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Dear Client:

The amount of sublease office space in the Austin area is increasing and the rental rates are dropping. As a result, it doesn't appear as if there is anything approaching a turnaround in the overall office space leasing picture. It's still a renter's market.

According to **Mike Buls** of Buls/Hodge Consulting, there was an increase of sublease space on the market of 261,000 sq.ft. during the month of November. It was up 138,000 sq.ft. just during the past two weeks of the month. **All this ran the total available square footage up to 2,949,000 sq.ft.** By the way, these are *net* numbers. In reality, 346,000 sq.ft. came on the market in November because 85,000 sq.ft. of sublease space was leased during the month.

Where is this activity occurring? Interestingly, **Buls reports the northwest sector is actually shrinking as a sublease market** – from 59% of the overall market for the 11/15/01 report down to 54% of the 11/30/01 report. Right now, there is a total of 1,599,000 sq.ft. of sublease space for renting in the northwest. Obviously, this is still a big number and it reflects the scaling back in the high tech sector of our economy.

If the overall total is rising and the northwest is shrinking as a percentage of the whole, which other sectors are seeing more sublease space becoming available? Buls notes the 346,000 sq.ft. **increase in sublease space in November occurred mostly in the Central Business District, the North and North Central.** In fact, he points out the Central Business District now has a 15.2% adjusted vacancy rate.

It's becoming more and more a renter's market in the Austin area. Even before there is any negotiating between a prospective tenant and the sub-lessor, **the average advertised rate has dropped from \$21 to \$19 for sublease space**, not adjusted for class. And you know there is a lot of haggling going on – with the tenants holding the upper hand.

But, if you're looking for a bargain on office space, you need to be aware of the **pitfalls of sub-leasing**. Almost by definition, the company that is offering sub-lease space is a company that is not necessarily thriving. And it could be a company teetering on the brink of survival or bankruptcy. What should you do if you come across a good deal? Be sure to structure your **sub-lease so it is set up to remain in effect in the event the master tenant defaults on the master lease**. This could help you avoid a future headache.

Down-ballot candidates may have a problem getting voter attention during their campaigns for the March primary party elections. It's true 2002 will be an important election year for Texans. And, both Democrats and Republicans are working overtime to avoid intra-party bitter battles in the spring, so they can emerge strong (with fat war chests) to take on the other party in the fall campaign.

As it stands right now – with less than 30 days before the filing deadline – both parties are trying to make sure they have **just one major candidate filing for the state's top statewide posts.** So far, with one notable exception, it's working like a charm. If this holds up, the down-ballot candidates in the spring will have to generate voter interest in their own races all by themselves. **There will be no major party get-out-the-vote effort and no heightened TV advertising** for governor, lieutenant governor, attorney general, etc. to interest voters in turning out for the 3/12/01 voting day.

The Democrats and the Republicans have exactly the same statewide goal for the next few months. **They want a coronation, instead of a contested primary, for all their statewide candidates.** This will allow them to raise as much money as possible, without spending most of it trying to win their own party's nomination. Then, in the fall General Election, they can emerge free of party primary scars with a bunch of bucks to bash the other guys.

The “notable exception” to this plan is the Democrat's contest for a rare political plum, a vacant 6-year USSenate term. The Republicans have pretty much settled on Attorney General **John Cornyn** as their anointed nominee to replace GOP senior Senator **Phil Gramm**, who is not seeking re-election. Cornyn will spend all spring raising money and organizing an expensive fall campaign – while watching the Dems batter each other, as they spend most of their campaign cash.

The prospect of an open USSenate seat is just too appealing for a number of Democrats, whose party has not held that seat since Midwestern University professor **John Tower** was a surprise GOP winner in 1961. As a result, the Dems have a host of recognizable names seeking the party nomination in March for the right to run against Cornyn in November.

You've got former Dallas Mayor **Ron Kirk**, former Attorney General **Dan Morales**, four-term Houston area Congressman **Ken Bentsen**, former USSenate candidate **Victor Morales**, lawyer and sports agent **Ed Cunningham**, etc. One or two of those candidates could withdraw before the filing deadline.

