MARKET WATCH: RENO

Self-Storage In The 'Biggest Little City In The World'

By Tim Garey

An arch over the main street in downtown Reno is inscribed with the city's nickname—the "Biggest Little City in the World." While it's the original home of Harrah's Entertainment, it is smaller than the other, more high-profile Nevada city to the south.

The history of Reno is representative of many of the western cities of the United States. Pioneers viewed the area as a farming community, and it soon became a regular stop for travelers before embarking on the treacherous crossing of the Sierra Mountains. The 1860s saw the discovery of large deposits of gold and silver ore near Virginia City approximately 20 miles south, where the bountiful "Comstock Lode" fueled significant wealth in the region. It also helped give the state of Nevada its nickname: "The Silver State." Reno is home to the National Bowling Stadium, also known as the "Taj Mahal of the Tenpins," the Reno Air Races, and Hot August Nights, a classic car convention.

The area is home to a number of recreational options that include the Lake Tahoe area, which offers skiing, boating, hiking, parasailing, fishing and biking. Other waterways include the Truckee River and Pyramid, Washoe and Donner lakes. The legalization of casino gambling in the 1930s helped create Reno as a destination for tourists and propelled the explosion of gaming and commerce in the area. Until the past 20 or 30 years, Downtown Reno was the capital for casinos and gaming; however, older hotel/casinos in the downtown core closed or gave way to larger developments outside of downtown.

Location

The Reno/Sparks metropolitan area is located at the eastern slope of the rugged Sierra Nevada Mountains, and the area is generally referred to as the Truckee Meadows. The MSA shows a population of approximately 420,000, which has benefited from large in-migrations from California, likely due to the fact that Nevada doesn't have a personal income tax.

COMING NEXT MONTH:
Orange County, CA

Las Vegas CBSA & Nevada Market Conditions (SF/Person)

Market	Existing Supply	Forecast Demand	Variance	Condition
Nevada:	11.99	7.31	-4.68	Over-Supplied*
Las Vegas CBSA	9.29	6.86	-2.43	Over-Supplied

Source: Cushman & Wakefield's Self Storage Industry Group and 2010 *Self-Storage Almanac*

*Compared to National Average

Reno is the second largest city in the state, located at the central western end of the state at the intersection of Interstate 80 (east/west) and US Highway 395 (north/south). It is strategically placed for distribution, generally only a day's drive to the western U.S.'s largest population centers of Los Angeles, San Francisco, Portland, Seattle, Las Vegas, Phoenix, Boise, Sacramento, and Salt Lake City. Some companies have located their distribution operations to this region for this purpose.

The region's climate is considered extreme based on its hot summers and cold winters. The average temperatures range from 20 to 25 degrees in the winter months to 90 degrees in the summer months. Due to its location at the base of the Sierra Mountains, snow is a factor. The average snowfall in Reno can range between 20 to 25 inches.

Reno benefits from being the seat of Washoe County, located approximately 30 miles north of the state capitol in Carson City. University of Nevada Reno has approximately 18,000 students. The employment base is supported by the location of corporate headquarters for PC-Doctor, IGT (International Game Technology), Port of Subs, Breaburn Capital, and the Hamilton Company. Other top employers include Bally's Technologies and Harrah's Entertainment.

Demographics

The estimated 2009 population for the City of Reno is 217,175, with population growth at approximately 2.34 percent annually since 2000. The estimated population is expected to increase to 239,323 in the next five years. The number of households in Reno in 2009 was estimated at 88,725 which is an increase of approximately 14,821 from 2000. The average household income in 2009 was $63,557 which is higher by an increase of approximately 17.4 percent over the 2000 figure.

The city's homeownership rate is approximately 50 percent—lower than the overall rate in the state of Nevada, which is at nearly 65 percent. A significant amount of residential development had come on the market over the past five to10 years and, unfortunately, foreclosure rates in Reno have been very high, mirroring the rising unemployment rate. Unemployment has gone from a low of 4.0 to 4.5 percent in the mid-2000s to a high of approximately 11 to 12 percent in the past couple of years. Additionally, there is a significant amount of vacant residential product on the market waiting to be absorbed.

Self-Storage In Reno

Self-storage development traditionally has followed the rise of residential development. While more recently, some storage developers have attempted to predict the growth of residential development in order to find that "perfect location." In the Reno/Sparks area, this certainly been the case. This trend extends to some of the newest self-storage developments in the area, located on the periphery of the city. They have had a difficult time absorbing and may continue so until the residential market shows some type of rebound.

