

Northern Nevada Commercial Investment Real Estate Report: Q217 The "Invisible Hand of Adam Smith" Issue

This quarter I have seen, heard and read many anecdotes about labor shortages, rent increases, house price increases, etc. This typically causes knee-jerk reactions about ways to "fix the problem". My consistent response has been that (1) there is no "problem", and (2) these events are examples of the "invisible hand" at work. This phrase – and its related theory – was written by Adam Smith, in his seminal book, The Wealth of Nations, published in March 1776, during the Scottish Enlightenment. An important theme throughout his work is the idea that economic systems are automatic, and, when left with substantial freedom, are able to regulate themselves. This ability to self-regulate tends to ensure maximum efficiency; however, it is often limited by externalities, monopolies, tax preferences, lobbying groups, and other "privileges" extended to certain members of the economy at the expense of others. For example, if today we cannot find carpenters at \$36/hour, then "tomorrow" more people will become carpenters – or they will move here from elsewhere. For the time being, continue paying them \$500 / week retention bonuses. Yes, this will raise the price of homes or apartments a bit – but probably trivial in comparison to the increase in costs attributed to implementing new building codes, government fees, etc. Finally, Mr. McKenzie: Please no rent control!!!!

Please be sure to read the Conclusions section re apartments at the bottom of Page 5 of my report.

Major Planned / Under Construction Apartments (Rowley proprietary research)

Every quarter I make about 40 phone calls and emails to developers to update my proprietary survey. This quarter, I added a net of only 164 total units to my inventory, consisting of a reduction of 524 planned units offset by a net additional 688 units under construction. This is even with 336 units completed in Q2 – mainly Silverwing's Fountainhouse at Victorian Square. As a result, the total number of projects I am tracking remained unchanged. I am now tracking the following projects:

Planned apartments: 33 projects totaling 13,240 units

Under Construction: 16 projects totaling 3,537 units

Total: 49 projects totaling 16,777 units

Here are the major apartments currently under construction:

1. ERGS' **North Peak Apartments** is underway with 104 units.
2. Silverwing continues under construction on 194 units in Victorian Square, called **The Bridges**.
3. Kromer's 210 units, **Vineyards at the Galleria**, is taking reservations for a late summer 2017 opening.
4. Kromer's 336-unit JV with Maddox is under construction, called **Sierra Vista** on ArrowCreek Parkway.
5. Nearby, Ryder's 252 unit, **Village South Apartments** continues building and leasing.
6. LandCap's 209 unit, **Waterfront at the Marina** has broken ground on their ultra-luxury apartments.
7. Guardian Capital is underway with 312 units called **Vida** @ Sharlands & Mae Anne.
8. **Summit Club**, by Reno Land Development, is finishing grading its 580-unit site by The Summit mall.
9. Lewis' 278 unit, **Harvest at Damonte Ranch Phase I** continues construction and leasing up.
10. Lewis is also underway with 148 units called **Latitude 39**, on Double R, N of South Meadows.

11. Blake Smith is underway with 280 units called **Lyfe at the Marina** in Sparks.
12. Sunroad is building 320 units at **Lumina**, up in Pioneer Meadows.
13. Greenstreet' s **Vintage @ the Crossings** is underway just NE of the Southtowne Crossing Wal-Mart.

The Local News Bag

Claire Cudahy, in the June 23, 2017 Northern Nevada Business Weekly (NNBW) reported that, after nearly 25 years in the making, **Edgewood Tahoe's \$100-million lodge finally opened on June 20th**. The 154-room lodge, which broke ground in October 2015, includes a spa and salon, 200-seat bistro and bar, ballroom, adventure center, kids camp, high-end shops, and a lakefront swimming pool. It will employ 240 locals. The project paired redevelopment with conservation in various environmental restoration projects on the 4,200-acre Edgewood Creek watershed that feeds directly into the lake. It enhanced wetlands, created new fish and wildlife habitat, and improved storm water systems. Golf course restoration improved 53 ksf of stream environment zone. BTW, all these improvements were required by the TRPA for the lodge to be built.

