

THE

Real Spelce

AUSTIN LETTER

www.AustinLetter.com

P.O. Box 1905 / Austin, Texas 78767-1905 / 512-498-9495 / Fax 512-327-1976 / e-mail News@AustinLetter.com

Volume 26, Number 43

February 4, 2005

Dear Client:

When several economic development coups were scored 20 years ago to vault Austin into the upper reaches of high tech leadership, other Texas cities – especially San Antonio – rallied around. Now it's time to acknowledge, and appreciate, San Antonio's accomplishments.

MCC's selection of Austin as its HQ in 1983, followed by another consortium's similar decision (SEMATECH, a couple of years later), proved to be the trigger that **launched the Silicon Hills of Austin into high tech preeminence**. Austin didn't do it alone. State leaders and many others were in lockstep in support of Austin's economic development efforts.

San Antonio, in particular, was in the forefront on Austin's behalf. After his city failed to make the cut, Mayor **Henry Cisneros** became an effective spokesman for Austin, showing a magnanimity not matched by other regions in the country. For instance, San Diego got little or no help from other California cities as it competed in the Final Four against Austin.

Now it's San Antonio's time to shine and Austin should be especially pleased to see significant economic progress just a short drive south on IH35. Until recently, San Antonio has relied on tourism and military spending as the linchpins of its economy. Now, it is moving into the economic Big Leagues, with some radical changes

Overnight, The Alamo City has become home to the nation's largest telecom company with SBC's acquisition of AT&T announced this week. SBC, the former Southwestern Bell, moved to Santone in 1993, with little indication that it would soon sit atop the telecom world in size.

The SBC move is not a one-trick pony for San Antonio. Remember the other radical economic change of a couple of years ago? **Toyota is spending \$800 million to build its newest US manufacturing facility** there, and it will ultimately employ 6,000 people – not to mention the ancillary suppliers that have moved to San Antonio to be near a huge customer.

Call the roll. USAA insurance has almost 15,000 employees in San Antonio, H-E-B has a similar number and Valero Energy employs about 3,000. Yes, The Alamo City has **expanded its tourism/military base in a big way**. And the entire region, including Austin, will benefit.

Is nanotechnology the next wave of economic development for Texas? Well, if it is, the state needs to make some big leaps to make it to the top of the heap.

Lux Research Inc. recently completed a report on nanotechnology (building objects atom by atom) in the US, and according to *The Dallas Morning News*, Texas just barely cracked the Top 15 Nano-*Leader* category. Two steps down and the Lone Star State would have been listed in the Nano-*Aspirant* category. Take Austin out of the nanotech equation and the state's ranking would have dropped precipitously.

The *strengths* for Texas, according to Lux: **UTAustin and Rice University have excellent facilities**, a low-tax and regulatory-friendly state environment, and Rice's **Richard Smalley**, a Nobel Laureate who is a major nanotech drummer.

The *weaknesses* for Texas: **A lack of startup funding for nanotech outside Austin**, no statewide plan to direct nanotech R&D, and few established companies focusing on nanotechnology in the Lone Star State.

Which states are ahead of Texas? **Massachusetts is #1**, according to Lux, followed in order by California, Colorado, Virginia, New Mexico, New Jersey (New Jersey?), Connecticut and Maryland in a tie, Illinois, New York, Washington, New Hampshire (New Hampshire?) and Pennsylvania. Minnesota rounds out the Top 15, behind **#14 Texas**.

The cavalry may be riding to the rescue, but it's still over the horizon. Economist **Ray Perryman** is quoted by *The Dallas News* as saying Texas can become one of the top nanotech states and that **nanotechnology will be one of the industries that could benefit from the proposed Texas Emerging Technology Fund (TETF)**. For the moment, the TETF is simply a proposal Gov. **Rick Perry** has placed before the Texas Legislature, with a request that it allocate \$300 million to finance the fund. Prospects look good for the fund, but there has been no definitive action taken during these early days of the legislative session.

Can Texas move up the nanotech state-listing ladder? **"I definitely think it's something we can achieve,"** Perryman told the *News*. "We didn't start out at the head of the pack in microelectronics either."

