Berkeley Investment Advisors

Real Estate Brokerage/Retirement Planning

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Focus on Las Vegas

As most of you know, Las Vegas has been my favorite market for some time now. Prices have been moving up quickly there for good reasons. This month I'll spell out the case for Las Vegas.

Land Shortage in the Middle of the Desert

Strange as it may seem, Las Vegas developers are facing a shortage of real estate. Federal law has established a "disposal boundary" that circles Las Vegas. Real estate outside the boundary is reserved for the federal government's purposes. Of the 327,300 acres inside the boundary, more than two thirds is already used or is subject to zoning rules that prohibit housing. Only 76,000 acres is readily developable and many parcels within this are either too small or undesirable for various other reasons. Many of the larger, more desirable parcels are owned by the Bureau of Land Management (BLM) which auctions off about 2,000 acres a year. Meanwhile developers are using up 5,000 to 6,000 acres a year and large sites are becoming difficult to assemble.

Consultants who have done the math say that Las Vegas will run out of land for major development in 10 years. After that only small scale infill development and redevelopment will provide new housing unless Congress acts to free up more real estate from the BLM. By then the current residents will be land rich and have a vested interest in keeping it that way (just like California); that will prevent the politicians from acting.

Land shortages have already boosted prices. From 1992-97 land prices increased 12% annually. Since then price increases have accelerated to 15% a year. Land shortages have historically increased volatility for home values. In boom times the shortage fuels excessive speculation that can result in large losses when demand declines suddenly. In the long run prices rebound but the swings can wreak havoc on investors. As an example, consider California real estate in the late 1980's.

The lesson here is that returns will be good in the *long run* but you must be careful not to overpay in anticipation of short run appreciation. If you can buy a property using 75% leverage and still have positive cash flow, you will be able to hold long term and make good returns even if sudden shifts in demand knock prices back temporarily.

Current Rental Market Conditions

Overall, vacancy stood at 7.6% at the end of 2003 – down from 7.9% in 2002. My sample of listed properties had a median vacancy of 5% though this is likely due to underreporting of vacancy on the local multiple listing service. Vacancy varies by area. Real estate near the strip is most in demand. Neighborhoods around the Las Vegas strip run the gamut from dangerous ghetto (west of the Stratosphere) to upscale timeshare neighborhoods (east of the middle of the strip). In between are working class neighborhoods with strong rental demand.

Based upon my observations there is currently an excess supply of studios near downtown Las Vegas because of the many old motels that have been converted to very small studio apartments. I expect vacancy in these properties to be much higher than the market and it will likely get worse since more properties are being converted all the time. For example 117 N 9th street is currently being converted into 84 studios with shared bath. These units do not have kitchens. Las Vegas has a lot of these sub-standard studio apartments and vacancies in such properties are higher than buildings built as apartments.

Las Vegas is pushing hard for redevelopment of the downtown area and investors are responding by buying up obsolete properties and pouring money into rebuilding. There is still a long way to go but the situation is definitely improving. Still, job growth downtown lags the strip: the new $2 Billion Wynn Las Vegas Casino alone will add over 8,000 jobs when it opens next year and many construction jobs are created in the meantime.

Overall, the average rent in Las Vegas edged up $3 to $722 in 2003. The most popular investments for individual investors were the Class B and C properties. The following table is based on a sample of 17 of these properties:

	Median Asking Rent	Median Size (Sq. Feet)	Median Ask Rent/S.F.
1 Bedroom	500	585	$.91
2 Bedroom	600	758	$.79

Concessions are much less generous in Las Vegas than Phoenix. Effective rents average 94% of asking rents.

According to Clark County, as of July 2003 there were 638,352 housing units in the county. Of these units, 615,944 were in urban areas - 207,286 in Las Vegas city limits, 87,891 in Henderson, and 46,959 in North Las Vegas. Two thirds of these units (425,640) are single family homes.[1] Apartments represent 29% (183,842) of the housing stock. The remainder is mobile homes. Of this supply, about 85,142 new single family units and 19,305 new multi-family units were built between 2000 and the end of 2003. In 2003 permits were issued for 31,193 new housing units – 25,213 single family units and 5,980 multifamily units. The pace picked up in the first quarter of 2004 with permits issued for 9,149 residential units. New deliveries of multi-family units are likely to be slightly up from 2003 at about 5,700 units. Single family deliveries should also increase further as builders rush to meet demand before rising mortgage rates cool the market later in the year. I estimate new single family home completions at 26,000 in 2004, up from 25,320 in 2003.

