

# THE GREAT RESET & LAS VEGAS COMMERCIAL REAL ESTATE

## THE JOBS PICTURE

Southern Nevada's commercial real estate markets appear to be finally stabilizing, albeit moderately. After four long and hard years, Las Vegas' economic recovery is now entering the "Great Reset" and slowly climbing out of the deep recessionary hole. As many of our indicators show in this issue of *Economic INsight*, we appear to have hit bottom. And this, we hope, will start benefiting region's commercial real estate markets, the topic of this issue.

Private sector jobs have been rising for several months, including, believe it or not, construction jobs, while government jobs continue to decline (See Page 6). On a net basis, the region is seeing positive job growth, but not a large-scale ramp up. This shouldn't surprise anyone. In fact, we seldom hear anymore hyperbole about Las Vegas coming back in a "V"-style recovery. And this is a very good thing since our expectations as to the rate of recovery must be based on realism.

We would like to focus on a couple of "background" indicators in Southern Nevada's commercial real estate markets' recovery: 1) RCG's latest Employment Index<sup>1</sup> and 2) initial (approved) unemployment claim filings. Our Index suggests that the economy is no longer on life support, but it isn't leaving the hospital either. As the issue's Index chart on Page 6 shows, the local job market has been bouncing along the bottom for the last couple of years. The Index for 4 distinct periods looks like this:

1. Today (9/2011) = 87.6
2. Long-Term Trend (1/1990 - 9/2011 avg.) = 97.3
3. The Boom Era Trend (1/1990 - 11/2007) avg. = 98.4
4. The Great Recession/Great Reset (12/2007 - 9/2011 avg.) = 91.9

The stability of the Index is largely the result of reductions in the local labor force rather than large increases in employment – a kind of an economic right-sizing. This has resulted, in what noted economist Paul Krugman calls a sort of "economic purgatory" when he talks about the national economy – not hell, but not heaven either.

As to what we consider one of the most important leading economic indicators, initial unemployment claim filings have been declining for the last 15 months, bringing the annual total at end of September to 72,445 from the peak of 127,671 in June 2009. For 17 months prior to July 2010, Clark County averaged more than 100,000 annual claims. This very important measure also points to the regional economy starting to stabilize.

The end result is a Clark County official jobless rate of nearly 14% in September and a US rate of 9% for the same month. According to a recent report by the non-partisan Congressional Budget Office, the US rate will stay at around 9% into 2013. We expect that the Clark County rate will still in the neighborhood of 13-14% into 2013. According to CBO report, "The unemployment rate would have been even higher during the past few years had the size of the labor force not fallen as much as it did. The decline in the labor force is partly owing to a marked rise in the number of unemployed workers who report dropping out of the labor force because they

<sup>1</sup> The RCG Employment Index for Clark County, Nevada is based on Clark County's **employment-to-workforce ratio** (Source: Nevada Department of Employment, Training and Rehabilitation). The ratio is indexed to a baseline of 100 in Dec. 1998. December 2008 had the highest ratio between January 1990 and YTD, and is used as the base-year.

were discouraged about their job prospects." Additionally, the CBO noted that the US rate will not head back toward the 5% "full employment" rate until 2017. Our model of the Clark County economy indicates that we will in the 9-10% range by 2017, and won't see 5% until 2020. Obviously, our forecast will change as new data comes in and time passes.

So, in the end the national and local economic indicators show that the worst of the Great Recession is behind us, and that our local commercial markets are also beginning to stabilize. Caveat: The blowback to the US economy of the Eurozone financial crisis is not fully known at this time. So a "wait and see" attitude is a good one to have.

On a going forward basis, the apparent stability we are seeing in the indicators means the time of economic rebuilding and reinvention has come – for the US, Nevada and Las Vegas. And part of this rebuilding/reinvention can be found in the new focus of Nevada's private and public leadership in long-term economic development planning. This new focus is encapsulated in the recent report by Brookings Mountain West Brookings Institution's Metropolitan Policy Program and SRI International on diversifying Nevada's economy - *Unify Regionalize Diversify: An Economic Development Agenda for the State of Nevada*.

