

Las Vegas Housing Outlook On The Path to Recovery?

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THE
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GROUP

The following analysis outlines The Concord Group's ("TCG") forecast for the Las Vegas housing market. This investigation succeeds TCG's United States housing market study completed in January 2009. The prior analysis focused on the United States as a whole and only briefly evaluated selected U.S. markets. Las Vegas is the first of several deeper regional examinations given its unique fundamentals, economic catalysts and exceptional growth.

TCG's conclusions draw from both demographic and employment driven demand assessments and various tools for evaluating supply levels and absorption velocity. The timing of the housing market recovery drives acquisition, planning and disposition decisions.

Executive Summary

Below are key findings and projections from TCG's analysis:

- Las Vegas metro has been longtime U.S. leader in demographic and economic growth
 - Population growth averages 5.2% annually; 2008 negative, first since pre-1970
 - Employment growth averages 5.6% annually; 2008 negative, first since 1982
 - Hospitality/gaming 30% of employment; 55,000 new hotel rooms since 1993
- Demand from out of town – second home and retirees, as well as investors
- Current U.S. recession affecting market stronger than previous post-war downturns
 - Job losses in construction outweigh growth in hotel/gaming
 - Key visitation/tourism indicators and gaming revenues have negative Y/Y growth
- Home sales levels (contracts not closings) significantly below structural demand – macro-economic, credit liquidity, employment and consumer confidence recovery needed to underpin sales
- Resale market challenges similar to new market: high competition from REOs (74% of total sales), sales down 60% from peak, price down 30% from peak and high supply
- Significant oversupply of available new units, including standing, available lots and recently built foreclosures
 - 48,000 for entire market
 - 37,000, excluding 11,000 high-density units, the majority of which are condotel/hospitality uses and the balance rentals
- Price drops have brought affordability below normalized ratio; oversupply and macroeconomic conditions will likely lead to additional 5% to 10% overcorrection
- Velocity increases in 2010-2011, holding at bottom through 2009
- Long-term structural new home demand of 23,500 units/year, but not reached until 2011
- 25,000 new hotel rooms (2008-2010) generate new jobs and stimulate economy
- Full recovery defined as one per week new home sales per project and low single digit price appreciation – TCG forecasts 4Q 2011 for traditional suburban product; Product-specific focus speeds recovery compared to TCG's prior forecast in U.S. Outlook paper
- Land/lot development opportunities precede recovery by 12 to 18 months; Opportunities for re-entitlement, land planning and product development best addressed immediately
- Fundamentals diverge by submarket and present opportunities in challenged environment
- Strategic analyses must focus on specific submarket and product supply as well as demand conditions.

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Overview and Purpose

The Las Vegas-Paradise Metropolitan Statistical Area (“MSA”), or Clark County, Nevada, consistently ranks among the nation’s fastest-growing metropolitan areas. Las Vegas experienced prior recessions mildly, as the powerful economic multipliers underpinned by hospitality/gaming growth insulated the market from turmoil seen elsewhere. This led to the oft-cited belief that gaming, and the Las Vegas market in its entirety, is “recession-proof.”

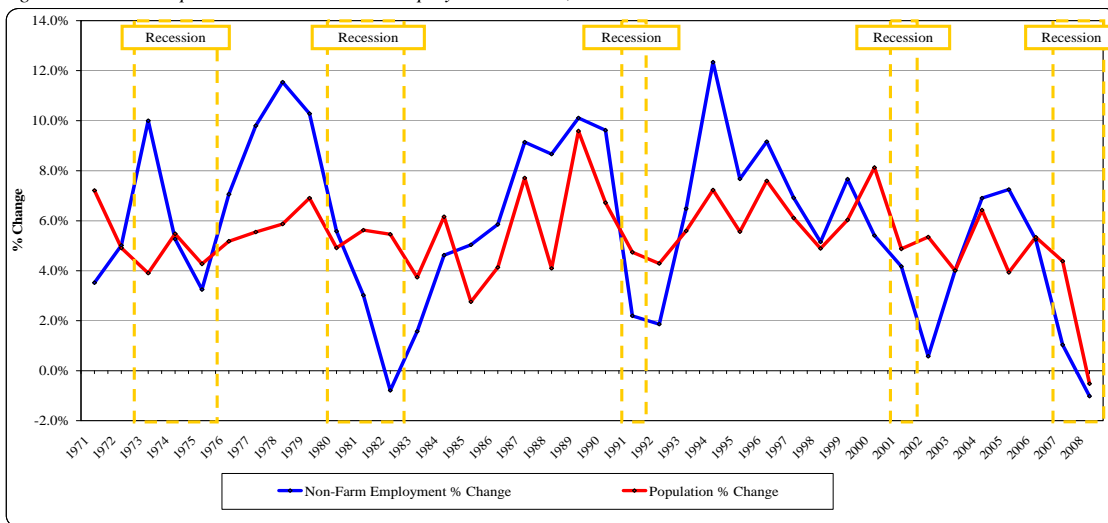
Recent events disprove this hypothesis. Compared to most U.S. metros, Las Vegas has suffered longer and more severely from the current recession, facing first a sharp housing correction starting in 2005-06 and then an employment and spending/tourism contraction from 2007 to present. This analysis seeks to identify the factors that derailed Las Vegas’ economic growth, assess supply and demand conditions and forecast housing market recovery.