Las Vegas continues to be one of the fastest growing economies in the U.S. A large part of employment in Las Vegas is tied to real estate based entertainment – casinos and resort hotels. These jobs cannot be outsourced to Asia and the clustering effects of the strip provide Las Vegas a built in advantage over other entertainment destinations. In addition, Las Vegas is drawing in lots of new businesses from higher tax states (California) thanks to Nevada's business friendly, low tax, low cost, environment.

Job growth has recovered from the slowdown following 9/11 and unemployment fell to 4.6% in March. According to the state employment department there were 34,800 new jobs in the Las Vegas metropolitan area in 2003. The University of Las Vegas Business and Economic Research Center projects 3.4% job growth in 2004 (28,600 new jobs) and long run job growth of 3.1%. Meanwhile, population is also growing at 3.4%. The Clark County Planning Division forecasts population growth of 56,000 in 2004 slowing to 3% growth in 2005 (51,000). This should translate into demand for housing units of 22,000 in 2004 and 20,000 in 2005.[2]

The above statistics indicate that the number of housing units produced in 2004 will exceed the amount demanded by 9,700 units! Assuming 30% of people moving to Las Vegas cannot afford to buy or rent a house, demand for apartments will exceed new supply (6,600 in new demand versus 5,700 new units). Las Vegas should also lose some existing apartments to demolition and condo conversions. By the end of 2004 multifamily vacancy should

[1] Including 25,779 townhouses and 43,673 condominiums.
[2] Based on a ratio of 2.55 persons per housing unit and 1.3 jobs per housing unit.

decline to 7.1% and rental increases should become easier to impose. On the other hand, the supply of new single family homes could exceed demand by more than 10,600 units. What is going on?

Single Family Home Investment Market

Many people have observed that the shortage of land is driving home prices ever upward as the city's population grows. I believe that real estate speculators have been driving up the demand for houses in Las Vegas and that there will be a huge glut of houses owned by investors that cannot be rented at current market rates. A local realtor who we work with in Las Vegas told us that 90% of new home buyers are investors. This may be an exaggeration but even if only 40% are investors it will be a problem.

There are several possibilities for how this gets worked out. Investors may just hold these houses as "vacation homes". They may all try to sell them when they realize renting will produce large negative cash flow. Or they may force down rents throughout the market by reducing rents enough to compete with apartments. In my opinion, the second option is likely to be the most popular. Other investors may bail out the early movers for some time but eventually I expect a halt in home appreciation; a drop in values is a distinct possibility in the Las Vegas market.

The home builders are aware of the problem and have tried to completely shut out investors from the Las Vegas single family home new construction market. It is difficult for builders targeting the California second-home buyers since they cannot distinguish between speculators and people who truly want a second home in Las Vegas. On my visit to Las Vegas last week I drove through one such luxury development where the prices were clearly above the means of the local market. I saw for sale and for rent signs all over a newly completed subdivision. If rapid appreciation has not carried home prices beyond the buying power of the people migrating to Las Vegas, interest rate rises may soon do so. While it's tempting to try to profit from the investor real estate rush by buying now and selling to another investor later, it is very risky. Get expert help and look forward, not backward, in evaluating your profit potential.

Note that while rapid home appreciation and rising interest rates spell risk for single family home buyers, they spell opportunity for apartment owners. Both these factors tend to price renters out of houses and therefore help to reduce apartment vacancies.

Apartment Investment Market Conditions

In 2003 there were 124 sales of buildings with between 5 and 99 units; 519 4-plexes traded hands. The vast majority of these are older, B and C grade buildings. Roughly 30% of buyers are from out of state (i.e. fleeing over-priced markets). Despite lackluster fundamentals, per unit prices rose 18% in the 5-99 unit market (to $43,800) and 5% in the 4-plex market (to $60,800). This is a very tough market to buy in. Well leased properties in decent shape draw multiple offers and are often sold within 10-14 days of listing. New construction 4-plexes sell on day 1.

