

Northern Nevada Commercial Investment Real Estate Report 3rd Quarter 2011 - The Bi-Polar /"Waiting for the Election" Issue

Major Transactions this Quarter

Commercial sales activity continued its downward spiral in Q3, with only 66 transactions totaling \$96 million – including foreclosures. In fact, four of the eight largest sales were foreclosures. Volume is down by 42 sales and \$37 million from the dismal volume in Q2.

A number of apartments were exposed to the market this past quarter, but none have yet closed, including Meadowood, Manzanita Gate, Westcreek and the Park at Idlewild. Many of the apartment buyers I have talked to recently are tapped out and waiting for 2012 to reload. The 498 unit Meadowood property was "separated" in late 2010 from the 208 unit portion on the east side of Neil Road, now known as the Delucchi Lane Apartments. Meadowood "West" attracted over ten offers, but was withdrawn by the seller when he did to get the price he wanted. It was listed at a pro-forma (sic) cap rate of 7.53%, which included a number of units at rents \$100/mo above the current market. Then there was the issue of deferred maintenance.....

Transaction	Address	Date	Price
Steve Biogotti sale of Veterans Corporate Services build-to suit to an investor	5460 Reno Corporate Dr	09/01/11	8,700,000
Flocchini sale of 790 Sandhill to a San Jose investor at \$432 psf.	790 Sandhill Rd	07/29/11	7,781,000
CVS drug store @ Northtowne lane and N McCarran Boulevard	2890 Northtowne Ln	08/26/11	5,525,000
Foreclosure of Allison dealership property by First Independent Bank	9190 S Virginia St	07/14/11	4,673,456
Foreclosure sale by US Bank of the busted Talus Point condo deal to Irvine, CA investors	Talus Way	09/08/11	4,225,000
Tami Topol & Mr. Kubinski lost their So. Meadows "Lake" property to Nevada State	No # on Double R Blvd	07/06/11	4,000,000
Green Leaf Partners purchase of the 116 unit Northgate Villas Apartments from BACM	100 Carville Drive	07/05/11	3,650,000
Wells Fargo forecloses on Air Center Plaza at the NEC of McCarran and Longley	3923 S McCarran Blvd	07/13/11	3,120,000

Local News – a mixed bag

Fernando Leal's new venture in downtown called CommRow held its grand opening on Saturday October 1st. About 60,000 square feet of the gaming floor of the former Fitzgerald's Casino has been turned into a non-smoking, non-gaming, pet-friendly property to create a completely new genre of hotel in Reno – the Urban Adventure Destination, complete with 11 restaurants and a the world's tallest competition climbing wall. Check it out on Facebook.

The Reno-Sparks Association of Realtors reported 1,611 sales of existing homes in Washoe County in Q3, an increase of 22% over the volume a year ago. Unfortunately, the median price of \$151,000 was down 14% from a year ago.

Per the Northern Nevada Business Weekly ("NNBW") Toys-R-Us cut the ribbon to officially open their e-commerce center at the Tahoe Reno Industrial Center on September 19. The highly automated 300,000 sf facility employs more than 60 people.

The NNBW reported on September 9 that the Sierra Trading Post has completed its move to a 31,500-square-foot location next to the Whole Foods Market.

On August 3 the NNBW reported that EDAWN worked with 17 companies that created 670 jobs in Greater Reno-Tahoe in the fiscal year ended June 30. A year earlier, the figures were 15 companies and 513 jobs.

On September 1st the Reno Gazette Journal reported that the Grand Sierra will get a \$25 million facelift. The property's new owner, the Meruelo Group, plans to upgrade the resort's 2,000 rooms, renovate the casino floor, including an improved upper-level lounge, and add a Mexican restaurant and a country & western dance hall.

On August 11, in the "News About your Fellow Members" email from the Reno Sparks Chamber of Commerce, reported that the Montage leads condo sales in Reno with 25 closings in the 2nd quarter and 45 thus far in 2011. Prices range from \$80,000 to \$715,000.

In the "Really Hard to Believe" category, the Money Game section of Business Insider.com, in an article titled, "The Best Housing Markets for The Next 5 Years", predicted Carson City as the #1 best USA housing market, with Reno in a tie for #8 with Bremerton, WA. According to data they attributed to Fiserv Case Shiller Indexes, Reno suffered a 46% decline and Carson City's homes lost 39% during the Great Recession. They predict the Reno market will bounce back achieving a 9.3% annual growth rate in 2011 to 2016, with Carson City achieving 11.9% / year.

