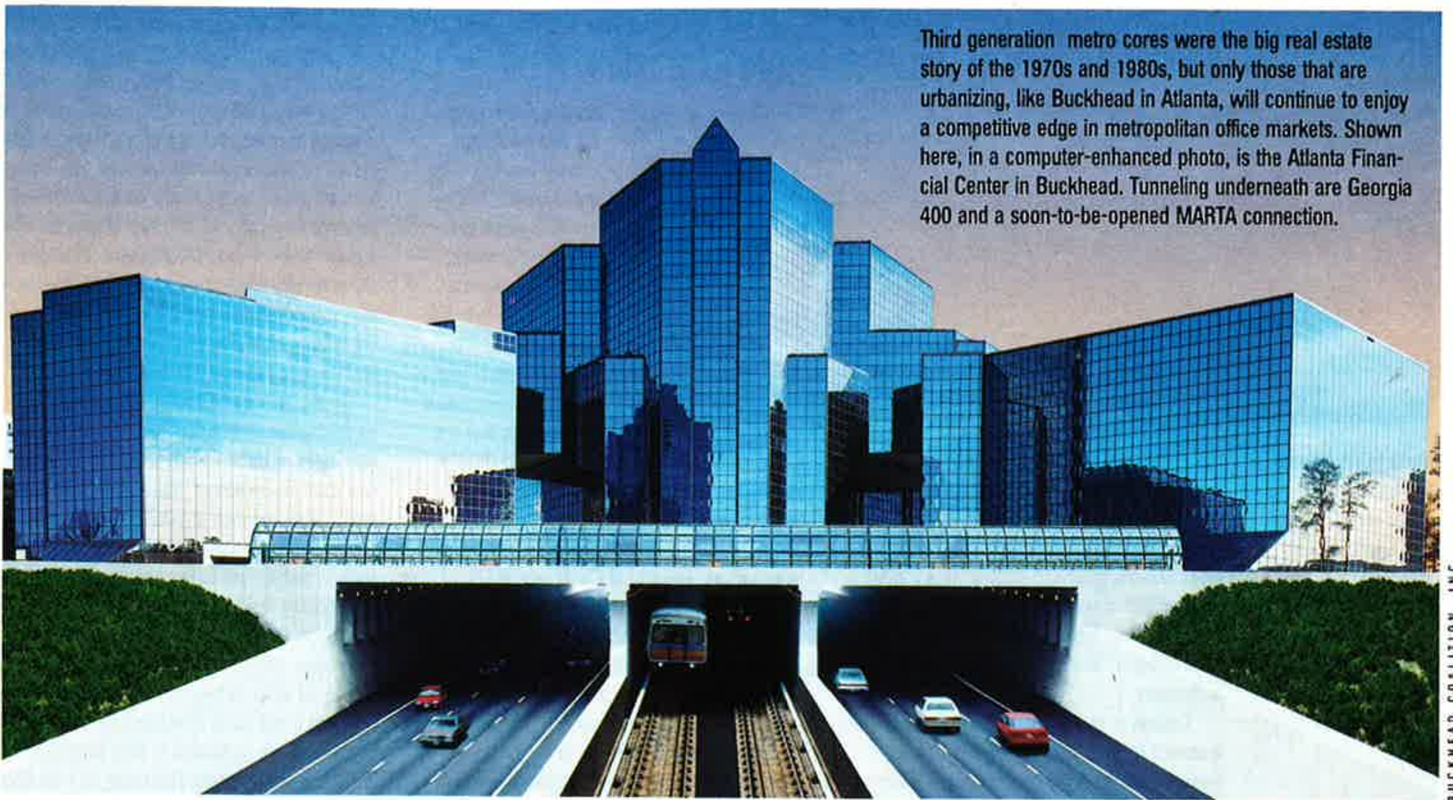


Third generation metro cores were the big real estate story of the 1970s and 1980s, but only those that are urbanizing, like Buckhead in Atlanta, will continue to enjoy a competitive edge in metropolitan office markets. Shown here, in a computer-enhanced photo, is the Atlanta Financial Center in Buckhead. Tunneling underneath are Georgia 400 and a soon-to-be-opened MARTA connection.