Perhaps Mark Muro, senior fellow with the Metropolitan Policy Program at the Brookings Institution, said it best recently in a story in the Las Vegas Review Journal about the importance of being realistic as we move forward in diversifying the Nevada economy:

*"We counsel you to reject grandiose thinking and silver bullets," Muro said. "Get your hands dirty with a piece-by-piece execution. We look at the economy as it really is rather than as you hope it would be." The same story also paraphrased Muro noting, "Progress will come 20, 80 or 300 jobs at a time, Muro said. Rather than promising to create 150,000 jobs in five years, officials' goals should be more realistic -- say, looking to bring in 15,000 new jobs in health care, or 6,000 in business services, in the next half a decade."*

Exactly.

To get a copy of the Brookings/SRI report, please visit [http://www.brookings.edu/papers/2011/1114\\_nevada\\_economy.aspx](http://www.brookings.edu/papers/2011/1114_nevada_economy.aspx)

## THE COMMERCIAL REAL ESTATE PICTURE

### Spec Office Market

#### Recent Developments

According to RCG's research, the Valley's **spec office vacancy** fell marginally by 0.5 percentage points from 23.5% in Q2, 2011, to 23.0% in Q3, 2011.<sup>2</sup> Although small and virtually unchanged, this marks the first quarter in five years that offices vacancy decreased. The vacancies have risen steadily since Q3, 2006's 8.3% rate, but have since hovered around the 23-percent mark during the last five quarters.

Market Indicator	Q3, 2011	Q2, 2011	Q3, 2010
Inventory (sf)	42.8M	42.8M	42.7M
Under Construction (sf)	0	153,500	222,400
Direct Vacancy Rate	23.0%	23.5%	22.7%
Avg. Asking Rent (\$ PSF, FSG)	\$1.96	\$1.99	\$2.10
Net Absorption (sf)	191,300	-18,400	11,400
Completions (sf)	0	85,000	0

At \$1.96 psf in Q3, 2011, office average **monthly asking rents** (calculated on a full-service gross basis—or accounting for all operating expenses) dropped from Q2's \$1.99 psf (-1.5%) and last year's \$2.10 psf (-6.7%). Asking rents have seen a continuous downward trend since Q1, 2008.

<sup>2</sup> Includes speculative office buildings or building parks that contain at least 10,000 sf of gross leasable area.

We recorded no new office space **completions** in the Valley during Q3, 2011. The Valley's total inventory remained at 42.758 million sf in 2,081 projects. With the exception of last quarter, there has been no new space brought to the market since Q1, 2010.

Demand (**net absorption**) during Q3 was 191,300 sf, an improvement over last quarter's -18,400 sf. For the four quarters ending in Q3, 2011, net absorption totaled -65,700 sf. Although still negative, this is significantly better than the -669,800 sf experienced in the four quarters ending in Q3, 2010 and -688,800 sf for Q3, 2009's four-quarter total.

Lastly, there was no spec office space **under construction** at the end of Q3, 2011. However, there were two Class C projects in the planning phase, including the 26,000 square-foot Horizon Ridge Professional Park (Phase 2) in Henderson and a 20,000 square-foot building on the northwest corner of Buffalo and Warm Springs in the Southwest.

## Future Outlook

The Valley's spec office market is bumping along the bottom. This will be the trend for the remainder of 2011. However, this will depend on a steadily improving private job market. Downward pressure on rents is expected to be a mainstay for the next 12-18 months, at least, as high vacancies and lease incentives continue to drive the market.

We expect net office absorption to continue to remain low or even negative in some quarters as firms continue to downsize, go out of business or leave the market. Although this situation has helped many tenants improve their bottom lines by finding cheaper space, we remain unconvinced of a major spike in office space demand.

