Floyd Rowley, CPA, CCIM
Founding Broker 775-224-3183
floyd@rowleyrealestateadvisors.com
www.RowleyRealEstateAdvisors.com

Q221 Northern Nevada Commercial Investment Real Estate Report

The "Let's Enjoy these "Brighter Days" while we can" Issue

Now that the $1,400 checks are done reigning down from Washington, we are starting to see the "temporary" bout of near-term inflation and shortages that the Fed predicted. The 1st half 2021 GDP came in at 6.9%, well below earlier estimates. It is unknown how full-year 2021 GDP will end up as consumers are encountering inflation at the gas pump and the supermarket. While Congress looks to pass a bipartisan infrastructure bill soon, there does not look to be any bipartisan consensus regarding the $3.5 (or is it really $5?) trillion Build Back Better plan – not to mention looming increases in income taxes. Locally we experienced a blow-out quarter for apartments as 2 Class A properties were added to the Johnson Perkins Griffin apartment survey as you will read below. Also, the apartment pipeline is shrinking as you will read in the next section. Finally, the Delta variant (sounds like a John Grisham novel!) is rearing its ugly head and causing politicians to re-introduce masks and ??? Please click on https://www.mayoclinic.org/coronavirus-covid-19/map/nevada for your own interpretation of "the surge".

Major Planned / Under Construction Apartments (Rowley proprietary research)

The data presented below is provided by all significant apartment developers in Reno and Sparks. All Planned data is confidential. The data below excludes Carson City and Fernley, both of which are seeing a lot of activity in planned projects. There was also one significant completion in Carson City this quarter, now 100% leased.

Rowley Research Totals		Planned	Under Const.	Total
Units:	This Quarter	7,113	3,134	10,247
	Last Quarter	7,858	3,407	11,265
	Net Change	**(745)**	**(273)**	**(1,018)**
	% Change	-9.5%	-8.0%	-9.0%
Projects:	This Quarter	28	14	42
	Last Quarter	30	18	48
	Net Change	**(2)**	**(4)**	**(6)**
	% Change	-6.7%	-22.2%	-12.5%

Planned Projects decreased by a net of 2 projects, due to the identification of 3 new planned developments, offset by 3 projects starting (or restarting) construction, and two projects being removed. One was perhaps a bit optimistically added in Q1, but the 2nd was Sunroad's selling of its planned Phase 2 land back to Lennar.

Units under Construction saw an overall 8% decrease, but it was based on adding 688 new units under construction, offset by 961 units previously under construction in 7 completed projects, mainly Azure, Parq Crossing, the Deco, Lakes at Lemmon Valley, and INOVA. My completed unit numbers do not tie to the Johnson Perkins Griffin survey because I count delivered units to the market every quarter, whereas they count the entire project in the quarter that it achieves 90% occupancy.

The 1,016 net reduction in total units planned and under construction completely wipes out the net gain I reported in Q1 and does not bode well for increasing the apartment unit supply in our region in the near term.

The Local News Bag

Jim Krajewski wrote in the June 5th Reno Gazette Journal (RGJ) that, after more than 23 years without a hockey team, **the NorCal Ice Raiders are moving to Reno** to become the Reno Ice Raiders. This semipro, Senior A team will play in the new Reno Ice Arena this fall. They played in Vacaville for 5 seasons. The bulk of the team will move here. They play in the Mountain West Hockey League, a series of clubs across the west, founded in 2012. Reno's previous hockey team, the Reno Renegades, played from 1995-97, in the WCHL, then became the Reno Rage in 1997-98, and folded after that season.

Kaleb Roedel wrote in the June 15 Northern Nevada Business Weekly (NNBW) that **Reno ranked as the 12th best city in America for young professionals**, according to a May 18 study by SmartAsset. The only other western cities to make the top 15 were #10 Boise and #14 Seattle. The top hot spot for young professionals is Sioux Falls, South Dakota. SmartAsset compared the largest 150 U.S. cities in 9 categories, including unemployment, cost of living, entertainment options and percent of the population aged 25-34. The rich quality of life in the Reno area is also a major pull for young professionals. The pandemic raised the appeal of Reno for young professionals; especially Californians who want to either move their business or to work remotely.

