

THE

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AUSTIN LETTER

www.AustinLetter.com

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Volume 24, Number 44

February 14, 2003

Dear Client:

While facing a 2-yr \$11.5 billion shortfall similar to Texas, New York is committing hundreds of millions of dollars to transform its economy into a global leader in high tech research, innovation and manufacturing. In other words, it's taking dead aim at Austin and Texas.

New York is energized after a big coup at Austin's expense – International SEMATECH was enticed to move part of its operations to Albany where it will establish a **\$400 million Research and Development facility to produce the next generation of computer chips**. This is especially galling because SEMATECH was founded in Austin and is generally credited (along with MCC) for triggering the high tech economic boom in Texas.

New York Governor **George Pataki**, in his 1/29/03 budget address, crowed: "The arrival of International SEMATECH to Albany could have the **greatest impact on our state's economy since the opening of the Erie Canal**. It's going to ignite a high tech economic boom throughout our state. It is going to do for New York what it has done for Austin, Texas – create hundreds of thousands of new jobs."

"My budget will fully fund SEMATECH," Pataki said. And he didn't stop there. "We have been aggressive. We must stay aggressive. I will also propose a new **high tech investment tax credit to leverage up to \$250 million** of new capital investments. This proposed tax credit will be a powerful additional resource that will further **increase our competitive advantage against other states** vying for the high tech economy of the future."

Additionally, Pataki pointed out New York has "**already committed nearly \$120 million toward micro and nanoelectronics for the University at Albany**" and created a new technology park.

Earlier, 1/8/03, Pataki challenged his state's budget writers who were addressing the shortfall to "**turn crisis into comeback**". The Republican urged state lawmakers to "look beyond the short term to the future" and "**out-compete any state** and continue to create new jobs. Even in these difficult times ... New York will persevere and stay on a path to job growth."

The challenge for state, local and university leaders in Texas is clear. As a result, a small group has been quietly working and should surface soon with specific plans to meet the challenge.

An attitude adjustment is required to enhance state economic development. Texas economist Ray Perryman is convinced incentives can help ensure prosperity.

Perryman points out business is more mobile these days and the locations process is more sophisticated. “Unfortunately,” Perryman says, “Texas doesn’t consistently provide the low cost site for new enterprises. Thus, **incentives are necessary elements** in the marketing and decision-making process.”

“The idea that incentives raid the State Treasury must be dislodged,” Perryman says. **“Incentives create opportunities to prime the pump** through investing in future growth.”

He says current economic development initiatives are cumbersome and difficult to assess. “Flexible, quantifiable packages that can be rapidly structured need to be instituted,” he says. Perryman goes on to recommend the **state should devote significant efforts to becoming more “business friendly.”** And he claims “such an approach will bring more certainty to economic development initiatives.”

With the flameout of many dot-com companies, some may question the value of high tech businesses to the economy. But those visible failures reinforce the value of dot-com payrolls.

First of all, high tech companies are not just the wave of the future, they are “now,” as well. High tech companies are replacing old-line manufacturers. Computer chips are in most of the products we buy these days, etc. No sense belaboring this. It’s obvious.

But what may not be obvious is the impact high tech payrolls have on our economy. When Austin lost 15,000 high tech jobs during the flameout of 2001, this was **only about 2.2% of the workforce. But those same jobs represented more than 10% of area wages.** High tech jobs are by and large high paying jobs. In fact, high tech companies represent about 31% of the total wages in the area.

This is very significant, and even though there have been – and will continue to be – ups and downs, this ratio will continue to rise. And don’t forget the spillover effect. When such a large segment of the economy is paying higher wages, other **non-high tech companies must ratchet up their wage scales to attract and retain good employees. More people outside of high tech are making more money.**

Yes, this increases the cost of doing business, but it also **pumps a lot of cash back into the community, throughout the low tech businesses** – restaurants, dry cleaners, movie houses, coffee shops, retail stores, barber shops, car dealerships, etc.

We've kept you up-to-speed on the office *rental* market (such as it is) in Austin, but what about office building *sales*? Are the bottom feeders making a move?