Siobhan McAndrew wrote in the June 15th Reno Gazette Journal (RGJ) that **UNR has broken ground on a new 42.5 KSF Arts Building** that is expected to be completed next summer. No state funds will be used as the building is funded entirely from donors and student fees designated for capital improvement projects. The new space is a benefit to students and the community to broaden their horizons by taking art classes or attending university events. UNR will also renovate other space to expand dance programs on campus.

The NNBW reported on June 8 that **McKenzie Properties has broken ground on the first speculative office project since 2008**. Located at 5520 Kietzke Lane in the Mountainview Corporate Center, the Class A building will be four stories, totaling 40 ksf. Situated on a 2-acre parcel, it will feature customized floor plans with generous TI allowances, with two of the floors featuring balconies.

The NNBW reported on July 14th that the **Reno Technology Park (RTP) will soon be home to a 60-megawatt solar energy facility**. RTP is the 2,200-acre data center campus 18 miles east of Reno, developed by Unique Infrastructure Group, and home to a major Apple data center campus. The new Turquoise Solar Energy Project is a joint development of Estuary Capital Advisors and Sumitomo Corporation of Americas. Turquoise Solar fulfills RTP's vision of an on-site, utility-scale renewable energy resource. Turquoise received its special use permit in July 2015 and closed on the purchase of 500 acres in RTP in June 2017. They expect to start construction in late 2017 and to begin producing solar energy in 2018.

Mike Higdon wrote in the June 23 RGJ that **Sprouts Farmers Market plans to finish its south Reno store by late summer** while another one in Sparks continues construction. Sprouts is one of the fastest-growing retailers in the country, and sells organic foods at low prices in competition with Trader Joe's and Whole Foods. The 30 ksf store at 587 South Meadows Parkway will open Sept. 13, and will bring over 100 full- and part-time jobs to the area. Headquartered in Phoenix, Sprouts employs over 25 thousand people.

In a press release dated June 2nd, **Starbucks announced that it is expanding its Carson Valley Roasting Plant and Distribution Center in Minden by 700 ksf**. It will create 100 new jobs, bringing the workforce to 350. The \$50 million project will be completed by the summer of 2018. Only the distribution portion of the 341 ksf building will be enlarged, allowing Starbucks to increase capacity and streamline regional sourcing, with the roasting operation unchanged. The facility serves all of California, Nevada and Utah, and parts of Arizona and Asia Pacific and does everything from coffee to syrups to behind the bar supplies. The expansion consolidates the company's Western Nevada operations under one roof from warehouses in Reno and Sparks and will reduce the amount of truck traffic to the plant.

In a press release dated July 13th, **Switch announced that it will establish a technology and co-creation hub on the entire 2nd floor of the iconic Virginia Street Post Office in downtown Reno** to house their rapidly evolving smart technology development and community co-creation initiatives. It will also serve as an advanced collaborative workspace for many of Switch's clients. This signals the company's continued investment in the community and the brand of Northern Nevada – as well as the growing vibrancy

and excitement of downtown Reno. The 1934 building was designed in the Art Deco Moderne style by Nevada architect Frederic DeLongchamps. It is one of Reno's most historic buildings and has undergone a careful renovation and adaptive reuse into a jewel of the city center. Switch and Rob Roy's initial entrance into downtown Reno was to co-sponsor and design the Innevation Center with UNR in 2015.

Amy Alonzo, of the Fernley Leader-Courier, in an article dated July 28th and published in the RGJ, wrote that **the USA Parkway opens to traffic September 8**. The road runs from I-80 west of Fernley to U.S. 50 west of Silver Springs. The road was originally built as a private, six-mile-long road connecting Tahoe-Reno Industrial Center to I-80. NDOT is completing a 12-mile extension to connect it to Highway 50. NDOT states that the \$75.9 million extension will reduce travel time between I-80 and Highway 50 by 38%, alleviate traffic issues at the underpass in Fernley, and, when weather closes Washoe Valley, vehicles may be able to travel over the parkway.

Geoff Dornan wrote in the July 18th NNBW that 17 years and \$203.5 million later, **the Carson City freeway bypass opened to traffic the first week of August**. It runs 9.71 miles from the Washoe County line at Lakeview Hill to the Spooner Junction. A bypass to move traffic through the capital off Carson Street has been talked about, considered and put off for 40 years before the actual work began in 2000. It would have undoubtedly been much cheaper if the State and Carson City had done it long ago. While the bypass itself is complete, the construction of the full freeway interchange at Spooner Junction will have to wait until there's funding available. That interchange is a multi-million-dollar enhancement that was put off in favor of a signalized intersection to get the bypass open several years earlier than would otherwise have been possible.

