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Office Building Market Update Austin Metropolitan Area

Third Quarter 2014



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OVERVIEW

Employment growth and an expanding economy continue to drive demand for office space. For the twelve-month period ending in September, the Austin-Round Rock-San Marcos Metropolitan Statistical Area added 31,400 jobs for an annual growth rate of 3.6%, according to the Texas Workforce Commission. More specifically, the Professional and Business Services industry led with the highest rate of growth at 6.9%. Businesses in this category are primarily situated in office buildings so job growth in this sector directly correlates to an increased demand for office space.

According to the survey of nearly 42 million square feet of Austin area office lease space, area properties experienced 337,467 square feet of positive net absorption in the third quarter. The total gain was evenly split between top-tier Class A properties, with 161,087 square feet, and Class B properties, with 169,704 square feet. Contributing to gains within the Class A submarket, tenant move-ins were led by HomeAway taking occupancy of more than 57,000 square feet at the newly completed Domain 2; HomeAway will take the remainder of their space in the fourth quarter. In all, the local office market has experienced 956,194 square feet of positive net absorption through the first three quarters of the year.

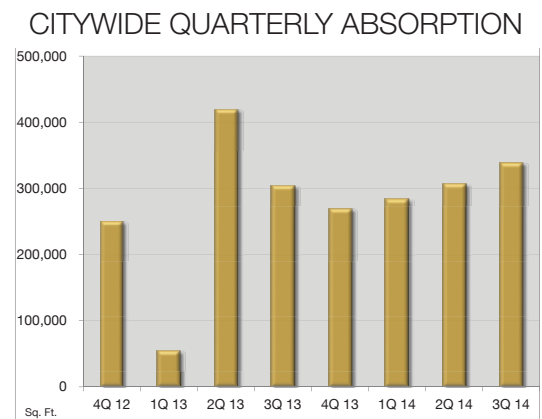
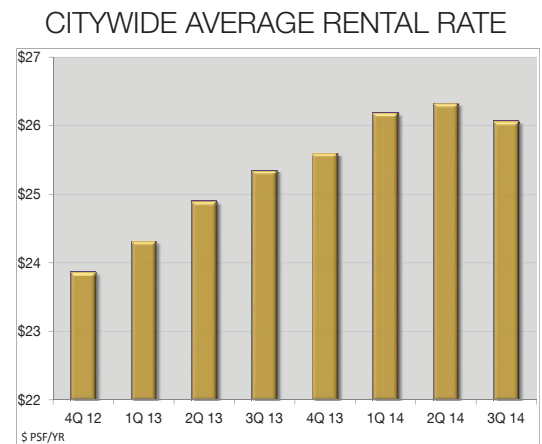
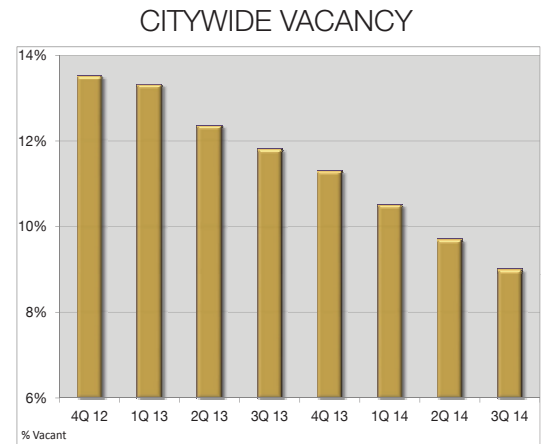
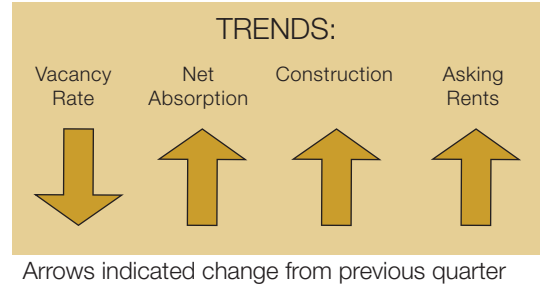
Steady demand has squeezed vacancy rates to sub-10%. The Austin office market closed the third quarter with a citywide vacancy rate of 9.0% which is down compared to 9.7% last quarter and 11.8% recorded in the same quarter a year ago. Similarly, the vacancy rate for Class A space tightened to 9.1% compared to 9.7% last quarter and 12.3% a year ago and Class B vacancy now stands at 8.4%, down from 9.3% last quarter and 11.2% last year.

As the market continues to tighten, office tenants have been challenged on two fronts – not only has it been more difficult to find space but the cost of renting that space has become more expensive. The citywide average quoted rental rate climbed \$0.72 over the year to reach \$26.06 per square foot per year on a full-service basis, which is up 2.8% compared to a year ago. (To adjust for buildings which quote rents on a triple net basis, operating expense figures have been included to arrive at an equivalent full-service rate for average calculation.) Rents are rising across the board but the cost for renting office space in the suburbs is cheaper, on average, than downtown. The average rent for suburban office space stands at \$25.16 compared to \$34.93 in the CBD. Likewise, Class A properties in the suburban submarkets average \$30.83 while Class A buildings downtown command an average of \$42.41.

