THE Neal Spelce AUSTIN LETTER

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Dear Client:

It's early, but it's entirely possible that as many as five of the most powerful political positions in Texas — USSenator, Governor, Lieutenant Governor, State Comptroller and Agriculture Commissioner – may be wide open in the next statewide four-year election cycle. And if that rarest of political events happens, hang on!

It all starts with the senior USSenator from Texas, **Kay Bailey Hutchison**. It's long been known she yearns to return to Texas to run for governor. In fact, some say even though the polls showed she could have easily defeated Governor **Rick Perry** in the last election, she was convinced by many fellow Republicans to forego such a challenge. The next decision for her is whether to seek re-election in 2006, and the betting is **she will not commit to another six years in Washington, and will instead fulfill a long-held dream of running for governor**. This will trigger the domino effect.

If this occurs, Perry may decide he would like to trade places with Hutchison and join junior USSenator **John Cornyn** in Washington. If Perry decides to run for the USSenate, he will most assuredly face off in the GOP primary against Agriculture Commissioner **Susan Combs**, one of the leading vote getters in the last election who has long expressed privately she someday wants to be a USSenator.

So, which office holders besides Hutchison might run for governor? Why Lieutenant Governor **David Dewhurst** and State Comptroller **Carole Keeton Strayhorn**, of course – opening up those two powerful state posts. If that happens, then you have any number of State Senators and other statewide officeholder wannabes who will try to move up the food chain to those jobs.

This is just on the Republican side of the ledger. The Republicans have had a near-stranglehold on this state in recent elections, and there's no reason to think this will diminish greatly. **But the prospect of so many wide-open statewide offices will start Democrats salivating, stop them from licking their wounds and kick-start them into grooming prospects** – to try to regain a foothold in the upper echelons of state government.

All of this also explains much of what you've seen during this legislative session — as some top Republican **statewide officeholders have been jockeying for position, sniping at each other**. It's not about positioning for *re-election*, it's about positioning for a *political promotion*.

Two Austin real estate success stories – one residential, the other commercial – are unfolding in this tight economy.

We've been reporting throughout this economic downturn about how high-end homes have been slow to sell. **Several hundred mansions have been on the market for a few years now**. The sales that have been propping up the Austin area *residential* real estate market have been mostly in the below-$150,000 range. But one luxury homebuilder is bucking that trend.

Since the beginning of January, Toll Brothers, Inc., the nation's leading builder of luxury homes, has recorded **36 sales in Austin**. **This is a 50% increase over the same period last year**. Prices ranged from approximately $300,000 to more than $1 million. The average price of a Toll Brothers home in Austin is close to $550,000.

This isn't just a recent phenomenon. For instance in 2002, Toll Brothers sold more homes in Austin than it did in 2001. **Steve Krasoff**, VP of Toll Brothers' Austin division, says one of the reasons for this success is the homebuilder controls some of the premier parcels of land in the Austin area.

The publicly-held (NYSE: TOL) company holds land positions in Alta Vista, Lakewind on Lake Travis, The Hills of Lakeway, Regents Hills, Bella Lago on Lake Austin, The Estates at Westridge in Steiner Ranch and The Woods of Forest Creek. **Toll Brothers often develops the community**, **or purchases every lot in a particular section of a community**, as is the case in The Estates at Westridge in Steiner Ranch.

The unfolding *commercial* real estate success story is the newly named and still under construction **Frost Bank Tower at Fourth and Congress downtown**. **It's a huge project** (**33-stories**, **525,000 sq.ft**.) that started construction last year amid dire prognostications. "Experts" were quoted as saying at the time that Cousins Properties was making a mistake, starting the Class A office building during a bad, and worsening, office market in Austin.

But look at what's happened. **About a year before its scheduled completion**, **the building is approximately 50% leased**. It started with two big commitments – the large law firms of Jenkens & Gilchrist and Winstead Sechrest & Minick. Its most recent additions are New York-based law firm Dewey Ballantine (committing to 35,000 sq.ft.) and Frost Bank (52,000 sq.ft.), which secured naming rights.

The above named companies account for a majority of the leased space, according to Colliers International Office Market Report. Cousins also holds lease commitments from the law firm of Graves, Dougherty, Hearon & Moody, Constructors and Associates, Seattle's Best Coffee, Murphy's Deli, Westbank Dry Cleaning, McCormick & Schmick and Taco Shack.

