

THE

*Real Spelce*

# AUSTIN LETTER

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Dear Client:

**It was a blip – not the makings of a real, upward trend. After showing a slight uptick in July, retail sales in the Austin area went back in the dumper in August and, this time, normally-strong Williamson County dropped into negative territory for the first time this year.**

In the most recent numbers – sales taxes collected in August – the City of Austin collections were a bit lower than August 2000. And, Travis County collections, which were somewhat higher the previous month, also **dropped into negative year-over-year territory**. But, the more disturbing report came out of growing Williamson County, where July's year-over-year sales were up 10.04%.

Williamson County actually **collected less sales tax this August than August 2000 and the same held true for the city of Round Rock proper**. Not once this year had Williamson County's sales tax collections dropped below the previous year. This was a trend that was not anticipated.

Only the retail powerhouse of **San Marcos/Hays County is bucking the trend, showing strong recent and year-to-date increases in retail sales (+12% in August for Hays County, +8.37% for San Marcos), as measured by sales tax collections**. Why this part of our metro area? Well, the bulk of the San Marcos/Hays County numbers come from the massive Outlet Malls that attract bargain hunters from a very wide geographic area with marked-down prices.

In other words, during difficult economic times, the fully priced retailers (albeit valiantly trying to lure consumers with regular sales) are the first to start hurting. **Shoppers, sensing economic unrest, are more inclined to travel a greater distance to save some bucks**. Also, if you check out the Outlet Mall parking lots, you'll see huge tour buses, giving sightseeing tourists a bargain-shopping break.

The two tiniest counties in our 5-county metro area (Bastrop and Caldwell) are maintaining a healthy increase each month over the previous year. And, if you simply looked at the year-to-date totals, you'll see retail sales as measured by sales tax collections are up for the year. Not bad, you say. And it provides some comfort. **But, you depend upon us to spot trends for you and the trend lines are decidedly soft or negative, month-to-month**. We'll continue to watch this for you – especially as none of these numbers reflect the economic impact of the events of 9/11/01, and they do not reflect the final results of August's sales tax holiday.

**It's not late-breaking news that Austin area apartments are offering incentives to lure renters. After all, we've been alerting you to this condition for months (see our 8/10/01 issue for examples of deals that were being offered new tenants at that time). The news value is *why* there was a decline in the rate of occupancy during the 3<sup>rd</sup> quarter (when students return to Austin) for the first time since 1996.**

The Austin area traditionally gets an economic surge when students return from other parts of the state to **occupy apartments and start spending mom and dad's money (earned elsewhere) in our local businesses.** The big kahuna, as always, is UTAustin – with the largest single campus population in the nation. But, the record number of UTAustin students who showed up did not trigger the expected upsurge in apartment occupancy. So, what happened?

Oh sure, you can say **"it's the economy."** And that's right. But, this generalization is too broad; it doesn't explain anything precisely. And, you can point out there are still **new apartment projects coming on-line**, creating new units ready for occupancy. While that's true, the newly completed projects have not dumped enough units on the market to explain the full extent of what's going on here. In fact, about a third of the construction projects in the pipeline have been delayed, according to Austin Investor Interests (AII).

"The primary reasons for vacancy differed from the previous quarters this year," reported AII, a firm that tracks the apartment industry in the Austin area. One of the reasons can be explained by the **aggressive competition within the apartment industry itself.** AII noted the central and southern sectors reported losing tenants to competing properties in the north.

Another factor: properties in the north (where there is a heavy concentration of high tech businesses) are reporting they are **losing tenants because of "many job transfers."** Obviously, this includes those techies who have lost jobs and moved on to other markets, or who have moved to locations nearer their new local jobs.

Interestingly, another marketplace force is at work here. **Apartment tenants are "moving up" to home ownership.** With mortgage interest rates running at the lowest level in years, the monthly mortgage payment on a small "first home" equates to what many tenants are paying in apartment rents.

Despite declines in apartment occupancy for three consecutive quarters, **there apparently remains a level of optimism among some in the apartment development community.** How else can you explain new starts included 2,953 units – bringing the total number of units under construction during the 3<sup>rd</sup> quarter to 12, 743. On top of this, AII reports eight new projects totaling 2,984 units were submitted into the planning process.

The optimism is not widespread because, as we've told you, about a third of the projects have been **delayed or placed on indefinite hold due to the market conditions.** It's a mixed bag.

**Office vacancy rates are rising and rental rates are declining, but leasing activity has not stopped. Deals are still being done, because Austin's office space market is now a tenant's market.** However, demand for office space still cannot keep up with the growing amount of sublease space returning to the market each quarter.

