RENO | NEVADA

RESEARCH & FORECAST REPORT

MARKET INDICATORS

	Q3-10	Projected Q4-10
VACANCY	↓	→
APARTMENT RENTS	→	→
CONCESSIONS	→	→
UNEMPLOYMENT	→	→
CONSTRUCTION	↓	↓

WASHOE COUNTY ECONOMIC DATA

	Q3 '10	Q2 '10
Unemployment Rate	13.3%	13.6%
Visitor Volume	407k	385k
Gaming Revenue	$71.57 M	$70.43 M
Taxable Sales YTD	$456 M	$395 M
Residential Permits	54	39
Commercial Permits	6	13

SOURCE: THE CENTER FOR BUSINESS & ECONOMIC RESEARCH, UNLV

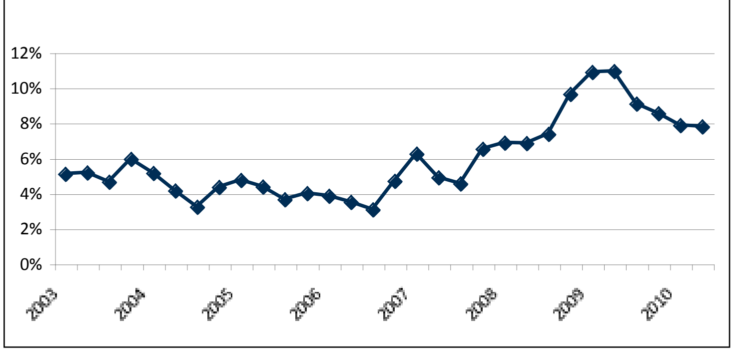
Investments / Multi-Family Market Review

THINGS KEEP GETTING BETTER NATIONALLY...

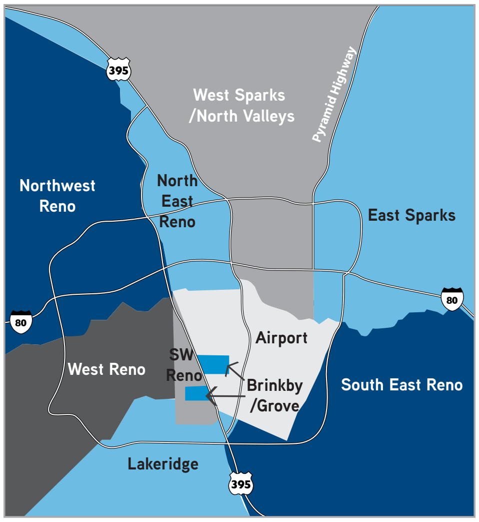
Apartment renters are gaining confidence, according to Matt Hudgins, in his October 20th article in the National Real Estate Observer. In the article titled, "At last! Apartment Investors Are Making Deals as Fundamentals Impress Analysts", he writes that researchers speculate that many employed Americans who have been living with roommates or family since the start of the recession have gained confidence in their own job security and are moving back out on their own. He cites U.S. Census data that suggests that 2 million people ages 20-35 moved in with family or roommates over the past five years. He believes that that pent-up demand will fuel further absorption. However, unless job creation increases to about 150,000 hires per month by the middle of 2011, absorption will again flatten out.

Ross Moore, Chief Economist for Colliers USA, reported recently that commercial real estate sales and offerings were up sharply in the third quarter. He cites data from Real Capital Analytics that confirms that the investment sales market is bouncing back with considerable vigor. The third quarter dollar volume closed $28.9 billion of sales, a 35% increase from the second quarter and more than double a year ago. For the third quarter, multi-family outpaced office properties by a slim margin, with multi-family investment sales totalling $8.5 billion compared to $8.1 billion for office. Retail ranked third with sales of $5.6 billion and industrial fourth at $4.0 billion. Continuing a trend for all of 2010, cap rates continued to move lower with composite commercial and multi-family cap rates down 29 basis points to an average of 7.3 percent nationally.

