



# **Suburban Boom: *How COVID-19 May Accelerate the Trend Already in the Making***

July 2020



## Background

**COVID-19 has elevated the narrative of the “resurging suburbs.”**

- Slow timelines for organizations to completely return to their offices.
- Virus transmission concerns heightened in cities heavily dependent upon public transportation.
- COVID-19 forced the majority of office workers into a work from home (WFH) experiment. Although not without challenges, one of the clear benefits is saving commute time.
  - In 2019, the average commuter in the U.S. spent 227 hours each year commuting. Time spent commuting, rather than working, is the equivalent of 28 eight-hour-days of lost productivity.

**Occupiers examining the future of the workplace and weighing the benefits of new (or expanded) workforce strategies.**

- Hub-and-spoke portfolios that include company-leased spaces in several (mostly suburban) submarkets around one city.
- Mix of traditional office space and flexible / coworking solutions.
- Expansion of distributed workforce.
- Transportation programs that alleviate commuting challenges.

**While COVID-19 is likely to accelerate interest in the suburbs, the trend predates the pandemic.**

- Suburban office markets have outperformed over the past few years.
- Prime-aged workers—Millennials, in particular—have been increasingly migrating to the suburbs.
  - Now in the prime home buying age range, many more are forming families, buying homes and moving to the suburbs.
- Just as businesses followed the labor force talent into cities, some are likely to follow them into the suburbs – particularly given the benefits of lower commute times, not to mention, lower rents.

## Investment Thesis

**Prior to COVID-19, demand for office space in U.S. suburbs was already outpacing Central Business Districts (CBD).**

- In 2019, 69% of Class A net absorption occurred in the suburbs, up from the 10-yr average of 60%. Fueled largely by aging Millennials, the rebirth of the suburbs was already well underway.
- 52% of U.S. office workers live in suburban neighborhoods, while only 27% are in urban environments. The remaining 21% are in rural communities.
- Demographic forces continue to drive strong migration to the suburbs. Today, nearly half of all Millennials are 30 years old or older, and the oldest are approaching their 40s. The median age to buy a home is 33. Half of home purchases are in the suburbs (13% of all home purchases are in a central city).

**There is opportunity for investor and occupiers alike.**

- **The mini-city.** A suburban cluster of high-quality office buildings and retail/lifestyle amenities that replicate many of the advantages of CBD locations at a lower cost and with greater ease of access to its suburban workforce. This is particularly attractive when the cluster is concentrated with a specific industry ecosystem. Value is enhanced by proximity to high-quality school districts or more attractive residential communities. The intersection of these factors forms a significant barrier to entry.
- **The back office.** As cities have become more expensive, back office workers have already been moving further outside the urban core. Suburban office buildings that are located closer to this worker base can offer better asset builds at attractive costs.
- **The outpost.** Occupiers with a primary presence in the urban core will find increasing pressure to provide options for a growing suburban workforce, particularly collaboration space. Many of the outposts will be part of the mini-city ecosystem. This is an area where flexible office could perform well, but there may be some cases where the outposts house more workers than the CBD hub.

# Chapter 1: The Drivers of a Changing Tide

Millennials have been the dominant “story” for HR professionals focused on attracting and retaining top talent.

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- This generation is no longer the youngest in the workplace, but will remain a vital source of talent, driving performance for organizations.
- The Millennial generation remains larger than those before or right after it, so they will continue to be trend setters in many ways.

There will be an elevated number of Americans in the peak home buying age grouping for the next decade.

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- The number of people in their early 30s will increase by 4.1% over the next five years and will peak just shy of 24 million.

Millennials are buying homes, although at a slightly older age than their parents.

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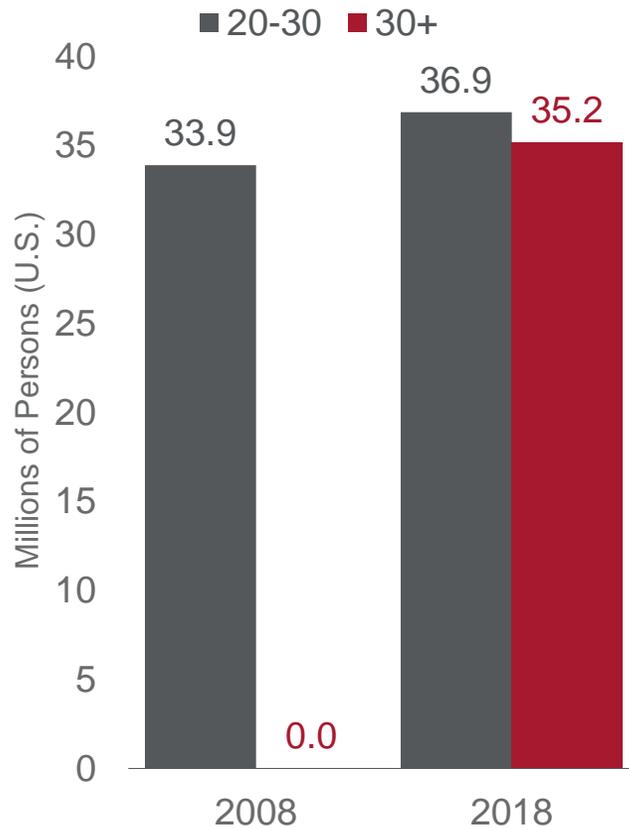
- Millennials have been the largest group of home buyers for the past three years.
- They are more likely than any other age group to buy homes in the suburbs.
- Only 14% of home purchases are in the city center.

Younger home buyers disproportionately value convenience and proximity, especially to work.

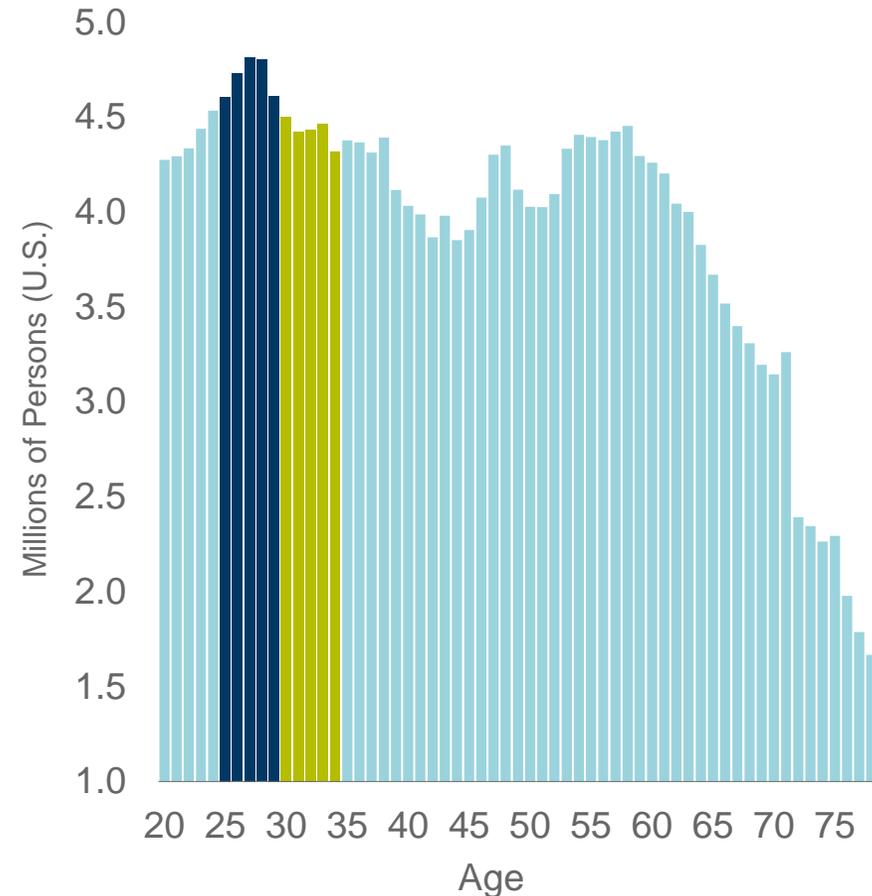
- This will weigh on their job search decisions as they settle down and start families.