Defining Characteristics

1. Demographic Growth

Incredible demographic and employment growth, retiree and second-home appeal, a resort atmosphere and limited land availability underpinned market opportunity. Las Vegas population growth averaged 5.2% annually and fell below 3.5% only twice (2.7% in 1985 and -0.5% in 2008) between 1971 and 2008. Comparatively, U.S. population growth averaged 1.8% during this period. Strong economic expansion in gaming/hospitality, construction and services fueled this demographic growth. The market had negative employment growth only twice since 1971, with -0.8% in 1982 and -1.0% in 2008.

Figure A: Annual Population and Non-Farm Employment Growth, 1971-2008



Sources: U.S. Bureau of Labor Statistics, UNLV Center for Business and Economic Research (CBER)

2. Hospitality and Gaming

Las Vegas’ economic vitality is predicated on growth in the hospitality/gaming industries. Between 1971 and 2000, gaming revenue averaged 11% annual growth and never declined until 2001-2002, when year-over-year growth fell to 0.5% following the events of September 11th. Since 1970, inventory expanded by over 115,000 hotel rooms, with 55,000 built since 1993. These properties frequently achieved occupancy rates above 85% and averaged close to 90% between 2004 and 2007. The hospitality/gaming sub-sector supports 220,000 jobs in the market, or approximately 20% to 25% of the workforce. The broader leisure/tourism sector encompasses over 270,000 jobs, or 30% of the workforce. Casino-resort development through the 1990s supported this fundamental industry; however, as new hotel deliveries slowed post-2001, the region’s economy grew robustly due to a housing-inspired boom.

3. Second-Home and Retiree Buyers

The impressive demographic growth above does not factor the impact of part-time residents. Las Vegas' relative affordability, proximity to major metropolitan areas, ever-expanding amenities and burgeoning international allure attracts second-home buyers to its housing product. This activity was not new to the housing boom of the mid-2000s. As a share of its total new home sales, Las Vegas routinely captured 30% to 40% more second-home and investor buyers than Phoenix, Orlando or the U.S. dating back to the mid-1990s.

Out-of-town second-home buyers represent approximately 30% of the second-home and investor sales. The remaining 70% includes investment purchases of rental units - always demanded in a rapidly-growing market - and true speculators. A high share of speculator buyers is assumed post-2002, when price appreciation reached double-digits and the increased activity in the subprime loan class. Despite the over-inflation engendered by amateur speculators, true second-home investment is an important element of the Las Vegas housing market and supplements the greater economy.

Retirees historically migrated to the desert for lifestyle, affordable living and climate. Themed AACs have at times captured as high as 10% of new home sales. Though smaller in scope than Phoenix's AAC offerings, Las Vegas communities such as Del Webb's Anthem Las Vegas and other developments proved amenitized, master-planned 55+ living successful.

4. Land Constraints

Developable land availability is limited in the Las Vegas valley and provides contrast to Phoenix's boundless growth. Land supply, together with water cost and availability, are important components to the relative higher density of newer-built product and strong competition among developers that lead to elevated land values even during normalized economic periods. Federal land control, coupled with the insistence of the gaming industry to remain concentrated around Central Las Vegas, also guide land market dynamics.

The factors above positioned Las Vegas as a desirable and affordable growth market throughout the last six decades. As with many fast-growing markets during the early 2000s, positive fundamentals gave way to an unsupportable bubble.

