

CLIFFORD COMMERCIAL MARKET BRIEF

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LET'S TALK ABOUT THE MARKET

By Kent Clifford CCIM

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“COMMERCIAL REAL ESTATE REMAINS COMPARATIVELY ATTRACTIVE. . .”

“Deloitte” includes Deloitte & Touche LLP, Deloitte Consulting LLP, Deloitte Tax LLP and Deloitte Advisory Services LLP.

Obviously, the sky has not fallen. Therefore, I would like to give you some insight into what is occurring in the commercial market place.

Nationally, according to a report released this week in “DeLoitte,” “Commercial real estate remains comparatively attractive with solid underlying fundamentals, plentiful capital and steady allocations.” The report further states: “In prior boom cycles, commercial real estate has responded by overbuilding. The industry has clearly learned its lesson because this time commercial real estate is enduring a credit crunch—not a crisis—partially because it resisted this urge. No doubt, the industry is in a strong position to withstand a recession, should one occur, and commercial real estate remains a viable investment option for those seeking to diversify and insulate their portfolios from market volatility.”

Locally, we should examine the supply and demand of *retail*, *office* and *industrial* as well as land prices.

The shopping center *retail market* in Las Vegas currently consists of 1,355 properties containing 57 million square feet of retail space. Total retail inventory contains 95.6 million square feet of retail space. In 2007, a total of 5.1 million square feet were built in Las Vegas and another 4.3 million were under construction at the end of the fourth

quarter. Even with all of this building, the vacancy rate only rose from 5.0% to 5.1% in the fourth quarter of 2007. Supply is keeping up with demand in the Las Vegas Valley.

The Las Vegas *office market* ended the fourth quarter of 2007 with a vacancy rate of 13%. The market had a positive absorption of over 600,000 square feet in the last quarter of 2007. Total office inventory in the Las Vegas metropolitan area, in 3,000 buildings, was 48 million square feet at the end of the fourth quarter of 2007.

The Las Vegas *Industrial Market* ended the year 2007 with a net positive absorption of 2.6 million square feet. Total industrial inventory in the Las Vegas metropolitan area has 3,400 buildings housing 100 million square feet of industrial space. The vacancy rate decreased from 7% to 6.6% overall in the final quarter of 2007.

According to CoStar Realty Information, Inc, in 2005, there were 407 commercial land transactions had an average of \$17.97 per square foot. In 2006, commercial land transactions with an average price of \$31.19 per square foot. There were 168 commercial land transactions occurring in 2007 with an average price of \$26.18 per square foot. If you are interest in more detailed information concerning land values, please call any of our agents at (702) 889-9898. ♦

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CASH ON CASH (YIELD)

by Vic Adkins, CCIM

Cash on Cash (Yield), simply put, is the return measure that is calculated as cash flow before taxes divided by the initial equity investment.

Cash-on-cash may be compared to the dividend on a stock, the interest payment on a bond, or the equity dividend rate used in real estate appraisal.

Cash on cash is another method to determine investment value or measure investment performance. It is calculated using the first-year cash flow before taxes as:

First year cash flow before taxes / Initial investment (down payment) = Cash-on-Cash (Yield).

Its uses are:

1. Calculating the length of time required to return the initial investment to the investor (i.e. 10% yield = 10 years, 5% yield = 20 years etc.)
2. Estimating the yield for short-lived investments with no change in value.
3. Estimating for an investment purchased for annual income, not appreciation (and assuming no depreciation). If you are looking for a 10% yield, then divide the NOI (net operating income) by 10% and this is your target down payment.

Cash-on-cash advantages:

1. Cash-on-cash is easy to use.
2. Many investors are cash-oriented.

3. Adjustments for vacancy and credit losses, operating expenses and financing on the income from the property are included.

