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Dear Client:

Retail has been the only hot commercial real estate sector in the Austin area over the past five years and is showing no signs of slowing down.

Throughout the first six months of 2005, retail buildings throughout the area are maintaining high average rental rates and occupancy. Obviously this speaks to the **economic vitality of area retailers** and, by extension, to you and your neighbors who are spending paychecks in the various retail establishments.

But all retailers are not created equally. According to **Sherry Naquin Sanchez**, retail specialist with Austin's NAI Commercial Industrial Properties (NAI CIP), "Some 'B' grade shopping center owners are **losing some of their tenants to newly constructed strip centers** ranging from 10,000 to 30,000 square feet."

As a result, some landlords are **seeking non-retail operations for their retail space**. Sanchez said "In order for these property owners to maintain healthy occupancy levels, they are spreading their risk by seeking out more service-based or medical-based tenants instead of traditional retail users."

"So far the retail sector has maintained its strong showing in light of the new construction," says **Dean Janeff**, another NAI CIP retail specialist. "**Time will tell if the market is able to withstand new large projects** such as Southpark Meadows in South Austin; The Triangle in North Austin; and The Shops at Galleria in Bee Caves *in the short term* ... and additional retail projects planned for Bastrop, Buda, Round Rock and North Austin *in the long term*."

But for now, as in the past five years, retail real estate is showing no signs of a let-up. For instance, the retail market absorbed 259,941 square feet during the first six months of 2005, according to NAI CIP. Much of this absorption was due to **two new projects in Georgetown: Wolf Ranch Town Center** (a Simon Properties center) and **Rivory Crossing** (developed by UCR out of Dallas).

This report covers **retail centers that are 50,000 square feet or larger** in the Austin, Cedar Park, Pflugerville, Round Rock and Georgetown areas. It does not include the big regional malls or free-standing, owner-occupied stores.

A Texas economist who specializes in real estate is raising some warning flags – even invoking the dreaded early 80’s Texas real estate recession.

“The commercial real estate market is looking eerily like the office market from 1982 to 1985,” says **Mark Dotzour**, chief economist with the Real Estate Center at TexasA&M. You remember the 1980s. This was the period when **friendly tax laws encouraged overbuilding** in office and apartment markets.

“When people base **real estate investment decisions solely on tax avoidance**, the economics of the investment are thrown out the window,” Dotzour noted. “Today, a lot of people are buying commercial properties because they recently sold property somewhere else and now have to buy another property to defer taxes.”

“**Buyers are often willing to pay record prices to avoid tax penalties**,” he observed. “Their return on investment must come from future price appreciation. Latecomers are going to be disappointed because prices have escalated to the point that future price appreciation could be much slower.”

But Dotzour **does not expect to see high foreclosure rates** in commercial real estate this time around, (remember the 1980s?) because most investors have a significant equity investment.

“Overly zealous investors and lenders in the *residential* market also are a concern. They seem to think residential real estate will go up in value by double digits every year. **Similarities to the speculative era of the late 1970s are remarkable**. People who bought homes in 1979 thought that house would appreciate one percent a month forever, but robust price appreciation didn’t return until the mid 1990s,” Dotzour added.

He says today’s speculators are “high” on exotic residential mortgage products, which are feeding the frenzy: Loans for which the borrower provides little or no income and/or asset documentation ... or the well publicized “interest only loan” ... or even the “Option Adjustable Rate Mortgage,” **which gives borrowers the option to pay less than the total interest expense** (when this happens, the amount owed actually becomes bigger).

Why take such a risk? Dotzour speculates it is most likely the borrowers and lenders are **banking on housing price appreciation continuing indefinitely**. “As long as prices are rising, foreclosures will be few,” he says. “Buyers who have trouble making their payments will sell at a profit, rather than let a lender foreclose.”

The Texas economist believes what will ultimately happen to curb this trend is that banking regulatory agencies will in the future **issue strong regulations to limit higher-risk lending**. Until then, he says, the frenzy will continue.

