jose; Dallas; Raleigh, N.C.; Nashville; and Charlotte, N.C.[3] These areas generally offer more space, safety, schools, walkability and outdoor activities, as well as essential amenities.

There are three primary reasons for this trend reversal:

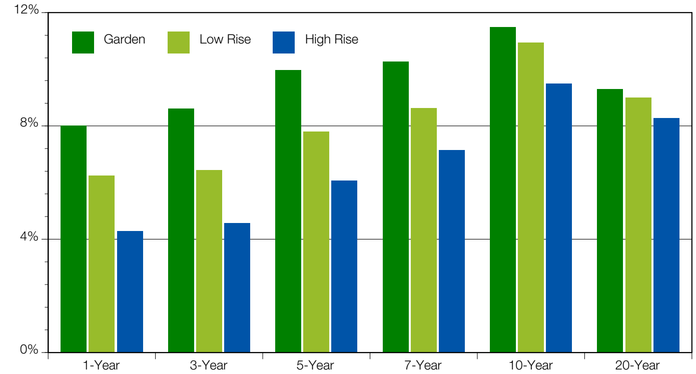
- **Aging millennials.** By 2030, millennials are expected to account for about 75 percent of the workforce.[4] Of the approximately 75 million in this generation, 30.9 million are currently over age 30, and 16.2 million households already have children.
- **Low affordability in the big-city CBDs.** The CBDs of top employment hubs are just too expensive for most households, driving outmigration from urban centers and spillover into surrounding areas.
- **The comeback of select suburban office campuses and buildings.** The expansion of suburban office campuses throughout the United States has been greatly influenced by big tech companies, such as Microsoft in Redwood, outside Seattle, and Apple in Cupertino, near San Jose. More recent examples are: Toyota's new campus in Plano (just north of Dallas), and the Amazon Robotics and TJX Companies offices in the Boston suburbs.

Suburban real estate investments outperform

In recent years, office and multifamily real estate investment performance has been better in the suburbs than in the CBD, and the outperformance has widened. NCREIF Property Index (NPI) return and CBRE-EA market data indicate:[5]

- Of the 865 office submarkets, 87 percent (or 755) are in the suburbs, while 110 are in the CBD.[6]
- Over the past one-, three-, and five-year time frames, NPI office returns in the suburbs have surpassed those in the CBD.
- In recent years, the divergence between garden-style and high-rise multifamily returns has widened (Figure 2).[7]

Figure 2: U.S. multifamily total returns by subtype



Sources: NCREIF Property Index, Clarion Partners Investment Research, Q4 2019

Sweet spots in the urban fringe and suburbs

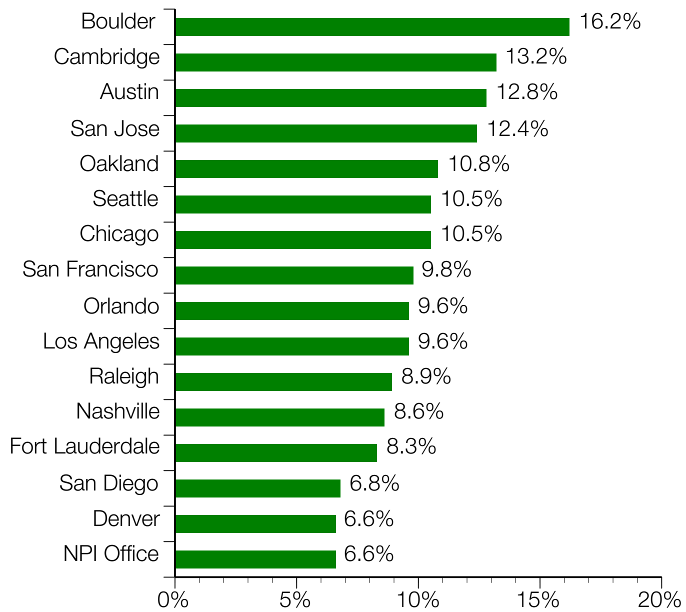
A big comeback of urban fringe (areas touching the urban core) and suburbs outside of big and high-growth metros is well under way. Clarion Partners foresees even greater movement beyond traditional CBDs of U.S. cities. Affordability, work-life balance and lifestyle amenities are now likely to be key factors with aging millennials and baby boomers.