Remember when there were two big computer manufacturers in Texas – Dell and Compaq? Three years ago Compaq merged with another Dell competitor, Hewlett-Packard. So, how's the merger doing? Not well. And Dell is crying all the way to the bank.

All you need to know is that since the merger HP's stock price is about **13% below** the level just before the merger was announced. And our little hometown company of Dell? What has happened to its stock since that time? Hang on. Dell's stock price is **up almost 90%!**

Looking back, the third quarter of 2004 was the turning point in Austin's apartment industry. As a result, the overall outlook is encouraging.

Coming into 2004, the Austin apartment market had seen better days. Occupancy and rental rates were on a steady decline and by mid-year, it seemed 2004 would be no different from the previous down years. Then the turnaround began.

“Historically strong, the third quarter was a turning point in this city's apartment industry, with the first reported rental increase since 2000 and an **occupancy rate that broke the 90% mark for the first time in two years,**” reports **Robin Davis**, who tracks Austin apartment trends through her Austin Investor Interests company.

“And despite a slight decline in occupancy during the fourth quarter, typical for the time period, the overall outlook for Austin is encouraging,” she said. “In fact, **annual figures report the highest yearly occupancy increase since 1997**, a rise of 1.67%.”

Davis predicts the next 12 months “will continue to see improvement.” She says “signs of this are evident in the optimism of developers, as the number of **expected starts in 2005 is expected to double over those in 2004.** Sales have also seen an increase with the number of transactions in 2004 increasing 65% over the prior year. In essence, Austin's apartment market is now back to the levels seen in 1997, prior to the development boom.” She concludes: “We can now expect to see very normal movement in occupancy and rents, with figures showing a trend toward increase.”

Another positive economic trend was marked at year-end as airport passenger travel came within a whisker of returning to the record setting levels of 2000.

It's been a long climb back for Austin-Bergstrom International Airport (ABIA). The effects of the downturn were already being felt in 2001 when the terror attacks of 9/11, using airplanes, hammered a weakening economy further, while dealing a devastating blow to the air travel industry.

Since 9/11, month-after-month and year-after-year, passenger travel at ABIA has failed to reach the 2000 record tallies. This appears about to change. **December's totals came the closest yet to reaching 2000 levels.** And the 2004 totals were up a healthy 8% over 2003.

Importantly, air carriers are now showing confidence in the Austin market by **increasing air service** “from here to there.” This is a good measure of individual wellbeing (leisure travel) and a business up-tick. We'll track the 2005 numbers for you.

The Austin area continues to drive the pace car as the state races toward full employment. But the pace is still so slow this continues to be called a jobless economic recovery. Is a “jobless recovery” all that bad?

Start with the fact that it’s always better to have a low unemployment. And **Austin still has the lowest unemployment of any major metro in Texas** (4%) and is better than the state (5.4%) and national (5.1%) averages. But with others lagging behind, some think segments of the economy still suffer the blahs. In fact, many feel the vitality of residential real estate is directly linked to jobs. Now, there is an argument to the contrary.

Today’s national unemployment rate is virtually unchanged from a decade ago, yet “the economy has grown through that period at a 3% to 4% pace,” according to **David Lereah**, SrVP/Chief Economist for the National Association of Realtors. “The fact is,” he claims, “**sluggish job growth keeps the economy from overheating**” and as a result, the Federal Reserve is free to follow a measured approach to raising interest rates.

The Fed this week bumped fed funds interest rates for the 6th time since last July by a quarter-point to 2.5%. If the Fed keeps increasing rates by a quarter-point at each of the eight scheduled meetings this year, the funds rate would be at 4.25% by year-end. While 30-year mortgage rates are not directly related to this action by the Fed (it primarily impacts borrowing rates for consumers and businesses), Lereah feels **this will leave “30-year mortgage rates well below 7%.”**

“With low rates, **conditions are right for sustained home sales** – as long as the economy keeps growing at that same 3% to 4% pace and households possess the financial wherewithal and confidence to buy,” Lereah concludes. “This backdrop sets the stage for a continued healthy housing market, and **may make us change how we think about a jobless recovery.**”

Speaking of jobs, **Dr. Louis Overholster** says his hiring policy is simple: hire recent college graduates while they still know everything!

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