# Rise of Millennials: Not Just “Kids” Any More

## Millennials in Their 20s & 30s



## U.S. Population by Age (2020)

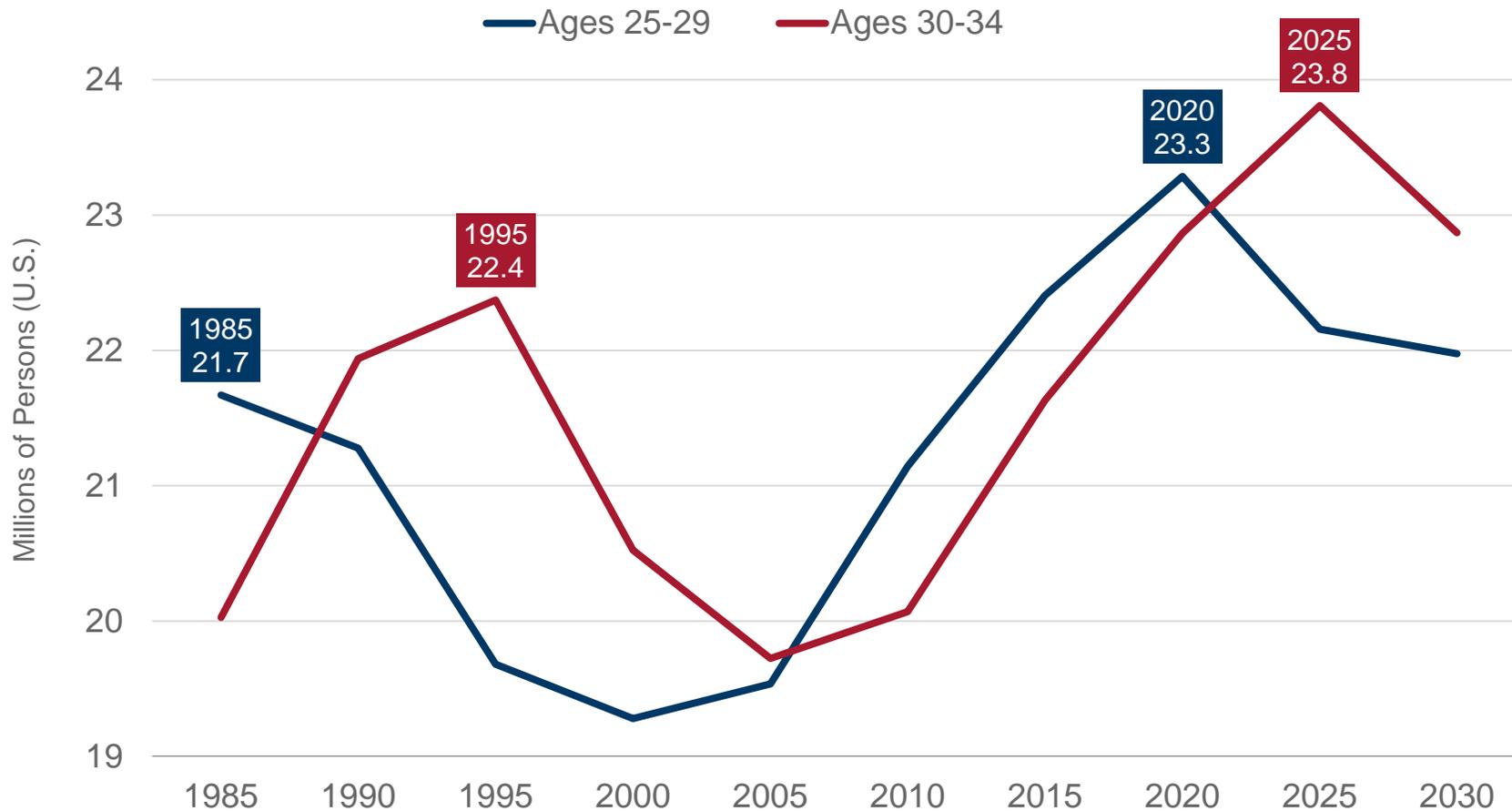


## The bulge is aging

- In 2008, all Millennials were under 30 years old. Today, half of them are over 30.
- Currently, 22 million Americans are in their early 30s. (See green bars in chart.)
- Another 24 million Americans are between 25-29 years old and will be in the peak home buying cohort for the next four-to-eight years. (See dark blue bars.)

# Pent Up Demand for Home Purchases

The population of people in their early 30s expected to peak in 2025



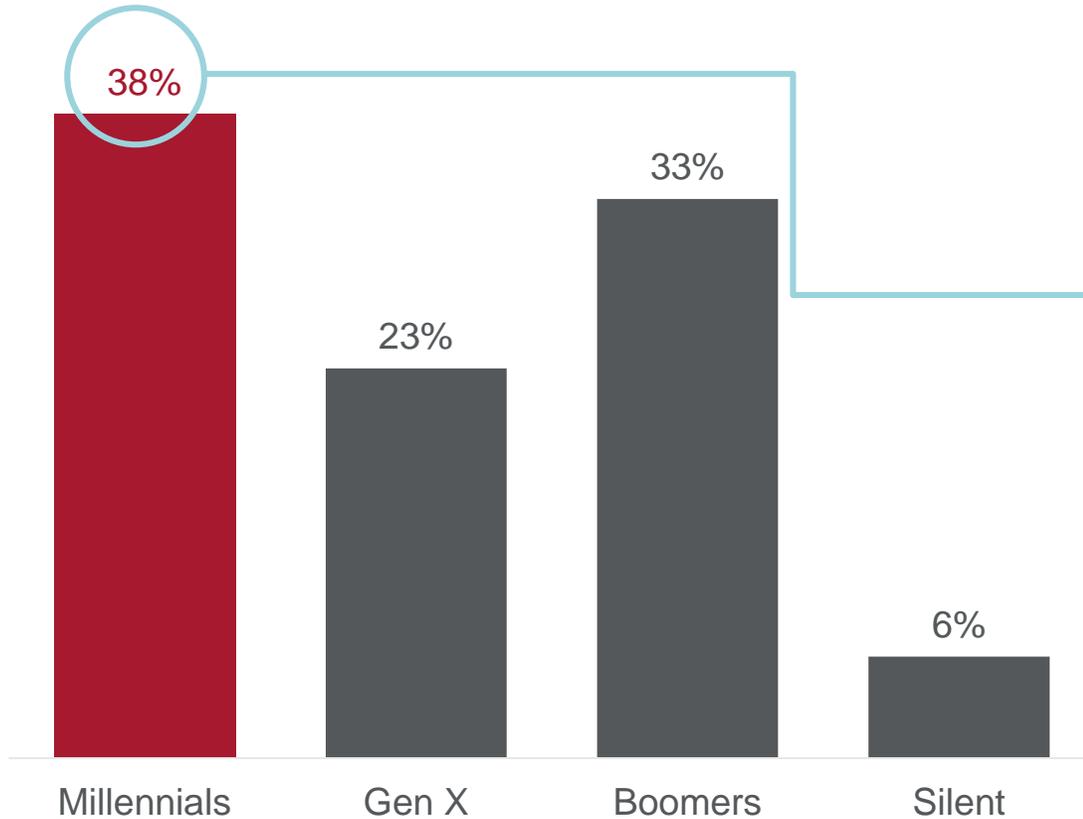
## Peak home buyer

- According to the National Association of Realtors (NAR), the median home buying age is now 33.
- Over the next decade, the number of people moving into the prime home buying ages will increase by 4.1% (+0.9 million) to 23.8 million.
- Buyers who were held back following the Great Financial Crisis also represent a source of pent up demand.

