

THE

Real Estate

AUSTIN LETTER

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Dear Client:

“Austin? That tech-busted city where Dell, AMD, Motorola and others have laid off tens of thousands of workers, gets the highest ranking in a national survey of real estate markets?” The *SmartMoney* Real Estate Index asked those questions and followed that with: “Who are we kidding? We’re not kidding, we just did the math?”

The *SmartMoney* editors said “our research shows that plenty of other, mostly smaller, companies are poised to hire the folks let go by those big names.” But what about real estate? **“Home prices never got as overheated in Austin as they did elsewhere,** so they won’t freeze up as badly.” So *SmartMoney* suggests Austin will be the best market in the nation as far as appreciation of housing values through 2003.

SmartMoney assessed the nation’s 65 biggest real estate markets and projected their findings out to the end of 2003. “Since Austin took its lumps early in this recession, it may well recover sooner. In fact, **Austin’s score of 76.6** in our *SmartMoney* Real Estate Index is **head and shoulders above the nearest competitor,** Nashville (71.2),” reports the magazine.

An ideal city where all factors are as favorable as possible would get a score of 100 in the Index. Markets with scores of 60 and above are **primed for price appreciation;** those below 50 may see values erode. Between 50 and 60, stability reigns in *SmartMoney*’s analysis.

Analyzing regional data that affects housing prices, *SmartMoney* gave each market zero to 10 points for predicted **job growth, recession resistance** (how many quarters out of the next 10 will bring good employment news), recent trends in housing **affordability** and the amount of **building permits** that will be issued, as projected by Economy.com. A city’s **vacancy rate** was assessed, as were **demographic changes** in each market (were typical 35-to-49 year-old homebuyers coming or going?). Lastly, the company **fine-tuned for layoffs** that occurred after its employment rates were generated.

Obviously, the Austin housing market did not get a perfect score, but it did get best in the nation. If *SmartMoney* mag is on target, then the **future is bright indeed for residential real estate in the Austin market through 2003.** You can check out the magazine’s website, www.SmartMoney.com, to see where all 65 cities were ranked.

You want free office rent? How about reduced personal liability? Even smaller security deposits? What about generous finish-out allowances? You can get all that, plus the lowest rental rates in more than a year right now when you move into new office space or re-negotiate your current high-rent lease.

The free rent, liability, deposit and finish-out perks are all common now as the Austin office market has softened, according to **Bill Wendlandt's** Office Leasing Advisors (OLA), a company that represents tenants in their office space negotiations. Okay, so how much free rent can you get us? "OLA can negotiate anywhere from **2-12 months of free rent** for tenants as buildings are forced to compete with the sublease market for credit-worthy tenants."

Obviously free rent can drastically lower the tenant's effective cost per square foot, while helping to offset moving expenses and other costs associated with relocating. But what about lower rents overall? OLA's projections are for **rental rates to remain down 10%-35%** compared to rates 12-18 months ago.

What's driving this 2002 situation? "Austin will have as much as 6 million square feet available in one form or another (either sublease, direct lease or new space). This represents an overall **vacancy rate of around 20%**, compared to the 6% vacancy rate in 2000," OLA reports.

Well, should tenants consider renewing a lease *early*? "Yes, especially if there are less than two years remaining on the lease," OLA states. "In this down market, building owners are very interested in retaining their quality, rent-paying tenants. OLA can negotiate an **early lease renewal that allows the tenant to lock-in and avoid future rent increases.**"

"The abundance of sublease space, with its lower rates, further strengthens the tenant's case when negotiating an early renewal," OLA points out. "OLA recently helped a long-time client execute a **10-year lease renewal, 2½ years before it expired.** The savings over the renewal term will be well in excess of \$1 million."

You just said a "10-year" lease. That's a long time. Should tenants consider long-term leases? "Yes, depending on the situation," OLA responds. "**Rental rates are down, thus reducing the risk of locking-in on rates for 7-10 years.** Conversely, in a landlord's market with high rental rates, tenants are usually better off looking for shorter terms and/or subleases."

We've been reporting for more than a year now that subleases are driving down office rental rates. Has the flood of sublease space finally slowed or can we expect more, driving the rates down further? "**It appears that most of the sublease 'damage' has been done** and that it will hold fairly constant," noted OLA.

Bottom line: If you're in the market for new office space, or lowering your existing lease rate, the Austin market is as good as it's been for tenants for some time.

