Vegasnomics

Economy and Real Estate On Training Wheels

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INDUSTRY INTERVIEW:
Determining the Lay of the Land

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Principal
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Contributors

The Macro View

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David Grana is a financial writer based in Las Vegas. He has worked as a content writer for the Financial Times in London and Institutional Investor in New York. David established Vegasnomics for the purpose of hosting the Las Vegas Property Development & Infrastructure Conference - a vehicle that delivers tangible information on the property market to real estate professionals. Just like the complex issues that he has covered in his conversations with portfolio managers from the investment management industry, Vegasnomics brings complex economic and financial issues to the forefront of real estate professionals' minds.

The Micro View

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Pam Junge grew up in Las Vegas and has made real estate her profession since the age of 17. Her vast knowledge spans title and escrow practices, private and commercial lending and every possible type of commercial and residential transaction. Most recently, Pam has pursued her passion of bringing technology and transparency to the home buying and selling process and aligned with eXp Realty, the fastest growing real estate firm in the country. Pam leads a dynamic team of commercial and residential agents on a platform built from three decades of providing consumers trusted services. Her mission is to grow industry leaders and real estate professionals through six core values - community, innovation, service, sustainability, collaboration and fun.

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The Macro View

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I can't help but feel that the reopening of the economy is like a classic scene from the Chris Farley film *Black Sheep*. As typical in any of Farley's films, a comedy of errors compounds.

Chris Farley in *Black Sheep*

In this film, he and his sidekick, played by David Spade, get pulled over by a state trooper while driving a stolen police car that has somehow leaked nitrous oxide gas, leaving both of them inebriated and acting completely goofy. Thinking that the pair were being pulled over for speeding, the look of shock on Farley's face when the state trooper informs him that they were, in fact, driving a grand total of seven miles per hour is utterly hilarious.

This slow crawl is indicative of what seems to be happening with the reopening of the economy and people's ability to adapt to this new environment. The problem stems from a number of places. First and foremost, direction from many state and municipal governments has been unclear or conflicting, leaving many businesses uncomfortable with opening up with confidence. Many consumers are also stuck in neutral, with no clear idea of how to take the next steps of integration, while harboring an air of distrust and extreme caution. Much of this could be traced back to the lack of guidance for businesses, as well as people's perceived lack of operational confidence that establishments are exuding.

"Whether we like it or not, we will be coexisting with this wretched virus and the speed at which we adapt to this coexistence will determine our economic recovery."

What is becoming quite clear is that business will have to move forward and that COVID-19 will be like our version of the Odd Couple's Oscar Madison - without any of the endearing qualities of the character that Walter Matthau so brilliantly brought to life.

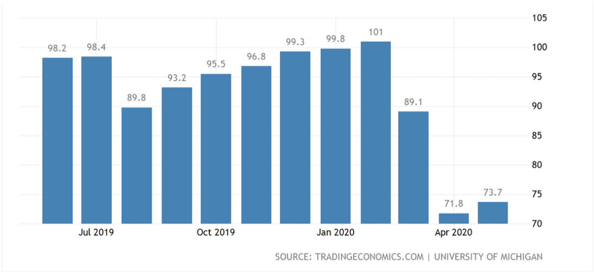
Jack Lemmon (L) and Walter Matthau in *The Odd Couple*

Whether we like it or not, we will be coexisting with this wretched virus and the speed at which we adapt to this coexistence will determine our economic recovery. This is likely the toughest pill that any of us will ever have to swallow.

Most of the numbers that were reported last week were unsurprising. Jobless claims were up just shy of 3 million, bringing the pandemic total to over 36 million. The number of new claims will likely subside for a while and then jump back up later in the year as PPP requirements get met and companies begin to reorganize. Retail sales figures were awful, but again, that's no surprise, since most of the country has been on some form of shutdown.

What is surprising and noteworthy, however, is the slight uptick in the University of Michigan's Consumer Confidence Index for the month of May.

US Consumer Confidence Index



"The repercussions will most certainly be felt for residential rental properties, with the duration of the impact dependent on state or local laws governing evictions."

Given the economic devastation that we've seen over the last few weeks, it makes many wonder if this confidence is fueled by the stimulus checks and additional unemployment benefits, combined with the moratorium on evictions and mortgage modifications. The hope of further stimulus may be propping up everyone's hopes, especially after the mostly symbolic $3 trillion coronavirus bill that was passed late-Friday evening by the House of Representatives.

I call it "symbolic" because it is highly unlikely to be put up for a vote in the Senate, however, it is paving the way for further stimulus talks and more Federal aid.

Residents of many cities may be determining where to move.

In that same breath, I also wonder if those "confidence dollars" will be directed towards brick and mortar establishments, or online companies. Perhaps our new habits will be more difficult to break than we had hoped.

