THE Neal Spelce AUSTIN LETTER

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Dear Client:

The median price of homes in Austin and throughout the state continues to rise, so is there a risk of a housing price bubble that could expand until it bursts, turning many Austin area mortgage holders "upside down" as has occurred in other parts of the US?

A few weeks ago (click the "Archives" button at the top of this page to pull up the 4/4/08 edition) we carried you through a process of logic that indicated the **value of your home would continue to rise in the foreseeable future**.

While this was comforting for Austin area homeowners who are getting news reports about falling home prices elsewhere around the nation, it does raise this question: **Is the Austin area lagging behind the rest of the nation and, as a result, is a housing bubble being created here and around the state that will soon burst** as it has in California, Florida, etc.?

An economist at the Real Estate Center at TexasA&M, **Ali Anari, says "the risk of a housing price bubble in Texas is still low.**" And Anari has run some very complicated economic models to prove this thesis. (Don't worry; we're not going to cause your eyes to glaze over with the minute details of such computations.)

All you need to know in this limited space is that Anari came up with Home Price/ Rent ratios that work the same as the stock market's price/earnings ratio. Again, without going into detail, you can use this as a gauge: the US price/rent ratio is 24.3 and in Texas it is only 16.8 in Anari's most recent calculations.

What does this mean? **The Texas ratio is only 69% of the national average. And this significantly-lower ratio than the national average "suggests the risk of a home price bubble is minimal**," concludes Anari. Austin is a tad more at risk than other Texas metros with a 20.3 ratio (Dallas metro is 18.7; Houston is 17.9; San Antonio is 15.4). But the difference between the Austin metro and the national number is still broad enough to temper concerns.

To bolster Anari's points, the RECenter concluded in July 2005 that the risk of a price bubble in the Texas residential market was low and, in updating the analysis this month, the same conclusion prevails: "**the risk of a home price bubble for Texas in current economic conditions is low**." (For more info, you can go to recenter.tamu.edu. Click on Tierra Grande.)

With a positive outlook for the rising value of your home, is the same thing happening in commercial real estate, specifically office buildings? Depends on which side of the negotiating table you are on.

If you are a tenant looking for office space within the next year, you could be in luck. If you own or manage an office building, it will be a bit dicey. The reason: **the Austin office market should be prepared to see vacancy rates continue to rise** as 2009 approaches and even more new office space comes online – meaning offices will be competing for tenants.

This is the outlook voiced by Oxford Commercial after assessing the marketplace through the first quarter. "After posting six straight quarters of positive absorption totaling over one million square feet (msf), **the Austin market has taken a step back during the first quarter of 2008** by experiencing 91,430 square feet (sf) of *negative* absorption," Oxford reports.

Whoa! How do you explain this? "This absorption can be partially explained by **AT&T moving out of over 100,000 sf** at River Place Corporate Park in the Far Northwest," said Oxford. "**Chase Bank's lease expiration of over 100,000 sf at 700 Lavaca downtown** that finally hit this quarter is another component that contributed to Austin experiencing negative absorption for the first time since the second quarter of 2006."

Despite the sluggish first quarter, the overall Austin occupancy remains at a healthy 84% and large leases have been signed that won't affect absorption until the tenants move in later this year. But this activity won't be enough to impact the slowdown, because more office space is under construction.

According to Oxford, there is **more than 2.0 msf of speculative office product under construction**. Speculative? Is any of that pre-leased? Only about 5.6% so far, reports Oxford. As this spec space comes on line, the vacancy rate will keep rising. What about rental rates? Well, they are still high. But you can see what is likely to happen as supply starts outstripping demand in the office market.

Tenants are acting cautiously so far. Why? "**The cloud over the national economy has pushed tenants to *trade action for time*** in hopes to make the right decisions for their real estate needs," reasons Oxford. "With tenants acting cautiously, **we should expect rental rates to flatten out over the year**." What's happening here is obvious. Supply is increasing more rapidly than demand.

In a nutshell, here is what to look for over the next year: 1) **the office vacancy rate will increase**, 2) **the rental rates will flatten out** as demand for office space fails to keep pace with the new office space that will become available, and 3) **construction starts will likely decrease** because of 1 and 2. We'll keep an eye on this for you.