We see attractive opportunities in these concepts:

Garden-style and low-rise multifamily
With aging millennials and baby boomers, we believe that branded and professionally managed garden-style and low-rise apartments are a smart play in areas outside of city centers, where rent growth has exceeded that of the CBD recently.

Select office buildings and campuses in more supply-constrained premier suburbs
Buying select office properties and campuses in growing premier suburban and urban fringe areas is likely to offer stable, long-term cashflow. Recently, a few top-performing suburban office markets were: Boulder, Colo; Cambridge, Mass.; and Austin (Figure 3).

Figure 3: NCREIF suburban office annual total returns in 2019



Sources: NCREIF Property Index, Clarion Partners Investment Research, Q4 2019

Redevelopment of traditional retail

Throughout the United States, only about 160,000 of the 2 million retail properties are institutional quality. There will continue to be large-scale redevelopment of retail, as well as massive remerchandising and mixed-use and warehouse conversion efforts at well-located class A, B and C properties.

Single-family rentals and manufactured home communities
Given the national affordability crisis in a rising number of urban areas, single-family rentals (SFRs) and manufactured-home communities will become more attractive housing options and rise as a share of total rental housing. Today, about 20 million households live in SFRs, mobile homes, RVs and similar dwellings.

New York City and San Francisco Bay metropolitan areas
New York City and San Francisco/San Jose remain two of the largest and most expensive metropolitan areas. Both economies are well diversified with sizable talent pools. In the years ahead, millions of millennials will disperse to the urban fringe and suburbs, given low affordability in the area(s) overall.

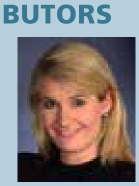
In addition to the outer areas of the "superstar cities" (New York, Los Angeles, San Francisco Bay Area and Boston), Clarion Partners is most optimistic about future growth prospects of recent high-returning suburban office markets, such as Oakland, Los Angeles and Seattle. We also believe that premier class A office assets in certain lower-cost areas, such as Orlando; West Palm Beach, Fla.; Portland, Ore.; and Raleigh, N.C., have compelling appreciation potential. Nearby multifamily, retail and industrial assets are likely to benefit.

Notes:

[1] Esri, U.S. Census Bureau, Q1 2020. Based on the population in the 53 metropolitan areas (over 1 million population). Most recent data as of year-end 2018; [2] Ibid.; [3] Ibid.; [4] *Forbes,* "The Millennial Arrival and the Evolution of the Modern Workplace," 2018. [5] *Note:* Both the Census and CBRE-EA define urban and suburban depending on different levels of population density within the zip code areas defined by the U.S. Census Bureau American Community Survey. [6] CBRE-EA, Q1 2020. [7] NCREIF, Q4 2019.

CONTRIBUTORS


Tim Wang
Managing Director
Head, Investment Research


Julia Laumont
Senior Associate, Investment Research

CORPORATE CONTACT

Hugh Macdonnell
Head of Client Capital Management, Clarion Partners
clarionpartners@clarionpartners.com
+1 (212) 883-2500 | www.clarionpartners.com

CORPORATE OVERVIEW

Clarion Partners has been a leading U.S. real estate investment manager for more than 37 years. Headquartered in New York, the firm has offices in major markets throughout the United States and Europe. With more than $54.9 billion in total assets under management as of fourth quarter 2019, Clarion Partners offers a broad range of both debt and equity real estate strategies across the risk/return spectrum to its more than 350 domestic and international institutional investors.