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Second-Tier Cities: The Right Size at the Right Cost

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As the United States economy recovers and facility location activity picks up, companies will be facing ever more complex location decisions. Decision factors such as market access and comparative costs will, as always, be a part of the decision. Forecasts for post-recovery labor markets demand that labor availability still be examined closely. And the complex issue of security will now be an important factor in most decisions. So where are companies going to find places that consistently meet these site selection needs? One set of locations that will—and can thus expect a lot of activity in the coming years—is the nation's second tier cities.

DEFINING SECOND TIER CITIES

Second tier cities (STCs) are like good art—hard to define, but you know it when you see it. One recent academic study looked internationally and defined STCs by economic structure rather than by size:

"... spatially distinct areas of economic activity where a specialized set of trade-oriented industries takes root and flourishes, establishing employment and population growth trajectories that are the envy of many other places." (Markusen, Lee and DiGiovanna, 1999, page 3).

This definition does not define STCs by size; the authors simply note that STCs are distinct from the large urban metropolises. The definition does capture the notion that STCs are spatially distinct (not suburbs of large metropolitan areas); they possess a specialized set of activities (paralleling the cluster concept in economic development), and trade-oriented industries (wealth generation), both of which take root (through attraction and growth) in those communities. It also doesn't take into account that STCs have comparatively strong growth characteristics in terms of both population and employment. The authors define a number of different structures, but all are characterized by the attraction of mobile capital and labor. They also discover that the two primary factors for the rise of a second tier city are industrial policy and regional policy.

Meeting Planners International offers a more practical definition, in which a second tier city is a city with a population of more than 300,000 and less than one million. This statement highlights that STCs are not just defined as "smaller" but also as "larger." STCs have a significant presence of their own that distinguishes them from small cities, micropolitan areas, and rural towns. So, STCs have a ceiling ("no bigger than") and a floor ("no less than").

A LOOK AT THE NUMBERS-CENSUS 2000

While the structural definition is revealing, it's important to get a sense of size

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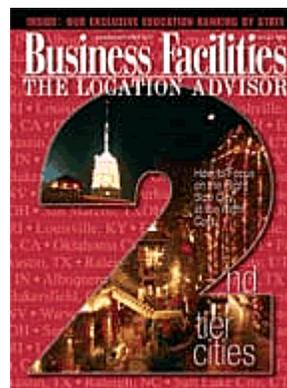
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when discussing STCs. A look at the population statistics from the 2000 U.S. Census provides some interesting insights into the concept of the STC.

The 2000 Census lists 19 Consolidated Metropolitan Statistical Areas (CMSAs), from the New York-New Jersey-Long Island NY-NJ-CT-PA CMSA (1st ranking, 21 million population) to Milwaukee-Racine WI (27th, 1.7 million). Many CMSAs encompass areas characterized by attraction and growth such as the Plano-Frisco area of the Dallas-Ft. Worth TX CMSA (9th, 5.2 million) and the Joliet area of the Chicago-Gary-Kenosha IL-IN-WI CMSA (3rd, 9.1 million). While these areas have distinct characteristics of their own, they would not be classified as STCs because of their presence within a CMSA.

Using the Meeting Planners Association ceiling of one million people would eliminate a number of cities that location decision makers will clearly consider as STCs. In fact, there are 50 CMSA and MSA with populations of one million or more. Many of these, such as the Kansas City MO-KS MSA (26th, 1.78 million), Las Vegas NV-AZ (32nd, 1.56 million), Providence-Fall River-Warwick RI-MA MSA (40th, 1.19 million), and Louisville KY-IN MSA (50th, 1.0 million) would arise in location discussions focusing on STCs.

