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Opinion

Will COVID 'End' Cities? No, There's Too Much to Love

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We've all seen the dramatic headlines that COVID spells "the end of cities." Yes, they're facing challenges now, but I believe in the long-term prospects for America's most vibrant urban environments.

Private real estate has long been a growing part of institutions' portfolios, historically producing attractive risk-adjusted returns with lower volatility than that of REITs, stocks and bonds. At a time when everyone seems to be searching for yield, asset managers may get questions about commercial real estate in mixed asset portfolios for investors with a long-term horizon.

Before the COVID-19 pandemic, U.S. real estate market fundamentals were extremely healthy, with strong demand, robust conditions and historically low vacancy rates in almost every U.S. market. There was a lot of liquidity in the marketplace and, as the **National Council of Real Estate**

Investment Fiduciaries' Property Index (NPI) data shows, most investors' returns reflected the excellent conditions.

Employers that wanted to attract top talent aimed to be in hot tech-oriented cities such as San Francisco, Seattle and New York. There was a strong desire among Millennials, in particular, to work in collaborative spaces within dense urban environments. This, in turn, drove the stunning growth in rents. Markets with concentrations of certain industries – especially high tech, life sciences and other innovative industries – were particularly impacted. Cities such as San Francisco, Cambridge/Boston, Bellevue/Seattle, New York, West Los Angeles and Austin experienced 30%-40% cumulative rent growth from 2015-2019.

Since COVID hit the U.S., however, changes have come at a speed that's almost inconceivable. One of the first environments impacted by the pandemic was the workplace. Many didn't anticipate the sudden, widespread work-from-home phenomenon. And while many office-based businesses have made the transition more successfully than anyone could've expected, the impact to the many service-based businesses that cater to office workers and contribute to the heart of a thriving city have been hurt immensely.

Thus, this has led to an acceleration of a trend that had started to take shape prior to the pandemic: a strengthening of suburbanization. Before March 2020, much of our live-work-play activities occurred beyond the central business districts and downtowns of the biggest U.S. cities. Over 75% of those residing in the most populous metro areas live in the suburbs or exurbs. Most of the largest office and housing markets nationwide are, in fact, predominately suburban. While urban population growth exceeded suburban areas briefly from 2010-2014, overall, the suburbs have re-accelerated and outperformed the central business districts every year since 2015.

Now, many believe the pandemic has slowed or stopped – if not fully reversed – the growth of major cities, possibly imperiling the future of urbanization, particularly in the larger, more expensive cities. However, I don't believe future changes will be quite so binary.

To be sure, the widespread work-from-home phenomenon has motivated certain populations to move to the suburbs. Yet this isn't new for parents with young children, for example, who are perpetually seeking lower-cost housing and higher-quality education (although the pandemic may have accentuated the numbers a bit). With Generation Z beginning to enter the workforce, the demand for urban living will remain high.

What does this mean for the cities that are currently seeing out-migrations? Short-term declines in both home prices and rents are likely. However, both were at historic highs in many cities, so younger Millennials and older Gen Z groups may view this as an opportunity to move to a high-cost area that has become slightly more affordable – and higher compensation helps to offset this.

It’s also possible that the high cost of living in areas like San Francisco will spur people to seek out secondary markets like Austin or Nashville that have reputations for offering a high quality of life but a lower cost of living.

Moreover, there’s going to be an ongoing need for office space, although it may look slightly different. Businesses will continue to provide environments that allow for flexibility and collaboration but the configuration of that workspace may change due to social distancing needs. For example, in 2010, offices devoted an average of 225 square feet of space to each employee; by 2019, that was cut to 125 square feet per person. This is one trend that may reverse itself due to new social distancing requirements.

Those predicting the death of cities would do well to reflect on modern American history. New York in the 1970s was anything but a destination. In fact, it was an international symbol of urban decay as recession strained the city’s finances and many people fled to the suburbs.

Today’s situation is quite different. Yes, American cities are stressed but they’re not dying, let alone dead. The prospects for the medium-term are solid. Specifically, we expect to continue to see demand for the best employees in the highest cost areas. Companies like Facebook and **Amazon** are still leasing large swaths of office space, even now.

For city dwellers, the hustle and bustle are the attraction. Moreover, we take pride in being highly resilient. Ask any New Yorker.