

Volume 28, Number 19

August 11, 2006

Dear Client:

**To fully understand how counter-cyclical the Austin economy is running compared to the overall US rate (specifically its real estate sector), an announcement this week underscores the situation. Or it may be a harbinger of things to come, if we are lagging behind.**

Hard on the heels of the report that more existing single-family homes were sold during the first half of this year in the Austin area than during any other comparable period came the announcement this week that one of this nation's largest high-end homebuilders cut, for the 4<sup>th</sup> time since November, the number of homes it expects to sell.

Publicly-held Toll Brothers, with a huge presence in the Austin market, said its **new orders nationwide fell 47%** in fiscal 3<sup>rd</sup> quarter that ended 7/31/06 from the same period a year ago. And it expected continued drop-off in the next quarter.

As a result, **Toll Brothers stock is getting hammered – with shares losing more than half their value since July.** This tracks what is happening throughout the stock market as the Dow Jones US Home Construction Index (a yardstick used to measure home builder performance) is down 44%.

If its Austin operations are keeping up with our hot real estate market, then **where is Toll Brothers nose-diving?** Orlando, Las Vegas, Phoenix, Palm Springs and Northern California. The company's explanation: speculators are unloading their investments and potential buyers are on the sidelines waiting for better deals.

What does this mean for Austin? For the short haul, **the Austin real estate market – and the economy overall – is bustling and should continue to stay that way.** But the crystal ball becomes a bit cloudier as you try to look further down the road.

Remember, our economy was lagging for the past couple of years, at the same time other US markets were hotbeds of activity. Now, they have cooled and we have picked up. Some would argue we are tracking behind and our economy is traveling down the same road, so we could end up with the same economic detours others are now experiencing. This should be closely, and continuously, monitored. But, more importantly, **our real estate market is not so much speculator-driven as it is economy-driven by job creation and in-migration.** This is a major difference from the others and, frankly, should bode well for our immediate future.

**One of the benefits of living, working and investing in Austin is that it is in Texas. Texas is doing well and the Austin area is one of the top economic performers in the state.**

The Lone Star State has a wider variety of resources to support its economy and greater overall diversity than most parts of the country, according to longtime Texas economist **Ray Perryman**, whose firm recently completed a long-term (reaching out to 2030) Outlook for the US, Texas and the state's metro areas.

In this Outlook, The Perryman Group pointed out that during the past few years, **Texas emerged again as a growth leader** following a relatively sluggish initial recovery from the recession earlier in the decade.

“Once hiring began to expand in mid-2003, employment in Texas experienced a consistent pattern of broad-based progress and has **maintained a higher growth rate than that of the nation**,” reported the economic firm. “Part of the reason for this achievement is attributed to the fact that Texas has numerous fast-growing industries and many of them also have been **expanding more rapidly than their counterparts across the US**.”

The Perryman Group is effusive in its praise for the Texas Legislature's role in this upsurge. “The Texas economy continues to move forward at a healthy pace having **significantly benefited** from the 78<sup>th</sup> Legislature's establishment of the Texas Enterprise Fund.”

“The success of this insightful endeavor, which enabled the state to compete aggressively, close deals, bring companies into Texas, and create thousands of jobs, is well documented,” Perryman said. “Last year, nearly 850 new and expanded facilities chose the state as a location, with Texas receiving its second ‘Governor's Cup’ as the **top economic development site in the nation**.”

Another recently-created fund, The Texas Emerging Technology Fund, Perryman believes “should position the state well to **capitalize on new, high growth industries in the future**.”

Speaking of the future, what are the key elements that will propel us forward for the next 25 years? “The large number of skilled laborers, low construction costs, and relatively inexpensive real estate are projected to continue to prove **highly important contributors** to the state's economic growth,” said Perryman. Although high energy prices limit the degree of economic advancement of some Texas sectors, “the resiliency of the energy industry and the state's strong presence in the oil and gas sector” will continue to provide a stimulus to our economy.

Perryman concludes: “Expansion of manufacturing and services industries, along with an overall favorable business climate, should enable Texas to remain productive and continue to be a **formidable global competitor over the coming decades**.”