The 6/18 Friday Fact Pack, published by Hightower Advisors, reported that, after months of shockingly high prices**, lumber is down nearly half from a year ago,** when sawmills and trucking companies shut down amid the pandemic. Builders saw a peak of $1,671 for lumber futures (per 1,000 board feet) in May 2021. In February 2020, the price was $423. Bank of America estimated that the recent increases raised the cost of a new home by $34,000.

Elizabeth Rodil wrote on the KOLO website that **the Nevada Cares Campus opened on May 17**. The new, 46 ksf homeless shelter is located at the former Governor's Bowl Park and was made possible by Cares Act funds. It is a collaboration of the state, the cities of Reno and Sparks, Washoe County, and Volunteers of America (VOA). The campus was built for ~$9 million. During Phase 1 it will serve ~600 people and includes bathrooms, space for couples, and a pet area. Sponsors hope this will be a game changer for our area's homeless. VOA will run the everyday operations and the County will eventually oversee the campus.

EDAWN's Business Retention and Expansion Update dated 7/15 reported that **the Davidson Academy of Nevada ranked #3 in the nation** for 'Best High School' by the U.S. News & Review, with a score of 99.98 out of 100. The Academy also ranked 1st in Nevada. The ranking was based on performance on state-required tests, graduation rates and how well it prepares students for college. Their AP® participation rate is 100%.

NAHBNow, the news blog of the National Association of Home Builders, reported on May 6 that **government regulations cost $94k, or 24% of the $397k average sales price of a new single-family home**. $41k is due to regulation during development, and $53k is due to regulation during construction. This new study excluded lumber and other materials that soared in the past 12 months. NAHB's April report showed that lumber, which soared 250% in a year, added $36k to the price of a new home. This is on top of the $94k. NAHB estimated that regulatory costs in an average home built for sale increased 10.9% from 2016.

An April 30 NNBW staff report stated that the **Victory Logistics District in Fernley broke ground on an 815 ksf distribution facility,** slated for completion in Q122. The 4,300-acre complex, previously known as Crossroads Commerce Center, was purchased in the summer of 2019 by Mark IV Capital for $45 million and rebranded. Since then, the firm has been designing all facets of the multi-phased development, including infrastructure, rail facilities and industrial buildings ranging from 170 ksf to 1.5 million sf. The District is located within an Opportunity Zone and is ~30 miles E of Reno and 14 miles E of the Tahoe Reno Industrial Center.

Jenny Kane wrote in the April 27 RGJ that **The Burning Man Project, for the second year in a row, was cancelling this year's event**, which was set for Aug. 26 to Sept. 3. The festival is set to return in 2022. Burners spend ~$63 million in Nevada/yr and attract ~80k people/yr from all over the country and the world.

Reno strikes down [Ed: Another!] appeal against Talus, formerly known as Daybreak

Jason Hidalgo reported in the July 21 RGJ that the Reno City Council struck down the appeal by Council-woman Jenny Brekhus, thus allowing the Talus housing project to proceed in SE Reno's Butler Ranch area. Newport Pacific Land (NPL) is planning to break ground in the next 1-2 years. The approval was preceded by spirited deliber-ation on both sides. This is not the first appeal against the Talus project which obtained approvals from the Reno City Council, the Reno Planning Commission and Truckee Meadows Regional Planning Agency. Those approvals were preceded by significant controversy, including a $50 million lawsuit against the City after council members initially rejected the project due to environmental concerns over the floodplain where the project is to be located. The long-running saga surrounding the project was reflected in the frustration shown during portions of the appeals process. The project has scaled down its initial plans after it was first pitched as a 4,700-unit housing project in 2018. The project is currently approved for 3,995 homes. NPL stated that the total number of units will be "way below" 4,000. The final number is still undecided.

