THE Neal Spelce AUSTIN LETTER

www.AustinLetter.com

P.O. Box 1905 / Austin, Texas 78767-1905 / 512-498-9495 / Fax 512-327-1976 / e-mail News@AustinLetter.com

Volume 28, Number 43

February 9, 2007

Dear Client:

With the soaring Austin area economy the envy of most other cities, **all facets are moving along at a brisk clip**, **right**? **Ah – ah – ah**, **not so fast**. **There is one sector where the green light may be turning to a yellow caution warning**.

It's been said that a rising economic tide raises all business ships. But this is not necessarily true. Yes, when so many jobs are created and people have money in their jeans, this does tend to flow through practically every aspect of our daily lives and businesses. **Optimism abounds**.

On the surface, **apartments appear to be doing quite well**. When occupancy rates plummeted back in 2001 (taking rental rates down with them), the next few years were spent trying to lure and retain a tenant base that seemed to be disappearing, or perhaps just disinterested, observed **Robin Davis**, who tracks apartment trends through the company, Austin Investor Interests. Concessions to attract tenants reached an all-time high.

But 2006 saw the dust begin to settle, with a return to **desirable rental rates**, **shifting tenants**, **new development and abounding investments**. Not bad. There is now a noticeable drop-off in incentives. So everything is rosy, right? Yes, for now.

But look at what may be in the immediate future. **New apartment developments will double the pace of the last 12 months**, **while occupancy has made very little headway**, Davis points out. In addition, Davis says, there is a likelihood of additional competition from the plethora of new condo developments that have the potential to convert to rentable units.

In other words, if major condo projects announced over the past year don't sell at a predetermined pace, the developers can cut their losses by **turning them into apartment units to generate cash flow**.

This has led Davis to say "**the caution flag will be waving**." The record rate of home sales the past year may also contribute to concern for future apartment occupancy. If this rate of home sales continues, some believe potential apartment dwellers may opt to buy starter homes, to take advantage of the rising residential real estate market.

Is the fact there were no new office building completions in the Austin area in the last six months of 2006 a sign of a slowdown in office construction? **Nope**. **Why**? **Because there are 12 new office buildings now under construction**.

Good thing – because *existing* office buildings are filling up at a pretty good clip. In fact, citywide occupancy **jumped three full percentage points** to 87.8% in the last half of 2006, according to **Charles Heimsath**, the president of Capitol Market Research. And rental rates jumped by 5.1% between June and year-end.

Yep, this is a hot office market. In fact, here is an amazing statistic from Heimsath that shows you just how prized this market is: **in 2006**, **almost 20% of all multi-tenant office buildings in the Austin area changed hands**! Think about this. These are cold, hard dollars being invested in the economic potential of this area.

And now there are 12 new office buildings coming up out of the ground. Where are they located, Charles? "**There are six office buildings under construction in the Southwest market area**, three buildings under construction in Far Northwest, a building under construction in Northwest Austin and two buildings under construction in the Central Business District," he said.

Okay, **does this heavy level of office construction signal a glut may be in the offing**? **Folks in the commercial real estate business don't think so**. For instance, NAI Commercial Industrial Properties reports that more than "one million square feet is expected to be added to the speculative office market over the next *twelve* months." Well, isn't this a lot? Sure, but Oxford Commercial reported just in the last *six* months of 2006, citywide, more than a million square feet of office space was leased.

This begs the question about rental rates. Hang onto your wallet. As expected, **rental rates overall are rising and will continue to rise**. Gone are the days several years ago when we told you it was the time to lock-in long-term leases *then*, due especially to the overabundance of sublease space. Now the price curve is moving upward and doesn't show signs of leveling off.

One of the reasons for higher lease rates is the new speculative space coming available this year will carry a rental asking rate of between $28 and $32 per square foot per year, according to NAI Commercial Industrial Properties. And, of course, the other reason is the age-old supply-and-demand equation – the more the demand, the higher the price tag for the supply.

Oxford Commercial says "**in 2006 the Austin office market stood out as one of the strongest in the United States**." A lot of investors, developers, speculators, commercial real estate interests, etc. are betting this will continue this year. But those of us who remember the vacant see-through office buildings during the 1980s real estate recession will watch this for you.

