THE Neal Spelce AUSTIN LETTER

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Dear Client:

More than 20% of the apartments in Austin have started offering up to a month's free rent to entice renters to move into their properties. Is this a further sign of softness in the economy and a warning signal to those who have money tied up in the multi-family market? The answer is yes. Or at least the green go-light has turned to a yellow caution-light.

The warning signs are obvious. According to Austin Investor Interests, first quarter **occupancy rates declined 2.2%**, dropping to 94.22%, a level unseen in three years. AII also reports, "absorption fell for the second consecutive quarter to minimal levels." Contributing to this slowdown is the fact there have been **2,501 new apartment units added to the market** over the last 90 days.

It doesn't stop there. According to AII, nine new apartment projects have begun construction, bringing the number of new apartment units under construction during the 1st quarter to 12,733. And, you can look for more than **8,000 of those new units to be completed this year** and to start trying to persuade renters to move in.

Break that down a little further, and you find during the 1st quarter nine projects were completed, AII reports. They had an average occupancy of only 63%. That's a **22% decrease in occupancy** from the prior quarter's completions.

The vacancies can be attributed to three major reasons. About 35% opted to **choose home ownership due to falling interest rates**. Job transfers accounted for less than 20% and competing property moves were also cited. In addition to those "move-outs", apartment managers report that traffic was slow throughout the 1st quarter.

With this downward trend, you would expect rents to drop, wouldn't you? Wrong! **Apartment owners raised rates** from an average of a buck a foot to $1.01 per sq.ft. – a small increase, yes, but still an increase in a declining occupancy situation. If occupancies continue to fall, can a drop in rental rates be far behind?

Those who make a living with apartments, or those who loan money for apartment construction, had best hope for a healthy net gain in jobs this year. **New jobs mean more apartment dwellers**. Net new jobs are still being created at a solid pace, but watch those numbers for an indicator of the health of this important economic sector.

With the end of the legislative session exactly one month away, **UTAustin has two money issues – other than the amount of money set aside for its annual budget – for which it is aggressively lobbying**. They both would generate significant income, but are controversial.

A tuition proposal has the potential to generate the most sparks. Actually, there are two tuition measures – one, would authorize a **$2 a semester credit hour increase** each year through the 2005-2006 academic year, and the other would increase tuition by **$1 a semester credit hour** for each of the following five years. Fifteen-percent of the tuition increase would be devoted automatically to student financial aid.

Those who back the tuition increase point out **Texas ranks 32nd among the states in total tuition and fees paid** to comprehensive colleges and universities. And, they further point out that tuition is a necessary part of the financing for university operations, since general revenue appropriated by the legislature provides only a portion of state appropriated funds.

By the way, **a tuition increase would go to *other* state universities**, **in addition to UTAustin**. Total dollars raised would be about $22 million. More than $6 million would flow to UTSystem universities.

The other money-raising maneuver is a bit more esoteric than the easy-to-understand move to raise tuition. The second effort would allow UTAustin to **retain 100% of indirect cost funds**. What's that, you ask? Well, when a university gets outside research awards or grants through its own non-legislative initiatives, 50% of the indirect costs in those research monies must, by law, go to offset university appropriations.

All of the **ten most populous states allow their institutions to retain 100% of their indirect costs**, except for Florida (whose institutions retain 98%) and Texas (whose universities get only 50%). UTAustin would gain an estimated $16.3 million per year in additional revenue with this change. But, the flip side – and this is where the controversy comes – is the state would lose that amount of money, because it would not go to offset university appropriations.

Incidentally, UTAustin would use this additional revenue to **expand its research capabilities** by supporting faculty, providing seed money for new projects and to purchase research-related equipment.

As with the tuition proposal, this initiative is not limited to UTAustin. And, the effort has the support of the Texas Higher Education Coordinating Board, a special commission appointed by then-Lt.Gov **Rick Perry** and by State Comptroller **Carole Keeton Rylander**.

If it is to become law, the Indirect Cost change would need to be nailed down in the final Conference Committee report on the state's budget.