The geographic expansion and decentralization of metropolitan areas in the 1990s seem to be a continuation of growth and development trends that began in the 1970s. But, in fact, future opportunities will be in different locations from those of the 1970s and 1980s.

The Changing Location of Development and Investment Opportunities

CHRISTOPHER B. LEINBERGER

Metropolitan development appears to be back on track with trends of the past two decades, after having been abruptly derailed by the real estate depression of the early 1990s. Continuing to push the metropolitan fringe further from downtown, new development is dramatically increasing the size of metropolitan areas. At the same time, some "metro cores" (centers of economic activity within metropolitan areas) that contain many fairly new buildings are maturing and even declining (see feature box on page 32). Investors should heed the warning signs and recognize some new trends in development.

What have the development trends of the past two decades wrought? Metropolitan areas have grown in size much more than in population. For instance, metropolitan Chicago's population grew only 4 percent between 1970 and 1990, but its land area grew

A Brief History of the Metro Core Explosion

H/P COMPANIES L.C.

Many fourth generation office-oriented metro cores like Fair Lakes west of Washington, D.C., are emerging as nearly self-contained low-density "new towns."

The typical U.S. metropolitan area has seen, over the past 30 years, the emergence of multiple centers of regional economic activity. Robert Charles Lesser & Co. has come to call these centers "metro cores," an umbrella term that includes downtowns, edge cities, and industrial activity centers that are local aggregations of export and region-serving jobs and businesses.

Growth in the number of metro cores has occurred roughly in tandem with real estate booms. With the exception of original downtowns, most metro cores were established during major real estate upturns, grew explosively during the next real estate upturn, matured, and then stabilized or declined.

First Generation. Until 1960, export and region-serving jobs were concentrated primarily in or near downtowns, as were high-end housing and major regional retailing. As is well known, after 1960, downtowns began losing population, retailing, and finally jobs to the suburbs. Today, most downtowns attract only three types of office users: professional services, financial services, and government. Employment in these sectors is stable or shrinking. Most manufacturers and other industrial space users that remain downtown do so because their occupancy costs are below the replacement value of their facilities or because they have access to rail, a service that has lost its relevance to most companies today. Region-serving retailing may retain a downtown presence, but on a much reduced scale. High-end housing exists in or near only a few downtowns. Obviously, the density of most downtowns is urban with floor-to-area ratios well above 0.5, and generally over 2.0.

Second Generation. In the 1960s, new office and industrial space began to locate two to six miles from downtown in metro cores that provided the first alternative to downtown for office and industrial users.

Those metro cores that are office-oriented have largely failed, victims of the decline of nearby neighborhoods. Their 1960s, 1970s, and a few of their 1980s office buildings look seedy and compete only in price. Office space generally rents for under $10 per square foot (net), well below replacement costs. Most region-serving retailing has left and most high-density housing, particularly rental, has declined in value. Suburban in character, these cores have a floor-to-area ratio between 0.2 and 0.5. The few second generation office-oriented metro cores that are successful are urbanizing and also continue to have good access to executive housing and superior retailing.

Industrially oriented second generation metro cores—like City of Commerce in Los Angeles, Kent Valley south of downtown Seattle, and Houston's Shipyard area—quietly established the concept of the industrial park. They generally continue to maintain their value to this day. As work centers only, these metro cores are generally immune to local demographic shifts. Their key concern is the maintenance of the transportation infrastructure.

Third Generation. The explosive growth of office-oriented third generation metro cores was the big real estate story of the 1970s and 1980s. Every U.S. metropolitan area, regardless of size, sprouted at least one in the 1970s. Even Tyler, Texas, population 77,000, has one on the south side of town, named Broadway Square for the regional mall it surrounds. Tyler's high-end housing district encircles the metro core. Most third generation metro cores are anchored by a regional mall and located next to a major limited access highway.

Many third generation office-oriented metro cores contained more occupied office space by the end of the 1980s than did the region's downtown, even though they had been in existence for barely two decades. More recently, their growth in regional market share of new office space has slowed. The chief factors causing this slowdown are traffic congestion resulting from insufficient highway capacity for the metro core, local neighborhood opposition to more growth in the metro core (because of its traffic implications), and lack of land for low-density, build-to-own development. Their density is usually suburban in nature with floor-to-area ratios between 0.2 and 0.5, though some are urbanizing and have new projects with floor-to-area ratios of 1.0 and higher.

