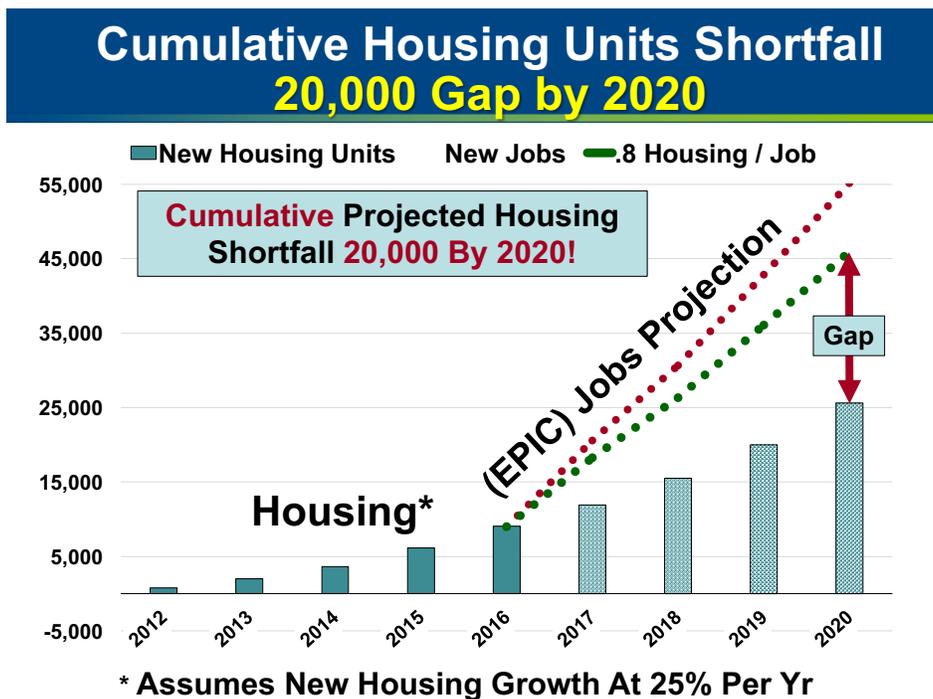


Northern Nevada Commercial Investment Real Estate Report: Q416

The "This is Not a Bubble" Issue

I attended the EDAWN 2017 Annual Economic Update on January 26th, where Mike Kazmierski assured the 650 attendees that we are not in an economic bubble. Our region is growing slightly faster than the pace to reach the 50,000 jobs EDAWN predicted in January 2015 – only two years ago. What is becoming clear is that our looming housing shortage is going to get worse before it gets better. See EDAWN's graph below:



Thus, apartment rents will continue to show robust growth AND vacancy rates will likely continue to drift along at their physical lower limits – despite the new apartment units in the 2017 delivery pipeline.

Major Planned / Under Construction Apartments (Rowley proprietary research)

In my quarterly phone calls and emails to developers to update my survey I added 764 new units this quarter – and removed one deal that I now don't believe will be built – and other adjustments for a net increase of 820 units. Units under construction showed a net increase of only 28 units, with 3 removals this quarter - see below. I am now tracking the following projects:

Planned apartments: 38 projects totaling 13,878 units

Under Construction: 8 projects totaling 1,035 units – described below

Total: 46 projects totaling 14,913 units

This compares to **6,362** total units in Q115 and **only 2,420 in Q114**. Active developments include:

- Silverwing's 220 unit, **Fountain House @ Victorian Square**, which started occupancy August 13th – final phase foundations poured 10/26. Overall completion scheduled for April 2017.
- Site work continues at Ryder's 252 unit, **Village South Apartments**, with several buildings now underway for a January 2017 delivery. The clubhouse is now completed.
- Lewis Homes' 278 unit, **Harvest at Damonte Ranch Phase I** continues construction of their luxury apartments for delivery in 2017. Their clubhouse is getting close.
- Basin Street's 94 units, called **3rd Street Flats** - the HUGE renovation of the former blighted Kings Inn – is now complete and held its grand opening bash on January 24th.

The Local News Bag

The NNBW reported on October 28th that the Reno-Tahoe International **Airport has started a 16-month master planning process to address airport growth, aviation industry changes, and FAA standards for the next 20 years**. It will provide a funding roadmap and address the dynamics of air service and cargo while balancing the needs of the community. Three focus areas are: airfield enhancements (runways, taxiways, aprons, airspace); terminal modernization (ticketing, gates, customs, concessions, baggage); and ground transportation (roads, parking, airport land use). It is an open process to encourage public input. The project team consists of national aviation experts, local stakeholders, and subject matter experts. The Master Plan Working Group to guide the process consists of airport users, airlines, tenants, the military, local community representatives, business leaders, trustees, and regulatory agencies.