The challenge is the lack of robust hiring by either local or outside firms along all sectors. Health Care & Social Assistance sector has been the one exception. Moreover, most recently, Professional & Business Services has seen some moderate improvements. This said, the office-using sector grew by 4,100 or by 1.9% from 210,700 in Q3, 2010 to 214,800 in the 3<sup>rd</sup> quarter. Despite this, we project that will take several years for the office market to absorb the current supply over-hang, before we see a significant demand for new spec office development.

Additionally, office construction activity will be minimal for at least the next five years. First, in our opinion, financing is and will remain almost non-existent (except for owner-user buildings, which cannot carry the market in any meaningful way) through 2012. There is simply too much spec space available to make large-scale, new project financing feasible. In the long-term, the lack of financing will play a critical role in addressing the 10 million sf of vacant spec office space as the job market recovers.

Based on the average quarterly absorption of the last 10 years (285,600 sf), we forecast that there is **over five years** of spec office supply in the Valley that must be absorbed to reach a 10 percent "normalized" vacancy. ■

## Industrial Market

### Recent Developments

After dropping in the first 2 quarters of the year, the Valley's **industrial vacancy** was unchanged in Q3, remaining at 16.2% (reported by RCG). This is similar to last year's (Q3, 2010) 16.3% rate. Prior to 2011, the vacancy rate has trended upwards over the last 5 years.

At \$0.52 per sf, **monthly asking rents** (calculated on a NNN basis — or not accounting for any operating expenses) for industrial space in Q3, 2011 went down from Q2 (\$0.53 psf) and is down from Q3, 2010 (\$0.56 psf).

There were no new **completions** during Q3, 2011 in the Valley's industrial market. Inventory remains at nearly 107.2 million sf in 4,273 projects.

Market Indicator	Q3, 2011	Q2, 2011	Q3, 2010
Inventory (sf)	107.2M	107.2M	107.2M
Under Construction (sf)	181,100	180,000	75,000
Direct Vacancy Rate	16.2%	16.2%	16.3%
Avg. Asking Rent (\$ PSF, NNN)	\$0.52	\$0.53	\$0.56
Net Absorption (sf)	43,700	323,800	107,000
Completions (sf)	0	22,000	275,928

On the demand side, **net absorption** in the Valley’s industrial market was positive at 43,643 sf in Q3. The industrial market has posted positive net absorption in three of the last four quarters, after seeing an unbroken trend of negative absorption from Q2, 2008 to Q2, 2010.

At the end of Q3, 2011, 181,100 sf of industrial space were **under construction**, including facilities for warehouse/distribution and light industrial projects in the Southwest submarket.

## Future Outlook

The Valley’s industrial market recession is slowly fading away with the vacancy rate now showing signs of stability during the past three quarters. However, we believe landlords and sellers will continue to face fierce competition for renters and buyers. Owners also face the added challenge of attracting tenants at profitable rents amid a very weak economy. What we are seeing is a growing acceptance by sellers that holding out for unrealistic sales prices (i.e., north of \$100/s.f.) is not a sound strategy at the macro-level, because the economy is not roaring back.

Until consumer demand and business activity moves forward in a sustained way driving net absorption toward its pre-recession trend rate, we do not expect to see rents or prices rise rapidly and vacancy to drop precipitously.

The Valley’s industrial market continues to look for a bottom. However, industrial-using jobs losses moderated significantly in 2010 and 2011. Largely driven by the ongoing losses in Construction, industrial employment dropped by -7,800 jobs, or -6.7%, from Q3, 2010 (116,200) to Q3, 2011 (108,400), but has been moving in a positive direction since the end of 2009 as shown the attached chart.

Additionally, the lack future new supply is certainly a good thing and is essential for the industrial market’s return to a healthy supply-demand balance of 9-10% vacancy. As noted, vacancy is at 16.2% and RCG estimates it would take just **over 3 years** to return to a 10-percent vacancy rate, assuming the last 10-years’ rate of average quarterly absorption of 535,700 sf. ■

## Retail Market

### Recent Developments

After 16 straight quarters of rising vacancies, the average direct **vacancy rate** for the Valley’s anchored retail market fell slightly to 12.8% in Q3, just below last quarter’s 13% rate. It was 11.2% in Q3, 2010.

