

THE

Neal Spelce

AUSTIN LETTER

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

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Dear Client:

A sure-fire way to know if the Texas economy is solid, and the future is on sound footing, is to look at how well state government is doing. Most states in the union should be so lucky.

The State of Texas fiscal year ended 8/31/07. Texas began its new fiscal year with \$1.5 billion *more* in its General Revenue account than it anticipated back in January, according to State Comptroller **Susan Combs**. To make it even better, this is on top of the predicted \$7.0 billion that would be in the coffers. **As a result, the state kicks off the year with an \$8.5 billion surplus.** Some of the surplus is already budgeted by legislators to be spent, but not all of it. And now there is an additional \$1.5 billion to add to that. Talk about a nice cushion.

How did this come about? Well, Combs said **revenues have been greater than expected.** Why is this? She cited “strong state economic growth” **as well as lower expenditures** “attributable to legislative and agency spending restraint.”

Yeah, but what specifically triggered the increased revenue? Plainly and simply, increased sales and use tax revenues. Would you believe **the sales tax revenues for the state were up by almost 11% over fiscal 2006.** This means most of those businesses that charge/collect the sales tax had a great year.

In other words, **a healthy economy triggered this better-than-expected result.** It was fueled by Texans who were not reluctant to spend money, because they had jobs and were confident about the near future. So, does all this money in the bank mean the Texas Legislature, that controls the state’s purse strings, will go on a **spending spree like drunken sailors in an exotic foreign port?** Not any time soon. Because the Texas Legislature will not re-convene in Austin until January 2009.

Another factor that bodes well for the fiscal integrity of the state is a move taken by legislators years ago. It set up a Rainy Day Fund (if you want to look it up, its’ formal name is the Economic Stabilization Fund). **Comptroller Combs will make a deposit to the Fund later this year to bring it to \$4.6 billion.** This Fund just sits there, earning money until, *or if*, it is needed for unforeseen circumstances.

Of course, if the roof caved in on Texas between now and 2009, anticipated revenues could come up short. But a solid footing today, with a huge Rainy Day Fund, offers some comfort.

Austin's strong economy continues to attract developers from all over the country, with almost 3 million square feet of office product under construction. Yet the vacancy rate of existing office space remained level at about 13.8% at the end of the 3rd quarter.

It's not as though there is an increasing number of tenants banging on the doors of office building managers looking for space. **The demand is not there so available space is holding steady, while at the same time rental rates are rising.**

And yet Oxford Commercial, a real estate services company, reports a **massive amount of office construction is underway**, especially in the Southwest and Far Northwest submarkets. It is the strength of the Austin area economy and its future prospects that are driving developers to build more office space.

Also, when you drill deeper in the numbers, you'll find a softer Central Business District (CBD) office market may be helping the Southwest and Far Northwest. "With rental rates in the CBD continuing to climb, **we are seeing more companies opting to operate cheaper outside the CBD**," Oxford Commercial reports.

How much have office rental rates risen downtown? Compared to last year's 3rd quarter, rates have risen 23.8%. Maybe this is the reason the CBD only absorbed 7,699 sq.ft. of space, down from 84,419 sq.ft. last quarter. The CBD is notching the highest average Class A rental rate since 2001.

So why are rates going up? Oxford Commercial says "the continued rent rise can be attributed to the **rising property taxes** and the high volume of investment activity." Demand is not as much of a factor in the office market as it is in the industrial space market.

By the way, **the AMD campus is the largest project, at 860,000 sq.ft., under construction in the Southwest submarket.** Of course, when completed, this facility will be fully occupied – but AMD will vacate other space it is now occupying in the Austin area.

"As office rental rates continue to rise, there will be increasing demand for R&D/flex space from office tenants **weighing their options between affordable flex space against more expensive office space**," reports Oxford Commercial. As a result, the industrial market just racked up its fifth consecutive quarter with more than 350,000 sq.ft. absorbed.

You know what happens when there is strong demand. Prices rise to reflect the demand. Rental rates for the overall industrial market saw a 3% increase from where it stood last quarter. But, because this steady demand has continued for five quarters now, the **Austin area industrial market has experienced a 15% increase in rates compared to the 3rd quarter of 2006.** So we now have both office and industrial space in the midst of rising rental rates.

