

Northern Nevada Commercial Investment Real Estate Report 2nd Quarter 2012 - The “Data Centers Are Coming!” Issue

To paraphrase President Reagan - here we go again. Just like Q211, Q212 was a letdown nationally from the prior quarter. The Washoe County unemployment figures were within 30 bps of **Q411**. On the bright side, the long-rumored Apple data center was officially announced, along with a 48 ksf office building to anchor the long-planned Téssera project in the NE corner of downtown Reno – more below. For once, our region seems to be moving in a positive direction, swimming against the national tide of economists gnashing their teeth over the coming US fiscal cliff, the ongoing European debt crisis, Iran and its nukes, global warming, etc.

Major Transactions this Quarter

The table below summarizes the nine largest Q212 transactions aggregating \$49.75 million, or 44% of the total dollar volume. I combined the 3 USA Properties sales into one, since the same buyer bought all three apartments at the same time. Distress continues to have an impact with 2 large foreclosures this quarter. Due to the large Manzanita and Delucchi transactions in Q1, multi-family dropped by \$29.4 million in Q2, with a 13% decrease in transaction volume. However, small apartment investors continued to stay active, accounting for 88% of all apartment transactions under \$1 million, increasing their average slightly to \$242,404 / deal.

Transaction	Address	Date	Price
Sale of Shoppers Square addition to Gershman Properties	355 E Plumb Lane	06/20/12	12,200,000
USA Properties Fund sale of Skyview, Skyline & Southridge Apts (293 units)	1550, 1570 & 1590 Sky Valley Drive	06/22/12	9,300,000
Sale of So Meadows Commercial (Kreg Rowe) to Chance Family Props	10345 Double R Blvd a/k/a University of Phoenix Bldg.	05/31/12	7,550,000
QGR Real Estate sale to Sierra Packaging & Converting	169 ksf industrial building @ 11005 Stead Blvd	05/17/12	5,950,000
Pinnacle Entertainment sells Boomtown to SJP (M1 Gaming)	350 Boomtown-Garson Rd	06/26/12	5,300,000
USBank forecloses on developer Kreg Rowe	5270 Longley Lane - Longley Town Center Line Shops	06/29/12	3,653,274
Weyerhaeuser sale to Crown Beverages	600 Spice Islands Drive, Sparks	06/08/12	3,000,000
CW Capital forecloses on Johnny Ribeiro’s Quail Vista property	4690 Longley Lane @ NEC of Mira Loma	04/20/12	2,800,000

Apple plans facilities in Reno

In the June 27th Reno Gazette Journal (RGJ) Brian Duggan wrote that Apple Inc. plans to build a data center east of Sparks to house its iCloud and iTunes services and to locate a purchasing center in downtown Reno, as part of a \$1 billion investment in northern Nevada over the next 10 years. "Project Jonathan," was kept under wraps for months despite the rumor mill. Apple plans to buy 350 acres in the Reno Technology Park for \$8.6 million. The data center eventually will result in 41 full-time jobs, 200 long-term contractor jobs and 580 construction jobs on top of an expected \$343 million of economic activity.

To attract Apple local and state governments approved tax cuts of \$89 million over 10 years, reducing Apple's tax burden by 79%. In return Apple will spend \$65 million on infrastructure upgrades for the data center, including a fiber optic network and a power plant to generate 35 megawatts that it will need by 2017. Reno's share of the tax abatement is a 75% reduction in sales taxes on purchases to be made at Apple's planned downtown office, estimated at \$100 million/yr. In 2009 the Reno City Council approved this special tax break for the T ssera District.

Washoe County Commissioners voted to give Apple an 85% break on its personal property taxes, with two, 10 year options. Steve Hill, director of the Nevada Office on Economic Development, said officials needed to give Apple tax breaks to be competitive with other "data center" states, notably sales tax-free Oregon. Earlier this year, Apple bought 160 acres in Prineville, OR to build a data center there. Facebook, Google and Amazon already have data centers in Oregon. Apple could have built there but chose to diversify locations - and to capitalize on Reno's vicinity to Apple's HQ in Cupertino. Apple also considered Salt Lake City and Phoenix.

There are many intangible benefits to having Apple open a major operation in the region, said Rich Miller, editor of Data Center Knowledge, a publication that tracks the industry. Besides the temporary boost in construction, a data center backed by Apple can attract others to the region and become an important intersection in the digital highway. While it's no guarantee, sometimes one big project can be the impetus for a lot of growth. Brian Bonnenfant, project manager of the Center for Regional Studies at UNR, says Apple's plans are a boost for the region, though the project will not generate a large number of jobs in the long-run. For that to happen, Apple must attract ancillary businesses in the hardware and software industries. "It's all about the spinoff, the ripple effect," he said. "That's really where it has to pack the punch."

