

THE

*Paul Spelce*

# AUSTIN LETTER

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Volume 28, Number 42

February 2, 2007

Dear Client:

**When a regional organization that holds sway over transportation in Central Texas (spelled: t-o-l-l r-o-a-d-s) was reconstituted, the shouting and name-calling that marked meetings stayed at a high decibel level. This brought a stern, momma-like lecture from the chair.**

State Senator **Kirk Watson** is no stranger to raucous public hearings. After all, as Mayor of Austin, he presided over City Council meetings that considered more than its share of controversial issues. **But Watson earned a reputation as a “uniter, not a divider,”** (where have we heard that phrase before?) because he worked toward consensus and a softening of the public debates that have long characterized this city’s sometimes volatile politics.

However, in his first meeting as Chair of the Capital Area Metropolitan Planning Organization Transportation Policy Board (CAMPO), he probably thought he was back in the mayor’s seat. **The trigger point: to toll or not to toll.** Change a few words and you would’ve thought you were attending the decades-old “to nuke or not to nuke” debates at City Hall over whether to participate in nuclear power.

Was Watson blind-sided? Here’s what he had to say a few days later: “Even though I said a month ago that I wanted the board to shelve its scheduled vote on a controversial toll road system that was devised years before I came onto the board, and even though there was every indication the board would do just that, the politics of this issue have degenerated to the point that **dozens of people screamed at us and called us names until nearly midnight – long after we finished doing exactly what they said they wanted.**”

Watson said by tabling toll road action for a while, “the board gave itself a blank slate on which to plot this region’s future. In endorsing by-laws changes and a recomposition of its board, it voted to become more functional, accountable and responsive.” Now what, Senator? “It is positioned to **create a truly comprehensive transportation system that includes rail, new roads, rapid buses and other tools.**”

So what about the angry toll road debate? “I don’t know whether there was ever a time for the blind, angry fighting that’s come to define this issue. I’ve never believed in that brand of politics. **Yelling and name-calling ain’t what our mommas taught us to do.**” **Then he added: “Now, eat your vegetables.”**

**Along with rising home prices, *land* prices in Texas have reached record levels. Is it time to sell or buy? One analysis says yes, another no – for *both* scenarios. Consider the facts, then you can decide.**

It's an intriguing set of circumstances. As more and more people flock to our area, more and more people are looking for elbow room and buying land. **In fact, final Texas figures will likely show Texas land prices posted more than a 10% increase for the 4<sup>th</sup> straight year**, according to the Real Estate Center at TexasA&M. These rapid price increases – fueled by intense buying for recreational and investment purposes – have led some to suggest a “**correction**” may be in the offing. There's evidence to suggest this may be the case.

Let's look at historical trends. (Remember, we're dealing with statewide averages, not specific land deals) Without boring you with the numbers run by Research Economist **Charles Gilliland** at the Real Estate Center, here is the conclusion he puts forth: “**History suggests that paying more than \$1,200 per acre will earn investors meager, if not negative, ten-year returns.**” And he points out that current average Texas land prices greatly exceed \$1,200 per acre.

“Conventional wisdom suggests that **the current price of \$1,681 per acre has surpassed the price prudent investors should pay** if they expect to see a positive return on landownership in ten years,” Gilliland continued. “That wisdom implicitly assumes the next ten years will unfold much like the previous 40.”

“For investors who believe the past four decades provide a reliable guide to future market performance, the land investment traffic light is flashing yellow, if not red,” he said. “For those investors, **current buyers are poised to become victims of the ‘greater fool’ theory of investing.**”

Meanwhile, the land market continues to thrive. Stay with us now, because this is where it really gets interesting.

**Current buyers may not be as foolish as the historically focused analysis might suggest.** Several factors cast serious doubts on the assumption that past market trends accurately portend future investment trends.

There are new realities at play in these times. From the tax environment to energy prices to market leverage, **2006 conditions were a world away from the 1980s milieu**, noted Gilliland. He said that when oil prices exploded last year, costs increased across the economy and fueled a boom in the energy sector. Increased royalty payments and energy industry profits continue to funnel income to would-be land buyers. Today, he says, many buyers insist on paying cash for land, eliminating the high degree of debt that made the 1980s market so vulnerable to foreclosures. There's even more to suggest **there may still be a great deal of upside potential in land** and we'll look at those in more detail in the next item.