Price rises have been driven by cheap financing. Two months ago you could have gotten a loan with the rate fixed for 5 years at 5.75% on a 5+ unit property. If the property was 4 or less units you could have had a fixed rate for 5 years at 4% with no principal payments the first 5 years. Since then, rates have come up at least .5% and may be up .75% in the next week. Current sellers watching the run-up in prices from the sideline may feel their properties deserve the same valuations (i.e. low capitalization rate) as when rates were lower. This will cause a valuation gap as smart buyers resist buying real estate at prices that don't allow them to maximize leverage in the new rate environment. Unrealistic expectations may slow the real estate market down for some time and make price negotiations tough.

Exhibit A shows recent Las Vegas real estate listings along with valuation metrics (capitalization rates and gross rent multipliers) and estimated returns. Some of these properties have already been sold. The first page is properties with 5 units or more, the second page is all 4-plexes except one double 4-plex. The stabilized return estimates shown here are fully leveraged (i.e. as if first year of ownership). Note that estimated returns are dependent upon financing and appreciation. Therefore, because different properties have different growth potential and different leverage capacity, higher returns do not necessarily correspond with higher initial capitalization rates.

For a comparison to where things stood last summer - see exhibit B for the Las Vegas real estate listings available at that time.

Conclusion

Given the growth prospects of Las Vegas and its long run land supply constraint, this is a very good place to invest for the long run. Real estate valuations are lower than California and the likelihood of strong growth in cash flow and value going forward is probably better than California. Expected returns are high enough to fully compensate for the risk of investing in this growth market. Be cautious in buying Las Vegas single family homes as investments – supply seems to be outpacing demand.

Featured Investment Opportunity

The property listed at 1720 Bonanza is especially interesting because each unit is separately titled. Therefore, an investor could potentially reap big gains by buying at the 5+ units valuation and then breaking the property into 3 lots of 4 units each for sale into the 4-plex market at a higher valuation (10 times gross rents?). Even without this strategy, this property would provide good returns.

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Berkeley Investment Advisors **EXHIBIT A**

Las Vegas Apartments (5 units +) Recently Listed for Sale

Asking Price	Address	Total # of Units	Studio	1 bed	2 bed	3 bed	Annual Gross Rents	Year Built	Unit Price	Current Gross Rent Multilpe	Proforma Cap Rate	Vacancy	Estimated Stablized return	Cash on Cash
8,250,000	29 N. 28th Street	349	344	4	1		1,538,700	1978	23,639	5.4	7.7%	0.9%	25%	7.8%
1,200,000	1400 S Casino Center	24	24				189,680	1980	50,000	6.3	7.1%	0%	21%	5.0%
684,000	1720 West Bonanza	12		12			85,680	1975	57,000	8.0	6.6%	10%	23%	3.8%
885,000	2592 Sherwood Street	22	20		2		123,720	1962	39,091	7.2	5.4%		8%	0.5%
1,125,000	3925 Coran Lane	22	12	9	1		126,000	1954	49,545	8.9	5.3%		7%	0.5%
1,300,000	2565 Lynnwood Street	26		19	7		162,840	1962	46,154	8.0	5.2%	10%	6%	-1.3%
500,000	3842 Royal Crest Street	8			8		55,200	1963	57,500	9.1	5.0%		8%	1.2%
1,150,000	2630 Sherwood Street	20		12	8		129,600	1960	50,500	8.9	4.8%	8%	7%	0.0%
375,000	1417 E Cartier Ave	10	2	8			40,500	1990	37,500	9.3				
1,550,000	117 N 9th Street	84	84				236,880	1953	18,452	6.5				
1,250,000	2619 Sherwood	22		21	1		122,460		56,818	10.2				
1,000,000	601 S 11th	16		10	6		93,480	1960	62,500	10.7		0%		
1,150,000	1005 Stewart	21		19	2		94,500	1948	54,762	12.2				
399,900	709 Jefferson	9	7		2		52,500	2001	44,433	7.6				
595,000	412 Monroe ave	24			24		129,600	1964	24,792	4.6		15%		

