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Dear Client:

Real estate activity in Austin seems to be slowly rebounding, according to the Texas Real Estate Confidence Index (TRECI).

“All of the metros are up from last quarter, and the numbers for Fort Worth-Arlington, Houston and San Antonio are particularly strong, says **Dr. James H. Leigh**, TRECI project director and associate research scientist for the Real Estate Center at TexasA&M. **“Austin has been on the negative side of neutral for some time, but real estate activity there seems to be slowly rebounding.”** Dallas and El Paso numbers are also a tad higher than Austin’s.

Now in its fifth year, the TRECI is a quarterly tracking of the state of the Texas real estate industry. The index is constructed from **responses of real estate industry expert panelists** to a series of questions about what they think about their market area in the coming quarter.

“Mortgage refinancing activity continues to boom, and commercial projects that were placed on hold are now being given serious attention, fueling the real estate industry’s lending optimism,” says Leigh. **“Realtors in most of the areas of the state have become increasingly positive** about the market in their area, now that the war in Iraq is decided and the national economy and consumer confidence have rebounded.” The survey’s full results are available at <http://recenter.tamu.edu>.

You may have noticed this week that Federal Reserve Chair **Alan Greenspan** told Congress the Fed stands ready to reduce interest rates even further if necessary to boost the sluggish economy. Many expressed aloud the rates couldn’t go any lower – they are at a 45-year low right now – but Greenspan says the Fed’s goal is to **get the economy growing at a faster pace**. At its last meeting 6/25/03, the bank’s interest rate-setting Federal Open Market Committee (FOMC) cut the funds rate by a quarter point to 1%. The next day, **banks reduced their prime rate to 4%**, the lowest for this benchmark rate for consumer and business loans since 1959.

It didn’t get much notice, but Greenspan also told Congress this week the FOMC discussed at some length using “alternatives” for influencing interest rates beyond simply adjusting the federal funds rate it charges banks for money. Remember we’ve told you on several occasions the Fed might try to **keep long-term mortgage rates lower by buying longer-term securities**. Greenspan said, after much discussion, no action was taken and it was “unlikely” the Fed would take such action in the near future.

Austin's office market is being impacted by low interest rates. And vacancy rates have leveled over the last three quarters, with sales transactions figuring in the equation.

Some recent sales transactions include FirstUSA Bank Inc.'s 160,000 sq.ft. call center located at 10908 Stonelake Blvd., Opus West Corporation's 60,000 sq.ft. Crystal Park Plaza, Hoovers Online's 80,000 sq.ft. headquarters located at 5800 Airport Blvd., and Bank One's 23,000 sq.ft. office building located at 3811 Bee Cave Road, according to Colliers Oxford commercial real estate firm.

But, "it's still a tenant's market as landlords lowered rents and offered substantial incentives for both new tenants and those contemplating a renewal," Colliers observed. The second quarter 2003 average full service **rental rate fell just over 3% from last quarter and 16% from the same period last year.** The Class "A" office rental rate, citywide, also dropped almost 16% since the 2nd quarter, 2002.

What about the vacancy levels? "**Citywide, the second quarter 2003 vacancy rate remained in the 23% range,** as it has the last three quarters, at 23.7%. Downtown vacancy remains in the 21.5% range, but Far Northwest is where you can find the most available office space. Colliers reports the vacancy rate there was at 32.7% in the second quarter.

Of the almost 8.6 million sq.ft. of available office space in the Austin area in the second quarter, just more than 2 million sq.ft. (23.5%) was sublease space. **Sublease space totals have been reduced by almost 200,000 sq.ft. since the last quarter,** and more than 800,000 sq.ft. since the beginning of the year. "The majority of that space," reports Colliers, "was **returned to the landlord as direct vacancy,** and was reflected as just more than one million square feet of negative absorption."

At the current rate of leasing, **Michael Buls** reports the 8.6 million sq.ft. of available space represents approximately a 3.5 year supply of office space available in the Austin area. Buls tracks sublease space through his Buls Hodge Consulting company. He notes that, with the large amount of lease space ready for occupancy, "the most obvious leasing option is 'expenses included,' regardless of term."

Speaking of quarterly numbers, the unemployment rate in Travis County remains lower than at any point in the first quarter of 2003. In fact, the number of people employed in Travis County remains well above any other level in the past two years.

