THE AUSTONIAN

NO TIME LIKE THE PRESENT:

An Analysis of Issues Surrounding the Current Status of Downtown Housing in Austin, Texas

Commissioned by

THE AUSTONIAN

Prepared by

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INTRODUCTION

Headlines throughout the world today are replete with gloomy or alarming stories about the health of the US economy and, in particular, the domestic housing market. It is clear that the nation is in the midst of a notable economic slowdown, though the magnitude of the adjustment is unlikely to be as severe as it is frequently portrayed.

It is also beyond dispute that the widely chronicled subprime mortgage situation and related phenomena are having a profound effect on the housing sector. What often goes unsaid, however, is that **while there are vestiges of this situation everywhere, the major weakness is concentrated in selected markets (particularly on the east and west coasts).** Many factors driving housing market performance are inevitably and inherently local, and many neighborhoods and communities are seeing ongoing relative strength and price appreciation.

In the midst of such confusing signals, it can be difficult to separate the national narrative from the realities of an individual area. The Perryman Group was asked to examine the critical factors affecting the climate for investing in residential housing in the downtown segment of Austin, Texas. This report presents the findings from this analysis.

HIGHLIGHTS OF STUDY FINDINGS

The analysis by The Perryman Group reveals the following:

- While a major national mortgage crisis and housing correction is in progress, **residential real estate is ultimately a local market, and patterns vary widely across the country.**

- Texas has one of the strongest and most diverse economies in the US, and **Austin is a perennial leader in business activity.**

- Austin continues to experience substantial increases in employment, output, income, and other measures that consistently rank it **among the leading centers of growth and expansion.**

• **The Austin real estate market has remained strong in the face of the national situation, with price appreciation expected to continue.**

• **Downtown living is becoming increasingly popular** in Austin and elsewhere.

• **Energy prices are stimulating the demand for centrally located residences.**

• The **foreign investment climate is conducive** to purchasing downtown properties in areas with momentum.

• **The interest rate environment is highly attractive.**

• Only a small fraction of the current local workforce and population will more than absorb all existing and planned downtown housing units.

• **The accelerating returns associated with high-quality real estate investments that are consistently observed in the expansion phase of a national cycle is likely to be experienced in this market segment.**

Thus, despite national headlines, the reality of the downtown Austin housing market is one of optimism and opportunity.

THE PERRYMAN GROUP'S PERSPECTIVE

The Perryman Group is an economic research and analysis firm located in Waco, Texas. TPG has maintained an extensive set of economic models for more than two decades, including econometric, impact assessment, demographic, occupational, and real estate absorption models developed to specifically reflect the underlying structure of the Austin-area economy. TPG has a long history of analyzing the Austin area economies. In fact, TPG has maintained an Austin-area economic model which has been used to develop subscription forecasts and present an annual economic outlook conference for the past twenty-five years. Throughout this period, projections have been prepared for the local housing market.

TPG has extensive experience in real estate analysis including numerous major developments in a variety of contexts. Among many others, TPG has evaluated significant projects including the area around Fort Worth Alliance Airport, Solana, and Vista Ridge as well as a number of sports and entertainment venues such as the American Airlines Center, the Alamodome, Fiesta Texas, the Austin Convention Center, Six Flags Over Texas, and Lone Star Park. In addition, TPG has completed numerous studies related to critical initiatives in the Austin area, including major new and expanded facilities, educational programs, technology initiatives, real estate developments of all types (including residential), recreation and convention venues, growth policies, corporate locations, and research endeavors. The firm has also conducted extensive investigations into real estate cycles and pricing patterns and is an advisor to numerous development companies, including several who are active in the Austin residential market.

THE NATIONAL ENVIRONMENT AND THE SUBPRIME MORTGAGE CRISIS

BACKGROUND

The national housing picture began to show some initial signs of weakness several years ago, although the pattern was somewhat camouflaged by escalating prices, relatively easy credit conditions, and substantial (and excessive) levels of development in many high profile areas. Nationwide, home sales have been steadily declining and have reached multi-year lows. The immediate outlook for US housing, which is experiencing its worst slump in 16 years, is rather weak.

Last year, the situation came into sharp relief. Creative mortgages with low rates in the early years and limited documentation began to suffer delinquencies, defaults, and foreclosures as rates were readjusted upward to levels beyond the capacity of many borrowers. These so-called "subprime" loan products were developed and rapidly expanded (with the assistance of the Federal Reserve and many political leaders) to facilitate home ownership on a broad scale in the aftermath of the Fair Credit Reporting Act (which, in and of itself, created a substantial and desirable stimulus). Their use accelerated markedly as a mechanism to provide high yields to investors in newly minted mortgage-backed securities which served as a hedge against stock market risk during the corporate accounting scandals. **The use of subprime loan instruments became far too widespread and ultimately unsustainable.** At their peak, subprime mortgages accounted for only 14% of aggregate home loans, but about 40% of new originations.

