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Dear Client:

**When the response of some leasing agents to the question, “what is your current market rate?” is “we will take a hard look at any offer,” it is difficult to identify positive aspects to the current Austin office market situation.**

This is the observation of a man who has tracked the commercial real estate market in Austin for decades – after trying to forecast what 2003 will bring. **Charles Heimsath**, President of Capitol Market Research, says **his forecast for 2003 “is not very encouraging** for the market as a whole.” (He did acknowledge there are certain office market areas and locations “that will out-perform the rest of the market.”)

Heimsath says the **collapse of the dot-com industry** in 2001 “continues to have a significant impact on the Austin office market.” But, he also fingers another culprit: “the **sluggish national recovery** has caused further deterioration of the office market.”

What about 2004? Heimsath noted there are **only two major office buildings under construction right now** – the Congress at Fourth building (525,000 sq.ft.) and the 1210 San Antonio (Texas Association of Counties) building (83,800 sq.ft.). Since there are no buildings planned for completion during the next six months, Heimsath says “hopefully, the inventory of sublease space (which now totals 3.7 million sq.ft.) will begin decreasing.” And he hopes this “will improve the prospects for the market to recover in 2004.”

The “glass half-full” viewpoint comes from Colliers International. “**The year 2002 ended optimistically for those advantageous tenants looking for office space in the Austin area.**” Colliers noted there is 5.6 million square feet of Class A office space available citywide at a full service rate of \$21.46 per rentable square foot. Citywide, Colliers reports a 16.4% decline in average full service rental rates from year-end 2001 to year-end 2002.

The commercial real estate firm reported that “**with an overall vacancy rate at 23%,” vacancy levels did firm up at year-end.** In fact, they decreased about 3.8% from the previous quarter. And the Central Business District closed out the year with an 11.1% decrease in the vacancy rate from the third quarter 2002. But, Colliers acknowledged: “as for landlords and sub-landlords with an abundance of direct space and sublease space, 2002 ended as it began ... a year of mixed signals and lackluster leasing activity.”

**The Austin area economy will begin to recover as this year progresses, but the job growth rate, estimated at 1.4% over 2002, will not be in the right sectors to provide measurable help to reduce the office vacancy rate.**

A rapid improvement in Austin's economic situation is not in the cards, according to **Angelos Angelou** of Angelou Economics. He says the recovery "pace will be slow and tentative." By the end of the year, he projects the Austin metro area will have added 9,200 new jobs (this is the 1.4% growth rate we mentioned). But this growth will not necessarily benefit the office market.

This is because most of the job growth will come from the *government* sector. Recent population increases, coupled with a projected 2.5% population increase for 2003, will "prompt **expansions in state educational institutions and school districts**," Angelou predicts. He also says this means "municipal governments will also boost employment to meet their security and social services needs."

Looking out even further, Angelou thinks it will be two-to-three, maybe three-to-four, years before there will be a "significant dent in the office market." The former Economic Development director for the Greater Austin Chamber of Commerce found some **good news** in this gloomy prediction. He says now that space is becoming more affordable, this should **aid economic development efforts** in the near term.

**Even though our local economy remains sluggish, you're going to soon see 58,000 more cars on the road. This is because people are still moving to the Austin area.**

With the possible exception of Las Vegas, where construction continues at a rapid pace, there is no city in the US where jobs are plentiful today. And while the prospect of a high-paying job in Austin is not the magnet it was a few years ago, Austin has enough assets – aided by a positive national reputation – that **folks who are looking for long-term opportunity are still streaming to our area**. The Austin area started 2003 with a population of 1.35 million.

That growth will continue, according to economist **Angelos Angelou**. He is forecasting that by the end of this year, we will have gained population at a **2.5% rate to reach 1.38 million**. The population growth rate, he predicts, will pick up to **2.7% in 2004, nudging us to 1.42 million people** in our metro area.

This growth rate will further strain our roadways and services required to protect and provide for a burgeoning citizenry, and it is exacerbated by the economic downturn. You see the daily headlines screaming about budget problems in our educational institutions, public schools, city and state governments. **Revenue is decreasing for these entities that maintain our roads and provide basic services such as educating our kids and providing police protection**, yet there is an increasing demand for these services. It's a tight time, calling for real leadership.