Remember the good ole days – say, 1998? There were 34 office building transactions that year. **Almost a half-billion dollars changed hands** (\$499,110,845, to be exact) at an average price of \$116/sq.ft., according to **Helen Jobs**, principal with Gold Eagle Investments, commercial real estate specialists. She also reports that even in 2000, \$412,519,646 was shelled out in 24 transactions and the average price per square foot climbed to \$145. Pretty heady.

But no mas. As you would expect, sales of office buildings dropped dramatically as vacancy rates zoomed higher and higher. For instance, **in 2001, there were only seven sales** involving 12 buildings and they sold for an average of \$115/sq.ft. with total consideration of \$170,498,500, according to Jobs.

Last year was not much better, she says. **In 2002, only eleven properties with more than 30,000 sq.ft. traded** — for a total consideration of approximately \$193,933,250 or an average of \$119/sq.ft. With these drops in per-square-foot costs, the values (and, future property taxes) of office properties have nose-dived as well.

Bargain hunters with big bucks love times like these. They lurk like buzzards – just waiting to swoop down when they feel the bottom has been reached. So, are the bottom feeders moving in and making deals?

Jobs says “there are an abundance of buyers in the marketplace.” However, she points out “**most of the transactions have been properties with long-term leases, not multi-tenant buildings.**”

So where does that leave us? “For the multi-tenant building, the spread between what sellers want and what buyers are willing to pay is growing,” notes Jobs. As a result, “many buyers feel there will be **some opportunities this year and into next year and have adopted a ‘wait and see’ attitude,**” she says.

So, the buzzards are still circling overhead. They feel values will drop. And that’s a function of office space demand. The demand has not increased, so buyers feel building owners will **continue to be squeezed by lack of revenue** and may decide at some point this year or next they don’t want any more cheese – they just want out of the trap.

Speaking of offices, we’re getting word that flexible work hours are gaining favor with employers and workers. One report out of Washington says that nearly two-thirds of all companies offer this low-cost benefit, which some say raises productivity among harried employees.

Many high schoolers may decide to seek business or engineering degrees because they don't think they have the writing skills necessary for more word-oriented disciplines. Well, it will soon be harder for those without writing skills to get into *any* degree program at UTAustin.

In just a couple of years, UTAustin will replace renewed emphasis on the importance of writing skills to gain admission to the Texas flagship institution. While parents may grumble, **businesses that hire UTAustin grads should applaud the decision.** For the past several years, UTAustin has required applicants to write two essays to send to the admissions office. But no one can tell if Momma or Daddy or the valedictorian helped write the student's essay.

So, starting in spring 2005, a high school senior must sit down, in front of a proctor and **write an essay in 25-minutes.** "We are going for a proctored writing sample – **nothing but the student, the paper and a #2 pencil,**" said Dr. **Bruce Walker**, associate VP and director of admissions.

"Obviously, **extemporaneous writing is what will be measured;** the same type of writing required to be successful on an essay exam in college and for promotions in a profession" Walker said.

The Dean of the McCombs School of Business, Dr. **George Gau**, says "the larger issue is for us to **support teachers of English in their attempt to help students understand the importance of writing.** The message will be pretty strong to both teachers and students."

Parents (and grandparents) have a couple of years to hammer on the school kids about the importance of writing, if the student hopes to go to UTAustin. Those who enroll in fall 2006 must have earlier passed the extemporaneous writing test.

Dr. Louis Overholster says he knows how a corporate board of directors cannot be aware of fraud, suspicious accounting and inside double-dealing taking place right under their noses: "closed meetings and open bars!"

NEAL SPELCE AUSTIN LETTER (ISSN 1071-0612) is published weekly, except last two weeks of the year, for \$150 (plus tax) per year or \$249 (plus tax) for two years. To subscribe, call 512-498-9495. Periodical Postage Paid at Austin, TX 78767 by Austin Letter, Inc., 1407 Wild Cat Hollow, Austin, TX 78746. POSTMASTER: Send address changes to: Neal Spelce Austin Letter, P.O. Box 1905, Austin, TX 78767-1905.

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