Cash-on-cash disadvantages:

1. It does not allow for most of the relevant investment factors, such as:
 - a. Appreciation
 - b. Income taxes
 - c. Mortgage amortization
 - d. Risk
2. It does not allow for meaningful comparisons among potential investments, for example, comparing an industrial property to a retail property cannot be done because market conditions for each can be different. The industrial market may be on the rise in your city and the retail may be on the downswing. Obviously the return and appreciation will have a wide margin. Compare apples to apples: comparable locations, growth patterns, size and construction to name a few.
3. The importance of many factors is obscured by the simplicity of the analysis.

Overall, cash on cash provides the investor a quick analysis of the investment based on the first year, however, the investor may require additional information to measure the investment such as the discounted cash flow approach. They include: IRR (Individual Rate of Return) and NPV (Net Present Value).

With this in mind, how is your investment standing up? Are you achieving your goals?

To find out how your portfolio is doing or to learn more about making the right investment choices in real estate, Vic Adkins can be reached at 702-889-9898 or 702-445-5711 for all your investment needs. ♦

PROPERTY CYCLES

By Pete Peterson, VP, Office/Industrial
& Chuck Haldeman, Sr. VP, Office/Industrial

What is a property cycle, and why is it important? The company **Integra Realty Resources, Inc.** divides the property cycle into four categories. They are recovery, expansion, hypersupply and recession. Now these are very broad terms and there are three levels in each category (See chart.)

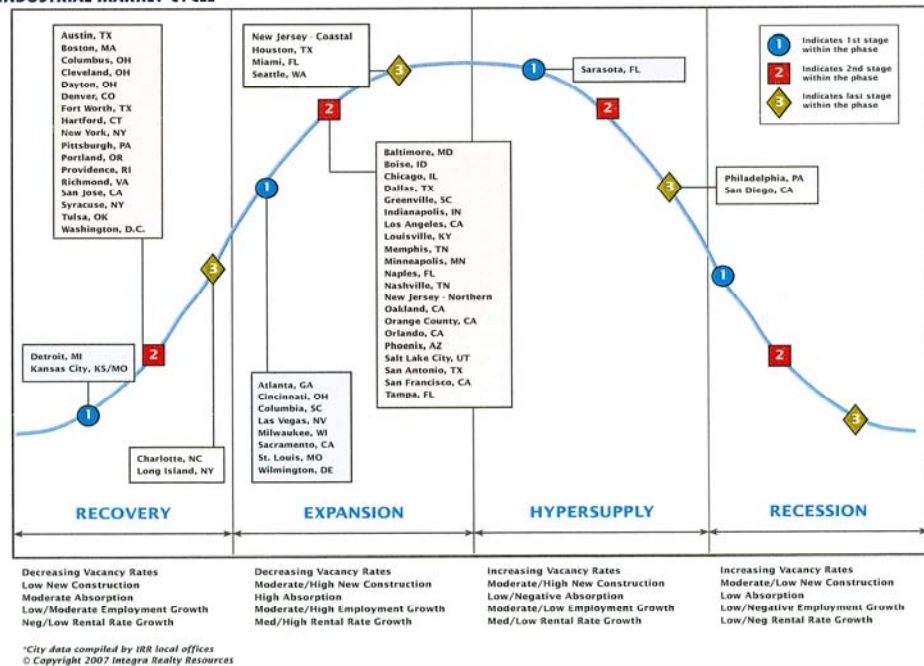
Data provided by **Integra** for the Industrial Cycle in Las Vegas over the last few years, gives the following information: The latest data (2008)

would expect decreasing vacancy rates, low construction, moderate absorption, low to moderate employment growth and negative to low rental rate growth.

The 2008 report lists the Industrial inventory at 92,344,059 square feet with a vacancy of 4,081,975 square feet. This equates to a 4.42% vacancy rate versus the national average of 8.63%. The report forecasts that the annual net absorption for 2008 to 2010 will be 25,500,000 square feet.

Phoenix is at level two in the expansion cycle and has an inventory of 257,920,907 square feet and a vacancy rate of 8.78%. The Phoenix forecast average annual net absorption rate for the next two years is only 7,000,000 square feet. Salt Lake City is also at level two in the expansion cycle and has an inventory of 113,454,381 and a vacancy rate of 5.13%. Salt Lake City forecast average annual net absorption for the next two years is 2,366,667 square feet.