For-Sale Housing Supply and Demand Conditions

1. From Housing Bubble to Bust

The Las Vegas housing market became over-inflated like many markets in the United States. Volumes were not supported by fundamental demographic growth and conservative second-home assumptions. Affordability was detached from traditional metrics as buyers were attracted by seemingly limitless appreciation and exotic lending instruments. Investors, who were always a component of the market, were increasingly drawn to Las Vegas in larger numbers given its relatively low cost of entry and attractive demographic and economic story. Builders responded to the increased demand by delivering large numbers of units, in both traditional suburban and transitioning urban districts. New home prices appreciated a cumulative 87% between 2001 and 2005, pleasing builders, banks and consumers.

The housing bust ignited the current U.S. recession, which coincidentally, has assumed a role as housing's main obstacle to its recovery. Current sales, price and economic performance reveals a market struggling to find traction.

Figure B: New Home Sales by Second-Home and Other Investment Buyers, 1997-2008

Year	2nd Home/Investor New Sales			
	Las Vegas	Orlando	Phoenix	USA
1997	39.9%	13.7%	38.2%	24.2%
1998	43.4%	15.3%	15.5%	23.8%
1999	37.9%	14.0%	19.4%	23.1%
2000	26.9%	18.2%	21.9%	19.8%
2001	24.6%	14.6%	19.0%	17.3%
2002	25.8%	15.7%	15.4%	18.7%
2003	34.3%	21.3%	20.5%	19.6%
2004	42.8%	21.5%	29.0%	22.1%
2005	42.5%	30.6%	31.7%	25.3%
2006	38.4%	36.9%	28.4%	25.1%
2007	33.2%	33.0%	29.9%	22.0%
2008	25.8%	23.7%	25.4%	18.3%
Averages:				
97-08	34.6%	21.5%	24.5%	21.6%
97-01	34.5%	15.2%	22.8%	21.6%
02-05	36.3%	22.3%	24.1%	21.4%
06-08	32.5%	31.2%	27.9%	21.8%

Source: MDA Dataquick

2. Sales Rate

New home sales reached 45,000 at the peak of the housing bubble in 2005. Between 1996 and 2001, sales barely deviated from an average of 24,000, illustrating the swift run-up to the market's apex. Current sales are at historically low levels given macro-economic disruptions to U.S. output, frozen credit markets, employment and population declines creating poor consumer confidence.

Approximately 7,100 new home units sold over the last 12 months ("LTM"). TCG excluded Central submarket high-density product – the vast majority of which are hospitality-related condotel uses - from the mix to clarify traditional single-family and townhome performance. Interestingly, removal of such product from the mix results in a higher sales volume of 7,650 due to over 900 cancellations from mothballed high-density projects. The net condo sales over the LTM period are negative. New home sales volume is 79% down from peak 2005 sales and 68% down from normalized 1996-2001 conditions. Resale volumes follow a similar trend. LTM resale transactions of 28,000 are down 60% from peak.

3. Supply

The available oversupply presents downward price pressure until absorbed by the market. TCG estimates 37,000 units of competitive new home supply are currently available. Competitive supply is defined as standing inventory, lots in actively marketed new home communities and recently-built available and projected foreclosures. Available and projected foreclosure inventory built since 2003 total 7,600 units, or 20% of overall supply. High-density units - including flats in high-rise and mid-rise configurations and condotels - are not included in the supply figure and total another 11,000 units. TCG's inventory assessment also excludes projects that re-position as rental units by the developer.

Current resale listings total 25,000. The inventory represents almost 12 months of supply at current sales rates, double the commonly-accepted six month equilibrium. Over 9,300 excess resale units are projected by UNLV's Center for Business and Economic Research ("CBER"). These units are vacant above the market's structural occupancy. According to CBER research, an influx of 23,000 people is required to fill these units at a market standard population/household ratio of 2.5.

4. Prices

Same product new home prices have fallen 40% from peak, with much of that decline over LTM (-32%). New home sales prices have reverted to 2003-04 levels, with an average of \$272,000. Builders are listing single-family units in attractive communities for as low as \$100 per square foot, a figure with very little profit margin, if any.

Foreclosures represent a major source of competition. Bank-owned properties are 75% of total existing home sales, much higher than the U.S. average of 20%. Consequently, resale prices are down 30% from peak.