Mike Higdon, writing on 11/22 in the RGJ, stated that **outdoor retailer Patagonia opened a 17 ksf retail store in downtown Reno on Center and State Streets in the Hudson Project**. The building was originally a Hudson car dealership in the 1940's. Most recently, the building housed Machabee Office before they moved to Sparks in '06. Patagonia operates a large outlet store, warehouse and employee day care center on "far" West 4th Street. The outlet store closed to make more room for more employee daycare "out there". Patagonia occupies the ground floor and basement. The adjacent liquor store has been evicted. Because of a moratorium on packaged liquor in downtown, a new liquor store will not be able to replace it. The developer is seeking a food use for that space. The Center Lodge across Center Street, once the most blighted building in the area, has been stripped and 24 apartment units are under construction.

The City of Reno website reported that, on November 16th, the **City Council approved the Park Lane Site Infrastructure Improvement Agreement in a 5-1 vote**. The motion contained a stipulation that the developer, Reno Land, follow a five-year timeline for **them** to complete the storm drain and sewer infrastructure. A five-year extension could potentially be granted. They asked the City to offset \$3.5 million of the total of \$11 million cost to relocate major community utilities and internal street network, specifically, the relocation of storm drain and sewer infrastructure - on and adjacent to - the Park Lane site. The 46-acre development is the largest infill site in the City. Reno Land recently purchased the former Park Lane Mall site located on the southeast corner of Plumb Lane and South Virginia. On October 12th, Reno Land presented its preliminary plan for the site to City Council showing how they and the property would follow Transit Oriented Development best practices and meet the recommendations of the April 2016 Urban Land Institute report. Reno Land said they expect to break ground in April 2017.

The 12/1 RGJ, reported that **UNR's Nelson Building is being sold to the Don J. Clark Group, developers of the 17-acre West 2nd District in downtown Reno**. The sale of the 1.6 acre parcel with two buildings and parking lot was approved by the Nevada System of Higher Education Board of Regents at their December meeting. A \$700k deposit has been made on the \$7 million sale, which is expected to close no later than May 15, 2017. The sales price is 190% above the May appraisal of the property since the parcel is an essential piece of the West Second assemblage.

The NNBW reported that **Switch quietly opened 1.2 million sf of its new TRIC data center on November 1st**, out of a projected 6.49 million sf in 7 buildings at full build-out.

The NNBW reported on January 6th that Reno-Tahoe International Airport (**RNO**) **announced that Southwest Airlines will offer daily, non-stop service to San Jose starting June 4th**. Southwest flew that route from 1993 until April of 2012. Our region was fortunate to have Alaska Airlines fill the San Jose route starting in June 2012. The restored Southwest flight will operate a Boeing 737 with 143 seats.

On November 4th the NNBW reported that **Westcore Properties acquired a 12 building, 1.17 million sf industrial property portfolio in Sparks for \$54.5 million**. The acquisition marks Westcore's entry into the Reno marketplace. The portfolio is 92% leased to 53 tenants. Combined with the purchase of Tranche 1 (5 industrial buildings) on October 3, 2016, this is one of the three largest industrial investment portfolio sales in northern Nevada. The northern NV market remains desirable due to its relatively low entry point compared to CA. Reno / Sparks is a good investment position for West Coast distribution locations.

Mike Wuerthele, writing in AppleInsider.com, reported that **Apple and NV Energy announced a deal on January 24th to build another 200 megawatts of solar power in Nevada**, aimed at supporting Apple's Reno data center, with completion in early 2019. Apple will dedicate up to 5 mw for NV Energy's future subscription program for residential and commercial clients. Apple's Reno data center supports cloud platforms like Siri, FaceTime, and iMessages. NV Energy said it will file the application to start a power purchase agreement very soon. The arrangement will presumably involve Apple Energy, a subsidiary created in May 2016 to sell excess energy into wholesale markets. Apple has been working to power as many of its own stores and offices as possible with renewable energy. The company says that its data centers are already fully powered by clean sources, which suggests that the Nevada solar expansion will be matched by an expansion in the data center itself, presumably to keep up with growing data traffic.

Tesla Will Produce Its Model 3 Drive Units at the Gigafactory

Source: www.fool.com (Daniel Sparks) ZAP Updated Jan 19, 2017



Tesla Gigafactory construction progress as of Jan. 3. Image source: Tesla Motors.

