GlobeSt.com Commercial Real Estate News and Property Resource

Last updated: September 6, 2007 09:21am

Mission’s Chris Finlay

By Sule Aygoren Carranza

While some in the general market describe Mission Residential as a contrarian player, the leadership says the firm is anything but. Although big-ticket sales are occurring for trophy assets in major markets on the coasts, the company generally focuses on middle-market apartments in second-tier cities. Since its inception just a few years ago, Mission Residential has used its founders’ expertise and strong research arm to build up a significant portfolio that is on track to reach 10,000 owned units this year and another 9,000 units under management. Now that most apartment markets seem to be improving, thanks to a slowing single-family home sector and improving economy, expect further growth from the company. Christopher C. Finlay, the Vienna, VA-based managing principal of capital markets and operations (and Mission Residential co-founder, with David A. Wieland, managing principal of real estate and research), recently sat down with **Sule Aygoren Carranza**, editor of **Multi Housing forum** to talk about his views on the market, the company’s strategy and why he believes the company’s game plan to be one of the most successful approaches to investing in today’s market.

***MHf:* Let’s talk a bit about Mission’s strategy. Why don’t you agree with the word contrarian?**

Finlay: Our investment strategy is based on what we view as obvious macroeconomic and demographic trends. The period from 2001 to 2005 is what we define as the perfect storm for apartments--there was a low interest-rate environment driving the transition to homeownership and a relatively weak national economy that wasn’t creating a lot of jobs. Also, the demographic cohort at the time that had the highest propensity to rent, Gen X, was tiny compared to the baby boomers that preceded them. The combination of those factors was fairly catastrophic from an effective-rent standpoint across most of America, particularly Middle America. These markets had huge declines in effective rents, as much as 30% in some cases.

Our investment strategy is based on the recovery of these markets. We have a research group that is dedicated to identifying those markets that are showing the best potential for rent growth over the next five to 10 years. That’s largely a function of the recovery, but not entirely. The key here is that we’re looking for markets that are really showing positive effective rent growth--not just potential, but growth that's actually in place and we're seeing it demonstrated. That's why we focus on middle-market apartments.

The recovery from this perfect storm is really a function of the slowdown in the single-family home and mortgage market, job growth and the surge of population that's expected as some 81.3 million echo boomers enter the workforce over the next seven to 10 years. That profile tends to be a necessity renter, so they're not exactly looking for the high-profile amenities like concierge services--those apartments are too expensive. What we strive to provide is quality, well-located, middle-market apartments. They've got a lot of the similar amenities--tennis courts, exercise rooms, swimming pools, business centers--and are well-maintained, but most important, they're well-located and close to employment and entertainment. We generally focus on the value proposition, as opposed to having all the bells and whistles, because we think that's where demand is going to be centered.

***MHf:* What are some of the markets you focus on?**

Finlay: We look at markets that are poised for this recovery, so we pick out those markets that are showing the most robust economic growth and demand-driver increases for apartments. We're called contrarians because we're not investing in the large, coastal markets. Yet. When I look at the markets that are showing the most robust growth across the US, they're places like Dallas and Austin, TX; Charlotte and Raleigh, NC; Atlanta; Nashville. These markets are all exhibiting two to three times the national average in terms of population and job growth.

They're still infill markets and they tend to be in suburban areas where there's very limited available land for new construction and the construction costs are higher than for new acquisitions, so we're buying at a discount to replacement cost. On top of that, a lot of these markets have very limited new supply. And last, the relative value of buying in Nashville or Charlotte is significantly better than buying in Manhattan, Boston or Los Angeles. The cap rates are 100 to 200 basis points wider in these other markets. So when we put all of that together, it's a smart investment choice to go into markets where we're getting better relative value and better going-in cash flow and where we're seeing better growth in demand, apartments and jobs.

***MHf:* Do you find the competition in those locations is less intense than in other markets?**

Finlay: The competition is intense right now for quality apartment acquisitions, period. There's no question there's a lot of capital out there chasing deals, and it's not just private buyers like us, but institutional buyers that recognize the benefits of middle-market apartments in these second-tier areas. Despite the fierce competition, cap rates are still higher in these markets than on the coasts.

MHf: **What's your average investment?**

Finlay: Our average acquisition is about $20 million, or $265,000 per unit, for the property, and our communities are generally around 300 units. However, we are looking at some larger acquisitions these days as well.

MHf: **Do you tend to perform any upgrades on the assets you buy?**

Finlay: It depends on the property. Our assets range from being built in the mid-1980s to 2003 or 2004. For a newer property, upgrades are less necessary. But for the 1980s-vintage properties, we actually have a program where we go in and routinely do everything from upgrading signs to the more visual, branding component of our business. We also paint a lot of properties, replace and repair siding, and we have an interior upgrade program as well. That really becomes a function of where the market is, where the property is relative to the market and whether there's an opportunity to recover costs for these additional upgrades. But generally, we're finding that the markets are so heated now that those upgrade programs are more warranted across almost our entire portfolio, but especially the vintage properties.

MHf: **What is your investor base comprised of?**

Finlay: They're all individual, high-net worth individuals. We have some investors who are real estate savvy and some who aren't. They cover a broad age range as well. We really cater to the individual investor who's looking to invest in quality real estate that's managed by an institutional-quality property manager, and someone who takes an institutional approach to investment management for real estate as well. The individual investor has limited options these days for investing in real estate, but real estate is a great area for individuals to be investing in.

MHf: **Mission's a private firm, but there's been some talk lately about the opportunity for private firms to go public in one way or another to increase their access to capital. Is that something you'd consider?**

Finlay: We're always evaluating the opportunities out there. Clearly the public REIT marketplace is shrinking, but having said that, there's still ample capital available on the private side and there are certainly advantages to being a private company right now in terms of being nimble and growing your business. The ability to be a public REIT is something we continue to evaluate, but no decisions have yet been made. At the end of the day, we serve our investors first and foremost, and we have to evaluate whether the public route best serves them. And if we think that liquidity and transparency is a benefit to them and will get them better long-term returns, that's a direction we will go.

***MHf:* For a firm its size, Mission has a very large research component. Why do you place such emphasis on research?**

Finlay: To us, research is a key requirement of the business. We manage investments for players who are placing significant amounts of capital into our properties, and we feel that we're obligated to utilize the best possible information to make investment decisions.

***MHf:* How do you feel about the slowdown in the mortgage market and single-family home sales? Do you think this will help apartments, as many believe, or ultimately hurt the economy?**

Finlay: In terms of the slowdown in the mortgage and housing markets, we've got approximately nine months of for-sale inventory in the market right now. We're not at the bottom; we think the bottom is a year or so away and I don't think we'll see a recovery until 2009 or 2010. The worst isn't here yet. I do think this will likely push us into a recession, simply because of the amount of liquidity that's been pulled out of this market and how much consumer consumption has been driven by refinancing. We view a recession as a probability and we think there will be a continued difficult period in the housing market.

Having said that, people have to live somewhere. As the economy slows, there's still going to be a huge surge of the population coming into the workplace and there are 16 million new immigrants projected, so there is going to be additional demand. The question is, where is that demand going to go in the housing spectrum. Frankly, we think the demand is going to be in middle-market housing, so that's why we're focusing on that. There will be demand for that product type regardless of a recession, and if there is an economic slowdown, the demand will only increase for those assets.