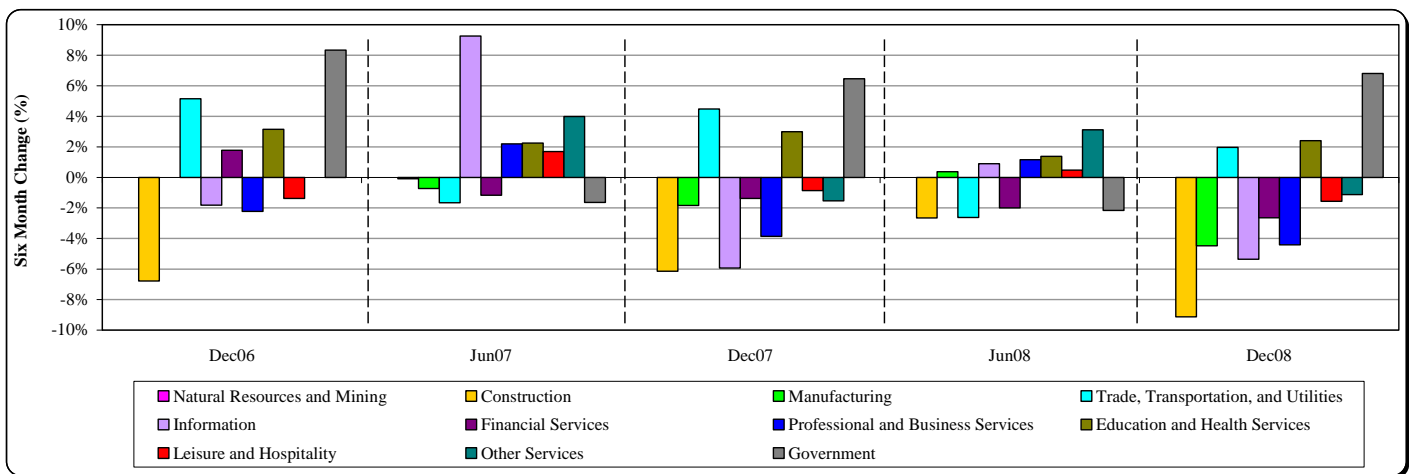
The threat of future foreclosures continues to depress pricing. Forty-seven percent of Nevada mortgages have negative equity. Las Vegas mortgages represent 75% of the state total. Distressed sales, many of which are located in the same community a builder is actively marketing a new community, are attractively affordable. Positive for demand indicators, realtors and builders report investors and first-time homebuyers re-entering the market. It remains to be seen how President Obama's mortgage relief and economic stimulus packages will affect the foreclosure situation.

5. Demand Drivers

The recession interrupted Las Vegas' exceptional record of unparalleled population, jobs and gaming revenue growth. 2008 represented the first year since 1982 with year-over-year negative job growth (-1.1%), the first year since at least 1970 with negative population growth (-0.5%, or a loss of 10,000 people) and the highest year-over-year gaming revenue drop (-9.9%) since at least 1970.

Negative employment growth began as far back as mid-2006, when construction employment peaked at 115,000 jobs, or 11% of the labor force. Starting in 2006, TCG tracked jobs lost by industry from peak to present. Over that period, construction losses capture 44% of all Las Vegas job losses. Jobs in the Professional and Business Services sector, strongly correlated to swings in population, represent 26% of lost employment. While possible that employees in these fields regained employment in another industry, the loss of jobs and resultant change in employment composition likely triggers multipliers that can add to cut-backs in other service-based sectors including retail.

Figure C: Employment Growth by Industry, June-06 to Dec-08



Source: U.S. Bureau of Labor Statistics

Las Vegas' hospitality/gaming establishments are harmed by economic troubles locally, nationally and worldwide. Fewer visitors (-4.4%) are choosing Las Vegas, whether they be convention-goers (-5.0%) or leisure travelers. Several airlines with major Las Vegas service have cut routes to McCarran International, some due to a close of operations and others from general economic and fuel concerns, leading to a 7.6% drop in passengers. Fewer cars are crossed the State line in 2008 (-5.3%), likely due to high fuel costs through the first half of 2008.