As these loans began to experience difficulties, **the magnitude of the situation initially did not appear large enough to disrupt global financial markets on a broad scale.** Approximately one-third of subprime mortgages, representing less than 5% of total mortgages, were experiencing significant problems, and the general credit quality of housing loans was good. **Unfortunately, however, the reaction among investors** (particularly foreign interests that were heavily involved in mortgage-backed instruments, inexperienced in US real estate patterns, and highly vulnerable to media reports) **was disproportionate** and quickly brought dramatic reductions in funds available for mortgages and single-family development.

Given the integrated nature of the modern economy, **this pattern quickly spread to other types of securities and sectors, thus contributing to an overall credit crisis and economic slowdown.** As the fallout continued, the resulting slowdown in the housing industry accounted for a significant portion of job cuts nationwide in construction and for approximately eight out of every 10 losses in the financial sector. Recently, banking giants have been writing off billions of dollars in the value of mortgage-backed securities in an attempt to stem heavy trading losses in equity markets while setting aside funds to protect from losses in the future. The action was caused in part by the loss of faith in mortgage-backed bonds as a result of the dip in the demand for high-yield loans. Regulatory and underwriting responses, while well-intentioned and necessary to a degree, have actually made the situation more problematic for marginal borrowers.

However, **it appears that the worst could be over for banks and other financial institutions (in terms of defining the problem), and cleanup has begun in earnest.** In fact, many major lenders appear to be accruing reserves in excess of the likely losses. Defaults, which are only about half of what they were in the 1980s, seem to be stabilizing. Moreover, interest rates are remarkably low as compared to the double-digit figures some 20 years previous. In fact, the **initial indications are that housing will see the beginnings of a recovery during the latter half of 2008, with general and accelerating recovery anticipated over the next two to three years.**

SIGNS OF LIFE, PARTICULARLY IN TEXAS

Real estate has historically proven to be a good long-term investment. Over the past 30 years, the median price of homes has increased an average of about 6% each year. According to historical data from the National Association of Realtors® (NAR), home values almost double every 10 years, with performance in high-growth markets being even more impressive. **Although the national landscape is currently weak, real estate is, by its very nature, a localized investment.** Although there is obviously substantial uncertainty at present, most recent forecasts call for relatively steady base prices in 2008 and modest increases in 2009.[1]

Even with 2007's challenges, residential real estate is showing some signs of life. In particular, several market reports in recent months have noted the more favorable conditions in Texas.

- The First American-Corelogic Index, the most comprehensive national index measuring home price movements, indicates that **prices are flat or positive in 31 of the 50 states**, meaning not all areas are seeing sizable declines. Some of the hardest-hit states are those

1 "See, for example," NAR Campaign Relates Real Facts About Real Estate," realtor.org. January 14, 2008.

that experienced major price run-ups over the past several years including California, Florida, Arizona, Nevada, and Rhode Island. However, 60% of states are experiencing positive performance including Texas, Utah, New Mexico, the Carolinas, and Montana.[2]

• The PMI Group's US Market Risk Index scores the likelihood of declines in home prices for the 381 metropolitan statistical areas (MSAs) across the country. It rates **Texas MSAs among the lowest risk and most stable** during the third quarter of 2008 compared to the 50 largest MSAs across the country.[3]

• Irving-based RealtyTrac Inc., reports that **Texas foreclosure filings were down** 4.6% in 2007 compared to 2006. It further estimates that the bulk of the worst-performing loans should be exhausted by the end of June.[4]

• According to Texas Real Estate Business, **investors throughout Texas will be able to find financing** in 2008 thanks to strong employment and continued expansion of the energy industry.

• The Office of Federal Housing Enterprise Oversight (OFHEO) House Price Index (HPI) showed a decline of 1.3% in home prices from third quarter to fourth quarter of 2007. This is only the second quarterly decline seen in 13 years. The annual price change was a drop of 0.3%. On the other hand, **Texas exhibited an annual price gain of 5.2% while Austin showed an increase of almost 8.0%.**

THE AUSTIN MARKET AREA

Austin has been one of the leading economic performers in the nation for years. The metro area's unique combination of (1) a very stable base (from government, higher education, and health care); (2) growth from high-tech manufacturing, research, and related operations; and (3) an outstanding workforce and quality-of-life characteristics has yielded strong expansion for many years. In addition, Austin benefits from the overall health of the Texas business climate.

TEXAS IS AMONG NATION'S GROWTH LEADERS

The state's business climate continues to garner major recognition. Texas was named **2007 State of the Year** by Business Facilities magazine in its first annual ranking of the most economically significant relocation and expansion projects of the year (December 2007). It was

2 "Real Estate Outlook: Good News!" Realty Times, realtytimes.com, January 31, 2008.
3 "What is a Normal Housing Market?," The PMI Group, Inc., Economic Real Estate Trends, Winter 2008, p. 3.
4 "Texas Foreclosure Rate Bucks Skyrocketing US Trend," Houston Chronical, chron.com, Jan. 29, 2008.

also chosen as the best place to be by corporate site seekers across the country in the Executive Survey Business Climate Rankings 2007 (Site Selection, November 2007).

In addition, Texas had the highest number of **FORTUNE 100 Fastest-Growing Companies in 2007**, is home to eight companies in the top 25, and 32 companies on the list overall (FORTUNE, September 2007). **Forbes 2007 Best States for Business** placed Texas in the top five (Forbes, July 2007). Texas can also boast being the nation's leading exporting state for the past five years, an important distinction in an increasingly global economy.