In the 1970s and 1980s, industrially oriented third generation metro cores grew up along interstates or other limited access highways. Like their predecessors, these tend to be pragmatic concentrations of industrial and warehouse buildings strung together with acres of surface parking lots with no regional retail or high-density residential elements nearby.

Fourth Generation. In the 1980s, fourth generation office-oriented metro cores emerged four to 12 miles farther out from their predecessors and in the same direction from the center city. They were innovative in their semirural character. For example, Fair Lakes on I-66 west of Washington, D.C., and Plano on the Dallas Tollway north of the city are very low-density, heavily landscaped campuses. Floor-to-area ratios generally are under 0.2.

Overbuilt in the 1980s, these newest metro cores appear to be recovering faster than other overbuilt office submarkets. Nearly all of the substantial build-to-own office activity that took place in the early 1990s was in these "new towns."

In the 1980s, industrial-oriented metro cores also sprang up beyond their predecessors, four to ten miles beyond, along interstate highways on the flanks of fourth generation office-oriented metro cores. Examples include the Vallwood area in northwest Dallas, White Marsh (a combined office/industrial metro core) in northeast Baltimore, and the Carlsbad/Palomar Airport area in San Diego County.

TYPES OF METRO CORES

Generation (Beginning Decade)	Character: Urban or Urbanizing[1]	Character: Suburban[2]	Character: Semirural[3]
1st (Pre-1960)	All Downtowns		
2nd (1960s)	Bala Cynwyd/Philadelphia	Northeast Expressway/Atlanta	
3rd (1970s)	Buckhead/Atlanta	Tysons Corner/Washington, D.C.	
4th (1980s)		Schaumburg/Chicago	Fair Lakes/Washington, D.C.
5th (1990s)			Hoffman Estates/Chicago

[1]Floor/area ratio of 0.5 or more. [2]Floor/area ratio of 0.2 to 0.5. [3]Floor/area ratio of under 0.2.

Source: Robert Charles Lesser & Co.

46 percent. During the same period, the size of the Los Angeles metropolitan area tripled while its population grew 45 percent. Greater Los Angeles has become as large as the state of Connecticut.

In general, growth has been occurring in only one direction from downtown. Only the five largest regions—New York, Los Angeles, Chicago, San Francisco, and Philadelphia—have been growing in multiple directions. Washington, D.C., exemplifies the tendency for growth to go in one direction: the region extends approximately 12 to 15 miles from downtown to the east and southeast, but 35 to 40 miles to the northwest.

Furthermore, housing for upper-middle-income and upper-income residents has tended to concentrate in one area—with the exception, again, of the five largest metropolitan areas that have multiple concentrations and of some regions with special geographic features like Tampa/St. Petersburg, which has an extensive waterfront.

The location of upper-end housing, the configuration of the limited access highway system, and the concentration of lower-income, predominately minority housing provides the strongest clues to where most employment growth and real estate opportunities have and will continue to take place. In short, employment and investment opportunities have clustered near upper-end housing adjacent to limited-access highways and on the opposite side of the region from most lower-income, minority housing districts over the past 20 years. These factors are still crucial but will play out slightly differently over the next five to ten years.