The average **monthly asking rents** fell further to \$1.35 psf (calculated on a NNN basis—not accounting for any operating expenses) in Q3, which is \$0.07 lower than last quarter (\$1.42 psf) and \$0.17 lower than Q3, 2010 (\$1.52 psf).

On the supply side, there were no new anchored retail **completions** during Q3, 2011. The Valley’s total anchored retail market remained at 43.9 million sf in 262 shopping centers. Only 3 retail projects have been completed over the past 9 quarters, totaling 520,300 sf.

**Net absorption** in Q3 was surprisingly positive at 79,800 sf, up from last quarter’s -274,800 sf and the -183,100 sf recorded one year ago.

At the end of Q3, there were 338,700 sf of anchored centers **under construction** in the Valley. We recorded approximately 288,000 sf of planned retail space, divided between a Community Center in the Northwest (132,400 sf) and a Neighborhood Center in North Las Vegas (155,700 sf).

Market Indicator	Q3, 2011	Q2, 2011	Q3, 2010
Inventory (sf)	43.9M	43.9M	43.7M
Under Construction (sf)	338,700	0	274,400
Direct Vacancy Rate	12.8%	13.0%	11.2%
Avg. Asking Rent (\$ PSF, NNN)	\$1.35	\$1.42	\$1.52
Net Absorption (sf)	79,800	-274,800	183,063
Completions (sf)	0	0	0

## ***Future Outlook***

The Valley's retail market continues to look for a bottom. Retail employment averaged 91,200 in Q3, 2011, 800 less jobs (-0.9%) than recorded in Q3, 2010 (92,000). The retail job-base is much smaller today, because of the recession. After significantly deteriorating in 2008 and 2009, the rate of quarterly retail job losses has been declining since late-2009.

Our outlook for the local and national retail markets remains subdued for the remainder of 2011 and in the first quarter of 2012. Taxable retail sales numbers reported by the Nevada Department of Taxation so far into 2011 indicate some signs of stabilizing, but we do not expect to see sustained jump in consumer spending.

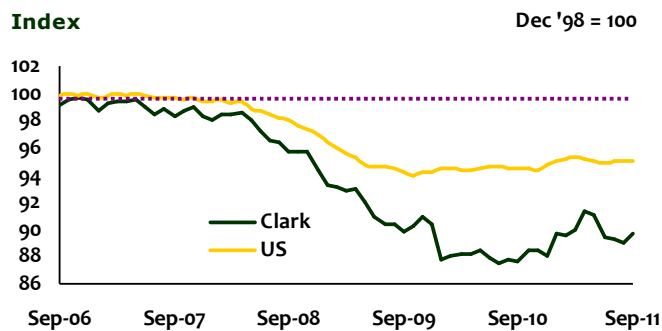
Uncertain economic conditions, along with weak overall job and housing markets are preventing consumers from spending vigorously. Until consumers feel more confident, see a rise in real disposable income and pay down debt for an extended period, they will hesitate to do a lot of purchasing. Accordingly, the retail job-base will not expand dramatically, which will affect the demand for retail real estate.

The lack of new additional supply will help the Valley's anchored retail market trend back toward a stabilized vacancy rate as the economy recovers. Our latest estimates indicate a timeline of **at least 1 year** before a 10% rate can be realized. An exciting but often overlooked trend is what we call "ethnic redevelopment" like what has continued for a number of years along West Spring Mountain and what has emerged in the last few years on the east side of the Valley. ■