The December issue of Expansion Management recognized the hard work of the Texas Legislature by listing Texas number one overall in its **2007 Legislative Quotient**. The Legislative Quotient ranks states according to the impact the state legislatures have on local business climates. Six different areas are measured, of which Texas placed either first or second on four of them.

The Tax Foundation placed Texas among the ten best states overall in its **2008 State Business Tax Climate Index**. Research indicates that keeping taxes low is vital when it comes to job creation and retention as well as location, although adequate public services and infrastructure are also important.

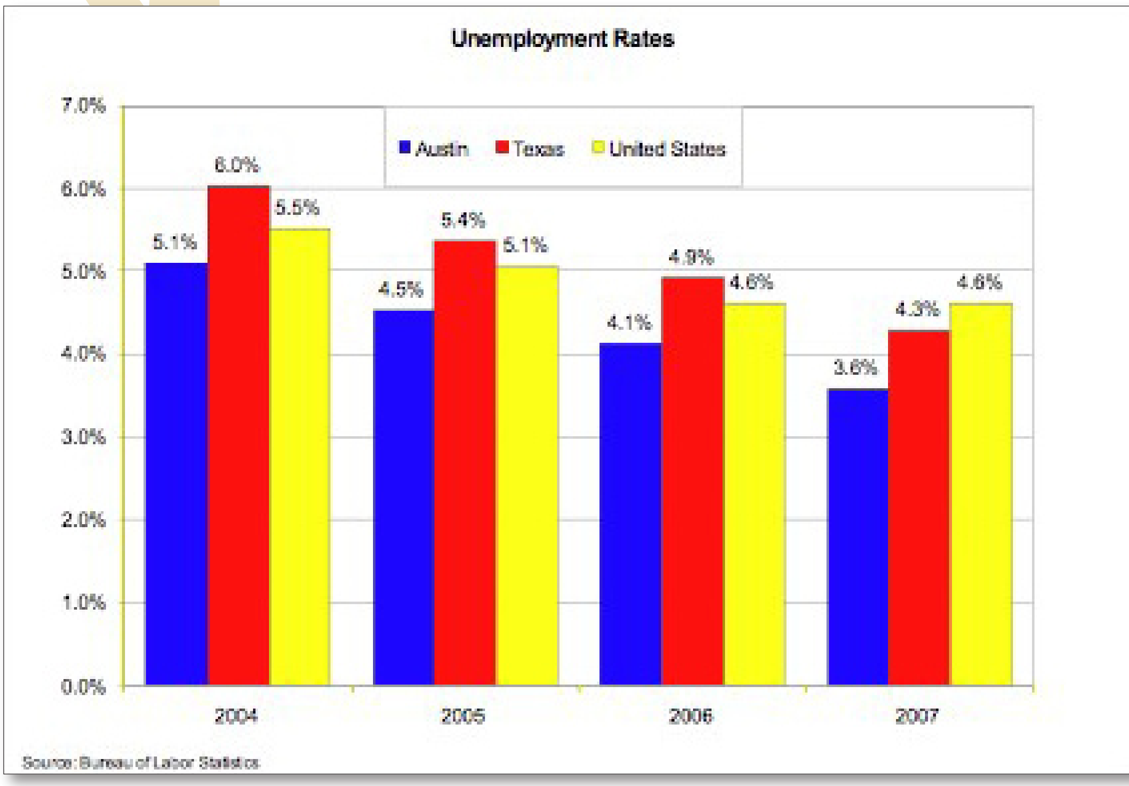
In addition to competitive taxes, the Governor and lawmakers have created several initiatives to help seal the deal on large investments, expansions, and relocations in Texas which seem to be working. In 2003, the Texas Legislature established the **Texas Enterprise Fund** (TEF), which has awarded more than $300 million to companies resulting in more than $15 billion in capital investments in the state and over 40,000 jobs. This program moved Texas from the middle of the pack to undisputed leadership in economic development.

Texas' commitment to attracting jobs in high-tech fields is complemented by the **Texas Emerging Technology Fund** (ETF), created in 2005 to expand development and commercialization of new technologies and attract and create jobs in high-tech fields. This initiative is designed to keep Texas at the forefront of economic performance for decades to come and to assist in implementing the next waves of high-growth sectors. These efforts, along with other incentive tools, regulation, and judicial reforms, have paid enormous dividends. Austin has been a significant beneficiary of these endeavors.

Perhaps the best news at present is that, **as the US economy faces a somewhat stormy short-term future, Texas should experience relative calm.** While growth rates will likely back off a bit, the state should continue to expand at a solid rate and set the stage for even greater performance in the future.

THE AUSTIN ECONOMY IS AMONG THE STRONGEST ANYWHERE

Even as the national unemployment rate has leveled off, Austin's has continued to drop. Job growth, output expansion, and other measures consistently point to ongoing strength and vitality.



Austin is frequently mentioned in various rankings of metro areas across the nation.

