

THE

Real Estate

AUSTIN LETTER

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Dear Client:

Back before “subprime” was an economic cuss word, the Austin area was building a solid economic base. This underpinning is so strong that during these uncertain economic times, Austin is now projected to be America’s Fastest Growing Metro between 2007 and 2012.

Two nationally-respected entities, Moody’s Economy.com and *Forbes* magazine, cited the area’s tech hub, world-class university, growing population base, low cost of living and doing business when it tapped **Austin as the nation’s #1 growth spot for the next five years.** (Other metros with similar characteristics rank just below Austin: Atlanta, Seattle, Orlando, Houston and San Jose.)

What makes this designation interesting is that national economic problems – such as those caused by the subprime crisis – are **impacting the Austin area less than elsewhere.** And, if this forecast is spot-on, it means **Austin will have a jump-start on the rest of the nation for the next five years.**

Oh sure, there will still be some negative stats in our area. For instance, the national homebuilders doing business here have scaled back due to the problems they face elsewhere and the widespread tightened credit situation. Metrostudy predicts production of new homes in the Austin area will continue to slow and the **annual home starts will decline 10% to 20%** from the 2007 4th quarter total.

But Metrostudy’s **Eldon Rude** predicts **home prices are expected to remain fairly stable.** “This situation contrasts with markets in California, Arizona, Nevada and Florida, where speculative purchases and unsustainable appreciation rates led to significant price declines,” said Rude.

One aspect to near-term pricing could be **beneficial to homebuyers looking for a newly-built home.** Metrostudy has found that when the Austin market has more than a two-month supply of finished, vacant new homes, **builders are usually forced to make concessions.** There was a 2.1 month supply in the 3rd quarter and it rose to 2.5 months in the 4th quarter.

The Forbes/Economy.com projection of Austin as the nation’s fastest growing metro came after an **analysis of the 100 largest metros in the country.** This designation is significant because area growth usually equates to economic dynamism and success.

While there is probably no better place than the Austin area in which to live and work during these uncertain economic times, vigilance is important. No question: 2008 will be an interesting year.

Let's look at one of the markers for a strong economy – leasing-up of available office space. The more space that is leased means more jobs are being created. Jobs are the underpinning of a healthy economy. But a **caution flag is flying in the office leasing market**. There was about 50% less absorption of vacant office space in 2007 as was counted in 2006.

Oxford Commercial real estate explains this decrease by attributing it to “a lower number of significant relocations to Austin, the rise in rental rates and tenants being more conservative in leasing additional space.” As a result, Oxford is predicting that **Austin office rental rates should probably decrease in 2008, as demand for space fails to keep up with the new office space coming online.**

How much office space will be coming on line in 2008? Oxford thinks it could be more than 2.2 million square feet. That's a bunch. So the **vacancy will increase** this year and this (good old supply and demand, from your Econ 101 class) will **drive rental rates down** a bit this year. While the office market overall in 2007 was healthy for *landlords*, the pendulum should swing back big in favor of *tenants* during 2008.

However, Oxford anticipates this situation will not deter investors looking to dump money into Austin commercial real estate. “**Investment sales transaction volume will stay active as Austin remains a favored market among out of state investors,**” predicts Oxford. It's all relative. Other markets are not doing as well as a slowing Austin market, so investors will still be attracted to the Austin area.

By the way, another facet of Austin commercial real estate doesn't appear it will slow down in 2008. **Demand for industrial product continues high**, so Oxford is predicting rental rates will increase in this sector in 2008, though it could get close to topping off, and “the Austin market will continue to see high absorption well into 2008” as construction activity increases this year.

Looking at another important segment of our economy, **you would think apartment rentals would be doing well this year** because of the slowdown in construction of new, less expensive homes. On the surface, this is true. But look down the road just a short ways.

Austin Investor Interests (AII), that tracks the Austin area apartment market, points out that **new apartment units are expected to flood the market this year with more than 14,000 units** that are currently under construction. And that's not all. There are **more than 23,000 additional units** actively proposed or already in the permitting stage, according to AII.