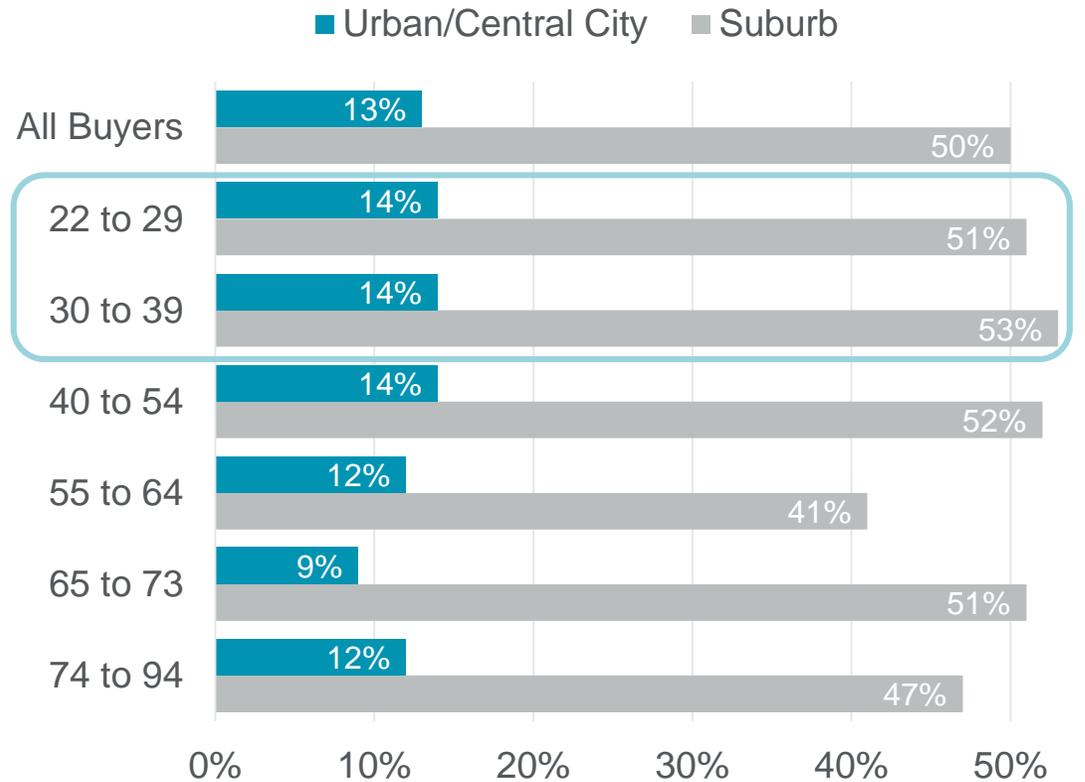
# Homeownership Predominantly in Suburbs

Plurality of home buyers are Millennials, and majority of their purchases are in the suburbs

## Percentage of Home Buyers by Generation



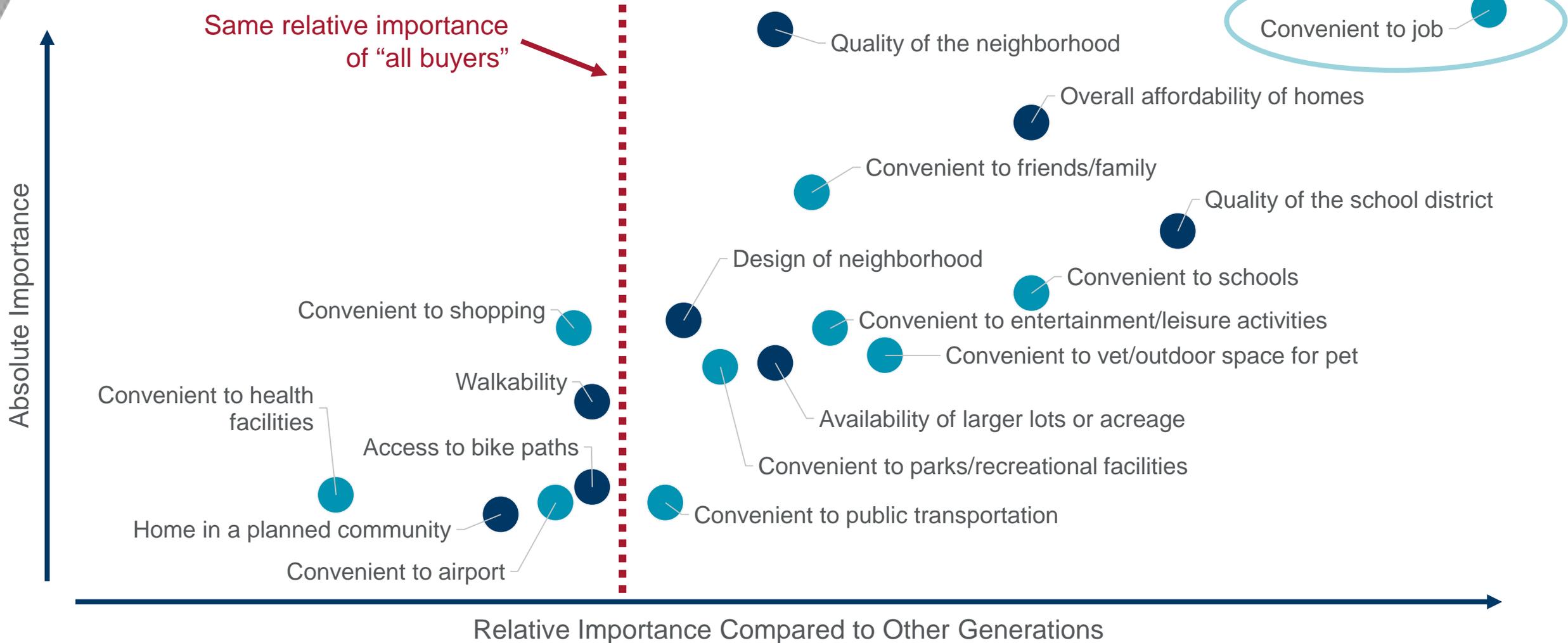
## Homes Purchased in Suburbs by Age



# Millennials Want to Live Where They Work

As Millennials become more heavily suburbanized, this will drive occupier demand

Same relative importance of "all buyers"



## Chapter 2: Data Shows the Trend

**In the U.S., the suburbs account for approximately two-thirds of office space inventory and occupancy.**

- As a share of all office occupancy, suburban submarkets increased from 63.6% in 2005 to 68.4% in 2020.
- The past two years have seen better leasing performance—stronger absorption, faster vacancy decline and stronger rent growth—in suburban submarkets.

**Historically, vacancy has been higher in the suburbs.**

- While still true, the gap between the CBD and suburbs has shrunk from a high of 406 bps in 2008 to just 35 bps in Q1 2020.
- Sixty-nine percent of Class A net absorption in 2019 occurred in the suburbs, above the 10-year absorption average (61%) and the suburban share of Class A office space (60%).

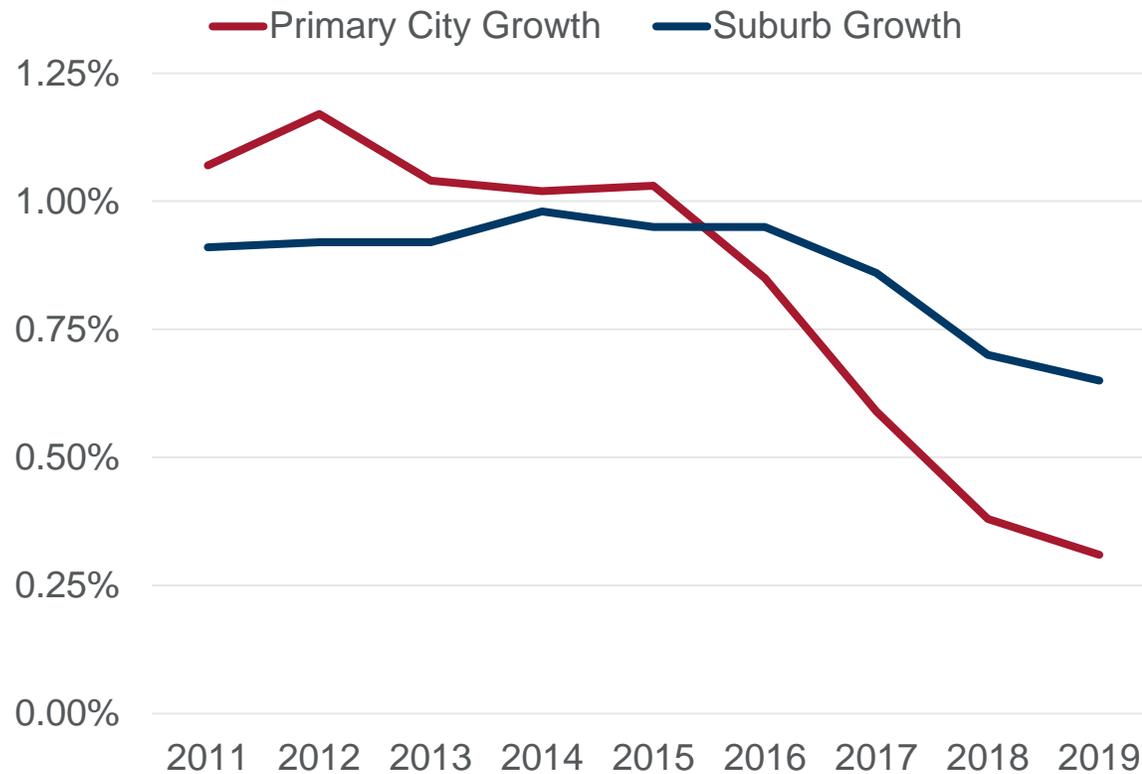
**Rental rate growth was faster in the CBD for the first six years after the Great Financial Crisis.**