Apple announces \$1 billion data center expansion east of Reno

Anjeanette Damon, writing in the May 10th RGJ, reported that Apple easily won approval from the Reno City Council for a new agreement allowing it to take advantage of millions of dollars in sales tax abatements as it works to double the size of its massive data center east of Reno. The agreement will allow Apple to buy (sic) land in downtown Reno instead of leasing it to be eligible for a tax break that will bring its sales tax rate down to 0.5%. The vote came moments after Apple announced that it will invest another \$1 billion to expand its data center at the Reno Technology Park east of Sparks. Apple needs to expand its data center to meet soaring iCloud storage demands. Apple's original \$1 billion data center was awarded \$89 million in state property and sales tax abatements in 2012. Due to a quirk in state law, the state can abate all but 2% of the sales tax rate paid for equipment. Also, Apple will build a warehouse on land in downtown Reno that's part of a tourism improvement district created in 2009. By moving its new computer equipment through that warehouse, it will chop another 1.5% off its sales tax rate. Apple plans to spend \$4 million on the warehouse. Usually Apple does not put signage on "high security buildings," but said it will make an exception for this warehouse to appease the Reno City Council, which hopes the Apple warehouse will spur additional development in the downtrodden Tessera District: they want it to advertise that Apple is a downtown business. Tessera's developers originally planned a \$350 million mixed-use development of hotels, retail and office buildings. That vision has changed after the recession. Tessera now hopes to develop an "innovation district" that is home to technology and research companies that want to be close to UNR.

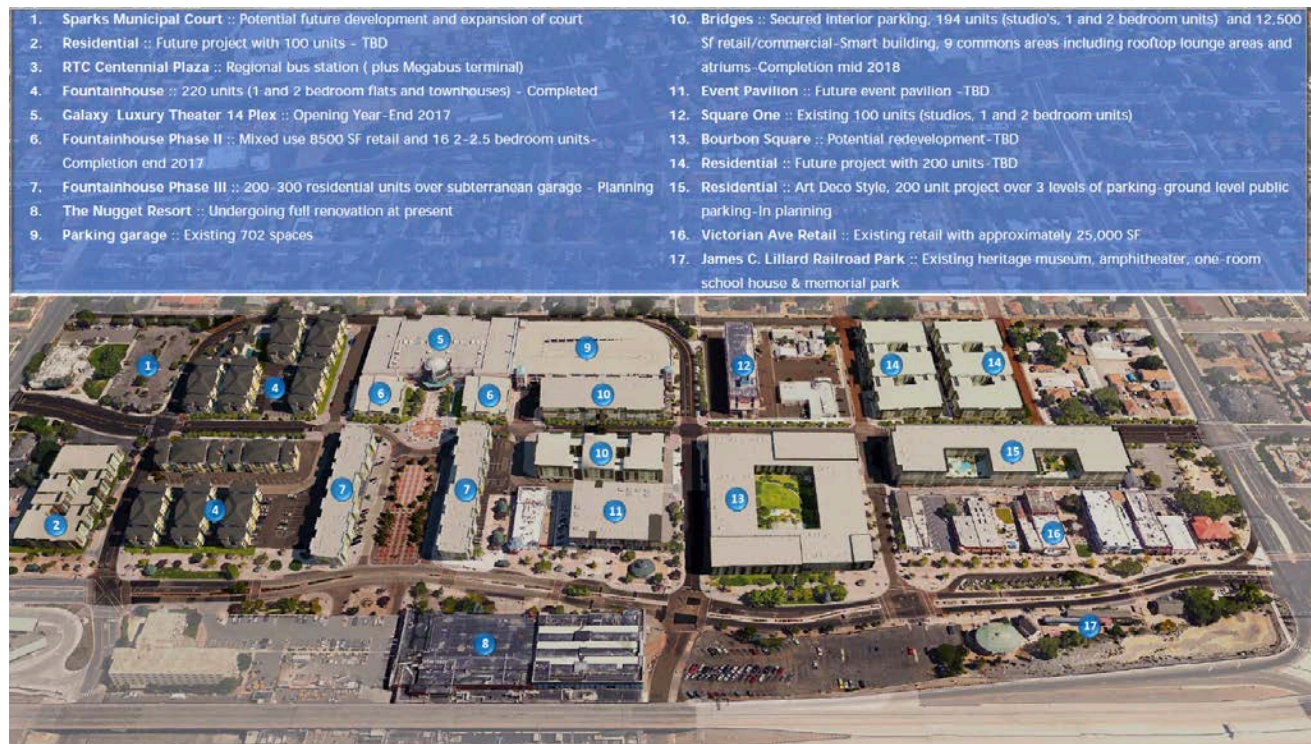
Reno housing crisis: Rent control, tiny houses, anti-vagrancy laws up for consideration