On October 17th the NNBW reported that Mark Estee, a Reno and Truckee "celebrity" chef, will open his new restaurant, Campo, in the Palladio in November. It will be another boost for downtown, featuring wood fired pizzas and "rustic cooking" that is built around seasonal offerings. This is also good news for the Palladio, which briefly hosted a Starbucks.

Bad Policy Resulting from Bad laws in Nevada and Nationally

Robert Barone, in an August 16th email from Ancora West Advisors wrote: Nevada leads the nation in underwater mortgages. Zillow reports numbers as high as 80% in Las Vegas and 70% in Reno. To deal with this the last Nevada legislature passed legislation which prohibits a 1st lien holder from collecting a deficiency judgment on a primary residence short sale. This means that everyone underwater can walk away without real consequences and means even more short

sales and foreclosures. Another new Nevada law prohibits note holders who purchased mortgage notes at a discount from collecting more than they paid for the note in a foreclosure, which can potentially be disastrous for the secondary mortgage market. Taken to its logical conclusion, no one would be willing to buy troubled loans at a discount because the best return possible is simply a return of capital.

Nationally, the Dodd-Frank legislation will impose significant restrictions on mortgage lenders. The natural consequence of Qualified Mortgages (“QM”) and Qualified Residential Mortgages (“QRM”) is that only the most privileged borrowers will be able to get mortgages. QRM requires lenders to meet strict underwriting standards. The FDIC has indicated that about \$8.5 *trillion* of current mortgages would **not** have qualified under these guidelines.

Scarier is the QM standard which prohibits negative amortization loans, loans with balloon payments, or loans with terms exceeding 30 years. But the kicker to QM, as proposed, is that there are severe legal and monetary penalties to lenders if it is determined that the borrower did not have the “ability to repay” when the loan was originated. Imagine what the legal profession is going to do with this standard. Barone suspects that the fact that the home went into foreclosure will be a strike against the lender under QM.

Accelerating? Foreclosures

Effective, October 1st Nevada’s new Foreclosure Law, AB284, requires a notice of default (“NOD”) and election to sell real property subject to a deed of trust (“DT”), to include an affidavit setting forth information concerning the DT, amounts due, the possession of the note and the DT and the authority to foreclose. This new law has slowed filings significantly. Ticor Title sent me an email on this subject that showed that there were only 13 NOD’s recorded in October, compared to 612 in September – with 89 filed on September 30th alone. Greg Hughes, founder of Hughes Private Capital, writing in his blog titled, “The Weekly Real Estate Blah, Blah, Blah with a Twist”, believes that around February or March of next year we will see a dramatic decrease in foreclosures. This is, of course, only a delay of the foreclosures and they will resume as soon as the lenders learn how to comply with the law. They may just pick up the pace as much as they can with short sales. Either way we may experience a tightening of the market in about 4 to 6 months.”

The State of Education in America

Becky Quick wrote an opinion piece in the October 17 issue of Fortune Magazine that dissected the President’s jobs bill that was recently unveiled. Many reasons were cited for our stubborn high unemployment, including regulation, but a key theme was education, or more specifically the lack of it. A recent McKinsey study predicts that in a few years America will be 1.5 million college graduates short in highly skilled areas where job demand is growing. She also quoted Michael Dell, “If we set up a new site to hire 100 engineers, we have to go find them and cajole them to come to work for us. If we set up a distribution center and we have 100 jobs there, we will have a line of 10,000 people waiting outside to try to get those jobs.” I suspect he is exaggerating, but the point is our kids really need to focus on math and science in schools.

Harry Reid's Jobs Math

Speaking of the jobs bill, the above title is also the title of an editorial in the October 20th Wall Street Journal. Ol' Harry has been widely lampooned for the following quote, "It's very clear that private sector jobs have been doing just fine; it's the public sector jobs where we've lost huge numbers and that's what this legislation is all about". The Journal cited the government's own sources to state that the feds added 253,000 jobs in the two years between 2008 and 2010, while private employment fell by 2.5 million jobs during the same period – hmmm.

Are We Near The Bottom?

The following are edited remarks from Joel Ross, writing in the October 19 issue of GlobeSt.com: Timing the market is always a challenge, but calling it can make a huge difference between large profits or falling into crisis. Starting in late 2006 and into early '07 several people I know had concluded that the end was near. Experienced people saw what was happening in the capital markets and with asset prices, and understood that the insanity was not sustainable. They put themselves in a good position for the collapse to take advantage of the opportunities. We may be at one of those turning points.