Rental rates have surged over the past year or so as vacancy has diminished but now the question is whether or not rents will slow as a wave of new construction hits the market. Recent starts include two buildings at Paloma Ridge (106,000 sf each) in the Far Northwest sector and Parmer 3.2 (190,000 sf) in the Northeast sector. In all, the market has nearly 3 million square feet of office space currently under construction. Roughly 725,000 square feet is expected to come online in the fourth quarter led by two downtown projects - IBC Bank Plaza (195,378 sf) and Seaholm Power Plant Building (113,063 sf) – which have both achieved a substantial amount of pre-leasing. In the suburbs, the Domain 7 (221,973 sf) and Champion Office Park I (115,000 sf) have yet to announce new leases and may come online next quarter without any pre-leasing activity.

In the midst of this flurry of new construction fueled by strong market fundamentals, Austin assets continue to be a major target for investors. Sales velocity remained strong in the third quarter with activity spread across the city.

New construction will deliver a significant amount of new product to the market over the next several quarters which will prompt a flight to quality for some tenants and create opportunities for others to backfill vacated spaces. Vacancy rates may fluctuate as new projects come online but area job growth will continue to translate into additional demand for office space to help fill vacancy keeping the overall outlook positive.



Austin Office Market 3Q 2014	Total Inventory (SF)	Total Direct Vacant (SF)	% Vacant	YTD Absorption (SF)	Avg. Quoted Rent Rate
CBD	8,355,282	668,708	8.0%	170,080	\$34.93
Central	2,246,769	216,659	9.6%	89,999	\$25.10
North	942,488	184,453	19.6%	72,328	\$19.17
Northwest	13,021,065	1,140,070	8.8%	247,588	\$26.80
Far Northwest	3,532,895	334,858	9.5%	159,017	\$24.37
Northeast	1,855,269	211,688	11.4%	41,561	\$16.40
South	1,688,035	88,707	5.3%	(6,642)	\$24.15
Southeast	915,462	119,054	13.0%	23,317	\$19.09
Southwest	8,463,665	674,998	8.0%	137,325	\$28.08
Round Rock	884,716	124,263	14.0%	21,621	\$20.11
Totals	41,905,646	3,763,458	9.0%	956,194	\$26.06

Analysis by REOC Austin based on data provided by Xceligent and approved by Austin Office Advisory Board. Includes all multi-tenant office projects of 20,000 square feet or more (excluding Owner-Occupied, Medical, Single-Tenant and Government-only buildings). Rental rates reflect the non-weighted strict average rental rates quoted on an annual full-service basis. Rents quoted on a non-full-service basis (such as NNN) have been calculated up to reflect the full-service rate.

CURRENT QUARTER LEASE TRANSACTIONS

Tenant	Building	Size	Submarket
Box, Inc.	One American Center	42,000	CBD
Under Armour *	Seaholm Power Plant	35,000	CBD
Main Street Hub	One American Center	32,674	CBD
WeWork	One American Center	32,000	CBD
Evernote Corporation	University Park	24,690	Central
IPSoft, Inc. *	Colorado Tower	24,184	CBD
Personify	River Place Corporate Park III	22,500	Far Northwest

* Pre-leasing

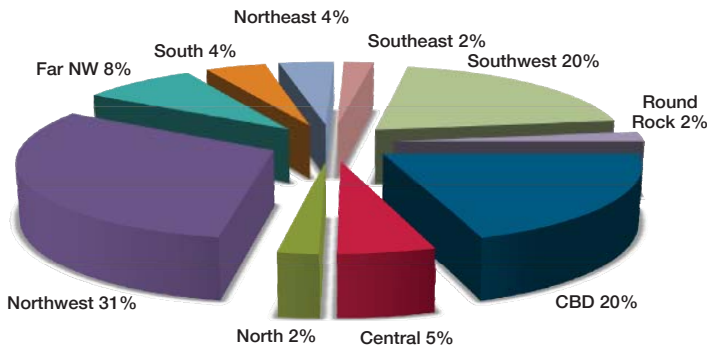
CURRENT QUARTER SALE TRANSACTIONS

Building	Buyer	Size	Submarket
Hill Country Galleria	CSTRS / Invesco Real Estate	257,000	Southwest
Stone Creek I & II	CH Realty VI / O Austin Stonecreek, LP	240,000	Northwest
Barton Oaks Plaza II & III	Invesco Real Estate	237,835	Southwest
Centennial Towers	Taurus Investment Holdings, LLC	156,293	Central
Arboretum Point	Property Reserve Inc	150,033	Northwest
811 Barton Springs	Cornerstone Real Estate Advisors	143,183	South
Pecan Park	IPIX Pecan Park LLC	136,444	Northwest
Plaza on the Lake	Clarion Partners	119,000	Southwest