Austin's economy continues to hum right along with a blip here and a surge there – but still among the best in the country.

If you go back to this time last year, you will find there are almost 22,000 more people who have jobs in the Austin area now than a year ago. And, if you look at the unemployment rate over that time span, you will see it holding steady – a very healthy 3.6%, compared to 3.5% last year at this time. **The Austin area job growth rate is better than that of the state and the nation**, **and the unemployment rate also betters the Texas and US averages**. Let's look at some interesting tidbits of info that play into this picture.

Even though more people have jobs and most everyone who wants to work can find work, the **sale of existing homes continues to decline** in the Austin area. One of the culprits: it's simply tougher, under new stringent credit requirements, for potential homebuyers to qualify for a home loan.

But, **Austin continues to gain national notice for the continuing increase in home values**, as reflected in median prices of homes sold. You can find increases in other cities such as: Raleigh, NC, Oklahoma City, Salt Lake City and Houston.

Houston's economy is really rocking now. The Texas energy capital is riding the wave of high energy prices and high gasoline prices. In fact, one economist says high gas prices may be saving Houston's economy. How do these massive energy dollars impact Houston? Consider this: **almost 800 buyers paid at least $1 million last year for houses**. This is up 23% from the year before and 64% over the sales of 2005, according to the *Houston Chronicle*.

Hurting the most are cities such as Detroit, **Cleveland and other Midwest cities** heavily dependent upon the beleaguered auto industry for employment. The Kiplinger Washington Editors also reports **New York City and nearby suburbs in New Jersey and Connecticut** are hurting because they are plagued by a large wave of layoffs in the financial services industries.

If you're thinking about buying a new home, **check out the national homebuilders** doing business in the Austin area. Even though Austin is doing well, they continue to mark down homes locally as part of their national policy to reduce the number of homes they have built.

Rumors were running rampant in Fort Worth this week that Round Rock-based Dell is planning to acquire Radio Shack.

If true, the acquisition of Fort Worth-based Radio Shack's 4,000-plus retail outlets would give Dell a huge platform to sell its PCs. Stay tuned.

So you think college-oriented Austin may be one of the smartest cities in the US? Yes, it does rank very high – just not in the Top Ten.

The old joke says there are so many highly-educated people in Austin that it's likely the bartender mixing your drink has a PhD. **There is no question the Austin area has long been noted for a highly-educated workforce.** Bizjournals, the outfit that publishes a number of localized biz pubs including the *Austin Business Journal*, analyzed the levels of education in the nation's top 100 cities and came up with a formula for ranking the "brainpower" in cities.

And the winner is – tah-dahhh – Madison, Wisconsin, with a Brainpower Index of 57.80. The factors that were considered and weighted were: those with a graduate and/or professional degree, those who stopped at bachelor's degree, those who stopped with an associate degree, those who attended college, but stopped without a degree (this category includes the richest man in Austin, **Michael Dell**!), those who stopped at high school graduation and high school dropouts.

The other cities in the Top Ten, followed by their Brainpower Index: **Washington, DC**, 57.30 … **San Jose**, 55.36 … **Bridgeport-Stamford, Conn.**, 55.24 … **Boston**, 55.07 … **San Francisco-Oakland**, 55.01 … **Minneapolis-St. Paul**, 52.81 … **Raleigh**, 52.60 … **Seattle**, 52.18 … and **Colorado Springs**, 51.76.

Where does Austin rank? Just a couple of spots lower, at #12. **Albany, NY**, with an index of 51.15 is #11 and **Austin is next, with an index of 50.68**. No other city in the nation has an index in the fifties. And no other Texas city made the Top 25.

Why are college grads and post-grads important economically? The reason is as simple as their paychecks. A worker holding a doctorate will **earn 70% more**, on average, than the holder of a bachelor's degree, and **215% more** than someone who never progressed beyond high school.

Speaking of college grads, **Dr. Louis Overholster** thinks each commencement ceremony should pause for those who have gone to their eternal rest – the ones who got a job with the government!

Sincerely

Neal Spelce

Editor/Publisher