An alternative working definition for STCs may be those locations with populations less than two million and greater than 350,000. This eliminates the 23 largest cities including some that may be perceived as second tier such as Tampa-St. Petersburg-Clearwater FL (21st, 2.4 million) and Portland-Salem OR-WA CMSA (23rd, 2.3 million). However, this still leaves a wide range and variety of locations-94 would meet this definition. Even with that there will be some cities that would fit into decision makers' concept of an STC but have a population of less than 350,000. One such city would be Reno NV MSA (121st, 339,000) which has been very successful in developing back office and technical service centers, and will be on a lot of short lists as a viable STC as the economy moves forward. Another would be the combined MSAs of Binghamton and Elmira NY (combined 119th, 343,000) which stand poised for successful attraction and growth in the coming years as a second tier alternative to such first tier cities as New York and Philadelphia-Wilmington-Atlantic City PA-NJ-DE-MD CMSA (6th, 6.2 million). Again, the lesson here is that we may not be able to define STCs simply by population alone-there is something more to it.

STCS AND SITE SELECTION ACTIVITY

A precise definition of an STC can be hard to come to, and will always be subject to debate. In the practice of site selection, the discussion of second tier city usually occurs with large office-oriented projects, including headquarters and research and development facilities. Such projects generally have various population criteria as an early part of their location consideration. Projects that a generation ago would have started with a list of the top 10 or 20 cities in the country are the ones that will now find STCs to be prime candidate locations. Manufacturing and distribution projects do not typically start off with an explicit consideration of "second tier cities," but often wind up in one and find great success in doing so.

STCs will have the characteristics that meet the needs of such projects while offering a mix of advantages that make them highly competitive with the largest locations. The STC will have what the large cities have, and have more of it (responsive government, labor growth), enough of it (transportation infrastructure, financial services), and less of it (congestion, housing costs) in a mix that makes them especially attractive. The fundamental value proposition of STCs for locating companies is the right size at the right cost.

- Population-STCs have a substantial enough population to meet the expectations of location decision makers. There is such a range of potential STCs that even those firms seeking cities with a minimum of one million population have 30 STCs from which to choose, ranging from Sacramento-Yolo CA CMSA (25th, 1.8 million) to Oklahoma City OK MSA

(49th, 1.08 million). Similarly, for those firms seeking the advantages of a somewhat smaller location but still wanting a substantial community, there are another 32 STCs between 500,000 and one million population such as Dayton-Springfield OH MSA (53rd, 950,000) and Little Rock-North Little Rock AR MSA (74th, 584,000).

- Higher Education-The presence of institutes of higher learning are important to STC projects in a number of ways. They will be a source of important managerial and technical personnel, they provide opportunities for advanced learning and development for employees, they can be a source of entrepreneurial activity and support, and they add substantially to the quality of life of their communities. The presence of higher education is an attraction and retention factor that is important to many locating firms and will grow in importance with the increase in knowledge-worker based jobs. STCs such as Austin-San Marcos TX MSA (38th, 1.25 million) and Raleigh-Durham-Chapel Hill NC MSA (41st, 1.19 million) have emerged as highly desirable STCs largely as a result of leveraging their institutions of higher education into regional economic prosperity.
- Air Transportation-The presence of strong air service is a factor most companies seek out for their projects. For headquarters and research facilities, this usually requires a location with a hub airport. This factor is one in which the new security environment favors the larger STC; with flight security adding time (sometimes substantial time) to travel, a location that allows executives to avoid a connecting flight on each direction of their trip is very attractive to decision makers. STCs such as Salt Lake City-Ogden UT MSA (36th, 1.3 million) and Memphis TN-AR-MS MSA (44th, 1.14 million) provide excellent hub airport service.
- However, if a hub airport were a "must" requirement for all projects, then there wouldn't be much activity outside the major metro areas.
- Non-hub STCs can often present an efficient non-hub airport alternative characterized by ease of airport access and a wide range of service providers. This, in turn, can present cost savings compared to the "fortress-hubs" often found in larger cities. Greenville-Spartanburg-Anderson SC MSA (52nd, 962,000) is served by most of the large carriers and offers service to almost every hub airport in the eastern half of the country.
- Cluster Clusters-This may be the most important competitive advantage many STCs possess. Most investment projects benefit from being in a community where there is a strong presence of related activities. Companies benefit from an enhanced ability to recruit talent, better access to suppliers and customers, availability of specialized services, and a more knowledgeable and responsive government. This gives STCs a very strong competitive position relative to large cities. Indianapolis IN MSA (29th, 1.6 million) has a strong cluster in medical and pharmaceuticals and is a desirable location for future activity. Albuquerque NM MSA (62nd, 713,000) is leveraging its remarkable concentration of research scientists into becoming a location of choice for the fast-growing security sector.
- Road Transportation (Congestion and Commuting)-A key driver in projects seeking out STCs is to find a location where workers do not face long commutes. Such commutes may arise from long distance (evidence of a housing cost and availability problem-see below) or inadequate infrastructure. Corpus Christi TX MSA (109th, 381,000) consistently ranks at the top of the list as Most Drivable (Sperling's Best Places) and Least Congested (Texas Transportation Institute). Tulsa OK MSA(59th, 803,000) also scores well on this factor and offers relocating companies a low congestion location.
- Housing Availability and Cost-One of the most frequently cited reasons for firms leaving large cities is the housing market. Housing close to urban facilities will be so expensive as to be out of reach of all but the highest-paid executives. In the search for affordable housing, employees can find themselves with commute times of greater than two hours. One statistic that is often used to screen locations is housing cost; it can serve as a first indicator of an acceptable housing market. Real estate firm Coldwell Banker prepares a housing cost comparison index (U.S. average = 100).

