

Northern Nevada Commercial Investment Real Estate Report – 1st Quarter 2014



The "VUCA" Issue

I read about the word "VUCA" in the April 7th issue of Fortune magazine. This acronym was invented by the Army War College in the early 1990's to describe the world after the collapse of the Soviet Union: **V**olatile, **U**ncertain, **C**omplex and **A**mbiguous. Seems like VUCA applies to a lot of things today – since twenty years later Russia seems to be expanding - again. VUCA could describe anything from the Kardashian's personal relationships to the status of Fannie Mae and Freddie Mac.

Major Planned / Under Construction Apartments

This quarter I added 560 units to my database: Village at the Peak and Sterling Sierra – both described below. The totals I am tracking now consist of:

Planned (there are more but these are likely to be built): 6 projects for 1,380 units – 2 described below
Under Construction: 4 projects for 1,034 units – all described below
Total: 10 projects for 2,414 units

- Construction of **the Silver Peak Apartments**, planned for 420 units in the North Valleys, continues to be on hold. Their Special Use Permit expires in March of 2016, so they have time.
- The **Villas at Keystone Canyon** continues in full-swing site work. Grady Kromer out of Truckee is the developer of this 288-unit project.
- Silverwing Development is planning **Edgewater at Virginia Lake**. The 1960's era rental housing will be demolished and replaced with 288 rental condos and 48 for-sale townhouses. Virginia Lake will be revitalized by covering the Cochran Ditch. They are still in the planning phase with the City.
- Silverwing's **Bungalow's at Sky Vista** are under construction with pre-leasing underway for occupancy starting in May 1st.
- The **Village at Arrow Creek** released their 1st building at the end of March, with the second building to be released mid-May - both 100% pre-leased. The property is 47% leased overall, with all buildings on schedule to be completed by the end of the year.
- **Sterling Sierra**, a Class A student housing development of The Dinerstein Companies of Houston, is now pre-leasing for the fall 2014 semester at its upscale community at 1550 Evans Avenue.
- **Village at the Peak** filed their master plan amendment to allow apartments to be built on the site on 1/18/13 and was rejected by the Regional Planning Agency. They are looking to build 360 units in two phases on Calle de la Plata, just east of Pyramid Highway.

Q114 Multifamily Sales and Analysis

Multifamily (MF) sales more than doubled to 13.6% of the total Q114 sales volume – even with the huge MEPT industrial transaction affecting the total. There were 2 sales over \$3 million – and only 1 sale in the \$1 – 3 million range this quarter. As a result, total MF sales volume this quarter of \$28.7 million was 85% higher than the \$15.5 million reported in Q413. Small MF sales under \$1 million dropped 25% to 24 deals – for a total of \$6.9 million. The average "small" deal size nudged up only \$1.5k to \$288.0 k.

Major Q114 Sales Transactions

In my Q312 issue, I announced that I was changing my reporting emphasis to apartments unless there is a regional impact from a sale in the office, industrial or retail world. Since this quarter the two top apartment sales made the region's "Top 10" there is no need to change from my earlier emphasis, as the following sales cover a wide spectrum of general interest:

Transaction	Situs Address	Date	Price
Several MEPT (Multi-Employer Property Trust) entities affiliated with New Tower Trust Company sell 4 industrial buildings totaling 1.03 million sf to an affiliate of Cornerstone RE Advisors	3450 Airway Dr, 7525 Colbert Dr, 895 E Patriot Blvd & 5555 Quail Manor Court	01/31/14	63,000,000
Dermody sells the 545,550 sf Logisticourt at Silver Lake to an investor and retains management.	12035 Moya Blvd.	02/25/14	26,300,000
Sale of Sky Peaks Independent Senior Living Community to a unit of Fortress Investment Group in NYC	1520 Sky Valley Dr., in the Summit Ridge area of West Reno	01/16/14	23,055,000
Woodside Village is sold to a JV between a CA investor and Morrison Street Capital out of Portland	4800 Kietzke Lane	01/23/14	14,900,000
Maryland investor buys three, two-story buildings, totaling 102 ksf, occupied by the State and HHS, along with two pad sites	4126 & 4150 Technology Way, Carson City	2/20/14	11,000,000
Two couples from Encinitas, CA purchase Green Leaf Pines, f/k/a Northgate Villas, from Green Leaf Partners who bought it out of foreclosure in 3/10.	100 Carville Drive	01/28/14	5,925,000
An entity controlled by Chuck Mathewson buys the Pyramid Building (Keller Williams, Capital Title, etc. tenants) out of foreclosure.	10539 Professional Circle	03/04/14	4,900,001
An entity controlled by John Serpa "donates" 32.39 acres of the Winters Ranch property to the BLM, along with 93.69 AF of water rights.	Old 395, across from the Bowers Mansion in Washoe Valley	01/17/14	4,870,000
Dermody transfers 19.39 acres into its LogistiCenter 395 development now consisting of 90 +/- acres, in which a 624 ksf industrial building will open in the fall of 2014 without a signed lease - yet.	Memorial Drive @ the SWC of Lemmon Drive and US 395.	02/21/14	4,436,000
Robert Cashell Jr. buys the former Chevron station and carwash from Overland Development Corp., owned by Larry Willard	7693 S Virginia Street @ Longley Lane	03/06/14	4,000,000

