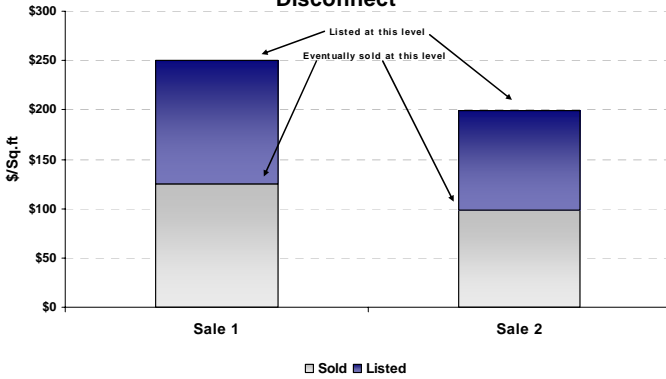


# The Disconnect in Commercial Property Values

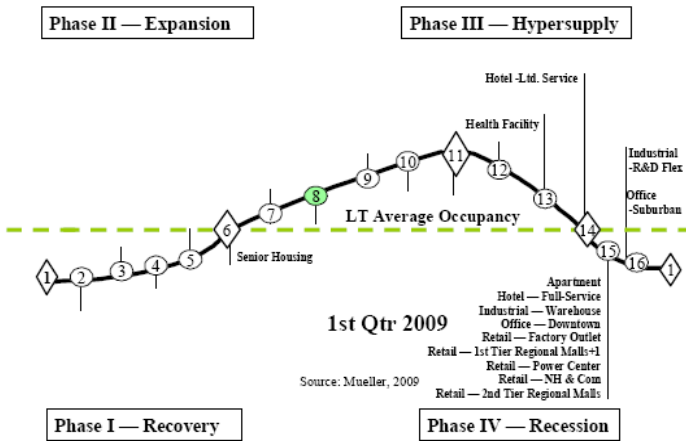
## Las Vegas, NV

Two Recent Sales Illustrate the Buyer/Seller Disconnect



I've worn a hole in the soles of two pairs of shoes this year. I find myself walking numerous properties looking at values from a bank's point of view, broker's point of view, an end users point of view, and an investor's point of view. To say there is a disconnect in values is an understatement. Sellers, (both owners and banks) view pricing as if it has fallen slightly from the peak, and investors and end users feel like the prices have fallen to 1997 and 1998 levels.

National Property Type Cycle Locations



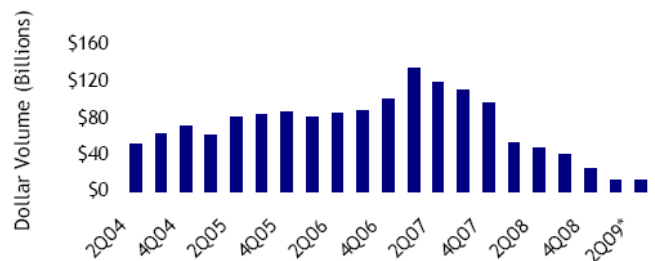
To understand where this difference comes from, you have to look at the real estate cycle. There are four stages to the real estate cycle: Recovery, Expansion, Hypersupply, and Recession. To tell where you are in the cycle, you need to look at many factors, including vacancy rates, new construction, absorption, employment growth and rental rates just to name a few. Business owners and investors have no doubt where commercial real estate is today. They observe and experience increasing vacancy rates, little to no new construction, low absorption, negative employment growth, and declining rental rates. To the end users and investors, we are in the middle of the recessionary cycle with more depths to reach before the recovery begins.

Sellers however, are pricing as if the recessionary cycle will be over soon and are making plans for recovery. There is a belief that with prices falling more than 50%, that a recovery will take place soon and prices will return to normal.

Commercial sales volume for the first half of 2009 is down 75% from the same period last year and down 90% from the first half of 2007. Reflected in this sharp volume decline are the tight credit market (which is a "loop" in the system) and a buyer/seller price gap. Interest is rising amongst buyers, however this is only for properties that can be purchased at what buyers perceive is an exceptional deal, which are those that are discounted enough to offset greater risk expectations.