- Austin is one of the **top four "retirement-friendly" cities** according to AARP The Magazine. It is predicted that the retirement age group will grow by 32% in the next 15 years.[5]

- Forbes magazine ranked Austin, in the top three in the country for **Best Cities for Jobs** in 2008, the top ranking for income growth, and second for employment growth.

5 "Boomers Watching Austin," AARP The Magazine, found on Austin Market Overview, www.weloveaustin.com.

• In 2007, Austin was one of the **Top 10 Most Desirable Cities for Relocation**, among the **Top Ten Most Affordable Cities** by Forbes, in the **Top Ten Greenest Cities**, and even one of the **Top Five Dog Friendly Cities**.

• In residential real estate, Austin is similarly in an enviable position. It is ranked in Forbes' **Top 10 Best Performing Housing Markets**, boasting a 7.2% increase in prices since third quarter 2006.

Relocations and expansions over the past few years demonstrate the vitality of the area's economy as well as its prospects for continued strong performance. According to the Austin Chamber of Commerce, in 2007 there were over 7,300 jobs created from expansions and relocations in Austin and immediately surrounding areas.[6] Among the largest was a new PC-based gaming call center by Blizzard Entertainment creating an estimated 500 jobs, 550 jobs by Indymac Bank, and 2,300 jobs by an expansion of Seton Healthcare Network in Kyle.

Additional recent activity includes an engineering center for Google in downtown Austin. California-based PayPal Inc., an eBay-owned online payment system, announced plans to relocate a data services center to Austin and expects to hire roughly 300 workers by 2009. Borland Software Corporation is moving its headquarters to Austin and expecting 150 to 200 employees in 2008. Another tech company expanding downtown is Silicon Laboratories Inc., a chip-design company.[7]

In southwest Austin, Advanced Micro Devices Inc., is spending $270 million on a new Lone Star business campus spanning 870,000 square feet of space in five buildings over 58 acres. It is expected to be complete in mid-April of this year.[8] Southeast Austin will be the location for HelioVolt Corp.'s initial manufacturing facility. The company makes thin-film solar energy panels and expects to create at least 150 new jobs with the plant.[9]

Austin boasts a number of strong local companies like Silicon Laboratories Inc., Dell, and Samsung Electronics. In fact, Samsung recently announced one of the largest plant investments by a foreign company in US history. In addition, venture capital continues to fund new startups in cutting-edge fields.[10] In 2007, the Austin area saw over $673 million of venture capital investment including $45 million in biotechnology, almost $68 million in electronics/instrumentation, $159 million in semiconductors, $139 million in software, approximately $126 million in medical devices, and $101 million in industrial equipment and energy to name only a few.[11]

6 Greater Austin Chamber of Commerce, Relocations and Expansions 2007.
7 Real estate center – market news "Google Signs Lease in Austin," January 24, 2008.
8 Real estate center – market news "AMD Spends $270 Million on its New Lone Star Business Campus," December 31, 2007.
9 Real estate center – market news "Heliovolt Picks Austin for First Plant," December 21, 2007.
10 Real Estate Center "Austin Positioned to Hold Up Despite National Economy," January 13, 2008.
11 Greater Austin Chamber or Commerce, Venture Capital.

These expansions, relocations, and investments illustrate the ongoing strength of Austin's business complex. Moreover, there are many other notable initiatives in the area which could be mentioned. **Austin is setting the stage to remain a dynamic center of jobs and opportunities for decades to come.**

STRONG PERFORMANCE LIKELY TO CONTINUE

The Perryman Group's forecasts, as well as those of other analysts, indicate that Austin will exhibit strong growth in 2008 and for the foreseeable future.[12] Expansion will likely be spread across a variety of industries. From 2007 to 2012, The Perryman Group projects that six sectors will experience compound annual growth rates in employment of more than 1.5%. They include services; information; finance, insurance, and real estate; transportation, warehousing, and utilities; trade; and durable manufacturing. Over the next five years, TPG forecasts indicate the greater Austin area will add some 170,000 residents.

The pace of expansion (4.52% per year as measured by output) is greater than that of the state as a whole, and far above national levels. Key indicators are presented in the following table.

EXPECTED GROWTH IN KEY ECONOMIC INDICATORS FOR THE AUSTIN-ROUND ROCK METROPOLITAN STATISTICAL AREA: 2007-2012

Key Indicator	2007 Level	2012 Level	CAGR* 2007-2012
Real Gross Product (2000$)	$73.32 bln	$91.46 bln	4.52%
Population	1.53 mln	1.70 mln	2.09%
Wage & Salary Employment	774,900	852,800	1.93%
Real Personal Income (2000$) (by place of residence)	$50.26 bln	$62.81 bln	4.56%
Retail Sales (current $)	$49.00 bln	$69.62 bln	7.28%

*CAGR is compound annual growth rate, meaning that they reflect changes in the base from which growth is calculated.

SOURCE: The Perryman Group

12 The Perryman Economic Forecast, Short-Term Outlook for the United States, Texas, Major Metropolitan Statistical Areas and Regions, Texas Economic Publishers, Inc., Winter 2007.

LONG-TERM OUTLOOK ALSO PROMISING

Looking to a long-term horizon, economic performance is expected to remain healthy.