The Local News Bag

The Alexander was purchased by a TIC consisting of Lodi people who paid \$55.3 million, or \$158k / door – at a reported cap rate of 5.65% - the first sub-6 deal in this real estate cycle.

The Sparks City Council on 1/13/14 unanimously approved the construction of a new Wal-Mart Supercenter to be built at the Outlets at Legends. To accommodate an increase in traffic, the developer will widen Marina Gateway Drive to four lanes and improve Windsurfer Drive. A wall will also be built to separate the store from nearby homes. Additionally, the company will need to meet various noise conditions. The 180-ksf store will open in mid 2015. Wal-Mart already runs six stores in our region and employs over 14k people in Nevada. In 2012 they donated \$11.3 million to Nevada organizations.

The February 11th Reno Gazette Journal (RGJ) Business Briefing section reported that Seattle-based **Lake Washington Partners (LWP) has broken ground on a multi-phase 1.5 million sf distribution center** and warehouse within the Spanish Springs Business Center. They purchased the 66-acre site in

October 2013. The first phase is expected to be completed in late 2014 as a 750-ksf distribution center for SanMar Corporation to be built by United Construction. They will be moving from a 622-ksf space on Vista Boulevard, also owned by LWP. LWP plans \$3 million in renovations there after SanMar moves out.

Marcella Corona reported in the 1/24 RGJ that **ArrowCreek filed for Chapter 11 BK** on January 20th to give the golf course time to restructure. The Club GM says it's business as usual. The Club owed \$300k to creditors, including \$197k to Washoe County for water, \$45k to the IRS, and \$100k for a loan from an investor. Rates will remain the same for its 250 members. The 500-acre facility contains two courses. ArrowCreek opened in 1999 and was valued at more than \$40 million by golf course experts in late 2012.

Bill O'Driscoll reported in the 2/13/14 RGJ that, less than three years after opening a distribution center in TRIC, **Toys R Us ceased warehouse operations in late March** and will vacate the 300-ksf facility on June 1. The company is shipping online orders directly from stores to strengthen its e-commerce business. The successful "Ship from Store" initiative enables them to more efficiently leverage inventory and fulfill e-commerce orders in more locations. The warehouse opened in 2011 with 120 employees.

He also reported in the 3/26 RGJ that, in a ceremony with the Governor on March 25th, **Dermody Properties broke ground on a 624-ksf warehouse-distribution center** that doesn't have a tenant yet [officially]. DP is the first Nevada developer to build a spec industrial building in 7+ years. When Completed, LogistiCenter 395 will feature three buildings totaling 1.2 million sf of warehouse space on the 91-acre site off Lemmon Drive overlooking U.S. 395. The 1st phase will open next fall with 36' clear heights and 140 truck docks to target e-commerce tenants. The Governor stated that Nevada had the fastest job growth in the nation in January, with unemployment falling to 8.7%, tied with Illinois for second-highest job growth behind Rhode Island. [Really? TRIC is bigger than Rhode Island!]