There is a less-explored element surrounding all of this, and it comes in the form of migration. Uncertainty about the return of many jobs and when schools will reopen, along with our overall economic future, may spur many into moving closer to family for the sake of childcare or to pursue employment opportunities. The combination of stimulus and moratoriums in evictions presents an opportunity for some individuals or families to increase cash reserves in preparation for relocation. The big question many people will be asking themselves is, "Why should we stay here when our future is so uncertain?"

The repercussions will most certainly be felt for residential rental properties, with the length of this impact dependent on state or local laws governing evictions. This could be a motivator for residential property investors to sell properties, and may also cause some headaches for multifamily owners, both of whom would need to ensure that they have ample capital reserves for the carry costs associated with holding onto these properties. As nefarious as all this may sound, this is part of the economic reality of today.

Over the coming weeks, most of us will rev our engines and, slowly but surely, move forward cautiously, down our new respective paths. Stay safe!

The Micro View

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As she slowly awakens from her unexpected hibernation, the city that never sleeps is opening her eyes to a whole new world. Her inhabitants are a mixed bag of emotions - excitement laced with fear and uncertainty of what the immediate future holds.

This digital mock-up, provided by MGM Resorts, illustrates what a hand-washing station beside the casino might look like when Bellagio reopens, possibly early next month. (MGM Resorts)

The Las Vegas that once was, the petri dish of unabashed fun and letting loose, is cleaning up it's act to be a safe haven for tourists and workers. Life as we know it has changed and, at least for now, Sin City will emerge slowly, as if on training wheels, into a brand a far cry from the exciting nightlife and entertainment we've so smashingly owned for decades on end.

The first week of Phase 1, The Road Map to Recovery, brought forth a wave of actions in the resort industry. The Gaming Control Board continues to update their guidelines on re-opening casinos, however, we're still living on "corona time." The procedures are taking shape, but the date when the Governor's Office gives us the green light is still a mystery.

A silver car drives up the Las Vegas Strip on Tuesday, May 12, with people holding a sign urging casinos to open up safely. The Culinary Union is asking Nevada casinos to adopt their public health guidelines before reopening.

PHOTO COURTESY OF THE CULINARY WORKERS UNION

Tensions are rising amongst culinary employees from Local 226 demanding transparency of the casinos' reopening plans. Tuesday evening brought a parade of cars on Las Vegas Blvd. that backed up for miles. Occupants honked their horns and held signs out their windows that read "transparency = safety" and "don't roll the dice with workers' lives." Even Nevadans for the Common Good threw their hat in the ring, lobbying for a ban on smoking in all casinos, citing health concerns relating to excessive hand-to-mouth contamination and the removal of masks.

"Let's just say that the days of having a beautiful woman that you may have met just ten minutes prior blow on your dice with her freshly-painted red lips for luck... are gone."

Perhaps the most shocking news of the week is the reality that not all casinos plan on reopening immediately. It's been reported that all but 200 workers at JW Marriott received a voicemail telling them that they no longer have jobs to come back to.

The Bellagio Hotel and Casino

MGM Resorts reportedly plans on opening only two of their flagship resorts, the Bellagio and the NYNY, when the time comes, with each operating at 25% capacity to promote health and to quell fearfulness through enforced social distancing. We've been hearing further news that The Palms and Palace Station will be put up for sale, right on the heels of significant renovations to both properties totaling $812 million, which were supposed to pay off big in 2020. Albeit a beginning, it's undoubtedly going to take some getting used to the new normal.

While we must remain grateful and confident that these measures are in our best interest, they unquestionably lack the carefree fun and appeal we're accustomed to. What immediately comes to mind are the images of the newly redesigned blackjack tables adorned with plexiglass walls and hand cutouts. Let's just say that the days of having a beautiful woman that you may have met just ten minutes prior blow on your dice with her freshly-painted red lips for luck... are gone. Most casinos will, however, be offering amenity kits equipped with masks, gloves and sanitizer for customer protection.

The media is, once again, targeting Millennials and speculating that they will be amongst the first tourists to jump back in. Low room rates and enticing incentives are among the reasons, along with a "coronavirus can't hurt me" mentality. We have a high likelihood of Californians making the drive to Las Vegas while travelers remain pensive over the idea of flying.

Millennials may be the first tourists to boost Vegas' comeback.

Either way, just like the early days of recovery after the 2008 crash, we're likely to see mostly low budget, weekend vacationers until well into 2021. Although people will be moving about the Strip, they won't be injecting any real revenue into the city's economy until jobs and consumer confidence returns. This, in and of itself, is a good thing. Think about it - training wheels. Every nightclub in town pays the cool kids to be their party starters. I believe the official title is "Party Kids." They look the part, act the part and bring excitement and exuberance to the club. Women (the very good looking ones) get in for free and men get double charged and interrogated by the bouncer. What a business! It works. These "kids" are writing the nightlife narrative. When we reopen, perhaps these carefree Millenials will be our city's party starters until we can take off the training wheels.