THE Neal Spelce AUSTIN LETTER www.AustinLetter.com
THE Neal Spelce AUSTIN LETTER www.AustinLetter.com

For a half-century, Austin's economic development leaders have targeted very specific industries and companies it wanted to provide jobs in Austin. So what are the industries of the future on which the Austin area should focus?

Admittedly his background is heavily larded in technology, but his expertise is also where it's at when you look at companies he feels should be **major targets of opportunity for the Austin area**. Economist **Angelos Angelou** began his economic development efforts on the staff of the Greater Austin Chamber of Commerce a couple of decades ago before forming his highly-successful company, Angelou Economics. His Austin-based company is hired by economic development entities all over the nation. What does he see for Austin?

> "While Austin has traditionally been known for its computers, semiconductors and software, growth in electronics manufacturing has waned while other industries are growing nationally," he points out. "**Nanotechnology**, **clean energy and data centers** all represent expanding industries that Austin should capitalize on to continue its economic growth."

His recommendations consider two factors that must work in concert: **1**) **the most promising industries**, **and 2**) **the assets which the Austin area can offer those industries**. (To stretch his point, he's not suggesting the land-locked Austin area try to become a shipbuilding center because there will always be a need for ships.) Let's take one of those suggestions – clean energy – to delve deeper into his recommendations.

> Angelou says "**clean energy is a long-term growth industry**," pointing out these industries "continue to expand across the nation in response to sustained high oil and electricity prices and growing concerns about future regulation of greenhouse gases." He argues that clean energy is increasingly becoming a "commercially viable alternative to traditional energy sources, with **biofuels**, **wind power and solar photovoltaics all expected to expand significantly over the next 8 to 10 years**."
>
> "Clean energy sources are widely available domestically, and falling costs and government incentives have made many technologies feasible today," added Angelou. **He cites higher demand in the US**, **China and India**, **and that clean energy is becoming price competitive**.

One of the reasons it's an attractive target is the average annual wage is about $80,000. And what does Austin have to offer? Well for one thing, it has the "**greenest utility**" **in the nation**, and the City of Austin has one of the most **aggressive** "**clean and green**" **policies** in the nation. He also says, **clean energy** "**fits Austin's personality**." More arguments: as we've reported in recent weeks, Texas leads the nation in wind energy, and Austin already has 150 jobs generated by Teco-Westinghouse that is manufacturing wind turbine components. But make no mistake, other areas are also courting clean energy companies, so it's a competitive environment.

UTAustin, one of this nation's leading book repositories, is part of a lawsuit-challenged grand experiment that could place every single book in its vast library holdings on the Web for anyone in the world to access and read. And it is not alone in this bold venture.

In fact, just this week, Princeton University became the 12th major library system to join Google's ambitious project to **scan the world's great literary works and make them searchable over the Web**. The combined collections of the university's libraries reportedly total more than 6 million printed works, 5 million manuscripts and 2 million nonprint items.

UTAustin and the University of Michigan are the only two institutions that have agreed to scan works that are still under copyright. The rest have said they are focusing on public domain works or are still considering whether to scan copyrighted works.

But this is not a done deal – even though Google is going forward. **Google has a Beta site that is up-and-running where you can check it out**. Just go to http://books.google.com. A lot of info is posted there – from Google's perspective, of course – about this massive undertaking.

The lawsuit was filed by five big US publishers, together with the Association of American Publishers, to block Google's plans. The case has yet to come to trial.

Google's plan calls for you to be able to **page through an entire book from start to finish, as many times as you like**, download it, save and print a PDF version – if the book is out of copyright or the publisher or rightsholder has given permission. Otherwise, you can see snippets and be directed to bookstores where you can buy the book or libraries where you can borrow it. There's no indication *when* this project will die – or move forward. But it's certainly ambitious and far-reaching. Stay tuned.

Dr. Louis Overholster thinks that things are changing so fast, you can't blame kids for being confused. In fact, he says some of them think the Gettysburg Address is ALincoln@aol.gov.

Sincerely

Neal Spelce

Editor/Publisher

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.