THE Neal Spelce AUSTIN LETTER

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Dear Client:

Expect to see even more construction cranes dotting the downtown skyline in the next few years. According to its semi-annual Austin real estate market report, NAI/Commercial Industrial Properties Company is forecasting a substantial increase in new central business district construction for occupancy in late 2001 and early 2002.

NAI/CIP's projection is driven by mounting rental rates and record occupancy levels downtown. "**CBD rental rates rose 14.8% last year and almost 40% over the last two years**," the report states. "With Class A office space rising to replacement costs ($30.00/sq.ft.) and the downtown occupancy rate hitting an historic all time high at 96%, new construction is becoming a reality downtown."

While citywide occupancy levels have actually decreased 4% since 1998 to 91%, NAI/CIP nevertheless predicts a **general tightening in the market** over the next year. Annual absorption in 1999 reached 2.1 million sq.ft. (a 13.2% increase over 1998), but only 1.5 million sq.ft. is expected to come onto the market this year. Some space is expected to come available in the northwest and southwest sectors of the city by June. But, the "majority of the sizeable blocks of space … have already been leased," NAI/CIP reports. "It remains to be seen if blocks of space in existing buildings will open up as large tenants move into their new spaces."

Austin's "center of gravity" continues to shift northwest. "The CBD was not the largest market for the first time in 1999. With more than 2 million sq.ft. added in 1999, the **NW sector is now the largest** single sector. It represents 35% of the total market." A similar northward shift is evident in the retail market, which has added more than 2 million sq.ft. of retail space in the last five years.

As the market tightens further, **expect rental rates to escalate faster and further**. "Citywide rental rates rose 9% during the last 12 months, with average rates in the NW and SW approaching new construction costs," NAI/CIP reports. Average rental rates in those sectors are about $24 per sq.ft.

Even with the rising cost of office space, the Greater Austin Chamber of Commerce estimates that the **cost of doing business here is 8% below the national average**. Moreover, as new construction comes on line, particularly in the hot CBD, NW, and SW sectors, rental rates should eventually stabilize.

Existing employers are driving much of the absorption in the office market. That's an important trend. In 1999, Motorola gobbled up 400,000 sq.ft,, EDS 270,000, and Intel 125,000. Continuing the trend in 2000 will be Radian International, the first phase of CSC's downtown expansion, and Tivoli's 1.5 million sq.ft. campus.

> This trend is nothing but good news for the long-term stability of Austin's high tech industrial base. Major employers function as a hub for both small entrepreneurial startups and the myriad of service businesses that support large industrial facilities. Clearly, this symbiosis continues to strengthen as Austin's anchor industries decide to expand here.

Austin continues to outpace the rest of the state in economic growth. In the most recent region-by-region index of leading economic indicators, Austin posted healthy gains in all categories, from employment to sales tax revenue.

The index, compiled by the Austin economic analysis firm Texas Perspectives, Inc. for the *Wall Street Journal/Texas Journal*, shows **Austin growing at a 3.9% clip** over 1998. The Rio Grande Valley and Fort Worth likewise posted strong growth rates of 4.3% and 3.1% respectively, while Dallas remained essentially level and Houston sagged 1.6%.

With state unemployment at a historically low 4.5% — and Austin's unemployment rate even lower — the availability of trained and educated workers is rapidly becoming the number one problem facing both government and businesses. The Comptroller of Public Accounts reports high tech businesses have an **immediate need for 34,000 new employees**, and retail and service industries can't find enough workers to man the stores, restaurants, and other businesses that support the high tech development, research, and manufacturing base.

> In this month's edition of *Fiscal Notes*, **Bill Bock**, President and CEO of Austin's Dazel Corp., warns that labor shortages pose a threat to continued economic growth in the region. "The long-term fix," Bock says, "is to upgrade secondary and primary education with an orientation towards math and science."