- The Austin-Round Rock MSA population is expected to grow by 2.00% per year (compound annual growth rate) from 2007 to 2030, adding an estimated **884,000 residents** to the area.

- Total wage and salary employment (which does not include proprietors) is projected to grow by an annual 1.75%, adding almost **380,000 jobs** over the long term (an average of 16,500 per year).

- The highest employment growth rates from 2007 to 2030 are forecast in the services sector (2.28%), information sector (1.82%), and transportation sector (1.68%).

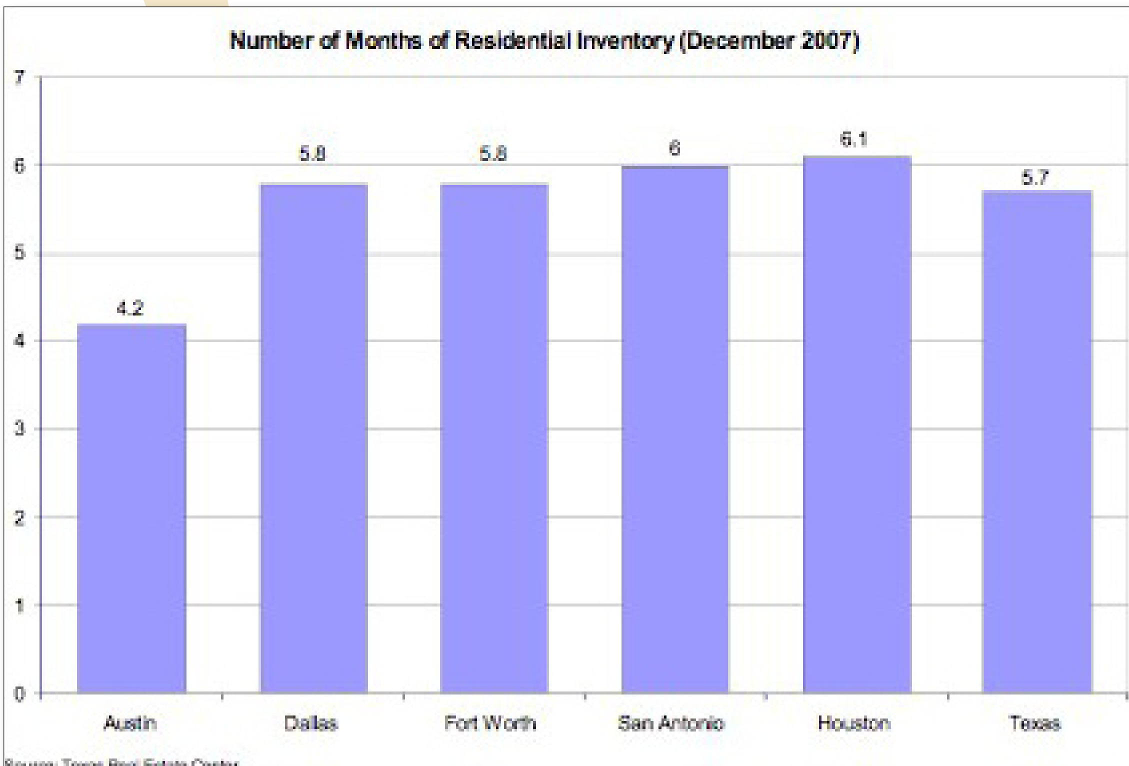
- The industries expected to have the highest real gross product compound annual growth rates during the 2007-2030 period are durable manufacturing (5.18%), information (5.02%), and transportation (4.40%).

- Real personal income is projected to increase by 4.60% per annum from about $50.26 billion in 2007 to $141.26 billion in 2030.

These favorable economic conditions will, in turn, enhance the prospects for the real estate market. Irrespective of short-term patterns, an expanding population and job market invariably and of necessity lead to an ongoing demand for housing over an extended period.

AUSTIN'S CURRENT REAL ESTATE MARKET SITUATION

The robust Austin economy translates directly into a generally healthy real estate market. Because the market was not radically overbuilt or overpriced during the recent national frenzy, the area is largely (though not entirely) insulated from the ongoing correction. Currently, the metro area has a low inventory of available residential housing compared even to other relatively healthy markets in Texas.

