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Dear Client:

**Almost 20% of the entire inventory of Austin's multi-tenant office space changed hands in the past 12 months. Talk about top-dollar turnover time!**

After languishing (some might call it "stagnating") for several years with office space begging for tenants, the empty spaces started filling, new leases began generating solid revenue streams and **office building buyers came out of the woodwork** looking for a good return on their investment dollars. At the same time, Austin's economy kicked into high gear and first thing you know, you have "a perfect storm" for sales – as well as new construction.

**Charles Heimsath**, president of Capitol Market Research, reports that during the first six months of 2006, **19 – count them, 19 – multi-tenant office buildings were sold throughout the Austin region**. Add these totals to the sales spurt during the last half of 2005 and you come close to 20% of all the multi-tenant office buildings changing hands in a 12-month span.

As far as construction is concerned, there were no new office completions in the first six months of 2006, but Heimsath notes there are **four** multi-tenant office buildings under construction in the Southwest market area, **one** building under construction in the Far Northwest, and **one** office building under construction in the Central Business District (CBD).

**The Southwest appears to be the hot area right now**, especially when you consider the *four* multi-tenant buildings under construction follow on the heels of *seven* office buildings in the area that were sold during the past six months.

"While the citywide occupancy decreased slightly to 84.9%, a steady increase in average rents in the Southwest, Far Northwest and the CBD markets areas has **caused an increase in new construction**," Heimsath noted.

What can we anticipate? Heimsath predicts that as the office buildings under construction "are absorbed at higher rental rates, the **average rates will increase**, and that will cause additional improvement in the office market." In addition, he says, "many brokers have noted the lack of large blocks of space in the existing inventory." And this, he notes, should provide more **impetus for even more new office construction** in the Austin area.

**A large number of new apartment building construction starts – unseen in several years – is likely to occur during this 3<sup>rd</sup> quarter in the Austin area.**

The is the forecast from **Robin Davis**, who has been researching apartment trends in the Austin area for some time now under the umbrella of Austin Investor Interests. One of the reasons for this concentration of construction starts is that **new starts were only half of what had been expected over the past 90 days.**

She points out that the reason the majority of these new projects did not begin construction was simply due to **delays of a month or two.** “Only one project failed to officially start construction because of increased construction costs,” she said.

So if the next couple of months will see a flurry of apartment construction activity, unlike what we have seen in a few years, what will happen beyond September? **“The following nine months will see new starts remain at last year’s pace,** with the central area containing over a third of these new units,” she predicts.

There are a couple of other interesting factors at play right now in Austin’s apartment world. First of all, Davis says property managers are reporting **“less and less tenants are being lost to homeownership.”** This is especially true, she says, as interest rates rise.

But, secondly, condo conversions and a new trend are having an impact on the apartment market. “While **condo conversions** have reduced the local inventory over the past few years, the trend toward mixed-use projects is also having an impact as **older apartments are torn down for redevelopment** due to the increase in land values and the scarcity of preferred site locations,” Davis said.

And she predicts this is likely to remain a factor. Prevalent in the Central and Downtown sectors, “expect this trend to continue as the City of Austin will vote on mixed-use development incentives in August as part of a plan to **create a town center that is attractive, environmentally friendly and functional for pedestrians,**” she commented.

Other developments for apartment dwellers: 1) this is the slow time for college students impacting the market, 2) many properties are reporting traffic from newcomers to the area, 3) there is more “separation” of roommates, 4) **landlord concessions have declined about 7%, quarter over quarter** and 5) only about 47% of the apartment buildings are still offering “specials” as a move-in incentive.

Finally, even though there has been a slight decline in occupancy, **effective rental rates rose for the sixth consecutive quarter** in the 2<sup>nd</sup> quarter of 2006. The highest apartment rental rates in Austin can be found in/near the downtown area.