- Since 2016, however, the gap in cost between CBD and suburban office has receded from a high of 68%.
- The premium remains significant (60% in Q1 2020), which offers opportunity for occupiers looking for cost-effective options during the current recession.

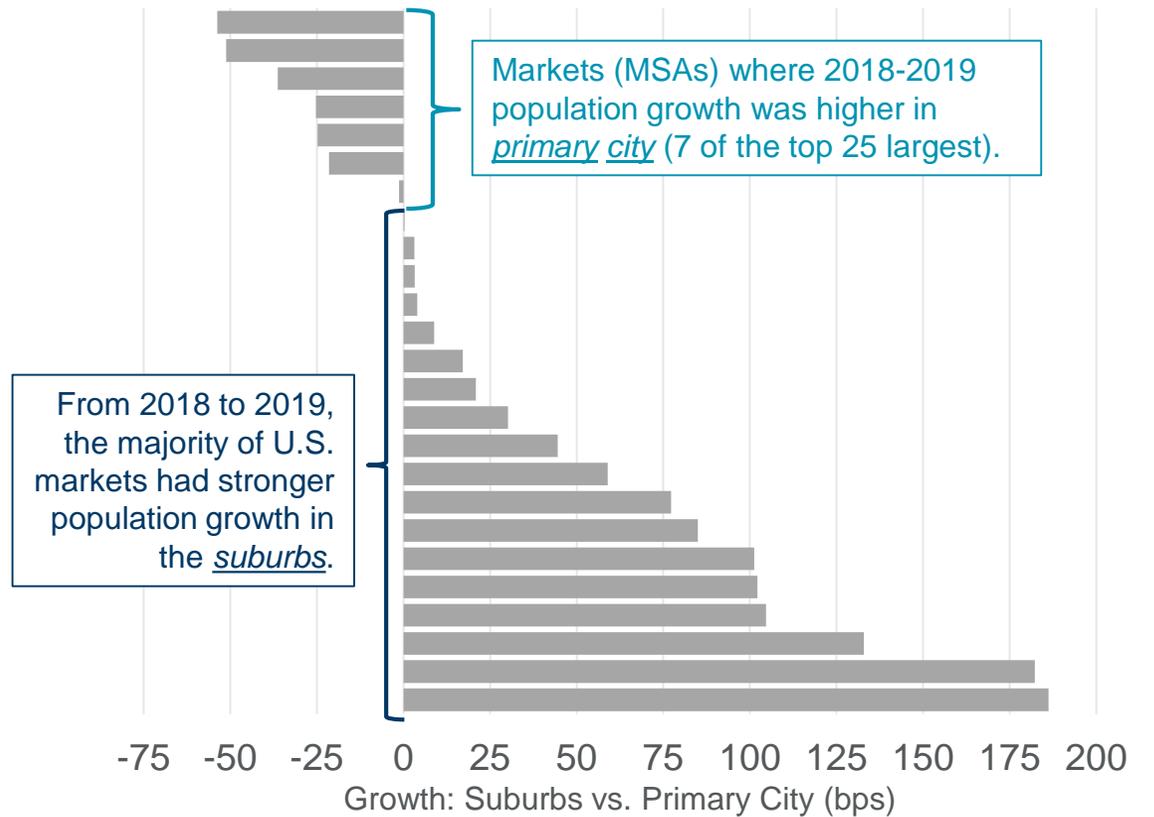
# Population Growth Leans Towards Suburbs

Annual growth rates stronger in the suburbs for second half of last decade

## Suburban Population Growth Stronger Since '16

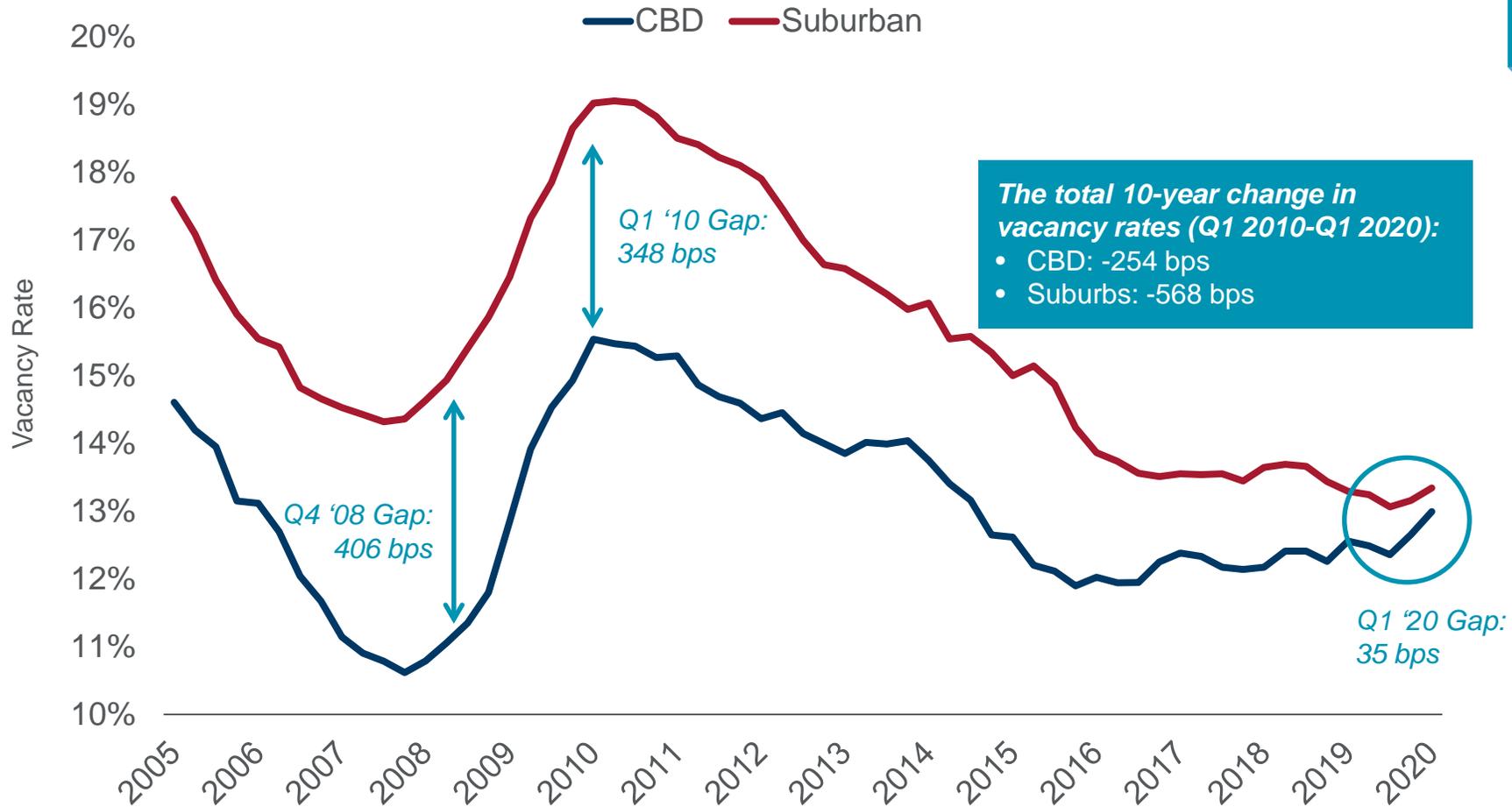


## Difference in Population Growth, 2018-19\*



# Vacancy Rates Converging

The suburban share of total occupancy has been rising steadily for the past 15 years

