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Neal Spelce

AUSTIN LETTER

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Dear Client:

It is gut-check time for Dallas-based Southwest Airlines, the airline that carries more Austin passengers than any other.

Even as a host of competitors are trying to take the low-fare business from Southwest (more about them in a minute), **Southwest will soon start serving the first city dominated by another airline since it started serving Baltimore more than a decade ago.**

When Southwest begins service in Philadelphia 5/9/04, it will once again tackle **USAirways** — the carrier it overpowered in Baltimore. But this time, USAirways (the airline accounts for 68% of the flights in Philly) is backed into a corner — scratching and clawing for its life, after emerging from bankruptcy a year ago. **The competition won't be pretty.**

While this battle is being waged, Southwest is facing an onslaught from several other fronts. We told you 3/12/04 that **JetBlue** will probably start serving Austin and other Texas cities (where Southwest dominates) next year when it takes delivery on 100 Embraer Regional jets. Already **Delta's low-fare carrier, Song**, and **United's counterpart, Ted**, have jumped into the low-fare competition.

Because of this competition, and because these other carriers are offering *more* to their passengers while trying to compete with Southwest on low fares, **Southwest is internally discussing changes that would have been anathema in the past.** It is debating whether to add the Embraer regional jets that, at a 100-seat capacity, are twice as big as most regional jets, to its all-Boeing 737 fleet.

That's not all. Southwest is also considering **adding audio-video seat-back systems** pioneered by JetBlue – at least on its planes flying cross-country. Other competitors are offering food and souvenirs. But, even if other low-cost carriers assign specific seats, Southwest is adamant it will **never assign seats**, because it feels this step will slow down the quick turnaround of its planes at the gate.

No matter the decisions it makes, **Southwest is still in a most enviable position.** It is making money (the others are not doing as well) and it has money in the bank. The airline is operating from a position of strength in a difficult environment. But it's interesting to note it is considering changing what, in the past, has been a tried and true formula.

The Texas governor is talking about a special legislative session to focus on school finance. And those who are touting taxes would do well to look at what happened recently in Oregon.

Oregon is not as conservative in its statewide voting habits as Texas. It went for **Al Gore** in the last presidential election (by a slim .44% margin, only 6,765 votes). Recent polls showed public support for school spending. But in an election in Oregon last month, an **overwhelming 60% of the voters defeated a proposal that included tax increases for public schools.** The result was all the more significant because the ballot showed the cuts that would be made if the measure failed, and it pointed out \$284.6 million would be pared from K-12 schools.

Those who fought against the new taxes maintained people tend to respond “Yeah, sure” when pollsters ask about spending more money for schools. But they **react differently when they see the economic consequences of such proposals.** As a result, they say it’s dangerous to rely on general polling information.

To be sure, the Oregon proposition called for further funding of health care, prisons and police – as well as education. In fact, the teachers and public employees’ unions joined forces to campaign hard for the increased funding. But the prospects of **increased taxes from income, cigarette and corporations,** apparently overpowered the needs for those state services in the voters’ minds.

Former USHouse Majority Leader **Dick Arme**y from Dallas (now chair of an anti-tax national organization) put this spin on the results: “Oregonians, faced with a vivid choice between **limiting government spending, or a job-crushing tax increase,** spoke loud and clear. When the dust settled, even liberal Multnomah County (which favored Gore by 35 points in 2000) went against the tax and spend class.”

It’s interesting that Multnomah County (Portland) **approved a local income tax** last year when they understood how the money would be used to aid schools – but turned down the broader tax package last month.

Obviously it’s apples and oranges to compare Texas and Oregon. Oregon has many more state budget problems than Texas. But **Oregon is a “competitor state”** for Texas when it comes to economic development and job recruitment. So what goes on there is important for us in the Lone Star State.

Armey said the message to other states is “**Don’t try to raise taxes until first cleaning up your budgets.** Otherwise citizens may rise up against you as they have done in Oregon, California and Alabama.”

