

Stonelake Capital Partners is developing Domain Tower 2, a 330,000-square-foot, 24-story office high-rise that will be The Domain's tallest building when it is completed in fall 2021.



# Can one of the fastest-growing office markets also see the quickest turnaround?

BY MATT BAKER

Over the past twenty years, Austin's population has exploded, growing more than 78 percent, with the MSA adding the equivalent of two Omahas in that time span. Concurrently, office development and investment just barely kept pace with staggering demand—a two-decade-long trend that skidded to a halt in March of this year.

At the opening of 2020, Austin's office market picked up right where 2019 left off, with strong leasing activity and an incredible development pipeline. The COVID-19 pandemic, however, has hit pause on much of this—leaving many to wonder how long until the city can get back to where it was.

“Austin has traditionally been such as a very strong, robust real estate market. We’re confident it is going to find its way back, just as it did before with ‘08 – ‘09,” said Ross Anders, general manager of Project Management Advisors (PMA) in Austin. PMA recently expanded its footprint to Austin with the acquisition of American Realty Project Management.

With a technology-heavy corporate base, the good news is that Austin will likely start to recover quicker than the more energy-dependent Houston and Dallas markets, for example, as the price of oil falls. According to Andrew Alizzi, associate in the capital markets group, investment sales in the Austin office of Avison Young, many of the landlords he has been in contact with are surveying tenants in their buildings to determine not only their immediate needs but if they anticipate any retrenchment of their future office use.

“The general consensus from other brokers, developers, economists and investors in the market is that Austin should start to pick back up by first quarter 2021,” Alizzi said.

## Potent submarkets

Assuming that we are headed toward (or are already in) a recession, the three strongest Austin office submarkets going in—the CBD, The Domain and the East Side—will guide the resurgence coming out. That begins with the central business district.

“The CBD is going to lead us out of this with the technology, finance and legal clients that are all downtown in the capital area,” Anders said.

Arguably even stronger is Austin’s “second downtown,” The Domain. According to Avison Young data, the submarket absorbed 497,113 square feet of Class A space in the first quarter—more than 10 times what the CBD experienced.

Developers have been trying to keep up with demand in this area. Stonelake Capital Partners, for example, broke ground last October on Domain Tower 2, which at 24 stories will be the submarket’s tallest building when it tops out. The 330,000-square-foot project is due to be delivered in fall 2021.

Even with new developments popping up in The Domain, the vacancy rate among Class A space stood at a vanishingly small 1.12 percent last quarter. The submarket is popular with technology clients, such as Embarcadero Technologies, which signed a 13,000-square-foot lease at Braker Pointe during Q1 2020.

## Dialing back on development?

Six office buildings totaling 1.23 million square feet delivered to the Austin market during Q1 2020 according to the Avison Young report. Additionally, there were over 6 million square feet of office space under construction last

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# Fastest-growing office markets

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3M signed the largest office lease of the first quarter in Austin, taking 204,399 square feet at Parmer 3.4, part of Karlin Real Estate's Parmer Innovation Center.



quarter, with another 15.8 million square feet proposed. It's unclear how much of that proposed space will be realized in the next few years.

At the moment, Anders reports that nearly all of their active projects, both ground up, and tenant improvement, are still moving forward, with a few deferrals into Q3 and Q4. For those projects that are in the pre-construction phase, little has changed. Most clients are pushing forward tweaking designs or seeking permits, confident that the turbulent seas will have calmed by the time they are ready to break ground. Most importantly, none of his clients have gone back to the drawing board to redesign a space due to COVID-19 jitters.

"It really is just too early in the grand scheme of things, even if we've been doing this for what feels like a lifetime," said Anders. "These are very large and expensive capital decisions, and no one's been ready to pull that trigger yet."

## Investors remain cautiously optimistic

The largest lease of the first quarter was 3M's deal for 204,399 square feet at Parmer 3.4. Located at 13011 McCallen Pass, the property is located in Parmer Innovation Center, owned by Karlin Real Estate and developed by Trammell Crow. Will it be a year or more before the Austin metro sees more office deals of this size?

According to Alizzi, he hasn't seen many major rent dips or concessions. The pre-COVID-19 office market was highly favorable to owners with so much corporate demand for space. However, this new reality hasn't upended the situation so badly that leasing teams are facing quieted phone lines.

"The pandemic has kind of evened the scales a little bit," said Alizzi. "If a tenant is negotiating for a new space or for a renewal, I would say that the landlord is going to be more receptive to those negotiations than they might have been in the past."

The Austin tenant base is diverse, though laden with tech-focused users—an industry that is more resistant to a recession. The result is that any interruption caused by COVID-19 should be slight. A brief downturn might provide an advantage for opportunistic investors looking to acquire at a time when there may be limited competition.

Though the debt markets are very conservative currently, those looking to spend their built-up capital have plenty of dry powder and are still looking to play. Conventional wisdom holds that Austin's office market should bounce back quickly, so investors are looking to lock deals in now for future development.

"They're scrutinizing deals, tenants and income a lot more, but there are groups that are out there that are that are still looking for deals," Alizzi said. "These investors know that they can acquire a piece of dirt and then have 18-plus months to get a site permit there." ■

## Outlook

COVID-19 has quickly injected significant uncertainty into the markets. The hope for Austin is that strong fundamentals—a highly educated workforce, inbound population and a diverse, tech-forward economic base—will leave it relatively insulated from the issues facing other metros over the next several quarters.