THE Neal Spelce AUSTIN LETTER

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Dear Client:

Evidence is piling up that the Austin area residential real estate market has hit bottom and is on the rise. **What will be the pace of this recovery**?

First of all, the rental market for multi-family units and single-family homes is doing very well. **The occupancy citywide is moving above 95%**. **Rental rates are rising by about 11%** and are anticipated to reach a citywide average of about a buck a square foot.

Will this continue in the near term? Likely. **More than 9,000 rental units were absorbed in 2010 and only about 1,800 units are to be built in 2011**. (These numbers are supplied by **Mark Sprague**, Mission Mortgage's Director of Business Development.) So rental rates are likely to continue to rise – especially as jobs are created and the population continues to increase.

The housing market differs from the rental market – if for no other reason than mortgages are the 900-pound gorilla affecting most transactions. And mortgage loans are hard to come by. But look at what is happening, adding weight to the conclusion that **the bottom is in Austin's rear-view mirror**.

Real estate economists like to compare the *pace* of sales with the number of homes *listed for sale*. They refer to this as "months of inventory." If the "inventory" calculates at **5-to-6 months**, **the economists say the market is balanced between supply and demand**. They call it being in equilibrium.

In July 2010, the inventory stood at 7.4 months. Today, the MLS inventory is at 5.6 months metro-wide. And Sprague says **this rebound has occurred twice as fast as the previous two recessions**.

If this trend continues at this pace, it could mean that within the next couple of months, **Austin's inventory could drop to less than 5 months**. If this occurs, it is a move toward *a seller's market*. Quite a change. We'll keep an eye on it for you.

And this raises another question about *averages*. Obviously there are more desirable neighborhoods (great schools, location, etc.). So does this mean that the **prime areas could already be at 3-4 months inventory** and less desirable areas at 6-7 months inventory?

What about Austin area residential real estate as an investment? **Is now the time to buy that duplex**, **fourplex or rent house**?

A lot of folks have done well in the past by buying properties, renting them out while they appreciate in value, then sell. And do it over and over again. As one investor said, **you make money on real estate when you *buy* it –** meaning if you buy it "right" you will realize a greater return on the back-end. So is this the time to buy Austin investment real estate "right"?

Robert Grunnah, Castle Hill Investments, says "we've never advised our investment buyer clients to try to time the market. In real estate, as in the stock market, it's never easy for the amateur investor to know the best time to get in or get out. However," he adds, "there are several **objective indicators that would suggest there is not much time left to pick up the best deals of this real estate cycle**." So, Robert, what are some of those indicators?

Prices have not yet surged. They are at or near prices from 2007, Grunnah notes. "We are **closer today to a cycle of appreciation** than we've been since 2007."

Cash flow is better today than it has been in years. Increasing rent values help the investor. Grunnah says "the leading apartment developer in Austin (AMLI) has **projected rental growth of 8.5% this year** as well as two solid years of continued growth." For his current investor clients, Grunnah says "**they have zero vacancy and have been able to recently raise their rents**."

Lending is freeing up. Grunnah said "there is still a 20% down-payment requirement for non-owner occupied duplexes and fourplexes, but the loosening overall qualifying criteria has made it easier for investors to get loans." He added "**if there was ever a lender willing to go down to 10% or 15% down-payments**, **I believe we'd see an all-out frenzy in the Austin market**."

The last of the bank-owned deals, **short sales**, **etc**. **are being bought up**. He said many bank-owned deals are being snapped up the same day they are listed. "As 2011 proceeds, this slack will continue to be erased and **the best of the best deals will be gone**," he predicted.

To reinforce the fact that the pace of activity in rental investment properties is picking up, he provided the following summary of **duplexes and fourplexes sold or pending contract**: in 2007, **the number was 207** … in 2008, **it was 73** … in 2009, **it dipped even further to 60** … in 2010, **it went back up to 76** … then, **it skyrocketed from January 1st 2011 through Valentine's Day**, **February 14th**, **to 132**.