Water is not a constraint to growth in Reno-Sparks

Mike Kazmierski, President and CEO of EDAWN, wrote in the 7/18 RGJ that there is little reason to be concerned about our region's water supply, managed by the Truckee Meadows Water Authority (TMWA). Water is one of our competitive advantages as we look at continued economic growth and prosperity. The current Western drought that started in 2000 is now a mega-drought – the 2nd worst in 1,200 years. It is not an issue for our region as we are only in our 2nd year. Since 2000, Lake Tahoe, the largest source of water for our region, has filled - or come within 6" of filling in 3 of the last 5 years. TMWA's water resources consist of Truckee River water, surface water reserves stored in 6 upstream reservoirs and 89 production wells. According to the 2020 TMWA Water Resource Plan, we use ~83k acre-feet (AF) of water/year, about the same as we used 20 years ago. Yet, the TMWA service area population has increased by ~50%. In that time, TMWA added capacity by acquiring the other half of the storage rights in Donner Lake, acquired additional Truckee River water rights, and groundwater development. We now have > 140k AF available/year (70% more than we currently use) and expect to add more. We use ~35 million gallons/day (mgpd) in the winter, and ~140 mgpd in the summer. The 2020-2040 Water Resource Plan analyzed our region's future water resources. TMWA modeled 3 scenarios to explore water supply and operational strategies through the end of the century. The results show that TMWA's water supply can withstand both a repeat of any major drought on record, as well as climate change scenarios including population increases over the next 50 years. Thus, any company that is a low or moderate water user and residents don't have to worry about water or unreasonable price increases in the future. Thanks to decades of planning and water acquisition, "we are special" when it comes to water in the West.

Lakeridge Golf Course housing project to take open space rezoning to Reno City Council

Jason Hidalgo wrote in the June 1st RGJ that Duncan Golf Management, which is partnering with Toll Brothers for a housing project next to the Lakeridge Golf Course, is seeking a master plan amendment to rezone its driving range to single-family housing for the 2nd phase of the Lakeridge Place project. They are also requesting a special use permit for attached housing to allow an additional 46 homes on the 6.6 AC site. Duncan called the amendments necessary because the driving range poses a safety threat to adjacent property. The driving range is located right behind Phase 1 of the Lakeridge Place project, which was approved for residential by the City in 2019. Large-scale grading for Phase 1 has been completed. Duncan has exhausted every option for the driving range and believes that turning it into housing was the most feasible solution. That argument failed to convince the Reno Planning Commission, which rejected the proposals on April 7th due to the loss of open space. The driving range issues were not "major enough" to meet the threshold for a master plan or zoning amendment, and the loss of the driving range business was "self-imposed." Duncan contends that the driving range is not open space. While it meets the standard from a zoning standpoint, it is private property that is not accessible to the general public. Duncan pushed back on concerns that development will eventually expand onto the golf course. They cited investments, such as revamping sprinklers and restrooms and $150k for new cart paths. A traffic study commissioned by Duncan showed 337 new trips / day, including 26 during rush hour. Regardless, the driving range will be closed. The golf course, however, will continue. Duncan has been a golf course company for 40 years. The development is not associated with the Lakeridge Tennis Club project.

