THE Neal Spelce AUSTIN LETTER

www.AustinLetter.com
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Volume 26, Number 33

November 12, 2004

Dear Client:

The American dream of owning your own home, bolstered by low interest rates and an active real estate market, is alive and well in the Austin area. But what happens now, as interest rates continue to rise?

"Most likely, higher interest rates will not kill the housing boom" if the market continues to behave as it has over the past eight years, declares **Dr. Jack C. Harris**, a research economist with the Real Estate Center at TexasA&M University. "**Contraction in lenders' willingness to extend credit would be a more serious threat**." The focus should be on lenders' policies about making loans to any homebuyer who shows up with a pulse and a decent credit score.

"In an environment of easily-acquired financing, the occasional rate increase had much less effect than during the earlier tight credit period," Harris noted. In fact, the real estate expert says "buyers may see **higher interest rates as signaling inflation that will be reflected in the value of the home and increase the resale price in the future**."

He argues "an increase in inflation expectations may actually make **real property more desirable** because of its reputation as a hedge against inflation. Higher interest rates often coincide with an improving economy, bringing more employment, higher incomes and added economic security, all of which tend to **expand the demand for housing**."

This is not to downplay the importance of low mortgage interest rates. After all, for most buyers, the interest rate represents a significant part of the price, translating into higher or lower monthly payments. But it's more complicated than this. In addition to low interest rates, the **main difference in the last eight years is mortgage lenders' attitudes toward risk**. Lending criteria have been loosened and down payment requirements reduced.

So what are the warning signals you need to watch to see if the current liberal lending policies are about to change? **Keep an eye on the financial institutions' foreclosure rate. The more bad loans the banks make, the more they will tighten lending**. "Fortunately, the only sign such a contraction might be imminent is the currently high delinquency rate on FHA loans," Harris said. "With the economy in recovery, the delinquency rate may recede, but it does bear watching by all who value a robust housing market."

A respected Dallas business writer has raised a red flag higher than most about the dangers of easy money for homebuyers.

"While some worry about housing bubbles in the obvious places – Boston, Florida's west coast, most of California, Las Vegas, etc. – all of us, wherever we live, should be worrying about the **long-term effect of irresponsible lending**," warns **Scott Burns** (www.ScottBurns.com).

"The same home finance industry that has extended homeownership to millions of Americans is now **threatening future home values with its generosity**," Burns maintains. The trigger for this strong comment came after Burns made a trip to Denver and picked up the local newspaper's real estate section.

"Three tabloid pages have 12 advertisements for home mortgages of 1% to 2%. Several offer no payments for six months. **Others offer nothing down, no closing costs and interest-only programs**," he reported. "About the only offer missing is a single-payment loan, made posthumously from the borrower's estate – but that doesn't mean some lender isn't working on it."

And that's the problem, he says. "People with no down payments, no work records, uncertain incomes and significant other debt can now **go to a mortgage broker to be embraced, not rejected**," he laments. "My thesis is simple: Much of the future appreciation today's homebuyers are counting on has been discounted into today's mortgage financing practices."

Obviously, this is the other side of the coin to the previous story. You need to weigh this gloom and doom prediction with the previous analysis. But Burns' comments reinforce the point where we started – **keep an eye on the lending policies of financial institutions**. If the banks start losing money on home loans (an inordinate amount of foreclosures), this will be the first warning sign that the residential real estate market may be slowing down – or heading south.

The Texas economy will continue to grow at a healthy rate, **but at a slower pace than previously forecast**, **according to a recently completed Fall 2004 economic forecast**.

Our state's economy is tied more and more to the national economy. "The nation's leading indicators index remains in positive territory, but it has **shrunk every month since April** when I released the Spring forecast," said Texas Comptroller **Carole Keeton Strayhorn**. "That appears to have been the high point for our nation's economic outlook."

"This has been an economic bumper crop of a year" for Texas, Strayhorn continued. "**The gross state product this year will grow 4.5%**. But Texas' real gross product is now expected to grow at an average annual rate of 3.3% in calendar years 2005 through 2007, down from the Spring forecast of 4.2% average annual growth rate for that same period."