Indicator	Region	Date	Value	Chart
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<b>RCG Employment Index</b>	Clark County United States	9/2011 9/2011	89.7 95.1
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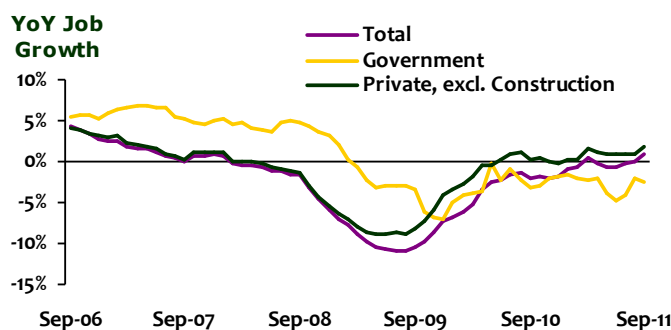
**Comment:** September's labor market readings reinforce recent trends that show signs of stabilization and improvement in some areas. Our Employment Index, based on the total employment to workforce ratio (December 1998 = 100), indicates that the local job market may have found a floor, but it's more of a function of a declining labor force than a ramp up of jobs. We continue to believe that firms, nationally and locally, will not begin hiring in large numbers for sometime.



<b>Total Jobs</b>	Clark County	9/2011	806K +1.0%
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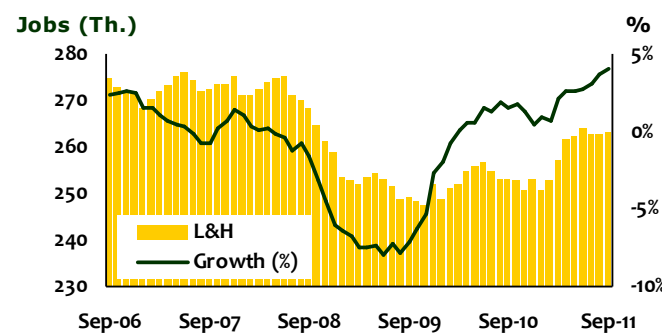
**Comment:** Total non-farm employment fell slightly (-0.2%) YTD in September relative to 2010's YTD average. However, on a Y-O-Y basis September jobs were up 1% (+8,000 jobs) compared to September 2010.

Employment rose in 4 of the 11 industry groups Y-O-Y, up from 2 years ago when only Education & Health saw gains. Private sector jobs are growing modestly, adding 10,300 jobs in the last 12 months. This was offset a bit by a loss of 2,300 public sector jobs, resulting in a net growth of 8,000 jobs. Further, when we exclude the Construction industry, Total private jobs was up 1.9% (+12,200 jobs) over September 2010, continuing a positive trend started in January 2011.



<b>Leisure/Hospitality Jobs</b>	Clark County	9/2011	263.3K +4.0%
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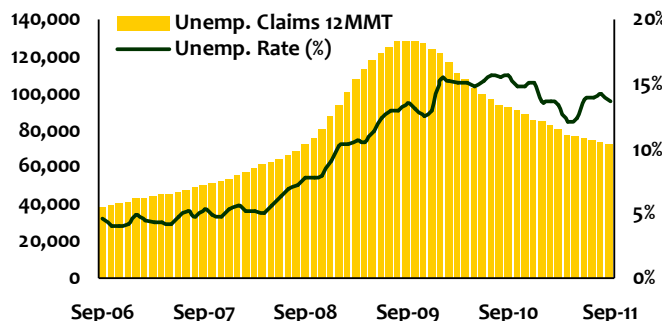
**Comment:** Clark County's "export industry"—Leisure & Hospitality—continues to post year-over-year gains. Leisure and hospitality jobs totaled 263,300 in September and in the last year added 10,200 jobs, a 4% increase.



<b>Unemployment Rate</b>	Clark County	9/2011	13.6%
<b>Unemployment Claims</b>	Clark County	9/2011	72.4K

**Comment:** After seeing 4 months of rising unemployment from May through August, the local unemployment rate dipped to 13.6% in September, down from 14.3% recorded last month.

There were 72,445 total approved unemployment claim filings (first payments) during the 12 months ending in September. It is far to say the decreasing trend of claims over the past two years is indicative some recovery is taking hold in S. Nevada.