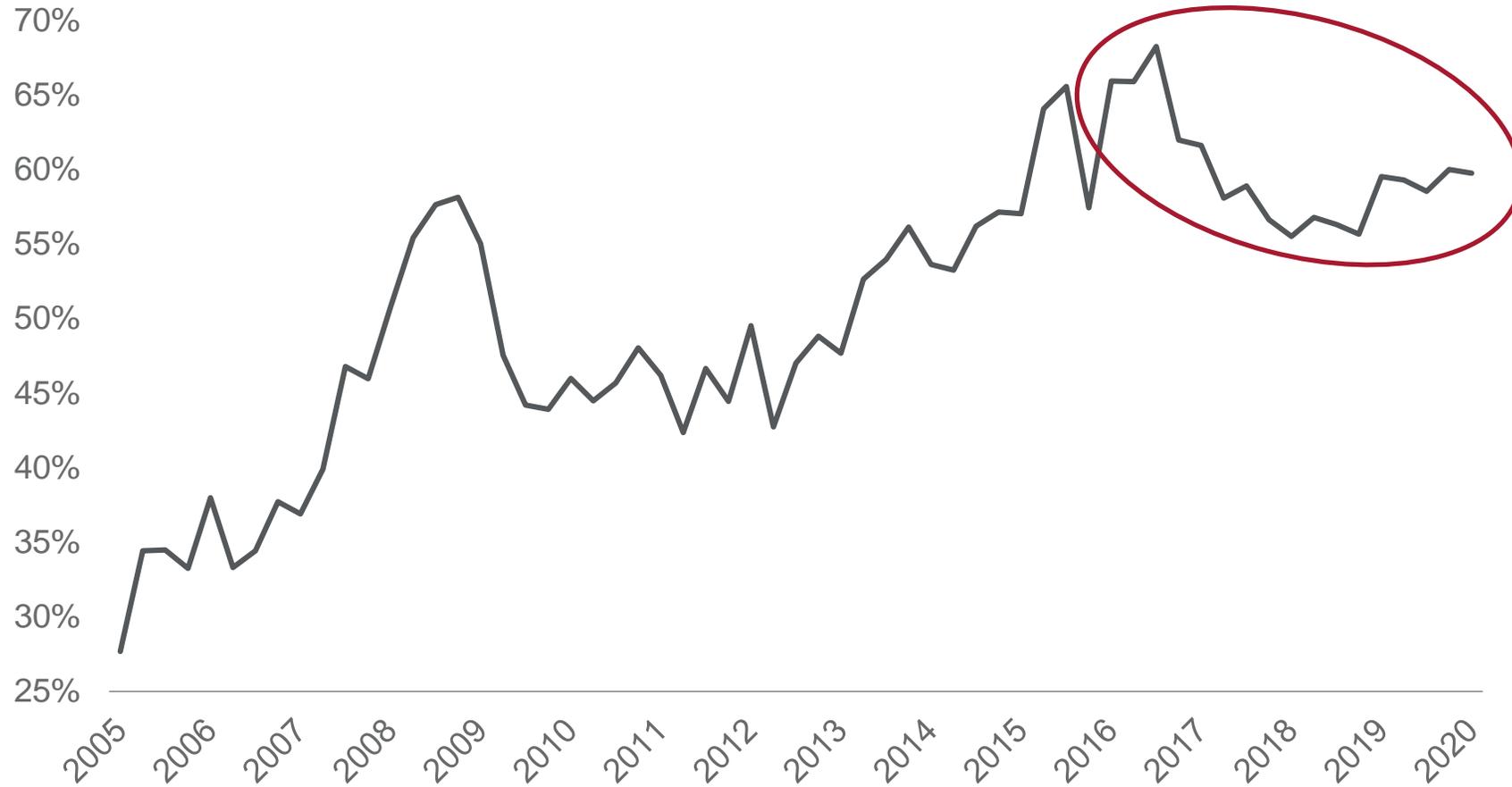


## Faster decline

- Vacancy rates peaked in mid-2010. Vacancy dropped for CBD and suburban submarkets over the next six years, but the declines were faster in the suburbs:
  - CBD: -357 bps
  - Suburbs: -482 bps
- Since then, suburban vacancy has decreased slightly while vacancy in CBD submarkets increased by 110 bps over the past 18 quarters.

