THE Neal Spelce AUSTIN LETTER
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Dear Client:

How much do you know about the changing face of downtown Austin? **Even if you go "downtown" every day**, **you may be intrigued by what is going on at street level**.

First of all, "downtown" is normally defined as that space south of MLK Blvd, north of Lady Bird Lake, west of IH35 and east of Lamar Boulevard. **It encompasses the State Capitol and many state office buildings**, **but does not include the expansive UTAustin campus**. And the character of this neighborhood is in a continual state of flux.

Most everyone can comment on the downtown skyline. Opinions abound about the condos, apartments and office towers that have altered the picture of Austin as they puncture the sky. **But what about street level**? How has downtown Austin, where you walk around, changed over the past few years? **What is happening to retail space that relies upon foot traffic**?

Not too long ago, city leaders were complaining about vacant and boarded-up ground floor space. Now? Well, consider these numbers provided by the Downtown Austin Alliance (DAA), as of August 2010: **How many restaurants – both full service and limited service – can be found within the downtown boundaries**? **The current count is 188**. That's a pretty impressive number.

Well, if there are 188 places to grab a bite to eat, how many places can you wet your whistle in the downtown area? **The total for bars and clubs is another big number – 139**. So, there are 327 eatin' and drinkin' places downtown. This is a far cry from not too long ago.

Retail is making a major resurgence. When malls and shopping centers opened in the 'burbs, **downtown retail all but died**. Now with a new vibrance in downtown, there are 127 retail outlets for goods and another 128 for services. **Talk about a comeback – 255 retail outlets are now located in downtown Austin**.

Another big change in recent years is the number of residences in this large downtown area. **DAA counts 212 outlets for residences** (not living units, but outlets) — many of them concentrated in the northeastern quadrant of the downtown boundaries. But some things never change. **Downtown is dominated by offices and state government spaces**, with 75 outlets for government and 379 outlets for general office.

Banks seem to be everywhere. In fact, there are 39 commercial banking outlets just in the downtown Austin area. But in this era of banking upheaval, are you likely to see more banks anytime soon?

As has been widely reported, financial institutions are in a dramatic period of adjustment. **Tight guidelines, mandated by the Feds, have limited much of what banks do these days.** As the old saying goes, "you have to prove you don't need money in order to borrow money." And many banks in this tough economic climate are still trying to deal with problem loans–especially in commercial and residential real estate.

But a lot of community banks in Central Texas and around the state are doing well. And many banking experts say those **stronger institutions or investors should take advantage of these economic conditions to merge and/or acquire other banks**. So, is there any noticeable activity along these lines? Yes.

In fact, Samco Capital Markets (a Financial Institutions Group) is reporting "**the second quarter of 2010 showed a pickup in Texas M&A activity as compared to the past year**, with six deals announced during the quarter. And Samco went on to report that "**the only non-FDIC-assisted transactions in the Southwestern US during the second quarter occurred in Texas**."

The operative words here are *non-FDIC-assisted transactions*. When banks go under, **the FDIC tries to find another financial institution to take over the good assets of the bank and run the institution under the new bank's umbrella**. This is called an *FDIC-assisted transaction.* Some solid banking institutions are growing rapidly during these tough banking times as a result of getting "the good stuff" from a failed bank and letting the FDIC handle "the bad stuff."

So, where is all this headed? Samco predicts that "despite the increased M&A activity during the 2nd quarter of 2010 in Texas, **Texas is on pace for only 20 announced transactions during 2010**. This would represent a significant increase from 2009 but would remain **behind the average of 26 completed transactions** in the state during the period from 2005-2007."

Samco predicts the FDIC will continue to close banks and FDIC-assisted transactions are more appealing to most bank buyers. However, Samco also suggested that as the "supply of failed institutions dwindles and the competition for failed-bank deals increases, **we expect well-capitalized banks to return to the marketplace in an effort to build market share and capitalize on the current pricing environmen**t."