There were some significant transactions during the 3<sup>rd</sup> quarter. Colliers Oxford, a real estate company specializing in commercial properties, ticked off some of the more sizable deals: **Display Products Technology** (100,000 sq.ft. at Crystal Park Plaza), **BroadJump** (90,000 sq.ft. at the Domain), **Winstead Sechrest & Minick** (40,000 sq.ft. at Fourth and Congress), **Texas Networking Inc.** (25,000 sq.ft. at The Terrace), **Mental Health Network** (23,000 sq.ft. at Stonebridge I), **Bluecurrent** (13,000 sq.ft. at Plaza 7000) and **Roy F. Weston, Inc.** (12,000 sq.ft. at Barton Oaks).

So, what's the latest on the Austin area office space market? Colliers Oxford reports that during the 3<sup>rd</sup> quarter, **overall rental rates dropped \$1 per rentable sq.ft., or 3.7%**, since the 2<sup>nd</sup> quarter. The Central Business District continued to soften as **Class A rental rates dropped \$2.18 per rentable sq.ft., or 6.3%**, since the 2<sup>nd</sup> quarter.

Citywide direct vacancy (excluding sublease space) rose from the 2<sup>nd</sup> quarter's 7.5% to 8.6%. That's a lot in just 90 days. **Overall vacancy from 14.7% to 16.1%, the highest since the 1992 vacancy rate of 17.4%**, reports Colliers Oxford. The impact of sublease space is dramatic.

The total amount of sublease space on the market, as of 10/15/01 according to **Mike Buls** of Buls/Hodge Consulting, is a whopping 2,746,000 sq.ft. That's roughly half of all the space on the market today. So where's the sublease space coming from? "The abundance of this space is from the high-tech industry and its service providers," says Colliers Oxford. So, give us some names. "**Charles Schwab, Janus Funds, Trilogy, BMC Software, Vignette, Tyco, Agillion and Motorola** are contributing large percentages of the space that has been returning to the market this year," Colliers Oxford notes.

By the way, Buls says that even though the overall amount of sublease space is growing, **the sublease space in the tech-heavy northwest may be stabilizing.** He says most of the reported new sublease space coming on the market is from other sectors of the city, such as the north and the Central Business District. He points out there are not only **fewer subleases added to the mix from the northwest**, but there is also greater leasing activity in the northwest.

Looking down the road to the end of the year, Colliers Oxford points out there will be about **1.5 million sq.ft. of new office space construction that will be completed by year-end 2001.** And "only a small portion of that space is reported as pre-leased," the company notes. So, if you're looking for space, you will have a lot from which to choose and plenty of location opportunities. This means you can also probably negotiate some pretty decent rental rates.

**Those supporting passage of the Travis County bond propositions on the 11/6/01 ballot talk a lot about opportunity and timing – the *opportunity* to address traffic and safety needs, and the *timing* to get the lowest cost of money for the projects.** There are four separate bond proposals on the ballot and they all cost money.

Proposition 1 provides \$57.4 million for county **roads, bridges, drainage and pedestrian access** improvements. Proposition 2 will allocate \$28.6 million for improving two existing **metro parks** and purchasing the land for the creation of two new regional **playing fields**. Proposition 3 will allot \$32.7 million to purchase **right-of-way for SH45North and FM1826South**. And Proposition 4 provides \$66.2 million to purchase **right-of-way land for SH130**, to divert traffic from IH35.

If all four bond propositions are approved, the average Travis County homeowner (based on the median property value of \$172,000) would pay an **additional \$3.50 per month in county property taxes**.

Supporters point out the timing is “perfect” for these long-needed projects. “With the economic downturn, **interest rates are at their lowest, making this the best time for the county to borrow funds** and put people to work on these projects,” commented **Cathy Bonner**, a spokesman for the coalition of business, civic and neighborhood groups pushing for passage.

The November election is likely to sneak up on many voters. There are **no highly controversial amendments** to the Texas Constitution and the special election for Mayor of Austin has, so far, not generated many sparks to stir up the interest of voters. When you look at the calendar, voting day is less than three weeks away. Not much time to motivate voters to go to the polls. So, you can assume this will be a **very low voter turnout election**. This means any well-organized interest group, no matter how small, could have an outsized impact on the outcome.

**Dr. Louis Overholster** said he really like this correction printed in the paper: “The marriage of Miss Frieda van Amburg and Willie Branton, which was announced in this paper a few weeks ago, was a mistake which we wish to correct!”

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