The Local News Bag

On July 17th Kinecta Federal Credit Union closed on the sale of the Delucchi Lane Apartments, foreclosed in Q1, to Fowler's Fund III for \$8.3 million, or \$40,291 / door. As I reported in my Q1 report, this property was spun off from the Meadowood Apartments.

On July 8th on the same page of the RGJ, our region's two major retail centers on I-80 seem to be heading in opposite directions: on the west side of town - for the 3rd time in a year - Cabela's tapped its reserves to cover its semi-annual payment on \$35 million of STAR bonds used to build their 129 ksf mega-store. Meanwhile, east in Sparks, Moody's upgraded their opinion on the \$80 million of STAR bonds at The Outlets at Legends, from negative to stable.

Construction on the long-awaited Southeast Connector, which will link Geiger Grade to East Sparks, will be delayed until the end of 2012, when the RTC hopes to receive a permit from the

Army Corps of Engineers for the 1,300' bridge (not a typo!) that will span the Truckee River. Jeff DeLong, in the July 17th RGJ noted that 4 miles of the southern end of the connector have already been built - by developers. We call that Veterans Parkway.

Washoe's January - May gaming revenues were down 4% from the same period in 2011, and down more than 29% from the same period in 2002. Observers blame the ongoing (Great) recession as well as tribal gaming in California over the past decade.

Taxable sales in the greater Reno-Sparks region for the first five months are up almost 5% from the same period in 2011, according to calculations using Nevada Department of Taxation data.

The look of the planned Virginia Street Bridge downtown became clearer on June 13. The Reno City Council voted to use a bowstring truss, which would be about 12 feet high, agreed to use a circular pattern for guardrails and a pewter color scheme to create a more modern design. Construction is expected to begin in early 2014.

With a \$142.8 million mortgage note due on March 1, the Silver Legacy filed for Chapter 11 bankruptcy protection in mid-May. Gary Carano, the ownership group's CEO, said the largest bondholder still supports ongoing negotiations towards a settlement. In Chapter 11 the Legacy will operate protected from its creditors. The restructuring plan does not involve the sale of the company or its assets, and the current management team remains in place. The Legacy's taxable property value has declined from \$320 million when it first opened to \$98 million now.

Local Rumors

The View and Park View, two out of the three Fore Properties apartment developments in northern Nevada built the last cycle, are rumored to be under contract at an undisclosed price.

Although the Austin Crest apartments were hit with an NOD on 10/25/11 my friends at Ticolor Title have not found an NOS as of this writing.

Four large call centers are in various stages of negotiations to come to the Reno area and would occupy a significant amount of existing office space, according to Colliers.

Data Centers get traction

Writing in the July 23rd Northern Nevada Business Weekly (NNBW), John Seelmeyer reported that NJVC Inc. will move into an existing 20 ksf data-center facility at the Reno-Tahoe Tech Center in Reno's South Meadows. The facility is a linchpin in the company's new strategy to expand into commercial markets from its traditional base as a contractor to the federal government. By late August they plan to begin hosting cloud-based data center services for industries that need high security for their data, such as healthcare and financial services.

NJVC will create 32 new jobs at an average salary of \$90,000 each, and projects growth to 45 employees by Year 2. They are retrofitting their facility 20% at a time. The space originally was home to Redundant Networks and has served other technology companies over the last 10 years. Because it's moving into an existing facility where past users made big investments, NJVC has a cost advantage against competitors who need to build new facilities from the ground up.

Data center development is likely to be big business for our region. More look to be on the way as executives of several of the biggest names in the data industry have visited in recent weeks. Our region appears poised to do well as the data-storage industry prepares to deal with a

historic shift in the way it does business. Several years ago the Telecommunications Industry Association passed Standard 942, which is now driving the development of large-scale data centers in northern Nevada. Based on that standard about 65% of all major data centers in the US will need to be refurbished or relocated to meet the new standard. According to Lance Gilman, the developer of Tahoe Reno Industrial Center, it will cost more to rehab existing facilities than it would cost to build a new one.

