



Economic Wrap-Up for 2008

Well, 2008 was quite a year. To say '08 was atypical for the Las Vegas economy and its commercial real estate market would be a major understatement. Market indicators that historically and consistently have gone up went down dramatically. The same can be said for those indicators that traditionally go down. In this issue of *CRE*, we attempt to show how 2008 ended and what Southern Nevada can expect in 2009.

The economy

More job losses reported

The latest numbers released by the Nevada Department of Employment, Training and Rehabilitation (DETR) showed the Clark County economy losing 4,300 establishment-based jobs in a 12-month period ending in November 2008, bringing total employment down to 927,900. Locally, the national recession is affecting goods-producing industries (-7.7 percent loss) much more than the services-producing industries (-0.5 percent). However, goods production makes up only 13 percent of Clark County jobs, compared to 87 percent in services. In other words, Southern Nevada appears to be weathering the storm relatively better than many other regions, because of its service-based economy ... so far.

During this period, there were 9,300 jobs gained in five of the 11 major Clark County employment sectors. Government (primarily in local government, including the Clark County School District) represented 5,300 (or 57 percent) of the year-over-year gains. This was followed by leisure and hospitality; trade, transportation and utilities; and other services. Natural resource jobs remained unchanged. That said, these gains were not enough to offset the loss of 13,600 jobs in the five remaining sectors. Construction and financial activities continued to be hit the hardest, followed by professional and business services, manufacturing and information services. As noted above, the result was a net job loss of 4,300 jobs relative to November 2007.

Unemployment numbers continue to climb

The DETR recorded 80,178 initial unemployment claim filings in Clark County during the 12-month period ending in November 2008, versus 51,972 filings during the same period in 2007, a very worrisome 54-percent jump. This was also six percentage points above what was recorded during the 12-month period ending October 2008. Total filings for the month of November also rose by 16 percent compared to this past October. Until this indicator shows a sustained improvement (at

least six months), the Clark County and Nevada economies will remain in a deep recession.

Concerning the local unemployment rate, the officially reported estimate was 7.9 percent, 2.7 percentage points higher than the 5.2 percent recorded in November 2007. This equates to a spike of 49 percent and is the highest jobless rate seen in Southern Nevada in more than 20 years. In comparison, the Nevada and U.S. unemployment rates in November were 8 percent and 6.7 percent, respectively. By all accounts, the published estimate undercounts the actual rate. Based on our preliminary research, the "hidden" jobless rate after accounting for discouraged workers and part-time workers who can't find jobs could be as high as 12 percent in Southern Nevada.

The commercial markets

Industrial market registers a weak year

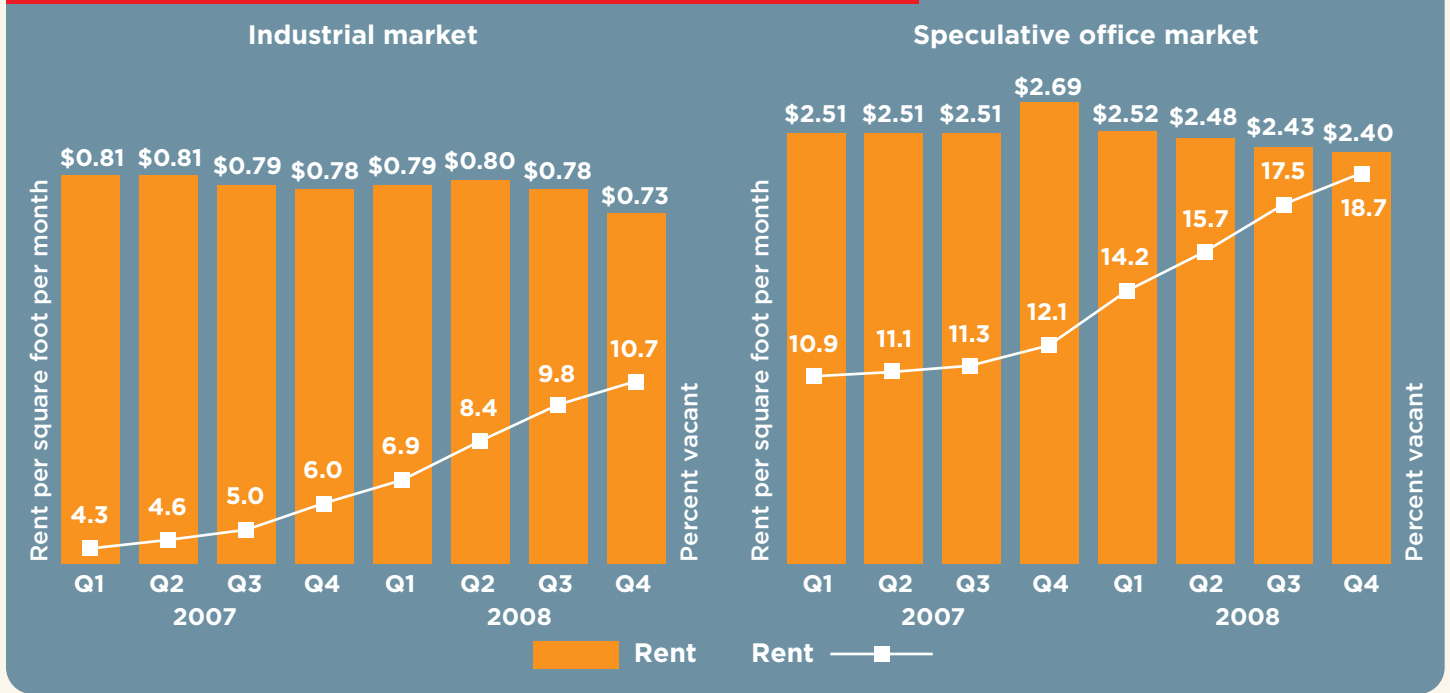
The Q4 industrial market survey prepared by Restrepo Consulting Group LLC and Colliers International reports the Las Vegas Valley market ended 2008 with 104.1 million square feet (sf) of inventory. Net absorption was negative for the third consecutive quarter. For the year, net absorption was a -813,900 sf, falling far behind the 4.4 million sf of new industrial product built in 2008. This is the lowest amount of annual new completions since 2005; in other words, back to levels posted from 1999 to 2005.

