

Northern Nevada Commercial Investment Real Estate Report 3rd Quarter 2012 - The “Peering over the Fiscal Cliff” Issue

According to a paper published by the Urban Institute and the Urban-Brookings Tax Policy Center dated October 1, 2012, Federal taxes are scheduled to rise in 2013 for six reasons:

1. Most of the Bush-era tax cuts that were enacted in 2001 and 2003 - and extended for an additional two years at the end of 2010 - are again set to disappear.
2. Some of the temporary tax cuts that were part of the American Recovery and Reinvestment Act of 2009 - and also extended at the end of 2010 - will expire.
3. Congress has not acted on dozens of short-term tax breaks that are regularly extended.
4. The payroll tax cut, always intended as temporary, is set to expire after a two-year run.
5. New taxes enacted in 2010's Affordable Care Act will take effect in 2013.
6. Finally, the AMT patch expired at the end of 2011 and has not been renewed.

Now for the part that drives me crazy – here is Footnote 3, “Throughout this paper, we refer to the tax changes scheduled for January 1, 2013, as tax increases. That makes sense, given our focus on how taxes in 2013 would compare to current levels. Those changes are not tax increases, however, for purposes of federal budgeting. The federal budget process focuses on how future taxes compare to what is implied by already enacted law. Under current law, the upcoming tax changes reflect expiration of temporary tax cuts or, in the case of health reform taxes, the initiation of previously enacted taxes. Because the scheduled changes are not treated as tax increases, legislation to avoid any of them would be scored as a tax cut.” Amazing!

RealShare Apartments Conference – Los Angeles – October 24, 2012

I was one of almost 2,000 attendees in downtown LA for this annual conference. The crowd was overwhelming, yet the topics and the information were fantastic. Here are my key takeaways:

- Hessam Nadji, Managing Director of Research for Marcus & Millichap, predicted a sudden 5% drop in our national GDP in Q113 if these tax issues are not addressed, combined with the \$110 billion in immediate, automatic budget cuts. Recession looms!!
- 50% of personal income goes to rent in San Francisco – it's 70% in New York City.
- 2 million jobs have been added in the private sector in the last 12 months – very broad based, with 2/3 of them going to Gen Y people – defined as those under 34 years old.
- 3 million young adults moved out of the family home since 2010 – they are renters by choice. There is pent up demand for 800,000 more units. 50% of that demand comes from single moms and middle-aged folks.
- If you can find it, apartment dirt in Santa Monica goes for \$300k / door.

- 85k apartment units will be built in 2012, with 100k planned for '13. Most in A locations.
- There are about 21 million apartment units nationwide, with about 135,000 going away every year – see above comment – we are not even keeping up with replacement needs.
- National investment sales reached \$64 billion through Q312, equaling all of 2011.
- The spread between A and tertiary (Reno) cap rates are back to the 2000-05 era, with B apartments poised for large price increases, since all the A properties are “fully priced.”
- REIT's have \$7.2 billion planned for development. Some, like AIMCO (whose stock I own) are investing in upgrading existing properties, such as replacing carpet with vinyl plank.
- 80% of people foreclosed out of their homes rent in the same neighborhood.
- 5% of Californians pay almost 80% of the State's income taxes.
- Freddie Mac's foreclosure loss in 2011 was less than its company phone bill.
- Freddie is lending in Las Vegas again. In 2010 Fannie had Vegas on par with Detroit. They have both dropped interest only on their loans back to 1 – 2 years max.
- LA is projected to add 50,000 jobs in 2013.

The best one-liner of the day was a developer who stated that real estate operates in 7 year cycles but developers have only 5 minute memories. The day concluded with me attending a private reception atop the Jonathan Club sponsored by Walker & Dunlop – my son's employer.

More Apple news

On October 8, Brian Duggan, writing in the Reno Gazette Journal (RGJ), reported that the Reno Planning Commission approved plans for a 15 ksf industrial building on a vacant lot off Sixth and Evans - just north of Louis' Basque Corner. The building will be used for light assembly by a single, long-term tenant. The Developer and city planning officials say they cannot confirm or deny if the tenant is Apple. However, Apple is planning to build a facility in downtown Reno to assemble computer servers for their data center east of Sparks. United Construction will build the facility being designed by Cathexes. The building could be complete by December.