But that's it. Unless there's a seismic shift in the two parties in the next few weeks, **all other statewide races will be quiet as can be – waiting for the fall.** Those running in contested local primary races, including for Congress, the State Senate and the Legislature, will have a tough time waking up voters to their candidacies – especially on the GOP side. It'll be interesting to watch this run-up to the all-important November General Election.

The big, long-haul Texas-based airlines are seeing a little glimmer of hope even though they are still in serious trouble. Dallas-Fort Worth based American Airlines and Houston-based Continental are reporting traffic numbers that show a positive trend. But, you have to dig a little bit to see what's happening.

In November, American Airlines reported its' passenger traffic was down by 25%. That's better than October, when it was off by 27.9%. Ditto for Continental. The Houston-based carrier was off 16.7% in November after being down by 22.8% in October. **Both airlines are trending in the right direction.** But, they still are feeling the effects of the double-whammy of less traffic and lower fares.

Looking at both these carriers closely, it's interesting to note their domestic routes are doing much better than their international flights. When you remove the international numbers from American Airlines' total, you see the **domestic flights are only down about 2.2%** from the same time in 2000. **Continental is doing even better, down last month only 0.1%** on its domestic flights compared to the year before. So there are some rays of hope.

But, make no mistake, these very important parts of the Texas economy are still struggling. You can look for both of them to report significant losses at year-end. In fact Continental, in a filing last week with the US Securities and Exchange **Commission said it was still spending \$3 million-\$4 million a day more than it was bringing in.** American's numbers were not available, but they could be just as high – or higher. (Footnote: as of this week, Trans World Airlines ceased to exist as a brand. TWA has now been formally absorbed into American.)

In spite of a dip in passenger traffic, Austin-Bergstrom International Airport (ABIA) appears to be rebounding faster than the national average decrease. At ABIA, through October 2001 (the latest numbers available), passenger traffic was down only 4%, compared to last year at the same time. The airline trade organization, The Air Transport Association, reports system-wide passenger totals decreased 23%.

Well, if ABIA's year-to-date passenger totals are down 4%, how are the individual airlines doing as they compete with each other? **The market monster, Southwest Airlines, is hurting the least in Austin. Its passenger volume is down only 1% for the year.** The reason for this is Southwest had been on a major roll prior to 9/11/01, racking up huge gains for the year. That's why a 15% drop for Southwest in October only pulled the airline down 1% year-to-date.

The others, year-to-date (**ranked in order of market share behind #1 Southwest**): American Airlines, down 10% ... Delta Air Lines, also down 10% ... Continental Airlines, down only 2% ... United Airlines, down 3% ... America West Airlines, down 3% and Northwest Airlines, with the fewest passengers, up 5%. We'll keep tracking this important economic indicator.

It looks like it's going to be a mixed bag for retailers this all-important holiday shopping season. Some will do okay, others will have problems. Here's a quick guide to the probable winners and losers.

Low-cost/low price operations should do well. Price-conscious consumers, especially those who've been brushed by the layoff broom, will show up at **Wal-Mart and Sam's Club**, as an example, to stretch their holiday dollars. **Toys will do well** because Mom and Dad are still going to spend on the kids, no matter the economic circumstances.

Home improvement stores (Home Depot, Lowe's, etc.) and **home furnishing operations** (Pier 1, Bed, Bath & Beyond, etc.) will do well because of nesting/family instincts that have been heightened as a result of 9/11/01. The big ticket furniture and appliance items will not do as well as lower cost products like pillows, rugs, cookware, etc. The San Marcos Outlet malls should do well because of price points.

Upper end operations will not do as well. Luxury stores, fancy specialty shops, apparel sellers, specialty outlets, department stores, etc. are hoping for a flat year, rather than anticipating any increase in business. Though the folks peddling entertainment items such as DVDs TVs, video games and the like may do okay if the mark-downs are tantalizing enough.

This could also be a **good selling season for catalog giants** (like Land's End and L.L. Bean) and for e-commerce in general. Most observers are predicting a **good year for sales on the Internet**, as more and more folks become comfortable with that method of shopping now that early fears about credit card security have all but vanished. Finally, without regard for specific retail operations, results from the first two weeks since Thanksgiving indicate a trace of vigor still left in the shopping public.

Dr. Louis Overholster likes to point out that a little luck and a little government are necessary in life – but only a fool trusts either of them!

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