Northern Nevada fits the bill, located at the western edge of the US seismic safe zone. California, obviously, is not. Our region is relatively safe from weather-related disasters such as hurricanes. And while data center operators sometimes are willing to fudge a little on this requirement, most locations in our region are outside of aircraft flight paths. The region's low humidity is a plus for the efficient operation of data centers, and our low nighttime temperatures dramatically reduce the cost of cooling. Data center operators also are drawn to our region's access to major fiber-optic lines and our business advantages: relatively inexpensive property, a good tax environment, and a pool of trained workers.

Reno's Historic downtown Reno post office sold

Riley Snyder wrote in the June 29th RGJ that the City of Reno and a development group led by City Council candidate Bernie Carter agreed to a \$1.2 million deal for the historic post office on S. Virginia St. just south of the Truckee River. The council voted 5-1 to approve the purchase. Carter's group is the only organization in decades that has approached the City to redevelop the former post office due to the \$4.9 million needed to renovate it. They deposited \$1.25 million into escrow, which the City will use to purchase the property from the Postal Service and then turn it over to the developer. They will have five years to complete renovations. If they fail to meet deadlines, the City has the right to repurchase the property. Photography shops, insurance agencies, hair salons, laundromats and liquor stores will not be allowed.

Holy Higgs Boson Batman!

The existence of the Higgs boson was finally confirmed in early July. The folks at CERN, who spent \$10 billion and 30 years in their quest, were excited to confirm that this little guy was proven to exist for a fraction of a trillionth of a second. The Higgs boson was the spark that lit the Big Bang. I am a big Dan Brown fan – his book Angels & Demons is a good read about this.

Reno-Sparks housing show positive signs

On July 29 the RGJ reported that Reno and Sparks have a 4.8-month inventory of homes for sale. Six months is considered a balanced market. Homes listed below \$400,000 are getting multiple offers at above the asking price, while higher-end homes are still feeling the effects of the Great Recession. Median home prices have risen \$35,000 since January to \$170,000, indicating that the overall mix of listed homes has improved. The limited existing home market supply is having a ripple effect on new home construction, as new construction is underway in Sparks and south suburban Reno. The Builder's Association estimates that 700 to 800 new home permits will be pulled this year - nearly double the number for the past few years.

CommRow Regroups

Rob Sabo wrote in the 7/23 NNBW that Reno Real Estate Ventures LLC, owner of the former Fitzgerald's Casino in downtown Reno, plans to renovate 12 floors to open 320 renovated rooms by the spring of 2013. The 4th floor of CommRow will be used for executive offices and

possibly a gymnasium. The first three floors were 80% finished when the property opened in late 2011. Since then \$1 million has been spent to complete restaurants, remodel bars, complete the 2nd floor check-in desk for the climbing wall and 3rd floor concert venue, and to bring a parking garage up to code. Once completed CommRow will have a modern, upscale look. Pete Wallish, economic development administrator for the Reno Economic Development / Redevelopment Agency, stated that CommRow is an excellent opportunity for the City to see a once-dark downtown hotel/casino renovated into a use for both locals and visitors whose amenities will provide an additional entertainment reason for people to explore downtown.

