THE Neal Spelce AUSTIN LETTER

www.AustinLetter.com

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Dear Client:

Are we seeing the first sign the office leasing market has hit the bottom? **Could be**, **if you consider what's happening in the sublease office market**.

Sublessors have the greatest motivation to slice prices. They're paying higher than current market rates for unused office space and they need some relief. As the old saying goes, "they don't want any more cheese, they just want out of the trap." As a result, "we are beginning to see our first series of *expense only* leases," says sublease space tracker **Michael Buls**.

That's right. Some leaseholders are now saying "forget about recouping my lease payments, **just cover my expenses and I'll sublease some of my office space to you**,". Buls puts it another way: "Those of you who were around in the '80s remember that, at the low point, remember this formula well."

Add expenses, brokerage commissions, plus taxes and insurance amortized over the lease and that's it. That's your sublease price. "**This is the theoretical lowest rate that we could realize for sublease**," Buls said. And "there is at least one 60,000 sq.ft. Class A lease with 18 months to go offering an expense-only lease."

How low have other sublease prices dropped in the last five months – 1/15/02 to 6/15/02? Buls says the average advertised rate for Class C space dropped by almost 14%. Average rate for subleases with less than 24 months remaining dropped 12%. Rates for sublease spaces larger than 50,000 sq.ft dropped by 21%. **Class C space downtown dropped 61**% — from an advertised rate of $23 in January to a current advertised rate of $14.27. You get the picture.

Even with 79,000 sq.ft. of sublease space gobbled up in the last couple of weeks, the total available sublease space *increased* to 3.699 million sq.ft. So more sublease space is coming on the market. The single largest addition was 60,000 sq.ft. for the Netsolve lease at Riata.

Obviously the lowest rates drive much of the activity in office leasing. That's why, for the past year, we have focused so much on low-rate subleasing. You can see the impact by looking at the overall occupancy rate. Colliers Oxford Commercial tracks the Austin office market quarterly. It reports the **occupancy rate in the 1st quarter 2001 was 91.1**%. **A year later, 1st quarter 2002**, **it had dropped dramatically to 78.2**%. But maybe, with the expense-only leases now surfacing, we are nearing the bottom of the drop in office leasing.

So, tell me about Oracle, the world's largest maker of database management software. It announced this week it will open a major computer data center in Austin. But, how's the company handling the downturn? Any layoffs recently? Are profits up or down?

Oracle bought a vacant building in North Austin (AT&T built it; but never occupied it) and when all is said and done, only about 30 to 40 people will be working there. However, it will pump about $80 million into computers and equipment for the Austin facility. Therefore, **it's a substantial commitment, and it ranks high on the symbolic scale –** by picking Austin as one of four sites for its server farm (California, Colorado and Europe are the other three).

But, these days you're foolish not to look carefully at tech companies. Goodness knows we've seen a number of them come and go just in the last year or so. So what about Oracle? First of all, it's big – the world's largest in its field. But, it too, has been hammered by the tech slide. **The technology bellwether suffered a sharp drop in software sales** and immediately and dramatically cut expenses.

As a result, the Redwood Shores, California company reported a 23% decline in net income for the three months ending 5/31/02, compared to the same time last year. However, the **results exceeded the consensus estimate of analysts by a significant amount.** And that cheered investors enough to drive the stock price up by about 11% after the earnings announcement.

The good news on the profit front overshadowed more bad news in Oracle's sales pipeline. **The company's new software sales plunged 29% from the prior year**, and its revenue in the quarter totaled $2.77 billion, a 16% decrease from last year.

One way to assess a company's operating philosophy is to look at how it cuts expenses when sales slide. Oracle pruned its expenses largely by **paying fewer bonuses and curtailing corporate travel**. The company **shaved 28% from its sales and marketing costs** and cut another 24% from its cost of services.

Layoffs? The company **didn't make significant layoffs in the quarter**, **nor does it plan any immediate job cuts**. That's what Oracle's CFO told reporters this week. Oracle had 42,006 employees as of 5/31/02, up slightly from the 41,935 workers on the payroll at the end of the prior quarter. The company's workforce is about 3% smaller than it was during the peak of the dot-com boom.

