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Northern Nevada Commercial Investment Real Estate Report
4th Quarter 2012 - The "From Fiscal Cliff to Sequestration" Issue

Last quarter I started my report by quoting the Urban Institute and the Urban-Brookings Tax Policy Center stating that Federal taxes were going up in 2013 for six reasons. Well, five of them happened. The only one that didn't was the AMT, which was extended and indexed for inflation – a good thing. Pulling back from the fiscal cliff at the 13th hour, and by a vote of 89 to 8, just before 2 AM on January 1st, the Senate approved the 153 page American Taxpayer Relief (sic) Act of 2012 (ATRA), with an effective date of December 30, 2012. The House had earlier approved it by a vote of 257–167, after plans to include spending cuts were abandoned. By waiting until after midnight to pass this bill, Congress could technically call the ATRA a "relief" act, as the increases in the ATRA were less onerous than the rates after the expiration of the Bush era tax cuts two hours earlier – makes one just a wee bit cynical about our Congress, eh?

Prop. 30 also passed in CA, increasing their top income tax rate to 13.3%, making its combined state and federal rate 51.9%. Also, the Global Warming Solutions Act of 2006, signed by the Governor, with rules enforceable as of January 1st of 2012, has many real estate agents fielding calls from business owners looking to escape.

National Multi Housing Council Conference – La Quinta – January 22, 2013

For the second year in a row I attended the NMHC Apartment Strategies Outlook Conference. Here are my key takeaways:

- According to the National Association of Business Economics, GDP will grow by an overall rate of 2.4% this year, starting at 1.8 and accelerating to 3% by Q4.
- 3 million households "doubled up" between 2008 and 10. Now 2 to 3 million young adults are starting to move out as household formation takes off even before the economy does.
- Pent up demand for household formation is 1.7 million units - unlikely to be met soon.
- Declining prices and interest rates caused home affordability to surge 10% since Q109.
- 730,000 young people, representing 45% of all jobs created, found jobs last year.
- Historically apartment construction averages 350k units/year to keep up with demand. As construction fell off dramatically starting in 2009, we are now 750k units short nationwide.
- Starts may be up from 2012's 212k units. Impediments are: conservative equity and lenders, high land costs and high labor costs which will increase 4 - 10% due to trade shortages.
- Unit size is trending to smaller units with new amenities such as dog washing rooms, bicycle shops and sky lounges. Leasing is trending to "stand up" contacts with tenants using iPads.
- Tanning beds are huge in the student housing sector. These properties need to have very robust internet networks to handle the peak traffic demand from 10 PM to 2 AM.

- 2012's $90 billion of apartment deals nationally is halfway between the recovery year of '04 and the boom years starting in '05 – except that cap rates are much lower now.
- Prices / unit for deals under $20 million did not drop much during the Great Recession and are now back close to 2005 levels, with national cap rates back to those levels as well.
- The buyer profile in 2012 returned to the component mix that existed in 2007.
- AIMCO is re-investing $150 million/year to upgrade their units. They are replacing carpet with vinyl plank. Another big REIT, Camden, is investing $10–12k/unit. This low risk strategy can be stopped if the market won't pay higher rents for the upgraded units.
- PNC, a large apartment lender, is underwriting for exit cap rates and interest rates to go up during the borrower's hold period by 2 to 2.5% as a hedge against anticipated rising rates.

Major Q412 Sales Transactions

The chart below summarizes the eight Q4 transactions over $3 million. As expected Q4 total sales surged $42.8 million to $155.1 million, with 94% of all transactions being under $3 million. Multifamily sales came in at 20.9% of the total Q4 dollar volume, due mainly to the Waterford deal. 2012 was a strong year for multifamily, racking up $126.9 million in sales over $1 million.

I personally drove the second largest apartment sale this past quarter and also had a $4.7 million buyer for the 8 acre student housing deal – but he could not close soon enough.

