THE Neal Spelce AUSTIN LETTER

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Dear Client:

Some intriguing developments are revolving around Austin's nuclear-powered source of electricity. And the end result is uncertain at this stage of the game.

As we reported June 19th 2009 (click on the Archives button at the top of the page and then to go to Volume 31, Number 12), NRG Energy was expected to be one of only four US power companies to split $18.5 billion in federal financing for its nuclear facility. **NRG supplies Austin with its cheapest source of electricity and is planning to double capacity** at its South Texas Nuclear Project (STP) in Matagorda County. Austin earlier refused to invest in the plant's expansion.

Now comes the intrigue. Chicago-based Exelon Corp recently cancelled plans to build its own nuclear power plant just a few miles away from the STP, also in Matagorda County. And Exelon was *not* one of the four companies in line for the federal financing. So, guess what? **Exelon is pursuing a hostile takeover bid for NRG. The bid is estimated to be worth $8 billion in stock.**

NRG is the parent of Reliant Energy in Houston, operator of the STP, in which **Austin holds a 16% participation and is guaranteed access to a portion of the nuclear-generated electricity** from the Matagorda County facility. NRG this week rejected the Exelon bid, saying it "fell short." But this doesn't end the story. It sets up a proxy showdown at NRG's July 21st annual meeting.

Another intriguing aspect: **water flows from Lake Travis**, down the Colorado River, through Matagorda County into the Gulf of Mexico, and **nuclear power plants require massive amounts of fresh water for cooling**. (See the fourth item below where we report water is released downstream for "industrial" and "power generation.")

We don't pretend to know the outcome of all of this intrigue **and how Austin will be impacted by this developing story**. But consider the interconnections. In summary, billions of dollars will be involved if the takeover is successful. Austin's cheapest source of electricity is right in the middle of this. Austin has a 16% interest in the STP. Massive amounts of water are needed for a *nuclear power plant, that may be doubled* and water from Lake Travis flows right through the middle of Matagorda County. **These developments have been flying under the radar so far.** There needs to be a heightened level of awareness about all of this.

Nuke-generated electricity is considered clean energy. **But most discussions of clean energy do *not* include electricity generated by burning coal**. **Yet coal-fired power is a significant part of the electricity used by customers of Austin Energy**. **So how "clean" is this coal-fired power**?

If you drive Hwy 71 between Austin and Houston, you will notice set back from the roadway to the north near La Grange, three towering stacks. They mark the Fayette Power Project (FPP). **These stacks funnel emissions into the air from coal that is burned in the plant to generate electricity**. Austin Energy co-owns Units 1 and 2 with the Lower Colorado River Authority (LCRA), and LCRA owns the plant's third unit.

For years, motorists have been able to see wind-blown clouds emanating from those stacks. However, the clouds are not as visible now as in years past. As a result, **FPP has become the first coal-fired facility in Texas to receive the gold award from the Texas Commission on Environmental Quality's (TCEQ) Clean Texas program**. The gold level is TCEQ's second highest level.

This doesn't mean FPP is operating at lower capacity than in the past. It means FPP has reduced Nitrogen Oxide and Sulfur Dioxide in its emissions. Pollution-control scrubbers are being installed and upgraded at the plant. **The new and upgraded pollution-control equipment will be capable of removing up to 97% of Sulfur Dioxide emissions from the plant's three units combined**.

If that is the goal, where does the plant now stand in terms of polluting the air with its emissions? The plant has a goal of **reducing Sulfur Dioxide emissions more than 80% by 2011 and reducing Nitrogen Oxide emissions by 70% by 2011**. It has already met the goal for Nitrogen Oxide.

Another environmental factor at play here is the conservation of water at the Fayette Power Project. **And part of the FPP goal in connection with the TCEQ Clean Texas standards is to increase water *re*use by 46% by 2011**. This, of course, is especially immediate today as a result of the serious drought conditions that are so pervasive throughout this area. Check out the next few items for more info on the drought's impact.

Much of Central Texas is classified as being in extreme to exceptional drought, **the next-to-worst and worst classifications of drought**.

Some limited areas have improved slightly with spotty, though well-below-normal, rainfall. But much of the effects, especially where water is concerned, are getting worse – exacerbated by a lengthy string of triple-digit temperature days. According to the state climatologist, **drought conditions across Central Texas during 2008 were the most severe since the drought of 1917-1918**. And those conditions are worsening as we speak.

