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Dear Client:

In Texas, fracking for oil and gas is a godsend for local and state governments – replenishing tax coffers and breathing new life into sputtering economies. Private enterprise is also benefitting from the oil and gas boom. The Austin area benefits from greater tax revenue to fund state government operations in Austin. But, opposition to fracking is growing nationwide. What are the pros and cons of fracking?

Hydraulic fracturing – or fracking, as it is commonly called – is a relatively new process for **extracting large deposits of natural gas and oil from shale rock** located deeply underground. Fracking uses pressurized fluids to force gas and oil from the shale formations. In addition to increasing the supply of oil and gas, fracking has the added advantage of being a relatively inexpensive process.

As a result, this low cost of recovering oil and natural gas has an impact on prices. **Prices for natural gas are down 75% since 2008.** *The Kiplinger Washington Editors* reports current US pricing is about \$3 per million British Thermal Units (btu), while the majority of industrialized nations pay \$10 or more per million btu.

But environmentalists are increasing their opposition to fracking. Their concerns are generally three-fold: 1) they cite the **potential for groundwater contamination**, 2) since fracking uses millions of gallons of water, they worry about **strained local water supplies**, and 3) they charge there is a **heightened risk of earthquakes** from the fracking process.

In fact, within the past week, three unusual earthquakes — 3.4, 3.1 and 2.1 in magnitude – shook an area just west of Dallas. No damage or injuries were reported but the Dallas area has not recorded a magnitude-3 quake since a series of small quakes occurred on Halloween 2008. And the current quake area is located over a geologic formation known as the Barnett Shale. A UTAustin senior research scientist, **Cliff Frohlich**, was quoted as saying he can't prove the fracking process contributed to the quakes, but he said "it's a plausible explanation."

A positive flip side of fracking is that **greenhouse gas emissions are at a 20-year low as utilities switch from coal to cleaner burning gas**, according to the folks at *Kiplinger*. Check out the next item for an analysis of the future for fracking as it affects the Austin area and the state of Texas.

Will the increasingly vocal opposition to fracking nationwide lead to a cutback or slowdown in the process? It has already has put the brakes on fracking in such states as New York and in other countries such as France. But in Texas? Not likely.

The battle against fracking is occurring on many fronts. Interestingly, it's not happening at the federal level at this point. But in the US, cities and states are embroiled in some serious court fights. For instance, in Pennsylvania and Colorado, **cities are challenging the jurisdiction of the state – arguing that if cities want to ban fracking, they can do so.** According to *The Kiplinger Washington Editors*, **dozens of local fracking bans are springing up around the nation.** And oil and gas production growth is lagging in those areas.

Some communities in the Dallas and Fort Worth areas are **making noises about banning the hydraulic fracturing process or adopting stringent controls.** The verdict is out on how widespread such actions will be in that highly-populated area of the Lone Star State.

But, consider South Texas. Draw a line from San Antonio across to Houston. Much of the land south of this line is home to the **Eagle Ford shale play.** This land is hardscrabble brush country, replete with cactus, sticker burrs and rattlesnakes. Along with parts of West Texas, this is one of the least-populated parts of the state. **For the most part, cities and towns in South Texas have long struggled just to exist.**

Now those landowners, cities and towns are seeing riches they could only dream about. The schools are getting unheard-of (for them) revenue. Businesses, even the **mom-and-pop shops**, are thriving as never before. **Communities** have revenue to improve roads and city services. **Jobs** are being created by the hundreds around cities that only have a few thousand residents. **Banks** are overflowing with deposits from residents who are raking in oil and gas royalty income. You get the picture.

Do you think those South Texas local governmental jurisdictions in the Eagle Ford shale play are going to clamp down on fracking? Not on your life. The oil and gas companies are bending over backwards to work with landowners and communities to protect their “golden egg.” So if the objections to fracking that are mentioned in the previous item are pursued in the Eagle Ford shale area, it is not likely that fracking production will be slowed or halted.