Anjeanette Damon, wrote a scathing article in the July 27 RGJ, about how a scattered Reno City Council continued to struggle at its July 26th council meeting with how to address the city's burgeoning affordable housing crisis, jumping from idea to idea even as city staff pleaded with them to provide a focused game plan. In a wide-ranging debate before a crowded chamber, council members ruminated on ideas they've been discussing for more than three years, threw out new suggestions and lamented the lack of progress on one of the most pressing issues facing a community in the throes of an economic rebound. Councilman Paul McKenzie demanded a legal opinion on whether the council can implement rent controls, as well as an analysis of what is standing in the way of affordable housing construction. Councilwoman Neoma Jardon urged city staff to build a tiny-house village for homeless individuals ineligible for the shelter because they have pets, a spouse or PTSD. She recently visited Seattle and returned with a strategy for completing such a

project in 90 days. Councilwoman Naomi Duerr said the Housing Authority could help seniors with large homes find roommates. Meanwhile, Assistant City Manager Bill Thomas begged the council to set a definable focus with achievable goals. As the debate waged for two hours, McKenzie erupted in frustration that the housing crisis has been a top priority for three years with little progress made.

Victorian Square to evolve into a Walkable Master Planned Community

On April 19, 2017 KTVN Channel 2 posted an article stating that Silverwing Development has unveiled plans to revitalize Victorian Square into a walkable master planned community. Over the next 5-7 years, more than 1,500 housing units will be added, with a wide variety of lifestyle options, combined with 60 ksf of retail / commercial space. Residents and visitors can expect to see the addition of a variety of unique bars, eclectic coffee houses, dining options, entertainment and boutique shopping. Silverwing’s goal is to revitalize Victorian Square to be a vibrant and engaging downtown where people want to live and/or visit repeatedly. They plan to provide mixed use living with community spaces and amenities unparalleled in the area. This, combined with walkability, connectivity to public transportation and freeway access, and a perfect blend is created for people looking for an urban lifestyle. Silverwing’s Fountainhouse was recently completed.



The Bridges is underway and will offer a modern amenity package for multi-family living, with 194 studio, one, and two-bedroom units. Also, 12.5 ksf of retail space will be on site. Leasing is planned to begin in early 2018. With \$25 million renovations under way at The Nugget, the revitalization at the Galaxy Theater and future plans coming, Victorian Square will be a unique blend of historic Sparks with modern living, amenities and commercial / retail spaces. These projects represent a total \$350 million investment.

Reno abandons alleyway for Fountain District development

In the 7/20 RGJ, Anjeanette Damon wrote that the Reno City Council unanimously voted to abandon a downtown alleyway between Washington and Ralston streets on the south of 4th Street - the first step in a planned \$500 million development dubbed the Fountain District by developer Jeff Jacobs [my main 2016 client]. Jacobs Entertainment, which has owned the Gold Dust West Casino for 12 years, recently bought the Sands Regency Casino for \$27.5 million. In the past year, it has [ed: I have] been busy acquiring multiple parcels between the two casinos. Few details have been revealed about what will ultimately be built in the

Fountain District, despite a protest by Brekhus that Council should know what will be built before giving up the public right of way. The company has described the Fountain District as a mixed-use project with market-rate housing that will include a strong arts and entertainment focus. They will install temporary pedestrian safety improvements at Washington and 4th where two pedestrians died last year, saving the RTC \$300k. Jacobs wants to eventually build a roundabout at the intersection. Jacobs will install a temporary median to give pedestrians a safety island in the middle of 4th Street and install pedestrian warning lights.