RENO APARTMENT VACANCY RATE



Source: Johnson-Perkins & Associates



Joanna Randell, writing in the October 1st issue of Real Estate and Finance and Investment, states that REITs are the borrowers of approximately $225 billion that will be maturing in the next 3–4 years. Already in the retail sector Taubman, Simon Property Group, Macerich and Vornado have executed strategic defaults on more than $340 million of properties. She quotes Derek Smith, vice chair of real estate at Paul Hastings, who stated, "This is something happening across the board and it should be happening. REIT's spend a lot of time negotiating for non-recourse debt and this is one of the benefits of non-recourse debt." The other reasons stated for performing strategic defaults are:

- For REIT shareholders strategic defaults can be a creative and positive solution to dealing with underwater properties. A new investor can buy the distressed property, re-rent it and stabilize the property in today's reduced market.
- A strategic default doesn't damage the creditworthiness of the borrower. A default is generally going to be performed by larger REIT's since these companies have large loans that are difficult to refinance and posses a large network of lenders.
- Borrowers who are trying to restructure commercial mortgage-backed securities tend to default on their payments in order to get someone to talk to them. Once the loans get transferred to special servicers, the borrowers get the special servicers attention and are more likely to renegotiate their loan terms.

In an article in the September 22, 2010 Wall Street Journal titled, "Multifamily Sales Defy the Slump", Dawn Wotapka writes that "as multifamily sales continue to heat up, new inventory is entering the market, with listings totaling $3.3 billion in August and $3.5 billion in July. Sales volume increases have caused prices to rise, with top-quality properties going for yields of nearly 5 percent, [emphasis applied] says Keefe, Bruyette & Woods REIT Analyst Haendel St. Juste." These are clearly trophy properties in the traditional Class A coastal markets, as opposed to a tertiary market such as Reno/Sparks. She concluded her article by stating that, "Buyers also indicate that benefits have come from Fannie Mae and Freddie Mac, with Freddie alone covering about $6.5 billion in multifamily financing year-to-date."

"The Recession Has Ended; Someone Should Send the Memo to Tenants" is the headline of an article written in CoStar's internet publication, "The Watchlist". Mark Heschmeyer's September 22nd article starts out by repeating the recent, much maligned quote, "The National Bureau of Economic Research, the official referee of the economy, announced this week that it determined that the recession ended and economic recovery began fifteen months ago in June 2009. However, according to commercial real estate service providers, economic conditions for most American tenants are still in the pre-June 2009 cycle and a long way from the pre-recession years." He cites examples from businesses from all over the country and who occupy all types of commercial space in his article, starting with Smith System in Arlington, TX, a professional fleet driver training company. Their Senior VP is quoted as saying that their business would have to increase 20 percent to return to 2008 levels. Also many businesses have mothballed space. Companies remain afraid of a possible a double dip recession. The author also states that industrial firms are closing smaller distribution and logistics centers. The closing of the 330,000 square foot Dell facility in McCarran, Nevada this year, is a case in point. The upside is that any lease renewals that are completed this year have locked in lower rental rates to ensure lower fixed overhead costs for years to come. The same thing is happening on the office side. He concludes his article by stating that the real recovery will not occur until unemployment and sentiment/confidence returns.

...BUT NOT LOCALLY

While total recorded sales in Washoe County over $500,000 have remained pathetically steady at 28-30 per quarter this year, third quarter sales volume dropped to $38.7 million from the $73.2 million recorded in the second quarter and the $61.4 million closed in the first quarter. The only significant sale in the third quarter was FedEx Freight purchasing 1050 Coney Island from Bragg Investment Company for $6.6 million, which was a user deal. The next largest sale was the purchase of a 17,600 square foot mansion on 25 acres in Washoe Valley near the Bowers Mansion. The good news is that none of this quarter's sales represented the foreclosure of any substantial property – unlike earlier this year.

In the second quarter the Reno/Sparks MSA took the top unemployment ranking away from Michigan, coming in at 13.6%. Unfortunately, the unemployment rate stayed flat in the third quarter. As can be seen on the nearby graph, the gap between unemployment and average rents that started in the third quarter of 2007 remains huge. When the Nevada economy starts to improve it will be important to watch the convergence of these two statistics back to their historical means and how they impact the average apartment rental rate. If these eventual newly re-employed people can afford (or want to) buy a home, the impacts on the apartment sector could be a problem to both vacancy and rental rates.

