

Q418 Northern Nevada Commercial Investment Real Estate Report The "Are We Approaching Peak Apartments?" Issue

During Q4 I performed a market study for a client, which prompted me to do a deep dive into the apartment units under construction in the Reno/Sparks market. As you will read below, I reduced the number of units under construction. All but one developer shared their projections on the timing of when their new units will be absorbed into our market. They are predicting that 77% of all 3,831 new units will be absorbed in the coming SIX quarters. This averages 164 units / month! I chose the phrase "peak apartments" because the original "peak" term was applied to crude oil in a 1956 paper by geologist M. King Hubbert. He predicted peak oil production would occur in the early 2000's, with dire economic consequences thereafter. His timing was close, but fuel efficiencies and alternative energy forestalled the economic malaise. The metaphor is appropriate as it unclear when and how the next wave of apartment construction will occur.

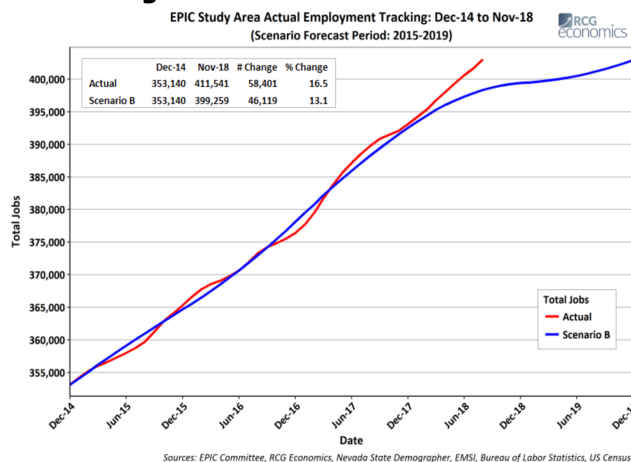
EPIC Job Growth!

Shortly after the Tesla announcement @ 4 PM on 9/4/14, EDawn commissioned EPIC, the Economic Planning Indicators Committee. The EPIC report was announced at EDWAn's January 2015 annual economic update luncheon - and the crowd was blown away at the brash projection of 52.4k jobs in 5 years. Well, our region did it in only 4: 58.4k announced jobs in 5 regional counties, with a 44k population increase. Therefore, as I have been predicting, a new EPIC projection was announced by EDawn CEO Mike Kazmierski on February 7th. EPIC 2, as it is called, calls for the following to occur in the next 5 years:

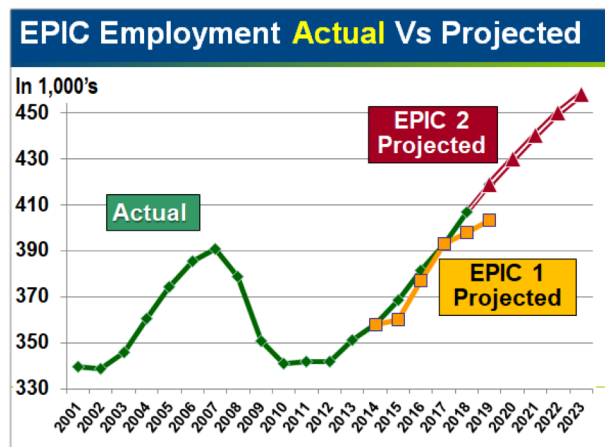
- 51,585 new jobs and
- 54,470 increase in population

EPIC 2 anticipates a mild recession and "some impacts from the housing shortage." It also is based on a slowing of job growth from 3% to 2.4% and increasing the population growth rate from 1.36% to 1.68%. Hopefully EPIC 2 will occur as projected and that the anticipated population growth will absorb all the new apartment units coming in the next 6+ quarters AND create a bit of pricing equilibrium to the benefit of all.