Next for the Truckee River Flood Project: Formation of a Project Needs Committee

On June 20, Chrisie Yabu, of KPS3, wrote in Nevada Business that AB 375 was signed into law on June 12, allowing the Truckee River Flood Management Authority (Authority) to continue its mission to plan, engineer and construct flood project improvements to protect the Truckee Meadows from a 100-year flood event. The Authority board met on June 20 and passed a resolution creating a Flood Control Project Needs Committee (Committee). Before April 2, 2018, the Committee must prepare recommendations regarding taxes, fees, or a combination of them. Taxes that may be considered include: room tax, supplemental government services tax, vehicle privilege tax, real property transfer tax, property tax or any other tax that the County is authorized to impose. Sales tax cannot be considered. If a fee is recommended, the Authority will impose it. If a tax is recommended, the County Commission will submit a question to the voters in the 2018 general election to approve the proposed taxes. The Committee also has 18 months to receive information and evidence regarding flooding in areas not covered by a flood protection plan.

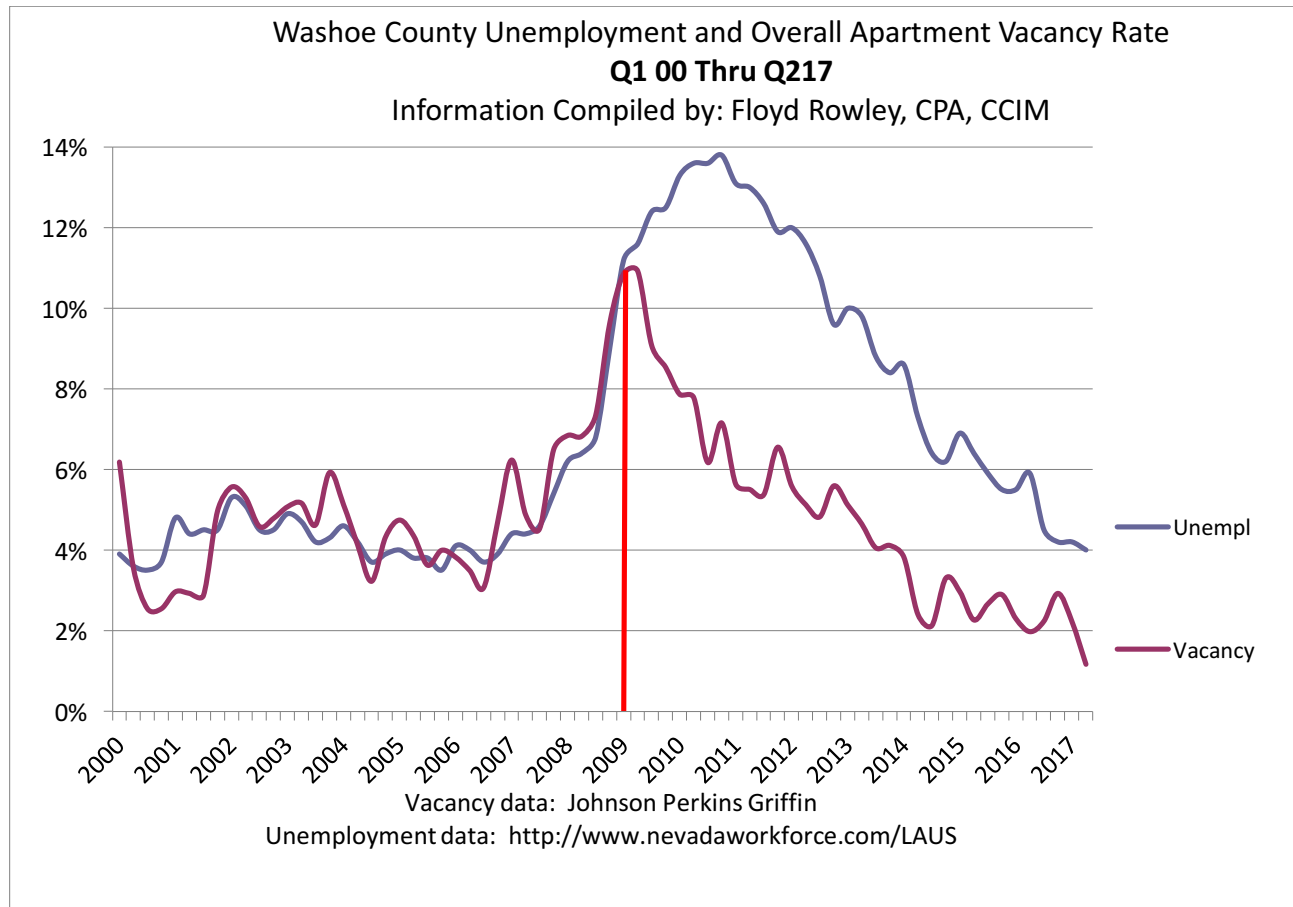
Apartment Statistical Review

The Johnson Perkins Griffin's (JPG) Q217 survey added 1 property this quarter (3rd Street Flats) to now cover 85 properties and 21,277 units. In Q1 they announced their intention to create a new submarket, called Downtown Urban. 3rd Street Flats and Square One comprise this new submarket, with Fountainhouse joining their survey soon. As always, JPG's data is representative of regional multifamily performance. A full copy of the survey is available at: <http://jpgnv.com/wp-content/uploads/2017/07/Q2-ApartmentSurvey2017.pdf>

- Overall vacancy dropped to 1.17%, an amazing 48% decline from the Q117 rate of 2.23%. This is now 12 of the last 13 quarters that our region's overall apartment vacancy rate has been UNDER 3%, and 17 quarters in a row that vacancy has been under 4%.
- In both Q217 and Q117, 8 of 10 submarkets registered vacancy decreases – with 4 of them under 1%.
- Average rental rates rose a healthy \$83 / unit / mo. this quarter, or 7.47%.
- While rents have risen 25% +/- in 2 years, they have increased 34.8% since the **TOP** of the last cycle in Q108 – an amazing 9.25 years ago. This works out to an annual growth rate of under 3.4% / year. Overall rents were basically flat for the preceding 7 years – but this does not make the news headlines.
