Economist: Real estate in store for reality check

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While it will continue to outperform the national market, Austin's commercial real estate sector will move from a period of "silly," inflated deals toward a more pragmatic approach as a dose of realism seeps in, a top Texas economist says.

Mark Dotzour with the Texas A&M Real Estate Center says that, as always, the health of the local real estate market is riding mostly on the Austin region's job landscape. While everyone agrees the region is going to gain on the jobs front, just how much remains somewhat in question. That could mean very different results for the numerous real estate projects on tap across the area.

The Texas Workforce Commission is reporting a current Austin job growth rate of about 4 percent. But Dotzour points out that the reality has differed from initial TWC reports in years past. He's forecasting job growth on the order of 3.5 percent in the year ahead.

"I estimate that the U.S. economy will slow and that Austin will slow as well, but still outperform the nation," Dotzour told more than 1,000 real estate industry professionals gathered for the Real Estate Council of Austin's 7th Annual Mid-Year Economic Forecast.

Coupled with the most recent reports from Capitol Market Research and NAI Commercial Industrial Properties, Dotzour gave his predications for the year ahead by sector:

- The local retail market absorbed 1.7 million square feet of space in the first half of the year as rents increased 5.8 percent, according to the Capitol Market Research report. Despite the positive absorption, however, occupancy declined slightly, 0.4 percentage points, to $92.1 percent. Nearly all of the 2 million square feet of new product that hit the market in the last six months was absorbed, suggesting high demand.

Dotzour anticipates another 3 million square feet of product will be brought to the market in the next year and that 2.5 million of that will be absorbed as retailers look to increase their presence amid a growing population base. Still, the volume of new product is likely to cause a dip in the occupancy rate, which Dotzour estimates could fall to 91.4 percent as rents jump to $23.23 a square foot.

- On the apartment front, the June citywide occupancy rate climbed 2 percentage points compared with the end of last year to 96.8 percent, the Capitol Market report shows. Rents climbed 3.3 percent, despite the addition of 3,016 completed units in the first six months of the year. Leasing at new properties is strong and about 776 units are being absorbed each month, a factor helping properties demand higher rents.

Dotzour forecasts that another 7,000 units will be completed in the next year with 4,600 units absorbed. Nevertheless, occupancy will remain high at 95.2 percent as the job market continues to expand. Rents could rise to a $1 a square foot.

- The booming Austin office market of last year has softened in 2007, despite a record number of building sales, the research report shows. A net 198,000 square feet opened up so far in 2007 as newly constructed buildings opened up vacant, or with very few tenants. A total of 760,915 square feet of space was added in the last six months, but only 36 percent of that was occupied upon completion. Therefore there's some concern over the large amount of new space still being constructed and slated for delivery in the next year, since most of it is being built on a speculative basis.

Dotzour says about 2.5 million square feet of new space is likely to come online in the next 12 months. But he anticipates that only 1 million square feet of that will be absorbed, bringing citywide occupancy down to 82.3 percent. Rents will still rise though, perhaps up $2 to $26.11, he says.

- About 351,300 square feet of flex/research and development space was absorbed in the first part of the year, according to NAI Commercial Industrial Properties. That sector is roughly 86 percent occupied. Investor demand for flex/R&D properties is actually stronger than tenant demand right now, Dotzour says. He anticipates another 600,000 square feet of product will hit the market in the next year, well below the 1 million square feet likely to be absorbed. That should push occupancy over 88 percent during that period as rents rise 6 percent.

The warehouse and distribution market is unlikely to fare quite so well. About 340,000 square feet of that product was absorbed this year bringing occupancy up to 90 percent, the NAI report shows. But 1.4 million square feet of warehousing and distribution product is likely to get built in the next year, says Dotzour. That's ahead of the 1.1 million square feet that should be absorbed, bringing occupancy down to 89.5 percent as rents stay about the same.

Courtesy of JB Goodwin