If a tax increase for public schools in Texas is proposed to solve the school finance problem, **it remains to be seen if Texas voters feel legislators scrubbed the budget enough** during the most recent no-new-taxes legislative session to warrant additional revenue.

The theme for Austin commercial real estate in 2004 is one of quiet confidence. According to one commercial real estate firm, corporate decision makers realize the market likely has hit bottom.

As a result of this bottoming-out, and with corporate earnings solidly moving north, corporate execs “now appear more willing to execute on strategic plans that previously were put on hold,” believes **Jerry Frey**, Managing Director for CB Richard Ellis. “**Transaction velocity picked up during 2003**, which usually is a leading indicator that market conditions are on the up-tick.”

So what can we expect in the Austin area? “Don’t expect measurable increases in net absorption or escalating rental rates until 2005 and 2006,” Frey noted. “But other **key performance indicators are improving**.” For instance, he points out “interest rates are projected to remain at historically low levels, although some upward movement is possible by the year’s end.”

“Lease concessions are diminishing and the pool of available **office sublease space in Austin should decline** from about 3.5 million square feet at the zenith in 2002 to perhaps less than 1 million square feet at the end of this year,” Frey observed.

Frey went on to note that while “the office sector tends to be the bellwether for Austin real estate, other market segments also are gaining momentum. **Retail has been the strongest performer** over the last couple of years and the multi-family segment is expected to move up as well.” And he added: “industrial properties may be the last property class in Central Texas to show marked improvement in performance.”

Through all these ups-and-downs of commercial real estate, certain properties have been great investments, while others have not performed well at all. Overall, **commercial real estate continued to outperform other investment classes**, according to CB Richard Ellis. But, be careful. Not all commercial properties are created equally.

“Market fundamentals, at lows not experienced since the early 1990s, have **punished properties with significant vacancies and near-term lease rollovers**,” reports CB Richard Ellis, while others have brought good prices. Not surprising. And the firm expects this dichotomy to continue into 2004.

Good properties are valuable. CB Richard Ellis says the good properties are those that are **entirely vacant so are suitable for owner/occupants** and net-net-net leased properties, including **governmental leased properties**, with little or no on-going maintenance or management responsibilities by the landlord.

As a result, “local entrepreneurs continue to take advantage of opportunistic plays with a number of **transactions closing without ever going to market**,” noted the firm.

First typewriters and carbon paper, now we're watching the demise of the big box, Cathode Ray Tube (CRT) computer monitor. Are you ready for the changes in your workplace?

Thin, flat computer screens – Liquid Crystal Displays (LCDs) – will this year, for the first time, overtake CRTs in total units sold worldwide. And one firm that tracks such business sales trends predicts **CRTs will almost disappear from the US and Western Europe workplaces by the end of 2007**. Those big boxes that overtook every desk are about to be business history.

“As the sleek new screens give Americans their desks back, a pall will be lifted from the workplace and productivity will boom,” declares writer **Daniel Akst**.
“People will rediscover their colleagues, for years hidden or visually overwhelmed by their computers. There will be more space again for flowers and photographs of children. Overcome with joy, workers will frolic in the aisles between cubicles.”

Well, we wouldn't go that far. But there is no doubt when you ultimately remove the single most significant visual element in the workplace, change will occur. One office furniture maker suggests that **spaces can finally be reconfigured around users, rather than technology**.

This same furniture maker is quoted by Akst as saying you can **“say goodbye, for example, to acres of cubicles where everyone faces into a corner** – what he called an ‘albatross’ of an arrangement necessitated by those big boxes. Workers can now face out into the world again.”

Akst refers to the CRTs as “awful boxes.” He wrote in *The New York Times*: “When this maze of cathode-ray boulders gives way to LCDs, **office workers can interact again, or at least reclaim their primacy in the work space**. And who knows? Once they can see one another, people may start dressing up for work again.”

Dr. Louis Overholster said he was thinking about retirement, until his wife vetoed the idea. She told him she was not about to get twice as much husband – for half as much money!

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