"Loan deferments continue to skyrocket as more Americans (and a lot of Las Vegans) come to realize they're not going back to the job they once enjoyed."

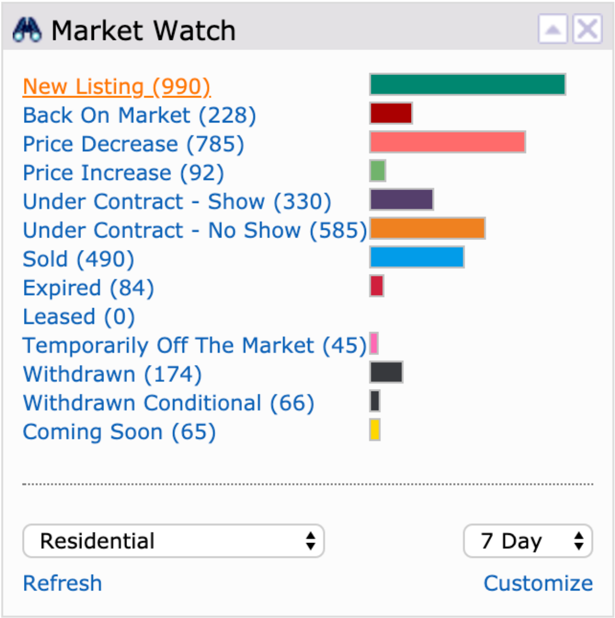
As we continue to change the way we live and work, we're seeing real estate assets morph, change and grow as well. JPMorgan Chase and American Homes 4 Rent have teamed up to bet on Vegas and the single family rental market.

They've recently purchased land in the southwest (Sovana) and in Spring Valley to build 34 homes to add to their rental pool. The deal is clearly an effort to capitalize on those fleeing dense, urban living . "We see this shift as particularly prevalent among the millennial generation, the largest U.S. age cohort, who are looking to transition away from apartment living," said Mike Kelly, Head of Real Estate Americas at JPMorgan Asset Management. "The move towards more spread-out living is also expected to accelerate in the wake of the COVID-19 pandemic, and we anticipate strong occupancy and rental growth rates across properties." The first home deliveries are expected this June and completion is anticipated by October 2020. And that's just the beginning. The two are looking to spend $625 million to develop approximately 2,500 single-family rentals across multiple markets in the West and Southeast.

These thoughts are echoed by the National Association of Realtors in a recent statement reported by HousingWire. "The pandemic is leaving an imprint on the fabric of American life, culture, and preferences which we could see for years to come," Realtor.com Chief Economist Danielle Hale stated.

"After experiencing life under quarantine, many buyers are searching for affordability and greater space, which is driving demand out of the nation's largest metros and into surrounding smaller towns." The Realtor.com forecast predicts that housing inventory will **remain low**, as sellers are going to stay put and housing starts will decline. Last week they publicly changed their tune on the "brightness" of the year's forecast, calling for a slight uptick in the summer, with a decline later in the year.

The local housing market continues its slow and methodical trajectory to widening the gap in supply and demand. While eviction moratoriums and loan deferments are holding the market down and keeping us stable, it's anyone's guess how this will all play out. We're waiting with bated breath to find out how the government plans on handling the lift on evictions since, right now, there appears to be no safety net.



Loan deferments continue to skyrocket as more Americans (and a lot of Las Vegans) come to realize they're not going back to the job they once enjoyed. While we speculated a couple weeks ago that these factors could rear their ugly head in the housing market in six months to a year, we are now bracing for it. New listings are up another 10% week-over-week, as sales continue to hold moderately below average. We attribute this to buyers and sellers stuck in transactions with the eternal hope of a furloughed buyer getting their job back. Cancelled transactions continue at a pace of approximately 25% per week. We may see a slight uptick in this number in the coming weeks while we flush out the remainder of pre-coronavirus pending sales. Buyers are still displaying confidence with another 885 homes placed under contract in the last seven days.

There are no alarm bells to ring at the moment on the housing front. At the end of the day, everyone needs a home, and consumers are taking advantage of low interest rates and affordable mortgage payments.

We've cracked the front doors open and we're peeking out. Dad's put the training wheels on the two-wheeler and promises he'll be there to catch us if we fall. We've strapped on our helmets and elbow pads and decide to take this new, scary bike for a ride. It's going to be slow going as we start. It's new.

It's hard to find balance and comfort. But like everything else in life, we will get the hang of it and it will be like we've been riding it all our lives. We're embarking on a new way of life, in a new world with a disease we must learn to live alongside. We've done an outstanding job as the citizens of this city keeping it at bay thus far, and we can continue this path with reason and care. Let's get this thing in motion, restart our economy and some semblance of the vibrant city we all know and love. Stay safe and healthy out there. We are **#vegasstronger**.

