

## Northern Nevada Commercial Investment Real Estate Report – Q211

### The “Not So Much Good News” Issue – July 29, 2011

#### Major Transactions this Quarter

Overall activity this past quarter dropped \$78 million from Q1, with transactions \$3 million and larger dropping by a whopping \$103 million. The total number of deals increased from 70 to 108 this quarter, with deals under \$1 million representing 76% of all commercial sales transactions. Deals over \$3 million dropped 53% from 17 to only 9 this past quarter.

The biggest sale of Q2 was the apartments-built-as-condos, known as Waterstone at Kiley Ranch. In early 2010 I had co-listed this property with the Colliers Sacramento office and secured 14 offers. We narrowed the field down to four finalists, and then, on the last day of a 60 day due diligence period, the deal cratered. It was re-listed this spring with CBRE – Sacramento.

The Waterford Apartments sale closed at 82% of its \$17 million asking price, after being exposed to the market in October 2010. After quarter end, on July 5<sup>th</sup>, the sale of the 116 unit apartment property Northgate Villas closed at a price of \$3,650,000 or \$31,465 / door, resulting in a cap rate of 11%. It went on the market in October 2010 at \$5.35 million.

Seller	Buyer	Address	Date	Price
Ursus Real Estate, Inc. (Bank of the West, lead lender)	Waterstone Village LLC (Village Properties)	815 Kiley Pkwy	06/08/11	22,061,000
BACM 2005-6 NICHOLS BLVD (LNR, as special servicer)	Aju Waterford Reno LLC (Silverwing)	800 Nichols Blvd	06/06/11	13,875,000
Spanish Springs Shopping Center LLC (Frank Lepori, Mging Member)	Hnm Properties Inc (Howard Misle)	102-282 Los Altos Parkway	06/27/11	13,300,000
Pyramid Hwy. & Robert Banks Blvd., LLC (1 <sup>st</sup> Independent Bank)	Naniloa Investment Co LLC (Bighorn Invstmnt Group, SLC)	7900 Pyramid Way	06/29/11	7,000,000
Whitley Trust, Hartman Trust & McKee (1/3 each)	Pedc-Mccarran LLC (PEDC Property Mgmt, Columbus, OH)	251 S McCarran Blvd & 185 E Nugget Ave	06/13/11	4,750,000
Baldinis Inc.	Golden Gate Petroleum Of Nv LLC	1055 S Rock Blvd	05/11/11	4,600,000
LATIPAC	Topol Judith K	28 & 34 W 2nd St (Riverboat Hotel)	06/29/11	4,600,000
DP Partners Stead I LLC	Urban Outfitters Inc	Moya Blvd	05/13/11	3,404,500

### **Local News (bad, good and rumors)**

The Reno City Council gave initial approval to rezone the 117-acre Rancharra estate for use as an events center and for commercial uses. The mansion would be used for special events, along with an outdoor plaza and amphitheater. Its equestrian center would become a commercial operation. Offices and shops would replace 156 homes zoned for the property.

The Reno City Council approved a \$2 hotel room tax to be used to pay for improvements to the National Bowling Stadium and other nearby publicly-owned entertainment facilities, but not to the Aces Ballpark. Once the taxes start to accumulate, it will take a two-thirds vote by the Council to decide where to spend the money.

Chase International reported that 435 single-family homes sold in the Lake Tahoe market during the first half of 2011, a 4% decline from last year's volume. The number of condo sales, 130, was up 13%. Median price for homes and condos alike was up 2%.

Northlight Financial LLC of New York City completed a \$28.5 million exit financing to Reno's Specialty Trust, a real estate lender that sought Chapter 11 bankruptcy protection in April 2010. Northlight will service about 30 assets in the Specialty Trust portfolio.

S&P downgraded three Reno Redevelopment Agency bond issues to junk status. The \$30 million of bonds require \$2.9 million annually to service them, yet the "tax increment" to pay them will only generate \$850,000. The City will have to dip into its Bond Reserve Fund to cover the shortfall.

Crossroads Commerce Park in Fernley looks to be close signing a deal to develop a 1 million square foot facility. It is also on the list of finalists for a 416,000 sf industrial facility – stay tuned.

### **The rich get richer**

8,700 property owners in Incline Village will be getting \$40 million in property tax refunds and interest stemming from 10+ years of lawsuits that their property tax assessments were flawed. The method used by the Assessor to value their lakefront views and beach frontage was declared unconstitutional because he did not get these valuation rules approved by the Nevada Tax Commission in advance of applying them. Residents at "the Lake" were irate that their property taxes soared between 1995 and the next 5-year reassessment in 2000. This was not a problem to those who sold or refinanced at the peak of the dot com boom. As a result the Washoe County Commission is considering a surtax on ALL car registrations to pay for this rule snafu.