What economic prediction is Oracle's business plan based upon? The company is operating under the assumption that business spending on technology won't pick up significantly until early next year. And, as far as *profits* are concerned, well, don't feel sorry for Oracle. For **its full fiscal year that ended in May**, **Oracle earned $2.22 billion**. Profits dipped a bit, but not by much. Oracle's profit a year ago was $2.56 billion. Conclusion: Oracle, though hit by the downturn, is a solid company that cut expenses wisely and is getting ready for the upturn.

Don't know if you noticed, but Dell Computer has added a new wrinkle to its consumer business, and the way it went about it is instructive.

If you buy a Dell Computer, you can now pay to get it professionally installed, rather than opening the boxes and setting it up yourself. The way this profit-maker came about is a testimony to how Dell comes up with an idea, tests it and implements it – all very quickly.

"We have hundreds of thousands of interactions every day with our customers, and we have all kinds of measurements to track their likes and dislikes, their satisfaction and loyalty," **Michael Dell** told about 25 entrepreneurs in Chicago, as reported by *Fortune Small Business*. "When you get to the consumer, one of the things our team has found is that there is a great value in testing things."

> "A few weeks ago," Dell said, "we set up a test in our consumer business to see **how many people wanted to buy installation of their computers as a service, in addition to maintenance**. In the test, we trained our operators to ask our customers what they like about the installation service, what they don't like."
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> "Then we tailored it," he continued. "**The test was successful, and then the very next week we rolled it out to the whole consumer business**." Well, how's it going, Michael? "It's working great," he exulted.

Even though Michael Dell talked about patience, his enthusiasm for the Internet as a tool for business was hard to contain. "**I think the Internet is like electricity**. **Every once in a while something comes along that fundamentally changes the way all business is conducted**," he observed. "And if you think about friction as any extra cost or any extra markup that exists, technologies like the Internet have a way of removing friction from the economy."

> While Dell relies significantly on the Internet for almost all aspects of its business, Michael Dell sees it evolving over time to be pervasive. He said it's "going to take, I don't know, seven, ten, 20 years to fully work its way into the economy. But, there's a new level of efficiency that can be reached. And we don't see it slowing down."
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> He said "**the best thing about the Internet is that you can experiment for free and figure out what works**. When you go to Dell.com, you'll see there's a primary offer. We learned that a lot of consumers go there and assume that's the best deal. They just buy that. Since that is what they're going to do, we make sure we have got something really good there."

Dell cautions, however, "**you can't just assume that once you put things out on the Internet, all of a sudden they'll sell**." He says you "have to have a sales and customer engagement methodology that is synergistic with the Internet."

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Most of us are interested in what's going to happen during the short term, but every now and then it's good to take a look at what economists think will happen to our metro area and other Texas regions over a long-term (30-year) horizon. And, by most measures Central Texas will lead a very robust Texas.

At least that's how The Perryman Group of economists sees it. You start with Perryman's prediction that the "Texas economy is predicted to remain one of healthiest in the US." That vitality attracts people to our region and keeps our young people here as they start their careers. Perryman predicts **the Austin 5-county metro area population will have 1.88% annual growth rate from 2001 to 2030**. So you don't have to do the math, this would run our population from 1.28 million now to 2.19 million by 2030.

Other Texas metros predicted population annual growth rates: Dallas primary metro area is 1.75% per year, El Paso metro is predicted to be 1.11%, the Fort-Worth-Arlington primary metro population is forecast to grow at 1.61%, Houston's primary metro population growth rate is pegged at 1.57% and San Antonio's metro will have a 1.45% annual growth rate.

So now that the lobbying effort on behalf of USSenator Phil Gramm for president of TexasA&M fell short, what's the economist going to do when his Senate term ends in January? Well, place your bets on the fact he'll make a lot of money.

The GOP senator, who holds a PhD in Economics, is counting on that. He'll be 60 years old when he leaves the USSenate and he told *The Dallas Morning News*: "I've got an opportunity to have one more career. I'm excited about it. **I see it sort of off in a haze, but I see it being highly paid**. I haven't decided yet exactly what I'm going to do, but I've got lots of good opportunities."

One of **Dr. Louis Overholster**'s patients turned down the Dr.'s advice to try to become more healthy, saying: "Health nuts are going to feel stupid someday, lying in hospitals dying of nothing!"

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Sincerely

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