Original EPIC: forecast & actual



EPIC 2 Projection in Red



Major Planned / Under Construction Apartments (Rowley proprietary research)

This quarter I eliminated Carson City projects as they are a distinctly separate market from Reno / Sparks. However, I do have separate surveys for Carson, Douglas and the Dayton area. The numbers are as follows:

Rowley Research Totals		Plan	Under Const.	Total
Units:	This Quarter	10,034	3,669	13,703
	Last Quarter	10,176	4,806	14,982
	Change	(142)	(1,137)	(1,279)
	% Change	-1.4%	-23.7%	-8.5%
Projects:	This Quarter	30	13	43
	Last Quarter	31	18	49
	Change	(1)	(5)	(6)
	% Change	-3.2%	-27.8%	-12.2%

The reduction in **projects** reflects the elimination of 3 projects in Carson that I had been tracking and the completion of 3 projects, mainly Vintage at the Crossings.

The reduction in **planned units** corrects the number of units under construction at a large property. The reduction of units **under construction** reflects: eliminating 370 units in Carson, separating several large projects into 3 phases and the completion of Vintage at the Crossings, Park & Kuenzli and Park Place.

The Local News Bag

A February 7 NNBV (Northern Nevada Business View) staff report stated that the **number of passengers flying to and from Reno-Tahoe International Airport increased 4.8% in 2018 to 4.2 million**. This represents the largest number of annual passengers since 2008. RNO has grown the total number of flights by 18% in the last four years, while seat capacity has increased 25% since 2014. December 2018 represented 43 consecutive months of positive passenger growth.

Jason Hidalgo wrote in the January 17 Reno Gazette Journal (RGJ) that **the \$120 million sale of the Ritz-Carlton, Lake Tahoe closed to Braemar Hotels & Resorts**. Kennedy Wilson purchased the property, consisting of 170 hotel rooms and 23 condos, in 2012 for \$74 million. They sold the condos in 2016 for \$50 million. The luxury hotel broke ground to much fanfare during the height of the real estate bubble in 2006 but ran smack into the Great Recession when it opened as the Ritz-Carlton Highlands in 2009. Braemar's purchase includes a 3.4-acre vacant lot nearby that is designated for residential luxury townhome development.

Jason Hidalgo wrote in the December 6 RGJ that the Reno-Sparks Convention and Visitors Authority (**RSCVA**) **voted to demolish the Livestock Events Center exhibit hall and the Armory building** due to the high cost required to fix both structures. The demolitions do not affect any other buildings. The RSCVA also voted to have the bathrooms saved if possible. Plans for the exhibit hall site include additional parking. Repairs also would have exceeded \$700k. The exhibit hall was built in 1968 with a cantilever roof design and is experiencing severe rust issues. Additionally, the State Public Works Division identified \$500k of additional repairs that would need to be done on the exhibit hall.

The NNBV reported in a January 29 staff report that **Marnell Gaming plans to build an amphitheater on the former Bourbon Square site**, with Toby Keith performing the first concert. The "Nugget Event Center" will seat ~8,500 people. The Sparks Planning Commission OK'd the project on January 3rd. Marnell Gaming, owner of the Nugget Casino Resort, is spending ~\$6.2 million to erect the outdoor events center.

Yvonne Beasley, writing in the December 22 RGJ, reported that **the Carnegie Commission on Higher Education put UNR in its "R1" list for doctoral schools** with "very high research activity" out of 130 universities. It's the first time UNR has had the highest designation, moving up from an "R2" designation. The designation means the school ranks in the top tier for the numbers and variety of doctoral degrees awarded, research money spent and other factors. As a result of building research and graduate programs, UNR's doctoral student enrollment is up 13.5% and new doctoral students are up nearly 30% since 2017. UNR

research expenditures grew 65% in the last five years, including neuroscience, treatment of infectious and rare diseases, transportation systems, robotics and environmental topics. UNLV also earned an R1 designation.