### **Did you know?**

Business activity at the Nevada Commission on Economic Development was up 159% in Q111 compared to Q110. NCED is negotiating with 20 businesses expected to make a decision about relocating to northern Nevada in the next 90 days.

Nevada ranks 45th among "Best States to Do Business" in a study commissioned by CNBC. The state ranks at the bottom in education and economic conditions, and ranks poorly on quality of life. It gets relatively good marks for its business friendly environment and its workforce.

Home prices in the Reno-Sparks area in the first quarter were 9.3% lower than a year earlier, and down 48 percent in the past five years, says the Federal Housing Finance Agency.

The current FHA and GSE loan limits were enacted in February of 2008 as part of the Emergency Stimulus Act. More than 669 counties in 42 states would be impacted by the proposed loan limit reduction from the current limit of \$729,750 to \$625,500. Good or bad – you decide.

REITs have outperformed the S&P 500 since the financial crisis. In 2010, investments in apartment complexes led to total returns of 47%. Returns for the overall REITs market was 28%, markedly higher than the S&P500 returns of 15%. Source: [www.finance.fortune.cnn.com](http://www.finance.fortune.cnn.com)

### **QE2 – Sink or Swim?**

Dr. Sam Chandan, adjunct professor at Wharton was quoted in a June 30 GlobeSt.com report, “Whatever QE2 did or didn’t accomplish, unemployment remains a persistent problem, along with a lack of growth in wages and consumer confidence. If QE3 is a go, it will continue to erode the dollar which will make US real estate comparatively cheap for foreign investors. More stimulation may foster employment growth, which is good for commercial real estate. *Neither QE3, nor any other step by the Fed or the White House will work without a coordinated approach that deals with the underlying problem, which is an absence of confidence in the government’s ability to get us out of this malaise [emphasis applied].* While inordinately low interest rates have been crucial to the current recovery in prices, credit availability and the management of distress, it has fomented greater risk-taking by investors, supporting the artificial inflation of asset prices. Further bond-buying will increase the risk of inflation once the slack in the economy is absorbed. Also the larger the Fed’s balance sheet grows now, the greater the tightening down the road. Market manipulations cannot persist indefinitely. Prices in major markets suggest that current monetary policy is [already] distorting investor behavior to the market’s long-term disadvantage.”

Wyatt Investment Research, in their June 22 issue notes, “It cost \$600 billion to increase the S&P 500 by \$3 trillion. QE2 was inflationary. The IMF says that a \$10-per-barrel rise in oil prices shaves a half-point off U.S. GDP. [Since] oil prices rose around \$20 a barrel during QE2, we lost 1 point of GDP growth, or \$1 trillion as consumers spent more on energy and food. We can never know how the economy might have performed without QE2. The bigger issue is that QE2 pushed the limit of what's acceptable. If the Fed feels free to engage in quantitative easing every time the economy slows, the U.S. economy will always be imbalanced.”

### **On the Other Hand - Speaking of Economists...**

Have you ever wondered why economists at the Fed exclude food and energy from their “core” inflation calculations? I don’t know about you, but to me food and gasoline are a pretty “core” part of my existence. Volatile or nor, I find it hard to live without either. The good news is that they do include alcohol in the “core” measurement – times like these require vodka, beer or wine as a “core” part of many people’s coping mechanisms!

### **The Ramifications of Residential Issues**

Joel Ross, in his column, The Ross Rant, writes in the June 28 issue of GlobeSt.com that, “the macro issue is that without a robust residential construction market, the general economy will continue to suffer. That segment generates millions of jobs and property and sales taxes. It has historically been the biggest generator of multiplier effect on the economy, and it will not be happening again for a long time. Home prices will continue to decline in many markets for awhile and the psychological damage to potential home buyers and lenders will last for a long time. The long term impact on retirement nest eggs tied up in home values is going to be felt for a generation, just as the baby boomers are hitting the key [retirement] age. You need to consider all of this when doing strategic planning for your business and investing. This is a generational macro change, and you need to understand the ramifications.’

### **Winners of the Rental Economy**

Nin-Hai Tseng, writes on May 25 in [www.finance.fortune.cnn.com](http://www.finance.fortune.cnn.com) that **prices** for apartments are expected to rise nationally by 4.5% in 2011 and another 3% in 2012, according to Rent.com. During the housing boom in 2001-05, rents fell by 10% as easy credit lured many to home ownership, while from 2006-09, rents increased by 15%, according to Moody's Analytics. This demand is driven by demographic changes, an improving economy and ongoing foreclosure problems in the single-family home market. Demand will likely come from younger people who tend to rent. The recent recession pushed many jobless young people to crash with friends and parents. The improving job market will get them to find their own place. Also, people aged 25 to 34 is forecast to grow 1.4% per year through 2013, helping drive demand further.

