

THE

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AUSTIN LETTER

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Dear Client:

With pundits and political parties posturing about who will control the US House and Senate following the mid-term elections in less than six weeks, we have the one true meaning of the election for you. And it's not pretty.

You can find all sorts of predictions on whether the Democrats will wrest control of the US House from the Republicans, or whether the GOP will still have a majority once all the votes are tallied around the country. Some of the more optimistic Dems even think control of the US Senate is within their grasp, but most predict the GOP will lose *seats* but not *control* of the Senate. And, between now and election day, these **predictions are sure to change** as the results of various polls are released and Election Day, 11/7/06, nears.

Throughout the month of October, **you will see/hear all sorts of pontifications** about what will happen as a result of the November elections. One of the reasons the predictions – no matter who makes them – could miss the mark is there appears to be an enormous amount of apathy among the voters.

Oh sure, the hard core from all sections of the political spectrum will march to the polls – as they always do. **But the average Joe and Jane Sixpack appear to be more turned off by the rants and raves than motivated to vote.** Even in Texas where we have a very unusual, high profile race for governor, the voters appear to have not been energized.

So, **what is the one true meaning** as far as control of the US House and Senate is concerned? In all honesty, the result will be the same no matter which party is in control of the House and Senate. If the Dems take control of one or both houses, or if the GOPers keep control, **the margin of control will be so razor-thin that, for the next two years, gridlock will be even worse than now. This is the true meaning.** Forget about bipartisanship.

Another legislative truth – both at the Texas Statehouse and the Washington capitol – is that it is easier to kill a bill than pass a bill. **The naysayers will hold sway and control the day.** A lame duck president is sitting in the White House with the power of veto, and wannabe presidential candidates will be preening.

No matter the final November vote tally, get used to two more years of gridlock.

So, Dell is planning to hire 500 more engineers to work here in Austin, at \$60,000 to \$100,000 a year each. Would you believe another high tech operation is going to tap into a \$30 million fund to bring seven or eight of the world's leading scientists – and their research teams – to Austin? Is this the start of another high-tech boom?

If it walks like a duck and quacks like a duck, maybe it *is* kicking off a high-tech boom. But when you compare this to the frenzy of the previous dot-com craziness (“**hey, everybody else is doing it, why don't we go for an IPO and get stinking rich!**”), it falls way short. And this is a good thing.

Because what is happening now does not have the “irrational exuberance” noted prior to the dot-com boom, then bust. Today's economic activity in the Silicon Hills of Austin is based upon **solid, well-thought-out, rational high-tech growth.**

Let's back up a minute and pull all this together. We told you *last* week about Dell's major investment in the Austin economy that was formally announced *this* week. **Hiring 500 professional engineers is a big deal.** Some of these hires over the next five months will come from other Austin companies, but many of them will be attracted to Austin by Dell's aggressive recruitment campaign, backed by a big advertising push.

This means **well-paid, highly educated families will move into the Austin area**, buy homes and furniture, set up housekeeping, start patronizing local businesses, pay taxes and become a part of our community. This is the best kind of economic growth.

Soon after the Dell announcement, another mind-boggling development was announced this week. This is really significant. **Another wave of the future started rolling over Austin this week.** Don't make the mistake of dismissing this as just another high-tech deal. This is the real thing.

Back in July, UTSystem Chancellor **Mark Yudof** received permission to seek grants from the state and industry leaders to create a **regional center for research and development in nanotech that can quickly grow into commercial applications of the technology.**

Well, it's now a done deal. The Southwest Academy of Nanoelectronics (SWAN) was created here in Austin, **bolstered by a \$30 million public/private investment.** And the world's best nanotechnology scientists will be brought to Austin to work on this project that has broad applications, including medical.

You can easily see the significance of what has happened here in the last few days. And we haven't even talked about the **fast-track construction of the multi-billion dollar Samsung Electronics semiconductor fabrication facility** that is moving head-long toward completion in northeast Austin. A lot is happening and it is all good.