**The three Texas-based airlines – that, coincidentally, carry almost three-fourths of all Austin commercial air travelers – are making mince meat of their competition. And they are doing it profitably, at last.**

Dallas-based **Southwest Airlines** (with a 35% share of the Austin passenger market) **more than doubled its earnings** in the 2<sup>nd</sup> quarter. Fort Worth-based **American Airlines** (26% Austin share) recorded only its 2<sup>nd</sup> profitable quarter – excluding those helped by one-time items – in the past five years and **recorded its best April-June period since 1998**. And Houston-based **Continental Airlines** (with a 12% Austin share of market) said 2<sup>nd</sup> quarter **earnings nearly doubled**.

All this is occurring as people are taking to the skies, despite rising airfares, in greater numbers since the devastating travel slump that followed the terrorist attacks using airplanes on 9/11/01. (Austin set a passenger traffic record in June.)

Of course, the **increased fares are helping the bottom line of the airlines**. In fact, Southwest – normally the bane of other airlines because they have held fares so low for so long – has **raised its fares four times so far this year**. And, of course, the others quickly followed suit.

But the healthy airline balance sheets came about as a result of more than just fare hikes. Like most airlines, Continental, for instance, has cut costs by finalizing **agreements earlier this year with its workers on pay and benefit reductions**. This could save Continental \$500 million a year – enough to offset the rise in jet fuel costs.

American has been eliminating some of its gas-guzzling jets from its fleet and, like Southwest, has put winglets on the tips of airliner wings to stretch mileage. It also has **added many more smaller, fuel-efficient, regional jets to serve cities such as Austin** – especially for short hops. And some airlines, not the Texas Three, have recently used the bankruptcy process to shave costs.

Are increases in fares likely to continue? **Gary Kelly**, Southwest's CEO, doesn't seem to think so. He was quoted recently as saying **fares have been pushed about as far as they can go**. His yardstick for that comment: he was seeing an increase in unsold seats on some routes, indicating the beginning of a push-back from travelers to the higher air travel costs.

We stay on top of the airline industry for you for a number of reasons. Obviously, air travel is important for your personal and business needs. **Air travel is also a major measure of the vitality of the local economy**. When times are tough, business and leisure travel are among the first cutbacks. The converse is also true. And because it is so **rare to have three of the major airlines domiciled in one state** – providing jobs for Texans and paying local and state taxes – the impact on the overall state economy is important as well.

**While we're on the subject of travel, some questions: Do you seldom take all the vacation for which you are eligible? When you go on vacation, do you take your laptop? Do you do any work while on vacation? If you answered yes, you are in the majority.**

Some think it's a travesty. Others think it's a sign of the times. But rare is the person who takes any vacation time and totally severs all ties to the work world. This wasn't always the case, so it could be a trend in the making – and/or, a sign of the times.

**The number of Americans who work during their vacations has nearly doubled in the last decade.** And the laptop computer has replaced the cellular phone as the most useful tool for working while on vacation or holiday. Is this good or bad?

**Edward Hallowell**, a psychiatrist and author of *Crazy Busy: Overstretched, Overbooked and About to Snap!*, said the good way would be someone who says **"Look, I really want to get away with my kids, but I do have work to do. I'm going to combine work and vacation."**

**"The bad,"** he says, **"is someone who is just so addicted to work that they can't ever leave it.** It's their only way of amusing themselves, and that's a problem."

Technology, not surprisingly, makes all this work possible. **The laptop is the #1 choice of most, with cell phones and Blackberry's/Treos next in line.** (In 1995, most named the cell phone first, along with their beeper and a fax machine.) "These tools can be very freeing," said Hallowell. "They can allow you to go away, but they can also be enslaving. It's all a matter of how you use them." Some thoughts to think about as you think about your time off.

**Dr. Louis Overholster** has some thoughts of his own for his patients, as they stand in front of the mirror to try on an old swimsuit for the upcoming vacation: 1) bathing suits can shrink, 2) there might be more calories in pizza than they're telling us about and 3) the most comforting thought of all – mirrors *do* lie!

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