

THE

*Real Estate*

# AUSTIN LETTER

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Dear Client:

**The force that has powerfully impacted the Austin office market for the past two years – subleasing – has dramatically diminished, pushing to the front other forces shaping this important part of our economy.**

The Austin market reached a peak 18 months ago with 3.7 million sq.ft. of office space on the sublease market. Since then, reports NAI Commercial Industrial Properties (NAI CIP), **“the sublease market has decreased by 62% and represents only 4% of the overall market.”** It dropped 54% from 3,055,168 sq.ft. at the end of 2002 to 1,420,210 sq.ft. at the end of 2003.

Sublease space drives down prices for office space. For instance, the current average quoted sublease rate (\$15.63/sq.ft.) is **18% less than average direct lease rental rates and 20% less than the average sublease rate at year-end 2002**, reports NAI CIP. Sixty-one percent of the sublease market is in the northwest, 25% in the southwest and only 9% in the central business district (CBD).

**Overall, the citywide effective vacancy rate, at 24%, remained unchanged during 2003**, prompting NAI CIP to say this indicates **“a stabilization in overall market vacancy.”** (*Effective* vacancy rate is the space vacant and available for occupancy either directly or through sublease.) The highest *effective* vacancy rate was 28% in the NW and S, followed by 25% in the southeast and 23% in the CBD.

Even though the vacancy totals remained unchanged, there was an increase in leasing activity in the past year. How can that be? **“The unchanging effective vacancy demonstrates that the majority of the activity was tenants with expiring leases taking advantage of market conditions to upgrade and right-size their space, while lowering rates,”** reports NAI CIP.

**“The significant change over the last 12 months has been the shift in control of vacant space from tenants (as sublease space) to landlords (as vacant space),”** notes NAI CIP. **“Landlords now face a 20% vacancy rate for the first time since 1990.”** It’s a brand new ballgame for landlords.

What else? As tenants move into almost-completed Frost Bank Tower in the 1<sup>st</sup> quarter, **repercussions will be felt over the coming year as tenants move around within the CBD.** By the way, this brings to an end speculative new office construction – for the near future.

**A 24% office vacancy rate is not all bad – especially if you’re a tenant looking for a deal on office space. In fact, this helped put Austin in the Top Ten on a national relocation list.**

The well-respected national magazine *Plants, Sites & Parks* will be out in March with its rankings of the **top metro areas in the US for corporate moves**. Austin will be listed at #10 in the nation on the carefully scrutinized list.

This ranking isn’t just the work of some magazine editors sitting in a room and throwing darts at a wall. **The magazine is required reading for relocation experts**, so each year, readers are surveyed to determine the top relocation destinations for the upcoming year.

The magazine asks the relocation pros to name the three metro areas, in order of preference, where they are **most likely to put their next office or industrial facility**. The criteria include general costs, availability and quality of the workforce, taxes, cooperation from state and community governments and access to transportation resources.

**Austin was #10 on the list of top cities projected for 2004.** Dallas was #1, followed by Atlanta, Charlotte, Phoenix, Greenville-Spartanburg, Chicago, San Diego, Kansas City and St. Louis.

The key to this list is that the corporate re-lo **experts are asked where they themselves are most likely to put their next facility**. This isn’t some esoteric, subjective ranking of qualities that make a good community. It’s where the guys who make the recommendations and decisions are focusing. To be in the Top Ten augurs well for future economic development and the creation of more jobs in the Austin area.

**Speaking of rankings, our area has popped up again on a couple of lists that further cements the high tech reputation of the Silicon Hills of Austin.**

A British think tank ranked **Austin #2 in the world as a knowledge-based economic region**. What qualifies a region for this list? The World Knowledge Competitiveness Index is based on 17 measures of economic performance – ranging from number of patents to the ability to create new ideas, processes and products and convert them into economic value and wealth. San Francisco is #1 and all others listed in the Top 14 are US cities. Tokyo comes in at #15.

The other list ranks US cities by **adults 18 and over who can access the Internet**, based on Nielsen Media Research’s Designated Marketing Areas. With a **37% broadband penetration, Austin comes in tied for second with San Diego**. Honolulu leads with 42%. San Francisco-Oakland-San Jose tallied 36% penetration. Syracuse, Rochester and Providence were at 35%.