Geoff Dornan, writing in the December 24 NNBV, reported that on December 21 **the Nevada PUC approved NV Energy's three-year plan to double the utility's renewable energy portfolio**. Under the plan, NV Energy will spend \$66 million / year to build more than 1,000 mw of new solar - a 30% increase over current spending. The plan also calls for construction of 100 mw of energy storage. Major employers in Nevada have committed to invest in energy efficiency and renewables and welcome NV Energy's decision to embrace clean energy sources. The plan also calls for the company to accelerate closure of the North Valmy Coal Plant in north central Nevada. Unit One would close in 2021 and Unit Two in 2025.

An NNBV staff report reported on January 8 that Chase international reported the overall Reno-Sparks real estate market saw million-dollar home sales increase 52%, while the number of homes sold under \$1 million declined 14%. Overall 2018 sales volume dropped 1%, and the number of homes sold dropped 13%. Inventory remained tight driving median and average prices higher. The region's median home price increased 11% to \$375k. Carson Valley home sales volume was down 1%, while median home prices rose by 13% to \$418k. Carson City home sales volume was down 13%, while median home prices rose by 14% to \$328.5k. Condo sales increased 11% in Reno-Sparks and 63% in Carson City.

Johnathan Wright wrote in the December 21 RGJ that the **Sparks Water Bar is coming to the eastern shore of the Sparks Marina**. The proposed 13ksf bar and restaurant will occupy two floors of LandCap's Marina Town Centre and plans to open in Q319. Tom Turner, the proprietor, has owned Gar Woods and Riva Grill on Lake Tahoe, as well as the Bar of America in Truckee. The restaurant will be 8 ksf inside, plus 5 ksf of terrace at the south end of the building. Sparks Water Bar is planned to be the social hub for the high-end Marina Apartments, now under construction, and other nearby residents.

Reno City Council turns down Daybreak - again

Anjeanette Damon wrote in the Nov. 28 RGJ that the Reno City Council stayed true to the City's new master plan by voting 6-1 to deny (again) the proposed 4,700-unit Daybreak project on the former Butler Ranch in southeast Reno. The massive housing development had been planned for the City's last natural floodplain. The developers argued they had engineered solutions to all of the technical challenges presented by the site: flood storage, mercury-contaminated soils, high ground water levels and traffic issues. They also argued that this in-fill development wouldn't tax infrastructure the way far-flung developments do and argued the region is in severe need of the housing units. Public comment on the project was split. Residents opposed the project, worried it would exacerbate flooding, traffic problems and fire protection scarcity. Builders, developers and trade unions spoke in favor of the development, pointing to a housing crisis rooted in a lack of housing supply.



Reno City Council rejects 'granny flats' as a means to address housing crisis

Anjeanette Damon wrote in the November 29 RGJ that the Reno City Council on 11/28 ended to a year-long effort to allow homeowners to build "granny flats" on their properties after residents in the Old Southwest filled council chambers to oppose the ordinance. Last year the council asked staff to pursue allowing accessory dwelling units (ADU's), or granny flats, in most Reno neighborhoods as one way to help the housing crisis gripping the city. After a year of community outreach staff put forward a draft ordinance that would allow such flats to be built on single family lots larger than 9 ksf, with some restrictions. Citizens called the plan a tricky

maneuver to increase density in their neighborhoods, usurping zoning that they relied on when they bought their homes. They worried ADU's would hurt the historic character of their neighborhood and bring more crime and traffic problems. Mayor Schieve was the first to speak out against ADU's. Councilwoman Brekhuis and other public speakers argued allowing ADU's is one piece of a multi-faceted approach to address the crisis by increasing inventory in the so-called "missing middle," a class of alternative housing at prices attainable by those making around the area's median income. She was roundly defeated by the rest of the council. 😞

