

THE

Real Estate

AUSTIN LETTER

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Volume 30, Number 31

October 31, 2008

Dear Client:

If you're in the market for office space in the Austin area over the next year, the pendulum is swinging in your favor. Landlords are going to be very competitive to sign you up as a tenant.

If you look at what has occurred in the 3rd quarter you might think otherwise. After all, the Austin commercial real estate market bounced back a bit during that time, with a positive **increase in space that was leased**. But a careful analysis shows this could be just a blip.

“The overall vacancy rate increased to 17.6% from where it stood at 16.5% last quarter and 13.8% this time last year,” reports Oxford Commercial, a local unit of the Cushman & Wakefield Alliance. Several elements are coming into play to indicate this trend will continue and **tenants will be gaining more leverage as they negotiate for office space**.

Consider that just more than a million square feet of new office space is scheduled to be completed before year-end 2008 and, according to Oxford, **only 10% of this space is pre-leased**. But there's more. When you look out another six months or so, Oxford estimates even more speculative office space that is under construction will come online and be scrambling for tenants.

Simply stated, **the supply of office product that has or is about to come online outweighs the demand for it**. Your Econ 101 textbook will tell you that rental **rates will decrease** as the demand slows. Landlords are no dummies. They will be getting aggressive as they compete for tenants. After all, it is best to fill up this new office space at *lower rates than originally contemplated* so that it does not sit empty with the interest meter running on the construction investment.

How long will this condition last? Hard to tell. You are **not likely to see major office building construction starting up anytime soon** – especially with the tightened lending market. So, you need to track absorption of the vacant space for the next few quarters.

If you are looking for office space, or nearing the end of a lease that you may want to re-negotiate, **the office market is turning in favor of tenants**. If you are a landlord, be prepared for some hard negotiations from prospects and tough competition from your fellow landlords.

It's a different story in the Austin area as far as *industrial* space is concerned. In fact, this segment of the local economy appears to be stabilizing.

“Stabilizing” doesn’t mean “thriving,” because concessions are being made to tenants seeking industrial space. (Maybe the office space folks can pick up some tips from those dealing in the industrial space market. We’ll mention a few items in a minute.) But after a rocky road for the last few quarters, **the trend lines seem to be leveling off in the industrial space sector.**

“After two straight quarters of substantial increases in the overall *vacancy* rate for industrial product, the rate escalated only minimally from last quarter – from 14.4% to 14.6%,” reports Oxford Commercial, a local division of the Cushman & Wakefield Alliance. “There has been an **increase in leasing activity** in not only second and third generation buildings, but also the new product delivered in the past year.” What has generated this increase in leasing activity? (Pay attention, office space landlords.) **Actual deals are being signed at lower rates and are including more rent concessions,** notes Oxford.

“In an aggressive effort to lease newly constructed buildings, **landlords are offering free rent and increased tenant improvement funds to attract tenants.** In response, landlords of second and third generation buildings are trying to **retain their current tenants by lowering their actual rates as well.**”

The net effect: “the Austin industrial market seems to be moving in the right direction,” Oxford suggested. “With the strong leasing activity increase seen this quarter, it can be expected that **absorption will remain positive through the end of the year.**” Vacancy should decrease by the end of the year as development slows and leasing activity increases.

Even though Christmas décor is popping up here and there as we slide past Halloween, the outlook for retailers during their most important selling season is not all that good.

Obviously, what ultimately happens remains to be seen. But the signs seem to indicate you can look for retailers to push early and push often to move their merchandise. It may not be enough as consumers’ easy access to credit is over. **The predictions are that shoppers will buy less of nearly everything** – even though luxury items (such as travel, spas, entertainment and leisure, etc.) are the first to feel the pinch.

The smart retailers will *not* load up on inventory. They’ll stock only enough items they think they can sell. So if you see an item you want to buy, better grab it before the inventory is depleted. And **watch for retailers to jump out there with early sales** to try to grab their share of what most predict will be shrinking shopping budgets. Even if Austin’s economy is better than most, the odds are that retailers here will still be applying the same logic. Stay tuned.