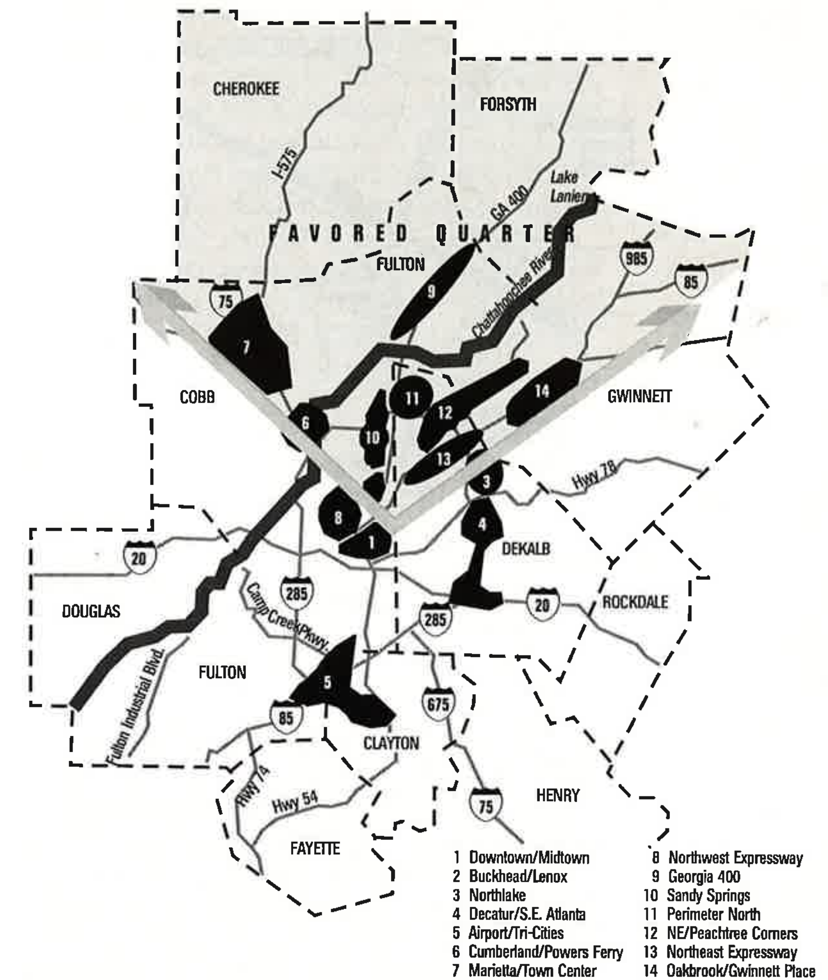
The quarter circle drawn from the downtown as center can be called the favored quarter. It encompasses most of the region's high-end housing and is where upwards of 80 percent of commercial real estate activity and job growth took place over the past two decades. It also is where the major share of new housing—both high end and entry level—has been developed.

The results of the predominant growth trends of the last 30 years are shown in the map at right, which represents a model of a typical metropolitan area in 1995.

The Example of Atlanta

Atlanta provides one of the best examples of these metropolitan development trends. Atlanta's favored quarter is north of downtown, where more than 90 percent of the region's housing priced over $300,000 is located. When built in the early 1970s, the I-285 beltway defined the region's northern boundary and a mall built in 1973 adjacent to the beltway was named Perimeter Center Mall to reflect this edge location. Since then, the continuing push to the north has been dramatic. (See graph on the following page.)

METRO CORES IN THE ATLANTA REGION



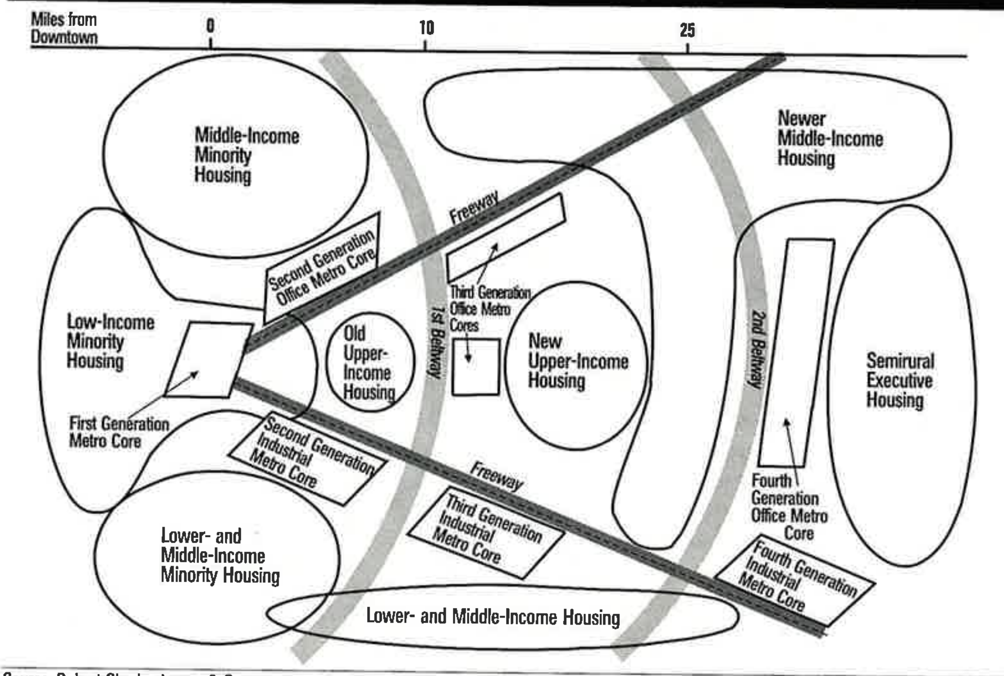
Source: Robert Charles Lesser & Co.