While many believed we had passed the turning point in 2010, with CMBS markets and REITs gearing up, they did not look at the whole world to understand what was really going on. In August it became clear, when the federal debt talks turned into a national disgrace, that Obama has no idea how to work with Congress and to fashion a workable economic program. The right wing of the Republican Party is equally unable to understand economics and how to do a deal. Throw in Pelosi and Reid and we get the totally dysfunctional government in America today.

On top of that we have a very dysfunctional Euro Zone. They have finally figured out that their dysfunction cannot go on any longer. Holders of Greek debt will take a major haircut. Ireland seems to be getting its act together. Spain and Portugal have issues but are working on them. Italy is hopeless until there is a real prime minister. China is trying to stop its real estate bubble and control inflation. Brazil is working to control their inflation and currency problems. In short, it seems that world leaders, other than Obama, do finally recognize that they can't just keep kicking the can, and it is well past time for genuine action.

I believe we are now bottoming, and while there will be more crises, the US will not really clean up its mess until after the election. Growth will remain slow, unemployment high. Yet, there is now a solid base. The major banks are well capitalized; large corporations have piles of cash. Interest rates are so low now that everyone can reset their debt. The stock market has possibly found a bottom. Investor fear is at a peak with huge amounts of cash sitting idle. Opportunity is best when fear is rampant and everyone is running for cover. This is not a trading market - it is a true investing market. If you choose good assets now you should do very well. Things will eventually get better. Obama will lose the election. It will be Romney or Cain or both. There will be big changes for the better in the US after 2012. Europe will get through this. Good US real estate, if bought right today, will be a solid investment if you stick to basic underwriting.

Echo Boomers: Rent Now, Buy Later?

Jennifer Duell Popovec, writing in the July 20th issues of GlobeSt.com reported that a study by Harvard's Joint Center for Housing Studies, found that demographic trends favor continued

growth in the number of renter households for at least the next decade, with population growth alone increasing the number of renter households by more than 3.6 million by 2020. That includes the Echo Boomers who are comfortable in urban areas and are willing to live in smaller spaces so they can be close to all the things offered by urban cores. The study also stated that nearly eight of 10 Americans age 18 to 25 are renters already, while more than 65% of 25 to 30 year olds are renters too.

Real Estate Looking Up in '12, Just Not That Much

In the October 28th issue of GlobeSt.com Morris Newman stated that multifamily will remain the hottest property type, according to panelists at the recent ULI Fall Meeting. That's not a surprise, but the ULI's annual Emerging Trends survey shows that even B and C properties may hold promise for investors next year [think Reno!]. Industrial real estate also looks to be headed for a strong performance during the long recovery. Panelists were also optimistic about improvements in both the office and hospitality sectors. Distressed assets in secondary markets however, do not look promising in the short term.

