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Dear Client:

**It's been exactly two months since the 77<sup>th</sup> Texas Legislature adjourned and it's now quite clear what went largely unnoticed at the time. There was a dramatic shift in spending policy.** In spite of all the moaning and groaning about budgeting, there was no fiscal crisis. In fact, there never had been. But, hang on, there probably will be a full-blown financial crisis in the next Legislative session in 2003. With clear-eyed hindsight, here's what really happened.

First of all, according to the Texas Taxpayers and Research Association (TTARA), **lawmakers spent the 2001 session desperately trying to outmaneuver the constitutional limit on budget growth**, while at the same time substantially increasing social service funding (particularly Medicaid), offering a sizeable state employee pay raise, and **passing the largest new spending program in recent history** – state-paid school employee health insurance.

To understand this dramatic shift in spending policy, you must understand that **for the past 20 years public education has been the focus** – be it more money for programs, teacher pay raises, or even additional funds to reduce reliance on local property taxes. But, this session there was no pretense of property tax relief.

In fact, the Legislature purposely took advantage of rising local values (and local taxes) to substantially *reduce* state program funding for public schools. And, while they boasted of the new state aid for teacher health insurance, TTARA reports **overall state aid to local districts may actually decline in 2002-2003 compared to the previous budget** – even counting the new health insurance stipend!

With the school finance system teetering on the edge of another legal precipice, lawmakers resigned themselves to dealing with taxes and school finance two years hence, and opted to **use what money was available today for social services**. They did it with a maneuver allowing them to skate by the state's constitutionally mandated spending limit. Additional money could be spent, but legislators would have to take a **special vote to exceed the cap** – not a particularly appealing prospect, especially in a politically charged redistricting session.

Instead, an alternative approach was taken – one in which unused funds were diverted from other agencies along with a mix of funds not subject to spending restrictions, and **lawmakers were able to close the gap without resorting to a controversial vote**. As a result of budget maneuvering, legislators will likely face a legitimate fiscal crisis next session.

**Don't let your eyes glaze over just yet. You need to know why the state's final budget figures may not be final and what that could do to you two years from now.** When all sources of funds are added together and the Governor's vetoes are counted, the Texas Taxpayers and Research Association (TTARA) reports the two-year state budget totals \$113.8 billion. **That's a whopping 11.6% increase over the current biennium.** And it could go even higher!

The reason the final figure could go higher is due to a number of **contingencies lawmakers placed in the budget.** In recent years, you've seen Texas' robust economic growth continually exceed expectations of most prognosticators. Better-than expected economic growth has generated additional state revenues – leading to a series of state budget surpluses.

Assuming a turnaround from the current downturn, it's possible surplus funds could materialize for the next 2-year budget cycle. **But, don't assume those monies will be there for education.** You see, rather than let excess revenue carry forward to help balance the next budget, lawmakers, in their wisdom, added a series of contingencies that would *draw down these revenues.*

This could result in a double whammy. It would not only **reduce the potential revenue available,** but it would also **add to the spending base** from which lawmakers would work to craft the next budget.

There's more. Remember in our 6/22/01 issue, we told you State Comptroller **Carole Keeton Rylander** warned the state could be as much as **\$5 billion in the red** for the next 2-year budget cycle. She pointed out that by using several one-time funding items, legislators may have created a mis-match between spending and revenues that could haunt them next session.

This includes the carryforward of the state surplus, **funding only one year of teacher health insurance,** using revenues from funds consolidation, speeding up revenue collections, and delaying certain payments and transfers. It's not unusual for Senators and Representatives to perform some gyrations like this with the budget, but anticipated surpluses usually cover the lawmaker's backsides. Now, with a long list of contingencies sitting there ready to soak up surplus revenues, it's a much tougher ballgame.

And, against this **backdrop of looming financial problems is public school funding.** A number of lawsuits are again working their way through the courts challenging various aspects of the state's school finance system.

The TTARA echoes our prediction of a few months ago that **the 2003 legislative session may prove to be the most difficult since the recurring deficits of the 1950s** that led to the passage of the state sales tax. By the way, when the sale tax was enacted it was 2%, with no local sales tax added on. Now, in Austin, the sales tax is 8.25%. With one of the nation's highest sales tax rates and among the highest property taxes, lawmakers may have no easy options.