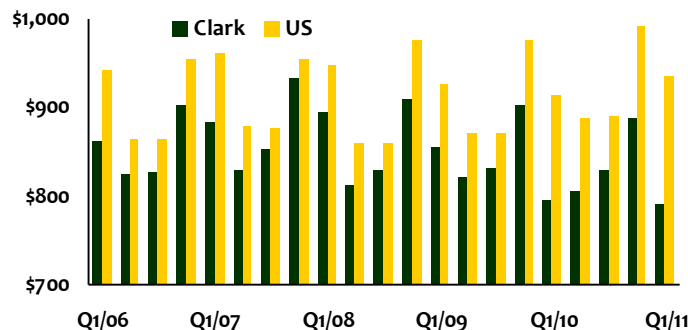


Indicator	Region	Date	Value	Chart
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<b>Average Weekly Wages</b> (in 2011 \$)	Clark County	Q1/11	\$790
	United States	Q1/11	\$935

**Comment:** The average weekly wage for the U.S. is improving and will help improve consumer confidence regarding spending, especially on discretionary products and services.

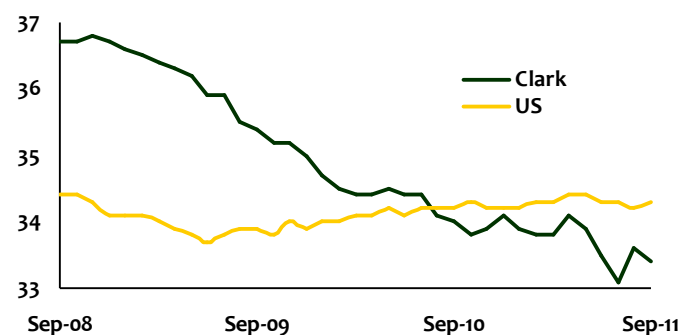
In Southern Nevada, average weekly wages is slightly down from last year's adjusted \$796.



<b>Average Weekly Hours Worked</b>	Clark County	9/2011	33.4 hrs.
	United States	9/2011	34.3 hrs.

**Comment:** The average workweek for all employees on private nonfarm payrolls at the national level appears to have stabilized.

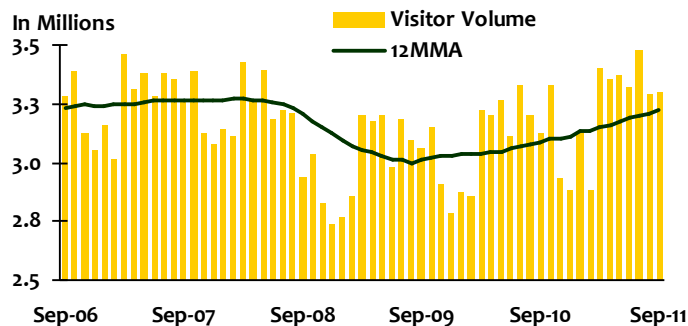
However, for Clark County, average weekly hours worked edged down by 0.2 hour over the month to 33.4 hours in September. Many workers continue to work part time due to getting their hours cut back or because they unable to find full-time jobs.



<b>Visitor Volume</b>	Las Vegas Valley	9/2011	3.290M
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**Comment:** There were 3.3 million visitors in September, an increase of +5.5% over last September and marking the 19th straight month of increases. While visitation has corrected itself, some important considerations are whether more visitors translate into more spending and improvements in room rates.

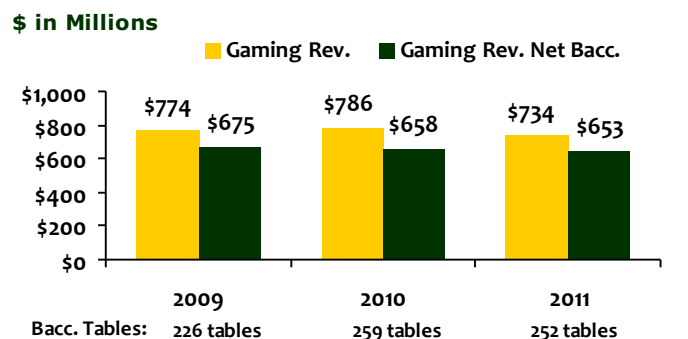
(Note: 12MMA = 12 month moving average).



