

September 2020

COVID-19 Office Impact Report

Downtown Austin, Texas

Introduction

COVID-19 has temporarily changed almost every aspect of our lives, including how we work, but it remains to be seen how much will change permanently. The primary purpose of this report is to lay the research groundwork necessary to understand the potential impact COVID-19 will have on the downtown office market. The report will be updated periodically and may evolve to include new trends should they arise.

It's important to note that prior to the pandemic our downtown office market boasted extremely strong market fundamentals. This will undoubtedly help. At the end of 2019 (Q4) our office space vacancy rate stood at 5.4% and had remained below 10% since the second quarter of 2011. The pandemic has already ticked that up to 8.2% and is expected to increase in the near future. With consistent occupancy rates and steadily growing rents, no one is surprised that developers have responded with project after project producing new inventory year after year.

This report has identified three important trends to watch in the coming year or so that could impact our office market. First, will the office market downtown absorb the record amount of office space currently under construction and scheduled to deliver in the next twelve months? Second, when will leasing activity in downtown rebound and return to pre-COVID-19 levels? Finally, how will the sublease market evolve as all of this unfolds? While these questions remain unanswered, it is important to monitor the trends to better understand levels of impact and possible paths to recovery.

Downtown Office Supply Expanding Faster Than Ever

Before entering the pandemic the downtown office market was in the midst of rapid expansion, with several buildings set to deliver between now and the end of 2021. Excluding the Apple Campus¹, approximately half of all office space under construction is located in downtown. It will be important to monitor how smoothly this new supply is absorbed and observe whether or not downward pressure is placed on overall asking rents.

Figure #1 Total SF Under Construction in Downtown and Share Citywide

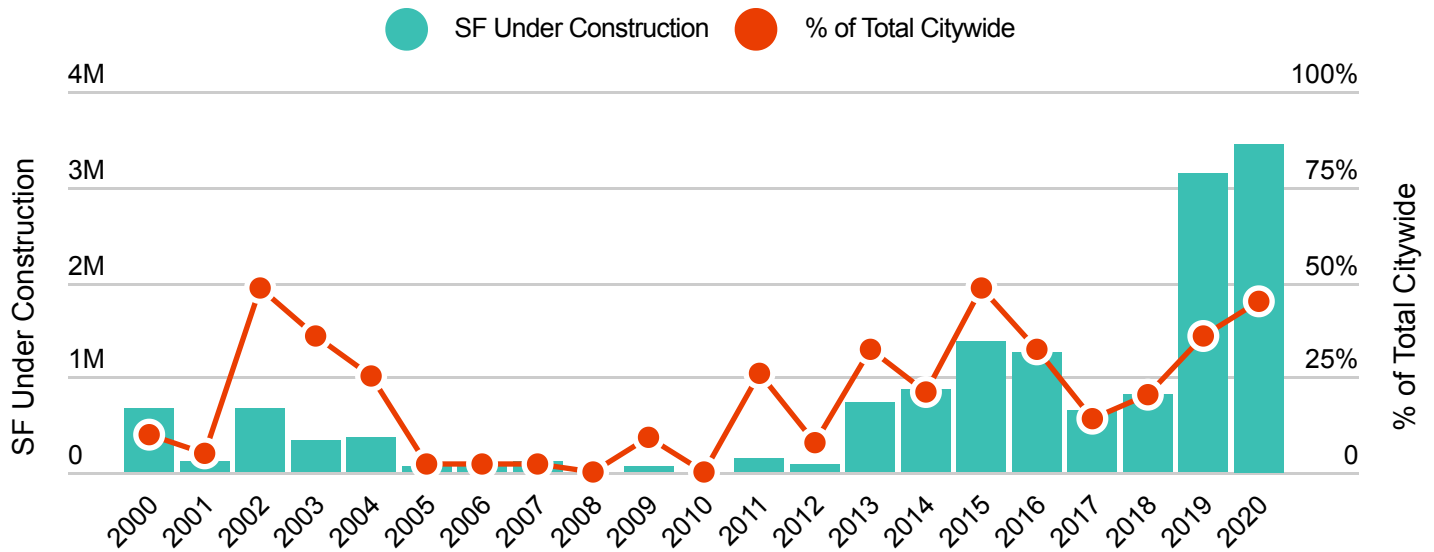


Figure #2 Downtown Office Space Under Construction

Property Name	Office SF	Est. Delivery Date
Block 185	793,883	2022
Block 71	667,988	2021
6X Guadalupe	597,500	2022
300 Colorado	358,000	2021
River South	328,458	2021
1313 Red River	325,000	2022
1836 San Jacinto	230,609	2021
405 Colorado	228,606	2020
701 Rio Grande	116,929	2021
The Quincy	77,781	2021
Alexan Capitol	21,000	2021

Source: CoStar YTD = 9.10.2020

1. In December 2018 Apple announced their intention to build a 3 million square foot campus at 6900 Parmer Lane. Construction is expected to begin shortly as building permits have been filed.