A lot of numbers are going to be tossed out to you Election Night Tuesday. To sift through the chaff, here are a handful of important races that deserve your attention – and what to look for as the numbers fly by on the TV screen.

There are two statewide races of consequence – both in the Democratic Primary. In the contest to see who will face Republican Attorney General **John Cornyn** to replace GOP US Senator **Phil Gramm**, check to see if Dallas-based **Ron Kirk** or Houston-based **Ken Bentsen** has turned out enough of his geographical base to get into a runoff with **Victor Morales**. Look at the South Texas returns to see if **Tony Sanchez** or **Dan Morales** is getting the bulk of the state's Hispanic vote, estimated to be as much as 40% of the Democrats' total, to win the right to face Republican incumbent Governor **Rick Perry**.

The most important race for US Congress, as far as the Austin area is concerned, is the brand new District 31 that runs all the way from Williamson County, through Aggieland, down to the eastern edge of Houston. Check to see who *leads* in the runoff. If **John Carter** is the frontrunner, that means Williamson County is exercising its' newly-found clout. If **Peter Wareing** is leading, then the district may be dominated by the eastern-most edge. Or if **Brad Barton**, whose strength is Bryan-College Station, is leading, then the middle part of the district is flexing its muscle. These three candidates appear to be the strongest of the 8-man field. They are all Republicans. Only one Democrat has filed in the conservative-leaning district.

There are two State Representative races worthy of special attention – one Republican, one Democrat – and both will likely conclude Tuesday with runoffs. District 50 is a conservative-leaning slice of West Travis County. Republican **Bob Richardson** is the most likely front-runner. **Jack Stick**, **Kris Gillespie**, or **Jerry Mikus** could end up with enough votes to get into a runoff with Richardson.

The other State Rep contest is in Southeast Travis County and it's really a tossup as to which two candidates will emerge Tuesday night in a runoff. There are six Democrats running and four of them — **Maria "Lulu" Flores**, **Sam Guzman**, **Eddie Rodriguez**, and **Marcos DeLeon** – for different reasons, all have a shot at making the Top Two.

Also keep an eye on two San Antonio Republicans who are slugging it out to represent a large chunk of Western Travis County in the State Senate. **Jeff Wentworth** is the incumbent, but some conservative Republicans didn't like his moderate stance as chair of the Senate Redistricting Committee in the last legislative session, so they've rallied around **John Shields**, who is running a well-financed attack campaign against Wentworth. This is a Republican oriented district, so Tuesday's winner is likely to carry the November voting as well.

There are a lot of other contested races on the ballot. But, for various reasons, these have emerged as the most significant. And if you're looking ahead to the runoff, be sure to mark 4/9/02 on your calendar. That's when the November lineup, GOP v. Dem, will be finalized.

It's not just the party animals that are looking forward to Spring Break. The Texans who check the barometer daily to see how the economic winds are blowing are hoping for a tidal wave of tourists to wash across South Padre Island during the month of March.

Don't know if you noticed the brief item earlier this week that quoted a Southwest Airlines exec as saying he wasn't sure if the Dallas-based airline would make a profit the first quarter. He also said **Southwest lost money in January and February**. Remember, this is the only major airline that made a profit in 2001. So, stepped-up leisure travel during Spring Break month would be more than welcome.

While Spring Break travel is certainly more widespread than just to the South Texas beaches, the **folks on South Padre Island really need the hearty partiers**. Because the news focus was so riveted on 9/11 and its aftermath, the horrendous economic hit taken by South Padre 9/15 was almost overlooked. **The Island's only land route to the Texas mainland was severed for two months** after a barge slammed into the Queen Isabella Causeway three days after 9/11.

Austin schools generally observe the same Spring Break period set by UTAustin which, this year, is the week of 3/11/-3/15. TexasA&M also observes the same week. But during the entire month of March, it's Spring Break somewhere so those who depend upon the travel business are really looking to this month to try to cure the 9/11 hangover. **No one is predicting a breakthrough travel month, especially since Easter falls early – 3/31/02 – this year**. This calendar quirk not only moved the Spring Break period earlier than normal, it shortened the season. But, this is the travel industry's best hope since the bottom fell out six months ago.

While interviewing young potential partners for his medical practice, **Dr. Louis Overholster** likes to probe the business ethics of the interviewee by posing this question: "If a patient comes in to pay off a \$100 debt and, after he leaves, you notice he's given you two \$100 bills stuck together, what is your biggest ethical dilemma?" The one who was *not* hired answered: "The ethical issue is, do you tell your partner?"

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