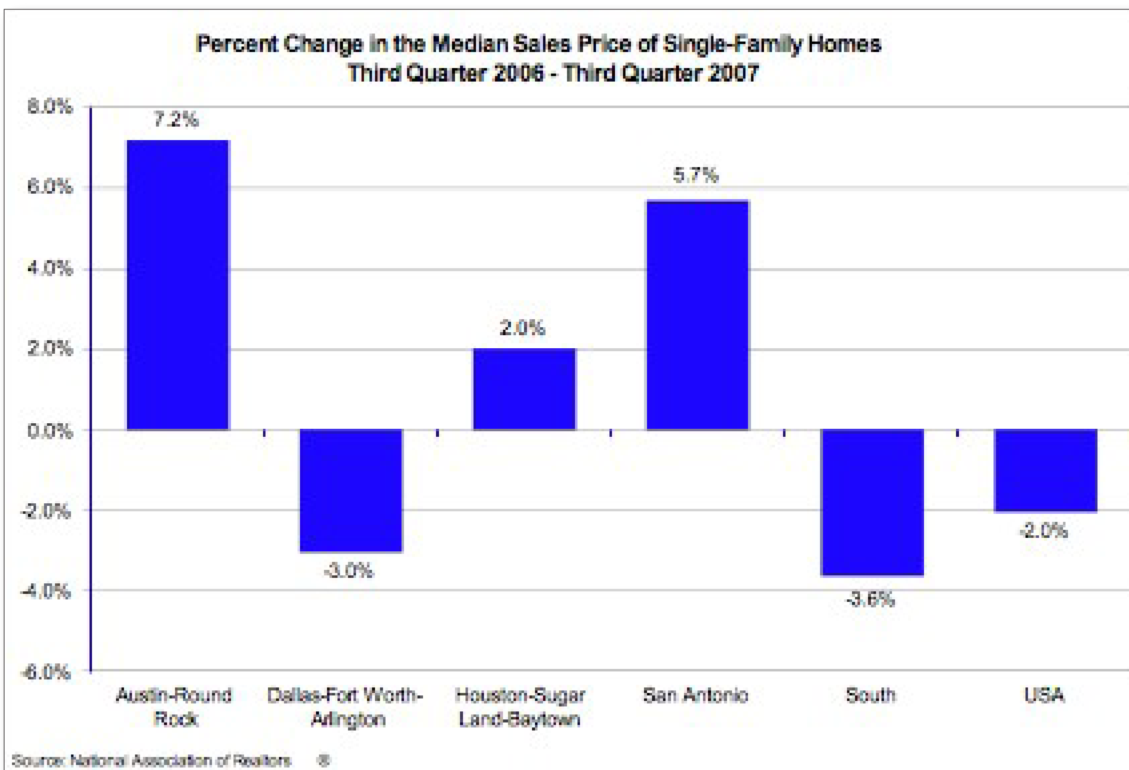


AUSTIN'S HOUSING MARKET IS WEATHERING THE NATIONAL STORM

Despite major disruptions in some housing markets across the nation, Austin has weathered the storm better than many areas. Because Austin, like much of Texas, did not experience the rapid appreciation curve characteristic of many areas, there is less downward pressure on prices. Other aspects of Austin that have somewhat sheltered it from the housing bubble are the previously noted unique combination of technology companies such as Dell and IBM and a stable base as the seat of State government and home to the University of Texas and several other sizable higher education institutions.

Austin has the amenities to retain many college graduates and is seen as a progressive and desirable urban center. In addition, the Texas lending law prohibits taking cash out of one's home in excess of 80% of its appraised value. This provision in itself has helped to deter Texans from increasing the debt loads on their homes to the extent observed elsewhere.

In fact, while pending sales were down modestly in Austin in third quarter 2007 compared to 2006, home prices continued to rise.[13] Although the most recent data are hinting at some degree of further correction, the magnitude remains well below the levels seem in other regions.



13 "Austin Market Still Healthy," 3rd Quarter, Austin Business Journal found on Austin Market Overview, www.weloveaustin.com.

The multi-family sector in Austin is performing well, with prime growth in the central business district (CBD). The current occupancy rate is 97%, aided by the area's strong and sustained employment growth.

OTHER COMPONENTS OF THE REAL ESTATE MARKET IN AUSTIN ARE ALSO HEALTHY

Sometimes, weakness in one aspect of the real estate market can drag down the performance of other types of assets. In Austin, **markets for all major types of real estate assets are currently healthy.**

In 2007, the Austin metro had over 20 million square feet in retail space with an occupancy rate of 93%. The occupancy rate has remained fairly steady over the past five years ranging only from 93% to 94%.[14] Last year was one of solid performance for Austin in the retail sector, with stable occupancy rates, increasing rental rates, and net absorption of 800,000 square feet. New construction of the retail market is being absorbed and more developments are being announced.[15]

The market for office space is also healthy. In 2007, the Austin metro absorbed 1.4 million square feet of office space and had a vacancy rate of 13%, down from 23% in 2003.[16] Millions of square feet are expected to be absorbed over the next few years. Office space absorption in Austin was positive in 2007, totaling more than 628,000 square feet during the last half of the year. Rental rates for office space continued to increase, reaching $27.83 at the end of 2007, up $0.41 from the mid-year price of $27.42 per square foot. In addition, the growth is expected to be ongoing in 2008 with low unemployment, positive job expansion, and low interest rates.[17]

Austin is among the **Sperry Van Ness top 10 markets to watch** when it comes to office space. The city ranked the highest for 2007/2008 relative population growth of all of the office markets evaluated. Perpetuating the need for office space are the many major office-using players (government, education, health care, telecommunications, high technology, and financial companies) making Austin their center of operations. The vacancy rate in the Austin metro is decreasing, and absorption for 2008-2009 is expected to top 2 million square feet.[18]

NAI Austin's year-end report for 2007 indicates that the Austin industrial real estate market absorbed almost 1.8 million square feet of space in 2007, up 17% from 2006.[19] The industrial