**How high can Texas land prices go? Well, the sky may not be the limit, but there are a number of reasons current prices may be nowhere near the ceiling.**

Analyzing 40-year historical data, without looking at the *current* conditions, is a short-sighted way to view Texas' record land prices. This is because there were some **major negative developments – not present today** — that kept land prices lower in the recent past.

First, the negative returns on a ten-year land investment in the past 40 years largely resulted from the **meltdown of a leverage-driven land market in 1986**, says Research Economist **Charles Gilliland** at TexasA&M's Real Estate Center. (Remember those dark real estate days that sent Austin's economy reeling?)

Secondly, the Tax Reform Act of 1986 **eliminated much of the tax shelter** motive for land ownership and **oil prices plummeted** at the same time, sending the Austin and Texas economy into a tailspin that resulted in **declines in population growth and numerous job losses**.

As a result, many land sales supported by borrowed funds collapsed. Financial institutions failed and land markets languished from 1986 through 1993. All this, obviously, had a **major impact on historical land prices**. Now, let's look at *today* to see the big difference.

**Texas population will increase by 16% between 2006 and 2016, and Central Texas will outpace the state.** This number will rise to an impressive 32% by 2026. "A growing population increases the demand for land, which results in rising prices," Gilliland points out. "The number of persons over 65 will increase dramatically. That group will inherit wealth and retire in ever-growing numbers. Many of those well-heeled retirees are likely to **seek quiet places in the country.**"

One of the truisms we've expounded for decades is that nothing occurs in a vacuum. Obviously this isn't original with us, but it helps to bring a focus to what happens *here* is driven, in part, by what happens *elsewhere*. In that context, "real estate prices in other states have soared far above prices for comparable properties here," Gilliland points out. **Investors from those states see Texas prices as bargains and are coming here to buy – bringing plenty of cash.**

Also, many institutional investors have set portfolio diversification goals that require real estate acquisition. And current economic conditions have some investors anticipating inflation. **Those concerns, says Gilliland, drive purchases of tangible assets, such as real property.** You get the picture.

Bearish land buyers look back historically and reason that growth cannot persist indefinitely, fretting about a collapse. Bullish buyers see the growing population, relatively low real estate prices and a lack of alternative investments. **These are all important developments cited here.** But, as usual, it comes down to personal philosophy – to buy, or to sell. You choose.

**Question: When is a “managed lane” in Austin not a “toll road” in the traditional sense?**

**Answer: when it runs to downtown, along MoPac/Loop1. Let’s explain.**

The head of the Downtown Austin Alliance, **Charles Betts**, lightly slapped our wrist when we referred in our 1/19/07 edition to managed lanes added to MoPac/Loop1 as “resurrecting the original debate about charging tolls for existing roadways that have already been built by tax dollars.” Wrote Betts: “Correction, please.” Here’s how he explained it.

“The proposed ‘managed lanes’ (which can be tolled) have not been built,” he said. **“They will be new lanes constructed in present right-of-way.** Express buses and car-pools will not pay a toll, but others will probably pay a toll to use it. Of course, **all existing lanes will remain non-tolled.**”

He elaborated further: “It is very important to downtown interests to not get this project caught up in the toll road debates. **It will be an additional access road to and from downtown** and it can be operational in two years.”

**Betts called it “a great thing for downtown access, which is growing worse every year.”** As he put it: “2008 could be a good year for access to downtown with both the commuter rail opening and a ‘managed lane’ ADDED (Betts capitalized this in his email) to MoPac for better access to and from the north.”

It’s interesting to note the discussion today centers around **expanding the capacity** of MoPac/Loop1, when it **almost didn’t get built** a couple of decades ago because of fierce and acrimonious anti-growth opposition. In fact, Austin’s mayor-at-the-time fought the road, saying there was no need for the roadway, no one would use it and that the only folks who wanted it were developers who would profit from the sale of land around it.

**Dr. Louis Overholster** has two painless slimming rules for his patients: “1) If you eat something when no one else sees you eat it, it has no calories, and 2) If you fatten up everyone else around you, you look thinner!”

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



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