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 30, Number 25

September 19, 2008

Dear Client:

**The battle lines are being drawn over what could be a bitter battle in the November 4th General Election – and it's a *local* issue we're talking about, *not* the presidential race.**

Whether to grant governmental incentives to businesses to create jobs in the Austin area has been controversial for decades now. (In fact, we wrote most recently about this in our 9/5/08 edition. Just click on the "Archives" button at the top of this page for the details). **Governmental entities nationwide have ratcheted up this practice to the point they compete aggressively to entice businesses to locate in their area.**

Those upset with this practice – especially as it relates to retail operations – successfully conducted a drive to secure enough voters' signatures to place an item on the 11/4/08 ballot that, if passed, would **terminate two major city agreements providing financial incentives to projects that include retail uses**.

The key word is "terminate." If Proposition Two passes, it would **end *existing* agreements with The Domain development in North Austin and the Mueller Redevelopment project in East Austin**. The business community, led by the Austin Chamber, is organizing to fight the proposition. It has formed a Political Action Committee called "Keep Austin's Word" to oppose passage of Prop Two.

The PAC points out that Prop Two would not change Austin's policy moving forward, citing the fact that the Austin City Council prohibited future retail incentives in 2007. So the group is arguing that **agreements made honestly and followed faithfully should not be broken without just, clear cause**. And it says the two developments have lived up to all of their obligations over a period of many years.

"This ballot initiative has **far-reaching reverberations** from Wall Street to international to regional about Austin's reputation than proponents would have people believe," said **Mike Rollins**, president/CEO of the Austin Chamber.

**This is an issue that should increase in intensity**. After all, those who favor Prop Two already have names/addresses of voters who originally signed the petition and the presidential election will likely result in a record turnout. Watch for heated campaigning on this issue.

**With the Wall Street turmoil involving financial houses this week, what about the lending environment with banks here in the Austin area?**

Obviously there are ramifications being felt locally. Just ask anyone who works at Merrill Lynch, Lehman Brothers, AIG, etc. But, for purposes of this report, let's focus on **your personal and/or business banking relationship**. What can you expect when you walk in to visit with your friendly banker about a loan? Or what can you expect to happen with your existing loans?

Sure, the Austin economy is not struggling similar to others around the nation. And while local business conditions are not soaring right now, there is a **strong economic underpinning in the Austin area and many companies and businesses are doing quite well**, thank you. So, shouldn't Austin have a better financial institution lending environment than in the more troubled US regions?

You would think so. But this is not necessarily the case. Because of the major problems on Wall Street and in areas such as California, Florida, Arizona, Georgia, Michigan, Ohio, etc., the **regulators of financial institutions are as goosy as they have been since the late 1980s**. And they have implemented stringent requirements – with very little leeway – on financial institutions nationwide including, obviously, the Austin area.

Even though federal regulators who audit financial institutions at least once a year say "we're just going to tell you what we found; we're not going to tell you how to run your bank," bankers better pay heed to what they report. **The examiners are so spooked these days they will nitpick every little thing in a bank – especially in the lending, loan reserves and capital areas**.

A local bank's overall operations may be in reasonably good shape, but **regulators are determined to prevent problems in the Austin area** such as those that have occurred elsewhere.

And this overcautiousness impacts how your banker treats you and your loans. Like what? Regulators will suggest (insist?) that business loans be called if collateral value has deteriorated. **They'll crack down hard on situations that at other times might have been shrugged off as temporary blips**.

The examiners are showing an unwillingness to wait out some potential problems. **They force the issue with banks** – even to the point of causing problems not just for the borrowers but the banks themselves.

If you're looking for a loan, realize — that even though your bank may be sitting pretty – it is likely to raise collateral requirements, and for businesses, it will set performance benchmarks and monitor those closely. In other words, **banks are keeping a tighter rein on borrowers**, even the good borrowers with strong financial statements. It's a new lending world.