14 "2008-2009 Economic and Technology Forecast," AngelouEconomics, January 2008, p. 22.
15 "Austin Metropolitan Area: Office, Industrial and Retail Building Market Update, Year-End 2007," NAI Austin, The Source, 2007.
16 "2008-2009 Economic and Technology Forecast," AngelouEconomics, January 2008, p. 24.
17 "Austin Metropolitan Area Office, Industrial and Retail Building Market Update, Year-End 2007," NAI Austin, The Source 2007.
18 "Top 10 Markets to Watch, Office Edition," Sperry Van Ness, Through September 2008, p. 3.
19 "Austin Metropolitan Area Office, Industrial and Retail Building Market Update, Year-End 2007," NAI Austin, The Source 2007, p. 1.

sector in Austin is the second most robust property type, behind the multi-family market. The **industrial market has enjoyed several consecutive years of positive absorption and a rapidly falling vacancy rate**.[20]

DOWNTOWN AUSTIN IS PARTICULARLY VIBRANT

Downtown Austin is experiencing notable growth, as potential residents are attracted to the area's **vibrant cultural, commercial, and residential activities**. The ability to walk to numerous day time and night time activities enhances the desirability of downtown. Downtown has seen 41.2% population growth from 2000-2005 and is expected to grow by 62.4% from 2005-2010.

Residents of downtown Austin enjoy a variety restaurants, theaters, and museums. In fact, the Downtown Austin Alliance reports supporting continued success of 20 museums, 22 performance venues, 50 galleries, and 60 live music venues all in the downtown area.[21] Residents also enjoy Town Lake, the hike and bike trails, unique retailers in the area, and an exciting entertainment scene.[22]

For example, Austin is the "Live Music Capital of the World," born out of the downtown music scene where there is a concentration of live music venues within walking distance of one another. Live music contributes $420 million in annual sales and $580 million in tourist revenue to the regional economy.[23]

The area is likely to continue to draw residents as business is rapidly expanding downtown. There have been 56 development projects announced with 23 currently under construction. About 90,000 employees work downtown during the day, and 363,000 Austinites live within 10-minutes of downtown. In addition, business activity is increased by the millions of visitors that frequent downtown.[24]

About 6,000[25] people currently live downtown, with sizable growth anticipated in the coming years.[26] As of November 1, 2007, there were 3,500 additional living units planned or under construction in downtown Austin.[27] The downtown area has planned over 7 million square feet of other development (either currently under construction or waiting for approval), which

20 "Broker Outlook 2008" Texas Real Estate Business, December 2007, p. 3.
21 "DAA 2007 Annual Report," www.downtownaustin.com/news/annualreport/.
22 "Living Downtown," downtownaustin.com.
23 document "downtown Austin plan," p. 12 http://www.ci.austin.tx.us/downtown/downloads/DAP_COMMISSIONS_BRIEFING_1-9-8.pdf.
24 "doing business downtown," dowtownaustin.com/business.
25 http://activerain.com/blogsview/339756/Downtown-Austin-Residential-Development; also in "Downtown living gaining traction," Texas Journalist: Business, http://tj.journalism.utexas.edu/business/shifhrise.html.
26 According to officer in Downtown Neighborhood Association "Downtown living gaining traction," Texas Journalist: Business, http://tj.journalism.utexas.edu/business/shifhrise.html.
27 "Broker Outlook 2008," Texas Real Estate Business, December 2007, p. 3.

will continue to bring new residents, businesses, and attractions.[28] **If even a small fraction of those who presently work downtown or live in the general vicinity opt to live downtown, all of the existing and planned units will be quickly absorbed, and demand will continue to escalate.** In fact, all of the completed and anticipated units could be filled by less than 0.8% of the present population of the Austin-Round Rock MSA.

Real Estate expert Barbara Corcoran recently listed Austin as the top up-and-coming market in the country stating that now was a good time to buy Austin real estate especially in the areas near downtown.[29]

Another, more global, factor that will increase demand for downtown in the future is higher energy prices. As commuting costs rise, the relative attractiveness of central locations increases.

AUSTIN'S REAL ESTATE OUTLOOK

As noted, Austin's real estate market has been weathering the recent weakness in the national market. Business relocations and expansions are helping office occupancy rates. Austin also saw growth in commercial and industrial real estate markets this past year. Employment expanded, and annual job growth increased, thus keeping the unemployment rate low.

In the residential sector, home sales fell only modestly in relation to other areas, while home prices appreciated significantly in 2007, and foreclosure postings were down.[30] The Austin housing market is expected to see average gains at 4.8% through 2008.[31] **While the real estate market is not seeing the rapidly growing appreciation of the past, it will likely be one of the leading markets in the country in the near term, setting the stage for substantial long-term opportunities.** The draw of high-tech business and working professionals will help the housing market remain reasonably strong in 2008. In fact, **Business 2.0 magazine ranked Austin among the top 10 cities that are prime for real estate investment**.[32]

While permits have dropped (a positive development in keeping the market stable and vibrant), continued population growth in 2008 and the relatively short supply of single-family residences will combine to strengthen the market. One local economist predicts that housing prices will continue to increase, though slowed to average growth of 4%-5% instead of the 7% annual rate

28 Number from Michel Knox of COA; found in document "downtown Austin plan," http://www.ci.austin.tx.us/downtown/downloads/DAP_COMMISSIONS_BRIEFING_1-9-8.pdf.