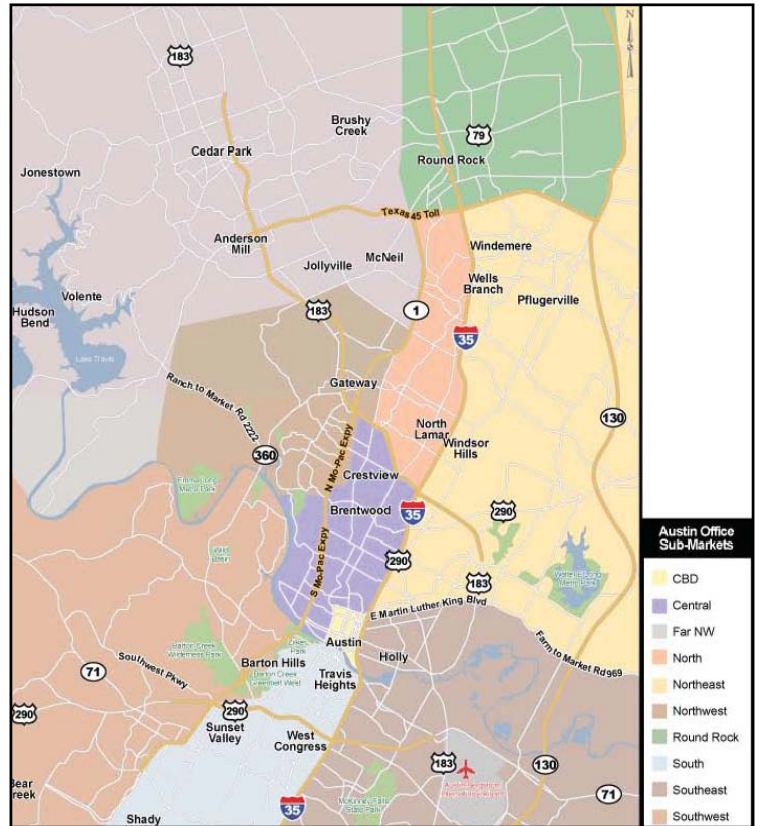
2014 NEW DEVELOPMENT - MAJOR PROJECTS

Project	Comments	Size	Submarket
COMPLETED: Domain 2	5-story; HomeAway-115,000 sf; Complete 4Q 14	140,000	Northwest
COMPLETED:Hill Country Galleria, Bldg W	Broke ground 4Q 13; Complete 4Q 14	50,000	Southwest
Colorado Tower	29-story; completion set for 1Q 15	371,348	CBD
3700 San Clemente	5-story; Spiceworks to occupy 95,000 sf; 2Q 15	249,870	Southwest
Champion Office Park I & II	Two 4-story bldgs; completion set for 4Q14/1Q15	230,000	Northwest
Domain 7	6-story; completion set for 4Q 14	221,973	Northwest
Capital Ridge	7-story; completion set for 2Q 15	217,490	Southwest
Rollingwood Center - 2500 Bee Caves	4-story (145,437 sf) + 2-story (69,150 sf); 2Q 15	214,587	Southwest
IBC Bank Plaza	13-story; IBC to occupy 27,000 sf; 4Q 14	195,378	CBD
Parmer 3.2	2Q 15	192,000	Northeast
Encino Trace Bldg 1	4-story; ARM Holdings preleased 120K sf; 2Q 15	160,935	Southwest
Encino Trace Bldg 2	4-story; 3Q 15	160,849	Southwest
Seaholm Power Plant Redevelopment	Mixed-use; office completion set for 4Q 14	113,063	CBD

MARKET SIZE



SUBMARKET MAP



DEFINITIONS

Absorption (Net)

The change in occupied space in a given time period

Available Square Footage

Net rentable area considered available for lease; includes sublease space

Average Asking Rental Rate

Rental rate as quoted from each center's owner/leasing/management company and, if necessary, adjusted to reflect full-service rates.

Direct Vacancy

Space currently available for lease directly with the landlord or building owner; excludes sublease space.

SF/PSF

Square foot/per square foot, used as a unit of measurement

Sublease

Arrangement in which a tenant leases rental property to another and the tenant becomes the landlord to the subtenant.

Sublease Space

Total square footage being marketed for lease by a tenant; sublease space is not considered in the overall occupancy or absorption numbers – only direct leases are included.

Sublease Vacancy

Space currently available in the market for sublease through the tenant to a third party for the remainder of the tenant's lease term

CRITERIA

This study includes office buildings 20,000 square feet or larger in the greater Austin area. These figures do not include owner-occupied, medical or government-only buildings.

OFFICE SERVICES

For more information about this report, please contact Kim Gatley, Senior Vice President & Director of Research - kgatley@reocaustin.com.

SERVICES

REOC Austin is actively involved in all aspects of commercial real estate: project leasing, acquisition and disposition, buyer and tenant representation, site selection, property management, construction supervision, development, research, marketing and consulting.

For additional information about our services, please contact: Blake Bonner, Senior Vice President, Director of Brokerage