Typical self-storage construction in the area consists of metal and masonry and ranges from 10,000 to 100,000 square feet, with a total number of units anywhere from 100 to 800 units per facility with a limited number of climate-controlled units available in the market. Construction costs for the area range from approximately $20 to $45 per square foot based on the location, size, and construction type of the development and which does not include land costs. There has been little to no development over the past two years. Typical land values for these facilities can range between $3 and $7 per square foot and are generally zoned for light industrial and commercial uses.

Generally speaking, monthly rental rates in the Reno market range from approximately $0.40 to $2.00 per square foot. Over the past six to nine years, typical occupancies have shown levels of between 80 to 95 percent. With the downturn of the local and national economies, owners and managers have indicated that their occupancies generally range in the 80 to 90 percent range. And they indicate that operating expense ratios range between 25 to 40 percent of the potential gross income; with the biggest expense items being on-site management, administration, and property taxes. Over the past three to five years, capitalization rates in the Reno area have been between 7 and 10 percent, depending on historical occupancy levels, condition, and location.

Regarding sales, as with most metro areas, there have been a limited number of them over the past two to three years primarily due to the limits in the financial markets, buyers' inability to make acquisitions, and a decrease in general property values. Of the sales in the Reno/Sparks market, they generally indicate price per square foot levels from $30 to $70. However, the superior facilities that have not sold would generally be traded at levels above this range. The sales have shown Effective Gross Income Multipliers of between 5 and 10, with net operating income that ranges from approximately $3 to $10 per square foot.

Developers, owners, and managers have all said that while the current market is very challenging, there are signs of optimism as some of the financial intuitions have begun to show an inkling toward potential financing. Additionally, they have indicated that while there have been a significant number of self-storage facilities built over the past three to five years, showing oversupply, it is not at the level of some of the other larger markets in the region.

There's no reason to dial 911 on the Reno self-storage market because the "Biggest Little City in the World" has had a history of pioneering and resiliency. If I were a gambling man, I would bet on Reno to be back on line with a strong future for self-storage.

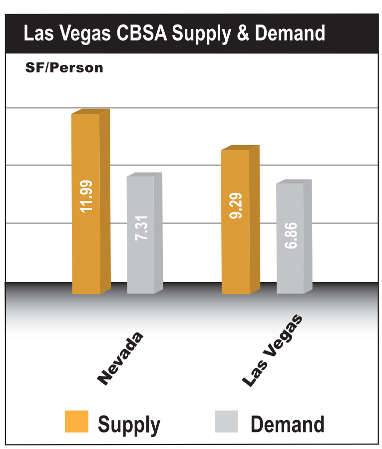
Tim Garey is Director of Cushman & Wakefield, Inc. Valuation & Advisory in Portland, Oregon.

EXCESS IN LAS VEGAS

Some characterize entertainment opportunities in Nevada as "excessive." There is certainly an excess supply of self-storage product. Nevertheless, as population returns over time, market conditions should return to equilibrium (especially since there is limited new self-storage construction in the state).

Data on the Reno sub-market has not been measured because of the small size of the CBSA (core based statistical area). Therefore, Nevada is benchmarked to the national average and market conditions in Las Vegas CBSA are summarized in the table on page 63.

Market activity has returned to the asset class in Nevada. In 2009, there was only one sale of a self-storage facility. In 2010, there may be as many as six. This demonstrates confidence in the market over the long run. One investor noted that properties were being purchased below replacement cost in a state that should have population growth over the long run. Disciplined investors are reviewing trailing 12 months' NOI and applying rates of return near seven percent if there is upside potential over the long run. Some estimate a return to stronger market conditions as a long term hold, estimated to be at least three to five years. But in Las Vegas, anything could happen.



Source: Cushman & Wakefield's Self Storage Industry Group and 18th Annual Self-Storage Almanac 2010

The demand forecast by the Self Storage Industry Group of Cushman & Wakefield is based on a proprietary, econometric model that uses a mathematical regression of demand variables to existing supply in order to forecast stabilized demand in a CBSA or trade area. In general, trade area forecasting is more accurate because of data consistency (wider range in CBSA data). The econometric model compares all top 100 CBSAs based on four key demographic criteria: total population, percentage of renters, average household size and average household income.

Self-storage performance in Nevada is likely to remain stable in terms of occupancy and income in the near term. As population growth resumes, demand for self storage will return. Even in these over-supplied markets, investors are returning to acquisitions betting on the long run performance of the market. However, investor discipline is high, focusing on income in place and a cautiously optimistic outlook for the market over the long run.

R. Christian Sonne is Managing Director of Cushman & Wakefield's Self Storage Industry Group, a nationwide team of appraisal, research, and analysis professionals specializing in the self-storage asset class.