If you hold Frequent Flier air miles on USAirways, or plan to fly the airline soon, we have a heads-up for you triggered by the 11/2/04 presidential election.

What does the presidential election have to do with USAirways? A lot. The US government is the airline's second largest creditor – behind General Electric – and, as you know, USAir is in the midst of its **2nd bankruptcy court reorganization in 25 months**. The outlook for the airline is not good. As a result, its two major creditors could move to shut down the airline.

It was not likely the feds would have joined in shutting down USAir *before* the election because that action may have backfired politically. Why then – and not now? **Because a shutdown will put 26,000 people out of work – many of them in the swing state of Pennsylvania**. This political roadblock was removed as soon as the election ended.

So, if a shutdown of this major airline occurs, **what happens to ticket holders and members of its Frequent Flier program**? Again, a lot – and it's not good. (But it could be good for competing airlines, especially Dallas-based Southwest Airlines that would likely swoop in to pick up a number of USAir's aircraft and expand its profitable presence in the lucrative Philadelphia market.)

"**There's a fair chance that no airline will swallow USAirway's Frequent Flier program –** enough of a chance that it's now time for travelers to make the most of the six million awards sitting in USAirways' accounts. Go to Paris. Burn your miles. Soon," reported *The Wall Street Journal*. There also are some options if you don't want to risk booking a free trip on the struggling airline.

You can book your free trip on a partner airline. USAirways is a member of the Star Alliance that includes partners such as Lufthansa and United. Use miles to **pay for non-travel items** through www.Milepoint.com. **Or give miles to family, friends or a charity**. And if you're just shy of enough miles to get an award, consider buying a few more at three cents per mile so you can immediately book an award or trip.

You're in a lot better shape if you're holding pre-paid tickets and the airline is shut down. By law, other carriers must honor their tickets (with payment of a $25 fee). The caveat is this requirement depends upon availability of seats. If you paid with a credit card, the credit card companies must give you a refund if the airline is shut down – if the purchase was made within 60 days of the time you plan to travel.

But couldn't another airline acquire USAirways out of bankruptcy? Not likely. Here's the way *The Wall Street Journal* responded to that scenario: "**If forced to shut down, USAirways would likely be hauled off to the airline chop-shop** simply because no US carrier is in a position to be the bold buyer of the whole company."

All rankings are suspect, but rankings that recognize UTAustin's excellence are less suspect that those that don't!

This somewhat tongue-in-cheek comment from UTAustin's Dean of Liberal Arts, **Richard Lariviere**, indicates how the various rankings of higher educational institutions are cussed (when the institution is ranked lower on the totem pole) and discussed (when a high ranking occurs). This item falls under "discussion," not "cussing."

The Times Higher Education Supplement (*THES*), "an important venue" notes Lariviere, **ranks The University of Texas at Austin as #15 on the list of The World's Top Fifty Universities**. Number 15 in the world! This is a heady ranking and, obviously places UTAustin in notable company.

The Top Fifteen, in order: Harvard, Cal-Berkeley, MIT, Cal Tech, Oxford, Cambridge, Stanford, Yale, Princeton, Federal Institute of Technology Zurich, London School of Economics, Tokyo University, University of Chicago, Imperial College London and UTAustin.

Universities were placed in the London newspaper's ranking with the help of findings from a **survey for the *THES* of 1,300 academics in 88 countries**. They were asked to name the best institutions in the fields they felt knowledgeable about. The table also included data on the amount of cited research produced by faculty members as an indicator of intellectual vitality, the ratio of faculty-to-student numbers (a category where UTAustin does *not* fare well), and a university's success in attracting foreign students and internationally renowned academics in the global market for education. Harvard was first by a considerable distance.

The editor of *THES*, **John O'Leary**, said "by taking account of the view of academics from across five continents and using the most up-to-date statistics, our ranking gives an informal picture of the world's top universities."

Dr. Louis Overholster: Will the next *war* in the Middle East be over who has the best *peace* plan?

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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