

Office Properties in Prime Suburban Districts are Getting a Second Look

As CBD Office Prices Rise, Investors Search for Better Yields in 'Urban-Style' Suburban Properties

By [Randy Drummer](#) August 17, 2017

Suburban office markets with emerging 'urban-style' live-work environments and good transportation access are gaining increasing cachet among investors and cost-conscious office users, according to a new survey of the nation's 25 largest suburban markets by CBRE Group, Inc.

As office prices and rental rates rise in the nation's CBDs, certain "urban-suburban" districts may offer investors opportunities at lower prices, according to CBRE, noting examples in suburban Silicon Valley's Palo Alto, the New Jersey waterfront and even Philadelphia suburb King of Prussia.

CBRE's analysis found that office occupancy rates and asking rents in these urban-suburban districts are typically on par with surrounding suburban markets, but received a disproportionate share of tenant demand and construction activity. In more than half of the cases studied by CBRE, rents in these suburban submarkets actually outperformed properties in some rival downtown areas.

"Alternatively, emerging urban-suburban markets offer investors and occupiers with longer-term strategies an opportunity to secure space in up-and-coming areas while there are still options to choose from and purchase prices and rents are more affordable," noted Andrea Cross, CBRE Americas head.

CoStar research confirmed that, while urban districts generally outperformed their suburban counterparts in occupancy, rent growth, and pricing earlier in the cycle, prime suburban submarkets now appear to offer higher growth potential.

"These submarkets contain institutional-quality product but have yet to record the same level of rent growth, and subsequently, the pricing levels seen in CBDs and secondary business districts," according to CoStar Portfolio Strategy analysts Paul Leonard and Marcos Pareto in a recent white paper analyzing the performance of CBD and suburban office markets.

Prime suburban districts are better positioned to perform over the long term than other suburban areas due to superior demographics and certain location advantages, such as access to major highway interchanges, Leonard and Pareto said.

"Investors looking for the next opportunity in the office market should consider expanding their investment target zone beyond the urban core and into the suburbs," the CoStar analysts said. "However, it is imperative that the investor first choose the right market."

Avison Young, in its Mid-Year 2017 North America and Europe Office Market Report, also picked up on the trend in both the U.S. and Canada of tenants' distinct preference for transit-oriented development (TOD), the emergence of suburban markets with a sense of place as their own urban centers, and the continued growth of co-working and flexible-office-space operators.

"This year we saw co-working and flexible spaces gain market share and we are tracking their impact on office leasing conditions," said Earl Webb, Avison Young's president, U.S. operations. "Landlords are responding to these trends by retrofitting common areas to include tenant amenities and social-gathering spaces."

Lower Rents, Occupancy Bring Growth Potential

According to CBRE's new report, emerging urban-suburban submarkets averaged 15.3% vacancy as of first-quarter 2017, compared with 13.8% for established districts. Rents in these emerging submarkets have yet to surpass the overall suburban average and are significantly lower than rents in more established urban-suburban submarkets.

In just over half the markets, however, the average weighted rent for established submarkets was actually higher than downtown rents, including Philadelphia, where the average established rent exceeded CBD rents by more than 10%.

Such emerging submarkets as the sprawling King of Prussia/Valley Forge area, historically known only for its 2.9 million-square-foot King of Prussia Mall owned by Simon Property Group, are seeing a burst of suburban mixed-use "place making" efforts and build-to-suit office construction.

In an example cited in the report, Brandywine Realty Trust earlier this summer opened a 111,000-square-foot, four-story office building at 933 First St., the first new office delivery in King of Prussia in almost a decade. The built-to-suit project mainly occupied by health insurance program provider Highway to Health complements such projects as the recently delivered King of Prussia Town Center.

A flurry of owner-user purchases were reported in the first half of 2017 and more under contract, according to JLL research analyst Gina Lavery.

While overall leasing activity has continued to be flat across the market, a few notable tenant moves helped shore up fundamentals in the Philadelphia suburbs. For example, Vertex Pharmaceuticals expanded to 180,000 square feet at 2301 Renaissance in King of Prussia.

"Suburban tenants require well-located, high-quality offices to attract talent," Lavery said. "King of Prussia offers that with its proximity to new residential and retail hotspots."

Silicon Valley Has Suburbs?

On the other side of the country, more than 650,000 square feet of office space is under way in Palo Alto, CA, a tony suburb of San Jose in the Silicon Valley. About half of that is the Innovation Curve Technology Park, a four-building project in the Stanford Research Park under development by Sand Hill Property Co. The buildings, a sweeping series of curves, peaks and valleys designed by Form4 Architecture, are slated to be completed over the next year.

About 70 miles east of Silicon Valley in the Roseville submarket of Sacramento, Adventist Health is building a 242,000-square-foot, five-story office building slated for delivery next summer.

In the Minneapolis metro's suburban St. Paul submarket, dairy provider Land O'Lakes is building a 155,000-square-foot expansion of its campus in Arden Hill, MN, a project slated for early 2018 delivery.

In Sacramento, Minneapolis/St. Paul, and other metros such as Kansas City and Austin, urban-suburban submarkets account for virtually all suburban office space under construction. On balance, however, the amount of new office construction under way in urban-suburban submarkets is slightly higher than its share of inventory.