Leasing Activity in Downtown at Record Lows

Leasing activity nationwide ground to a halt when the pandemic began in March. Leasing levels have remained well below recent years dropping below levels established during the Great Recession. Since the started of the pandemic, there have been no downtown leases signed greater than 50,000 SF. And our largest lease to date is a renewal and therefore didn't affect our rising vacancy rate.

Figure #3 Total YTD Leasing Activity by SF in Downtown

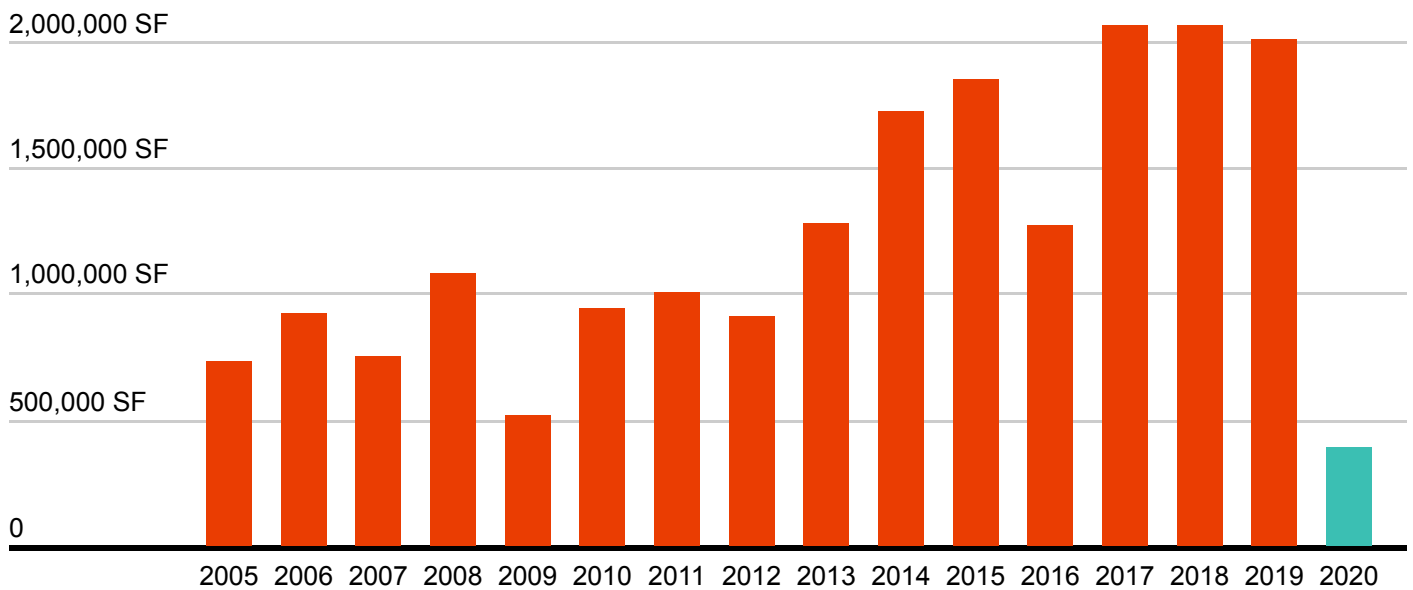


Figure #4 YTD Leasing Activity as % of 2019 Total SF

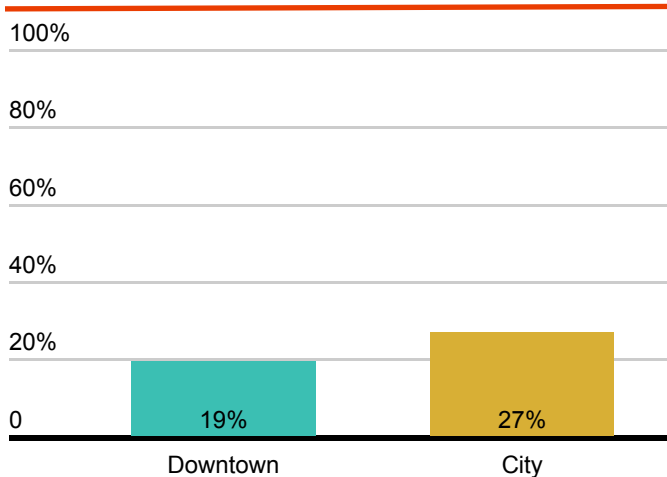
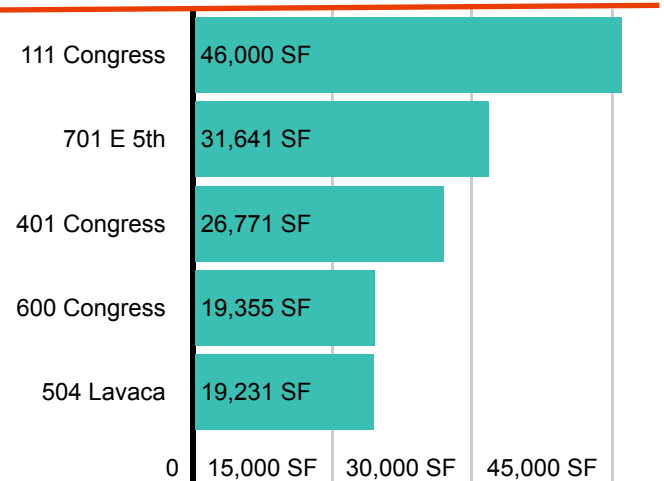