INDUSTRIAL MARKET CYCLE



In 2006, the average capitalization rate (cap rate) for industrial property in all cities was 8.01 and currently the average rate is 7.49. Remember, the lower the cap rate the higher the selling price. The question is, does it make sense to wait for the better cap rate? For example, let's say the annual net operating income in both years is \$167,400.00. This example assumes the lease increase is offset by the increase in expenses. The sale price in 2006 was \$2,089,888.00 and is \$2,234,980.00 in 2008. It looks like there was an increase of just over \$145,000.00 by waiting the two years. However, if you adjust the increase for the two-year inflation of 2% each year, the increase is only \$60,600.00. When Uncle Sam takes capital gains of 15%, which equal another \$20,000.00 which comes out of your profit, your real increase is just north of \$40,000.00

shows the industrial market in the expansion cycle at the first level (1 on chart.) In the expansion category there are Decreasing Vacancy Rates, Moderate to High New Construction, High Absorption, Moderate to High Employment Growth and Medium to High Rental Rate Growth. The data for 2006 and 2007 indicated the Las Vegas Industrial Market was in the recovery cycle. In this cycle you

If this amount of additional space is to be built, then it will require approximately 1,400 acres of land. In that event, in two years, Las Vegas will have just over 143,000,000 square feet of industrial space. Is this adequate for a city of two million people with construction of thirty billion dollars on the strip? According to this report it is adequate; otherwise the report may have Las Vegas in the hypersupply cycle.

We feel it is in the best interest of owners of industrial buildings to understand the property cycles as they consider when is the best time to sell or buy to enhance their portfolio. The Integra Realty Resources, Inc. reports are a valuable resource and you only have to call our office and we can provide you with the information. ♦

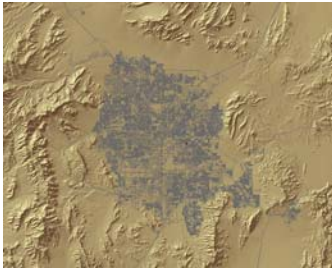
LOCATION, LOCATION, GEOGRAPHY

BY PETE JANEMARK

It's said that a picture is worth a thousand words. Experiments have actually shown that if text information describes geographic phenomenon, approximately 500 pages of information can be conveyed with one single map. Not only does a map have the power to consolidate information, but it also has a powerful, lasting effect of immediately changing the viewer's understanding of the information.

One of the primary reasons some countries never emerged as economic powerhouses is geography. Miserable terrain, poor soil conditions, flood-prone areas, and generally impossible road maintenance conditions have held back many otherwise resource-rich and promising economies.

The same kinds of forces are at work in your own backyard and are affecting your business every day. A simple example of the effect of these forces is the relationship between slope and development. Almost all development in the Las Vegas valley has taken place on low-slope terrain.



Street Network in the Las Vegas Valley

Why is this? Economics may be the first answer. But upon further examination, slope, soil conditions, flood conditions, regulatory constraints, and a host of other visible or invisible constraints conspire to keep development in the low-slope areas.

This point may be so obvious – or so subtle – that it initially may not be considered of value, but bear in mind that this effect is cumulative and has held back entire countries for centuries. The pattern of existing development funnels every subsequent action of every business in the valley.

Google Earth (www.googleearth.com) is an easy-to-use tool where you can take a virtual trip anywhere in the world on your desktop. This tool has brought Geographic Information Systems (GIS) to the masses, but the technology has its origin from a much more scientific angle; specifically, analyzing the way geographic phenomenon can affect an outcome.

One of the strongest capabilities of this technology is the way it can be used to understand, evaluate, and possibly transform a real estate deal.

In the next few issues, we will examine how GIS can be used to make better decisions regarding real estate.

For more information contact Pete Janemark at **702-889-9898**. ♦

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