# Cost Differential Closing

Spread between CBD and suburban rents down from late-2016 peak

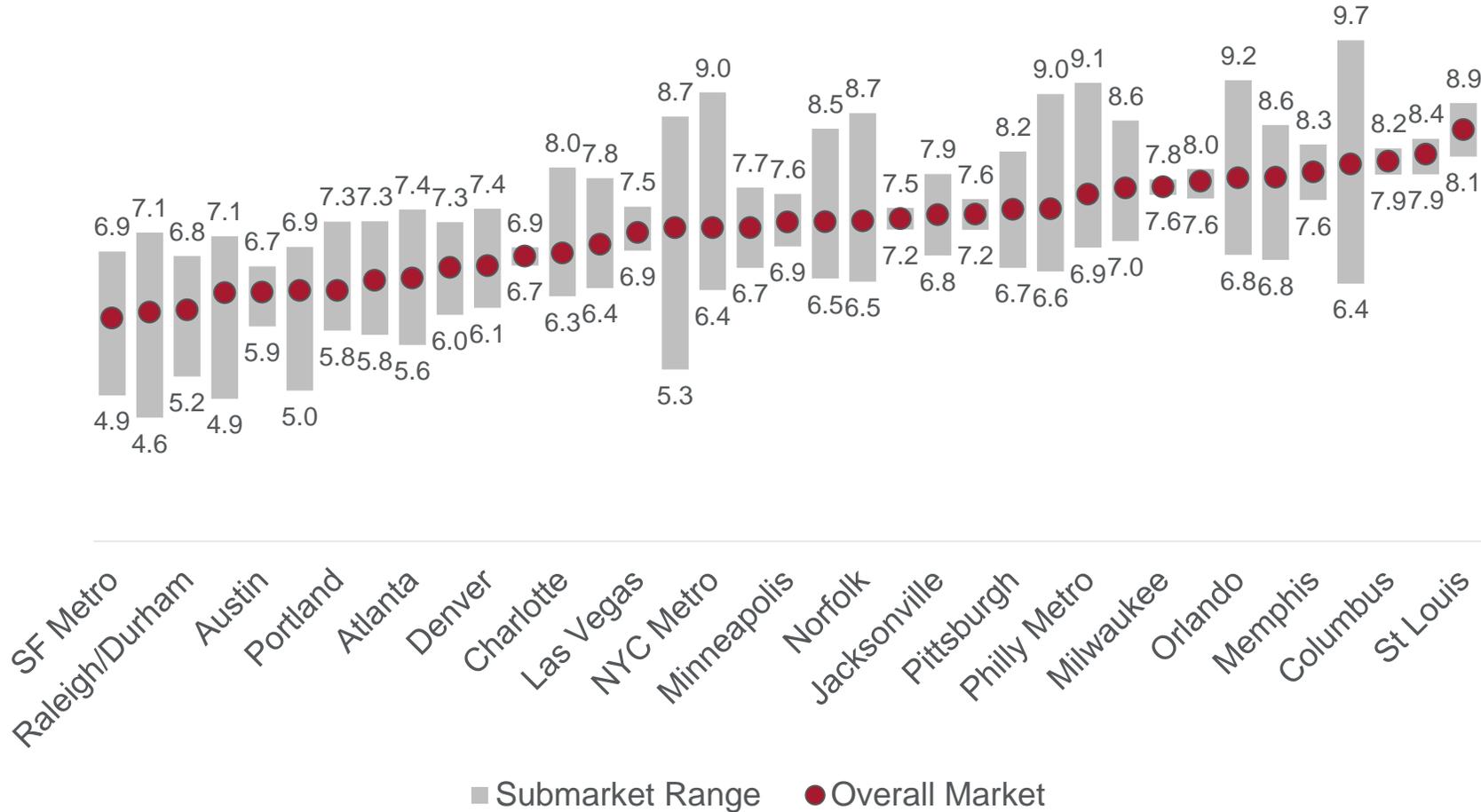


## Premium shrinking

- From 2005 to 2015, the CBD asking rent premium more than doubled.
- Since 2016, suburban rents rose 330 bps more than the CBD (19.8% vs. 16.5%).
- The cost differential remains well above historical norms, which makes hub-and-spoke or co-location expansion strategies attractive for employees' commutes and companies' pocketbooks.

# Significant Variation in Yields Across & Within Markets

2016 - 2020 average cap rate (%)

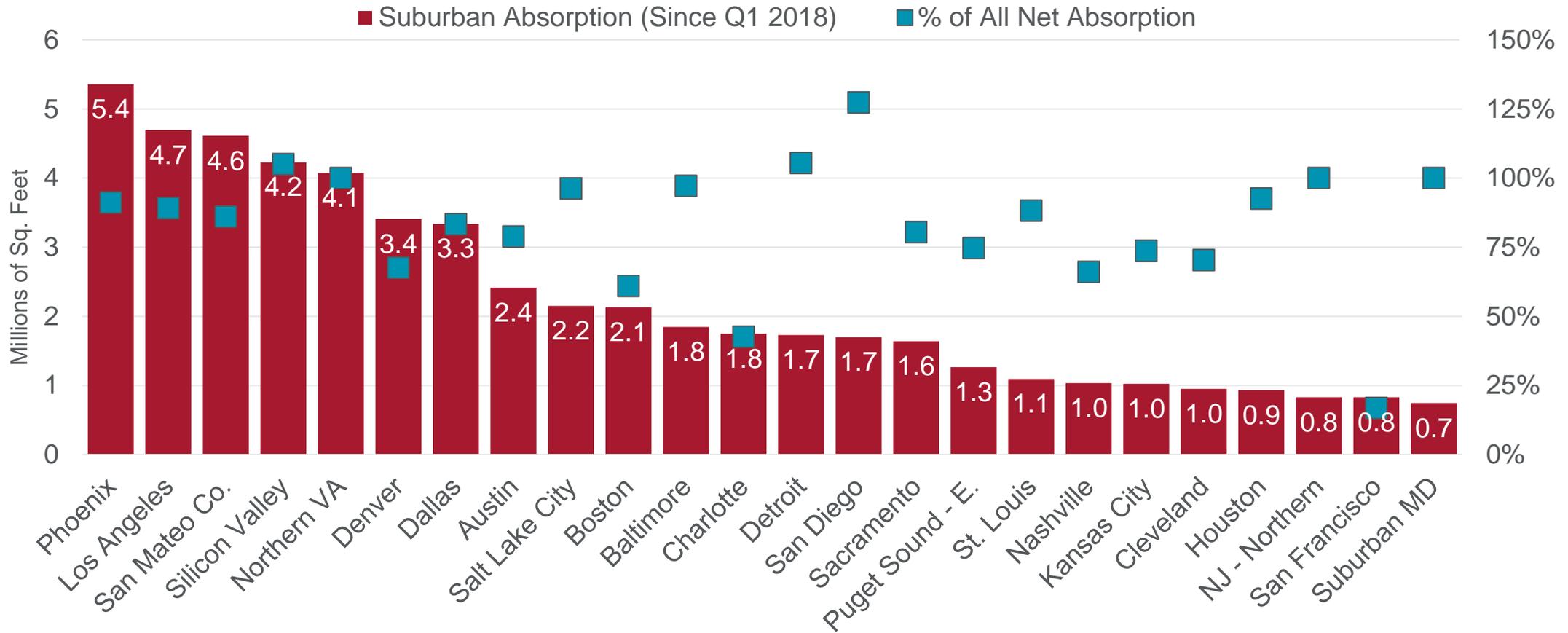


### Broad range

- Tech drives investor demand for suburban space.
- Lowest overall market cap rates in tech-driven markets both major (e.g., SF Metro) and secondary (Raleigh/Durham, Austin).
- Greater variation within and across markets means there is a bigger potential investor pool.

# Most Active Suburban Markets – Top 24

Total net absorption of suburban office space (Q1 2018 – Q1 2020)



## Chapter 3: COVID-19 an Accelerator or Disruptor?

**Employment will follow over time; initial move will be from urban dweller to commuter.**

- As the suburban population grows, occupiers will move more offices to suburbs.
- COVID-19 could further the move as the barriers to working in the city on a daily basis make suburban space more attractive to workers.

**COVID-19 could accelerate Millennials and Generation Z moving to suburbs.**

- Generation Z and Millennials find working from home a challenge because of inadequate work spaces (shared housing, small spaces). This may drive both cohorts to look for more space in the suburbs.

Age Cohort	Percent Reporting Challenges	Main Challenge
Generation Z	70%	Inadequate Workspace
Millennial	69%	Caregiver duties
Generation X	63%	Caregiver duties
Baby Boomer	55%	