City of Reno reaches tentative $4.5 million settlement re Swan Lake flooding litigation

On April 23 Terell Wilkins wrote in the RGJ that the City of Reno reached a $4.5 million tentative agreement to conclude all litigation related to the 2017 Swan Lake flooding in Lemmon Valley. The City was ordered on March 15 to pay $1.1 million to three Lemmon Valley residents for damages plus interest for 4 years of court fees. The residents didn't receive the money after the Nevada Supreme Court placed a temporary hold on the order. They will receive their payout as part of the total settlement of the 30 claims in state and federal court. In 2017, over 60 homes in Lemmon Valley were damaged when the City pumped or diverted excess stormwater into the Swan Lake basin. Residents filed a class action lawsuit against the City shortly after, with a jury ruling in 2019 that the City was responsible for the flooding and should be responsible for paying residents for damages. Though still liable for the damages, the City moved in 2020 to decertify the class. They argued that having the lawsuit as a class did not serve the interest of justice and each resident should provide individual proof of the financial extent of damages to their home. Second Judicial District Court Judge Barry Breslow ruled to decertify the class in favor of the City but rejected the argument that compensation should be limited to the rental value of the property. According to court documents, Breslow declared that residents should be reimbursed for the rental value at the time of the flooding, plus damages, relocation costs and attorneys' fees.

Reno Rodeo officials moving forward with plans for new arenas, exhibit hall

Jim Krajewski wrote in the June 14 RGJ that the Reno Rodeo Association is pushing ahead with plans to revamp the entire Reno Livestock Events Center (LEC). Since the Rodeo is the largest event at the LEC, they thought it is in their best interest to take the lead on the project. A new 52 ksf exhibit hall is first in the plans to replace the 20 ksf hall that was demolished last year, which would have cost over $500k to bring up to code. Next is a second indoor arena and upgrading the current one, which does not meet the needs of many equestrian events that occur throughout the year. Construction costs were estimated at $120 million 2018. In 2019-20 the Rodeo used state funding, matched by the Rodeo, to develop 30% schematic designs and preliminary cost estimates. The earliest both projects could be completed is 2023. A new 15,000-seat outdoor arena is planned for the NE corner of the LEC parking lot, which would not be ready until 2025-26. A 2,400-vehicle parking garage is planned where the current outdoor arena sits. UNR and Washoe County could also use the new garage. Locating the new arena there would allow events to continue while construction is underway. The current outdoor arena was built in phases through the mid-60's into the late 80s. It holds 9,000 and has sold out almost every night during the Reno Rodeo in recent years. More horse stalls are also planned. Financing will be a combination of public and private funds. Most rodeo facilities ~100 acres while the LEC is only 43 AC.

US Home Prices—No Bubble Here

Vishwanath Tirupattur, wrote in the Morgan Stanley (MS) Wealth Management Midyear Investment Outlook that the latest Case-Shiller Home Price Index shows a 13.2% year-over year (YoY) gain, with prices surging in all 20 metro areas, for an increase of ~$37k in the median home price: the fastest pace since 2006. Any comparison with 2006 brings bad memories the financial crisis. However, this time is indeed different. Unlike then, today's price is based on demand and supply. MS has a strong conviction that we are not in a housing bubble. Contrary to the 2006 narrative that loose lending to people with low credit was central to the excesses, MS thinks it was more about the type of credit they had access to. Mortgage credit risk consists of borrower risk and product risk. Borrower risk assesses the likelihood of a default using loan/value (LTV), debt/income ratios and credit scores. Product risk is based on the type of mortgage that has a higher risk of default such as those whose payments could vary significantly over time. During the 2006 boom, product risk increased a lot. When prices stopped climbing, these mortgages reset to payments that borrowers could not make, leading to delinquency, foreclosure, and to distressed sales and even lower prices, creating a vicious cycle. Affordability products made up ~40% of all 1st mortgages from 2004 to '06. Today that number is only 2%. Lending standards are much tighter now and leverage has declined dramatically. The value of the US housing market peaked at $25.6 trillion in 2006, with mortgage debt of $10.5 trillion, for an LTV of 41.2%. Today, the value is $33.3 trillion, while mortgage debt has only increased to $11.5 trillion, for an LTV of just 34.5%. This gives us confidence that housing finance is healthy and sustainable. Also, millennials continue to drive household formations at a pace 30-50% above the long-run rate. Monthly payments as a % of income remain near the most affordable levels of the past 5 years resulting in a nationwide supply shortage. The number of existing homes for sale has plummeted to historic lows while the supply of new homes remains muted, making the supply of homes near record lows. Robust demand and tight supply, along with tight mortgage lending standards, augur well for home prices. Higher interest rates and post-pandemic moves will likely slow the pace of appreciation, but the upward trajectory remains on course.

