THE Neal Spelce AUSTIN LETTER

www.AustinLetter.com

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Dear Client:

Because of the psychological dark cloud hanging over the office building market in Austin, **it may be hard to sell the idea that the high vacancy rate could soon be a good thing for our economy**. **But this will likely be the case**.

Think back to the dark days of the eighties when it seemed as if un-leased "see-through" buildings were everywhere. There were also a lot of people looking for work, much like today. But lo and behold, when the economy started turning around in the late eighties and early nineties, **available office space and a ready**, **educated workforce turned into attractive assets** to lure job-creating, tax-paying companies to the Austin area.

Make no mistake, attractive office space and willing workers **by themselves don't trigger corporate re-locations or expansions**. Especially when companies are reluctant to spend capital — as they are now. It takes an economic turnaround to create the climate where these forces come into play.

As the turnaround occurs – and there are signs it's starting right now (see next paragraph) – Austin's assets, which have generated so much buzz nationwide, **will propel our area to the top of most lists for consideration**, as firms loosen up and decide to invest in their future growth.

"The majority of economic news is positive," notes **JoLynn Free**, financial consultant with RBC Dain Rauscher here in Austin. She also points out the **stock market recently completed eight consecutive weeks of positive results**, **something not seen since 1988** (there's another reference to the turnaround at the end of the eighties!). "Since the lows in October, we are up 30% in the NASDAQ and 20% each in the S&P500 and Dow Jones Industrial Average. Technically, a 20% move up from the lows is the definition of a market reversal," she noted.

It may be a little early to start seeing business moves to the Austin area or business expansions. But, as we near year-end and look forward to 2003, it's time to stop licking our wounds and start spreading the word more vigorously. The tech wreck is history, as is the financial institution/real estate recession of the eighties. **The embryo effort by the City of Austin and business leaders to prepare a new economic development strategy is on the *right* track – it just needs to be on the *fast* track**. Our vacant offices, reasonably priced, are sitting there ready for instant occupancy. And 2003 should be the year of increased activity.

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It costs more than twice as much to rent a truck to move from San Francisco to Austin as it does from Austin to San Francisco. **Does this say something about the two economies**?

We went to www.drivebudget.com, the Budget car and truck rental Web site, to compare the costs of the two moves. To rent a 15' truck (enough to move two or three bedrooms) on 12/18/02 for a week – in time to get from **SF to Austin by Christmas – the cost would be** $**1**,**467**. That's with a 10% online discount. To go from **Austin to SF** (we put in the same parameters) **the cost was** $**632.70**, again with the 10% online discount.

> Why does the move from the Left Coast to the Third Coast cost more than twice as much? "Simple," says financial consultant **Scott Burns**. "**People are moving out of the Bay Area**. **The Northern California boom is over**. **Gone**. **History**."

Burns says "one of the fastest ways to learn how an area is doing is to check how much it would cost to rent a truck and move there". To bolster his point, he says a recent Bureau of Labor Statistics listing of employment changes over the last year has **San Francisco and San Jose at the bottom of the list**, **with major year over year job losses**. Remember we told you just last week, 12/6/02, the **Austin metro area has *added* more than 2**,**300 jobs** over the past year.

The financial consultant, who maintains his own Web site at www.ScottBurns.com, recently visited the Bay Area and Silicon Valley and came back with some anecdotal evidence to further underscore the problems. "At a small conference of seasoned management consultants, there is a worried edge to the discussion," Burns said. "For some, the backlog of work – **the contracts for services that are the lifeblood of consulting – is down and perilous**. For a few, the backlog is nonexistent. Demand went over a cliff."

> "The change has people in shock," he continued. "Over dinner on Russian Hill, a friend in public relations – a 20-year survivor who can tell war stories of the 1983 technology crash and name the forgotten companies of the first PC boom – tells me **his retirement is wrecked**. All the shares he took in lieu of cash, hoping for the big hit, are virtually worthless."
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> "Visiting a friend in Santa Rosa, I learn that jobs are hard to find. But real estate appreciation is great. In four years, my friend says, her **house has 'earned' more in appreciation than she received in income during the entire period**," he adds.
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> Is this a real estate bubble? "No, **it's real estate froth**, **a collection of bubbles**," Burns believes. Some will pass peacefully. Some won't. Northern California is a major froth center. It won't pass peacefully."

The Silicon Hills of Austin appear to be in a turnaround. What about Northern California and Silicon Valley? "**Ironically**, **this doesn't mean it's over for California**. **It just means the usual upheaval**, the continuing, incredible churn of winners and losers," Burns concludes.

