

# CLIFFORD COMMERCIAL MARKET BRIEF

Volume 2, Issue 1  
January 2006

www.cliffordcommercial.com

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## MULTI-FAMILY OUTLOOK FOR 2006

By Kent Clifford CCIM

On the national level, the multi-family sector weathered the low interest rates resulting in more individuals coming out of the apartment market into home ownership. More people own their own home than at any time in history. While this is good news for the single-family market, it did not bode well for apartment owners.

But, Wait! Do not feel too sorry for the owners of apartments in our local market. Let's take a look at what is really going on in the market place. First, the condo conversion craze took 7,700 plus apartment units out of the Las Vegas multi-family market in 2005, and only 1,900 new units were completed last year. This resulted in the apartment rental market tightening which resulted in higher rental rates and less concessions being offered. Additionally, 6,000 plus new residents arrived in Las Vegas each month and the local unemployment rate is historically low. All these factors are positive for the multi-family market.

Investor demand for apartment complexes over 100 units is strong and will remain strong throughout 2006. Comparable sales information gathered from Costar indicates the average price per unit rose from \$77,716 in the first quarter to \$120,831 in the fourth quarter. Average cap rates declined from 6.84 to 5.25 in the same time period. Costar tracked 78 apartment complexes with an average of 286 units per complex.

### Are Cap Rates Likely to Rise?

Maybe this is wishful thinking, but with the Fed continuing to raise rates, the long term interest rates are starting to increase. Michael Schall, COO of Essex Property Trust quoted in an article in Apartment/Finance Magazine said, "long term interest rates appear headed further north, but overall that's not necessarily a bad thing." The Fed's actions reflect expectations about stronger economic activity, so the implication is that employment, and hence resident demand and lease rates, will likewise strengthen. He elaborated further stating that if you gave him a choice between lousy economy with lower rates and a better economy with high rates, he would prefer the rising rate environment every time.

Personally, my belief is the Fed never knows when enough is enough! They keep raising the interest rates until they drive the economy into a recession. I have watched this happen too many times in my lifetime.

These rising interest rates pose an interesting question and that is: will cap rates accompany the interest rates on

their way up the ladder? Many experts believe that cap rates will most likely rise but not as fast or as high as interest rates. No one knows how long or how many points the Fed will raise the interest rates in 2006. If you purchase an apartment complex at a 5% cap rate and your debt cost is 6%, your leveraged return is 2%-2.5%. This is a problem for those who have to leverage their purchase. The two groups of buyers affecting the multi-family market are 1031 buyers making an all cash purchase, and buyers who are going to convert the property into condominiums and can accept lower capitalization rates. The 1031 buyers are spoiling other types of investment property sellers as well.

The one factor that is a heavy contributor to long-term mortgages is that there is a huge amount of money coming from offshore inventors in long-term U. S. treasuries, thus reducing upward pressure on long-term mortgages. This will help keep the gap between interest rates and cap rates at a minimum. Another upside is that lease rates are on the rise as well, which will increase the NOI and increase the internal rate of return on the property. It will be an interesting year. If you need assistance, call one of our well-qualified and experienced sales executives.

### University Housing

As nearly 80 million echo boomers reach college age, interest is picking up in this segment of the multi-family market place. Developers, investors and universities, are all in the market to take advantage of this opportunity. Experts put the value of the U. S. student housing market around \$160 billion. These young people are the most "wired" generation in the history of our country. They have had easy access to personal computers and many electronic gadgets all of their lives. Nationally, brokers are indicating the volume of student housing property transactions doubled in 2005 over 2004 with close to \$3 billion worth of properties. They also report that, because of the activity, the prices have increased by 10% in the same time period. It is a different product than a typical apartment complex, because student housing demands higher lease rates, due to the fact that a landlord will have three months of vacancy and nine months of 100% occupancy. Before you jump into this market, do your homework and know all the nuances before you invest. ♦



### Special points of interest:

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- ARE CAP RATES LIKELY TO RISE?
- UNIVERSITY HOUSING
- 2006—WHAT'S ON THE HORIZON
- FULL STEAM AHEAD
- INDUSTRY HEAVIES WEIGH IN
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- WHAT IS THE REAL MARKET VALUE?

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«Comments»

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CLIFFORD COMMERCIAL REAL ESTATE

## Real Market Value

### What is the Real Market Value?

By Kimmen Olsen

With all the recent press about skyrocketing housing prices, ever-increasing land values, mounting construction costs, escalating rents, rising interest rates, etc., we have found that nearly everybody we talk with, including owners, investors, buyers, sellers, tenants and landlords, seems to be asking "How am I supposed to determine the real market value?"

One approach some have used is to find out what other owners in the area are asking for similar properties. While this is not a bad idea in principle, it can sometimes be very misleading. It is important to remember that asking prices represent a maximum starting price at which the seller or landlord will consider entering into the transaction. This price may be negotiated down depending upon factors such as the motivation of the parties, the desirability of the property, the abundance or scarcity of like property, etc.