<b>Gaming Revenue Gam. Rev. Net Baccarat</b>	Clark County	9/2011	\$733.7M
		9/2011	\$652.5M

**Comment:** With a tough comparison to last year's particularly high revenue levels, Clark County gross gaming revenue for September was down -6.6%. Compared with last month, revenues are down 2.5%.

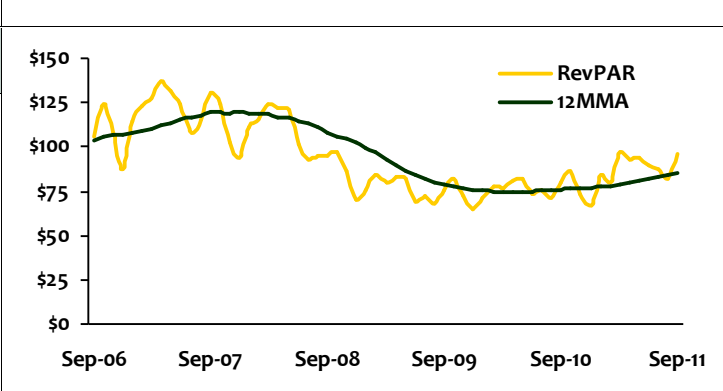
Excluding volatile, high-end baccarat play wins, gross gaming revenue for September was \$652.5 million, -0.8% over September 2010.



Indicator	Region	Date	Value	Chart
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<b>Hotel Revenue Per Available Room</b>	Las Vegas	9/2011	\$95.52
	Valley	9/2011 (12MMA)	\$85.65

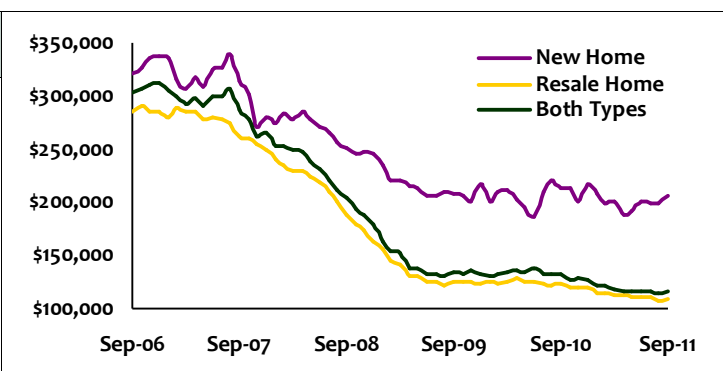
**Comment:** Year-over-year hotel revenue per available room (RevPAR) for September increased by 19.6% to nearly \$82. This month continues the slow, through gradual, upward trend that began mid-last year, mainly due to increases in average daily room rates (which were up +14.6% in September over last year.)



<b>Median Home Price</b>	Clark County	08/2011	New: \$198.6K
		08/2011	Resale: \$107.0K

**Comment:** According to Home Builders Research, when comparing August 2011 to last year, the median price for new homes dropped 3.0%, from \$220,000 to \$206,480. Median resale home price also continued to plummet, dropping to \$108,100 in August, -12.1% less than the \$122,000 recorded last August.