STCs rank well below the large cities in housing cost. An example would be to compare locations in first tier city Los Angeles-Riverside-Orange County CA CMSA (2nd, 16.4 million) with second tier city Bakersfield CA MSA (65th, 662,000). In the 2002 report, communities in the Los Angeles CMSA have housing cost index values of 164 in Irvine and 279 in Manhattan Beach, while Bakersfield has a housing cost index of 74.

- Quality of Life-Large cities have the population base to support every kind of quality of life amenity including cultural and historical assets, the arts, professional sports teams, recreation opportunities, etc. One of the challenges of STCs is to communicate their large and diverse quality of life assets to location decision makers who may presume that smaller cities just don't have the quality of life benefits of the larger cities. In fact, STCs can often boast a full set of such assets, more easily accessible, and at lower cost than larger cities. Some STCs such as New Orleans LA MSA (35th, 1.3 million) and Chattanooga TN-GA MSA (90th, 465,000) can demonstrate the vitality of their communities by showing off their revitalization and redevelopment activities. Other STCs such as Charleston-North Charleston SC MSA (77th, 549,000) are able to promote their unique quality of life strengths as one of their most important assets.
- Putting It All Together-Some STCs meet all the definitions of "second tier" including being spatially distinct, attracting trade-oriented activities, demonstrating attractive employment and population growth, and being the right size (smaller than the big cities but bigger than the small cities). These locations have the population, the higher education facilities, the available qualified workforce, the air transportation services, a cluster core, and a high quality of life that firms are seeking. In addition, they do not have the costs, congestion, housing market challenges, commuting and tax issues that often face firms in the larger cities.

Charlotte-Gastonia-Rock Hill NC-SC MSA (34th, 1.5 million) is a second tier city that is very attractive to location decision makers. It has a substantial population and available, quality workforce. It is home to a hub airport as well as major league professional sports teams. Charlotte grew to its status as one of the country's leading second tier cities on the basis of its banking and finance cluster (it is now one of the top U.S. cities in the world for banking) and is a growing center for insurance firms.

Nashville TN MSA (39th, 1.23 million) is a second tier city that shows how attractive and successful such locations can be. The city is of substantial size but is still half the size of the smallest of the 20 largest cities in the U.S. It has maintained a good quality workforce with strong education achievement characteristics. Vanderbilt University is one of the top universities in the country and is the hub of the vibrant west-end village part of the city. While the city is no longer a hub airport for one airline, the Nashville airport now has more flights to more locations from multiple carriers than it did when it was a hub. The city is well known as the home of country music and as such has a strong entertainment industry cluster. The community has a strong quality of life with a growing set of cultural assets, major league professional sports teams, and a diverse set of housing and living alternatives supported by a strong road and commuter network. And the state, community and region have political leadership committed to economic development.

Facility location activity is increasing in response to economic expansion and to ever-present cost pressures. While second tier cities are hard to define precisely, they present a location alternative with manageable size, strong assets, lower costs and development-savvy leadership. Companies will find themselves well served to take a close look at second tier cities.

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