All the talk (ours included) about the irrelevancy of Texas in the presidential primaries, because the Texas Legislature failed to move balloting in Texas to an earlier date, is now out the window. So, hang on.

If you are aware of the daily news developments, or even if you turn on the tube only from time-to-time, you will soon start hearing even more about **Hillary Clinton, Barack Obama, John McCain, Mike Huckabee and Ron Paul**, even though **George Romney** suspended his campaign yesterday. If you think you've heard too much already, you ain't seen nuthin' yet.

Up to now, you've simply seen the national news reports on what has been going on *elsewhere*. **You have been spared all the local TV ads, the phone calls, the mailers, the proliferation of signs**, etc. that inundated the states that held primary contests so far. Not any more. Now, it's your turn to be hammered by the messages of the presidential wannabees.

It will be a crescendo that will start slowly in a couple of weeks, **rising to a loud roar by the end of the month right up until Texas polling places open their doors 3/4/08** (which, by the way, is the birthday of McCain's highest profile Texas post-Giuliani supporter, Gov **Rick Perry**).

Remember, even though Texas has voted overwhelmingly Republican in recent election cycles, **this state is very important to the Democrats** during the primaries because, obviously, the Dems will troop to the polls to have their say on Obama/Clinton, just as the GOP faithful will want to place a Texas imprint on the Republican contest.

In effect, you will have two elections going on at the same time. What's the old gum slogan, "double your pleasure, double your fun?" This could mean "double the dollars" being spent to woo your vote. With the Ds wooing the Ds and the Rs pitching the Rs, no one is safe from the anticipated barrage of messages.

We've told you of two big changes that may soon impact Austin-Bergstrom International Airport (ABIA). Now we've learned there's another on the way.

At the first of the year (1/4/08), we gave you a heads-up that a **major terminal expansion** would probably be initiated this year (and take till 2013 to complete). Then on 1/18/08, we told you **Delta Air Lines would very soon effect a merger** to become the largest airline in the world. It was trying quietly to cut a deal with either United Airlines or Northwest Airlines.

Now, another merger may be in the works. The word we get this week is that **Continental Airlines is also making a serious merger move with United**. And Delta is focusing now on Northwest. All four airlines haul Austin passengers at ABIA, so the impact could be major.

One aspect of Austin's economy is little-known (figuratively flying below the radar), but it is an indicator of the area's impact globally.

Excuse the "flying below the radar" pun, but it seemed an apt cliché to use to describe the business of exporting products from Austin to foreign lands. In the latest tabulations from the USCommerce Department, **the Austin area ranks 25th in the nation when you analyze the economic impact of exports from Austin.** Not bad, especially when you consider this ranking includes all the huge metro manufacturing areas in the nation, a total of 369 metros.

A bit of explanation. This tabulation includes data that reports the *value* of merchandise that is exported – not, for instance, the number of shipments. The *value* of Austin area exports in 2006 (the latest data available) **contributed more than \$8.3 billion to Austin's economy**, according to the Commerce Department.

As you might expect, **Austin's largest export category is computer and electronic products.** What are the foreign destinations for these Austin exports? South Korea, Taiwan, Mexico and China. In fact, when you drill down deeper, you find **the Austin metro ranks 2nd in the nation in exports to Taiwan and 3rd in the nation in exports to South Korea.**

Does anyone you know have an understanding of the importance of such rankings? Probably not. This is what we mean by "flying under the radar." **Texas, by the way, is well represented** in this governmental analysis. Texas' big shipping center, the Houston metro, ranks #2 in the nation. Dallas, that solidified its export position with the hugely successful Dallas-Fort Worth Airport, ranks #9. And the city that has the Texas border's largest manufacturing base, El Paso, ranks #20 in the nation. As the USCommerce Secretary **Carlos Gutierrez** said: "Exports boost jobs, grow the economy and allow businesses to prosper."

While analyzing the subprime housing crisis in other states, **Dr. Louis Overholster** turned to the animal world for guidance. As he put it: "Californians have gone from being a bull – to being a bear – to being a pigeon – and now, they're chicken!"

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