Transaction	Address	Date	Price
GE Capital Real Estate **forecloses** on its $18.3 million loan on the Courtyard Motel S of Neil Road.	6855 S Virginia	10/03/12	18,614,234
J. Witt and investors flip the Waterford Apartments to Green Leaf after owning it for < 19 months	800 Nichols Boulevard, Sparks	12/27/12	17,100,000
The Hamilton Co. continues to expand its campus between Rock & Edison by buying a 94.5 ksf industrial building from the McKenzie family.	645 Edison Way	12/20/12	6,860,000
A Reno neurosurgeon buys a 1,148 unit mini storage facility S of US 395 between Red Rock & Stead Blvd. from Barton Stern.	9950 N Virginia St.	12/28/12	6,050,000
Sale of the 8.07 acre Luce Warehouse property to Dinerstein, the largest student housing developer in the USA.	2399 Valley Road	12/13/12	4,700,000
Rowley-led syndication buys the 96 unit, 1965 construction, Regency Park Apartments from Tamkin for $43,625 / unit at an 8% cap rate.	3200 Lakeside Dr.	12/27/12	4,182,000
The Gorelicks buy the 1952 construction Casson Apartments with 62 units just S. of St. Lawrence Avenue for $55,242 / unit @ a 7% cap.	700 Forest Street	12/11/12	3,425,000
CW Capital **forecloses** on Ribeiro's Quail Vista Business Park on behalf of USBank.	4690 Longley Lane	12/12/12	3,400,000

The Local News Bag

EDAWN brought pastry maker French Gourmet Inc. to Sparks after 28 years in Hawaii, making it much easier to reach their west coast markets. They moved into a 78 ksf warehouse on Coney Island Drive, employing 54 people. They have plans to double in 2 years and have been ramping up production since June 2012.

PPG Industries has opened a new 187 ksf distribution center at Tahoe Reno Industrial Center. They also make paint and architectural coatings in a 95 ksf manufacturing facility nearby.

Northlight Financial has acquired the remaining real estate assets of Old Greenwood, a recreational resort / golf community in Truckee, from East West Partners.

Ryder Homes has broken ground on its 208 unit Class A apartment community on Arrow Creek Parkway. It will consist of 13 buildings and a rec center. 63% of the units being two by two's.

Apple's fabrication facility at 5th and Evans was supposed to open in December. Their contractor has not picked up the building permit that has been ready since October. Meanwhile, construction on their data center east of town continues.

EDAWN's site visits in 2012 increased 85% over 2011 - a sign that the economy is improving. With EDAWN's 80% close rate last year, this bodes well for our region.

Tahoe Regional Plan Update Approved

Writing in the December 9th Reno Gazette Journal (RGJ) Jeff DeLong stated that years of effort were coming to a head as the Tahoe Regional Planning Agency (TRPA) was set to approve a Regional Plan Update, which the TRPA's Governing Board did approve on 12th. The last regional plan was approved in 1987. The new plan (Plan) is designed to offer a regulatory approach to encourage private investment to redevelop aging urban areas around the Basin. Such projects could offer a needed boost to Tahoe's economy while at the same time provide vital private dollars to build environmental improvements within urban areas most responsible for the inflow of sediment that clouds the lake. Public financing paid for much of the $1.5 billion in projects over the last 15 years which made measurable progress in slowing decline of the lake's famed clarity. The Plan encourages removal of some of the thousands of homes and businesses built on Tahoe's most sensitive lands back in the 1950's and 1960s by a transfer of development rights program to provide a builder who removes structures from sensitive land with more flexibility to build within a dozen existing urban centers from the South Lake Tahoe-Stateline area to Tahoe City, Kings Beach and Incline Village. The Plan eases regulations affecting decks and patios for properties where drainage and environmental improvements have been accomplished; loosening rules long a sore point for Tahoe homeowners. The Plan will also provide local governments a greater role in land-use decisions. The Plan came with often-lurching progress in recent years, which prompted Nevada lawmakers in 2011 to pass legislation to pull out of the 1969 compact in 2015 if a new regional plan was not in place.

Ritz-Carlton - Tahoe acquired by Kennedy Wilson

Jason Hidalgo wrote in the December 19th RGJ that Kennedy Wilson acquired the 170 room, 400 ksf resort at Northstar on December 18, 2012. Kennedy supplied $18 million in equity for a 50% stake in the resort that was completed in 2009. Pacific Western Bank provided a $45 million loan. BofA had filed an NOD on March 31, 2010 against the-developer East West Resort

Development, who were behind on $19 million in payments on loans totaling $157 million. East West also filed for Chapter 11 bankruptcy in 2010. The property has 23 luxury penthouses - the Ritz-Carlton Residences - which Kennedy Wilson plans to sell.

RTC Approves $65 million contract to begin Southeast Connector construction

Construction of the Southeast Connector will begin in February. The RTC approved $65.1 million to build a 1,300' bridge over the Truckee River and 1,800' of road south of the river. They will also pay UNR $7.4 million to purchase 165 acres in the University Farms area needed for the project. When finished, the Connector will run 9+ miles from the base of Geiger Grade, through Rosewood Lakes and University Farms to Sparks. About 4 miles of the southern portion was built by developers and is known as Veterans Parkway. The new contract is for the 1st phase of the unfinished 5.5 miles of six-lane road. The total project cost is now estimated at $250 million, with Phase 2 starting in April of 2014, according to Garth Oksol, Project Manager.