In times of strong market growth or widely publicized "rising prices," asking prices are often inflated by speculative principals who put their properties on the market at exorbitant prices hoping to cash in on the boom.

A second method of researching market value is to use the actual sales prices or lease rates of comparable properties. In hot markets, however, comparable prices sometimes fall behind

the growth curve and may not accurately reflect the current market value.

How, then, does one determine an accurate market value for a particular property? This is where a competent real estate professional can help. It is important to remember that the definition of "market value" is the price at which a reasonable seller will sell and a reasonable buyer will buy (or lease, as the case may be) a specific piece of real estate, in the absence of any abnormal motivation.

We have found it useful in determining market value to analyze and compare both the asking prices and the comparable sales prices. Examining both factors not only gives a clearer picture of what is actually happening in that segment of the market, but enables us to make reasonable adjustments to offset issues like inflated asking prices, lagging comparables, or recent announcements or changes to the market.

For example, in a recent analysis we did for a client on a 10-acre piece of industrial land, the average asking price was \$10 per square foot, while the average comparable sale was just over \$7 per square foot (nearly a 30% difference!). After making adjustments for all the mitigating factors, we were able to come up with a price that not only worked for the buyer, but also met the needs of the seller.

Give us a call if you would like to know the *real* market value of your property. ♦

*Industry  
leaders speak  
frankly about  
change—in  
markets, in  
consumer  
habits and in  
investor  
expectations*

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**2006  
WHAT'S ON THE HORIZON**

A special Research Report  
By REZA Investment Group Inc.  
In the NATIONAL REAL ESTATE INVESTOR

**Full steam ahead?**

In many markets, properties are selling at record prices. Cap rates are hovering in the 5% range, and some people believe they could go lower still. Vacancy rates are low. Rents are high. Americans spent heavily at shopping centers in 2005, and that trend is expected to continue in 2006.

Interestingly, predictions seems to split the retail investment community down the middle. "It's as if investors are the passengers on a big cruise ship in the North Atlantic spotting icebergs on the horizon. Some are putting on their life vests while others are going back for more drinks and toasting—full steam ahead," notes Terry Bortnick, President of REZA Investment Group Inc., a twenty year industry veteran.

Some investors believe that the traditional business cycle is changing. Due to the unprecedented amount of capital scouring the country for retail investment opportunities, they say, retail real estate can remain buoyant, despite factors such as slower consumer spending. Institutions, including pension funds and life insurance companies, are still in the market for shopping centers. So are 1031 tenant-in-common (TIC) exchange sponsors. Further, small investors are bringing money to the table, including the baby boomers, who are now inheriting family wealth and looking for investment vehicles to grow their nest eggs.

At the same time, foreign investors are teaming up with domestic developers and investors, and bringing offshore resources to U. S. real estate. Although it seems expensive to many domestic investors, real estate in their country is surprisingly affordable compared to assets in many parts of Europe and Asia. These investors view U. S. retail assets as safe havens and are willing to accept modest yields in exchange for safety. Indeed, retail investments may be governed increasingly by the eagerness of money that is looking for a home, rather than by the performance of the underlying asset.

However, during our recent Meeting of the Minds conference in Palm Springs, some investors flatly rejected that premise. "Either you believe in the business cycle or you don't," said one investor impatiently, "I do."

"We are seeing a weakening of fundamen-

als," noted another attendee. "We are seeing consolidation among anchor stores. Inflation is a concern. Interest rates will have an impact. More people are trying to spread out their refinancing dollars, in anticipation of some rough years."

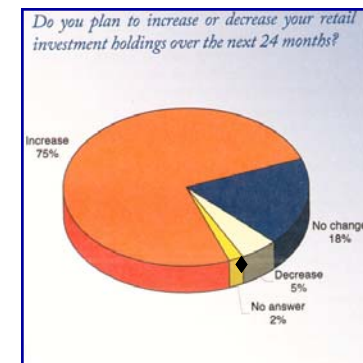
If there are causes for worry—and there always are—there are causes for optimism, as well, such as the adaptability of investors themselves.

The retail market remains highly sensitive to both social and economic change, such as shifting demographics, trends in household formation and variation in consumer confidence. Shopping center owners and investors are trend-spotters, economic forecasters and futurists. Like good boxers, retail investors are agile, light on their feet and prepared to respond to changing conditions. ♦

**INDUSTRY HEAVIES  
WEIGH IN**

Individuals surveyed for this research project are heavy hitters of the industry. They represent businesses across the nation and hold all types of retail assets. The average respondent owns 4.4 million sq. ft. of retail. For respondents who own 1 million sq. ft or more, retail comprises more than three-quarters (77%) of their portfolios.

Respondents sound generally positive about the current state of retail real estate investment. In fact, three-quarters of survey respondents



say they want to buy more retail assets this year. They are bullish on growth markets in the Northeast, Southeast and Southwest. And increasingly,

investors say they are looking at opportunities in the newest frontier: mixed-use and urban development.