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Without a major, widespread, sustained rain event, it is likely Lake Travis will drop to a low this month not seen since 1985. But, cross your fingers, the dry, hot weather pattern could change sometime late this summer or fall. It has to do with La Niña and El Niño.

The average level of Lake Travis in July is 669.28 feet above mean sea level. This week, Lake Travis dropped through the 642 mark to around 641 feet. **This is 28 feet below the average for July**. If you consider the lake has a "**normal operating level**" of 681 feet (enough remaining capacity to manage a flood), then **Lake Travis is down about 40 feet**. This is quite dramatic.

> Even though the current low level is serious, **Lake Travis has been lower during past droughts**. It bottomed out at 636.58 in October 1985. In November 1963, Travis dropped to 615.02 and the all-time low elevation occurred August 14th 1951 when it was measured at 614.18 feet above mean sea level.

It is **not just evaporation**, due to the triple-digit temps, that is lowering Lake Travis. Nor is it the **rainfall deficit** that impacts the **lack of inflow** from rivers, creeks and streams. The Lower Colorado River Authority (LCRA) is also **releasing water downstream** to meet municipal, industrial, power generation, agricultural irrigation and environmental needs.

LCRA meteorologist **Bob Rose** has examined the changing weather patterns and sees a possible moderation within the next few months. And he says it is due to the **change from a La Niña pattern to an El Niño pattern**.

Without getting technical, the patterns have to do with sea surface temperatures in the Pacific. The Pacific water temps are cool in a La Niña situation, and warm during El Niño. This affects the jet stream aloft. As Rose put it: "**El Niños and La Niñas are often big players in our region's weather**."

> So, in **La Niña**, **there is very little precipitation** over this part of the US, and with an **El Niño pattern**, **more rain and more storms** fall over Texas during the fall and winter. Many climate forecasts indicate the current La Niña pattern will change to a weak-to-moderate El Niño by fall.
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> "The change to El Niño is significant," said Rose. "With El Niño strengthening over the next few months, **the atmosphere should eventually respond**, **bringing more frequent periods of rain and thunderstorms**, beginning sometime in the late summer or fall."

While more rain will be good, "**I also don't expect a clear end to the drought**," cautioned Rose. As for those insufferable high temps, Rose said "summer's temperature will average warmer than normal, but **I don't expect it will be as hot as last summer**. Still, expect several days over 100 degrees." Other rain makers? Rose said hurricane development should be limited, but he also hedged his bet by saying "some big surprises" could be in store.

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Texas is one of the best places in the world to work through the current global recession, according to a major financial institution's chief economist.

In the world? Well, that's what BBVA Compass Chief Economist **Nathaniel Karp** told the media. BBVA Compass is the 4th largest bank in Texas, ranked by deposits. It is based in Birmingham and is a subsidiary of Banco Bilbao Vizcaya Argentaria of Spain. Karp also said that the **3rd quarter of this year could mark growth in the state's economy**.

Another report, this one from Wells Fargo Economics, indicated that the foundation for recovery is also visible in the Austin market. And it pointed out that this **downturn has not been as severe for Austin as was recorded in the dot-com bust**.

The Texas Business Cycle Index, put out by the Federal Reserve Bank of Dallas, seems to reinforce the viewpoint that a bottoming-out is occurring in the Austin market. Analyzing the Index's trend line data for the state as a whole along with Austin, **Beverly Kerr**, the Austin Chamber of Commerce VP of Research, said "**the rate of decline is no longer increasing and the trend line has taken an upward turn, perhaps more decisively for Austin at this point.**"

Meanwhile the population growth trajectory doesn't appear to be impacted all that much by the economic downturn. **The 5-county Austin-Round Rock metro area is still one of the fastest-growing regions in the country**.

In fact, in the USCensus Bureau report just released, **Round Rock is listed as the second-fastest growing big city in the US**. This reflects the 12 months that ended July 1st 2009. It grew by 8% in the 12 months just completed. **Austin was the nation's 9th biggest gainer** of population during the same time frame.

Dr. Louis Overholster has an economic reason why advice is so cheap. As he phrased it: "Because supply always exceeds demand!"

Sincerely

Neal Spelce

Editor/Publisher