She believes that higher rents could benefit the U.S. housing market. In Moody Analytics' latest list of rent ratios for 54 U.S. metro areas, 29 cities are now in the "better to buy" category. With experts predicting that home prices have further to fall and with higher expectations for rentals, more cities could end up on the buy side of the buy-versus-rent calculator.

### **Distress Taking Less of Toll on Nations' Banks**

Mark Heschmeyer writes in the June 29 CoStar Watchlist that the burden of commercial real estate on the nation's 7,584 banks and thrifts is gradually decreasing. According to the FDIC new provisions for loan losses fell to \$20.7 billion in Q111 from \$51.6 billion a year earlier. This marks the 6th quarter in a row that loss provisions have declined year-over-year. It is the smallest quarterly loss provision for the industry since Q307. The balances of foreclosed assets continued to grow at the nation's banks to \$31.2 billion at March 31. Of the 7,584 insured banks at March 31, distressed CRE made up 1% or less of total assets at 4,298 banks. Unfortunately 566 banks out of the total (7.4%) hold more than **80%** of the distressed commercial real estate. The 10 largest banks hold \$49.4 billion in delinquent, foreclosed or restructured assets (29%).

### **Housing Double Dip Helps Apartments, Hurts Economy**

In the July 7 StreetSmart column in GlobeSt.com, Hessem Nadji writes, "after climbing in early 2010, home prices have dropped once again, reaching an eight-year low. According to data from the S&P Case-Shiller Index, prices are down by 3.5% year-over-year, and 32% from their peak in 2006. The nation's homeownership rate has dropped from a peak of 69% in 2006 to 66.4% as of Q111, a rapid decline drop in such a short time period.

Foreclosure activity remains disturbingly high. While the number of distressed sales is down, so is the number of total sales, keeping the distressed percentage at 28%, down from 32% a year ago. And it appears that the distressed-sale factor will remain with us through year-end 2012, placing a damper on price appreciation. The downturn in the housing sector is placing a clear drag on the nation's general economy. According to Moody's, cuts in spending in residential fixed investments accounted for more than 30% of the decline in the GDP in recent years.

The for-sale housing market will inevitably correct upward to reflect the new fundamentals. However, we have to wait until consumer sentiment turns positive and/or the inventory of foreclosure product is substantially reduced before we see any major improvement. This could take into 2013, assuming job growth returns. At the current lackluster pace, the economy won't be expanding sharply, but enough demand will be released from demographics-based household growth to improve sales and pricing.

The implications from the recent double dip in the housing market include less-than-normal growth in the economy and in CRE demand during 2010 into early 2012. However, once the housing market finally begins its recovery, it could stimulate above-normal growth in the economy and in demand for CRE late in the recovery cycle: 2012, into 2014.”

### **Decline in Home Prices Ebbs, Consumers Still Gloomy**

On June 28 Leah Schnurr wrote in Reuters that the plunge in U.S. home prices showed signs of leveling off in April, but worries that unemployment pushed consumer confidence to a seven-month low in June. The Conference Board said its index of consumer attitudes fell to 58.5 in June, short of expectations for 60.5. The U.S. economy added just 54,000 jobs in May. The weaker pace of economic growth in Q111 persisted into Q2, though economists still expect growth to pick up in the second half of 2011 as temporary factors such as high energy prices and supply chain disruptions from Japan's March earthquake ease. Forecasters see Q2 growth at around 2% after the economy grew at a 1.9% pace in the first three months of the year.