Don't know if you've been tracking mortgage interest rates lately, but an interesting thing is happening and it is bolstering the Austin area's counter-cyclical positive economic activity.

While hardly anyone was paying attention, **mortgage interest rates this week dropped sharply below a four-year high** of 6.86% touched in June. Borrowing costs, excluding fees, dropped to the lowest level since February.

This development has been largely obscured because of the national hand-wringing over the problems in residential real estate around the country. (**These problems are *not* being felt in the Austin area.**) For instance, one of the lead national stories this week was "US Mortgage Applications Fell For The First Time In Four Weeks." This is despite the drop in interest rates mentioned above. Sure, it's a problem nationally – but not here in the Austin area.

Historically low mortgage rates fueled the most recent national housing boom, but this past week's plunge in interest rates failed to make an impression on consumers in the big, formerly overheated markets on the two coasts. Well, duh! Those markets are sitting there with **overpriced housing and the buyers are not about to pay those inflated prices.**

But here in the Austin area, **our home values have been increasing *steadily*** – not at a crazy, out-of-sight, over-the-top ridiculous rate. So homes, while increasing in value, are still "priced right". And, now, mortgage interest rates are dropping on reasonably-priced homes — **a good thing for Austin homebuyers.**

The positive impact is a double-whammy, because the **homesellers are also the beneficiaries of low interest rates.** You see, those folks who are driving down the street looking at Realtors' signs in the yards can now afford a pricier home – as the low interest rates translate into **lower monthly payments.** Good for the seller.

Austin homes are selling at a record pace, prices are moving upward (but at a measured rate) the number of homes for sale, at the current rate of sales, is low (keeping the choices limited) and now **dropping interest rates are aiding the situation.** So far, so good. We'll keep an eye on this, but don't worry for now about what is happening nationally in residential real estate.

A new group of Austin voters is being courted for the November election. The group: those who are supportive of the burgeoning movie and film business in the Austin area.

Filmmaker **Richard Linklater**, who is the founder and Artistic Director of the Austin Film Society, is encouraging "friends of Austin film" to vote for Proposition Four ("I'm for 4"). Linklater's logic: **"If Proposition 4 passes, Austin Studios, a city-owned facility, will receive \$5 million to make critical upgrades"** in its local production facility.

Are Delta Air Lines and Northwest Airlines giving up on the Austin market? It sure looks that way as their share of Austin air travelers is dwindling dramatically.

Passenger activity at Austin-Bergstrom International Airport (ABIA) is quite robust and many airlines are showing significant increases in the number of passengers they are serving at ABIA. Some, as we have told you as recently as 9/15/06, have **added more and more flights** serving Austin, and two airlines (American and Continental) are **replacing smaller planes with larger aircraft** to carry more passengers on the same flights.

But not Delta and Northwest. For eight months, year-to-date through August, **Delta has carried 16.5% fewer passengers at ABIA than last year while Northwest's passenger Austin total is down 27% for the year.** These down-in-the-dumper numbers are in stark contrast with their competitors and with the Austin market as a whole.

Only one other airline at ABIA is down for the year (United, at only -1%). The remaining airlines' revenues from Austin air travelers are soaring for the year: **Southwest is up 10.5%, Continental is up 9.5%, and American is up 7%**, as an example. Even with low market share, much smaller Frontier is up 12%.

It's hard to find a silver lining in the cloud hanging over Delta and Northwest's Austin operations. When you look at the most recent month to see if there has been a turnaround, you find the opposite. **Delta was down 24.5% in August and Northwest's passenger business was off 27.5%** for August, compared to the same month a year ago. Austin's newest airline competing for less than a year at ABIA, **JetBlue Airways**, is close to matching Delta and Northwest's totals.

With the push-pull between the White House and Congress over whether to authorize the CIA to continue tough questioning tactics of suspected terrorists, **Dr. Louis Overholster** came up with the perfect compromise: set the guidelines somewhere between the Geneva Convention and USSupreme Court nominee hearings.

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