

Why Investors Are Flocking to Secondary & Tertiary Markets

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Watch out, New York City. You may be a favorite to many, but other office markets are getting their time in the spotlight. While traditional primary markets such as San Francisco, Chicago and Los Angeles continue to hold the largest sales volume in the United States, secondary and tertiary office markets are experiencing greater investment activity.

Why are investors looking at secondary and tertiary markets?

1 Some investors don't have a choice. Growing investor interest in U.S. office real estate is generating significant competition in primary markets, raising costs and forcing some investors to look in other markets. In 2014, average sale prices were \$350 per square foot (PSF) in primary office markets while sales prices in secondary and tertiary markets were significantly lower, averaging \$151 PSF.

2 There are low barriers to entry. Less competition keeps prices lower than primary markets, accommodating a wide range of investor types. Significant competition in primary Central Business Districts (CBD) yielded average sales prices of \$506 PSF compared to \$164 PSF in secondary and tertiary markets. Average sales prices for suburban space in primary and non-primary markets were significantly lower at \$205 PSF and \$145 PSF, respectively, in 2014.

3 Secondary and tertiary markets offer higher returns. Rising occupancy and rental rates in secondary and tertiary markets yield higher returns given the lower investment required for real estate acquisition. Cap rates are declining throughout the U.S. but remain higher in secondary and tertiary markets. RCA reported average cap rates of 6.1 percent for sales in primary markets and 7.3 percent for sales in secondary and tertiary markets in 2014.

4 Market fundamentals are improving. Many secondary and tertiary markets are exhibiting growing populations, above-average job growth, emerging technology sectors and high levels of educational attainment. For instance, Atlanta, which is increasing in rank among markets with top sales volume, posted a 3.1 percent growth in total non-farm employment from June 2014 to June 2015, exceeding national growth of 2.1 percent. Additionally, Dallas, which is making a name for itself as growing tech hub ranked among the top 10 office markets for sales volume in 2014.

5 The current economy encourages taking risks. The improving national and local economies are encouraging investors to enter markets they previously would not have dreamed of. Investors are also showing interest in suburban office buildings as prices in CBD are becoming too high for some. RCA reported faster growth in suburban sales activity than in the CBD during the first half of 2015. Suburban sales made up 56 percent of sales volume compared to the average of 49 percent since 2011.

As the economy recovers further and smaller markets grow, capital investments in secondary and tertiary markets are expected to continue. Primary markets will always see strong activity, but secondary and tertiary markets will likely account for a growing portion of investment sales. For those watching the capital markets, keep an eye on smaller markets as they may offer the greatest investment opportunities.

- An economist with a passion for analyzing trends and data, Jessica Rahal is the Research Coordinator for Colliers International in South Carolina, where she reports on market conditions and offers insights to brokers and clients.. Read more great content at the