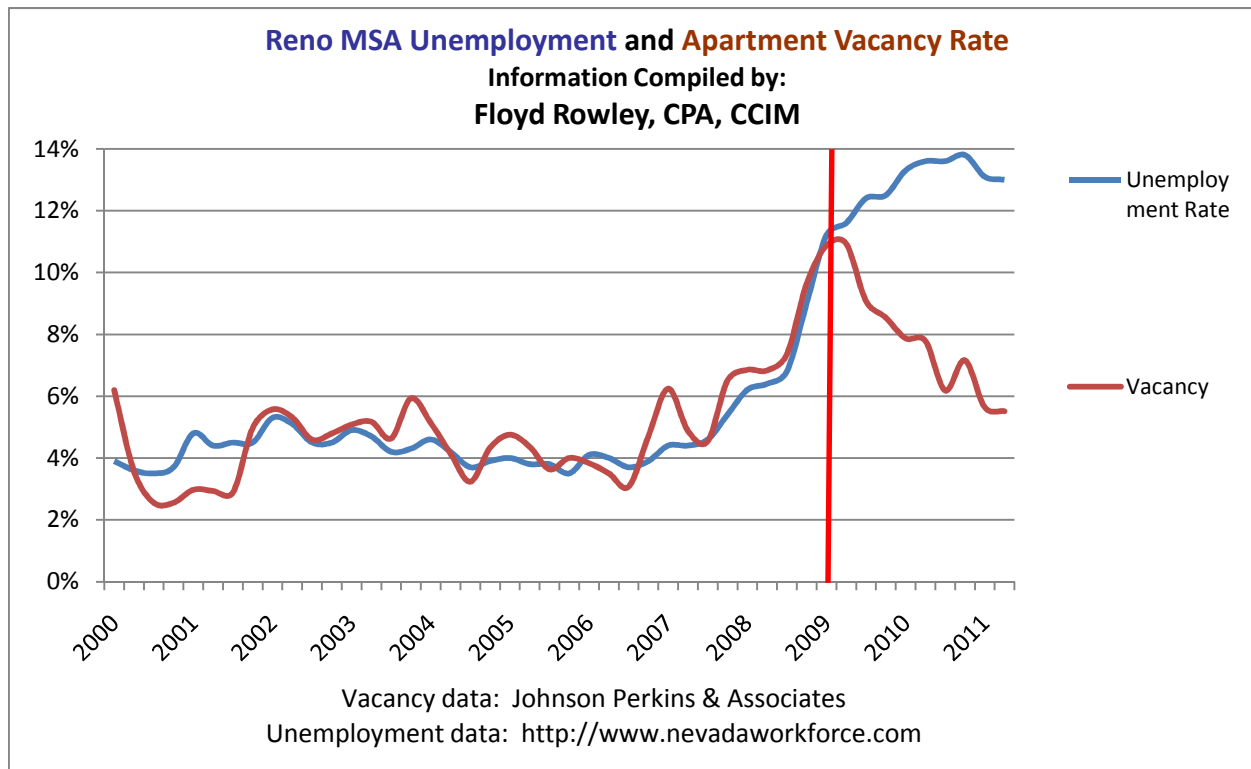
### **Rough Patch or Double Dip?**

Howard Gold wrote in MarketWatch on June 24, the following edited comments: Economist Gary Shilling predicted another recession in 2012 - not a double dip - but a brand new recession. Many Americans will be forgiven if they can't see the recovery we've been experiencing. That's Shilling's point. Usually, deep recessions like the recent one are followed by strong snapbacks. This time, however, the recovery has been distinctly subpar. Shilling believes the economy is like a four-cylinder engine: (1) consumer spending, (2) employment, (3) housing and (4) the reversal of the inventory cycle - only the last is really recovering. Shilling is actually looking for another 20% drop in housing prices before we hit bottom in 2013. Robert Shiller, co-creator of the S&P Case-Shiller Home Price index, has a similar prediction. For Shilling, it's all about inventories - from a high 6.3% of GDP in Q405, residential construction now represents only 2.2% of GDP - a half-a-trillion-dollar gap. A further 20% decline in home prices would raise the percentage of homes worth less than their mortgages to a stunning 40%. Shilling estimated it would also cut homeowners' equity to a mere 8% of total home values, from 50% in the early 1980s.

### **Apartment Statistical Review**

As always, I am indebted to Johnson Perkins & Associates (“JPA”) for their Quarterly Apartment Survey to present the graph below and to make the following commentary:

- Vacancy overall decreased by an insignificant 13 basis points in Q2, dropping from 5.64 % overall to 5.51%. Seven of the 10 market areas are now at or below 6%, with only the predominantly blue collar area of Brinkby/Grove coming in at a 12.88%.
- The overall vacancy is now back to Q307 levels, right before the Great Recession took off.
- Overall rents are back to Q405 2005 levels, just prior to the 3-year run-up that peaked in April 2009. The average increased to \$837 in Q2 from \$821 in Q111.
- The overall number looks to be influenced by the addition of The Trails at Pioneer Meadows and The Alexander, in the South Meadows, to the survey. They achieved 90% occupancy this quarter and were therefore added to the JPA survey. Their respective submarkets leaped by an average of \$47 / mo and \$20 / mo, respectively. While the entire increase cannot be solely attributed to these properties, they are both new, Class A properties that command top rents in their submarkets.



**About the Author**

Floyd joined the Johnson Group in January 2011 to continue his commercial investment real estate brokerage practice in northern Nevada after serving over seven years as a Senior VP of the Colliers Investment Services Group. He focuses on representing buyers or sellers in investment property sales: large apartments, office buildings, retail and industrial properties. Floyd also does sale / leaseback and negotiates build-to-suit transactions. Since 2004, Floyd has closed over \$122 million of investment transactions in the Reno MSA. Starting in the fall of 2008 he has focused on distressed assets, mainly apartments. Since then he has completed over \$257 million in broker price opinions, resulting in \$24 million of apartment listings.



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