NDOT Reveals Alternatives for Spaghetti Bowl Project

Jason Hidalgo, writing in the December 12th RGJ, reported that NDOT presented 3 alternatives to fix and expand the "Spaghetti Bowl", aka the intersection of I-80 and US-580. Alternative 2, which is NDOT's preferred plan, will cause 326 displacements affecting 850 people. About 22 business will be displaced. Alternative 3 would cause 233 displacements affecting 650 people and displace ~26 businesses. Alternative 1 is the most expensive, at a cost of \$4.5 billion due to the amount of construction. Alternatives 2 and 3 will each cost about \$2.5 billion. The project will likely displace some residents of affordable housing, with Alternative 3 having the least impact. NDOT is bound by law to pay fair market value for displaced houses and to find comparable rental units for displaced renters. NDOT says it might extend rental assistance from the required 42 months to 66 months. NDOT also plans to provide funds for building replacement housing and provide property tax assistance to residents who struggle with higher property taxes on replacement homes. While NDOT described the displacements as one of the biggest impacts for the project, they also described the Project as essential to address congestion and to reduce accidents as our region grows. Travel time from westbound I-80 to Pyramid Way is projected to increase 1,818% by 2040 if nothing is done. In addition, the Project could impact Sage Street Park and Fisherman's Park – and potentially others near the interchange.

4.5 million square feet of industrial space planned for 2019 in Northern Nevada

Rob Sabo wrote in the January 28 NNBV that 2019 is shaping up to be a record year for industrial construction in our region as 4.5 msf of new industrial is planned, far exceeding the 2.8 msf added in 2018. Nearly every building built in 2018 was leased, including the largest speculative building ever built in Nevada, an 800 ksf facility at Panattoni's North Valleys Commerce Center, leased to S&S Activewear from Chicago. Right before the 2007 downturn, more than 3.37 msf was built. A severe national downturn soon followed. Many of the industrial buildings planned for 2019 are a hedge against escalating construction costs, which continue to rise as much as 15-25% annually. Rising costs are changing the way developers build their projects. Historically, developers would erect 1-2 buildings and wait for them to be leased before breaking ground on new buildings. However, Panattoni plans to construct all six buildings in the 2nd phase of its North Valleys Commerce Center this year simultaneously over 18-months. They will contain costs by buying all the steel in bulk and do all the site work at once. They have already built and leased four buildings totaling 2.28 msf at the center, with institutional investors snapping up 3 of the 4. Panattoni also will also deliver a 270 ksf building at the Longley Commerce Center this spring. Other developers building in 2019 are Scannell, with a 200.2 ksf build-to-suit on North Virginia Street for OnTrac, while Dermody plans a 405 ksf building in the North Valleys. Tolles Development Company is building a 610.4 ksf building at Tahoe Reno Industrial Center. Seattle-based developer Avenue 55 plans to erect two buildings of 230 ksf in Spanish Springs.

Tesla will 'most likely' produce Model Y at Nevada gigafactory

Nathan Bomey, writing in the January 31 USA TODAY, and printed in the RGJ, reported that Tesla is gearing up to make its new crossover called Model Y that it says "most likely" will be produced at the Gigafactory. The Model Y will share the same platform as the Model 3. Pricing, styling and specifications haven't been revealed. With a debt payment of over \$900 million due within weeks unless the company's stock takes a sudden leap, Tesla is under pressure to improve its operations through cost reductions, faster production and increased sales. The automaker made a profit of \$139.5 million in Q418, up from a loss of \$675.4 million a year earlier. Elon Musk said that the company expects to make a profit every quarter after Q119. Tesla projects 2019 sales of 360-400 k vehicles, representing growth of 45-65% over 2018.