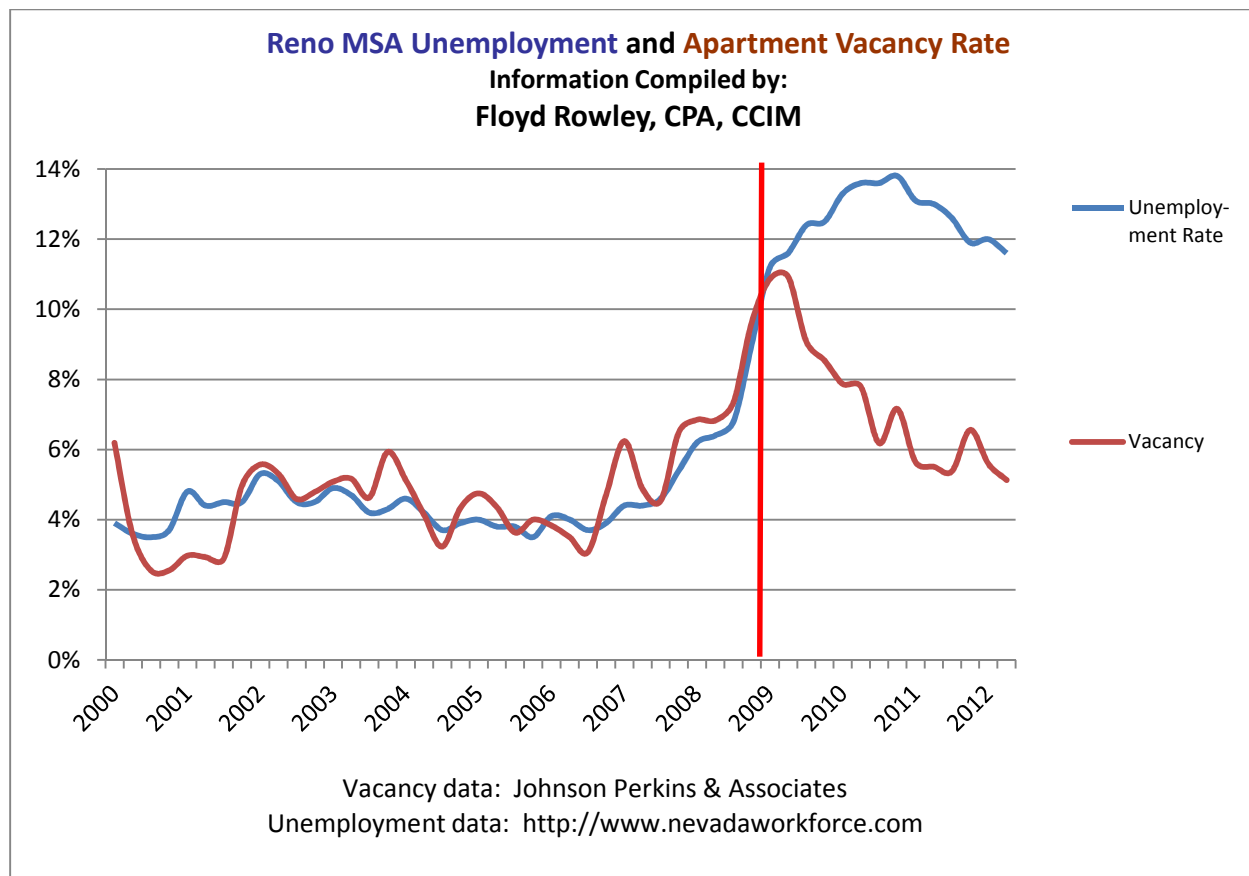
False internet rumors about “real estate transaction tax”

The July 30th Journal of Accountancy Online (Yeah, I get some pretty exciting daily emails!) reported that the recent flare-up of chain emails purporting that all real estate transactions will be subject to a 3.8% federal sales tax starting 1/1/13 is not true. The rumors are based on the 3.8% Medicare tax on **unearned** income that does take effect in 2013, resulting in a few taxpayers paying tax on the gain on the sale of their principal residence. False real-estate tax rumors emerged in 2010 when Congress passed the Patient Protection and Affordable Care Act, a/k/a Obamacare. Since June, when the Supreme Court upheld the Act, there has been another spike in email-rumors. The new tax **only** applies to single taxpayers with modified adjusted gross income (MAGI) over \$200k and married taxpayers with a MAGI over \$250k filing jointly, or \$125k if filing separately. They will pay tax only on the gain that exceeds \$250k for single taxpayers or \$500k for joint returns. **Example:** A married couple with MAGI of \$325k purchased a home in California years ago for \$350k and sold it in 2013 for \$900k, for a gain of \$550k. After excluding \$500k of gain under IRC Section 121, they have \$50k of investment income (assume they have no other investment income). Since their AGI is \$75k over the tax’s threshold for married taxpayers filing jointly, the \$50k would be taxed at 3.8%, resulting in a tax of \$1,900.

Apartment Statistical Review

Thanx (every quarter) 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, with the exception of Q412, continued its gradual downward trickle from 5.64% in Q111 to 5.13% at Q212 – essentially 5 quarters in a row.
- Overall average rents are essentially unchanged from Q210. However, the average rent jumped \$14, or 1.7%, from Q412 – a good sign of strength.
- As usual, Lakeridge, NW Reno and East Sparks continue to have the highest rents in the region, with all three coming in at over \$900 / month for the 1st time in a long time.
- West Reno, which reported an amazing 3.11% vacancy last quarter, is now at 0.44% - time to raise rents guys!
- The Brinkby/Grove and Airport sub-markets continue to make huge reductions in their vacancy, with their vacancies now only 1.5% greater than the overall average, down from over 3% in previous quarters. Are blue collar workers coming back to our market?
- Finally, vacancies in 3 X 2’s, which increased in Q1 to 9.3% as a number of these tenants probably bought homes in this incredibly affordable market, came back down in Q2 to 7.1%, likely due to the ongoing foreclosures of single family homes throughout our region.



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 over \$124 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 \$38 million of listings, mainly apartments.



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