On September 3rd the Northern Nevada Business Weekly (NNBW) reported that Apple's planned data center on 2,200-acres east of Sparks is currently beyond the reach of municipal services such as fire and police protection. The county began work on the proposal in February 2011. Back then the county's zoning didn't make provision for data centers as an allowable use. Another challenge was the land along I- 80 had been designated for services to be provided by the City of Sparks, but its location at the eastern end of Truckee Canyon put it outside the area that could be served by the city in a cost-effective way. Apple expects to build a 365 MW natural gas power plant on site to meet the heavy electric demand of its server farms, and to take advantage of the center's location near major natural gas lines, electrical transmission lines and a big fiber optic line. The facility is expected to get some power from a farm of solar panels. Developers of the data center will also need to provide a full array of urban services. Two water tanks of 1 million gallons each are planned, as well as on-site security services, roads and fire protection. Finally, the agreement calls for Apple to build and staff a fire station at the facility. Upon completion the center is projected to contain over 2 million sf of buildings.

Major Q312 Sales Transactions

Two of the 3 largest real estate deals in Q3 were the sales of Saint Mary's Hospital's real estate: first from Catholic Healthcare West to Prime Healthcare Services and then the flip to Medical

Properties Trust for \$80 million. Since these sales were related to the sale of the business I have excluded them from the data presented below. Another non-investment transaction was Washoe County selling the Pioneer Center to the non-profit that has been running it since 1988.

The following table summarizes the 10 largest Q312 transactions aggregating \$124.2 million, or 64% of the total dollar volume. Distress continues to have an impact with one foreclosure, one large “deed in lieu” deal and three sales out of foreclosure in Q3. In multifamily there were 3 transactions over \$3 million, totaling \$47.4 million – accounting for 86% of total multifamily sales dollar volume. In Q2 there was only one – the \$9.2 million Skyview / Skyline sale. Small apartment investors continued to pick up the pace, accounting for 90% of all apartment transactions, with the average price per sale increasing 17% to \$284,241.

Transaction	Address	Date	Price
Prologis conveys 9 buildings, consisting of 2.43 million rsf, via a deed in lieu to Pacific Life	1316 Capital Blvd., 45, 55 & 695 Vista and 250, 350, 360, 450 & 475 Lillard	07/02/12	36,767,500
Fore Properties sale of 308 units in both View apartments to a TIC composed of 3 investors from the CA Central Valley	1195 & 1850 Selmi Drive	09/14/12	35,000,000
John Benjamin purchases the 241 ksf Pfizer Building from Panattoni	1025 Sandhill Road	08/20/12	10,900,000
Wells Fargo forecloses on the Smith's Shopping Center @the SEC of So. Meadows & Double R Blvd.	748 S Meadows Pkwy	09/04/12	8,400,000
Fowler Properties acquires the eastern 206 units of the former Meadowood Apts from Kinecta Fed Cr Union out of foreclosure	825 Delucchi Ln	07/17/12	8,300,000
Panattoni sells the Bally's Technologies building to a local couple	900 Sandhill Road	08/14/12	6,000,000
Washoe County sells the Pioneer Center to the Pioneer Center	100 S Virginia Street	07/03/12	5,789,500
The doctors at Gastroenterology Consultants sell their building to a family trust	10619 Professional Circle	09/19/12	5,500,000
BofA sold this 113 unit apartment property out of foreclosure to an individual from Las Vegas	1850 Idlewild Drive	08/20/12	4,137,500
Turner Real Estate Fund of Newport Beach bot Quail Vista out of foreclosure from CW Capital.	4690 Longley Lane #9-12	07/16/12	3,400,000

The Local News Bag

Yun Long reported in the August 4th RGJ that Lyon County Commissioners voted 5-0 to allow Walker River Meat Processing a special-use permit for a processing plant to be located 10 miles north of Yerington on U.S. 95A. The facility will be able to process up to 3,500 sheep, cattle and hogs per day in separate plants - and could create up to 600 jobs. Lyon County's unemployment

rate was 16% in June - the highest in the state. The plant is expected to employ 350 to 400 construction workers, with groundbreaking in 4 - 6 months. Construction is expected to take 18 months. The project was first proposed over 1 year ago. The \$175 million plant will be built to USDA and European Union standards. It will feature water treatment plants, a geothermal plant and a hydroponics facility. ESTELCO Investments/Developments of Modesto is the developer.

The RGJ reported that on October 3rd Rubicon Data Centers, a new San Francisco company, announced plans to develop a data center campus near Reno. It is partnering with industrial real estate developer Prologis to build a 44-acre data center project in the Tahoe-Reno Industrial Center, nine miles east of Reno. Plans include 300 ksf building with 20 MW of critical power, data center suites and multi-tenant collocation rooms. Easy access to utilities, Reno's climate and Nevada tax incentives were cited as reasons for the data center campus project – all conducive to achieving a low PUE – or Power Usage Effectiveness.