Hotels are responding to a drop in occupancy (-4.8% to 85%) by cutting prices (RevPAR down 10.0%). It should be noted that all is relative in Las Vegas; national hotel average occupancies are closer to 60% in top locations. Gaming revenues are down 10%, as mentioned above, but have shifted over the last ten years to represent 40% of average hotel-casino revenue. The 60% majority characterizes the diversification of the Las Vegas experience to non-gaming activities; making it more susceptible to this economic crisis than past downturns. As visitation mix shifts to more resort-oriented non-gamers and gambling excursions can be had locally - gaming is now available in 48 states, albeit on a much different scale - in the face of a nasty recession Las Vegas trips may be cut in favor of household expenditures or other vacation destinations. Despite struggles, hospitality employees are highly unionized and wholesale staffing cuts may be difficult.

The loss of jobs and population, together with struggles in gaming and hospitality, impair the demand catalysts necessary for a housing recovery. The market can not recover while it continues to lose jobs and people. Available units can not be occupied when households are leaving the market or are unemployed. Its largest industry can not be struggling, particularly with significant deliveries planned from 2008 through 2010. TCG's forecasts isolate and conservatively assess future performance of these demand drivers to build to a housing recovery.

TCG Market Outlook

The following methodology was utilized to predict key recovery milestones.

1. Forecasted annual new home demand was two econometric models:
 - a. Base demographic growth from published sources, qualifying with conservative homeownership, turnover and affordability ratios; and
 - b. Employment, household growth and housing need forecast assuming historical multipliers (new hotel room x 1.5 employees spread over three year period) from near-term hotel/gaming deliveries.
2. Assessed current inventory levels:
 - a. By product type, cataloged competitive new home supply, including standing inventory and available lots in active communities and recently-built foreclosures; and
 - b. Supply outlook versus demand projections.
3. Forecasted prices to reach normalized affordability levels.

1. Recovery Definitions

TCG's forecast identifies two key recovery milestones:

A. Land Market Recovery: When competitive supply reaches 12 months, the normal cycle of finished purchases by builders from land developers will likely restart. Builders, gaining confidence from increasing absorptions and manageable overhang, will begin acquisitions for future development. This land buying will signal a key inflection point.

B. Housing Market Recovery: TCG defines housing market recovery as one sale per week per project combined with single digit price appreciation. While overall absorptions will recover earlier (even with supply overhangs), price appreciation will not likely begin until inventory levels are six months or less. Assuming additions of some months of supply from competitive foreclosures especially from mortgage (Alt-A) resets and selected planned and proposed projects, TCG pegs this recovery to when the currently available supply balance is eliminated.

2. New Home Demand Projections

New home demand recovery will be a major element to drive market recovery. TCG examined two models to forecast structural demand.

A. Demographic Growth Model

TCG utilized published employment projections, structural household growth, turnover and obsolescence. TCG also used conservative financing assumptions to adjust for the tightened credit market. Within this framework, TCG projects long-term Las Vegas new home demand potential for 23,500 units annually. A conservative 10% second-home uplift (non-speculation buyer) is included in this figure.

This projection is based the creation of 115,000 new households, or an average 3.3% annual growth assumed over the next five years; lower than all years since 1970 save for two. TCG qualified for percent own versus rent, percent buy a new home versus a resale and income ratios.

For milestone forecasts, TCG used a "blended" demand number, assuming the current run rate for the next 12 months followed by a "recovery" rate below structural demand levels for 24 months until the employment and foreclosure situation normalizes. The blended run rate assumes macroeconomic and credit issues will keep demand at current levels in the near term. However, since intrinsic household growth would support significantly more sales and some positive credit market impact is likely from various relief programs, 2010-11 sales are expected to growth from 2009's bottom in the direction structurally supportable levels.

B. Hospitality/Gaming Employment Model

The primary driver of the Las Vegas economy is the hotel/gaming industry. As such, employment growth is directly related to the net expansion of hotel rooms in the Las Vegas MSA. Hotel construction has been weak from 2002 through 2007, with 6,300 rooms, or 1,050 per year added. This activity is low compared to the 1990’s when 50,000 rooms opened, or 5,000 per year. Given their strong multipliers, the limited hotel deliveries over the past six years would suggest slow economic growth. However, the economic boom accompanying the recent housing market upswing likely had more in common with hyper housing growth markets such as the Phoenix metro and the general over-leveraging of the American consumer than significant net growth in Las Vegas’ fundamental industry.

Between 2008 and 2010, approximately 25,000 net hotel rooms are projected to open in the market, or approximately 8,300 rooms per year, a significant expansion from recent trends. Given financial and macro-economic conditions, it is highly possible some of these projects will be pushed-out, however industry sources project on-target delivery for the largest developments.