Salaries for graduating law school students at the big Texas law firms have skyrocketed. Would you believe \$160,000 a year for a first-year law associate? But one firm has decided to put the brakes on escalating salaries.

The spring 2006 salary in the big firms for first-year lawyers was \$115,000. Then it jumped to \$140,000 and now \$160,000. So what you have is **a nearly 40% increase in just 16 months – a hefty hike by anyone’s measure.** The situation is exacerbated by the fact that each of the major Texas firms – in order to be competitive in recruiting bright law school grads – offers basically the same entry-level salary package. One firm raises the salary bar and the others follow suit. Until now.

A not-quite-as-big law firm (though still sizable) decided not to go along with the larger law firms. **Dallas-based Winstead PC, with a significant presence in Austin, decided to not match the latest salary hike.** It’ll be interesting to see if Winstead will continue to hold the line as it still competes with the bigger firms for the top 10%, 15% or 20% of graduating law school classes.

Simmering under the surface of this salary surge is a change in the bigger law firms, where it is **getting harder and takes longer for a young attorney to reach the really lucrative partner level.** Some say the recent grads may be taking the *short-term* view of linking up with a large law firm – and placing more emphasis on “**getting their money now,**” rather than planning way down the road when they *might* make it to partner. Hence the skyrocketing salaries.

Sometimes quality of life trumps the size of the salary for those making location decisions. In these cases, Austin is recognized widely as a great place to live.

For instance, *National Geographic Adventure* in its September 2007 issue said “**Austin is the ideal amalgam of art-house style and rough-and-tumble Lone Star play.** Audiophiles relish 200-plus live music venues ... cyclists tackle the technical six-mile Emma Long Loop downtown.” Of course this pub is nationally respected and widely read.

A writer for the *Kansas City Star* had an article about Austin picked up in *The Orange County Register* in Southern California. At the top of his story, he exclaimed “**Austin has always been celebrated for its one-of-a-kind flavor** that comes from being a university town, state capital, high-tech center and, of course, smack in the middle of Texas.”

Even the October 2007 issue of *Dog Fancy* named **Austin as a runner-up (to San Diego) as a place where “it’s good to be a dog.”** It cited as highlights: “An off-leash island – Red Bud Isle – just for dogs, proactively working toward a no-kill status at its shelters, community outreach, and focus on humane education.”

Now that no less than *The Wall Street Journal* (see our 9/14/07 edition) has labeled Austin as “Luxury Town U.S.A.,” you wonder if Neiman Marcus is going to blanket the area with its 81st annual Christmas Book catalog, where you can find a gift that costs \$2.3 million.

This year’s catalog, that some call the “ultimate wish book,” includes 160 pages detailing more than 400 items such as the NM Exclusive Prada clutches for \$995 or fish cuff links for \$7,500 (from Henry Dunay). **The \$2.3 million gift is a getaway to the Ameya Preserve in Montana,** enhancing the catalog’s reputation for exotic, fanciful and expensive gifts.

The Neiman Marcus “His and Hers” gift, one of the catalog’s more famed traditions, is a **\$110,000 his and her portrait by Vik Muniz.** What’s so special about the portrait? **It is painted in Bosco chocolate syrup.**

Other gifts: **a 305-carat uncut diamond necklace starting at \$1 million** and a NM 2008 Lexus IS F Special Build Sedan for a price “so secret, Lexus won’t even tell us,” according to the catalog description.

For \$1.59 million, shoppers can have a **private holiday concert** hosted by Neiman Marcus featuring the **Kirov Orchestra** performing the Nutcracker Suite, Tchaikovsky’s 1st Piano Concerto and another Tchaikovsky masterpiece of the buyer’s choice. **The buyer gets to keep the Steinway Concert Grand after all the artists autograph it.**

Not all the gifts will sell. **Last year, no one bought a \$160,900 fountain pen** (a diamond-encrusted Montblanc – they call it a “writing instrument,” not a fountain pen) nor did they sell an All-Star sports celebrity package that was to be auctioned off for a minimum bid of \$250,000. Neiman’s claims that not all the gifts are chosen to sell, saying some are chosen for their publicity value. The point is to make people say “Who in the world buys these things?”

Reading over this last item, **Dr. Louis Overholster** observed that it is almost impossible to exaggerate the complete unimportance of almost everything!

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Sincerely



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