The recession has pushed industrial vacancy to 10.7 percent from the 6 percent vacancy in the Q4, 2007. Vacancy has been consistently trended up since Q2, 2006 and is now above the long-term benchmark of 10 percent. What is extraordinary is how quickly we reached a double-digit vacancy for an industrial market that was very supply-constrained for several years.

Q4, 2008 numbers also showed warehouse-distribution space having the lowest vacancy (6.3 percent) among the various industrial products, while R&D/Flex had the highest at 26.3 percent. Vacancy was up in all submarkets in the valley compared to Q4, 2007, with sharp rises in the airport, east Las Vegas and west central submarkets.

The average monthly asking rent in Q4, 2008 was \$0.73 psf NNN (not accounting for any operating expenses), \$0.05 lower than the \$0.78 psf rent recorded for Q4, 2007. This is a welcome sign for tenants and users that were finding the Las Vegas industrial market increasingly expensive before the downturn. And obviously, not such a good sign for owners and developers, many of whom based their rents on "bubble" land prices of the last few years. Adjusting asking rents for inflation

Las Vegas Valley Industrial Market Rent v. Vacancy: Q1, 2007 - Q4, 2008



to our base year of 2001 indicates that industrial rents, in real terms, were not keeping pace with inflation until Q2, 2006. After adjusting Q4's average asking rent for inflation, the rate dropped to \$0.60 psf just under the Q1, 2001 base rent of \$0.62 psf.

Forward-supply (space presently under construction and space planned to begin construction in the next four quarters) declined to 3.8 million sf in Q4, 2008 from the nearly 5.9 million sf recorded for Q4, 2007. Of this amount, 1.1 million sf were under construction, representing 1.1 percent of existing inventory. The remaining 2.7 million sf of forward-supply at the close of 2008 was in the planning stages. Much of this future space was in warehouse-distribution facilities in North Las Vegas and R&D/Flex space in the southwest.

One of the measures we use to judge the current health and near-term future of our commercial markets is to compare the amount of existing vacant space and forward-supply, and divide it by historical quarterly absorption. Using the past 16 quarters' average absorption, we have accounted for the ups and downs in the business cycle. Accordingly, adding the 11.2 million sf of vacant space in existing industrial projects and the 1.1 million sf of under-construction space, then dividing by the 16-quarter-average absorption of 964,000 sf, results in a 3.2-year supply of space. If the 2.7 million sf of planned space were taken into account, the potential absorption period grows to four years.

With Q4 data showing a considerable deceleration, because of very weak demand, and more projects in the construction pipeline, fragile market conditions are expected to linger in 2009 and into 2010, marked by rising vacancies and moderate downward pressure on rents.

Speculative office vacancy at historical highs

The valley's speculative office market ended 2008 with 39.7 million sf of inventory. In addition to the 1.6 million sf of new office space that entered the market in 2008, tenants vacated 1.2 million sf of space in existing projects, resulting in an upsurge in available space for lease. New completions have outpaced net absorption for 11 straight quarters, sending the vacancy rate to a historical peak of 18.7 percent in Q4, 2008. This is 6.6 points above Q4, 2007's 12.1 percent rate.