Reno council OKs Aces Ballpark deal

In the January 31st RGJ Brian Duggan reported that the Reno City Council voted 5-2 to keep the Aces in town. The next step is to get the County to approve a $15 million subsidy to help pay off a $55 million construction loan used to build the stadium five years ago. The five key points are:

1. The Council approved a $30 million subsidy over 30 years to help pay off the stadium.
2. After 30 years of payments, the stadium will become publicly owned. Until then, the developers will be responsible for all improvements and maintenance to the ballpark.
3. The developers will personally guarantee the new long-term debt that will be privately issued, and largely backed by public dollars, to refinance the stadium.
4. The $4 million the city still owes for a loan used to move a downtown fire station to make way for Aces Ballpark will be forgiven by the stadium developers after five years.
5. If the developers sell naming rights to the ballpark, the city will get a credit of 10% of that to their annual payment as long as the sponsorship brings in at least $300k in any given year.

12 Commercial Real Estate (CRRE) National Predictions for 2013

2013 looks to be a lot better than the last two years, according to Mark Heschmeyer, writing in the January 2nd CoStar Watch List. He assembled the following forecasts:

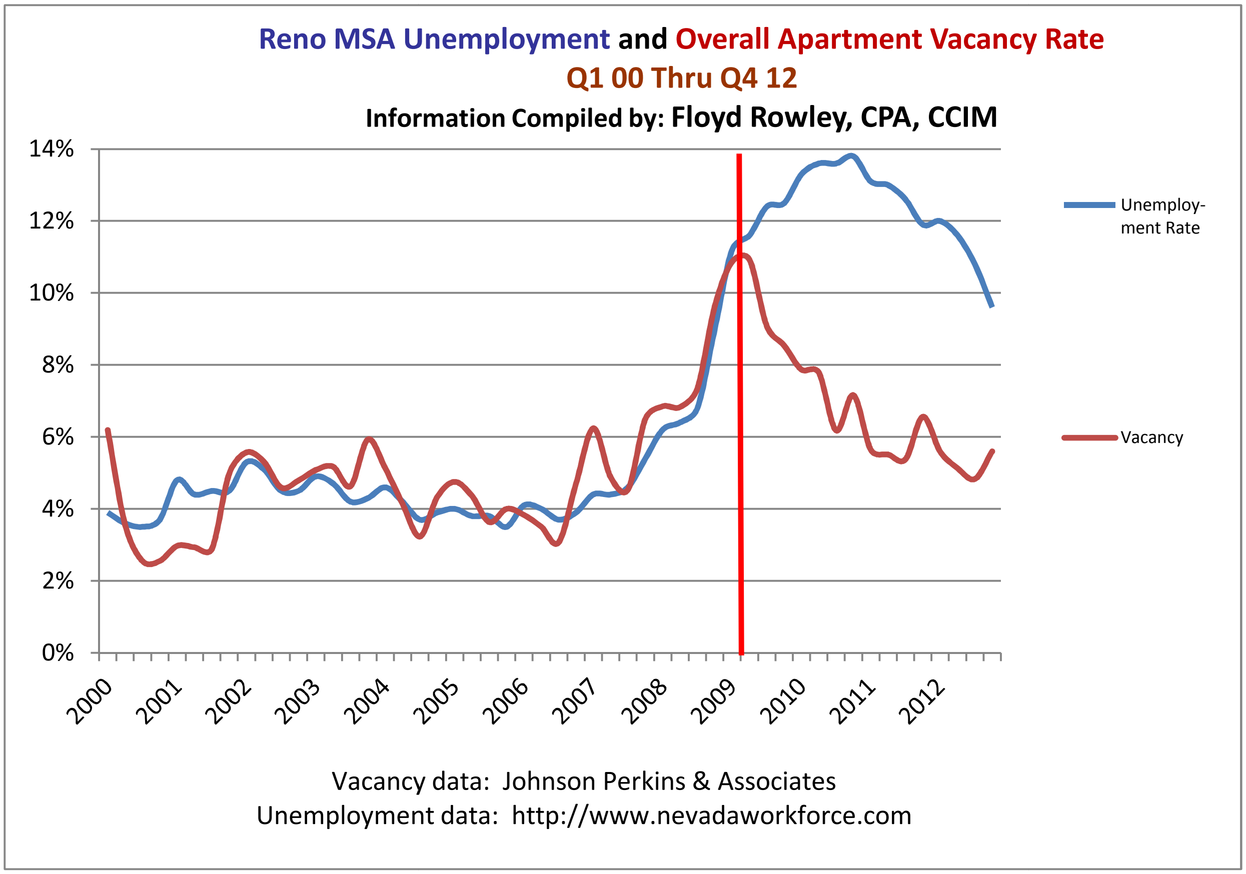
1. **Investment Market Will Be Up 20% -** JLL expects the commercial real estate recovery to continue, with s greatest demand being multifamily, office and industrial.
2. **Earliest Buyers Will Be Sellers -** Buyers of distress in '07 and '08 will be sellers in 2013, after converting property from distressed to core. They will be selling at very low cap rates.
3. **More Sellers Will Emerge -** Sellers will emerge wanting to do a 1031 exchange. They will face limited supply for their up-legs, which will discourage many of them. Low interest rates will continue to push caps lower on quality properties.
4. **Strongest Markets Will be on the West Coast -** Kiplinger sees Denver, San Francisco, San Jose, Portland and Seattle among the strongest office markets. Warehouse demand is heating up in Seattle, Denver, San Diego, and L.A., H. The outlook for retail is brightening. Apartments retain their appeal in Phoenix, Denver, Salt Lake City and the Bay area.
5. **Shift to Secondary and Tertiary Markets Will Continue -** Robert W. Baird Co. believes that investor interest is likely to move to secondary and tertiary markets where pricing is more favorable and demand is strong.