Tesla Gigafactory surpasses job creation, capital investment projections

Michelle Rindels wrote in the December 5 Nevada Independent that an economic impact report released by the Governor’s Office of Economic Development shows Tesla had 7,059 employees as of June 30, more than the jobs that legislators expected when they approved the incentive package in 2014. Those jobs involve an average of at least 30 hours/week. Average hourly wages of \$25.78 are above the state average of \$22.54. Tesla projected it would create 6,500 jobs at an average wage of \$27.35 / hour. Factory wages were \$379 million/year, \$9 million above projection. The taxes that Tesla employees pay to state and local governments from their own purchases is ~\$58 million/year. Tesla was required to hire at least 50% Nevada residents. Tesla reported a 93% in-state residency rate. An estimated 17,000 construction jobs were created from 2015 through 2018. The total economic impact of construction so far is estimated at \$3.2 billion - well over the projection of \$2.4 billion. The deal was designed assuming Tesla would invest \$5 billion: the actual capital investment has been \$6 billion. The project has a \$3.56 billion economic impact in Washoe and Storey counties annually. The report estimated that the Gigafactory is responsible for creating 15,300 jobs, counting direct jobs at the factory, those at vendors and “induced” jobs created by the consumer demands of the workers. An estimated 34,000 people — including families — rely on the wages from those jobs. Note that the incentives offered to Tesla were based on abatements or reimbursement of actual taxes paid by the company.

Jacobs building parking lots

[Ed note: This article is based on a blog post on [REreno](#) on January 12]. Jacobs continues to add open parking lots in their Fountain District. “Open Parking Lot” is an allowable land use in DRRC Keystone. Jacobs Parking lot #1 is along 4th Street for 104 parking spaces. Parking lot #2 is for an additional 100 surface parking spaces. Both lots will increase parking convenience for the Sands Regency Casino Hotel.



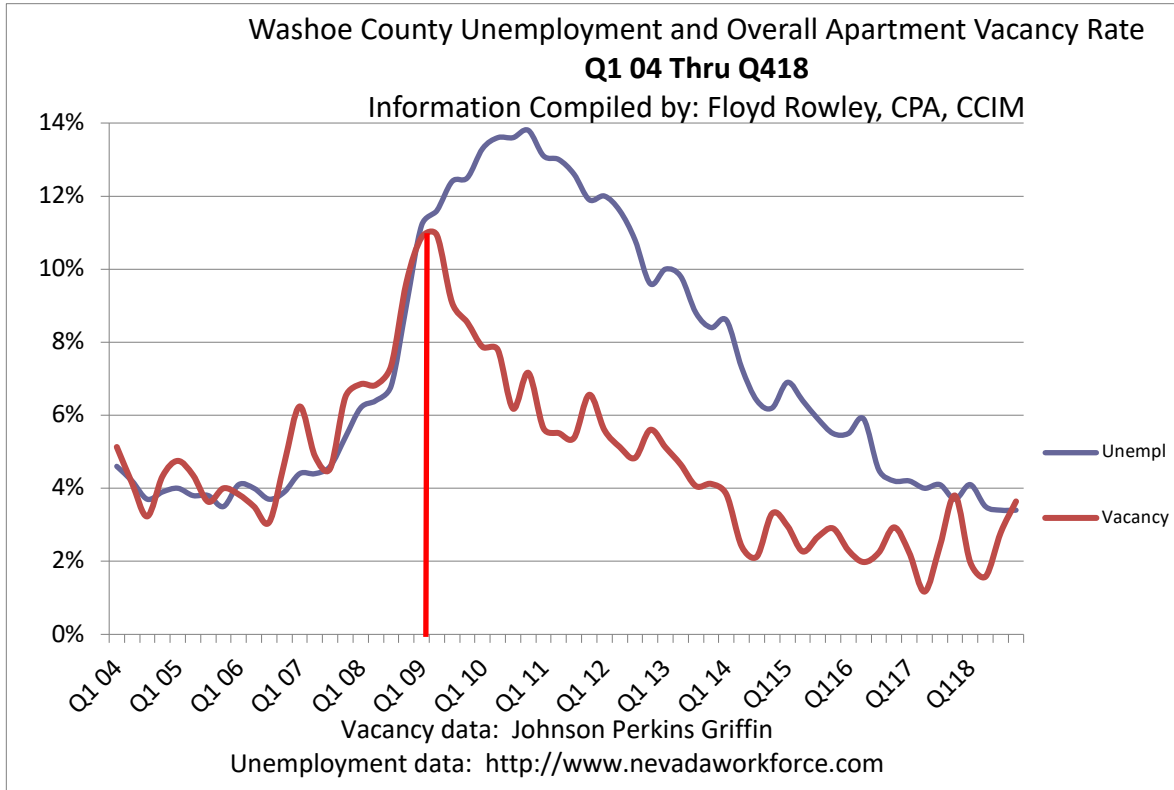
Apartment Statistical Review (Rowley proprietary analysis)