Remember the biggest, boldest headline on the front page of the *Austin American-Statesman* last week that screamed “Housing Price Fall Predicted?” Well, the next day an eminent Texas real estate economist disagreed vigorously, but didn’t get quite the notice.

The *Statesman* story noted that Central Texas homes sales fell for the 15th consecutive month, and citing interviews with Austinites involved in real estate, reported that **“some observers say prices could drop as much as 10% within the next year** as a near-record supply of homes for sale, anticipated rising mortgage rates and aggressive incentives by new-home builders pressure sellers to cut their prices.”

The day after the story ran, **Mark Dotzour**, chief economist for the TexasA&M Real Estate Center, spoke to the Austin Board of Realtors. To the *Statesman*’s credit, it covered his speech and reported **Dotzour “disagreed vigorously with predictions by other real estate observers** who said the Central Texas’ median home sales price will decline by the end of the year, or sometime next year.”

Dotzour was quoted on Statesman.com (not on the front page) as saying about the Austin real estate market: **“This market is good. This market is healthy. It’s not going down in price.”** He also referred to the region’s positive job growth that is twice the national average and cheap mortgage rates.

Dotzour also took issue with another item in the *Statesman* story – where local real estate experts cited a near-record supply of homes on the market. Dotzour said **Austin’s inventory of unsold existing homes is still around 6½ months, which is considered a balanced market.** He said inventory levels are still low enough to support prices and he also added: **“all the facts would say home prices would continue to go up.”**

What does Dotzour think about the *national* economic picture? The *Statesman* website reported: “based on trends from previous recessions, during which employment decreased, on average, for 17 months, **he thinks this downturn is likely to end by next summer.** He expects corporate profits to tick up in the first quarter of next year, followed by an end to the decline in employment nationally around May.”

Dotzour said he thinks the nation fell into recession earlier this year and could be halfway, or more, through the downturn. **“By May, June, July, things will start looking better,”** Dotzour was quoted as saying.

The web article ended by reporting that Dotzour believes the **future trends for Austin and Texas are positive – which he said has been “greatly outperforming” the national economy.** He said 13 million more people are forecast to be living in Texas between now and 2030 and that means more new homes, schools, stores and roads. His concluding comment in the story on the website: **“The trends here are good.”**

There are those (maybe jokingly... maybe) who claim the first weekend in November should be declared an official holiday. November 1st marks the opening of deer hunting season statewide.

Deer hunting – especially in the Hill Country around Austin – is a big deal. There are more than 1 million paid hunting-license holders in Texas and **more than \$44 billion is spent each year in Texas on hunting.** An example: One Central Texas County, Llano, derives its biggest economic boost each year during the two-month hunting season. So what are the prospects for deer hunters this year? Frankly, not quite so good in Central Texas. Here's why:

Rainfall amounts throughout Central Texas have been below average since early last fall when the faucet was turned off after the exceptionally wet spring and summer of 2007, according to **Mike Krueger**, Texas Parks and Wildlife Department (TPWD) district biologist. **Deer did not come through the winter in as good as nutritional condition as they would have with a wet winter**, so they were not in optimum condition when bucks initiated antler growth last spring and does were entering the last stages of pregnancy.

How tough are the conditions for hunters? “I’m seeing a lot of acorns on most ranches in my area,” said TPWD technical guidance biologist **Mike Reagan**. “It should make hunting a little tougher.” Acorns provide food so deer do not need to go to feeders. **“I also think antler growth will be below normal, but I have seen excellent antlers on some mature bucks,”** he observed.

“We’re getting reports, mainly from the Hill Country, that indicate another good acorn crop,” said **Mitch Lockwood**, TPWD white-tailed deer program leader. And because of this good acorn crop, **“it could be one of those years when it’s not in favor of somebody who doesn’t like to leave the corn feeder,”** Lockwood added.

Looking ahead to Thanksgiving, **Dr. Louis Overholster** points out that the holiday is a time to count your blessings — and he says it helps if you’re not too good at arithmetic!

Sincerely



Editor/Publisher