You may have noticed the lack of announcements of layoffs recently. The number reported was **only 193 layoffs in May and 169 through the middle of June.** You need to keep alert to see what happens in the public sector when the new, reduced state budget goes into effect.

Don't let the "Austin Was Lone Big Texas City To Shrink In '02" headline of a few days ago cause you concern. This is the logical result of a growing metro area and reflects a trend we mentioned weeks ago.

Sure, the USCensus Bureau reported the population inside Austin's city limits dropped about 1,100 last year. But the **Austin metro area population increased by 27,000**, reflecting a predictable trend of growth in the suburbs. Major cities all over the US have gone through this same sort of cycle in the past.

Hey, those same USCensus numbers show **San Antonio will soon be the 2nd largest "city" in the state behind Houston**, but no one believes "San Antonio" is bigger than "Dallas," because the metro areas are what count economically.

Another point. Using those same USCensus figures, do you know the **two fastest growing cities in the entire state**? Number 1 and Number 2? They are **Leander**, with a 20.9% growth rate, and **Cedar Park**, with a 16.8% growth rate – both in the Austin metro area.

And if that's not enough, when you go down the list of the **Top 20 growth cities**, the USCensus Bureau picks up **two more Austin metro area cities** — #15 **Pflugerville**, with a 7.5% increase and #20 **Round Rock**, with a 5.6% increase.

This population shift becomes all the more obvious when you note all the retail establishments and shopping centers being built outside the Austin city limits. **Retailers follow rooftops**. Remember we told you 6/27/03 retail sales were up bigtime in Round Rock (+19.72%) and Williamson County (+16.31%), while Austin (-6.7%) was down.

As we said then, "residents north of Austin no longer have to come into the Capitol City for much of their shopping needs. **This is a trend that could continue far into the future.**" The USCensus figures released just a few weeks later confirmed this analysis – and should not be a cause for concern about the vitality of our region, despite the headline.

Of course, there are those who say the City of Austin development policies are to blame for the slight slippage in Austin's population. To some extent, they have a point. But it's much more complicated than that. Traffic, for instance. And schools. Schools outside Austin, such as the Eanes and Lake Travis districts, continually rank higher than Austin ISD, and that **attracts families seeking to live where their kids can get the best education**. And with traffic congestion worsening inside Austin, many are electing to **move closer to their work** – such as near the area's largest private employer, Dell, in Round Rock. Make no mistake, though, **Austin will again show an increase in population and the suburban communities will continue to outpace Austin for the foreseeable future**. It's easily predictable. After all, the Austin area population has doubled every 20 years since Stephen F. Austin staked out the city.

An unusually optimistic economic report is coming out of competitor California at the same time its political and state financial crisis seems to be worsening.

Here's a direct quote from the *Los Angeles Times*: "Please God, Just One More Bubble.' That's the message on a legendary Silicon Valley bumper sticker, and whaddaya know? It seems to be coming true. **Close your eyes and it feels a little like 1999**, that giddy, amazing lost moment when Silicon Valley was the most important place on Earth, and just about everyone in it happily was adding a zero or two to his or her net worth."

The report goes on, in part: "The stock prices of unproven Internet companies that no one has ever heard of ... are once again doubling in a single day. The tech-heavy Nasdaq composite index is up 56% from a five-year low reached in October. Insiders happily are selling shares, **cashing in options that recently were fit only for making paper airplanes**. Call a chic Bay Area restaurant on a typically dead night like Monday and you will be told, no table, no way. The hottest car is a \$50,000 Hummer. The future, once again appears to be unlimited in many eyes."

But hold on, that same *LATimes* report contained a dose of reality, quoting **William Cockayne** with a Menlo Park think tank: "Part of the advantage of Silicon Valley is that it has no memory. That's how it can continue to innovate. But that's also its Achilles' heel – **it will continue over the next 10 years to do the same things wrong again**. The valley finds something amazing, and instead of letting it slowly develop, accelerates it and draws in all the people who want to be part of the next big thing. There will be another rise, then another bubble and then another crash."

This report was published at the same time supporters claim they have twice as many signatures needed to recall embattled Democrat California Gov. **Gray Davis**, the legislature still hasn't solved its \$38 billion budget deficit and new and larger taxes are looming. Stay tuned.

Dr. Louis Overholster maintains that life is unfair. "Just when you have enough money, time and opportunity to smell the roses, you develop allergies!"

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