Employment generated in the year of delivery, as well as the years prior to and following opening, leads to a net gain of 82,000 jobs by the end of 2010. Some jobs will be filled by those currently unemployed. TCG normalized unemployment at 5.0% and adjusted down from the current unemployment rate of 9.1%. These new hospitality-generated jobs demand 41,000 new employees who require 33,000 housing units.

3. Current Inventory and Recovery Forecast

TCG projected Las Vegas market recovery dates in Figure D at right. As mentioned above, the competitive inventory figure combines currently available new homes/lots and recently completed foreclosures considered probable to compete with new inventory offered by builders. This overhang results from the 80% drop in sales volumes from peak and drives prices downward. As mentioned on the prior page, the “blended” recovery assumes published employment and household growth projections. TCG assesses these projections conservatively.

The “blended” model at right projects 4Q 2011 recovery. These assumptions exclude central submarket high-density product, which if added, extends the recovery by at least two quarters.

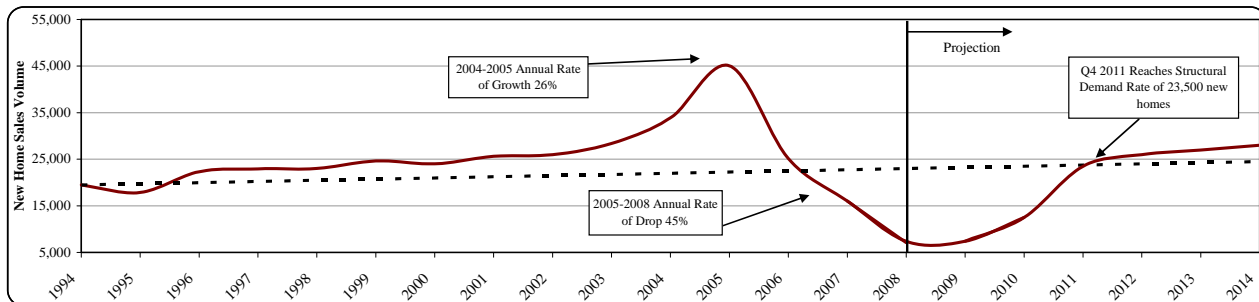
The hospitality/gaming growth model presented above assumes job growth and related household creation through the end of 2010. These net new jobs are assumed to absorb the majority of vacant unsold units to stimulate recovery. TCG considers this an aggressive case, particularly since the recession is projected to continue through 2009, possibly with harsher consequences for hospitality and generating additional job losses to be absorbed by the market.

Figure D: Las Vegas Recovery Projections

Factor	Market Total ⁽¹⁾
Demand	
LTM Sales	7,646
TCG Annual Demand ⁽²⁾	21,091
Supply	
Units Remaining	
SFD/TH	29,858
High Density	0
Competitive Foreclosures	7,588
Total Inventory	37,446 ⁽³⁾
Market Outlook Blended ⁽⁴⁾	
Months Supply	37
Market Normalization	4Q 11
Lot Sales Start	1Q 11

- (1) Excludes central submarket high-density product, the vast majority of which are condotels. Nets out over 900 cancellations during LTM at high density projects that were subsequently mothballed.
 - (2) Income Qualified annual demand potential for homes priced over \$190K; Demand excludes 10% for high-density buyers; Full Income Qualified Demand = 23,500 units annually
 - (3) Includes standing inventory and homesites in actively-marketed and recently-mothballed product. Also includes foreclosures built 2003-08 and projected future foreclosures assuming conservative foreclosure rates.
 - (4) Blended sales rate assumes LTM sales rate for next 12 months, mid-point recovery rate for 24 months, then projected full annual demand thereafter
- Sources: TCG, Hanley Wood, MDA Dataquick

Figure E: Las Vegas MSA Historical and Projected New Home Sales, 1994 to 2014



Note: Year indicates annual rate of new home absorption as of December 31st.
Sources: TCG, MDA Dataquick, Hanley Wood

4. New Home Price Forecast

Las Vegas affordability has overcorrected beyond long-term levels. The income to housing ratio ranged from 28% to 31%, averaging a healthy 30%, between 1993 and 2003. After 2003, however, the ratio increased to as high as 50%.

