

THE

*Neal Spelce*

# AUSTIN LETTER

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Dear Client:

**Staring straight down the barrel of a new year, let's examine if the steel bullets likely to come at us throughout 2002 will impact the Austin economy, or be deflected by the "Superman" of metro areas.** There's no question there are some explosive scenarios that could wound or cripple our economy. The answer lies in whether the Austin area business base is nimble enough and strong enough to leap the hurdle of such an assault.

In no particular order, let's analyze the various facets that are important to our economic well-being. First of all, jobs are **going to appear to take a direct hit initially**. It's entirely likely, in fact probable, that the **unemployment rate will go up** the first few months of 2002, rather than go down. But, frankly, this will just be a glancing blow.

The reason: the Austin area will continue to **create new jobs at the same time the number of unemployed rises**. Remember, all the temp workers hired during the just-concluded holiday season are now joining those laid off in the high tech industry looking for work. That'll push the numbers up. But, the **total number of workers in the Austin area should continue to increase** – albeit at a slower pace than the go-go days of 2000.

Bottom line for jobs: **We saw the worst of the layoffs during 2001**. There may be a few more announcements here and there, but nothing like the tens of thousands that were announced in 2001. **The second quarter should see a turnaround in the job market.**

And, by the way, while the latest figs (for November 2001) show Austin's unemployment at 4.7%, **statewide the tally was much worse (5.4%) as was the national total (5.7%)**. Dallas came in at 5.8%, Houston (before the Enron impact) totaled 4.4%, Fort Worth/Arlington recorded 4.8% in November and San Antonio's unemployment was 4.5%. So Austin is in relatively good shape.

And don't forget our underlying strength – public sector employment. The two largest segments that generate jobs in the Austin area are high tech and government work. While job problems in certain high tech sectors are well chronicled, **public schools, area universities and city and state government in general are not laying off workers**. In fact, they're hiring. Those government paychecks are steady and dependable (almost to a fault!) and they provide a basic underpinning that should not be underestimated.

**Jobs are basic to an economy. If jobs are being created and people are pulling down paychecks, then there is a positive ripple effect throughout much of the rest of the economy. Jobs are critical to residential real estate – less so for commercial. So, what is the status of our residential and commercial real estate economies?**

There are many factors that will determine the success of residential real estate in the Austin area during 2002, and the **one factor that local real estate pros can't control is the long-term interest rate**. There's been a solid surge of home sales during recent months, mainly because interest rates are as low as they've been in years. Rates should **start inching upward in 2002**, but don't look for them to zoom into the stratosphere while the national economy is still struggling. So that's a good short-term sign.

Another good short-term sign for real estate is that **home prices are not soaring out of sight anymore**, pricing many potential buyers out of the market. There's no doubt prices continue to move upward. But the ridiculous demand of 1998, 1999 and 2000 that had homes selling for *more* than the asking price is long gone. In fact, the average price per square foot has dropped over the past year.

**The market, while still good, has stabilized.** At the current sales pace, it will take almost six months to sell all the houses currently on the market. A year ago, the inventory of homes-for-sale was less than half today's tally. **So sanity has settled in for a while.** And there are those who feel total 2002 sales will be in the same neighborhood enjoyed during 2001 – a good year by most measures.

It's a different story for apartment rentals. The apartment market should continue to be a renter's market for much of 2002. While a good job situation helps apartment rentals, the **new construction pipeline wasn't shut down quickly enough so apartments are overbuilt in the Austin market right now**. Look for rigorous competition and deals, deals, deals to continue to be the daily diet of apartment operators.

The same is true for commercial real estate. **For office space, it's a tenant's market and will stay that way through much of 2002.** The availability of more than 3 million sq.ft. of sublease space is knocking down rates all over town. Sublease space is technically leased or set aside for owner-tenant's future use. In many cases, rent is being paid on the space to office building operators. But, the tenants need help carrying the load so they are cutting their own contract rates if somebody will just lease part of their committed space. This is keeping tenants out of the 2.5 million sq.ft. of direct space that's available, usually at higher prices.

**There is office space available all over the Austin metro area.** This situation will not change in the foreseeable future. So developers, operators and lenders must factor this into their 2002 planning.

