

Volume 27, Number 46

February 24, 2006

Dear Client:

The noise is getting louder. But the chatter about the housing market bubble bursting after five years of irrational growth relates to markets other than Texas and the Austin area.

In fact, those making the most racket about the bursting bubble turn right around and point to Austin and Texas as being one of the housing market bright spots. **The spots where prices are most likely to fall are in California, Florida and the Northeast.** And because these are major media markets, it seems the tenuous situation in those areas is getting a lot of ink. These are also locales that have an outsized impact on the overall national economy as well.

And make no mistake, the housing bubble in those areas is a big time problem. One economic researcher in Washington, DC (**Dean Baker**) is quoted as saying the run-up in the housing market is approaching the size of the stock market bubble that burst in 2000. So this is serious stuff – for the two coasts and the northeast. Not us.

FORTUNE magazine points out that 15 of the 25 most overheated US housing markets are in California and **17 of the 25 most undervalued locales are in Texas.** We are in the midst of bargain country.

There are a number of side effects to this housing dichotomy. One long-term effect is that you will probably see homeowners in the overheated areas bail out before the bottom drops out too far, take their profits and **move to less expensive places – such as Austin and other parts of Texas.** Even the investors who have already started cutting-and-running in the overvalued areas are looking for other places to place their dollars. They may not get the return here they've been getting for the past five years, but most forecasters seem to think there is **still a lot of upside in the Austin and Texas housing market.**

As a matter of fact, sales in the Austin market started off strong and solid in 2006. The Austin Board of Realtors (ABoR) reports that, compared to January 2005, home sales increased an impressive 16% last month. If this heady pace keeps up, 2006 could go down as the fourth year in a row that home sales in the Austin area set a record. Meanwhile, **Austin area homeowners are watching the values of their homes steadily rise.** ABoR indicated the median price of homes increased by 12% over January a year ago. Austin homeowners should ignore the dire stories from the overheated markets around the nation and enjoy this steady increase in value.

After becoming accustomed to rising interest rates this past year, what can you expect to happen this year – especially now that there is a new hand on the interest rate throttle?

When questions like this creep up, we frequently turn to our longtime source for business news in Washington, the folks at *Kiplinger Forecasts*. **They've been watching business developments for more than 80 years** – now, with the third generation of Kiplingers at the helm. While not always right-on-the-money (for that matter, who is?), they have a good feel for “the moment.” And this is what they feel at the moment.

“Two more interest rate hikes from the Federal Reserve by midyear: That’s our judgment after new Fed. Chm. **Ben Bernanke**’s statements this past week,” noted Kiplinger. “Bernanke sees a robust economy, with growth dampened only a bit by a softer (national) housing market and easily able to weather higher rates. With unemployment likely to continue under 5% and factory capacity use hovering close to the maximum, inflation remains the greater concern.”

So what does this mean for the prime rate that affects your bank loans, credit card debt, etc.? Kiplinger is predicting the **prime rate will hit 8% this summer**.

Speaking of increases, the price of electricity is expected to get much pricier through the end of the decade. The culprit: significantly higher coal prices.

If you drive Hwy71 between Austin and Houston, near La Grange you’ll notice some huge smokestacks back off to the north of the roadway. They are part of the Fayette Power Plant. **Those smokestacks are “scrubbing” the residue that is emitted as coal is burned to generate electricity.** The City of Austin, through its wholly-owned city department Austin Energy, relies heavily on this source of electricity. The coal is shipped to the Fayette Power Plant, via rail cars, from way up in-and-around Montana.

Not speaking about Austin specifically, but for the nation as a whole, our friends at *Kiplinger Forecasts* are predicting that **“by 2011, electric bills will have climbed roughly 13%, or 2.6% a year on average,** with the steepest increases coming between now and 2008. That’s a sea change ... price increases had been running at 1% or less.”

It’s not known how this price surge for coal will impact your electric bill, but it is a factor for you to watch. **The City of Austin years ago made a policy decision not to put all its energy eggs in one basket.** After getting burned by a natural gas supplier (that generated most of Austin’s electricity), Austin invested in the Fayette Power Plant to diversify by using coal as an additional source and, amidst massive controversy, also invested in nuclear generated power. Today, by the way, the nuclear generated power is Austin’s cheapest source of electricity.

While Austin-Bergstrom International Airport (ABIA) has moved back to record passenger traffic levels, other major airports such as Dallas/Fort Worth are still facing traffic declines. This is also true of some other US “hub” airports.

