

AUSTIN OFFICE MARKET

2008 Mid-Year Summary



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

The first half of 2008 showed a continuing erosion of strength in the office market, reflected primarily by the decline in occupancy. Absorption was a positive 292,707 sq. ft. (including sublease space) in the first half of the year. Quoted rental rates increased to \$26.81, but the occupancy rate dropped, due, in part, to the completion of several buildings that opened with no tenants. Citywide, quoted rental rates increased by an average of \$1.34 per sq. ft. (4.4%) to \$26.81, but occupancy, including sublease space, dropped to 84.3%. Absorption, including sublease space, was 292,707 sq. ft. for the first half of the year, but it was overwhelmed by the completion of 845,185 sq. ft. in new buildings, which caused the decline in occupancy. The occupancy rate for "direct" space decreased from 86.3%, in December 2007 to 85.4% in June 2008 and absorption of "direct" lease space was 322,686 sq.ft. However, the inventory of sublease space increased to 404,637 sq.ft. (1.1% of the total inventory), which caused the overall occupancy rate decline to 84.3%.

Citywide average rental rates continued to move upward as landlords attempt to maintain profitability while facing increases in operating expenses. Class "A" space is quoted, on average, at \$30.38 per square foot, Class "B" space is quoted at \$22.15, and Class "C" space is renting at \$15.00 per square foot. The CBD market area had the highest average quoted rates at \$30.84 and the average rental rate in the CBD for Class "A" space is \$32.75. Average rents in the suburban market areas continued to increase to \$25.89, up \$1.57 since December.

Building sales are much slower this year (2008) than they were in 2007 but there were still several large building sales recorded in the first six months of 2008. In the Southwest market area one building was sold, Barton Oaks Plaza I (99,792 sq.ft.) Three buildings were sold in the North Central market area, including Reunion Park (123,280 sq.ft.), Parkcrest (40,936 sq.ft.) and Parmer at MoPac Office Centre (57,796 sq.ft.). One building sold in the Northwest market area, Northpoint Centre (151,136 sq.ft.) and two buildings sold in the CBD, CSC (219,828 sq.ft.) and the Perry Brooks Building (131,372 sq.ft.).

The new construction boom that began in 2006 continued into the first half of 2008 with the delivery of eight new office buildings. The building completions included Park Central (114,091 sq.ft.) in North Central Austin, Prominent Point II (105,000 sq.ft.), Parkline (90,000 sq.ft.) and San Felipe Professional (12,000 sq.ft.) in Far Northwest Austin, and in Southwest Austin completions included: The Park on Barton Creek (210,000 sq.ft.), Las Cimas (142,500 sq.ft.), Offices at the Hill Country Galleria (141,868 sq.ft.) and The "Y" at 71 (28,226 sq.ft.). Only 25% of the completed space was pre-leased in June 2008. Consequently, these 8 buildings added 629,385 sq.ft. of new, unleased space to the available inventory.

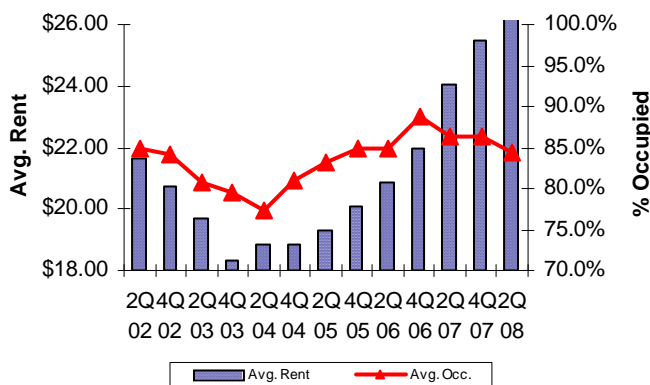
The first half of 2008 showed continuing erosion of strength in the office market, reflected primarily in the decline in occupancy to 84.3% in June 2008. Declines in rental rates are likely to occur in the second half of 2008.

This addition of new vacant space caused an erosion of the potential positive absorption, which resulted in a very modest absorption of 322,686 sq.ft. for the first half of 2008. Once again, a bright spot was the strong leasing activity in downtown, which posted a net positive absorption of 116,329 sq.ft. in the first half of 2008, with no new building completions.

The first half of 2008 continued the trend from late 2007 with a modest amount of office absorption, but the market strength and occupancy rates were adversely affected by the completion of new vacant buildings and the continued resistance from tenants to the higher quoted rental rates, particularly among the recently completed and under construction inventory.

In addition to the 844,000 sq.ft. of space delivered in the first half of 2008, there are also fourteen new buildings under construction, with a total of 2.0 million sq.ft. of space, most of which is not preleased. This new supply is being offered at rates that are substantially higher than rates among older buildings and only a few tenants are committing to the new rates. As we predicted in the June and December 2007 reports, the "effective" rates for new space have begun to come down as building owners offer incentives like free rent and enhanced TI allowances to capture the few tenants that are actively in the market. We expect this trend to continue as additional vacant buildings are added over the next twelve months.

Rental Rates and Occupancy



Absorption vs. New Deliveries