Tesla Motors confirmed it will produce the drive unit for its Model 3 at its Nevada Gigafactory, adding to their plans for producing batteries there. This represents an important step for Tesla ahead of its planned high-volume Model 3 production later this year. It is expected to yield over \$350 million of incremental investment, and add 550 new skilled jobs to Nevada's economy. Drive-unit production expands the already mind-boggling scope of Tesla's Gigafactory. Tesla has over 1,000 full-time employees and 2,000 construction workers on site. 5 million sf of the Gigafactory is already built. When finished, it will be the largest building on earth. It was designed primarily to build battery cells for its vehicles and packs for its energy storage products. Tesla is building the factory in a unique phased approach, building it in sections and then immediately beginning manufacturing in finished areas. Tesla has already started mass-producing the lithium-ion battery cells for its energy storage products. It will begin Model 3 cell production in Q217. Tesla just announced the Gigafactory had doubled in size between July 2016 and now, expanding to 1.9 million sf,

with 4.9 million sf on several levels of operational space. When completed, the Gigafactory will be the largest building on Earth. In Tesla's third-quarter shareholder letter, they said the Model 3 was on track for volume deliveries in the second half of 2017. Tesla has completed its production layouts for the vehicle and would soon begin installing body-welding and final-assembly lines for the vehicle. To support increased production for the Model 3, Tesla received approval in California to double the size of its car factory. Building the foundation for higher production capacity is critical for Tesla, as they are planning to increase production from under 80k units in 2016 to 500k units in 2018 with the help of its lower-cost Model 3.

City Council approves agreement to bring hockey to Reno

In the 12/16 RGJ, Jim Krajewski reported that the Reno City Council approved a 10-year agreement with the Reno Puck Club to establish a professional minor league hockey team in Reno starting in 2018. The council voted, 6-1, to approve the term sheet and to direct staff to negotiate with the Reno Puck Club. This was after unanimously approving on 9/16 a resolution directing City Staff to enter into a 45-day exclusive negotiating period – which I reported in my Q316 report. The club would spend up to \$5.7 million for a professional ice surface at the Reno Events Center (REC) through public-private partnerships. It would also add locker rooms, a new elevator and be responsible for other repairs to the REC. The hockey team would begin play in the ECHL starting in October 2018, if approved by the ECHL, which is a Double A hockey league based in New Jersey. It is considered a tier below the AAA American Hockey League, with both officially recognized as hockey minor leagues by the NHL. The ice rink could also be used by youth and adult hockey leagues and for public skating. The rink would be 200-feet long by 85-feet wide. Finally, there is no general fund commitment from the city in the agreement. Reno's previous hockey team, the Reno Renegades, played at the Reno-Sparks Convention Center from 1995-98.

School Board approves \$76 Million in school projects

Trevor Milliard, wrote in the 12/20 RGJ that the Washoe County School Board unanimously approved a plan to spend \$76 million on construction. The new funding source is the countywide sales tax increase approved by voters in November, increasing Washoe's sales tax rate from 7.725% to 8.265%, with the District receiving 100% of that increase. The tax increase won't come into effect until April 2017, and the District won't see any of those tax collections until about June. The project list was recommended by The School Funding Protection Committee. The projects, to be completed over the next two years, include the following:

- \$23 million to add 22 classrooms to Damonte Ranch High School. It is 25% over its capacity – or about 350 more students than it was meant to hold.
- \$15.9 million in repairs and upgrades to schools and support facilities, including the nutrition services center, that prepares school meals.
- \$12.2 million to design and engineer new elementary, middle and high schools.
- \$15.6 million to buy land to build new schools and expand a bus yard.

The spending in the last 2 categories will be done so the District can start the much more expensive work of constructing new campuses in 2017. District officials estimate being able to sell \$781 million in bonds against tax revenue in the next decade. The School Board promised in the recent election that it would use that money to build 15 new schools – 9 elementaries, 3 middle schools and 3 high schools – to alleviate crowding at existing campuses, with new elementaries and middle schools coming first. The District plans to break ground on a new elementary school in the South Meadows area in 2017 - to open in 2018. A new high school won't be built for four or more years.