In 1983, downtown Atlanta contained nearly one-third of all occupied office space; a decade later, its market share was only one-quarter. Similarly but even more starkly, the second generation Northeast Expressway metro core saw its share of occupied office space fall from nearly 12 percent in 1983 to only 7 percent in 1993.

In contrast, the third generation Perimeter North metro core gained market share, from 14 percent of the region's occupied office space in 1983 to almost 20 percent in 1993. All told, the favored quarter had captured more than 80 percent of net employment growth since 1983. Nearly all relocating businesses from within the region went into this quarter.

The three fourth generation metro cores in the favored quarter—Georgia 400, Marietta Town Center, and Oakwood/Gwinett Place—contained almost no occupied office space in 1983. By 1993, they had nearly 4 million square feet, which represents 12 percent of the total metropolitan area's speculative office space. These cores also attracted most of the owner-occupied buildings constructed in Atlanta

PREDOMINANT METROPOLITAN GROWTH PATTERN, 1995



Source: Robert Charles Lesser & Co.

during the decade, like the regional headquarters of AT&T, Honda, and Siemans.

The growth of employment in these three outlying metro cores has had two consequences. The first is the development of new housing projects even farther north, continuing the expansion of the metropolitan area. The second is a heated political debate over whether an outer beltway should be built connecting the three metro cores and eventually encircling the metropolitan area. This new beltway would be 12 miles from the "inner" beltway, the frontier of the metropolitan area only two decades ago.

Opportunities and Pitfalls

True, the underlying trends of decentralization of economic activity and geographic expansion of metropolitan areas appear to be continuing and may even be accelerating. But the location of opportunities is changing.

Downtowns (First-Generation Metro Cores). With employment bases that are generally shrinking relative to employment in suburban areas, most central city downtowns face limited futures: stability, moderate decline, or severe decline.

One mark of stable downtowns is the presence in or near the downtown of a significant amount of high-end housing, generally well-maintained housing built 60 to 100 years ago. Executives living close to downtown are inclined to locate their businesses downtown. A second key to stability is a vibrant retail element that serves both local workers and residents and tourists. Successful convention facilities, professional sports facilities, and tourist attractions help retailing, particularly if they connect to downtown via a convenient and safe walk for pedestrians. Only a handful of U.S. downtowns—including Washington, D.C., Seattle, Portland (Oregon), San Francisco, and midtown New York—meet these criteria for stable downtowns.

Most U.S. metropolitan downtowns will continue to experience employment and office space growth at only half the rate of their regions as a whole and are therefore in moderate decline. While many of these downtowns contain some upper-end housing, it is not sizable nor is it growing. Some also have a vibrant retail sector supported by a convention facility, professional sports facilities, and tourist attractions. Some of these retail-rich downtowns, like Denver, are becoming healthier and may eventually become stable. A few like Baltimore and San Diego are in moderate decline but are unlikely to decline further. Others, like Atlanta (particularly after the stimulus from the Olympics has died down), Philadelphia, and Los Angeles, are in danger of slipping into severe decline in the absence of further remedial action.

A typical, moderately declining downtown Los Angeles's CBD in 1960 contained 60 percent of all occupied office space in southern California; in 1985, this figure had dropped to 22 percent. Between 1985 and 1992, however, downtown absorbed only 11 percent of net new office space, thus, in effect, suffering further decline. A gleaming new skyline that replaced millions of square feet of obsolete space masked this decline in market share and soaring vacancy rates.

