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Dear Client:

**If you're interested in acquiring office space, moving or re-negotiating, hang on for a little while longer. Office rental rates are likely to drop as much as 20% by the end of the year.** That's the prediction of **Charles Heimsath**, president of Capitol Market Research.

Heimsath points out the steady pace of increasing occupancy and escalating rents has come to an abrupt end. In the first six months, **pre-leasing in buildings under construction virtually stopped** and occupancy in existing buildings decreased from 95.5% in December to 92.4% in June. And, importantly, **absorption was negative for the first time in ten years**, in spite of the completion of several pre-leased buildings.

What will drive down the office rental rates so precipitously? **Supply and (lack of) demand.** With 2.5 million sq.ft. planned for completion this fall and a growing inventory of sublease space (which now totals 2.2 million sq.ft.), **the market is likely to drop to 81% occupancy** (including the sublease space), Heimsath says.

In the first six months, average rental rates citywide dropped slightly and Class A rates barely moved. "This situation is unlikely to last when there is so much sublease space available at lower rates," Heimsath forecasts. "In fact, a few **leasing agents said that they would do deals at rates substantially below their quoted rates.**"

So, how can a tenant maximize this market change (especially since tenants have been hammered in the last couple of years by a quickly escalating market)? **Bill Wendlandt's** Office Leasing Advisors (OLA) suggests "**if your company is within 1-2 years of a lease expiration, it is likely your landlord would be willing to enter into negotiations for a lease renewal.** Building owners know how much space is now available, and they will make an attractive deal to keep you as a tenant."

What if your company is looking for **opportunities to expand**? "If you need more space, or know you will in the future, now is a good time to explore such an addition," OLA observes. "**Tenant finish allowances will be greater**, and you can add things like **renewal clauses, expansion options** and other things."

As a tenant, now is a good time to assess your options, and year-end could be even better, especially if you want to renegotiate your lease in return for extending the overall term.

**Austin's economy is uneven. Some sectors are doing very well right now – though you wouldn't get that impression with the barrage of information about layoffs. For instance, how much have you heard about new companies getting ready to open here, and the number of workers they're planning to hire? And, how much have you heard about expansion of local companies? Well, get ready because you're going to hear all of that right now.**

Here are some examples of new companies that have announced they will open in the Austin area during 2001, and the number of employees they estimate they will hire in this calendar year: **Costco Wholesale**, a wholesale members only product store (200 jobs) ... **Edeagroup, Inc.** transaction-based software (60 jobs) ... **Ignite! Inc.**, educational software (70 jobs) ... **Jefferson Wells International**, accounting services (40 jobs) ... and **Mahindra Consulting**, the IT division of Mahindra & Mahindra Ltd. (50 jobs).

That's not all. Here are some local companies expanding in Austin this year: **Harte-Hanks**, direct marketing services (250 jobs) ... **Prodigy Communications**, DSL Internet service provider (150 jobs) ... **Tokyo Electron**, semiconductor equipment (50 jobs) ... and **Active Power**, uninterruptible power source manufacturer (40 jobs).

These jobs estimates were **confirmed directly with the companies** by the Greater Austin Chamber of Commerce (GACofC) within the last few days. The GACofC said "it also appears that **most laid off workers are getting reabsorbed into the workforce**, according to the Texas Workforce Commission.

Obviously, the list is not complete. All you have to do is refer back to our 6/29/01 issue where we brought you a report from Denver, quoting a commercial real estate broker, saying **Sun Microsystems** was listing a 133,000 sq.ft. building ("they have the furniture in there and everything") but "**the group they had ready to move into that building is now going down to Austin**. They feel 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."

Interestingly, a similar scenario is being played out nationally. Some industries are doing very well, while others are closing plants and laying off workers. **On balance, it appears more sectors are in good shape than bad.** Our friends at *The Kiplinger Letter* have surveyed various industries nationwide and here, in a capsule, is their analysis:

Energy (booming), Housing (a near record year), Construction of offices, schools, roads and bridges (strong), Health Care (mostly flying high), Aerospace (coasting), Entertainment (mixed), Autos (big sales but smaller profits), Retail (a middling year), Restaurants (faring pretty well), Hotels (off a bit), Insurance (spotty), Financial Services (mixed), Agriculture (so-so), Technology (lousy), Telecom (dismal), Steel (slammed by cheaper imports), Chemicals (reeling), Appliances and Furniture (lagging), Publishing (rotten), Airlines (suffering) and Freight Transportation (poor). This should help you keep the national economy in perspective.