Of the valley's eight office submarkets, downtown was the only submarket to end the year without a double-digit vacancy. Vacancy rose across all office categories when compared to Q4, 2007, with the largest jump in Class A space. Class A also had the highest year-end vacancy rate at 21.2 percent. The lowest rates were in Class B (15.6 percent) and medical office space (15.7 percent).

With plunging demand, overall office asking rents dropped for the past four quarters, settling at \$2.40 psf FSG (accounting for all operating expenses) in Q4, 2008. This is 12.1 percent less

than Q4, 2007's \$2.69, and is the lowest asking rental rate since Q4, 2006. Adjusting historical monthly office rents for inflation to our 2001 benchmark shows that rents, in real terms, did not keep pace with inflation until Q4, 2006. Also, Q4's rent, after adjusting for inflation, was \$1.99 psf, just 2.9 percent higher than Q1, 2001's average asking rent of \$1.93 psf.

The 1.8 million sf of forward-supply recorded at the end of 2008 was significantly less than the 5.3 sf recorded for Q4, 2007, due to the cancellation and postponement of various planned office projects. Of this amount, more than 1.4 million sf were under-construction, representing approximately 3.6 percent of the existing inventory. The remaining 340,800 sf planned to begin construction in 2009 is the lowest quarterly level recorded since Colliers International and Restrepo Consulting Group LLC began tracking the office market together eight years ago. Forward-supply was concentrated in Class A product in the Northwest and Southwest submarkets.

If the 7.4 million sf of vacant space in existing office projects were added to the 1.4 million sf of under-construction space and then divided by the past 16 quarters' average quarterly absorption of 477,500 sf, the result would be a 4.6-year supply of spec office space in the valley. If all of the 340,800 sf of planned space at the end of Q4 were to be built, the period potentially grows to nearly 5 years.

The strong absorption rates experienced between 2005 and early

2007, combined with easy credit, sparked a major wave of office construction in Southern Nevada during the past four years. This resulted in a steady and rapid rise in vacancy, because of declining leasing demand resulting from the rapidly deteriorating local economy.

Looking forward, expect office demand to remain very restrained through 2009, because of dire employment conditions, and vacancy to rise further, because of 1.4 million sf of office space in the construction pipeline. As these projects are completed during the next four quarters, and construction continues to taper off, the market will be given a chance to stabilize. However, we don't expect the office market to show signs of recovery (vacancy below 10 percent) until some time in late 2010, at best.

"Anchored" retail market: not business as usual

Completions of anchored retail space in the valley during 2008 totaled nearly 2.2 million sf, bringing total inventory up to 4.2 million sf. The market absorbed a bit more than 1 million sf during the year, less than half the absorption recorded in 2007 and 2006, but comparable to the 934,124 sf absorbed in 2004.

With new supply outpacing demand in the valley's retail market, vacancy has been on the rise for the past 5 quarters, resulting in a year-end vacancy rate of 5.8 percent. This is 2.6 points higher than the 3.2 percent recorded in Q4, 2007. Compared to Q4, 2006, vacancy growth was seen in all submarkets except North Las Vegas, where it decreased slightly by 1 percentage point to 6.2 percent. Vacancy rose for all center types over the course of the year and, in Q4, settled at 3.8 percent for power centers, 6.3 percent for community centers and 6.5 percent for neighborhood centers.

Conversely, average asking rents declined to \$2.04 per sf (calculated on an NNN basis, or not accounting for any operating expenses) from \$2.17 recorded in Q4, 2007. Inflation-adjusting average retail asking rents to our base year of 2001 indicates that real retail rents have generally kept pace with inflation for most of the past 7 years. Q4's average asking rent of \$2.04 psf, adjusted for inflation, equaled \$1.69 psf. This is 15.3 percent above Q1, 2001's average asking rent of \$1.47.

At year-end, there were 4.8 million sf of retail forward-supply composed of 2.4 million sf of under-construction space and another 2.4 million sf in planned projects. The amount of under-construction space represents 5.7 percent

of existing anchored retail inventory when 2008 ended. Much of this forward-supply space was in planned power center space in Henderson.

There were just over 2.4 million sf of vacant space in existing anchored centers plus almost 2.4 million sf of under-construction space at year's end. Comparing these figures to the past 16 quarters' average absorption of 449,400, results in a 2.7-year supply of anchored space. Factoring in the prospect of another 2 million sf of planned space, the absorption period potentially grows to just under four years.