- East Sparks again continues in 1st place for the highest average rents, with a huge \$130/unit/mo. rent increase – after \$155 in Q1. The new Downtown Urban submarket debuted in 2nd place – as should be expected. NW Reno jumped back to 3rd place, bumping Lakeridge down to 4th place.
- In Q117 we achieved 5 out of 10 submarkets topping \$1k / unit / mo. in average rent. Only 1 submarket joined the "\$1k / mo. Club" in the last 5 quarters. This quarter an astounding 9 of 11 submarkets exceeded \$1k average rent / month – with only the blue-collar submarkets of Airport and Brinkby-Grove now left out of the "club". Given the age, size and condition of many of those properties, it will take a long time for them to join the \$1k club.

Conclusion: With our region's 2 blue-collar submarkets now at an amazing 99% occupancy, all the workers we lost in the Great Recession have now either returned or been replaced. JPG's planned projects number has now grown to 7,822 planned and 3,453 under construction. They continue to catch up to my proprietary research numbers on Page 1. While still lagging the demand published by EDawn, these numbers prove that apartment developers are doing all they can to provide new units, albeit at premium rents - caused by a combination of rising land prices, high construction costs and the ever-increasing code requirements - plus

approval delays by various agencies Finally, I believe that these new expensive units will be snapped up by all the new employees coming to our region who don't feel that rents > \$1,500 / unit are all that expensive, leaving the existing apartment stock to be renewed by the existing workers in our region.



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 14-year brokerage career in northern Nevada, interrupted by a brief “walkabout” with a national firm for 13 months in 2013-14. Before joining Johnson Group, our region’s premier boutique commercial brokerage firm, Floyd served for 7+ years as Sr. 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 mid-2004, Floyd has closed over \$199 million in 75 transactions in our market. Starting in the fall of 2008 he started focusing on distressed assets, mainly apartments. He has completed 64 broker price opinions totaling \$472 million, mainly during the Great Recession, resulting in \$61 million of listings, mainly apartments and land, since early 2009.

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