**Keep your eye on the construction of a new bridge rising alongside the northbound lanes of IH35 at the southside Ben White Blvd intersection (though you can't be faulted for staying away from that massive highway construction nightmare).** Nothing is more important to the future of the IH35 /Ben White project than this bridge.

“This is Detour 1,” says **John Murray**, project manager for the Texas Department of Transportation (TxDOT). “It’s a critical path for us. When it’s done, then we can progress underneath. Everything rests on this.”

“Everything” refers to the guts of the project – the **realignment and depression of Ben White Blvd** under the interstate and construction of **new frontage roads** for Ben White as well. While contractors have made strong progress on the excavation on both sides of IH35, they cannot continue until the **old interstate bridges are demolished** and the support slopes cleared away. So, it’s easy to understand the importance of opening the new bridge to handle IH35 traffic.

**When will the new bridge open?** Murray expects to have the first span open by the **end of the year**. The new bridge will be wide enough for **six lanes of traffic**, with shoulders. This means the current north-south flow of motorists on IH35 can continue unimpeded through the construction zone, with just a slight easterly detour.

The new bridge will handle the entire interstate traffic load for most of the rest of the five-year \$88 million project. But, and this is pretty interesting, a **second new bridge will be built later in the project** to carry southbound-only traffic on IH35.

While you may cuss these hot, dry summer days, they are perfect for highway construction. “The weather had hurt us,” Murray says, “but it’s gotten better” after a wetter-than normal spring. In the meantime, **motorists are enduring slow commutes** through the much-maligned intersection. “**We know people are upset**, but we still have to do the best possible job. We have to look at the long term results,” Murray added.

**If you see about 700 younger-than-normal looking students, surrounded by as many as 40 UT Austin students wandering around the campus in a couple of weeks, be nice to them. The 700 are the best and brightest youngsters from Texas high schools. And, UT Austin is doing its best to entice them to enroll on the Forty Acres when they graduate.**

They’ll be in Austin for three days, starting 7/26/01, and will participate in academic lectures, campus tours, group discussions and social events. They will interact with faculty and students. This is the 20<sup>th</sup> year UT Austin has staged this event the academic types call a colloquium. But, frankly, it’s a **recruiting event that Football Coach Mack Brown would envy**. And it works. UT Austin regularly ranks among the **best in the nation, with the highest number of National Merit Scholars** enrolling as freshmen each year.

**“Capital of an Oil State Feels High-Tech Fall. But Austin Would Be Envy of Many Cities.”** That was the headline in *The New York Times* Sunday, 7/8/01. The lengthy article also featured a picture of the see-through Intel building downtown with the caption, “The unfinished Intel building is a symbol of how the downturn in the high-tech market has affected Austin, Texas.”

The article in the nation’s most influential daily newspaper highlights the problems. “In recent months, **nearly 15,000 people have been laid off** here as some companies have closed or streamlined. There is a **glut of high-end houses** and no shortage of **sports cars with ‘For Sale’ signs**,” noted reporter **Jim Yardley**.

But, Yardley also balances the article by pointing out **“most cities would ache to have Austin’s problems.”** He writes: “though the city’s unemployment has roughly doubled since December, it still stands at a paltry 3.3%. This city of 643,000 people, called Silicon Hills, has benefited from a huge influx of new wealth. From 1994 to 1999, **roughly 17,000 ‘millionaire households’ were created**, according to a consulting firm.”

“A \$94 million performing arts center is under construction and a once-moribund downtown is very much alive. Only a year ago *Forbes* magazine ranked Austin as the **best city in the nation in which to do business**,” Yardley continued.

The article is a general recitation of facts, many of which we have passed along to you in previous editions of the newsletter. But, it’s important to realize we’re not operating in a vacuum here — that **readers all over the nation, and the world for that matter, are kept informed on what’s happening to the Austin area economically.** And this article, while flagging the negative, at least is good, balanced reporting – keeping the perspective that while we may have been flying very high in the past, we’re still cruising along at a higher altitude than most other cities during these barrel-rolling economic times.

Speaking of economics, **Dr. Louis Overholster** always manages to keep the proper perspective. He points out it now costs more to amuse a child than it did to put his father through college!

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