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:

Austin attracted more venture capital investment than Dallas-Ft. Worth, Houston and San Antonio combined in 2006 and 2007. The presence of UTAustin is a major reason for this.

The Austin area benefits tremendously from UTAustin's presence. Obviously, UTAustin is a job generator. It provides well-paying jobs for faculty and support staff as 50,000 students are being educated. And, not incidentally, those students spend a bundle of money on everything such as living quarters, food, entertainment, gasoline, etc. **But its economic impact is much more than that because UTAustin is one of this nation's major research institutions.**

The research component of UTAustin's mission has both a short-term and long-term impact on our economy. It draws talent, federal research dollars and innovation to our area. And it's a big business. "For example, **UT faculty generated more than $511 million in research awards in fiscal year 2007-2008**," points out UTAustin president **Bill Powers**.

And that $511 million has a tremendous multiplier effect as it is circulated through the area economy. "**Every state dollar invested in the University generates more than $18 in spending in the Texas economy. That's an exceptional return on investment**," Powers noted.

So, you would think UTAustin would like to keep this lofty status all to itself, right? Wrong. As we have reported previously, **California has nine national research universities**, New York has eight. Texas has three – UTAustin, TexasA&M and Rice.

"We are a rapidly growing state and these three schools can't perform all the needed research, and they **can't begin to accommodate all our young people who want to attend a national research university**," said Powers.

And there's the rub. "Too many are leaving Texas to realize their dreams," Powers continues. "Some 10,000 high school graduates are leaving Texas each year to attend doctoral degree-granting universities elsewhere, while only about 4,000 students from other states come to Texas to enroll at similar institutions. **That's a potential brain drain of about 6,000 of our best and brightest students**," he said. This is a strong argument for supporting more national research universities in Texas, that will in turn strengthen the Texas economy.

Look for the possibility of fire sales of undeveloped builders lots in the Austin area. This is not simply to cut builder losses in a slowing marketplace, but also for year-end tax advantage.

This trend is already showing up in the national marketplace where the housing crisis is more severe than it is here. But it points to a situation that local builders may find advantageous as we near year-end. And if it happens, **local investors who have staying power could pick up some land at bottom dollar** to hold until the uptick begins. The tax advantage to the builders could make the bitter pill of a fire sale somewhat easier to swallow.

Here's how it is working on the national scene. Let's use Fort Worth-based homebuilder D. R. Horton (who builds new homes in the Austin area) as an example of some of the sell-off deals out there. *The Wall Street Journal* reports that Horton recently **sold about 2,000 house lots in Southern California for $7.8 million**. And Horton reportedly **paid a whopping $110 million** for the land *before* grading and installing some infrastructure.

Want a smaller fire sale example? Horton also recently **sold a 4-acre parcel near San Diego for $4.4 million – about 25% of what it paid** for the property in 2005. The buyers of these properties are investment groups who plan to sit on the land until the housing market comes back.

Those are some big discounts. So, how does the tax angle figure into this for the builders? Tax law allows companies to apply losses from land and other asset sales to past profits and reap a tax refund. Bingo! At a time when revenues are down for builders, with no light at the end of the immediate tunnel, a **builder can unload inventory, and even though the builder will take a hit, it will put some additional cash back in the bank**. The investor who buys the discounted lots obviously gets in on a good deal if the investor has the capacity to hold the land.

The tax law also provides a sense of urgency for the builders. Companies can apply losses only to profits earned as far back as two years. And, if you recall, 2006 was a pretty good year in the housing market in the Austin area. For many builders, 2007 was not quite as good a profit year as 2006. By dumping land in this manner, it allows builders to chase **cash that could allow them to keep current with steely-eyed lenders and to pay overhead expenses**.