**While on the subject of money matters, let's examine what *is* happening, what *may* happen, and what a Texas real estate economist thinks *should* happen to home mortgages.**

What *is* happening, according to the TexasA&M Real Estate Center's Chief Economist **Mark Dotzour** is that **interest rates on mortgages will stay higher than normal**. This, he feels, will be one of the results of the recent government takeover of Fannie Mae and Freddie Mac. "Fannie and Freddie were doing a great job of providing low cost mortgages to a large majority of American families for three decades of the 20th Century," said Dotzour. "Somewhere in recent years, **they lost track of their mission and morphed into the largest mortgage bond speculators on the planet**."

> "They did this," he continued, "by **veering away from their mission of 'packaging mortgages' into the risky waters of keeping mortgages** and hoping they hold their value. That bet has completely failed, and now they become a part of the problem and not part of the solution to the housing market."

What *may* happen? Fannie Mae and Freddie Mac (or "Frannie") may "be re-chartered to their original purpose of serving as a conduit for mortgages. **They shouldn't be in the business of holding mortgages**." What *should* happen? "The government should monitor the spread between Frannie mortgage rates and the ten-year treasury rate. **Mortgage rates should be about 1.6% higher than the current ten-year Treasury**. This means that 30-year mortgages should be about 5.1% today." (They were at 5.93% last week.)

The reason rates have not dropped to this level is two-fold, he says. One: mortgage bond investors are very skeptical about the truthfulness of Frannie's earnings reports. Two: Congress is making noises about **freezing interest rates on troubled mortgages** so that when a rate re-set period rolls around, the interest rates will not rise.

> The Congressional action would be **great for homeowners that bought more house than they could afford** (with a low interest rate initially that could go higher later), but it is **terrible if you are a bond investor**. "Consequently, you won't buy any more of those bonds where there is a threat that the contractual promise in the underlying mortgage could be abrogated," Dotzour observed.
>
> Also, he says the new housing law already in place allows **existing mortgages to be "crammed down" to 90% of the current value of the home**. "This sounds great for homeowners as well. Say you bought a $500,000 house with a $500,000 mortgage. Today, it's worth $400,000." And if the principal amount is lowered to 90% of that, the loan is reduced from $500,000 to $360,000.

"Who will want to buy any more US mortgage securities when the **government is willing to wipe away value of your investments with a stroke of the pen**?" asks Dotzour. As a result, he believes interest rates will stay higher than normal.

**There is no doubt about it**: **using the highway system is going to get more expensive**. **So what are the sources of more money**? **In addition to toll roads**, **or an increased tax on a gallon of gas**, **there is another proposal to charge you a tax based on the distance you drive**. **Say what**?

You can see the logic behind such a proposal. Hey, charge the motorists who place demands on highways by basing the cost on the distance they drive. **There's no reason that someone who uses the roadways a small amount should pay as much as those who are in their vehicles most of the day** – so the reasoning goes. But, how do you make such a system work?

Well, last year, the Oregon Department of Transportation (ODoT) completed testing a program using the **Global Positioning System** (**GPS**) **and wireless technology** to create such a fee. The fee was automatically calculated and collected when drivers filled up at the pump.

Like all states, Oregon charges a *state* fuel tax and adds the *federal* tax to the price of a gallon of gas. ODoT concluded after its study last year that **this high-tech road user fee could replace the state tax on a gallon of gas within 10 years**. As a result, Congress is also checking on the feasibility of such a user fee.

Hoooo, boy! Can't you hear the privacy uproar? **Any device put in a personal vehicle to track the travel of drivers is bound to run into opposition**. And there is another criticism aimed at the Oregon test: a mileage fee in place of a gas tax would reduce the incentive to buy fuel-efficient vehicles.

It is an alternative that is out there and it is being seriously considered. How far it will go is anybody's guess. But make no mistake, **roadways are going to need additional funding – locally**, **in Texas and across the nation**. Raising taxes is always an option (though unpopular). Tolls? You know about the controversy there. Stay tuned. Decisions will be made soon.

**Dr**. **Louis Overholster** said the Wall Street crisis this week ran his phone bill up to $876. "And that was just to Dial-A-Prayer!"

Sincerely

Editor/Publisher