**One of the bright spots in the Austin area economy is Dell Computer Corporation. It (along with Austin-based Silicon Laboratories) bucked the downturn trend and actually added to employment levels in 2002.**

Much is made by financial analysts, business pundits and economists about the weak computer market. Even though many have admitted Dell is gaining market share and has become the largest seller of personal computers in the US during a two-year industry-wide slump, they still hedge on **how long Dell can sustain this track record.** (As the Austin area's largest private employer, you have a vested interest in the health of Dell Computer.)

Because no business operates in a vacuum – it's a competitive world out there – it's important to note the effect Dell is having on its competitors. Just this week, **Gateway personal computer manufacturer reported another quarterly loss.** Last year, **Compaq and Hewlett-Packard merged** in the face of Dell's aggressive cutthroat marketing and sales tactics.

Now, look at the onetime darling of the personal computer world – Apple Computer Inc. **The born-again Apple posted its first back-to-back quarterly losses since 1997** (and since co-founder **Steve Jobs** returned as CEO), and has now sliced prices of its products by about 20%. Power Macs, introduced just last August at \$1,699, \$2,499 and \$3,299, are being replaced with models selling at \$1,499, \$1,999 and \$2,699.

Would Apple have cut prices if Dell didn't exist? Not likely. Dell not only is operating profitably with its low-price models, socking away lots of cash, it is **causing its competitors to “alter their shots”** (Apple, Compaq/Hewlett-Packard) **or it is “blocking their shots”** (Gateway) — to use a basketball analogy.

There's another factor at play here. **Dell spends less on research and development than its competitors — waaaay less than Apple.** For instance, Apple is spending big R&D bucks developing sleeker designs, faster processors, newer software and its own operating system software – *not* using Microsoft Windows, that is on about 95% of the world's PCs.

While this was going on “across the street,” Dell execs were sitting down with AT&T Wireless Services honchos cutting a deal that will **provide wireless connections to its notebook PCs almost anywhere there is cell telephone service.** This will be available to Dell customers in just a couple of months. Think about it. Dell's new AT&T deal gives it another marketing tool to help increase market share, with very little developmental cost to Dell.

When you look at these developments, it's clear that Dell is continuing to put competitive pressure on its computer manufacturing rivals. And there is no letup in sight. So, it's a reasonably safe bet that, **as long as Dell stays this course, it will continue to gain market share and do it profitably.** If so, this is good news for the Austin economy.

**Dell and Delta. What do the computer manufacturer and the airline have in common in Austin?  
Both gained on rivals during turbulent times.**

The Austin-Bergstrom International passenger air travel picture was not a pretty one in 2002. In fact, the totals for 2002 were down 6.65% from 2001 – the year that went straight downhill after the 9/11 terrorist airplane hijack suicide bombings. **There was an uptick in December 2002 where the passenger totals surged 10.45% above December 2001.** But, December 2002 was below the marks set in 2000 and 1999. There is still a way to go.

However, in a terribly tough time, the #4 carrier of Austin passengers, **Delta Airlines, gained ground on #3 Continental** – so much so, the two airlines are practically neck and neck in the battle for Austin travelers.

In January 2002, Continental carried 5,405 more Austin passengers than Delta (51,492 to 46,087). **But in December 2002, Delta was within 520 passengers of Houston-based Continental** (66,041 to 65,521). Also, Delta actually beat Continental three months out of the year. The 2002 tally: Continental, 757,391 (11.3% share of the Austin market); Delta, 748,275 (11.1% market share).

The market monsters continued their dominance of the top two places. Dallas-based **Southwest Airlines**, the only major airline that hasn't laid off any employees and remained profitable throughout some of the most traumatic times in airline history, closed out 2002 with a huge **35.9% share of the Austin passenger market.**

Fort worth-based **American Airlines**, the world's largest air carrier, has a solid lock on the #2 slot in Austin with a **25.4% market share.** The others: United, 5.5% ... America West, 3.5% ... Northwest, 3.1%. This relative order of ranking has been maintained for years. But, it looks as if Delta has a chance to knock Continental from its #3 perch in 2003.

**Dr. Louis Overholster** noted this week that winter is that wonderful time of the year when you sweat only when you're in gyms, saunas and the stock market!

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