With that in mind, and assuming the Texas Legislature will remain under Republican control, **legislators convening in Austin in January are not likely to do anything to curtail or slow the tax revenue from this oil and gas boom.** If nothing else, the increasing revenue helps the GOP majority keep its “no new taxes” pledge as state agencies and institutions plead for more money in the next biennial budget. And as you know, most legislative appropriations are spent in the Austin area, boosting the local economy. This should continue in the foreseeable future.

Another positive economic sign: new homes are going up at an increasingly faster pace in the Austin area. In fact, it's been more than four years since the number of new home starts equaled what occurred during the 3rd quarter.

As regular newsletter readers know, the market dynamics are such that **this is *not* likely to result in an overbuilt situation, even though builders started construction on 2,376 new homes during the 3rd quarter** — a 37% increase over the same quarter last year.

One reason this fast pace of building is not likely to result in a large amount of unsold homes is **demand continues strong. It's a seller's market.** This is being triggered by a steady increase in the population of the Austin area, many of the new residents attracted by one of the best job-creation markets in the US.

Also of note: **in many cases, lenders are financing the construction of these homes.** Money has been tight for years and financial institutions have instituted more stringent lending requirements. **Yet, the overall economic picture in the Austin area and the current success in home sales have caused an increase in construction financing.** Of course, builders are pleased. Especially with interest rates lower than they have been in years.

One reason for so many people moving to Austin – in addition to the availability of jobs – is that Austin is one of the best cities in America based on a number of other qualities. In fact, a current ranking of America's Best Cities placed Austin as #8 using a variety of criteria.

Bloomberg BusinessWeek examined the nation's 50 largest cities to come up with its list of "America's 50 Best Cities." Economic factors were only one category in a list of many varied qualities against which each city was measured. What qualities other than economic were considered? **Sports teams and park acreage, educational facilities, crime, air quality, number of restaurants, museums and libraries** were on the magazine's checklist.

Here's some of what was said about Austin. "The capital of the Lone Star State, **Austin is our largest city without a major professional sports team**, but don't feel sorry – its main college attraction, the UT Longhorns football team, can draw more than 100,000 spectators to games."

It also cited Austin as a "**major destination for top tech talent.**" And it listed the "annual tech and music festival, **South by Southwest**," and singled out the "annual outdoor **Austin City Limits music festival**, which lures acts from around the globe each fall."

Other Texas cities to make the list: **Houston (#22), San Antonio (#30) and Dallas (#40).** Number one on the list was San Francisco.

In addition to checking out the local and presidential elections next month, you may want to keep an eye on the state that is sending jobs and new residents to the Austin area. Californians will vote on issues that, if passed, will impact their economic competitiveness.

California's economic distress has been well-chronicled. In fact, a Manhattan Institute report notes that **"taxes, regulations, the high price of housing and commercial real estate, costly electricity, union power and high labor costs ... are prompting business to locate outside California."** And it further notes that, even though California used to be a destination state, it has "outsourced 3.4 million residents in the past 22 years."

So, what is going to be on the California ballot in 30 days? "If voters approve Proposition 30, **California's income tax rates will be the highest in the nation** – 21% above the 2nd highest state of Hawaii and 34% above the 3rd highest state of Oregon," writes California journalist **Steven Greenhut**.

While the huge tax increase item has a solid lead in late polls, another proposition that would chip away at union power is failing. Greenhut further said "the most troubling thing I've seen is the **delusion ... that California is only one massive tax increase away from being fixed.**"

Greenhut went on to opine that "the state's problems don't bother me nearly as much as knowing that **voters and officials here are in denial about the problem and have no clue how to fix it.**"

And it's more than just taxes. Check the list in paragraph two above. Political cartoonist **Steve Breen** may have put it best with his cartoon whose caption read: **"If you're a Californian and want to start a small business, there are a number of different routes you could take."** It then shows the various Interstate Highways that lead to other states!

Dr. Louis Overholster has a suggestion if you run into a certain breed of California transplant in Austin: "Be nice to the nerds, for all you know they might be the next Bill Gates!"

Sincerely



Editor/Publisher