THE Neal Spelce AUSTIN LETTER

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Dear Client:

Big-time investors are buying up huge chunks of residential property in the Austin area at the same time there are reports that home sales volume is declining? **What's going on here**? **Why are big bucks being bet on the future of the Austin housing market**?

After their due diligence, what are these investors seeing that is causing them to go "all in" in the Austin metro? These are long-term players with deep pockets. In the main, they are not relying on borrowed money. **They are investing their own cash**. **And they expect a solid return on their investment**. So, what gives?

Look at some of what has happened in recent weeks. A **1,000-acre subdivision** in Western Travis County – Sweetwater, with infrastructure already in place — was bought out of foreclosure. In Eastern Travis County, Texas Industries just announced plans for **Rio de Vida**, **a 2,133-acre mixed-use residential community**. Previously, a **1,000-home planned subdivision** near Dripping Springs – Headwaters at Barton Creek – was acquired. You get the drift.

First of all, **they are seeing what you know to be true** – the Austin area is leading the nation by most economic indicators. And practically all prognosticators predict the Austin area (as well as the State of Texas) will be on the leading edge of the recovery from the recession.

This is all well and good, but **why *housing* – when many claim housing was a primary factor that caused the nation's downward spiral**? One reason is that an uptick in home sales follows naturally an increase in job opportunities. And Austin, right now, is among the nation's leaders in job growth.

But there is more to it than that. And it comes down to **housing supply and demand**. The *supply* side of that equation could be woefully lacking in the very near future. And *demand* is expected to increase as jobs are created.

One Austin real estate market tracker has been predicting for some time now that **there will be little or no supply of lots on which to build within the next year or so**. We'll break that down for you in the next item. But it's possible these huge land-for-housing investors have run the same numbers and will be in a race to bring housing product to the Austin area market.

How could Austin be running out of lots for houses to be built on if there are almost 25,000 developed and another 7,700 in the pipeline? **Let's do the math**.

Numbers can be deceiving. Without throwing so many numbers at you that your eyes glaze over, let's simply summarize first why the 25,000 lots is deceptive. **Mark Sprague** with Mission Mortgage helped with this summary.

He says that by the time you **remove the optioned lots** by production builders … **the "dormant" lots** (those in developments with no starts in the last 12 months, indicating developments that do not have high consumer demand) … the 7,000 lots that are loosely classified as **cull lots**, **in areas that are hard to build on** or those in questionable absorption areas, etc., then **further factor the 6,500 lots expected to be absorbed next year**… **there will be only 736 developed lots left at the end of 2011**.

Well, what about the 7,700 lots in the pipeline? Sprague says **if all those lots in the pipeline are finished**, **it only takes the demand through 2012**. And this is conservative, because it assumes there will be no uptick in the home buying pace in 2012, which he says is possible, but not likely.

And he further points out that with current job growth, apartment occupancy, etc. there is a strong possibility of going through these lots and leaving none in the pipeline.

Sprague also notes **it generally takes plus-or-minus 2.5 years to bring a parcel of land to full entitlement where you are able to start actual development and construction**. Add all of this together and you can see why he is suggesting there could be a shortage of supply in the not-too-distant future.

Enter the big bucks investors. They have run their own sets of numbers and projections before making their recent huge investments in the future of the housing market in the Austin area. And they are not necessarily looking for a quick return. **Projects such as Sweetwater**, **Headwaters and Rio de Vida are normally planned to build out over many years**.

But a word of caution needs to be interjected. Not too many years ago, there were similar reports of a lack of *office* market space. In hindsight, some have speculated that developers were reading the same reports and began racing to erect office buildings to meet the predicted demand. As a result, numerous office buildings were built in a short period of time **creating an oversupply**.

Right now, however, it will be interesting to see if the **confidence in the Austin housing market is well placed –** and if future growth projections are somewhat accurate.

Apartment occupancy is a good measurement of potential housing demand. **More apartment dwellers lead to more "move-up" first home buyers**. **What's happening to apartment occupancy**?

"Thus far, 2010 has been a turn-around year for the Austin apartment market," reports **Robin Davis**, who has been tracking Austin area apartment trends for years. "**On the heels of two previous quarters that saw positive gains**, **the third quarter solidified those gains by posting increases not seen in the market for years**."

"Occupancy rates were up almost 3% from the previous quarter, while rental rates were up 4%," she noted. "Absorption figures have also improved, with **close to 4,000 more units occupied during this quarter than last**."

She added that year-to-date figures show that **the Austin area has absorbed more than 8,000 units – a figure unseen since 1985**. Right now, the average occupancy is 94%. In other words, apartment units are filling up with renters. This is providing an ever-increasing pool of potential "first-home" buyers.

A clearer vision of the housing market will emerge in coming months, **according to longtime Texas economist**, **Ray Perryman**.

Perryman focuses on what we have previously reported. He says "**the remainder of 2010 may look bleak in comparison to *artificially inflated* housing sales during the first part of the year**." You'll recall this was the period that the Feds gave tax credits to new home buyers, and later widened the criteria to include additional homebuyers.

His observations were echoed by **John Horton**, the chair of the Austin Board of Realtors, who was quoted as saying: "**It has been a unique year in evaluating trends in the real estate market** due to the impact of the expired homebuyer tax credits. Monthly comparisons are still being skewed by the artificial stimulus the tax credits provided."

Perryman points out October and November are traditionally slower months of the year in real estate, and he says that "**the ability of the market to remain even modestly strong during this period may portend a significant recovery in 2011**." This is why he says "a clearer vision" will soon emerge.

Perryman cites an important factor that will contribute to possible future dynamism in the housing market — affordability. He notes that "the Texas Real Estate Center studies illustrate that **housing in Texas historically has been and continues to be more affordable than those in the rest of the nation**." He said that such affordability is particularly important as the nation moves forward out of a time of significant job uncertainty and credit restraint.

A new economic index has been created for Texas by a major Texas banking group. **And its first report indicates the state will continue to outperform the national economy**.

It's called the Comerica Texas Economic Index and it will be updated monthly. **Dana Johnson**, the Chief Economist at Comerica said "**Looking ahead**, **I expect the Texas economy will outperform the nation as it has done for the past five years**."

Johnson added that the Texas economy will accelerate "faster than the national economy over the balance of 2010 and into 2011." He continued by pointing out "if that pattern emerges, our Texas Economic Activity Index should make an **upside breakout in upcoming months**."

Comerica's Johnson is especially proud of this new Index, especially since it comes out monthly and, as a result, "**fills in the long gaps between the annual releases of data for the state**." The Index equally weights nine seasonally-adjusted indicators of real state economic activity. The indicators reflect activity in the **energy**, **manufacturing**, **travel and trade sectors**, **as well as job growth and consumer outlays**.

Comerica said to **adjust for monthly volatility and to better highlight the underlying trends in the Texas economy**, the Index will be expressed as a three-month moving average.

We'll keep an eye on it for you to see how it all shakes out. But if you are interested in diving deeper into the economic weeds, Comerica is making it available free online. In fact, if you want to receive the Index directly to your inbox, you may subscribe by going to www.comerica.com/econsubscribe.

As has become our custom, we are making this edition available prior to the Thanksgiving holiday period. It doesn't matter what decisions you may make over the holidays because, as **Dr**. **Louis Overholster** points out, even *bad* decisions make *good* stories.

Sincerely

Neal Spelce

Editor/Publisher