City Council approves higher-density zoning for Lakeside Drive housing project

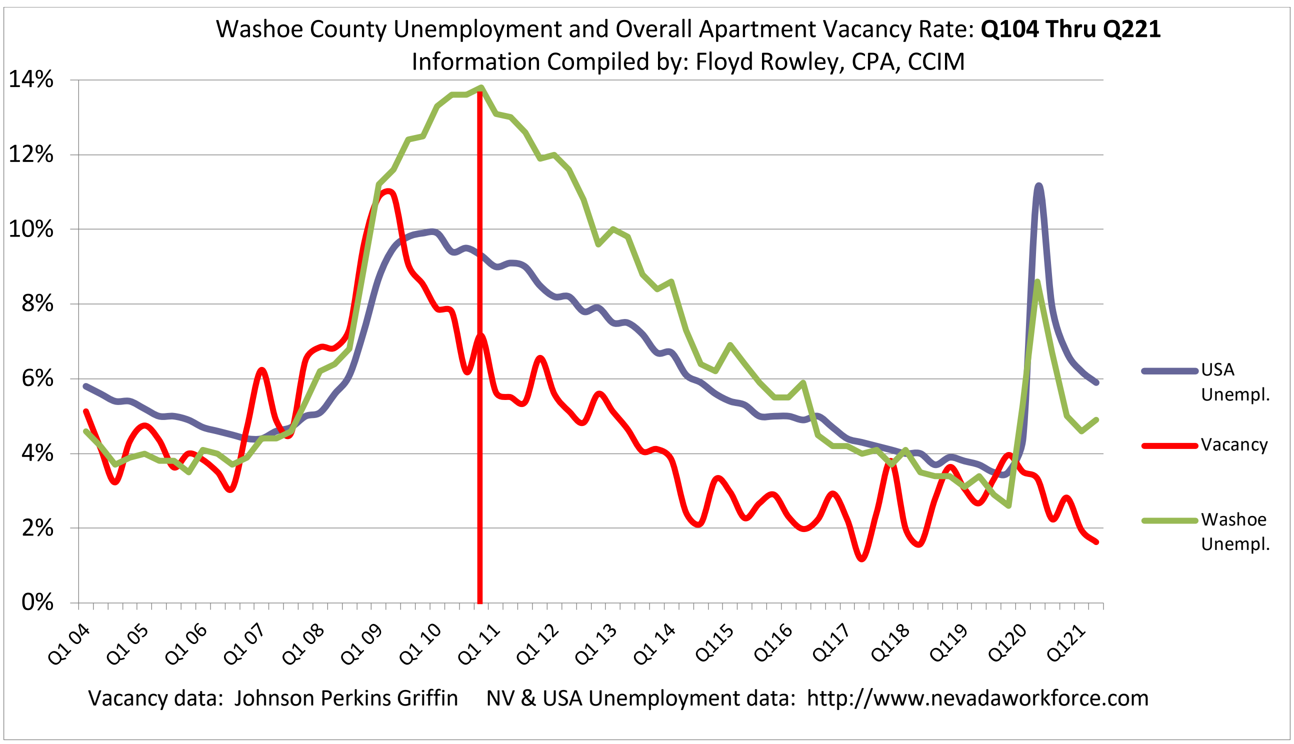
Jason Hidalgo wrote in the 5/26 RGJ that the Reno City Council voted to change the zoning for a 3-acre site on Lakeside Drive between Moana and Peckham from SF-3 to MF-30, which will allow 3 stories at a max of 45'. The zoning change was requested by BRG Homes. City staff recommended approval stating that it complies with the City's [Ed: new] master plan. The proposal received pushback from several residents. Arlo Stockham, Community Development Director for the City, acknowledged the complaints, stating that "when infill new development comes to a property near you, it's difficult. At the same time, it's very hard (for developers) to make the money work and provide a more affordable housing product with buildings that are capped at two stories." Our region is currently in the midst of a housing affordability crisis fueled by strong demand for homes and inadequate supply, which has led to record median home prices, recently eclipsing $500k, as well as record-high apartment rents. Ward 2 Councilwoman Naomi Duerr, who represents the neighborhood, voted against the zoning change. While she supports a change in zoning for the project, she preferred an MF-14 designation. Duerr Stated, "I, for one, am not averse to infill. I just want to do it right. We've got to do thoughtful infill that makes sense - that leaves people whole and their property values whole." BRG Homes stressed that the zoning change does not give it approval to develop. Building more than 20 units will require a conditional use permit. Building more than 100 units for the project site requires BRG to go before the planning commission and city council once again.

