

AUSTIN OFFICE MARKET

Mid-Year 2007 Summary



605 Brazos St., Ste. 300, Austin, Texas 78701 Ph: (512) 476-5000 Fax (512) 476-5011 email: cheimsath@cmraustin.com

After the strong performance in 2006, the first half of 2007 has been disappointing. Quoted rental rates have gone up, but the occupancy rate has dropped, due in large measure to the completion of several buildings that opened vacant, or with very few tenants. Citywide quoted rental rates increased by an average of \$2.15 per sq.ft. (9.8%) since December, but occupancy, including sublease space, dropped 2.5% points to 85.3%. Absorption, including sublease space, was a negative (198,151) sq.ft. during the first six months of 2007, and the occupancy rate for "direct" space decreased from 88.9% in December 2006 to 86.4%, in June. Absorption of "direct" lease space was also negative at (199,795 sq.ft.). The inventory of sublease space remained relatively stable at 376,818 sq.ft., which is only 1.1% of the total inventory.

Citywide average rental rates continued their rapid increase, with the largest increases in Class "A" space. Class "A" space is quoted, on average, at \$28.15 per square foot, Class "B" space is quoted at \$20.35, and Class "C" space is renting at \$24.11 per square foot. The CBD market area had the highest average quoted rates at \$28.83 and the highest average rental rate in the CBD for Class "A" space is \$30.87. Average rents in the suburban market areas continued to increase to \$22.28, up \$2.64 since December.

The buying frenzy experienced last year has continued into 2007 when 25 multi-tenant office buildings were sold throughout the Austin region, comprising 6.13 million square feet of space. In the Southwest market area three buildings were sold, The Escalade (115,000 sq.ft.), Centre II (54,610 sq.ft.) and Parkway at Oak Hill (145,500). Eight buildings were sold in the Northwest market area consisting of Park 22 (203,000 sq.ft.), Stonebridge Plaza II (193,000 sq.ft.), Research Park Plaza I & II (273,000 sq.ft.), Westech 360 (179,000 sq.ft.), Northpoint (149,894 sq.ft.), Greystone II (47,318 sq.ft.) and Great Hills Plaza (141,000 sq.ft.). Waterford Centre 1 & 2 (28,230 sq.ft.) and Chase Park II (54,610 sq.ft.) were the only two buildings to be sold in the North Central market area. Avallon (318,217 sq.ft.), Plaza on the Lake (118,745 sq.ft.), and Parmer Business Park (256,731 sq.ft.) were the three buildings that sold in the Far Northwest market area. Only one building was sold in the Northeast market area, Walnut Creek Office Park (34,000 sq.ft.). There was only one building sold in the Central market area, Shoal Creek Professional Center (43,210 sf). The CBD market area experienced the sale of eight buildings, totaling 3,780,362 sq.ft. Of all the market areas, the CBD market area saw the most square footage sold during the first six months of 2007, including the 561,000 sq.ft. at the Frost Bank Tower.

By far, the largest transaction was the Thomas Properties Group acquisition of 10 Class "A" properties for \$1.15 billion.

“...the first half of 2007 has been disappointing. Quoted rental rates have gone up, but the occupancy rate has dropped...”

For the first time in several years there were multiple new office completions in the first six months of 2007. The building completions include Research Park Place (251,403 sq.ft) in Far Northwest Austin, Riata Gateway (150,000 sq.ft.) and Offices at the Domain in Northwest Austin, Stonegate (48,760 sq.ft.) in South Central Austin and Parkway at Oak Hill (145,475 sq.ft.) and San Clemente I (90,277 sq. ft.) in Southwest Austin. All together, a total of 760,915 sq.ft. were added in the first six months. However, only 36% of the new space was occupied upon completion, therefore, when the buildings opened, so 483,811 sq.ft. of new vacant space was added to the market.

This addition of vacant space overwhelmed the modest absorption experienced in the first six months, leading to a negative absorption of direct space of (199,795).

The decrease in absorption across the city is due, in part, to the dramatic increase in quoted rents, which is, in turn, due to the increasing cost of construction and substantial increases in operating expense. The new market rents are being met with considerable resistance from both existing tenants and companies relocating to the area.

In addition to the "delivered" space, there are also fifteen new buildings under construction, with a total of 2.3 million sq.ft. of space, most of which is not released. This new supply is available at rates that are substantially higher than existing leases and very few tenants are committing to the new rates. Eventually, the quoted rates will have to move down and the tenants will have to increase the leasing expenses in their annual budgets.