Figure #5 YTD Largest Downtown Leases Signed



Source: CoStar YTD = 9.10.2020

A New Supply Story in Downtown

Downtown Austin office supply has been historically very tight, enabling new developments to be quickly absorbed. Figure 6 below illustrates a troubling new trend in our supply story. There has been a rapid increase in subleasing, both in existing square footage as well as spaces under construction. This is a remarkable shift in just six short months. We are seeing an unprecedented amount of sublet space added to the market, a 225% increase compared to 2019. For example, Parsley Energy has placed 154,532 SF on the market in 300 Colorado due to oil market concerns.² Likewise, the Teachers Retirement System put up 100,992 SF in Block 71.² While those two leases represent a large share of the new sublet inventory, there are many smaller leases that have also been placed on the market since the year began.

Figure #6 Total YTD Sublet SF Available in Downtown

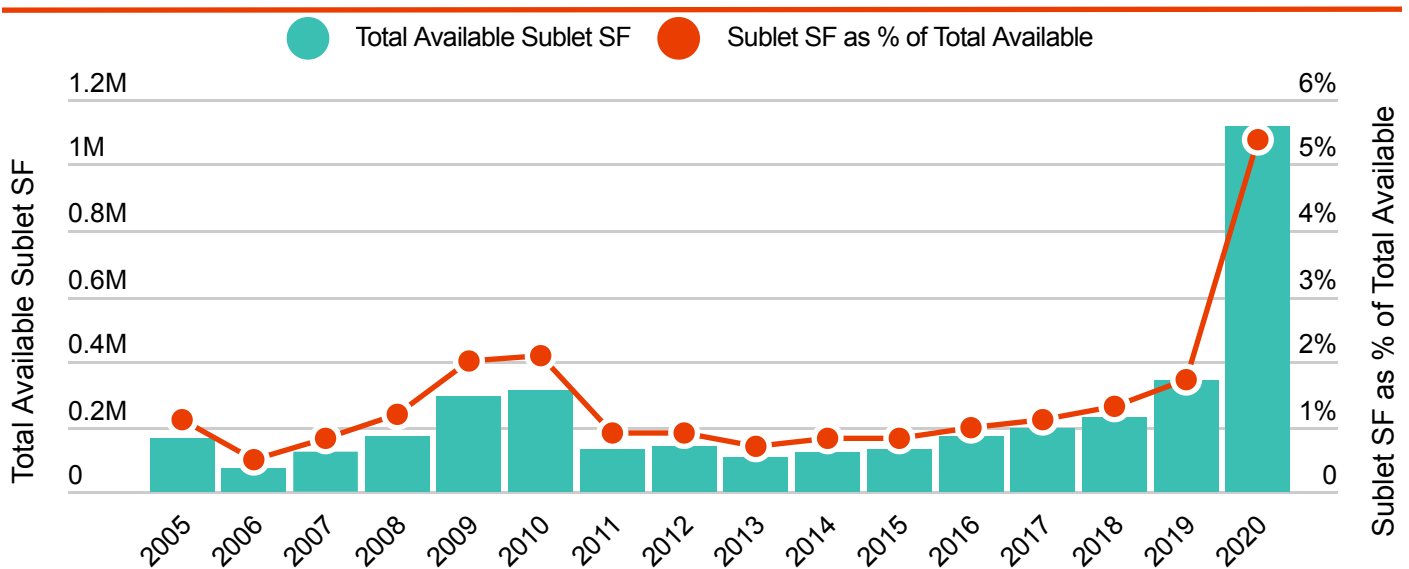


Figure #7 Top 6 Buildings by Sublet SF Available in Downtown

Property Name	Building Status	Rentable Building Area (SF)	Sublet Available Space (SF)
301 Congress	Existing	446,839	129,617
One Eleven Congress	Existing	518,385	112,522
Austin Centre	Existing	326,335	95,417
Colorado Tower	Existing	373,334	89,913
300 Colorado	Under Construction	358,000	154,532
Indeed Tower	Under Construction	669,130	101,673

Source: CoStar YTD = 9.10.2020

2. CoStar as of 9.16.20



Many Questions Remain Unanswered

Many questions about the future of downtown's office market remain unanswered. At the top of everyone's mind is the great work-from-home debate that could impact central business districts nationally. The primary fear is that if talented employees want to spend less time in their downtown office, it may enable employers to hire more without necessarily increasing their total lease square footage. Major tech companies like Facebook and Google have yet to return to their offices and have signaled a permanent increase in their use of work-from-home options. Others have explored options to expand their lease space in an effort to promote a safe employee return.

While downtown asking rents have only declined slightly for the first time in years, the increase in sublease inventory as well as new supply delivering may place additional pressures on rent if leasing activity remains low. The downtown office market will surely recover in the long run but it remains to be seen what the total short-term pandemic impact will be or if any new national trends will arise.

Photo: Manuel Velasquez