So, where are the hot spots? Which banks will be the likely targets? "There continues to be **demand for small, rural bank charters** as investor groups try to gain entry into the banking industry," Samco reported. It'll be interesting to see how this plays out.

Speaking of bank loan problems, did you know that more than 11% of residential properties in Texas are underwater? No, we're not talking about flooding. "Underwater" in this context means the property is worth less than what is owed on the mortgage.

"Upside down" is another phrase used to describe this phenomenon. How many homes does 11% upside down homes in Texas equate to? The real estate data provider, CoreLogic, said this means there are **3,249,196 properties in Texas that are underwater**. This is a big number.

But let's put that number in perspective. **Nationally, 23% of all residential properties reported negative equity** at the end of the 2nd quarter. The national number is twice as high as Texas's.

But you ain't seen nothin' yet. **More than two-thirds of mortgaged homes in Nevada are underwater**. That's an unbelievable number. **Arizona has half its mortgaged homes underwater**. Unreal. There's more. According to CoreLogic, **46% of the mortgaged homes in Florida are upside down** and **38% of Michigan mortgaged homes owe more than their homes are worth**.

And California? About 33% of residential properties with mortgages in the Golden State were underwater at the end of the 2nd quarter. CoreLogic also forecasts that the end is not yet in sight for this situation nationwide. Stay tuned.

What about home sales in the Austin area? What does the year-to-date look like? And is there a pick-up or a drop-off as summer ends?

If you look at the seven months of 2010, January through July, and compare the results to the same timeframe in 2009, you get a good comparison. Also, remove condos, duplexes, etc. from the equation and zoom in on single-family homes only. Here's what emerges:

The number of homes sold this year through July 2010 in the Austin real estate market is 11,078. **This is 5.12% more than the 10,538 homes sold during the same period in 2009**. Overall, this year's results are better than last year's.

But here's the caveat, and this goes back to what we have reported previously. After the government rebate program was phased out earlier this year, sales dipped significantly. For instance, **in July 2009, there were 2,013 homes sold in the Austin area. It dipped to 1,927 sold in June 2010 and to 1,422 sold in July 2010**. This is a 29.36% drop from July 2009 to July 2010.

Even with the dip in number of homes sold, **prices have moved upward**. In July 2010, the average sold price was $289,765 compared to $248,217 in July 2009. Market value is still good.

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It's easy to complain about City Hall. You hear it all the time. But when Austin city leaders do something right, they should be recognized. We have such a situation that usually flies below the radar.

It's boring stuff, but it is so important – especially during difficult economic times. This is about **bond ratings**. (See, I told you it was usually boring). A bond rating is a measure of a city's ability to repay its debt. There are three major US financial rating agencies in the US. They simply **measure a city's credit worthiness**.

And the reason this is so important is that, just like your personal credit score, **the better your rating the less interest you have to pay when you borrow money**. Austin borrows millions of dollars, so a good rating saves big bucks. The highest attainable bond rating a city can achieve is AAA. And all three rating agencies have assigned a AAA long-term rating to the City of Austin. So, what criteria did the three agencies use for their decision?

Standard and Poor's report cited Austin's strong and diverse economic base, strong financial management and moderate overall debt levels. **Fitch Ratings** noted that one of the key factors for the AAA rating was the city's experienced management team and its sound fiscal and budgetary practices. And **Moody's Investors Services** described Austin's financial policies, expenditure controls and conservative budget assumptions.

Mayor Lee Leffingwell was justifiably proud: "As a result of the tough choices we made during the last two budget cycles, **we find ourselves in a considerably stronger financial position than many other cities**. Our bond rating reflects those efforts." What he didn't say is also true: **the overall economy – among the best in the nation – plays a major role in the city's financial success**. Be that as it may, the AAA ratings are great for City of Austin.

Dr. Louis Overholster holds himself up as an example of getting daily exercise, but what he doesn't tell his patients is that he got lots of exercise the past few years – just getting over the hill!

Sincerely

Editor/Publisher