2016 Single Family Sales

Writing in the January 16, 2017 issue of Nevada Business, Chrisie Yabu reported that the Reno / Sparks Association of REALTORS (RSAR) released its 2016 year-end report for existing single family residential (SFR) sales for our region. RSAR obtains its information from the Northern Nevada Regional Multiple Listing and includes sales of bank-owned properties. All sales numbers are for existing "stick built single family

dwelling's" only and exclude condominium, townhome, manufactured, modular or newly constructed homes. **Washoe County** had 6,559 sales of existing SFR, a 4% increase from 2015 (YOY). The median sales price was \$304,990, an increase of 9% YOY. **Reno** (including North Valleys) had 4,335 sales of SFR in 2016; an increase of 2% YOY, with the median sales price of \$318,000; an 8% YOY increase. **Sparks** (including Spanish Springs) had 2,224 SFR sales in 2016; an 8% increase YOY. The median sales price was \$282,000; an 8% increase of 8% YOY. **Fernley** had 518 SFR sales of SFR in 2016, one more than 2015. The 2016 median price was \$189,900; a 13% increase YOY. Finally, Q4 sales volumes were down across the board.

Station Casinos project on track after Reno denies Atlantis' appeal

Jason Hidalgo reported in the RGJ that the Reno City Council voted on November 2nd to allow Las Vegas-based Station Casinos to move forward with a planned gaming facility near the Reno-Sparks Convention Center. The council voted 5-2 to reject an appeal by Monarch, the Atlantis' parent company, which opposed having the proposed 84 ksf project in its backyard. Hotel rooms, or the lack thereof, were the crux of the debate. Monarch says it goes against the City's master plan, which typically requires hotel rooms for new gaming developments, especially given the project's proximity to the Convention Center. By building a gaming facility without lodging amenities, Station's new project will also cannibalize guests from surrounding establishments instead of growing the market, said John Farahi, CEO of Monarch Casino and Resort. When Station Casinos first received approval for its project in 2005, their proposal included 500 hotel rooms. That plan was scrapped after the recession. Since then, Stations acquired the gaming license for the former Turf Club, which did not have rooms. They argued that this license allows them build a new gaming facility without lodging. Station said that it would add much-needed entertainment options in the area, such as a bowling center, theater, sportsbook and sports bar, mobile sports wagering kiosks and cafe. The project cost will range from \$50-70 million and employ up to 200 workers when completed. It also estimates about 350 construction jobs will be created. The new property's design allows for the addition of lodging in the future should Station decide that it is ideal to do so. Station Casinos has yet to finalize a construction timeline for the project. The company provided no updates about their other proposed site across from the Summit mall.