ABIA is not a “hub” airport, where flights converge, passengers change planes and hop on another flight to their ultimate destination. You don’t have many connecting flights at ABIA. **This is the final airport destination for the vast majority of passengers who fly into ABIA.** (This may explain why the Austin Airport Hilton hotel is not doing as well as hotels located in “hub” airports, where delays and cancellations help fill hotel rooms).

Even though Austin is getting more and more direct and non-stop flights to major US airports, a **high percentage of Austin air travelers still use “hub” airports, such as D/FW.** The old saying that “when you die, it doesn’t matter if you’re going to Heaven or Hell, you’ll change planes in Dallas” is still somewhat true. So what happens at D/FW and other “hub” airports is important for the Austin air traveler.

What is happening is that passenger traffic is 3.3% *below 2000 levels* at D/FW, 15.3% at San Francisco, 7.8% at Los Angeles, 9% at Miami and 6.7% at Newark. Industry experts say this reflects a **shift of millions of passengers away from connecting flights at “hub” airports to more point-to-point service.** Airlines such as Southwest, JetBlue and AirTrans are the beneficiaries (cause?) of this shift.

You can see it at ABIA. American Airlines, in an effort to keep its strong #2 position in Austin and not lose ground to #1 Southwest, next week is starting a **major promotion for Austin/Dallas travelers – to tie-in to its new service to close-in Dallas Love Field (DAL), not D/FW.** From 3/2/06 through 5/26/06, you can fly between Austin and Dallas Love Field for around \$158 plus tax.

But the kicker is the bonus you can earn from 3/2/06 to 5/26/06: after three round-trips between *either* Love Field or D/FW (because its passenger traffic is down at D/FW) and Austin, you will earn 30,000 frequent flyer miles, or the **equivalent of a free ticket.** Six round-trips will earn 60,000 frequent flyer miles, or the **equivalent of two free tickets.** The flights to DAL are on American Eagle’s 50-seat Embraer 145 Regional Jets. American is scheduling five Eagle flights per day between Austin and DAL.

By the way, this reduction in air traffic at “hub” airports is, in many ways, benefiting the air traveler. This means D/FW is less crowded and flights are more spread out throughout the day so there is **not the mad scramble there once was to change planes during peak morning and afternoon travel periods.** This also makes it much easier on air traffic controllers so they can work more efficiently to ease bottlenecks and delays. This condition may continue for awhile. For instance, D/FW is scrambling to try to lease 18 unused gates given up by Delta Air Lines when the Atlanta-based carrier dropped D/FW as one of its hubs.

Smokers who are badgered with health data that tells them they are on a fast track to poor health, or even death, received a bit of good news from researchers at UTAustin.

Longtime smokers will tell you how tough it is to stop smoking. Smoking addiction is difficult to break for many – even though they hear all the dire predictions about how **smoking shortens their life span**. Well, UTAustin researchers found a ray of hope – in one health area, at least – that smokers can take to heart (so to speak!).

Even if you cannot stop smoking, you can lower your risk of cardiovascular disease by exercising regularly, according to a UTAustin study. Smokers who exercise have increased blood flow to the legs. And this is a good thing.

Cigarette smoking causes a distinct, immediate decrease in blood flow to the legs because **blood vessels going to the legs become constricted**. Over time, this can lead to peripheral artery disease and increases the risk of heart attack, stroke, amputation or death.

UTAustin's Dr. **Hiro Tanaka** discovered that smokers who exercised had increased blood flow to the legs. "Everyone thinks that 'exercising smoker' is an oxymoron, but now we know that there's a **tremendous incentive to take control of your health and get up and get moving** even if you can't stop smoking right away," Tanaka observed.

Tanaka continued: "I smoked and know how difficult it is to give up something that addictive, but if a smoker can **go ahead and initiate an exercise routine** as she attempts to give up the habit, she'll **start enjoying the benefits of the exercise even before she puts down her last cigarette**." Tanaka is an exercise physiologist in UTAustin's College of Education.

Dr. Louis Overholster follows two rules in committee meetings if he is, shudder, ever asked for his opinion: 1) If you want members of the committee to think you are wise, agree with them and 2) when all else fails, opt for incoherence. Or as he put it: "If you can't convince 'em, confuse 'em."

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., 4105 Bee Creek Rd, Spicewood, TX 78669. POSTMASTER: Send address changes to: Neal Spelce Austin Letter, P.O. Box 1905, Austin, TX 78767-1905.

Sincerely



Editor/Publisher