On October 5th the NNBW reported that Campo, the downtown Reno restaurant owned by Mark Estee, has been named to Esquire Magazine's list of Best New Restaurants in America.

The NNBW reported on October 16th that the inventory of existing home for sale in the Reno market was 2,926 in September, a decline of nearly 29% from the same month a year ago, according to Realtor.com. Homes on the market averaged 90 days.

On October 18th Bill O'Driscoll reported in the RGJ that the Reno-Tahoe Airport Authority board approved up to \$6 million for a new, 12 ksf administrative building at Stead, to replace a World War II-era structure. It will be built with funds from an existing airport authority loan and will help boost the Airport's preparedness, along with \$45 million in improvements made over the past decade, including a new air tanker facility opened by the BLM, 9,000 feet of new runway and upgrades to runway lighting. It will also include an emergency operations center. Stead is a federally designated "reliever" airport for Reno-Tahoe International - to relieve congestion and act as an alternative airport in emergencies. In the 1997 flood commercial flights could not be sent there as Stead's equipment could not handle it. Today, emergency supply flights and corporate aircraft can utilize Stead, as well as it serving as a major base for firefighting aircraft.

On October 25th the NNBW reported that taxable sales in Washoe County in August were up 10.5% from a year earlier. Carson City was down 0.2%, and Douglas County was up 10.7%. Heavy and civil engineering construction in Washoe County was up 55%, and general merchandisers saw a 12% uptick in sales.

Local Rumors

- Hamilton Zanze is NOT selling the Lodge at Galena anytime soon.
- A developer is under design for a 320 unit apartment property in the North Valleys.
- Another property up there is considering adding some "big house" style apartment buildings on land they have owned for a while.
- Just like they did in 2011, a developer is again considering starting construction of a luxury apartment complex in the South Meadows totaling 280 units.

Divided Reno council backs Aces Ballpark refinancing

Brian Duggan reported in the RGJ that, by a vote of 4-3 on October 24 a deeply split Reno City Council approved a plan to use Reno's general fund to refinance a distressed \$55 million

construction loan that was used to pay for the Aces Ballpark. Mayor Bob Cashell phoned into the Council chambers from home while recovering from open heart surgery. He cast the crucial vote in favor after making an impassioned plea to keep the Reno Aces in town. Councilmen Aiazzi, Hascheff and Gustin voted yes, while Dortch, Zadra and Sferrazza voted no. The plan is to use Reno's general fund and potentially the County's, as well as new private funding from the Aces owners, to issue new private debt to refinance the \$55 million loan. The County is being asked to chip in \$500,000 per year for the next 30 years. If approved, the direct public contributions from Reno and Washoe County will amount to \$45 million over those 30 years. Once the stadium is paid off it will become a publicly owned building. Originally, the ballpark loan was going to be mortgaged using assumed increases to downtown property taxes. Instead, that revenue collapsed during the recession as casino revenues dramatically declined.