Many other downtowns are in severe decline in terms of employment and office growth. They lack virtually any upper-end housing or any retail except for a small amount serving office employees. Any convention or professional sports facilities exert little impact because visitors drive to the event and then immediately leave when it ends. Although Detroit's is probably the most severely declining downtown, other metropolitan areas with a similar situation include St. Louis, Tampa, Phoenix, Dallas, Houston, and Jacksonville.

Stable downtowns offer investment and development opportunities in nearly all product types—office, industrial, hotel, residential, and retail. The best opportunities in downtowns that are in moderate decline are tourist-related hotel and retail products and, possibly, residential products. Justifying new office construction in downtowns that are in moderate or severe decline will be next to impossible, except for the occasional government-sponsored build-to-own building, which is of dubious merit.

Denver is an outstanding example of a moderately declining downtown in which some real estate sectors have revived: high-end residential, entertainment, retail, and restaurants. The revival of the hotel sector is sure to follow when the new Coors baseball stadium, housing the Rockies, opens in 1995. But the revival is not spilling over into office and industrial markets, because even in the midst of a regional job boom, downtown job growth is relatively weak.

Second Generation Metro Cores. Second generation metro cores that are office-oriented—the Northeast Expressway area in Atlanta, for example, or the Stemmons Freeway area in Dallas—offer little in the way of investment grade opportunities. They are losing employment and few boast either a retail base or high-end housing.

There are exceptions to this rule. Bala Cynwyd, literally over the Philadelphia city line, continues to maintain high office lease rates, active retailing, and healthy, nearby high-end housing. Fear that crime will cross Philadelphia's boundaries is the biggest threat to this core. In the Washington, D.C., area, the success of the subway system has helped revive second generation metro cores. Areas around many inner suburban subway stations, such as Courthouse, Ballston, Friendship Heights, and Bethesda, have attracted employment, which has spurred retail and high-density residential development.

Second (and third) generation industrially oriented metro cores should continue to maintain their underlying value, assuming transportation is adequate and local crime, if a problem, can be prevented from spilling into them. Most second generation areas, however, are built out and the opportunity to redevelop at higher densities is limited by the fact that most industries demand space that is single-story with plenty of surface parking. If demographics, access, and visibility are favorable, some industrial facilities in these areas could be converted to retail power centers. Third generation industrial cores, such as NE/Peachtree Corners in Atlanta and the area along Route 1 northeast of Philadelphia, still offer land available for new development.

Third Generation Metro Cores (Office-Oriented). Some of these cores are in the process of urbanizing: connecting to mass transit systems, adding high-density housing, expanding the retail base, and generally developing a more urban, pedestrian-oriented character. These urbanizing areas—examples include Buckhead/Lenox and Perimeter North in Atlanta, Costa Mesa/Newport Beach/Irvine in Los Angeles, Cherry Creek in Denver, and Country Club Plaza in Kansas City—will experience faster employment and office space growth than their metropolitan areas as a whole. (A few fourth generation cores, such as Reston in the Washington, D.C., region, are also urbanizing.)

These metro cores are appealing because they offer safe urban experiences. To continue to be successful, they must be actively managed via a business improvement district organization, a property owners organization, a transportation management association, or the like that can, for example, provide security, maintain common areas, program events, develop programs to manage traffic congestion, and lobby for infrastructure improvements. One of the best examples of such an organization is the Buckhead Coalition in Atlanta, which focuses on the Buckhead/Lenox core.

These "new downtowns" offer investment and development opportunities for nearly every product type. Many have recently seen dramatic declines in office vacancies and they tend to lead their metropolitan areas in effective office rents.

A different future may be in store for third generation metro cores that retain a suburban character. Employment and office growth in these areas, as a general rule, will either just match or fall slightly below growth for their metropolitan areas as a whole. Effective office rents are likely to stay below replacement levels, meaning that little new space can be developed. Similarly, retail and rental housing values may experience a weaker recovery than these sectors are experiencing nationally.

Some of these suburban cores are showing signs of decline, usually as a result of an influx of lower-income residents. Change can occur rapidly as fears of crime and the deterioration of school systems flourish. The Greenspoint area in northwest Houston serves as an example. After 6,000 rental apartments near the Greenspoint Mall completely turned over to low-income families, area residents, shoppers, and office workers perceived that crime was sharply on the rise, a perception fed by a murder outside the mall (even though those involved had no connection with the mall or the core). Office tenants are not leaving in a panic, but certainly the fourth generation metro cores in the region are benefiting. Metro cores like Southfield in the Detroit region and Cumberland/Powers Ferry in Atlanta face similar prospects in the absence of actions to avoid fear-based demographic changes.