Prepared by Ray Meadows 4/30/04

EXHIBIT A

Las Vegas Apartments (4 units -) Recently Listed for Sale

Asking Price	Address	Total # of Units	Studio	1 bed	2 bed	3 bed	Annual Gross Rents	Year Built	Unit Price	Current Gross Rent Multilpe	Proforma Cap Rate	Vacancy	Estimated Stablized return	Cash on Cash
325,000	120-124 N 13th Street	8		8			39,360	1955	40,625	8.3	5.6%	0%	22%	8.5%
420,000	Glendale Avenue	4			3	1	42,300	1954	105,000	9.9	5.3%		27%	8.6%
299,000	305 Eastminister Ct.	6	2		4		36,264	1979	49,167	8.1	5.3%		22%	0.3%
300,000	6160 Camino De Rosa	4			4		28,800	1978	75,000	10.4	4.1%	8%	3%	3.3%
300,000	1904 Goodwill	4			4		26,400	1981	75,000	11.4	3.7%	8%	9%	1.4%
350,000	1204 Jones Blvd.	4			4		29,040	1963	75,000	10.3	2.9%	8%	-2%	-1.0%
300,000	496 Albert	4			4		26,400	1963	75,000	11.4		0%		
380,000	1904 Lirio Way	4			4		32,400	1984	95,000	11.7		3%		
379,990	6959 Mendon Lane	4			2	2	28,800	1983	94,998	13.2				
360,000	4155 Solteros St	4			4		28,800	1980	90,000	12.5		5%		
380,000	1605 Cordoba Lane	4			4		28,080	1978	95,000	13.5		0%		
300,000	2913 Stewart	4			4		26,400	1962	75,000	11.4				
325,000	3640 Kolendo Court	4			4		24,360	1977	81,250	13.3		0%		

Prepared by Ray Meadows 4/30/04

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EXHIBIT B

Las Vegas Apartments listed in August 2003

Price	Address	Total # of Units	Studio	1 bed	2 bed	3 bed	Annual Gross Rents	Year Built	Unit Price	Gross Rent Multilpe	Est. Cap Rate
489,000	1919 Fremont	17	17				91,800	1953	28,765	4.4	8.5%
1,695,000	225 Flower (between Eastern and Stewart)	40					249,600	1963	42,375	6.8	7.4%
800,000	2504 Las Vegas Blvd	24	20	4			134,940	1962	33,333	5.9	7.4%
376,000	1813 Harding	11	4	6	1		47,220	1945	34,182	8.0	6.5%
270,000	1805 Coolidge	7					33,720		38,571	8.0	6.4%
2,990,000	730 Center, Henderson	68			68		485,520	1963	43,971	6.2	
2,200,000	118 S. 15th	70					344,400	1963	31,429	6.4	
499,000	178 Winnick	6	1	5			32,640		83,167	15.3	
2,850,000	170 Winnick	25	1	23	1		127,992		114,000	22.3	
249,000	512 S 1st	9					43,200	1947	27,667	5.8	
350,000	230 West Boston	10		10			51,000	1955	35,000	6.9	
240,000	802 Stewart	6		6			30,600		40,000	7.8	
300,000	237 W Chicago	8		8			38,400		37,500	7.8	
190,000	119 W New York	5		5			24,000		38,000	7.9	
895,000	213 N. 6th	15	12	2	1		80,400	1937	59,667	11.1	
569,000	1712 Fairfield	8					30,000		71,125	19.0	
479,000	3842 Royal Crest	8					50,400	1963	59,875	9.5	
283,000	3689 Van Dyke	4					27,600	1977	70,750	10.3	
275,000	513 Calcatera	6					36,800	1963	45,833	7.5	
367,245	1014 North 4th Street	10		9	1		48,120		36,725	7.6	
545,000	311 North 16th Street	18	18				74,520		30,278	7.3	
600,000	500 N. 14th Street	12			12		74,400		50,000	8.1	
260,000	200-208 West New York Ave	8		8			38,400	1970	32,500	6.8	
650,000	1761 N. Nellis Blvd.	17		8	9		97,656	1963	38,235	6.7	
225,000	496 N. Circle	4							56,250		
1,600,000	1704-08 Fairview	20							80,000		
239,000	4880 West Twain	4						1977	59,750		
130,000	4596 Villa San Marco	2						1980	65,000		

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