I recently performed an analysis of an office building in the Las Vegas area. If you purchased this asset with cash and leased it below market you would have to factor in 62% appreciation at the reversion to yield a 20% IRR. Herein lies the problem. End users are now thinking like investors. They are doing the math and it is not making sense at asking prices. Buyers are looking for industrial product below \$50 per/sq.ft and office buildings below \$100 per/sq.ft. With each buyer call I receive, these numbers get lower and lower. Meanwhile, sellers are lowering industrial prices to the \$100 per/sq.ft range and office prices to the \$150 per/sq.ft range.

Commercial Real Estate Investment Dollar Volume



Estimate (includes apartment, office, retail and industrial sales)  
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., RCA

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# The Disconnect in Commercial Property Values

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We are also starting to feel the effect of the Silver State Bank/FDIC Note auction. Many of these notes were purchased at a substantial discount providing the new note holder with incredible opportunities. Office buildings that once sold for \$250 per sq.ft when Silver State placed the lien against the property have re-sold in the last few months for \$125 per/sq/ft with tenant improvements complete. The second wave of Silver State bank distressed properties has not hit the market yet and neither have the assets of Colonial Bank or Community Bank. These properties will definitely place continued downward pressure on pricing.

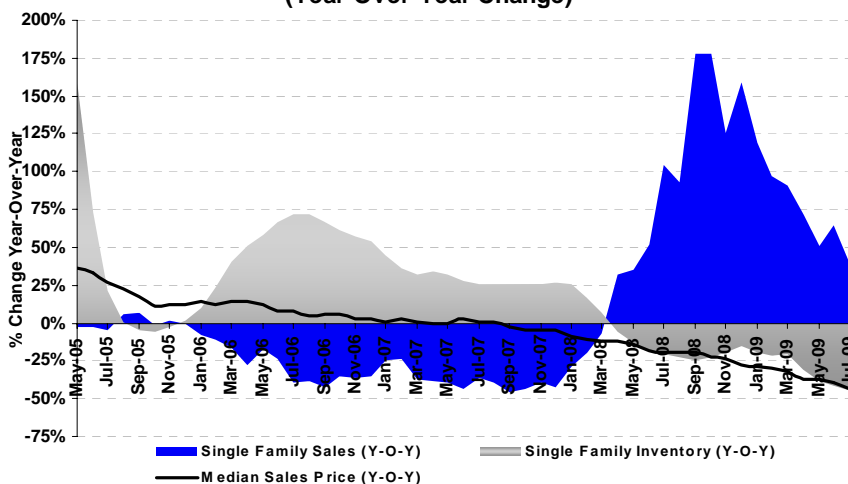
There are numerous multi-building office and industrial developments where the number of foreclosed buildings outnumber those of owner buildings. Banks are competing with other banks in the same development. Today, they are both priced above market hoping to preserve values. Deep down they know that the first to sell in these complexes will get the highest price and those that follow will sell for even less.

Las Vegas has only begun to scratch the surface. Estimates are that there are over 10 billion dollars of distressed commercial properties in Las Vegas and that number is probably much higher. Lenders have extended loans and modified loan terms delaying a clash with the price expectation gap. Many banks are reluctant to foreclose to avoid adding these dollar value losses to their bottom line. This strategy just serves to further delay a recovery.

There is a bright side to all of this if we take our lead from the residential market. When residential REO's began to climb, sellers and banks did not discount the properties enough and inventory soared to an all time high at the same time sales plummeted to an all time low. Today, REO's are leading the recovery in residential. Banks are pricing the properties in such a way that a majority of properties receive multiple offers. Current listed inventory is very low and sales volume is very high.

The truth about the disconnect in pricing is that the real estate cycle can't be changed by sellers holding out for higher prices. However, sellers can lead the recovery by pricing real estate in such a way that properties move quickly. The inventory will have to change hands and will most likely do so at a price point that motivate buyers to move quickly. When the price expectation gap is narrowed, commercial real estate will begin to enjoy a recovery.

**Single Family For-Sale Inventory, Sales & Pricing  
(Year-Over-Year Change)**



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