TCG projects an additional Las Vegas new home price decline of 5% to 10% before market bottom through the end of 2009. Though current prices are slightly below historical affordability levels, the combination of builders overcorrecting to move inventory without regard for profit, distressed/REO home sales, tougher lending standards and poor buyer sentiment will contribute to reduced non-distressed sales volumes and thus prompt sellers to continue to cut prices.

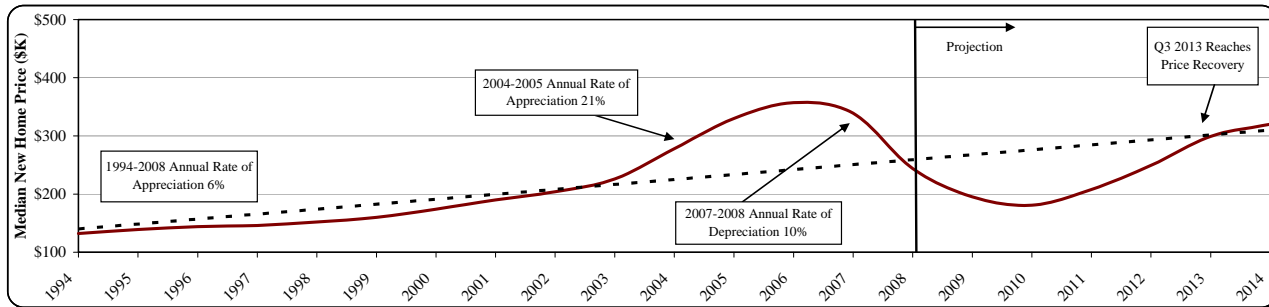
Sharp home price depreciation and lack of credit liquidity have eliminated land development's financial feasibility. Finished lots pencil at \$40,000, though are currently valued in the mid-\$20,000s, and thus are roughly \$20,000 in the red. Builders, too, are going to be underwater until the home prices increase enough to pay for the difference in land value.

Figure F: Long-term Affordability-Driven New Home Price

Assumptions	Values
2008 Avg. HH Income:	\$56,415
Current Avg. New Price:	\$244,000
Down Payment:	20%
30-Yr Mortgage Rate:	5.75%
Associated Points:	0.6
Income/Housing Ratio:	24.6%
'93-03 Avg. Affordability:	30.1%
Supportable Home Price Given 20-Yr Affordability:	\$300,000
% Change from Current:	23.0%

Sources: U.S. Census Bureau/HUD; The Concord Group

Figure G: Las Vegas MSA Historical and Projected New Home Price, 1994 to 2014



Sources: TCG, MDA Dataquick, Hanley Wood

5. Acquisition and Investment Opportunities

The current economic recession is creating opportunities for investment in the housing market. TCG is bullish about the long-term opportunities for new housing in the United States given the high demographic growth for an industrialized nation, governmental support for ownership and consumer preferences. TCG recognizes Las Vegas' long-term opportunities given its growth potential, the unique economic catalysts and natural barriers to development.

Depending on the region, the high volume of distressed assets, continued reduction in bid/ask spreads and possible overcorrection of home prices will allow for favorable deal conditions. These opportunities are predicated on liquidity in the capital markets. TCG employs a conservative valuation strategy that analyzes both liquidation and going concern assessments, with valuation driving off recovery dates that assume limited finished lot and no raw-land sales prior to recovery. In cases where the discounted cash flow value is above the market liquidation value, TCG identifies a possible favorable investment.

Specific submarkets present opportunities despite challenges to the greater region. For example, prior recovery cycles have demonstrated that absorption and pricing in master planned communities outperform stand alone development. Locations with proximity to quality schools, accessible leisure and entertainment options and diversity of jobs will also outperform recover timeframes. Submarket-level and product opportunity analyses will identify opportunities and constraints that diverge from the regional average.

About The Concord Group

The Concord Group is a leading real estate strategy firm with offices in Newport Beach, San Francisco and Boston. TCG's 40 consultants complete over 350 assignments annually in the U.S., Europe, Asia and Latin America. Our services include market and consumer analyses, transaction due diligence and asset valuation. Recent private equity assignments have included multiple analyses of distressed assets of commercial banks and new acquisitions for next-cycle development. We also continue to assist developer and financial clients on value maximization of owned-assets. We cover all property types (commercial, residential and land), in all metro areas and work under tight due diligence deadlines.

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