Consumer confidence and spending, as well as business investment, are at their lowest levels in years. And it doesn't help that consumers have debt levels also not seen in many years. This is reflected in retailers that have filed for bankruptcy, closed their doors or are struggling and, who in turn, are vacating their spaces. The positive absorption seen in 2008 is a brief respite from the weak retail leasing activity expected for 2009. Retail employment was down significantly from last year, and we are likely to see further store closures in 2009, as retailers and investors operate in an increasingly bleak retail environment.

Commercial sublease space

Sublease space in the valley represents a small but growing and important part of our three commercial markets. With the emergence of negative net absorption in these markets, we are paying a lot of attention to trends in the sublease sector. The challenge for our commercial development industry is that sublease space is often seen as a very attractive alternative by start-up businesses, new market players and companies experiencing rapid expansion or contraction. The reduced term and often lower rents, as well as completed space requiring no or very limited TIs, continue to make sublease space an attractive short-term solution for businesses dealing with uncertainty, and never more so than today.

In the valley's industrial sector, sublease space nearly tripled from the 296,621 sf recorded at the end of Q4, 2007 to 871,101 sf. Of this amount, 11 percent is occupied by sublessors. Adding the vacant sublease space to the direct vacant space in existing projects, industrial vacancy rose to 11.5 percent from the 10.7 percent noted above for Q4. This is a growing concern considering the potential length of the



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valley's recession, which we think will last through the first half of 2010.

Sublease space in the valley's spec office market has ramped up by a factor of three from the 271,547 sf in Q4, 2007 to 908,458 sf in Q4, 2008 (40 percent of this space was in Class B office product). This is an extraordinary year-over-year jump. Of this amount, 6.9 percent is occupied by sublessors. If vacant sublease space is added to the direct vacant inventory, the valley's total office vacancy in Q4 rises to 20.8 percent from the 18.7 percent noted previously, making the office market the valley's weakest segment for the foreseeable future.

Anchored retail sublease space rose from 54,559 sf in Q4, 2007 to 223,025 sf in Q4, 2008, a 300 percent spike in just one year but a relatively small amount considering the size of the valley's anchored inventory. Of this total, 11.5 percent is occupied by sublessors. When vacant sublease space is added to directly vacant space, the valley's anchored retail vacancy at the end of 2008 moved slightly upward to 6.3 percent from the 5.8 percent direct rate.

Further thoughts

If there was ever an argument for the benefits of amnesia, it applies to the

events of 2008. The near collapse of the financial markets combined with one of the deepest recessions in memory (13 months long and counting) saw consumer and business confidence and spending plunge, further dragging down the Southern Nevada and national economies. And at the base if it all was a housing market crash preceded by a massive housing market bubble — quite amazing. These events had a profound impact on the performance and health of local commercial real estate markets in 2008. The office market is expected to be on life support for at least 18 months, our once-vaunted industrial market saw vacancy edge up to the low double digits and, even anchored retail, which has been very supply constrained, is seeing a steady trend in rising vacancies.

And the dismal business news from around the globe didn't help. Three cases in point:

- Toyota reported its first operating loss in 71 years, because of plunging demand. The company reported a \$1.7 billion loss this year through March.
- China, according to The Wall Street Journal, is seeing labor strikes around the country, because of rising layoffs

and bankruptcies.

- Several European governments are considering bailouts of their respective economies, albeit at lower levels than the United States.

Additionally, according to a recent release by the U.S. Census Bureau: "Nevada, which had been among the four fastest-growing states each of the last 24 years, grew 1.8 percent and ranked eighth over the most recent period." The period in question was July 2007 to July 2008. On the other hand, the bureau also noted that, "Six of the 10 fastest-growing states from 2007 to 2008 were Rocky Mountain states: Arizona, Colorado, Idaho, Nevada, Utah and Wyoming." This is very good news and speaks to the good fortune Nevada has being located in the very desirable southwestern United States.

The latest estimates show a growing federal stimulus of \$2 trillion, starting with the \$123 billion check mailing last February and ending with the recently announced \$825 billion. And no one really knows how effective the stimulus will be, and how long it will take to percolate down to state and local economies.

So what does all this mean for Southern Nevada? It means that we continue to have healthy long-term economic prospects but that we are experiencing a sea change in our economy and community. It is a change that is not likely to revert any time soon, if ever, to the frenzied growth of the 1990s and early 2000s. It also means, as we have often said, that until consumer confidence and spending, and business investment, are restored for a sustainable period, we will be in for a plodding recovery.

In other words, there is no quick fix. The current recession and financial crisis are unmatched in size and complexity in modern history. That said, we have all made investments in Southern Nevada, both personal and professional. They're investments that are not easily given up, because of Southern Nevada's history of comebacks and long-term prospects, which are, in large measure, the result of the resilience of our economy and of our citizens. <



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