

THE

Real Estate

AUSTIN LETTER

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Dear Client:

The most important change in Austin's commercial real estate market in recent years is occurring right now and the trend lines indicate it will have an even more profound impact in the immediate future.

It's good news if you lease office space. **A flood of sublease office space is coming on the market**, as we first reported to you 6/15/01. Now it's picking up. This is particularly true in the northwest part of the Austin area. **Mike Buls** of Buls/Hodge Consulting, reports the northwest is continuing to show an increase in sublease space availability. "It currently represents 65% of the market, while in February it was 51%," Buls pointed out.

This sublease phenomenon is **driving down office rental rates and even delaying construction of some new buildings**. **Bill Wendlandt's** Office Leasing Advisors (OLA) company says rental rates in the northwest area were reduced in some buildings by as much as \$5-\$6 per sq.ft. Rates fell as tenants made deals to get subtenants in their unused space. "The 'best buys' for companies looking for space continue to be in the sublease inventory," OLA notes.

"Proof of the northwest slowdown came in mid-May when **construction was suspended on the 150,000 sq.ft. Riata Gateway building** (on Hwy183, between Duval and Oak Knoll)," OLA noted. "With its large 50,000 sq.ft. floors and its proximity to the Riata apartment and office complexes, Riata Gateway would have been in high demand a year ago."

The trend is unmistakable, and it will be **moving from the northwest into other sectors of the Austin office market**. "Even the southwest sector showed signs of the slowdown as construction was further delayed on the previously-announced RobRoy/360 and San Clemente office projects," OLA reports. Traditionally, the last to be affected by a slowdown is the South MoPac/Loop1 and South Loop360 area. It's fairly solid for the time being.

What about downtown? If you have an interest in downtown office space, you're going to feel a major impact. With new office buildings coming on line to join the massive amount of sublease space flooding the market, OLA is projecting that **rental rates in the Central Business District will fall 20% to 25% from the all-time high rates seen last year**. And, this should continue for the remainder of this year through the first part of 2002.

We're not alone. Denver's version of the Silicon Valley — the US36 northwest corridor — had its office vacancy rate skyrocket from 1% at the end of 2000 to 28% today. The culprit: a huge amount of sublease office space in Denver, and Austin may be a beneficiary.

When buildings under construction are included, there's about 1.5 million sq.ft. of subleased space on the market, **more than even existed along Denver's high tech corridor just a few years ago**, according to **Chris Phenicie**, a commercial real estate broker who specializes in doing deals along Denver's high tech corridor (as quoted in the *Rocky Mountain News*).

So, how does this benefit Austin? Phenicie is listing a 133,000 sq.ft. building for **Sun Microsystems** in the Westmoor Technology Park. "They were ready to occupy it — they have the furniture in there and everything," said Phenicie "But, it doesn't have to do with the usual dot-com reasons."

"The group they had slotted to move into that building is now going down to Austin," Phenicie disclosed. "There have been so many high tech layoffs in Austin, they feel like it is a **real opportunity to recruit people they need down there.**" So, in some cases, the news of Austin's layoffs is viewed as beneficial to companies seeking trained talent.

Commercial real estate experts in Denver are likening what is happening now in their high tech sector to what happened to **downtown Denver in the mid-1980s**. At that time, downtown had an office vacancy rate that topped 30% — right up there with what was going on in Austin, when we were in the midst of our real estate recession.

The difference in Denver now, is the US36 high tech corridor has **spiraled downward much faster** — due, in part, to the fact the tech sector is much smaller than downtown. What are the prospects for Denver? Phenicie said he expects the market will end the year with about a million square feet of subleased office space available, and it will **take about a year to lease up that space**. He expects building to pick up again by the end of 2001.

Let's put that into perspective with Austin. **Mike Buls**, of Buls/Hodge Consulting, **reports the available office sublease space, throughout the area, is now about 2.85 million sq.ft.** As we pointed out in the previous story, about 65% of that total is in Austin's northwest sector, where high tech businesses abound. So, you could extrapolate that Austin has more tech sublease space available than can be found in Denver's tech sector.