**As dot-com and high tech companies folded or downsized by laying off workers, the tight office space market in Austin quickly turned into a tenants' market. Now that we have two consecutive months of diminishing retail sales (April/May), is the same thing happening with retail space?** It's just becoming apparent, but to a much smaller extent, the answer is yes.

You can't measure it by empty storefronts. The Austin-area retail market is **maintaining the roughly 95% overall occupancy rate** experienced of the past two years, according to NAI/Commercial Industrial Properties. It is interesting to note, however, that **Austin finally broke the trend of a continual increase in occupancy rates**, which has been ongoing since NAI/CIP began tracking the retail market in 1992.

“The effect of a slowing national economy and a bruised high tech industry is carrying over in varying degrees to many Austin retailers,” notes NAI/CIP. As a result, the commercial real estate company is predicting **landlords will see more tenant turnover**, with fewer lease prospects to choose from, in the near term.

The pendulum has officially swung back from the landlord to the tenant. Overall **rental rates will most likely remain flat, or may soften slightly**, while landlords experience higher finish-out and turnover expenses, predicts NAI/CIP.

But the outlook is far from dire. Remember, retail space is 95% leased up right now. And, there is a **minimal amount of speculative retail space coming on-line** – unlike the large number of apartment units in the soon-to-be-leasing category. NAI/CIP concludes “tight building restrictions and cautious lending practices for speculative projects have prevented an overbuilt situation” in the retail space category.

Long term, the Austin retail market looks exceptionally strong. **“Ultimately, there is still tremendous buying power in the Austin area for retailers,”** adds NAI/CIP. And while we're seeing some initial signs of retail sales slowdown compared to last year (see our 7/20/01 issue), it's important to remember many Austin area retailers had their best year ever during 2000.

**Austin area retailers should get a nice uptick in sales next week. The Sales Tax Holiday is expected to generate massive retail sales statewide. How much? Well, look at it this way. The sales tax rate of 8.25% is predicted to save shoppers, during the 3-day holiday, an estimated \$31.2 million in state sales taxes and \$8.4 million in local sales taxes.** To achieve that much tax savings, retailers will generate an enormous amount of gross revenue.

Shoppers, with an extra \$300 to \$600 income tax rebate in their jeans, can take advantage of the savings 8/3/01 through 8/5/01. And retailers are ready for this onslaught of spenders. While many items, such as jogging apparel, will not be taxed, the Sales Tax Holiday was originally set up for back-to-school purchases – primarily clothing and footwear priced under \$100 per item.

**The City of Austin's Emergency 9-1-1 Call Center processed 833,923 calls last year. The amazing aspect of that large number of calls is that approximately 50%-60% of them were of a non-emergency nature.** There's no question, Austin's 9-1-1 emergency response capability is strapped by the huge number of calls. But, the cavalry is riding to the rescue.

The rescue for 9-1-1 is not coming in the form of expanding resources for the 9-1-1 operation. The assistance is in the creation of a new entity for the almost **half-million NON-emergency calls**. The Austin Police Department is gearing up to introduce a new 3-1-1 call system this fall.

The 3-1-1 launch should be the city's **largest public safety initiative in recent memory** – because it will take a great deal of education, information and public awareness to make the 3-1-1 system work well enough to provide relief for the emergency operations.

The knee-jerk reaction to call 9-1-1 in case of a problem will need to be modified. So, which number should you call? The difference between a call to 9-1-1 and 3-1-1 will be fairly simple. **The calls that do not require a response for police, fire or emergency medical services should go to 3-1-1.** Period.

As more and more Central Texas residents become conditioned to dial 3-1-1 if they don't need a cop, firefighter or EMS personnel, 9-1-1 will be much more efficient for what 9-1-1 is designed to do – **respond as quickly as possible to real emergency situations.** But, don't underestimate how big the job will be to educate a half-million people to call 3-1-1. It could take awhile. But, for every non-emergency call that goes to 3-1-1, it enhances the city's response to actual emergencies.

**Dr. Louis Overholster** says it's ridiculous claiming video games influence children. "After all," he noted, "if Pac-Man affected kids born in the Eighties, we should now have a bunch of teenagers who run around in darkened rooms, eating junk food and listening to monotonous electronic music!"

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