

Volume 26, Number 16

July 16, 2004

Dear Client:

While home sales in the Austin area are continuing at a healthy pace, home prices declined so much in the 1st quarter 2004 that Austin now ranks dead last in the nation in house price appreciation over the past 12 months.

The numbers are sobering. For the 12 months ending 3/31/04, Fresno, CA leads the nation, with a 21.38% appreciation in house prices. Riverside-San Bernardino, CA is #2 at 20.20%. **The Austin metro area is dead last, #220, with a 0.47% appreciation in a year's time,** following a drop in appreciation of -0.12% in the 1st quarter this year. What's happening?

Obviously, the run-up in home prices over the past five years has cooled down to a frigid level. Even with the drop in the past year, the Austin metro still has a 5-year average change in house prices of 32.95%. This shows just how much house prices skyrocketed a few years ago.

Also, what's happening to price appreciation here is symptomatic of what's happening around us. Average home prices in the US increased 7.71% from 1st quarter 2003 to 1st quarter 2004. **But the state of Texas ranked next-to-last, above Utah, with a 2.34% increase.** Hawaii (15.16%) and Nevada (15.08%) were #1 and #2. It's not just Texas. Lumped together with Oklahoma, Arkansas and Louisiana, this region saw only a 3.22% change – compared to Washington's, Oregon's and California's 12.21% increase in house prices.

This development can be viewed any number of ways: Austin area home prices are becoming more affordable ... But homeowners looking at the investment value of their homes see them not keeping up ... This is a normal "correction" ... It means, due to the anticipated Austin growth, that home prices should soon go up ... Other areas of the nation, particularly California (the lone exception being San Jose, which ranks slightly above Austin at #205), Florida and New England are heading for a big tumble as their housing bubble bursts, etc.

But, no matter how you analyze it (or rationalize it), this is a factor with which the Austin economy must contend. By the way, these figures are from the Office of Federal Housing Enterprise Oversight, www.ofheo.gov. OFHEO'S House Price Index is published on a quarterly basis and **tracks average house price changes in repeat sales or refinancings of the same single-family properties** – based on data from Fannie Mae and Freddie Mac.

Historians may be able to look back on this being the year when some of the most far-reaching transportation decisions were made affecting Austin. We're not just talking about this week's toll roads decision.

Transportation decisions – good and bad – have a way of altering history. Look back a hundred years or so and you can see what happened to many communities that welcomed the loud, rumbling, smoke-belching railroad trains (**they thrived economically**) and those that kept the railroads from slicing through or near their towns (**they generally languished**).

Interstate highways are the same. Many of those communities bypassed by the Interstate have become sleepy towns, while Interstate highways have been an economic boon to other communities linked to the system. (Transportation is not the sole determinant of economic success of course, but it is a biggie.) You can decide whether these were right or wrong moves, but there is **no question history was altered by these decisions over the years.**

So it is with the decision this week to dive, big time, into a system of toll roads criss-crossing the metro area. It's not so much a question of contributing to growth – after all, the Austin area has historically doubled in size every couple of decades since it was founded. **It will, however, drive (pardon the pun) where this growth will occur – for decades to come.**

But toll roads are only a part of the major transportation moves likely to happen this year. You can now look for another far-reaching decision to come screaming to the forefront. **Shades of a couple of years ago, we're talking about rail once again.** This time, it is a revised plan that will be built around the concept called commuter rail (not the reviled “light rail” that was defeated by voters).

Wait a minute. Wasn't the previous rail election defeated primarily by road advocates who shepherded the toll roads plan to success? Well, not really. **The adversarial lines are really blurred now** from just a few years ago as far as transportation issues are concerned.

Some of those who fought light rail, claiming roads were a better alternative, were *against* the toll roads this week (such as Travis County Commissioner **Gerald Daugherty**), and those who were out front in favor of light rail in the past were leading the charge this week *for* toll roads (such as former Austin City Council member, **Lowell Lebermann**).

What's going on here? Oversimplified, it is a coalescing of opinion that the Austin area has a **serious transportation problem that will only get dramatically worse** (remember the doubling of population) if something isn't done about it. And what you see happening is, again oversimplified, something like this: **“Okay, you want roads, I'll back you on roads, if you'll get behind commuter rail”** – or vice versa. So look for massive support for rail in the coming weeks and months. Rail and toll roads. This could be a watershed transportation decision year.