So, if you're in the market for office space, 2002 will be a good year for you.

**What about retailing, high tech, travel and hospitality, and the health care segments of the Austin economy? What does 2002 hold for these important elements of the business community?** Here are some thumbnail quick takes.

RETAILING. A good job climate is good for retailers. And we have a relatively good job climate, as noted in our first item. But there is this thing called “consumer confidence”, which drives folks to hold onto more of their paychecks when there is a feeling of uncertainty. That uncertainty is still out there to some extent following 9/11, so **Austin area retailers will need to fiercely compete during 2002 – and that means aggressive pricing** (low prices/sale prices) to get consumers back into their shops.

HIGH TECH. Keep your eye on Dell. **The stock market likes the way Dell is taking advantage of the tech downturn** to gain market share at the expense of its lesser-capitalized competitors. A vigorous, healthy Dell is an important benchmark for Austin’s high tech prospects. Elsewhere, the conventional wisdom is that semiconductor companies can expect a slow recovery in 2002 with most gains coming in the 3<sup>rd</sup> and 4<sup>th</sup> quarters.

TRAVEL AND HOSPITALITY. Tough times will continue to face those who make their money in the Austin area off those who travel. **Travel agents** (who had their commissions cut by airlines long before 9/11), **tour operators** and **taxicabs** are the obvious ones hurt by the slowdown in travel. But the hospitality industry is much more than that. **Hotel bookings are down** and the Texas Legislature doesn’t reconvene until 2003 to give a boost to occupancies. Look for some of your favorite **restaurants to go belly-up** in 2002, if the operators don’t have deep pockets. On the flip side, the same situation is occurring elsewhere, so you can save some bucks in 2002 on your airfare, hotels and dining when you travel.

HEALTH CARE. This is one of those little-publicized business success stories of 2001 (especially if you focus on volume) and it should continue throughout 2002 – and beyond. **Health care, as a percentage of economic output, is big and getting bigger.** The Austin area, despite its relatively young demographic, has a population that is living longer and utilizing health care operations more and more. The economic slowdown has little impact here.

Obviously, there are more areas we could delve into such as **financial institutions** (still healthy and playing it conservative when it comes to doling out money) and **car dealers** (wrapping up a great ride over the past few months, but settling down somewhat when the factory drops interest-free financing in a couple of weeks).

We also should point out the **costs of doing business are leveling off.** Look at the low gasoline prices and utility costs, for example, and occupancy costs, if you’re in a position to cut a better deal.

Throughout all this, remember: whatever problems we may have here, and there are not many of them, this is still one of the nation’s premier places to live and work.

**You've seen our take on what 2002 should bring. Now what about a little longer horizon? What about the next five years?** We're coming off a good run. The population of the Austin metro area more than doubled over the past two decades (1981-2001) as it has every twenty years since our city was founded.

"Even more phenomenal growth was seen in the area's output, which quadrupled," according to The Perryman Report (TPR). But what about the future? "By the standards of the past, the Austin area is set to see significant slowing. However, compared to virtually any other region, the **Austin area is likely to lead the economic growth pace,**" added TPR..

By the way, TPR predicts the metro area's **population is likely to approach 1.42 million** over the next five years. And the **workforce is expected to expand by almost 100,000** (we're talking new jobs here) – from 707,700 in 2001 to 803,600 in 2006. So, robust growth is just around the corner.

**Thoughts while thinking about chickens and eggs: which came first – massive, impersonal, company layoffs or employees with little loyalty who jump to other companies at the drop of a hat?** We haven't seen any empirical evidence to suggest one preceded the other, but the move away from lifetime employment sure seems to have meant much heavier cuts during times of recession. And now that we have some gray in our hair, we can be forgiven if we yearn for the Pollyanna days when **employees were fiercely loyal to their companies and the companies responded in kind** by creating family atmospheres that genuinely rewarded longevity – even during tough times.

And, while we're on the subject, wasn't it much better when **pro baseball and football teams kept the same squads intact year after year** – generating fan loyalty, support and involvement unheard of today. Ahhhhh, the good ole days!

This time of year, **Dr. Louis Overholster** says if you want to see the Ghost of Christmas Past, just check your credit card statements. As he put it: "Money talks – but credit has an echo!"

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