**The Battle of Midway (airport, that is) has ended and it has wide-ranging implications for the Austin air traveler. The Texas-based airline that carries the most Austin travelers, Southwest, is expanding its service area by aggressive, take no prisoners, actions.**

Which airport offers more daily Southwest Airlines flights than any other? Most people would say Dallas Love Field, where the airline started its operations. Love has been a longtime hub for the discount carrier. But most people would be wrong. **It's Las Vegas, with 223 daily departures.** So Love Field is 2<sup>nd</sup>, right? Wrong! Chicago Midway is second with 208 daily flights and growing. In fact, with what is already locked-in, the 208 flights will jump to 216 by 10/5/06, hard on the heels of the well-established Vegas.

And what Southwest is doing at Midway is a perfect example of its take-the-battle-to-the-competition approach. How successful has Southwest been at Midway? **The discounter now carries nearly three-quarters of the traffic at Chicago's 2<sup>nd</sup> biggest airport, Midway.** And it plans to grab a lot more.

Southwest's invasion of Midway began back in 1991, when Midway Airlines shut down. The next day, a team of Southwest deal-makers parachuted in and worked a deal to **acquire Midway Airlines' gates – the life-blood of airline operations at any airport.** Following that quick victory, Southwest outbid AirTran for ATA's assets in bankruptcy court, again gaining gates.

One of the requirements when ATA surrendered its gates to Southwest, was that ATA would re-emerge and Southwest would agree to a code-sharing arrangement with ATA. This means, simply, the two airlines can sell connecting tickets and funnel passengers to the other. Now, the loser in this fight, ATA, is doing quite well thank you (think Japan, following WWII), while Southwest is going and blowing, as well. Ironically, ATA's business model is to **follow Southwest around and pick up the leftovers – flying out of Southwest strongholds to places Southwest chooses not to fly.**

All this is great for Austin Southwest travelers. Low fares, it goes without saying. But now, the Austin air traveler has **more low-fare options** from which to choose.

Okay, okay, but what if the Austin traveler doesn't like the cattle-car, no seat reservations, no first-class approach of Southwest? Well, due to the aggressive pricing structure of Southwest, the **airlines that fly to the same destinations as Southwest lower their prices to keep their customers from switching.** Every air traveler wins in this scenario.

Some industry analysts predict **Chicago may become Southwest's largest city by year-end.** They feel the Southwest battle plan will include more east-west routes out of Midway, similar to recently-announced flights between Washington Dulles and Midway. In the meantime, Southwest has spent \$75 million equipping/upgrading Midway Airport for the assault.

**There's a new travel trend that you may want to avoid – or take advantage of, if you like to hang with rock 'n' roll bands.**

There are a number of hotels around the country that are frequented by musicians and make up a kind of **loose network of rock 'n' roll hotels**. And these are not your Motel 6's or Holiday Inns. In fact, a touring rocker once wrote (exhibiting the twisted psychology of some musicians on the road): "It was not possible to walk into the identical room in 20 different cities without wanting to hurt it just a little" calling the rooms "extremely boring and soul-destroying."

According to *The New York Times*, "the modern rock star appears to be more docile than his television-hurling predecessors" such as those that christened the Continental Hyatt House on Sunset Strip in Los Angeles, the "Riot House." But they are still an **up-all-night, sleep-all-day crowd**. If this appeals to you – or if you want to avoid them like the plague – here are some rock 'n' roll hotels:

Yes, Austin has some of these properties. **One of them is the funky Austin Motel on South Congress Avenue**. It's inexpensive and near the "action" of Austin's club scene. Another: The Phoenix, called by one rocker "the most sexually, intellectually and culturally stimulating hotel in San Francisco."

Some others: the Hotel on Rivington, on NYC's Lower East Side, the Hotel Congress in Phoenix, the Park Plaza Lodge in Los Angeles and, if you're traveling abroad, The Portobello Hotel in London.

Speaking of such things, did you know **Austin hotel bartenders compete each year to create the "Official Drink of Austin" – the Batini**, a drink using Austin's Tito's Handmade Vodka and commemorating the nightly flight of the Congress Avenue bats. This year's competition will take place on the south stage at, where else, the Austin Bat Fest from 7-8 pm, 9/2/06.

**Dr. Louis Overholster** said he will never understand why meetings called to think outside the box are held in small, crowded, windowless meeting rooms!

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.

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