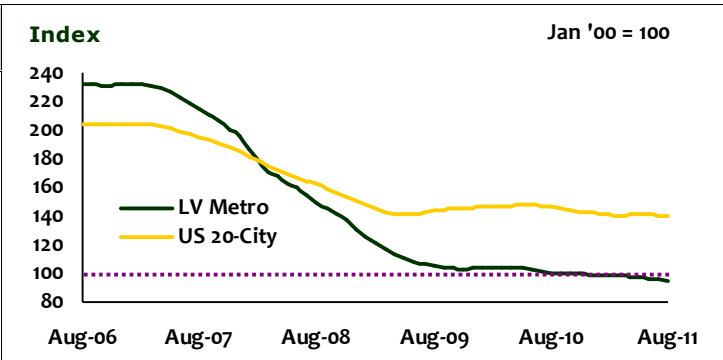
Over the same period, the weighted median price of new and resales, combined, decreased 12.3% to \$116,603 in August.



<b>Case-Shiller Housing Price Index</b>	Las Vegas MSA	8/2011	94.72
	United States	8/2011	140.56

**Comment:** The Case-Shiller Index (January 2000 = 100) for the Las Vegas area showed a new index low in August at 94.7. Average home prices in the Las Vegas market are lower than they were 11 years ago.

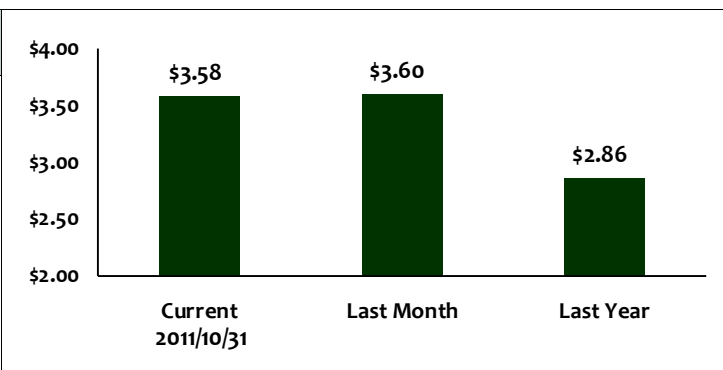
The 20-City Composite has been virtually flat since January and remained at 140.6 in August.



<b>Average Gas Price</b>	Las Vegas Valley	10/31/2011	\$3.58/gal.
		10/31/2010	\$2.86/gal.

**Comment:** The average price of a gallon of regular gas was \$3.58 at the last week of October, up 25% compared to the \$2.86/ gallon recorded last year.

Relatively high gasoline and commodity prices are another recovery drag that we are concerned about. While not impacting the rate of recovery like some other indicators, like job growth and consumer spending, gas and commodity prices warrant watching.



## SOURCES

- **Nevada Department of Employment, Training & Rehabilitation:** *Nonfarm Jobs, Leisure & Hospitality Jobs, Employment (indexed by RCG), Unemployment Rate, Unemployment Claims, Average Weekly Wages, & Average Weekly Hours Worked.*
- **Las Vegas Convention & Visitors Authority:** *Visitor Volume, Hotel Occupancy, Average Daily Room Rate.*
- **Nevada Gaming Control Board:** *Gaming Revenue.*
- **Home Builder's Research:** *Median New Home Price.*
- **Greater Las Vegas Association of Realtors:** *Median Resale Home Price.*
- **Standard & Poors (S&P):** *Case-Shiller Housing Price Index.*
- **AAA's Daily Fuel Gauge Report:** *Gas Price.*

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## RCG Economics LLC

RCG Economics LLC is the most established & prominent Nevada-based urban economics, public policy & real estate consulting firm in the state. John Restrepo, principal of the firm, has been providing socio-economic, real estate market & public policy research services research in Nevada since 1988. RCG advises a variety of public & private organizations. The firm uses its deep expertise in regional economics & demographic modeling, market analysis & database management to assist its clients. RCG has prepared over 500 demographic & economic forecasts, highest & best use studies, market analyses, public policy & regional economic reports.

The firm's other services lines include financial advisory services, strategic planning & hospitality industry consulting. The firm is sought after by many of Nevada's most prominent companies & public agencies. RCG has offices at 3980 Howard Hughes Parkway, Suite 290 89169. We can be reached at 702-967-3188. RCG's website can be accessed at: [www.rcg1.com](http://www.rcg1.com).

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