It's nice to hear two success stories in today's downturn. (These stories may give new meaning to "family values", since the two firms are Toll *Brothers* and *Cousins* Properties!).

The citywide office vacancy rate is the highest it's been in more than 10 years. And while there has been movement, it has largely been a case of "musical chairs," with firms taking advantage of aggressive deals.

This is the assessment of Colliers International, which reports the citywide office vacancy rate reached 23.9% by the end of the first quarter, 2003. "**Austin tenants continue to take advantage of low office rental rates in some of the most desirable 'digs' in town**," Colliers noted. Class A average rental rates in the first quarter 2003 stood at $20.73 per square foot.

> "**Overall, average rental rates have declined 3.5% since the end of 2002 and 15.4% over the previous twelve months** to $19.59 full service (including operating expenses)," reports Colliers. This is down from $20.31 in the 4th quarter and from $23.15 in the 1st quarter of 2002.

The Central Business District Class A rental rates fell from $29.19 to $24.80 over the past year, **a 15% decline**. The more popular suburban sub-markets (Far Northwest, Northwest and Southwest) also reported a **double-digit descent**. But the "musical chairs" movement "did very little to advance absorption of the approximate 8.6 million square feet of space that remains available citywide," Colliers reported.

It's getting more difficult to get a commercial real estate loan in Texas. The reason: state and federal regulators are raising caution flags about commercial real estate loan portfolios in Texas-based banks.

"Texas institutions have increased exposures to commercial real estate during a time when some markets within the state are showing stress," **David Barr**, a spokesman for the Federal Deposit Insurance Corporation (FDIC), told *The Dallas Morning News*. "**The FDIC is closely monitoring the markets and the risk posed by commercial real estate loans to institutions**." But Barr did say, "insured institutions in general have performed well."

> According to the FDIC, 35 *Texas-based* banks have commercial real estate portfolios that are **five times the size of the banks' equity**, and 191 banks have portfolios that are **two to four times the size of their equity**. The *Dallas News* says the percentage of banks with such exposure, **32%, is among the highest the state has ever seen –** rivaling the 1980s numbers when 9 out of the top 10 financial institutions either failed or were sold.

This is nowhere near a replay of the 1980s real estate recession. It's a vastly different, and better, time. But you need to know the pressures being placed on your friendly banker, if you deal with a Texas-based bank. Especially if you currently have a commercial real estate loan or you are planning to apply for one.

As you look at laptop computer purchases (**as well as handheld communication devices**) **in the future**, **make sure they can use Wi-Fi**, **a new technology that could soon be almost universal**. **Austin and Texas companies are in the forefront of this surge**.

Wi-Fi is the buzzword for Wireless Fidelity technology. Simply put, **Wi-Fi allows you to link to the Internet**, **without wires**. Its initial drawback is that you must be within a very short distance of the Wi-Fi transmitters. Right now, you can link up without wires in airports, hotels and even many Starbucks, Borders and Kinko's locations. Soon, maybe very soon, it could become almost universal.

An Austin company, **WayPort Inc**., **is providing Wi-Fi in hotels and airports** and also has a deal with the US's largest phone company, Verizon, that recently announced it will install Wi-Fi equipment in 1,000 of its pay phones in Manhattan. This major move is making Wi-Fi "universal" to all the nearby buildings throughout the nation's biggest city.

Here in Texas, SBC indicated to *The Dallas Morning News* "it too was studying Wi-Fi … and **plans to make a deployment announcement in a couple of months**." **San Antonio-based SBC is the nation's 2nd largest phone company**, and of course, is dominant throughout Texas and many other states.

There's more to this than simply being first with new technology. The phone companies are in an intensely competitive battle with cable companies, scrambling for broadband customers who are looking for the most convenient, reliable, inexpensive and fastest ways to utilize the Internet. **The phone companies feel Wi-FI may be the competitive edge they need in this classic corporate competition**. This, as much as any single factor, is what may increase Wi-Fi's universal availability sooner, rather than later.

Looking back on the successful inaugural of the PGA Champions Kinko's Classic of Austin last week, **Dr**. **Louis Overholster** observed: "Golf is a game in which people go to enormous efforts, emotional involvement and expense to wind up in a hole. It's a little like the stock market!"

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