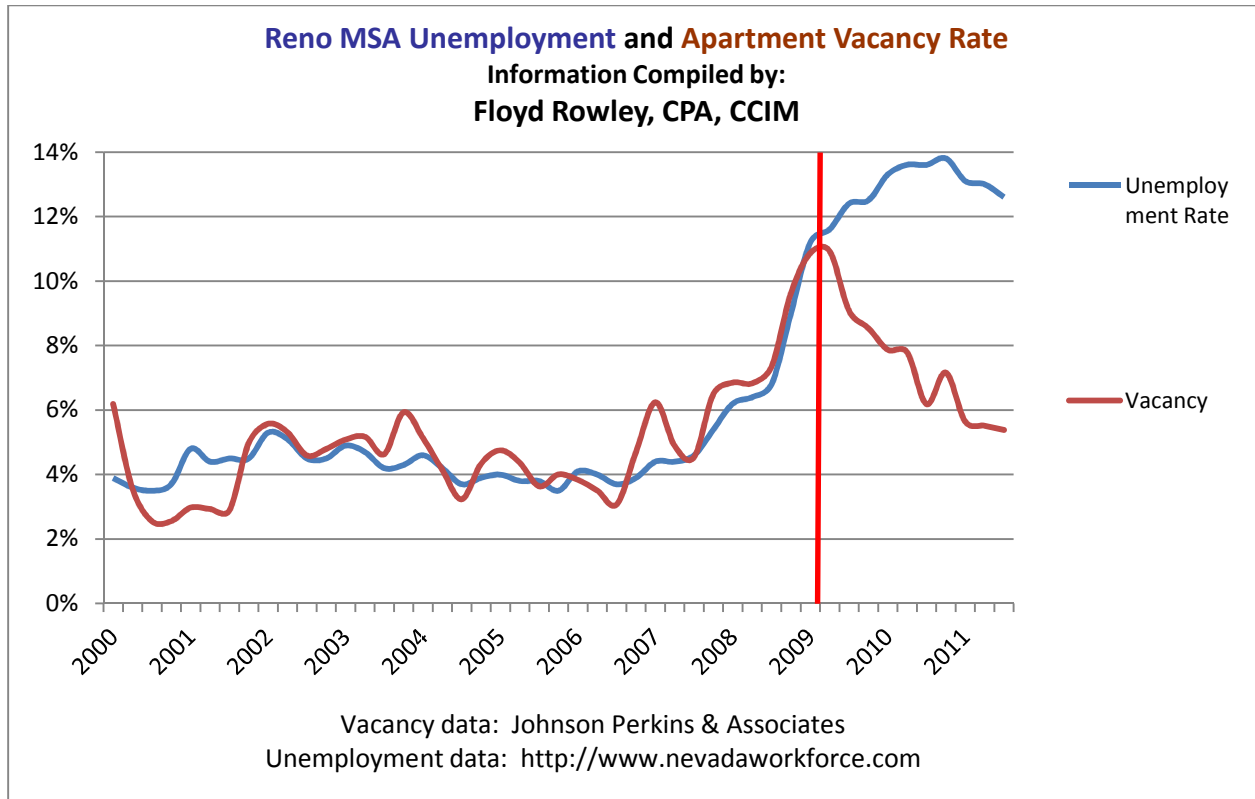
Economy Remains in Stagnation Status Until Elections are Over

Natalie Dolce, writing in the October 17th issue of GlobeSt.com also reported on the ULI Fall Meeting, where Hessam Nadji, managing director of research for Marcus & Millichap, outlined progress in the commercial real estate markets. He was generally optimistic, stating that the economy is still in “stagnation status until elections are over, although there have been significant improvements. We have lived through major events. The last two months were a big test of whether companies were going to panic and lay off, but we have passed a number of critical tests since the downgrade. If I had a magic wand, I would fix the short term and then the long term and not try to do both at the same time.” He believes that apartments are the only sector in a full-fledged recovery, with Industrial second. In terms of investment sales, “we have seen the market come back rapidly.” He also noted that corporate profits are well ahead of 2006. “Capital spending by corporate America is key to sustainable recovery”. In terms of jobs, Nadji expects employment growth to regain momentum in 2012—even if it is just catching up to the long-term average. He cited several favorable factors behind his long-term economic and real estate outlook, including demographics, which he said is “a huge positive.”

Apartment Statistical Review

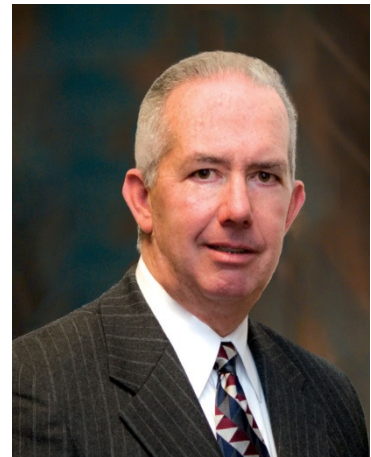
As always, I am indebted to Johnson Perkins & Associates for their Quarterly Apartment Survey: for the data in the graph below and to enable me to make the following observations:

- Vacancy overall decreased by a statistically insignificant 13 bps from 5.51% to 5.38%.
- The overall vacancy is now back to levels from the 2002-07 era – the last big run-up era leading to the peak before the crash in 2008.
- Vacancy by unit type shows a 79% increase in 3 bedroom / 2 bath from 5% to 9% - looks like tenants might be finding rental homes or (gasp!) buying a house for under \$200k.
- Other than the Brinkby/Grove and the Airport submarkets coming in at 10%, and weighing down the overall average, vacancies in the other 8 submarkets ranged from 3.09% (Lakeridge) to only 5.96% in Southeast Reno – a very healthy market overall.



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 / leasebacks 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 \$265 million in broker price opinions, resulting in over \$24 million of apartment listings.



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