Apartment Statistical Review (Rowley proprietary analysis)

The Johnson Perkins Griffin's (JPG) Q221 survey inventory increased by 3 properties to 101 with the addition of Parq Crossing, Azure and INOVA. The total units in their survey grew by 1,016 units, or 4.1%, to 25,945. As always, JPG's data is representative of our region's multifamily market. Their survey is available at:
http://jpgnv.com/wp-content/uploads/2021/07/Apartment-Survey-2nd-Quarter-2021-FINAL.pdf

Here is my analysis of JPG's survey:

- **Overall rents surged 9.4% this quarter**, after a 3.2% increase in Q1. I was expecting a big surge in the rent numbers due to both Azure and (especially) Inova coming online in Q2.
- **Overall rents Jumped $138 to $1,607**. Since Covid started in mid-March 2020, average rents have increased $266 / unit, or 19.8%. It is likely that many folks bailed on their $3,500-$5k / mo. apartments in San Francisco and worked "at home" from their new, Class A apartment in Reno.
- Once again E Sparks led in average rent / mo.: up $254 to $1,940, or 15%. Lakeridge stayed in 2nd place reporting a $213 / mo. increase or, 13.5%, to $1,789. NW Reno stayed in 3rd place, coming in with a $100 / mo. increase, or 6.5%, to $1,630.
- **Overall vacancy continued its significant drop, now down to 1.63%** from 1.95% in Q1.
- The lowest vacancy submarkets moved around a lot. Due to their massive rent increases, both E Sparks and Lakeridge reported the highest vacancies in the region, at 2.39% and 2.72%, respectively. When you push rents that hard, a higher vacancy is to be expected. Still, a ~2.5% vacancy is amazing.
- The vacancy at Downtown Urban continues to drop nicely, going from 4.93% in Q1 to only 1.81% now. They were at 6% in Q420.
- **Only 3 submarkets out of 11 reported vacancies *__under__* 1% this quarter**, with W Reno reporting a ZERO % vacancy, followed by SW Reno @ 0.56% and NE Reno at 0.91% This was a big increase for them – reporting only 0.15% in Q1.



About the Author

Rowley Real Estate Advisors went live on November 1, 2018, as the culmination of Floyd's brokerage career in northern Nevada. Previously, he joined the Johnson Group in January 2011, after 7+ years as Sr. Vice President for the Colliers Investment Services Group locally. Floyd represents buyers or sellers of large investment properties: apartments, office buildings and land. Floyd also does leasing, sale-leasebacks and build-to suit leases. In the last ~18 years, Floyd has closed $285 million in 97 transactions, of which $81 million were apartments and $56 million was land. Floyd completed 74 broker price opinions totaling $519 million, many during the Great Recession, resulting in $71 million of listings, mainly apartments and land, since 2009.