What is Grunnah doing now? **Looking for duplex and fourplex owners who've been waiting to sell**. He is especially seeking duplexes under $200k in South Austin and duplexes in the technology corridor and northwest Austin. This part of Austin real estate is humming along.

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Another important element in Austin's economic recovery is the office market. What are the prospects for improvement in this vital sector for the remainder of 2011?

"**All signs point to a very active market in 2011**." This is the view of Austin Office Space (AOS), a local commercial real estate firm specializing in *tenant* representation and brokerage services in the Austin area. "Most professionals in our industry were extremely busy in Q4 and **the surge in activity is continuing into the first of the year**."

What kind of activity is this? "The majority of transactions in our office were organic growth with **local companies taking additional space to accommodate rapid hiring** (primarily high tech)," AOS continued. Obviously this sort of growth speaks to the health of certain local companies.

Have we hit bottom in office space demand? "Although many 'problem' buildings in the far North and Northwest suburbs still sit vacant, **it's very tempting to say that we have hit bottom and are now feeling the effects of pent-up demand**," AOS observed. "For the first time in 18-24 months, we're actually running into competition for prime spaces on the market."

AOS reports it is **tracking no less than seven medium to large transactions currently searching the market for office space**. "Our firm alone stands to announce three 20,000-50,000 square foot office transactions in the first quarter," AOS added.

As a result of this activity, AOS expects a gradual increase in office space leases over the course of the year and a "slight increase in rental costs as **landlords start to pull back on free rent and other leasing concessions that have become standard practice during the recession**."

If you or your company is currently leasing office space, what should you be considering? AOS suggests that "**if your lease expires in 12-24 months**, **it's worth crunching the numbers** on a blend and extend due to the potential for increasing rates."

"**If your lease is coming up within 12 months**, **you should be meeting with your broker NOW** to come up with a plan of action specific to your current situation and future needs," AOS urges.

We know of one company this past year whose landlord refused to negotiate a better lease renewal upon the lease's expiration. So the company started looking around. It ended up with a **multi-year lease on 45,000 square feet that saves them about a million dollars over the term of the lease**, compared to what they had been paying.

However, while good lease terms are still possible in certain areas, conditions appear to be slowly changing as the **vacancy rate has dropped significantly to about 14.2%**.

Two different rail projects in California are struggling in different ways. **And the result is the same – they are awash in problems**.

A completed streetcar project had a 2010 budget of nearly $2.5 million for running the streetcars. **But the Seattle South Lake Union streetcar is nowhere near paying for itself**. In fact, it only generated $760,000 in revenue. Its route begins in downtown Seattle. Mayor **Lee Leffingwell** is proposing a streetcar system for Austin.

California's bullet train planners have not been successful in getting public funding for the $43 billion project. So now the California High-Speed Rail Authority is reaching out to private enterprise. **It is advertising for businesses of any size to propose participation in the project**. The bullet train is supposed to zip riders between San Francisco and southern California in less than three hours.

Closer to home, **a unique nationwide ranking for cities has just been issued**. **Which Texas city do you think was named the 12th Most Romantic City in the Nation**?

Nope, it wasn't Austin. Though **Austin was listed as the 2nd Best Place for Dating in the US** (Miami topped that list). **Vavoom.com** used data such as available singles, fun things to do and affordability. But, hey, this doesn't mean Austin is a "romantic" city.

Amazon.com puts out an annual list of the **Top 20 Most Romantic Cities in America** and Austin didn't even make the Top 20. But one Texas city did. And it was – tah-dahhhh! – **Round Rock**, coming in at #12. (This is not a typo!). Amazon said the list was based on its sales data of romance novels and relationship books; romantic comedy movies, digital movies and DVDs; Barry White albums, CDs and MP3s; **and sexual wellness products** since January 1st on a per capita basis in cities with more than 100,000 residents. Hmmmmm.

Dr. Louis Overholster says when you think about going back to your youth, think of Algebra!

Sincerely

Neal Spelce

Editor/Publisher