# Commuting Time Continues to Climb

Younger home buyers' desire for proximity may change long-term commute patterns

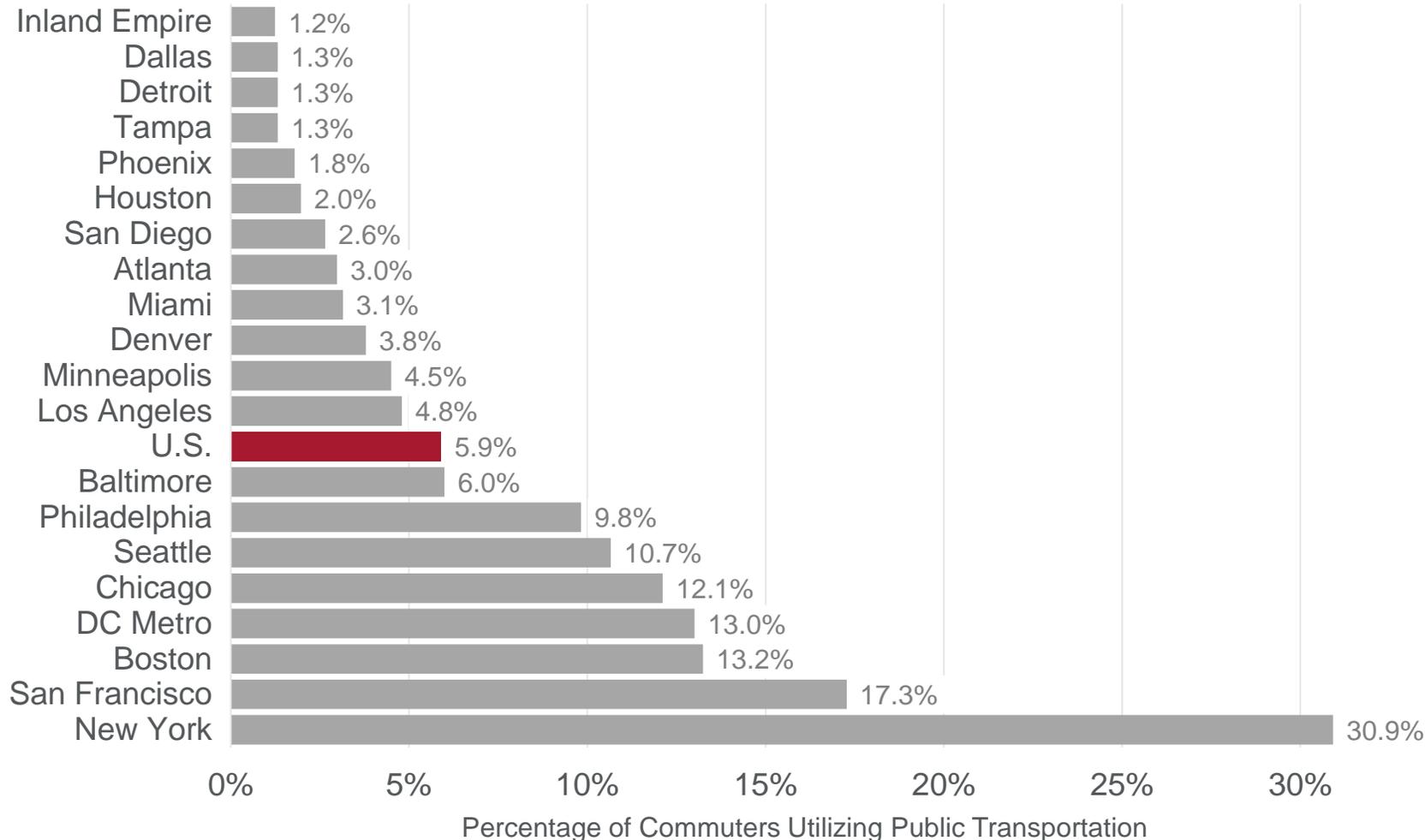


## Wasted time

- In 2018, people spent the equivalent of four weeks of eight hour days on their commute. A whole day longer per year than in 2010.
- An upside of working from home during shelter-in-place has been the removal of commutes for most office workers.
- Giving workers options closer to their home reduces wasted time and (often) frustration for commuters.

# COVID-19-Driven Concerns with Public Transportation

High public transportation usage may slow workplace reentry in certain markets

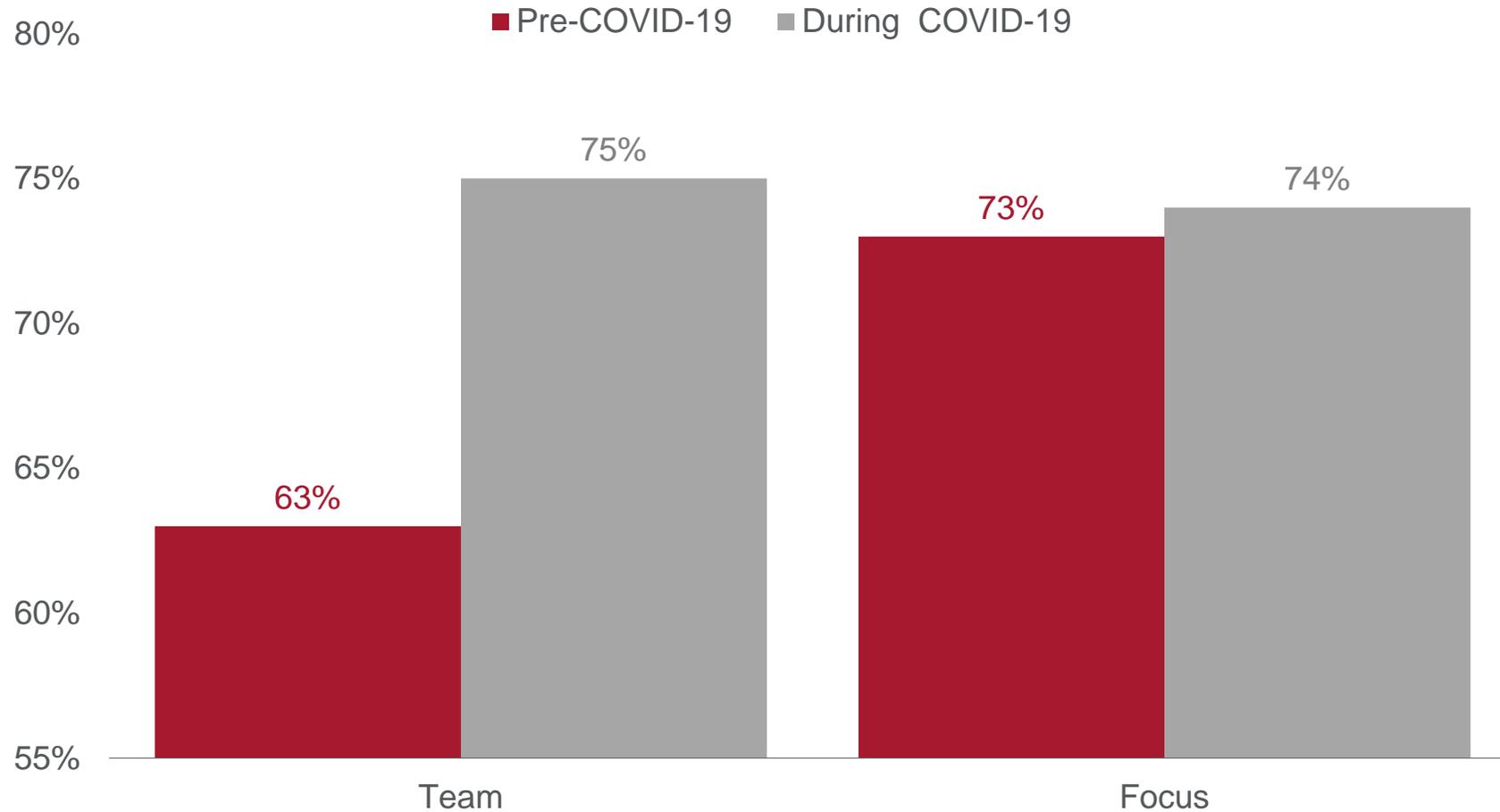


## Transit worries

- Avoiding public transit may be a priority for some commuters, at least in the short-term.
- Even after COVID-19-related disruptions subside, 45% of those who previously used public transportation expect to decrease their use.\*
- Avoiding public transit makes working in the suburbs more attractive relative to urban core. Accordingly, occupiers are looking at hub-and-spoke model options.

# Work-From-Home (WFH) a Reality...At Least for Now

Employees have shown resilience to work and working together during shelter-in-place