29 "Austin Texas Real Estate – Nationally Known Expert Cites Austin as #1 Up-and-Coming Market," Localism.com, November 20, 2007.

30 Market Trend Analysis, Mortgage Guaranty Insurance Corporation, Credit Policy Department, January 2008.

31 "Texas," Housing Predictor, www.housingpredictor.com/texas.html, January 24, 2008.

32 "10 Cities That are Prime for Real Estate Investment," The XBroker, October 23, 2007 in Investing, Mortgage 2.X and Real Estate 2.X.

seen from 2004-2007.[33] These projections are comparable with those of external sources as well.

INTEREST RATE CONDITIONS FAVORING PURCHASE

Mortgage interest rates are presently only slightly above 40-year lows, with short-term rates being pushed down by the Federal Reserve. In fact, monetary authorities have shown a continuing willingness to lower the costs of funds and make reserves available for lending in the face of sluggish national economic performance.

The fallout from the subprime crisis is clearly a tightening of credit availability and underwriting practices, but the effects of these steps are primarily being observed at the lower end of the housing sector. **For potential buyers of the types of units offered in the downtown Austin market, the interest rate environment is highly attractive and ample funds are available.**

WEAK DOLLAR FAVORS FOREIGN INVESTORS

Recent declines in the value of the US dollar against major currencies have opened the door even wider for foreign investors looking to buy land and real estate in the United States. The pound has increased 34% against the dollar in the past five years, 10% in the past year alone. The euro has risen even more by 47% since 2002. This results in higher purchasing power for Europeans investing in the US market.

While many foreign investors interested in Texas are from Mexico, the Texas Association of Realtors said they are seeing growing interest from investors in Spain and other parts of Western Europe and expect interest to expand because of the currency situation. Not only are Europeans buying homes to live in but as vacation and investment properties as well. Austin is described as a "desirable" location for these purchasers due to its "cultural oasis in the middle of the state" and its "progressive feel."[34]

The National Association of Realtors® survey taken in mid-2007 indicated that despite the slowdown in the US housing market, 25% of the sample indicated that their international business had increased. One-third of the international buyers came from Europe, with 12% from Britain alone. Asia was the second highest at 24%. The US is also seeing an increase in Australian investors, who spent $3.78 billion in the US in 2006.[35]

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33 "Austin Housing Market Slows as New Permits Drop to 4-Year Low," AngelouEconomics, January 2, 2008.
34 "Foreign Home Buyers Finding Bargains in the US," Austin American-Statesman, December 9, 2007.
35 "Aussies at the Gate," Global Real Estate Monitor, April 2007, Vol. 2.

Surveys indicate that 47% of the international investors were buying for vacation purposes, and 22% were buying property for investment opportunities. One-third of the respondents listed both of those reasons for buying property in the US.[36] Florida led the nation in foreign home buying with 26% of all international purchasers, California followed with 16%, and Texas was third at 10%.[37] Many cities have long been hotspots for international investment (such as New York and Miami), but the recent expansion of investment is leading to increasing purchases in rapidly growing, non-traditional markets (such as Austin).

In addition, **international buyers generally show stronger preferences for condos/apartments** (22%) than US buyers (12%). This pattern further contributes to the attractiveness of the downtown area.

DOWNTOWN AUSTIN OFFERS HIGH PROBABILITY OF ACCELERATED RETURNS

It is a widely chronicled and documented phenomenon that **fundamentally healthy and growing real estate markets experience accelerating rates of return as the overall national situation enters the expansion phase of a cycle.** In essence, during a correction period, construction of new units slows (as is occurring in Austin now). Thus, as demand begins to increase, developers will be induced to initially bring new residences to the market through higher-than-normal returns in the most desirable areas. The result is a period of rapidly accelerating values, which accrues to the benefit of existing owners.

This pattern is an essential element of the real estate cycle and has been repeatedly observed. The end result is that **those who purchase residences in downtown Austin during the current national housing downturn will likely enjoy above-market returns both in the expansion phase of the current cycle as well as over a long-term horizon.**

36 "Foreign Home Buyers Finding Bargains in the US," Austin American-Statesman, December 9, 2007.
37 "Foreign Home Buyers Finding Bargains in the US," Austin American-Statesman, December 9, 2007.

CONCLUSION

This analysis has provided a relatively comprehensive overview of factors impacting the current market environment for residential housing in downtown Austin. A number of phenomena are combining in the midst of the national mortgage and housing crisis to make investments in this market segment highly attractive.

A strong underlying economy with excellent prospects; a much healthier regional housing market than the norm; a favorable interest rate environment; growing demand resulting from higher energy prices; a favorable climate for foreign investors; an increasing trend toward downtown urban living; enhanced local amenities; and the accelerating returns observed on investments of this nature over an extended period all suggest an optimal situation both for a high-quality lifestyle and excellent appreciation potential.

While national headlines may discourage some activity, the reality of the downtown Austin housing market is one of optimism and opportunity.

Respectfully submitted,

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