The Federal Reserve Board closed out the year this week without raising the lowest short-term interest rates we've seen in decades. But, what about mortgage rates — the lifeline for a robust housing market?

Mortgage rates do not depend upon the short-term interest rates. Many potential homebuyers (and those who want to sell at the most advantageous time) wrongly think mortgage rates are tied to the Fed funds rate. **Alan Greenspan** and the Fed have direct control over the short-term interest rate, but not the long-term rate.

So who controls mortgage rates? "The short answer is investors who buy bonds in the two major corporations that buy home mortgages, Fannie Mae and Freddie Mac," explains **Mark Dotzour**, chief economist at the Real Estate Center at TexasA&M. "These two private corporations make money by selling bonds and using the proceeds to buy mortgages which pay them a higher rate of interest than they are paying to their bondholders."

The mortgage rate will always be higher than the bond interest rate because Fannie Mae and Freddie Mac want to make a profit. And, **the bond interest rate will always be higher than the expected rate of inflation**, because bond investors want to beat inflation.

Well then, how does all this work? "If investors invest $30,000 for 30 years at 6% and the inflation rate is 7%, they earn a lot of interest, but the prices of things they want to buy will have gone up faster," said Dotzour. "**Investors hope their money will earn a better return than the inflation rate**. Consequently, the mortgage rate is always going to be higher than the expected rate of inflation."

"**If investors feel that the US economy is slow, then inflation is likely to be low**," Dotzour observes. "Wages and prices of goods are unlikely to rise rapidly. In such a scenario, **long-term interest rates are low**. Investors are willing to buy Fannie Mae and Freddie Mac bonds at lower interest rates and the result is lower mortgage interest rates."

Bottom line: The long-term interest rate is broadly defined as the rate offered on US Treasury securities that mature in ten to 30 years. Mortgage rates are largely determined by long-term interest rate, **most commonly identified as the ten-year US Treasury bond**. This is where you keep up with what is happening to interest rates for the home you're buying or selling.

Now, a look ahead to 2003. **When the Fed this week left its interest rate target at a four-decade low of 1.25%, it signaled the US economy should resume stronger, steady growth** without any need for lower interest rates. Greenspan and others said they believe the economy is mired in an economic "soft patch." The most recent data point to some improvement. The factory sector seems to have bottomed out and home sales and capital spending have exceeded expectations. There are still problems, but you can look optimistically to 2003.

Texas is the only state with two presidential libraries. It will soon have three, and the battle lines have been drawn between six — count them, six — locations wanting to land the third.

If **George W. Bush** wins re-election to a second term in 2004, it will be awhile before he leaves office and settles into an office at his Presidential Library. But UTAustin (home of the **Lyndon B. Johnson** Library) and TexasA&M (home of the **George H. W. Bush** library) will tell you how valuable a presidential library, museum and associated School of Public Affairs can be. That is why there is an intense behind-the-scenes struggle to convince **George** and **Laura Bush** to select one of the six as soon as possible for their papers.

UTAustin and **TexasA&M** are two of the six, each arguing Bush's library at their campus would result in a synergistic quantum leap in complementing the existing library. But, three other Texas universities argue their location would set the younger Bush's facility apart.

SMU claims Laura Bush as an alum and Trustee, **Baylor** is near the Bush homestead ranch at Crawford, and **TexasTech** claims a West Texas base where President and Mrs. Bush have deep roots. Even **Arlington**, where Bush ran the Texas Rangers baseball team, has expressed an interest in the facility.

The reason for the rush: millions of private dollars must be raised to build the facility. By the way, presidential libraries are a fairly recent phenomenon – starting with **Herbert Hoover** (located in Iowa). Others: **Harry S Truman** (Missouri), **Dwight D. Eisenhower** (Kansas), **John F. Kennedy** (Massachusetts), **Gerald F. Ford** (Michigan), **Jimmy Carter** (Georgia), **Ronald Reagan** (California) and **Bill Clinton** (Arkansas).

As has been our custom since we started this newsletter in 1979, the only two weeks we do not publish are the last two weeks of the year. Therefore, your next newsletter will carry a January 3, 2003 cover date. In the spirit of the season, **Dr. Louis Overholster** hopes you do *not* get one of the greetings he received: "Happy Holidays! (Some Restrictions May Apply!)" **Our hope is that the holidays and 2003 bring you the serenity and success you and your loved ones deserve.**

Sincerely

Neal Spelce

Editor/Publisher

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