**If you want to be in Texas's hottest growth market over the next five years, the Austin area is still the place to be.**

Texas economist **Ray Perryman's** Short-Term Economic Forecast takes a look at each area of the state — large and small — and projects how each is likely to perform over a five-year horizon. **The Austin metro area is at the top of the statewide pack in three of the five categories and is just a smidgen out of 1<sup>st</sup> place in the other two.**

Take *population* gain. The state is projected to gain 2.06 million people over the next five years and almost 70 % (69.54%) will occur in the six largest metros – with **Austin-San Marcos leading the way with a compound annual growth rate of 2.39%**. This compares to Dallas at 2.05%, Fort Worth-Arlington at 2.03%, Houston with 1.94%, San Antonio at 1.86% and El Paso at 1.49% growth.

It's the same story with *job* gains. **Austin's workforce will grow at a 2.20% annual rate.** Dallas at 2.15%, Fort Worth-Arlington at 2.08%, San Antonio and Laredo at 2.07%, Brownsville-Harlingen-San Benito and McAllen-Edinburg-Mission at 2.06%, Texarkana at 2.04% and Lubbock at 2.03% will all gain jobs at a faster rate than the **state's annual growth rate of 1.97%**.

There are five metros in Texas that will exceed the state's *average output gain* of 4.20%, a measure of the overall economic activity in an area. Again, **Austin is at the top of the list with 4.51%**, followed by Dallas at 4.44%, Fort Worth-Arlington at 4.41%, Sherman-Denison at 4.35% and Longview-Marshall with a 4.22% annual expansion of real gross product.

Perryman predicts eight Texas metros will equal or surpass the state's 6.36% *retail sales* yearly growth rate. **Austin is right at the top with 6.59% annual retail sales growth**, but is nudged out of 1<sup>st</sup> place – barely – by Dallas at 6.60%. Next in line – all equaling or surpassing the state average — are Odessa-Midland at 6.51%, Fort Worth-Arlington at 6.48%, San Antonio at 6.38%, Laredo at 6.37%, Longview-Marshall at 6.37% and Lubbock at 6.36%.

As far as *real personal income* is concerned, **Austin again is right at the top with a projected 3.90% annual growth rate**, barely losing the #1 slot to Dallas that came in at 3.91%. Others: Odessa-Midland, 3.81% ... Fort Worth-Arlington, 3.79% ... San Antonio, 3.69% ... Laredo and Longview-Marshall, 3.68%, Lubbock, 3.67% and Houston, 3.66%.

When it's all boiled down, Perryman's numbers seem to put the Silicon Hills of Austin and the Dallas area Metroplex as the two Texas metros that should exhibit the most economic vitality during the next five years. The same is true for the regions that surround these metros. Perryman's extensive, numbers-filled publication, *The Perryman Short-Term Forecast (2003-2008)*, is available for purchase. You can call 800-749-8705 for details.

**While we were on our two-week hiatus, a prominently displayed news story pointed out Texas was next-to-the bottom in federal arts grants. But it failed to mention where Austin ranked.**

The local story was actually an Associated Press re-write of an analysis by *The Dallas Morning News*. The gist of the piece was that, **even though Texas is the second most populous state in the country, it ranked *second to last* in federal funding for the arts in 2003.** The re-write, however, left out the very important point about how Austin fared in the funding.

It fared quite well, thank you. In fact, the fed art funds that flowed to Austin in 2003 were twice that of the second place city, Houston. Or put it another way, **Austin's tally was greater than that of Houston and Dallas combined.** The numbers: Austin, \$1,094,600 ... Houston, \$509,000 ... Dallas, \$463,000 and San Antonio, \$255,000. Other Texas cities were in the five digits. Austin's arts groups obviously know how to write grant requests.

**If you've watched TV news, you've been bombarded by ads for drugs such as Celebrex, Singulair, Clarinex, Allegra, Zyrtec, Nexium, Zolofit, Procrit and Prevacid. But they aren't the biggest selling drugs in terms of dollar sales volume.**

That honor goes to those two **cholesterol-fighting drugs, Lipitor and Zocor.** Lipitor, especially, was on its way to a record-setting year of sales in 2003. The totals haven't been released yet, but Zocor is expected to have a firm lock on second place.

Lipitor, however, is *not* the drug most prescribed by doctors, though it is in second place. **Guess which drug, through November, has been on 86.4 million prescriptions. It's a pain-killer. Hydrocodone.** Or you may know it by one of its trade names, Vicodin.

**Dr. Louis Overholster** is watching language-challenged Arnold Schwarzenegger's utterances as California governor. He wonders if he'll follow in the footsteps of former Governor Pat Brown who, following a flood, said "This is the worst disaster in California since I was elected!"

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