REGIONAL NEWS UPDATE

Rumors abounded that Caviata's bankruptcy reorganization plan was approved earlier this year – it turns out the rumors are true. I have read a number of judge's writings recently and the writing style in the Memorandum Decision for this case is very entertaining. The judge ripped the lender for increasing their claim for interest in a six month period by $2.84 million and the claim for legal fees by $398 thousand – not bad for six months work – if you can get it. The judge used the term "astounding" to describe the increase in attorney's fees and the terms "shenanigans" and "devious" to describe the lenders actions, as well as "astounding" and "not credible" to describe the testimony of the lender's appraiser. Needless to say, the judge sided completely with the reorganization plan proposed by Cavaita's developer. The plan allows them three years to continue to manage the property into the anticipated real estate recovery, while paying the lender 4.75 percent on a 30-year amortization.

I have now completed nineteen broker price opinions, mainly consisting of apartments that were purchased or refinanced at the height of the market from early 2006 through mid-2007. These are slowly turning into requests for listing proposals, which (hopefully) will turn into listings in the foreseeable future. Two of my opinions resulted in negative values – I am not sure what the owner and the lender plan to do, but clearly the loans on these properties are completely worthless.

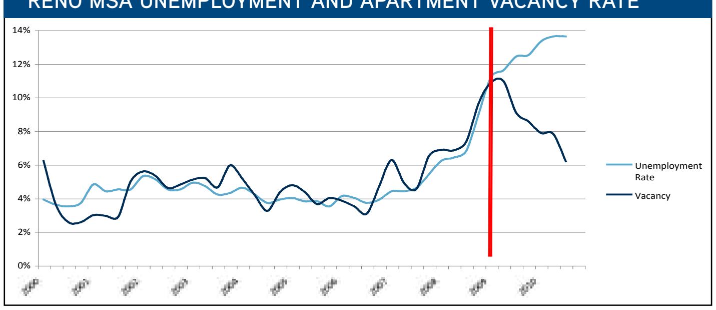
Waterstone at Kiley Ranch was pulled off the market in the third quarter after the buyer, who survived the best and final round, withdrew their offer on the last day of the due diligence period. This now makes $30 million of deals that have disintegrated this year at the end of the due diligence period. Potentially the property will be put back on the market in the spring of 2011.

QUARTERLY APARTMENT STATISTICAL REVIEW

The third quarter Apartment Survey by Johnson Perkins & Associates ("JPA") shows a significant drop in the overall vacancy rate to 6.2 percent. The rate has been flat at 7.8 percent throughout the first half of the year. From the peak of 10.93 percent reached in second quarter of 2009 the vacancy decline continues steeply. The bad news is that the overall rental rate continues to drift downward - a drop of $23 per unit per month from one year ago. Average rental rates have now fallen back to the levels of the fall of 2005. According to JPA, the largest vacancies continue to occur in the three submarkets of Northeast Reno, Brinkby-Grove and Airport. These three areas are populated by older, blue collar, B and C properties. Airport Area 8 made a huge recovery this past quarter, going from 13 percent to 7.7 percent. Conversely, the three areas predominantly consisting of newer Class A properties have the lowest vacancies: Lakeridge, Northwest Reno and East Sparks reported vacancies ranging from 4.6 to 5.25 percent.

The continuing decline in vacancy throughout 2010 is encouraging in that we may finally have hit the bottom of the market. Unfortunately, the vacancy reduction is probably due, in substantial part, to the ongoing wave of home foreclosures that continue in the range of 125–250 per month. Unlike Las Vegas, where unemployed people tend to leave the market, people in Reno tend to stay – as long as one breadwinner still has a job.

RENO MSA UNEMPLOYMENT AND APARTMENT VACANCY RATE



Sources: Vacancy data per Johnson Perkins & Associates
Unemployment data per http://www.nevadaworkforce.com

480 offices in 61 countries on 6 continents

United States: 135
Canada: 39
Latin America: 17
Asia Pacific: 194
EMEA: 95

- $1.9 billion in annual revenue
- 2.4 billion square feet under management
- Over 15,000 professionals

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