With all the talk about outsourcing, and the focus on India and China as high tech hotbeds, are we losing our technology edge?

Our friends at *The Kiplinger Letter* in Washington, DC, don't think so and they have some persuasive facts to back up their claim. **They point out the US is way ahead in three areas – molecular biology, IT and nanoscience.** In fact, they claim “each will spawn global industrial changes with tremendous financial gains for innovators.”

The *Kiplinger* editors report **high tech has produced half of the US economic growth since 1980** and now accounts for about 6% of GDP. This growth feeds funds into new developments and, as a result, this is a chief reason the US lead keeps on growing.

For instance, the US outspends everyone on R&D. It was \$276 billion in 2002 and 30% of that came from the US government. **This is three times what second-place Japan spends** and the funding gap continues to widen.

Oh, how times have changed. Think back to Austin in 1983. The US was losing so much technology market share, the US Congress bent its anti-trust rules to allow the major US tech firms to form a consortium to **pool its R&D resources to stop the slide and to, hopefully, re-gain world tech dominance.** Austin aggressively pursued, and won, the right to be the site.

The consortium, MCC, opened in Austin with one employee (Adm. **Bob Inman**) and soon each of these **US companies sent their best and brightest researchers to Austin to work furiously to regain the US lead.** Another consortium, SEMATECH, set up shop here during the meantime. US government dollars joined private industry dollars. MCC was so successful, it worked itself out of business. And the rest, as they say, is history.

American companies are much quicker now than the foreign competition at making R&D gains pay off. This is why productivity grew so rapidly throughout the past decade, say the *Kiplinger* editors. And **tech advances are playing a bigger role in the service industries** so crucial to the economy.

As an example, service firms made up 35% of R&D in the US in 2000. In the European Union, they made up 13% and in Japan, just 2.5%. Also **US R&D attracts talent.** Seventy-five percent of worldwide PhD grads spend two to three years in postdoctoral programs – a real boon to the US.

One of the problems cited by *Kiplinger* is an opportunity for UT Austin. The problem: nearly 25% of US science workers are nearing retirement. US colleges and universities are turning out too few graduates to replace them. In fact, since 1990, BS degrees in math have dropped 20% nationwide. UT Austin can put on a major recruitment for students in the essential disciplines with a promise of a bright job future when they graduate.

Okay, you double-majored in philosophy and computer science at UT Austin, what's your goal in life? "I'm going to drink coffee in every Starbucks store in the world!" We're not kidding. This guy has already been to more than 4,000 locations.

His name is John "Winter" Smith, but everybody just calls him Winter. He lives at his parents home in Houston, when he's not living out of his Honda Civic, dashing in and out of various Starbucks' locations (the most he's hit in one day – 28 in Portland, OR).

For seven years now, Winter, 32, has pursued his passion – working as a contract computer programmer just enough to pay for his obsession and the **caffeinated coffee he sips in each location**. He told *FORTUNE* magazine, "After about four stores, the **coffee loses all taste**. After an extreme number of stores, I have to wash out the taste with water after every sip because it's starting to make me sick."

This doesn't deter Winter. **He's been to 4,122 stores in North America, 114 in Britain and 53 in Japan**, reports the business mag. Starbucks operates 4,025 stores in the US and 846 internationally, so he's doing pretty well. (He only visits company-owned stores, not the 3,000-or-so located in airports and grocery stores.)

But, here's a problem: Starbucks is **opening an average of 10.2 new company-operated stores a week around the world** and has no plans to slow down. Does this deter Winter? Not on your life. "I can always visit them faster than they can build them. That's just a numerical fact," he says.

When will he achieve his goal? "There's no way to be finished unless Starbucks goes out of business or changes its name. **The best I can hope for is to keep up. I can't foresee myself stopping**," Winter told the magazine. So, if you see a jittery guy dashing into Starbucks, ask Winter how many he's visited so far – or, better yet, ask him when he's going to get a life.

Dr. Louis Overholster doesn't use the glass-half-full/half-empty cliché when talking about attitude. He just points out an optimist invented the airplane and a pessimist invented the parachute!

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.

Sincerely



Editor/Publisher