

Austin Office/Industrial Report

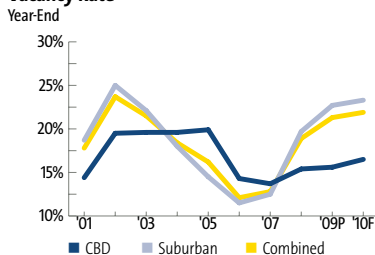
Excerpts from the Austin Office & Industrial Market Reports by Grubb & Ellis



Austin Office

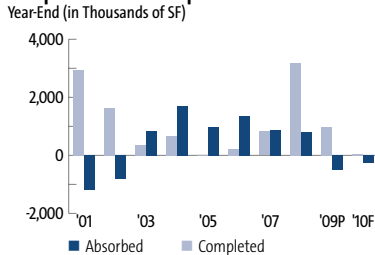
The office market saw its first negative absorption since 2002 as vacancy inched upward, sublease space rose and new construction was met with sluggish demand.

Vacancy Rate



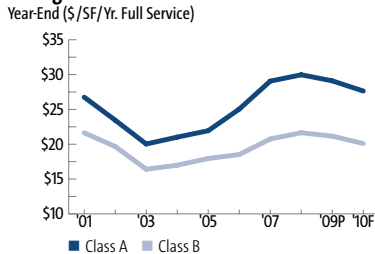
Source: Grubb & Ellis

Completions vs. Absorption



Source: Grubb & Ellis

Asking Rental Rates



Source: Grubb & Ellis

Austin's office market fundamentals weakened this past year as demand eroded against the deepening effects of the recession. Reflecting a slowdown in leasing activity, negative absorption struck the office market causing vacancy to reach a five-year peak. Sublease inventory also reached a six-year high. Further adding to the rising vacancy were construction deliveries met with sluggish demand. As a result of the demand/supply imbalance, landlords have been lowering rents and offering higher concessions – up to 12 months of free rent – in order to attract and retain tenants.

Developers have also responded to the weakened market

conditions. Construction levels tapered off dramatically as less than 900,000 square feet of competitive office space was added to the inventory during 2009, compared to the 4 million square feet built in the preceding two years. With nearly 9 million square feet of vacant space across the city, new speculative developments will be unlikely without significant preleasing in place.

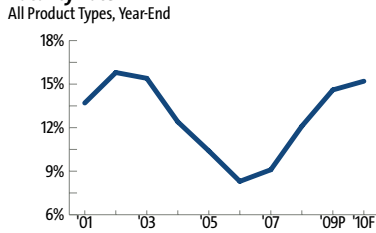
Landlords of newly constructed properties will face a particularly difficult challenge as ample opportunities exist for tenants. Stable firms should seize this opportunity to renew their leases, as landlords become increasingly willing to lower effective rates and provide more favorable concessions. As landlords attempt to balance the need for positive returns on their investments with the realities of the market, the financial crunch will limit the availability of funds to finance tenant improvement allowances and construction financing for renovations. Without available financing, concessions available to a tenant will be limited to those which do not require cash from the landlord.

Although leasing activity is likely to pick up as businesses begin to revisit their real estate needs by mid-year 2010, asking and effective rents are expected to further decline before they reach bottom in late 2010 or early 2011. As sublease space shifts from tenant to landlord control throughout 2009, the biggest decline in rents will be seen in the Class A market, which is home to over 80 percent of the sublease space. Landlords will feel increased pressure to fill the increasing volume of newly direct vacancies. The erosion in net operating incomes, due to rising vacancy during this period, will place additional pressure on owners struggling to refinance their loans in tight capital markets.

Austin Industrial

Austin's industrial market is heavily driven by local market consumption. As consumer spending and job growth declined, so has the demand for industrial space.

Vacancy Rate

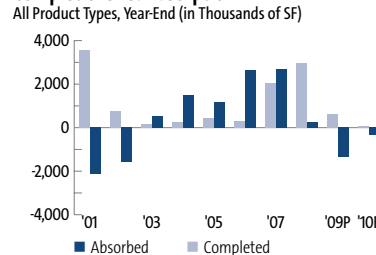


Source: Grubb & Ellis

Even though Austin fared better than many parts of the nation, posting only modest job losses, the local industrial market saw contraction among tenants, resulting in the largest annual negative absorption loss since 2002. A significant chunk of the space returning to the market was the result of recent corporate consolidations including Dell Computer Corp. The combination of diminished leasing demand and increased supply pushed the vacancy rate to its highest level recorded since 2003. A large portion of this space lies within the warehouse/distribution sector, which saw vacancy jump to its highest level this decade.

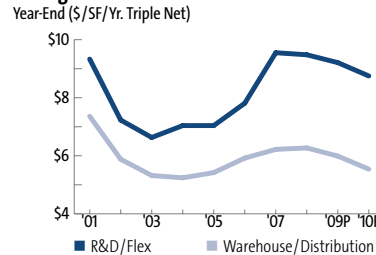
Negative absorption and rising vacancy rates had a negative impact on rents as the citywide average fell to its lowest level in

Completions vs. Absorption



Source: Grubb & Ellis

Asking Rental Rates



Source: Grubb & Ellis

three years. Higher tenant improvement allowances, free rent and effective rents that are dramatically lower than asking rents have become more common as landlords aggressively compete to attract scarce tenants. In the year ahead, expect asking rents to further subside while tenant demand remains sluggish resulting from a slow economic recovery.

Construction activity has virtually vanished as the tightened credit market and lack of demand has shelved any speculative development until the market recovers. Over 3.6 million square feet of new industrial space was delivered within the past two years, of which 68 percent remains available. These large spaces can accommodate large relocating businesses looking to reduce their real estate costs. The decrease in construction should benefit the leasing market by providing an opportunity for leasing activity to chip away at vacancy over time.

Landlords will face unique challenges to fill an abundance of vacant space. Those landlords in a position to be aggressive could benefit the most since many companies are now redefining their revenue growth strategies, reorganizing operations, reducing costs and positioning themselves for what many economists project to be a 2010 turnaround for the economy. For tenants looking to renew a lease or expand in the near future, the window of opportunity is wide open to negotiate favorable long-term leases with their landlords. Building owners with little or no debt on their industrial property will have an advantage, as they can afford to reduce their rents in order to attract tenants without taking on added financial risk. Developers with the flexibility to offer owner financing and tenant improvements will have the upper hand in absorbing space, as lending practices have tightened dramatically over the past year.