6. **The Recovery Accelerate Through 2014 -** C & W believes that 2013 will be a turning point for the economy and the CRE industry. It will get off to a slow start, but we are set for a big upturn by year end, setting the stage for a strong global rebound in 2014 and beyond.
7. **Slow Growth for Office -** PwC believes that office investors have accepted slower growth and are OK moving farther out on the risk curve. Core trophy assets are still the target of domestic and international investors, who are bullish on the US. Some investors are now moving to core in strong secondary markets or less-than-core in primary markets.
8. **Recovery Will Require New Technology To Keep Pace –** Deloitte believes that CRE firms are finding growth in technology. Cloud computing drives efficiencies, mobility improves customer experiences and social media helps firms gather data about consumer behaviors.
9. **2013 Will Be Good for REITs** Equity REITs will continue to have access to capital. Retail, industrial and CBD office REITs should have modest NOI growth, but not suburban office. Expect REIT's to use equity proceeds for development and growth - not reducing debt, yet acquisition volumes in 2013 to remain unchanged from 2012.
10. **CMBS Fall Off –** Wells Fargo Securities does not expect the CMBS sector to deliver the outsized returns achieved in 2012, forecasting $115 billion of new issues. Liquidations should be stable with extensions declining as most maturing loans are pre-2005.
11. **Bricks & Mortar Retail -** E-commerce will redefine shopping center tenant mixes according to Chainlinks Retail Advisors. Retailers will focus on urban, Class A locations with greater population densities and higher incomes. Restaurants will account for 40% of new tenants. Housing-related retailers will rally by 2014 thanks to the return of the housing market.
12. **Steady Housing Recovery -** The NAHB states that a steady housing recovery is underway, but could be derailed by tight lending standards for home buyers and builders, inaccurate appraisals and proposals by policymakers to tamper with the mortgage interest deduction.

__Apartment Statistical Review__

As always, 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, after declining for 3 straight quarters, ticked up ¾ of a percent to 5.6% - within a rounding error of the rate one year ago.
- Overall average rents are flat again – dropping only $2 psf – or ¼ of 1%.
- As usual, the Lakeridge, NW Reno and East Sparks submarkets continue to have the highest rents in our area, with all three coming in at over $900 / month for the 3rd quarter in a row.
- West Reno, which reported the lowest vacancy for the last 2 quarters – stayed flat at 2.67%. Repeat: time to raise rents there guys!
- The Brinkby / Grove sub-market continues to have the lowest average rent at $597 / unit. It posted a healthy $20 increase in Q4, yet is still $99 / mo less than the next lowest sub-market, Southwest Reno.
- The Southwest Reno sub-market vacancy jumped this quarter from 3.5% to 5.0%.
- Vacancies in townhouses skyrocketed from 7.1% to 9.4% in Q4, perhaps reflecting people moving into or buying homes.
- Finally, vacancies in studios more than doubled from 4.25% to 8.8%, perhaps reflecting the move to 1 bedroom units with generally around 50% more room.



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 $129 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 44 broker price opinions (BPO's). Since early 2010 these BPO's have resulted in over $44 million of listings, mainly apartments.

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