Lakeridge West Use Agreement Hearing and Property Auction

On January 8th a Reno brokerage firm posted a listing on LoopNet for the 128-unit Lakeridge West (West) apartment complex for sale at auction by the Reno Federal Bankruptcy Trustee. After losing Lakeridge East to foreclosure in March 2010, the Topol's were determined not to lose West and thus filed for BK in the summer of 2010. Even with major deferred maintenance, the listing attracted significant local and regional interest due to its prime location. Also, auctions always draw out the bargain hunters. For the next five weeks various groups toured West. The broker consistently stated that \$7.5 million would be the minimum bid – even though the loan that led to the BK filing had a principal amount of \$11.95 million when it recorded on 6/30/06. I attended the hearing / auction on February 20th as I had represented a potential bidder for this property, who had wisely backed out after it became clear that the lender's special servicer was not going to be outbid. At 3:15 PM the judge finally invited the 5 bidders to come forward. He declared that bidding would start @ \$9.5 million, a nice round figure between the Johnson Perkins as-is appraisal of \$9.3 and CBRE's as-is appraisal of \$10.5 million. Increments would be \$100k. The bidding was over in 90 seconds with only one bidder left @ \$10.6 million. Of course, the special servicer bid \$10.7 and it was done. [**Note:** as of this writing the sale has not recorded – as the parties are still arguing over the LTC use agreement – closing in on almost 4 years after the NOD was recorded]

Apple expanding data center east of Reno

In the Feb 27th RGJ, Jason Hidalgo reported that Apple is moving on the next phase of its data center project east of Reno at its Reno Technology Park complex. County records show that they submitted permit applications, totaling \$170k, for four new data cluster buildings. They will be built within 25 feet of current structures and will total 103 ksf. \$17 million worth of TI's are planned. Apple completed the first phase of its project - a 20 ksf, 2.5-megawatt "Rapid Deployment Module" data center in 2013. Late last year, they completed the second phase, consisting of two more data centers, an engineering support

building, a facility for administrative staff and shipping, and two six-story water storage systems. They also inked a deal with NV Energy to build a 137-acre solar array to help power the site. The data center complex is the bright spot in a deal that had Nevada approving \$89 million in tax abatements for Apple over a decade to entice the company to bring its new data facility to the region. Unfortunately, the proposed downtown facility - a lynchpin to the city's plans to revitalize its downtown core - remains in limbo. Reno officials said they still have no concrete information about Apple's downtown plans.

EDAWN opposes the Margins Tax a/k/a The Education Initiative

On February 27th EDAWN issued a press release stating that its Board voted to actively oppose the Margins Tax / Education Initiative, after receiving testimony from both sides of the issue and conducting a thorough review of available materials. EDAWN believes this initiative will adversely impact their ability to attract companies, retain existing companies, and facilitate job creation. Several companies considering Nevada have indicated that they are delaying a decision pending the outcome of the vote in November. Some have indicated that they will not move to Nevada if it passes. Many existing companies have also made it clear that they will relocate out of state if it passes. The initiative will make it more difficult to diversify our region's economy and for entrepreneurs to grow their business here by driving young talent and college graduates out of state. While EDAWN agrees that Nevada's education system is significantly underfunded compared to the national average, this tax will not solve the problem. There is no structure to ensure that the funds raised by the tax will actually increase the amount of funds contributed to education. There is also no provision to address school infrastructure needs in our region. The education of our region's future workforce is critically important to EDAWN, as an educated workforce is essential to attract and retain quality companies and jobs, and to grow and diversify our economy. Also quality education increases the earnings of individuals and the economic health of the community. EDAWN is historically very selective in engaging in political issues and initiatives. However, after a thorough investigation into the Margins Tax they believe this initiative will adversely impact its ability to accomplish its primary mission: quality job attraction, retention and entrepreneurial job creation.

The Nevada Society of CPA's came out strongly against the Margins Tax in the Spring 2014 edition of its magazine The Silver State CPA. It was on the cover and contained two lead articles, titled, "Taxation without Education!" and "Margin Tax Initiative: A Poorly Designed Tax". When the state's CPA's get wound up - the Teachers Union better watch out!

Update: On May 2nd the AFL-CIO officially came out against the Margins Tax - it's a job killer.

UNR drone center coming to downtown Reno

In the March 17th issue of the NNBW, Anne Knowles reported that the Nevada Advanced Autonomous Systems Innovation Center (NAASIC) will occupy the 3rd floor of the Sinclair Street building that formerly housed Reno's Community Development Department. The City recently leased the 25-ksf building to UNR, which is occupying the building under a 14-year, lease-purchase agreement, with UNR paying rent of \$134k / year. NAASIC, created to collaborate between UNR and businesses in the unmanned autonomous vehicles (UAV) space, is one of the first concrete signs of the growing partnership between UNR and the City, which have both committed to bridging the gap between them. UNR sees a business, as well as an academic opportunity, in Nevada's recent designation as one of six national UAV test sites by the FAA. UAV businesses often partner with universities, since their research function allows expedited permits and authorizations to test new systems. They will also work with Nevada Industry Excellence, the statewide resource for manufacturers, which will also have an office in the building. One of the Center's goals is developing a K-12 curriculum, taking advantage of its proximity to the Terry Lee Wells Discovery Museum nearby. UNR has already established a minor degree program in Unmanned Autonomous Systems, which include drones, industrial robots and driverless road vehicles. NAASIC is being funded

primarily with \$3 million from the state's Knowledge Fund. The building will also likely house a pre-enrollment information center for prospective students, a Wolf Pack store, space for community meetings and possibly incubator space for start-up businesses. UNR is doing TI's and hopes open by this summer.