The majority of suburban-oriented metro cores are not likely to experience dramatic demographic changes over the next five to ten years, but will still grow slowly relative to the growth of their metropolitan areas. Examples include Tysons Corner in the Washington, D.C., area, King of Prussia in the Philadelphia area, and Encino/Ventura Boulevard in Los Angeles.

Fourth Generation Metro Cores. Metropolitan area employment growth is shifting to fourth generation metro cores, where the bulk of new and

Urbanizing third generation office cores like Atlanta's Perimeter North are attracting new office development such as Faison's 63-acre Concourse complex because they offer safe, attractive pedestrian-oriented urban experiences.

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relocated employment will occur in the late 1990s. These cores are still relatively close to high-end housing. They contain an abundance of land. They have virtually no social problems, like crime or welfare needs. They are in communities that are generally progrowth and impose a tax burden that is below the average for their metropolitan areas. (In general, these high-income areas actually are subsidized by the rest of the metropolitan area taxpayers, particularly for the building of their roads, sewer extensions, and schools.)

In the early 1990s when very little speculative space was being developed, the vast majority of build-to-own relocations and expansions took place in these areas. JC Penney moved its headquarters to Plano on Dallas's fringe; Sears moved its headquarters to Hoffman Estates 45 miles northwest of its former downtown Chicago location; a number of pharmaceutical R&D facilities moved to Route 422, eight miles northwest of Philadelphia's King of Prussia metro core; and U.S. Borax relocated its headquarters to Valencia, 30 miles from downtown Los Angeles, its former base.

Purchases of office buildings in fourth generation cores represent one of the best real estate investment opportunities available. Development opportunities spanning every product type will grow stronger as middle- and upper-level housing is built nearby. Regional- and neighborhood-serving retail will be in demand. Employment growth will generate a need for hotels. Entertainment facilities also will be needed. Located in semirural areas, fourth generation office-oriented metro cores will emerge as nearly self-contained, extremely low-density "new towns." They will develop in response to market forces with little or no direct government interference.

A word of caution is in order. With almost no barriers to entry, no community opposition to new development, and plenty of available land, overbuilding could easily occur. Investors here will not be protected by the barrier to entry provided by the growth management policies pursued in some third generation cores.

Fifth Generation Metro Cores. Because existing fourth generation metro cores still offer considerable capacity for development, fifth generation metro cores probably will not emerge very rapidly in the late 1990s. Still, some have come into being with a focus on owner-occupied warehouses. Examples include warehouse concentrations northwest of Atlanta on I-75 and northeast of Baltimore on I-95. Warehouse development can take place on relatively cheap highway-accessible land well beyond the fringe of the metropolitan area because warehouses employ few workers and thus need not be located near concentrations of employees' housing.

What It All Means

The ways in which metropolitan areas are developing have important national social and policy implications. Residents of central cities and inner suburbs will be increasingly isolated from new employment opportunities, especially given the lack of transit connections to the new and relocating jobs in fourth generation cores. Some inner suburbs will decline rapidly, because they lack a strong job base and have few existing cultural or civic institutions that are regionally supported. Declines in property values and educational standards and an increase in crime are sure to follow.

The declining tax base of the central city and inner suburbs will exacerbate social problems. Municipal costs will increase, which will probably lead to more state takeovers of financially bankrupt jurisdictions. These financial difficulties may also lead to more regional tax sharing, such as the current vigorous debate over this issue in Minneapolis/St. Paul.

As regions continue to grow toward the fringe without building enough limited access highway capacity, which often seems to be the case due to antitax and anti-road-building sentiments, traffic congestion will increase and air and water pollution will worsen.

Current growth trends offer many investment and development opportunities to people who understand the underlying determinants of growth and decline. Some markets that were the most overbuilt in the 1980s may yield some of the best investment bets for the late 1990s. On the other hand, paying as little as 60 cents on the dollar for a five-year-old Class A office building in the wrong metro core may be an investment that never pays off. ❖

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