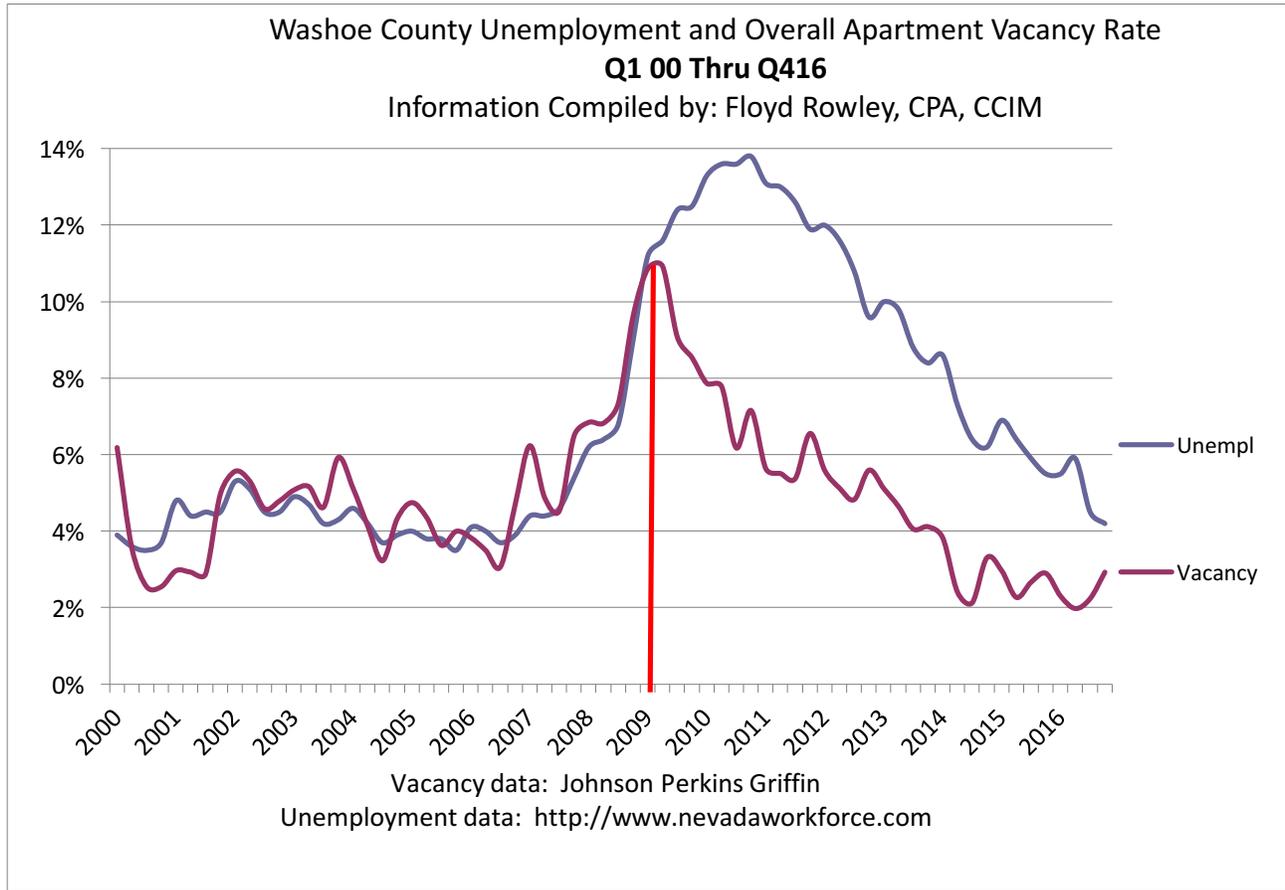
Apartment Statistical Review

Both the Johnson Perkins Griffin (JPG) Q3 and Q416 survey covered 83 properties and 21,082 units. Thus, their data continues to be representative of regional multifamily performance. A full copy of the survey can be found at: <http://jpgnv.com/wp-content/uploads/2017/01/Q4-ApartmentSurvey2016.pdf>

- Overall vacancy increased 69 bps from 2.24% to 2.93% in Q416 – a statistically insignificant increase. This is now 8 quarters in a row that our region's overall apartment vacancy rate has been UNDER 3%.
- Unlike the last 2 quarters, 9 of 10 submarkets registered vacancy increases, ranging from 0.25% in NW Reno, to 2.72% in SW Reno. This blue-collar submarket was 0% vacant in Q2 and is now back to the 2nd highest vacancy in the region at 5.76%. Lakeridge for once leads all vacancy at 5.83%, likely due to the scope of unit renovations – and huge price increases - at Lakeridge West.
- Average rental rates rose a modest \$12 / unit / mo. this quarter, or 1.14%. While rents have risen 22.8% in 2 years, rents have increased ONLY 20.3% since the TOP of the last cycle in Q108 – an amazing 8.75 years ago. This works out to a measly 2.14% annual growth rate / year since then!
- East Sparks reclaimed 1st place for the highest average rents, scoring a \$23/unit/mo. rent increase, with NW Reno moving back to 2nd place. Lakeridge was bumped back to 3rd place, losing \$19/ unit / mo.
- We continue to have 4 submarkets topping \$1k / unit / mo. for average rents, consisting of SE Reno, East Sparks, NW Reno, and Lakeridge. However, NE Reno and SW Reno are closing in fast, at \$986 and \$980, respectively. Two more submarkets are within striking distance in 2017 at \$941 and \$937.

The conclusion I continue draw from the JPG submarket data is that there continues to be a huge amount of bottom-up compression occurring – the blue-collar submarkets are now 94% full - having recovered from the Great Recession. As you have read in my lead-off article, rents have nowhere to go but up as workers continue to flock to our region. While there are thousands of new units in the pipeline, most are Class A – which might

start to cause top down compression – especially among the older “A” properties. The good news is that all classes of apartments now have the cash to tackle deferred maintenance they have accumulated since 2009.



About the Author

Floyd joined the Johnson Group in January 2011 as the culmination of his emphasis that had been moving towards apartments throughout his 13-year brokerage career in northern Nevada, interrupted by a brief “walkabout” with a national firm for 13 months in 2014-15. Before joining Johnson Group, our region’s premier boutique commercial brokerage firm, Floyd served for 7+ years as SVP of 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 mid-2004, Floyd has closed \$176 million in 66 transactions in our market. Starting in the fall of 2008 he started focusing on distressed assets, mainly apartments. He completed 61 broker price opinions totaling \$457 million during the Great Recession - resulting in \$47 million of listings, mainly apartments, since early 2010.

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