Look for Charles Miller of Houston to become the next Chair of the UTSystem Board of Regents. **A UTAustin grad** (**math**, **1959**), **Miller is Chair of a private investment partnership called Meridian Advisors**, **Ltd**. The post has been vacant since February when Former Congressman **Tom Loeffler**'s term ended. Miller has served two years on the Board of Regents and should be tapped by his fellow Regents at their May meeting.

Three new regents are appointed by the Governor every two years to serve six-year terms. So, Miller has four years remaining on his term. A few weeks ago, Gov. **Rick Perry** re-appointed **Rita Clements**. And he named Judge **Cyndi Krier** and Dr. **Judith Craven** to join Clements in a six-year term. All three of his appointees are UTAustin grads.

For your personal and business planning, **be sure to budget more money for gasoline**. **Prices have been creeping up steadily and are expected to continue rising through the heavy summer usage months**. And, don't forget the City of Austin's electric utility, Austin Energy, will once again hike your electric rates this summer. Remember, under the guise of urging conservation, the **City raises your electric rates during the time of peak air-conditioning usage**. So get ready for high utility bills. The positive side of this: you're not in California, where utility bills will soar 25% to 60% and rolling blackouts will still occur. But then, that's a different story altogether.

Interest rates have been cut a full two percentage points so far and additional cuts are likely if the Federal Reserve Board doesn't see enough oomph. It's important to note it usually takes 6-12 months for the impact of lower interest rates to kick in, so the effect of the Fed's action is still to be felt throughout the economy, even though the stock market reacts immediately to interest cuts.

The residential real estate market in Austin is obviously a big beneficiary of lower interest rates. As you noted in our lead story, with apartment rental rates remaining high for the moment, more and more **apartment dwellers are comparing monthly rental rates with monthly mortgage payments on homes** priced around $100,000 and seeing some distinct advantages to buying that first home.

Homes priced even higher – remember, the average sale price of homes in the Austin area has now zoomed past $200,000 – also are helped by the low interest rates. Realtors point out **buyers can now afford more home** with the same mortgage payment. And, bankers are pushing that "now's the time" to refinance your home if you're carrying a high interest rate.

Finally, while we're on the subject of homes, if you've owned your home for at least a few years, don't complain too loudly about the high prices Austin homes are bringing these days. Sure, Austin homes cost more than similar houses in other Texas cities – if you're a buyer. But, it also means **the value of your home has increased exponentially**. That's a good thing.

The Dallas/Fort Worth contest with Denver and Chicago to convince Seattle-based Boeing Company to re-locate its headquarters operation, **is as much a battle among Texas**, **Colorado and Illinois as it is a city sweepstakes**. With a mid-May decision date looming, it's appropriate to consider some of the arguments made on the *state's* behalf, rather than site specifics. After all, these are the same sales points Austin uses in its quest for out-of-state relocations.

First of all, two strong sales points for any business considering a move from out-of-state are that Texas has **no personal income tax**, and among the 15 most populous states, Texas ranks as **one of the lowest in business taxes as a percentage of total state revenue**. These are two compelling, bottom-line points.

Also, Texas is a **right-to-work** state. (Remember, "right-to-work" is a code word meaning labor unions are not very strong here.) And one of the state's big pitches to business is that Texas has instituted major reforms in workers' compensation, which **lowered employers' costs** substantially over the past several years.

Other items included in most pitches to interested companies: Total **energy costs** in Texas rank among the **lowest in the nation –** a timely topic these days to folks on the West Coast. More than 90% of the state is in the **Central Time Zone**, making nationwide and international business easier to conduct.

By the way, as the spotlight shines on Boeing's re-location plans right now, don't forget Boeing has a major presence in Texas already. In fact, in 1998, **Boeing expanded its operations in El Paso** by selecting it as the location for production of the Minuteman III Intercontinental Ballistic Missile Guidance Replacement program. El Paso's proximity to Mexico, its maquiladora program and inexpensive labor, are important assets for many manufacturers.

Dr. **Louis Overholster** says the multi-million dollar homes dotting the western hills of Austin make him think if the Publishers Clearing House van dropped off a million dollar check in any of those neighborhoods, they'd arrest the driver for littering.

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