At the same time, bubbles of anxiety surfaced in the data. Investors seem uncertain how to climb down safely from the mountain-top, after one of the longest sustained periods of growth in industry history. The big question: How long can the current boom sustain itself? ♦

**IS THERE GOLD UNDER THE  
SAGEBRUSH IN LAS VEGAS  
OR WHAT?**

By Kent Clifford CCIM

At Clifford Commercial we track land prices by using the CoStar Group.

In the 4th quarter of 2004, we found residential land prices had climbed to \$10.43 per square foot, almost reaching the price of a square foot of commercial land. For the year of 2004, residential land averaged \$8.06 per square foot while commercial land had risen to \$24.07 before settling down to \$14.66 per square foot in the 4th quarter of 2004.

In the 4th quarter of 2005, residential land prices reached an all-time high of \$17.04 per square foot or \$742,262.00 per acre. A disturbing trend was revealed as we tracked 60 residential land sales in the first quarter, 53 in the second quarter, 37 in the third quarter and only 19 in the fourth quarter. As we tracked the price per square foot from the 1st quarter to the 4th quarter of 2005, a dramatic price increase was obvious. As the prices increased, the number of sales decreased as dramatically. Have we reached the point of no return on investment with the residential price?

While prices of land have risen, the average price of new homes has increased by \$54,843 or 18.9% according to the Home Builder's Research. Another consequence of higher land prices is smaller lots and higher density, all trends of a cosmopolitan city. We have more people living in one square mile than most cities of comparable size in the United States.

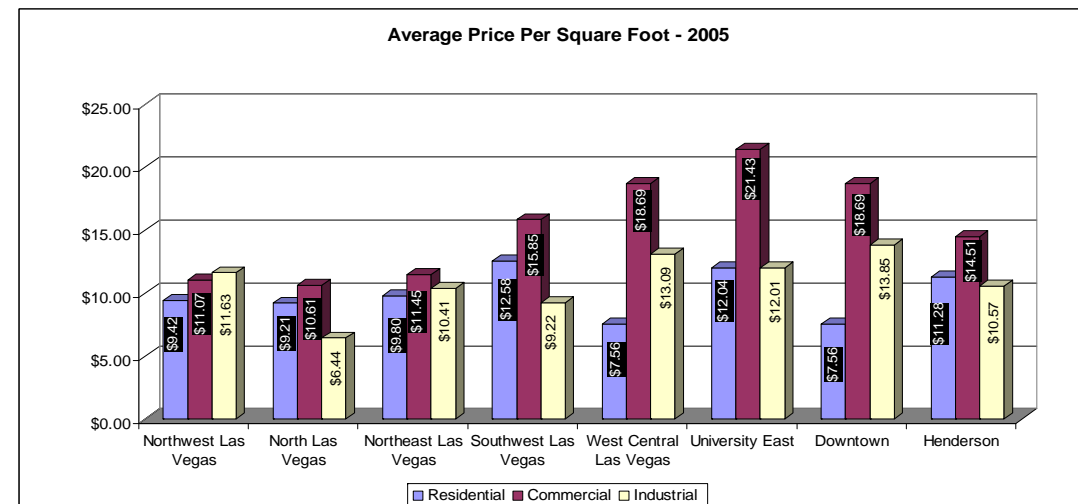
Commercial land prices have increased from a yearly average in 2004 of \$16.12 per square foot to an average of \$19.83 per square foot in 2005, or \$863,686.00 per acre. This is \$2.79

per square foot more than the price of a residential acre of land. As with houses, the rental rates on commercial properties have gone up; and when the retail tenants pay more, they must raise the cost of their products as well.

Industrial land is running in short supply and has increased in value as well as residential and commercial properties. In 2004, the average price of industrial land was \$3.62 per square foot. At the end of the 4th quarter of 2005, the price was averaging \$10.85 per square foot. Again, tenants looking for space must pay a higher rental rate, which in turn must be passed on to the consumer of their products.

We have talked about the increase in the cost of land and not the increase in the cost of building the new homes, retail shops, office buildings and industrial properties. In addition to land costs, the cost of materials, i.e. cement, steel, lumber, etc., all contribute to higher home prices, increased rents and pricier products. This is one of the reasons the FED is determined to raise interest rates. However, you could argue that by raising the interest rates you are just compounding the problem. When you raise the cost of money, you are affecting everyone in business to the end consumer. There are two major reasons we have recessions—cost of money and changes in the tax code. As you can see with land prices, when the price reached \$17.00 a square foot, developers quit buying. This is the market working as it should. Maybe the wild card is the greed that is in all of us. We all want the most for our land, our office space, etc., and then we want Wal-Mart prices for the products we purchase to stay the same.

Overall our economy is good, and 2006 will be another good year in Las Vegas. ♦



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