

COMMERCIAL REAL ESTATE

Austin office market gains momentum

Occupancy rate for top-quality space is at a five-year high.

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Austin's office market continued to strengthen during the first quarter of 2006, with tenants paying more for first-class space and the occupancy rate at a five-year high, new figures show.

First-class, also called Class A, office space in Austin was nearly 85 percent full during the first three months of 2006, up from 82.5 percent during the first quarter of 2005, according to Colliers Oxford Commercial Inc., which tracks the market.

Rents rose to \$23.46 a square foot, the highest in four years, from \$20.60 a year earlier.

But the increasing demand for space as companies add employees is only part of what's behind rising rents.

Landlords' costs, primarily expected increases in property taxes this year, "are a big part of the overall increases," said Rick Whiteley, a senior vice president with Colliers.

In Travis County, appraisals for some office complexes are expected to rise by double digits this year, based on numerous sales at high prices.

A Colliers sampling of about a dozen first-class office buildings downtown showed that rents increased from about \$23 a square foot in late 2005 to about \$26 early this year, with about 30 percent of that attributed to projected increases in operating expenses, which also include items such as maintenance and insurance. For a similar sampling of buildings in Northwest Austin, rising operating expenses accounted for 24 percent of the rent increase.

But base rents are rising because more companies are expanding their work forces.

"The office market will continue to improve rapidly due to the continued strong employment in Austin," said Sam Houston, office division project partner with Hill Partners, an Austin-based commercial real estate company. "A very high percentage of companies in Austin are growing and adding additional staff, which will further reduce the office vacancy rate."

Citywide, the occupancy rate for all office space increased to nearly 84 percent from about 82 percent a year earlier. Rents across the board increased to an average of \$20.91 a square foot from \$18.88 a foot a year earlier.

Houston predicts that the occupancy rate citywide will hit 87 percent or 88 percent by the end of the year.

Rents and occupancies for top Class A space moved up in several key submarkets, including Southwest Austin. That area, where work has started on the first new office buildings in years, continues to lead the recovery.

With occupancy topping 90 percent, the average rental rate for Class A space in Southwest Austin climbed to \$22.39 a square foot from \$19.09 a year earlier. Occupancy was 84 percent a year earlier.

Hill Partners started work last fall on the first of eight office buildings planned for San Clemente at Davenport, an 800,000-square-foot, \$150 million development at Westlake Drive and Loop 360 (Capital of Texas Highway). With tenants already lined up for half of the first building, Hill Partners anticipates starting on a second building in July, Houston said.

"There have been a number of firms in the 50,000- to 100,000-square-foot range that are seeking office space in the Loop 360 corridor, and the largest block of (existing) space in Southwest Austin is 40,000 square feet," Houston said.

Stratus Properties Inc. also started construction earlier this year on an 80,000-square-foot office building at its Lantana development off Southwest Parkway. Stratus wouldn't comment on prospective tenants.

In Northwest Austin, Trammell Crow Co. will break ground on its \$40 million Research Park Place at the end of this month. The project, at the northwest corner of U.S. 183 and Oak Knoll Drive, will consist of two office buildings, each with 125,250 square feet.

"Prospect activity is brisk, and we are confident the project will be substantially leased by the time the buildings open in April 2007," said Lance Sallis, a principal with Trammell Crow.

"Demand for office space will be strong, and there will be minimal new construction," Sallis said. "While several new office buildings are being planned, few will be completed by the end of 2006."

Brokers expect this growth to be more sustainable than it was during the heyday of the tech boom.

"Many of those dot-com tenants were not profitable, and ultimately their business was not sustainable," Houston said.

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