Nevada a finalist for Tesla battery plant

In the RGJ on Feb. 27 Anjeanette Damon reported that Tesla is considering four states where it would build its Gigafactory to produce lithium ion batteries for its electric cars: Nevada, New Mexico, Arizona and Texas. The Gigafactory would cost \$5 to \$6 billion. Tesla plans to produce 500k cars by 2020 - up from 35k this year. The two-story factory would be 10 million sf - or 229 acres - on a site ranging from 500 to 1,000 acres, and would contain both wind and solar power generators. Tesla has looked at sites near Stead Airport and the Tahoe Reno Industrial Center. Tesla stated that the factory would employ 6,500 people - or 3% of the northern Nevada workforce. Northern Nevada has a [big] site advantage due to our proximity to Fremont, CA, where Tesla assembles its cars. Tesla's interest in our region follows the state's awarding a record tax incentive package to Apple in 2012. Nevada could abate all but 2% of Tesla's sales tax for 2 years, up to 50% of its property tax for 10 years and up to half of its payroll taxes for up to 4 years. Tesla will invest \$2 billion with its partners investing the rest. Its current battery supplier, Panasonic is expected to be among the investors. Tesla currently sells only the Model S sedan, which starts at \$70,000. It plans to begin making a crossover later this year, and wants to bring a lower cost, mass-market vehicle to market in 2017. Tesla said the factory will lower its battery costs by 30%. Tesla plans to raise \$1.6 billion in a debt offering to help finance the factory - and the lower cost vehicle.

Big-box vacancies dropping

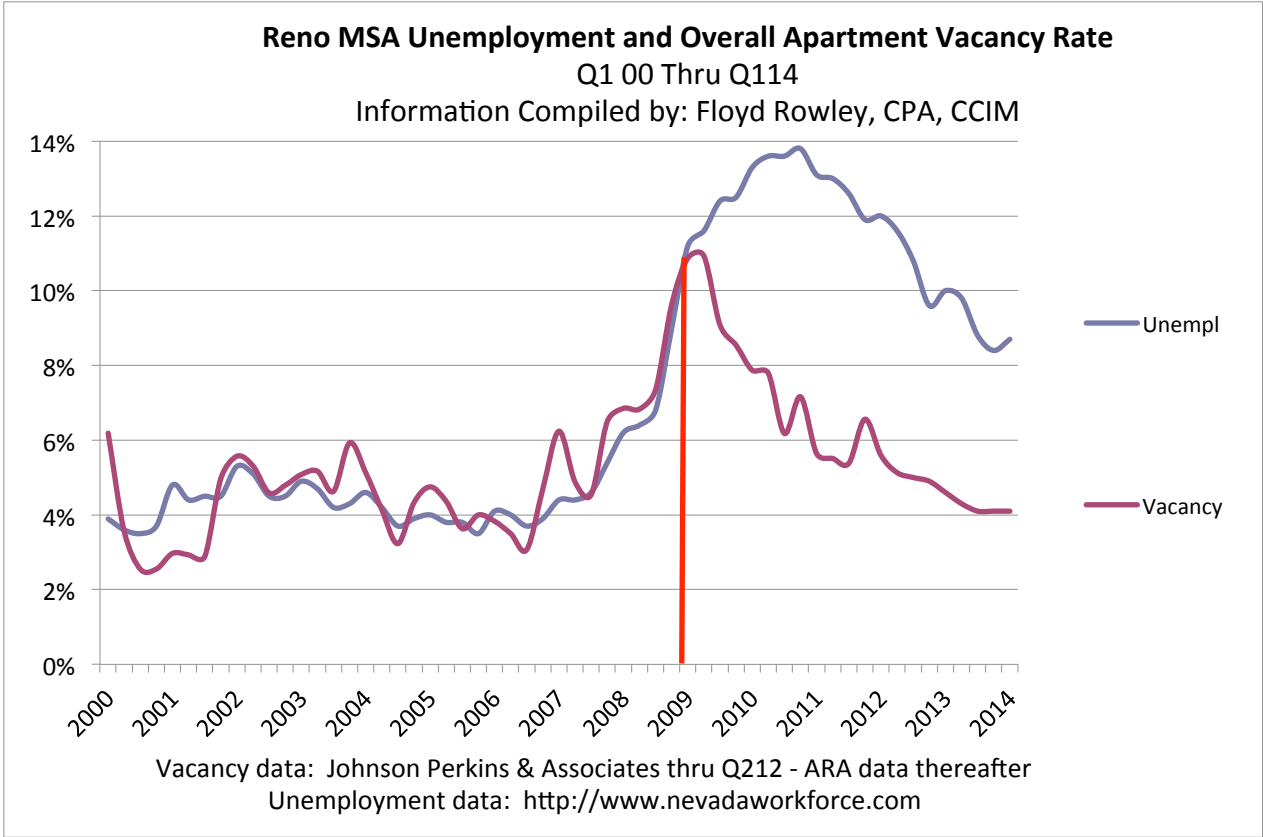
Bill O'Driscoll reported in the 3/2/14 RGJ that the area's empty big boxes - generally defined as 20 ksf or more - are beginning to fill again, left vacant by Mervyn's, Kmart, Circuit City, Lowe's, etc. In mid-2013 Reno had 14 available anchor locations - now there are 10, taking big-box vacancy from 1.4 down to 1 million sf. The marquee catch will be the opening next year of a 31 ksf Nordstrom Rack outlet store in the former Borders Books location. The former 173 ksf Super Kmart in NW Reno was purchased by Reno's Naumann family, who are refurbishing it into the Great Western Marketplace with hundreds of merchants and artisans opening in May. Also, Hobby Lobby is opening in May - across from the Meadowood Mall.