Well, is this good or bad? Depends on your perspective. If you're looking for office space, high tech or not, **you can get a much better deal than you could a year ago**. Hard-nosed businesses, like Sun, who see Austin layoffs as opportunities for them, can move into this area for less office investment than before. But, if you're trying to sublease some of your space, **be ready to wheel and deal on your rates**. It's now a tenant's market.

Even though the lawsuit was first filed in Austin in 1992, and the USSupreme Court this week let stand the Hopwood case that prohibits the consideration of race in college admissions, it will be a long time before a final, definitive ruling locks in stone this controversial ruling one way or the other.

You'll recall that, for years, affirmative action policies allowed universities to admit a diverse student body by giving preferences to minorities. But, in 1996, a local federal court **prohibited any consideration of race, even as one factor among many, either to maintain an ethnically diverse student body or to cure the effects of past discrimination.** The court found the affirmative action policy aimed at ending racial discrimination actually discriminated against qualified white students seeking admission to the UTAustin School of Law.

Since that time, UTAustin has followed the law, but has worked "aggressively to recruit those minority students that the courts will let us admit," said **Douglas Laycock**, a UTAustin law school professor. But, *other* universities, not affected by the Hopwood ruling, **continued aggressively recruiting qualified minority students**, using the affirmative action preferences, putting UTAustin at a competitive disadvantage in its quest to maintain a diverse student body. This week's High Court ruling keeps the status quo.

The reason this will drag on: The USSupreme Court a month ago let stand an *opposite* ruling from the University of Washington Law School. And, there are other similar cases from other states working their way through the federal court system. **So far, the highest court in the land has not actually considered the basic question.** UTAustin President **Larry Faulkner** says "At some point, the court will take a case involving these issues and will resolve them for the nation as a whole."

President George W. Bush's political cadre has California in its crosshairs for a potential Bush re-election effort in 2004. The Bush brain trust would like to oust the state's Democratic Governor as the first major step to winning the nation's biggest political prize. The GOP has zeroed in on a candidate who it thinks can win — and it's not Arnold Schwarzenegger.

In fact, just this week, Bush administration political officials gathered at the White House with the man they feel is the strongest contender – Los Angeles Mayor **Richard Riordan**. Riordan is a rare Republican who was elected, and re-elected, mayor of heavily-Democratic LA. He was prevented from seeking another term because of term limits, but now that Riordan is about to give up the post – to a Democrat – he has his eyes on the California Governor's mansion.

If Riordan runs, he'll have an uphill battle to defeat incumbent Democrat **Gray Davis**. The **GOP has a dismal record in recent California elections**, but if Riordan wins it would energize the Republican Party there and provide a big impetus to Bush. And there's no question a Bush presidential re-election effort would be bolstered mightily if it could carry California.

If high tech companies want to retain good employees, one way to do it is to encourage them, and support them, in spending more time away from work — even though the company culture may be focusing on 10-12 hour workdays.

The Benchmark Company has discovered that a key element in retention strategies is to encourage employees to become more involved in their communities. “One negative of the tech age has been a tendency for people to become **less interdependent, to replace human interactions with virtual interactions,**” observes Benchmark CEO **Rob Balon**, in the company’s “Austin at The Crossroads” report.

“The message here is simple,” says Balon. “Companies that initiate programs for employees to become involved in the community take the first step toward **creating citizens as opposed to residents.**”

“Research has shown that **citizens are more likely to put down roots and stay.** *Residents*, who by definition are less involved in their community, are not as likely to stay,” notes Balon.

Balon concludes that a way to narrow the perception of a Digital Divide (the wide separation between the haves and have-nots in a high tech-oriented community) is to **get employees involved.** He maintains the byproduct of that involvement is not only visible, but also tangible.

Texas ranks first among all states in crude oil and natural gas output. And, the Lone Star State is also the overall leader in the amount of energy consumed. The Perryman Group reports that, of all the energy used in Texas, 46% is generated from petroleum, 37% from natural gas, 13% from coal, 3% from uranium and 0.7% from renewable resources (solar, wind, biomass gases).

Dr. Louis Overholster is trying very hard not to show his age and to stay up-to-date with tech-speak. Yesterday, he referred to the eraser on one end of his pencil as the pencil’s delete key!

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