The problem, as Bock indicates, is that retooling the education system will take a lot longer than employers can wait. To make matters worse, technology changes so fast **schools can't keep up**. Compounding the problem is the chronic teacher shortage in math and science, fields employers need the most. Technologically-deft high school and college graduates are more interested in fast-paced, high-paying jobs than they are in teaching algebra to eighth-graders.

In short, the very industries that are feeding this unprecedented economic upswing are consuming our intellectual capital faster than it can be replaced. While allowing more foreign workers into the United States might mitigate the shortfall, it can never completely make up the difference. Only public education can do that.

The revelation the Texas Education Agency is downgrading the accountability rating of three more Austin high schools couldn't come at a worse time for Superintendent Pat Forgione.

Beset by cost overruns in the Austin Independent School District's massive building program, financial accounting and data collection problems, and an upcoming vote on the district's share-the-wealth options, the new superintendent must figure that this time, at least, **things really have hit rock bottom**.

Sixteen AISD schools, including **six of Austin's 10 high schools**, are now rated as **"low-performing"** by the state. The primary culprits are rising dropout rates and the poor quality of AISD student attendance data.

TEA found that dropout rates at Crockett, McCallum, and Travis were actually much higher than AISD thought, while the overall AISD **dropout rate is hovering at 8.5%**: not the 2% AISD reported.

Eight Austin schools have dropout rates in excess of the 6% threshold that triggers "low-performing" status, with Johnston's staggering 17.7% rate leading the pack. AISD is **one of four districts** statewide (out of 1,036) that are rated as "**unacceptable**" because of questionable data quality.

Although AISD officials have been bracing for the news since January, the principals of the three schools apparently didn't know their campuses were at risk. Parents and students were likewise taken by surprise. Communication between the administration and the campuses and PTAs is clearly a problem.

Moreover, if AISD — whether at the central office or campus level — can't account for all its students, one wonders about the accuracy of its average daily attendance and special population counts. Since the state doles out school funding partly on a per-head basis, **inaccurate data may be costing AISD money**.

Whether AISD can clean up its act has yet to be seen. The proceeds from this year's hefty tax hike are supposed to go toward improving student data collection and reporting, but that won't solve the underlying dropout problem, nor will it address chronic concerns about student academic performance and workforce readiness.

Still larger questions must be asked. How can a community with Austin's educational assets and booming high tech economy tolerate an "unacceptable" school system? **Are Austin's new business and civic leaders willing to step up and run for the AISD Board of Trustees**?

One thing is certain: if these problems persist, they will eventually **undermine Austin's economic growth and quality of life**. All those who have a personal or business stake in Austin's future need to be concerned.

After enjoying record surpluses for the last two budget cycles the Legislature will have some additional money to spend next session. The past surpluses allowed **Gov. Bush** to push his tax cut agenda. But, this time around, it could be barely enough to cover increases in basic state services.

According to the Texas Taxpayers and Research Association (TTARA), current trends will produce about $3.6 billion in revenues above 2000-01 spending levels, but increased spending demands for public and higher education, health and human services, and employee benefits could top $3.5 billion.

"An early look ahead to next session suggests that **money will be tighter than we're used to**," said **Dale Craymer**, TTARA's Chief Economist and former chief revenue estimator for the State Comptroller. TTARA also reports that an emergency appropriations bill may be necessary to cover a $100 million shortfall in State Medicaid and mental health programs. "It isn't unusual for the Legislature to pass emergency spending bills," Craymer added. "Trying to predict budget needs two years in advance isn't always easy or completely accurate."

This is a far cry from the $5 billion surplus the Legislature had to spend in 1999. "If current trends hold," Craymer concluded, "the Legislature will have just enough money to maintain basic needs, but will **lack funds for new initiatives**."

Should these projections remain on track, **Austin could feel a big impact**. State employees may not get pay raises to cover rising living costs. State funding for the Austin School District and UTAustin will be harder to come by. Social services to those on the low side of the "digital divide" may be squeezed even more tightly. As Austin leaders look for ways to solve the problems created by growth, they should keep an eye on the state of the state coffers.

Dr. Louis Overholster wonders why *abbreviation* is such a long word.

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