The Johnson Perkins Griffin’s (JPG) Q418 survey remained unchanged at 90 properties and 22,375 units. As always, JPG’s data is representative of regional multifamily performance. Their survey is available at: <http://jpgnv.com/wp-content/uploads/2019/01/Q4-ApartmentSurvey2018.pdf>

This quarter I truncated all data in the graph below prior to 2004. The truncated 4 years proved the very strong correlation between unemployment and vacancy in our region that I observed almost 15 years ago. The Great Recession changed all that – and we have been moving back to convergence ever since.

Rent increase update: Since Q408, overall average rents in our region has grown 47.7%, or 4.0% per year. Clearly there have been big dips along the way, but sewer bills and property taxes never dipped.

Consistent conclusion: Most of the *new* “expensive” units being built are still being snapped up by *new* employees coming to our region who don’t feel that these new Class A rents are all that expensive, leaving the existing apartment stock to be re-rented by existing workers in our region, albeit at higher prices as well.



- **Overall vacancy continues to rise:** from 1.6% in Q2 to 3.64% in Q4. This is still 14 of the last 16 quarters that overall vacancy rate has been UNDER 3%, and 20 quarters in a row that vacancy has been under 4%.
- **Every submarket recorded vacancy increases** in Q418, while in Q3, 9 of 11 submarkets did. The overall vacancy increased 0.85%, with submarket increases ranging from 0.25% to 2.4% in SW Reno.
- **Average rental rates decreased** \$27 / unit / mo., or 2.0%, after being flat in Q318.
- **West Reno continued as the lowest vacancy submarket**, although it jumped from 0.44% to 1.33%. Brinkby Grove moved up to 2nd place, displacing Airport to 3rd at 2.5% Note that 2 of the 3 lowest vacancy submarkets are blue collar - after years of having the highest vacancies. Construction remains strong.
- After breaking through the \$1,500 / mo. threshold in Q218, **East Sparks average rents have now dropped 2 quarters in a row** – now to \$1,448 – still the highest in the region. 5 of 11 submarkets are still over \$1,300 / mo., with the blue-collar submarket of Brinkby-Grove left out of the “\$1k / mo. club”.
- Finally, vacancies in studios and 3X2’s are both notably above average, at 5.3% and 5.6%, respectively.

About the Author

Rowley Real Estate Advisors was formed November 1, 2018 as the culmination of Floyd’s 15.6-year brokerage career in northern Nevada. Floyd joined the Johnson Group in January 2011, after serving for 7+ years as Senior VP for the Colliers Investment Services Group locally. Floyd represents buyers or sellers of large investment properties: apartments, office buildings, retail centers and industrial properties. Floyd also does sale-leaseback transactions and build-to suit leases. Since 2004, **Floyd has closed \$258+ million in 85 transactions, of which \$97+ million are apartments or apartment land.** Starting in the fall of 2008, he started focusing on distressed assets, mainly apartments. He has **completed 68 broker price opinions totaling \$507.4 million**, mainly during the Great Recession, resulting in \$66+ million of listings, mainly apartments and land, since early 2009. Floyd has 2 land deals under contract and 5 more currently underway.