Political analysts are making a big deal out of GOP State Comptroller Carole Keeton Strayhorn trying to unseat GOP Governor Rick Perry in the Republican primary. But when you get right down to it, it's the same-old, same-old.

In the overall scheme of things, Texas was a two-party state for a very short period of time. Following decades of dominance by the Democratic Party, there was a brief period where Democrats and Republicans had a fairly even chance of winning. Now every single statewide elected official is a Republican. And, for the foreseeable future, **if you're a Democrat you don't have a snowball's chance in Houston to be elected to statewide office in Texas.**

What's happening in the Texas Republican Party, as evidenced by the Perry-Strayhorn gubernatorial battle, is exactly what happened to the Texas Democratic Party when it held every statewide office. And if history is an indicator, the **Republican primary elections will become more and more the most important battleground for those seeking statewide office.**

When the Democrats dominated, the intra-party struggle was between the left-leaning and right-leaning segments. **Many right-leaning closet Republicans gave money to the Dems who were closest to their philosophy** – to maintain some modicum of influence with the Dem office holders. Now the same thing is happening within the Texas Republican Party.

Heavy-hitting Democrats, especially those who play the political power game, are cramming big bucks into Republican Strayhorn's campaign war chest. *The Dallas Morning News* analyzed Perry's and Strayhorn's financial reports and found some familiar Democratic donors and that old nemesis of the GOPers, trial lawyers, as major contributors.

Look at these Democratic political power players who show up on Strayhorn's list of contributors: Former Lt Gov **Ben Barnes** (\$57,000), the McAllen beer distributor who provided a plane to Democrats fleeing the 2003 redistricting session, **Greg Lamantia** (\$53,000) and the Houston investor who is a longtime major contributor to Dems, **Fayez Sarofim** (\$92,000).

This isn't all. One of the biggest groups backing Democrats (and by extension, opponents of GOPers) is the trial lawyers. The trial lawyers giving to Strayhorn include: **Walter Umphrey** (\$205,000), **John Eddie Williams** (\$150,000), **Wayne Reaud** (\$35,000), **Lance Lubel** (\$40,000) and **Mark Lanier** (\$31,000).

Look for these contributions to become a major campaign issue in the GOP primary. But the big story is that "the more things change, the more they are the same." **The Democrats are meddling in the GOP contested races now just as the Republicans did to them a few years ago.** And it becomes all the more ironic and interesting when you realize both Governor Perry and Comptroller Strayhorn were once Democrats before switching to the GOP.

What is the most prolific consumer device on the planet? Not only is it the most prolific today, the prediction is its pervasiveness is growing so fast that there will be one billion sales of the device in a single year – 2009.

You guessed it, it's the cell phone (or, more correctly, the mobile phone). Our story 7/22/05 about the culture change triggered by the cell phone raised enough interest that we thought we'd probe this phenomenon a bit deeper for you this week. How's this for a number? In the aforementioned 2009, **2.6 billion people around the world will be using a cell phone.**

Gartner, the research group, issued a report from Amsterdam that compares the pervasiveness of the mobile phone to PCs and TVs. You think everyone you know already has a cell phone? Well, how about this: **779 million new cell handsets will be sold this year.** And to show you how that compares to other common devices, Gartner says 200 million PCs and 200 million TVs are sold each year.

Of course, this also means cell phone prices will come down with each passing year, even though the handsets will have more memory and better screens and cameras than current models. **However the price differences will be huge.** The simplest basic handset, primarily sold in emerging world markets, will sell for around \$20, while smartphones with computer-like functions will retail for hundreds of dollars.

Much of this sales expansion is occurring outside the US. In fact, Gartner is predicting one out of every three mobile phones sold will be in the Asia Pacific region, primarily in China and India, with India passing China in sales by 2009. Here at home where the mobile phone market is quite mature, **a big part of the sales is simply replacing your old handset with a newer, more advanced model.** But the fact remains, cell phones are everywhere.

Speaking of technological marvels, **Dr. Louis Overholster** likes to pause in his busy day to give thanks for the wonders of technology. As he put it: "Thanks to computers, we still make all the same mistakes – only we make them much faster."

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