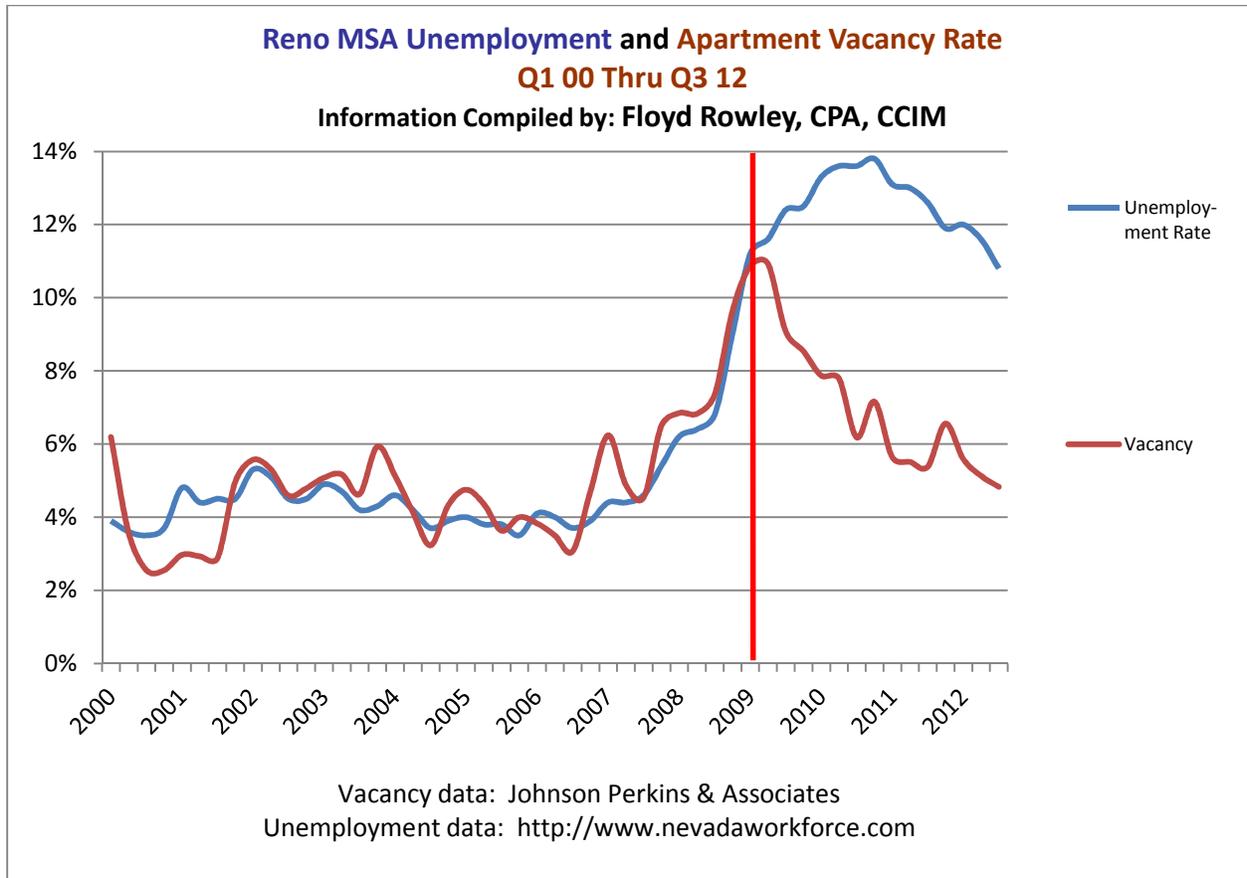
Silver Legacy bankruptcy agreement is official, owners look to the future

The Silver Legacy's bankruptcy settlement became official on October 24th, according to Bill O'Driscoll's article in the RGJ. The company filed for Chapter 11 protection in May after it failed to pay off a \$142.8 million, 10-year loan that was due in March. The settlement is based on a revised total debt of \$97.5 million, including a new \$70 million bank loan and cash from the owners - and the Silver Legacy itself. Bondholders will receive a \$27.5 million 2nd lien on the 35-story, 1,700-room property at the corner of Fourth and Virginia. The loan was taken out in 2002 at a 10.125% interest rate. The Legacy will announce a rebranding by 2013 not just for the tourist market but to become the sweetheart of the Reno community like it was when it opened. The Silver Legacy, built at a cost of \$350 million, was the brainchild of the owners of the Circus Circus and the Eldorado hotel-casinos. Former Reno lawyer Don Carano, now 81, built the Eldorado in the early 1970s and was instrumental in the Legacy's birth. He has since moved to in Sonoma County, CA where he operates the Ferrari-Carano Vineyards and Winery.

Apartment Statistical Review

As usual, my thanx to Johnson-Perkins & Associates for their Quarterly Apartment Survey for the data in the graph below and to enable me to make the following observations:

- Overall vacancy, with the exception of Q412, has continued its gradual downward trickle from 5.64% in Q111 to 4.83 % at Q312 – now 6 quarters in a row.
- Overall average rents are flat again - essentially unchanged from Q210. However, the average rent jumped \$14, or 1.7%, from Q412 – a good sign of strength.
- As usual, Lakeridge, NW Reno and East Sparks continue to have the highest rents in the region, with all three coming in at over \$900 / month for the second quarter in a row.
- West Reno, which reported an amazing 0.44 % vacancy last quarter, is now at a still amazing 2.67% - still room to raise rents there guys!
- The Brinkby/Grove sub-market continues to have the lowest average rent at \$577 / unit, which is \$145 / unit lower than the next lowest sub-market – the Airport area.
- The Airport sub-market vacancy skyrocketed this quarter from 6.6% to 8.2%.
- Finally, vacancies in 3 X 2's, which increased in Q1 to 9.3% ,came back down in Q2 to 7.1%, and were the only unit type to register a vacancy increase in Q3 – to 7.2%.



About the Author

Floyd joined the Johnson Group in January 2011 to continue his commercial investment brokerage practice in northern Nevada after serving over seven years as the 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 / leasebacks and negotiates build-to-suit transactions. Since 2004, Floyd has closed over \$124 million of investment transactions in the Reno MSA. Starting in the fall of 2008 he has focused on distressed assets, mainly apartments, completing \$294 million in 45 broker price opinions (BPO's). Since early 2010 these BPO's have resulted in over \$38 million of listings, mainly apartments.



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