INDUSTRY INTERVIEW:
Determining the Lay of the Land

Tyler Mattox
Principal
MCA Realty

Mr. Mattox is a Principal at MCA Realty and is responsible for directing the investment related activities including the acquisition, development and disposition of all investments. Mr. Mattox has over 27 years of broad based real estate experience and is a California licensed real estate broker.

Prior to MCA Realty, Mr. Mattox was the Principal Owner of Mattox Property Services, an opportunistic real estate investment and development company that identified and acquired underperforming assets. In this role, he managed all facets of the repositioning process, including acquisitions, financial underwriting, debt and equity capitalization and physical due diligence. Prior to the formation of Mattox Property Services, Mr. Mattox was employed by CBRE and during his tenure rose to the level of Senior Vice President, the highest office available to producers at the time of his departure.

How have your tenants fared through the economic shutdown?

About 70-80% of our tenants seem to still be in operation in some capacity, in spite of the shutdown. Our tenants in strip-adjacent properties have had the most severe impact to their businesses as a result of the complete cessation of convention services and casino operations. Our North Las Vegas properties have tenants that may have lower credit quality in general, but their businesses don't seem to be as directly related to the Strip and they have had less issues with making their monthly rent commitments.

Do potential tenants with a heavy client focus on resorts all of a sudden become less appealing?

Not from our perspective. Liquidity may come under more scrutiny, but not necessarily a company's reliance on resort clients. Because our portfolio is composed of mostly small and mid-sized buildings, we try to have an in-depth knowledge of who our tenants are.

"We’ll definitely see disruption in the Las Vegas market and it’s inevitable that some of our tenants will go out of business."

They tend not to have large balance sheets on average, which is why we look at factors such as years in business, revenue generation, leverage, and gross margins. We’ll continue looking at those factors, and probably a bit more diligently as we look to re-stabilize our portfolio in the aftermath of this crisis.

What adjustments have been made in the management of your properties?

Our property managers are following social distancing guidelines in order to protect tenants and employees. Because our portfolio is primarily industrial properties, they tend to have less tenant density than other types of commercial properties. These properties don’t usually have communal facilities that require special sanitary treatment, so we haven’t had to make major adjustments out of the norm of our standard maintenance procedures.

What differences do you see among tenants through this situation across the various regions where you own properties?

Our California tenants’ ability to pay April rent were in the 90% range, while our Nevada properties were around 80%, and Hawaii was closer to 60%. We’ll definitely see disruption in the Las Vegas market and it’s inevitable that some of our tenants will go out of business. At the moment, we’re trying to figure out what that number will ultimately be, and what our options are to fill the shortfalls that are likely coming.

"Lenders are careful in underwriting deals, and Las Vegas is currently out of favor for everything but the most core assets, given the increased uncertainty due to the reliance on the resort corridor as a demand generator."

In an effort to be proactive, when the shutdowns began, we hired a consultant to help our tenants access funds from the various Federal programs that were available for businesses. We see this as a short-term fix, since it enables the payment of staff salaries and rents, but we may begin to see some tenants struggle beginning in mid-summer, depending on the pace and level of the re-opening of the economy, and more importantly, the resort corridor in Las Vegas. At this stage, I'm cautiously optimistic, but visitors' experiences with travel complications and the safety protocols in place will largely dictate the velocity of the recovery, in my opinion.

Does the economic environment open the door for investment opportunities?

We're trying to determine where vacancy levels are going to level out, but no one is sure just yet. The number of new construction projects in the market indicated that vacancies would increase, but that number will likely be higher than those pre-COVID projections, given the new economic climate. A negative change in the vacancy rate will ultimately lead to rent decreases, and loss in real estate values follow reductions in Net Operating Income. It's just a question of how deep and when.

We've also started seeing institutional capital pull back a bit. Lenders are careful in underwriting deals and Las Vegas is currently out of favor for everything but the most core assets, given the increased uncertainty, due to the reliance on the resort corridor as a demand generator.

That sentiment may change once the resorts begin to open up, but debt spreads have definitely increased, and equity is expecting a higher rate of return than the pre-virus period, given the increased risk of investment.

In discussions about the state of the market with our broker relationships, estimates of their expected revenue reductions range from 30-50% of earlier projections. This is a pretty profound revenue shift and is a function of reduced transactional velocity, as well as expectations for disrupted third and fourth quarters.

What is your long-term view of Las Vegas?

Our long-term view for Las Vegas is optimistic. It's going to be a choppy recovery and different when it comes back, but it will be back. There will be a return to normalcy at some point. That timeline is murky right now, but it is coming. The Strip is still one of the most unique demand generators in the world, and it's not going away.

Navigating the New Normal in the Property Market.

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