Apartment Statistical Review

For the first time I am presenting my statistical review based on ARA data that we have been compiling back to Q312 - one year before I opened the ARA office in Reno in June 2013. I am indebted to Johnson Perkins & Associates for them sharing - and allowing me to present with attribution - their quarterly data all these years. Now ARA is proud to be a second source for Reno /Sparks apartment market data, based on submarkets that I defined. I am proud that ARA is the only brokerage firm in the region to capture and report this information. Please note that I will be reporting ARA data in year over year (YOY) comparisons rather than report quarter over quarter. Key takeaways this quarter are as follows:

- The overall average rent increased by 4.6% since Q113, with Class A rents soaring by 13.5% vs 7.0% in Class B properties - and only 2.5% for Class C properties.
- Vacancy dropped an insignificant 0.5% in Q114 to 4.1% compared to Q113. However, Class A vacancy dropped to 2.3% vs 5.1% a year ago, supporting the large run-up in rents. Class B vacancy was flat and Class C vacancy actually increased by 0.4% - indicating a flight to quality as our region's economy continues to improve.
- 6 of the 7 ARA submarkets showed a drop in vacancy with only NE Reno reporting an increase in vacancy to 5.6% from 4.6% a year ago.
- The highest 3 rent submarkets are East Sparks, South Reno and Northwest Reno, respectively. South Reno's rents soared by 14.2% YOY and East Sparks rents climbed 13.7% in the last year.

Based on being in the market – and the above statistics - it is clear to me that 2014 is off to a fast start in multi-family. Based on deals I am working on it is clear that both the Lakeridge and the South Meadows areas are “on fire”. In conclusion our region’s apartment market continues to be very stable by almost every measure across most of the region’s submarkets and most unit types.



About the Author

Floyd joined Apartment Realty Advisors (ARA) in June 2013 as the culmination of his brokerage emphasis that had been moving towards apartments throughout his 10-year brokerage career in northern Nevada. Prior to joining ARA Floyd joined Johnson Group in January 2011, Reno’s premier boutique brokerage firm, after serving for over seven years as a Senior Vice President of the Colliers Investment Services Group. Prior to ARA, Floyd’s focus was representing buyers or sellers in large investment property sales: apartments, office buildings, retail centers and industrial properties. Floyd also did sale / leaseback transactions and build-to suit leases. Since mid-2004, Floyd has closed over \$138 million in 40 transactions in the Reno MSA. Starting in the fall of 2008 he increased his focus on distressed assets, mainly apartments. Since then he has completed 45 broker price opinions totaling almost \$297 million during the Great Recession, resulting in \$44.5 million of listings, mainly apartments, since early 2010.

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