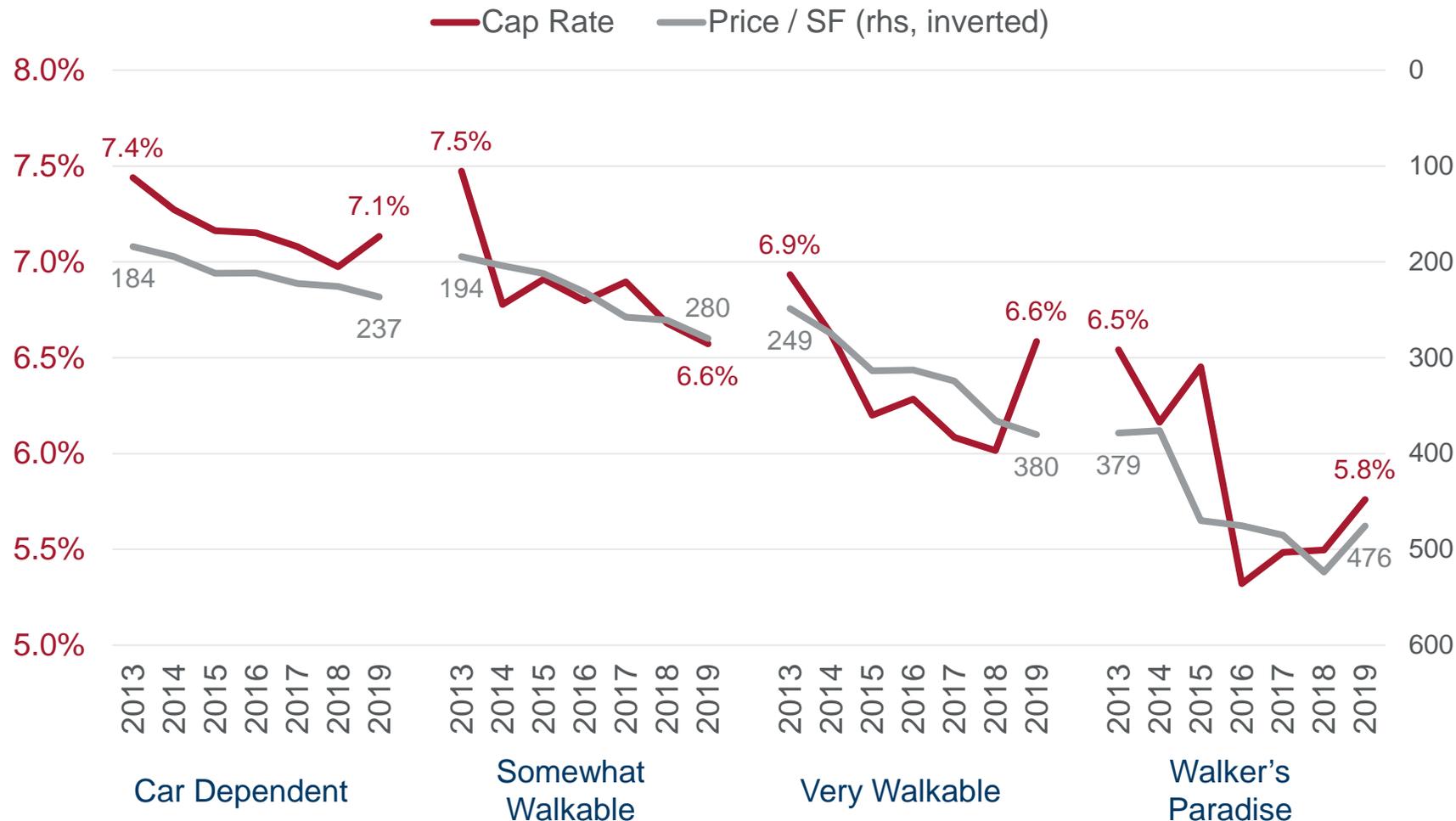


## WFH has benefits

- Cushman & Wakefield's proprietary XSF@home consulting tool shows that workers can team together and maintain focus when working from home.
- The downsides? Working remotely full-time decreases personal connection to the purpose and culture of the organization.
- A rise of "third offices" may be one solution. Providing a place to convene between the CBD office and the employee's home.

# Not All Suburbs Are Created Equal

The suburbs will continue to evolve to the tastes of people who live and work there

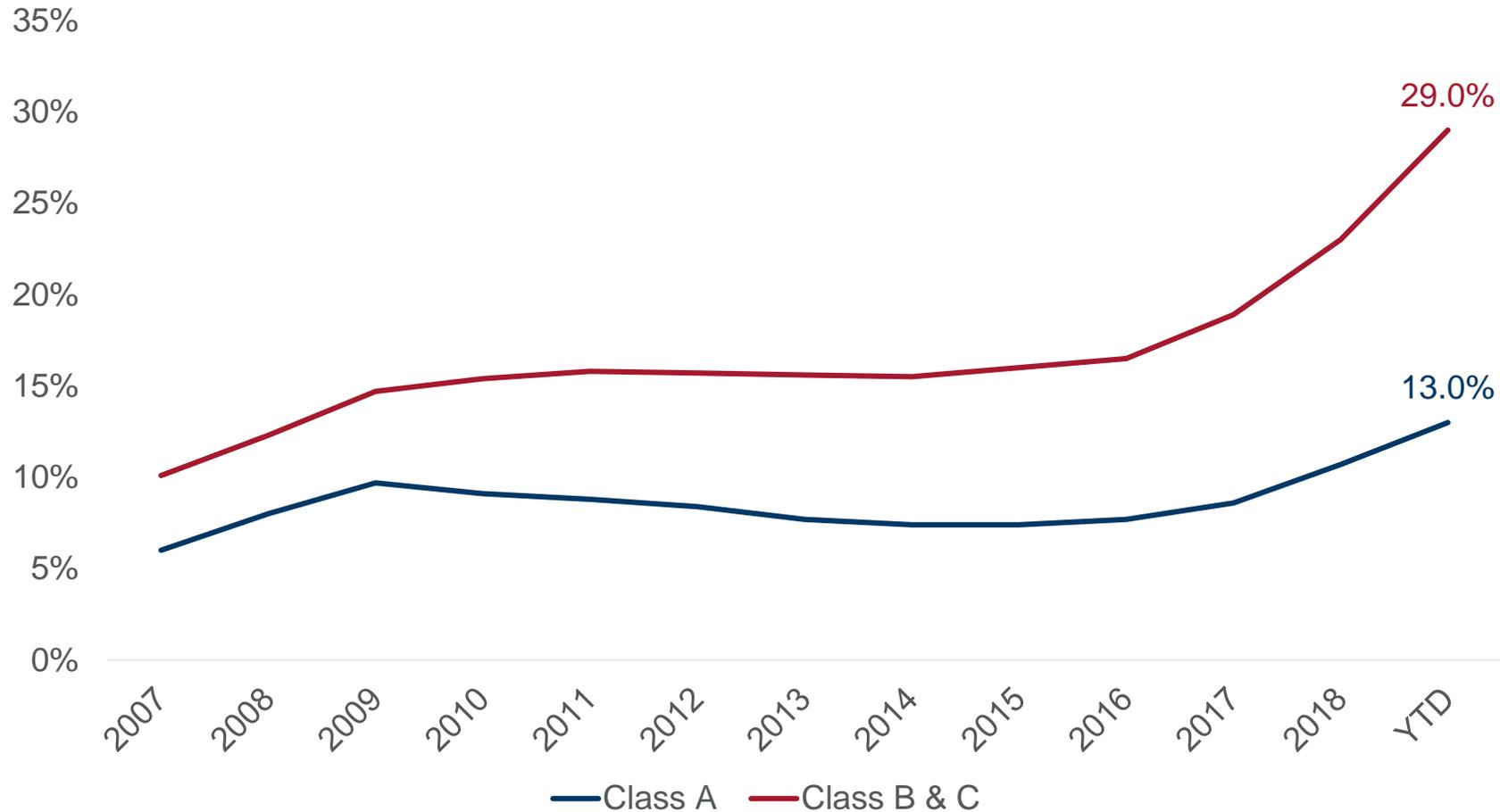


## Walkability matters

- Areas with higher levels of walkability are much more attractive to occupiers and therefore to investors.
- The suburbs that Millennials are drawn to provide urban-like features: walkability chief among them.
- Empty nesters (both Baby Boomers and the eldest Gen X) looking to downsize also may find walkable suburbs to be more attractive and manageable than urban core neighborhoods.

# Rethinking the Mall

Mall vacancies were already challenged prior to the onset of COVID-19



## Repurposed

- Enclosed malls are being hit much harder by the crisis than outdoor centers. Many suburban malls are convenient to highways and well-situated to be redeveloped for different purposes: healthcare, office, residential or mixed-use.
- Retail moving from standalone destination to the ultimate amenity in live/work/play communities.
- The mall of the past becomes the town center of the future.

## Closing Thoughts

### **The suburbs continue to be a living destination for a majority of Americans.**

- A huge cohort of home buyers are heading to the suburbs.
- Millennials may be doing things later in life, but they are doing all the things their parents did: buying homes and forming families. For many, the most cost-effective place to own a home is outside of the urban core.
  - Young home buyers care more about convenience and proximity than their older colleagues, which will impact their willingness to spend 45-75 minutes a day commuting.
  - Also, health concerns make public transportation and ride sharing less attractive in the immediate wake of COVID-19.

### **Employers searching for digital, tech, creative and knowledge workers will provide employees with flexibility and options.**

This may include:

- More freedom to work remotely.
- Multiple locations around a market to ease commutes.
- Access to flexible / coworking space.

### **The most attractive suburbs offer the best of the city center without some of the challenges:**

- Walkability / bikeability
- Access to multiple modes of transportation
- Amenities and entertainment venues
- Experiential retail
- Food options
- Parking (yes, it's back for now)
- Charging stations



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