Many small builders in the Austin area use project-specific financing. In other words they need a bank's approval before they can start a new development. As you know, banks are more tightfisted than they have been in a long time. Some of them have simply cut off new credit to builders. **This type of fire sale could give the builders a bit of breathing room – possibly staving off bankruptcy for those on the edge**. Again, the **Austin situation is nowhere near as dire as in other places**. But national builders in *this* market are subject to home office corporate pressure. And the small builders are feeling the credit squeeze. All of this makes for potential opportunity for buy-and-hold investors.

So how much money did Texas-based homebuilder D.R. Horton pull down, due to the tax angle on the bargain-basement price dumping of lots?

Again, according to *The Wall Street Journal*, Horton told investors in June that it expects to receive a tax refund of **$519 million over the next two years**. This is serious money. And that's not all. Consider another homebuilder. Lennar pocketed a **$200 million tax refund** after taking a 60% discount on its sale of 11,100 lots to a joint venture that it formed with Morgan Stanley. Any way you cut it, it is a silver lining in a tough situation for many homebuilders.

Speaking of home builders, a new study by J.D. Power and Associates has identified the top home builders in the four major Texas markets.

Its "2008 New Home Builder Customer Satisfaction Survey" ranked the builders in each of the big Texas metros based on overall customer satisfaction, home quality and new home design.

> **And the highest rating across all three categories in the Austin market went to David Weekley Homes.**

Darling Homes and Medallion Homes earned the #1 spots in each category in Dallas-Fort Worth and San Antonio respectively. In Houston, Trendmaker Homes won the "overall customer satisfaction" spot, while Darling ranked highest in home design. If you need more detail, you can go to the J.D.Power and Associates' website.

Investors appear to be holding back on scarfing up foreclosed homes, if Dallas is an example.

You know the mantra: buying a foreclosed home is a quick and easy way to make a buck. Well, if a report from Dallas is any indication, not many investors are moving in to pick up a foreclosed home at a bargain price.

> In fact, *The Dallas Morning News* recently reported that **3rd-party investors have purchased only 5% of Dallas-Fort Worth properties sold at foreclosure auctions** so far this year. They're paying an average of about 60-cents on the dollar to purchase the properties, based on tax values. And *The News* reports, 3rd party buyers paid an average of $103,629 for a foreclosed home.

But the remaining 95% of the homes in the Dallas-Fort Worth area that went on the foreclosure auction block were **taken back by the banks**. No figures were immediately available for the Austin area market. Foreclosure activity in the Central Texas area has not been as intent as in other places.

You are well aware of the serious problems airlines have faced for years now. But what about *airport terminals*?

Passenger traffic has been steadily increasing at Austin-Bergstrom International Airport (ABIA in spite of the fact that **airlines have been cutting routes and, in some cases, pulling out of airports around the country entirely**. It seems to be business as usual at ABIA. But this is certainly not the case when you step off the plane in other airports.

For instance, if you've flown to Pittsburgh lately, you may have noticed that certain parts of the terminal have been sealed off. No, not to keep you away from construction work. Just the opposite. A huge terminal was built for 30 million passengers a year. Traffic peaked at 21 million. **But it is now down dramatically to 8-to-9 million passengers a year**. And this means airport revenues are down.

Another example. **The Ontario airport, near Los Angeles, used to have non-stop flights to 36 cities. Now it has only 17**. JetBlue Airways and ExpressJet Airlines have shut down at Ontario. Dallas-based Southwest Airlines has cut its flights. There are other examples, but you can see what is happening.

Many airport terminals over the past few years have assumed the burden of providing more and more services as airlines have cut back on services. As a result, **costs have risen at many airports and many of them have raised fees they charge airlines**. But it's a catch-22. As airlines continue cutting costs, they look at charges they pay to airports – and many airlines are either bailing-out or cutting-back.

ABIA is so far surviving these pressures, even though some airlines have cut back on flights. But this is a situation worth watching. We'll keep an eye on it for you.

With mergers being announced almost daily due to the declining national economy, **Dr. Louis Overholster** said he will not be surprised to hear that FedEx has merged with its competitor UPS and renamed the combined operation FedUp!

Sincerely

Neal Spelce

Editor/Publisher