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Lee-Wen: Austin real estate market hot but frothy

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Austin Business Journal by Cody Lyon, Staff writer

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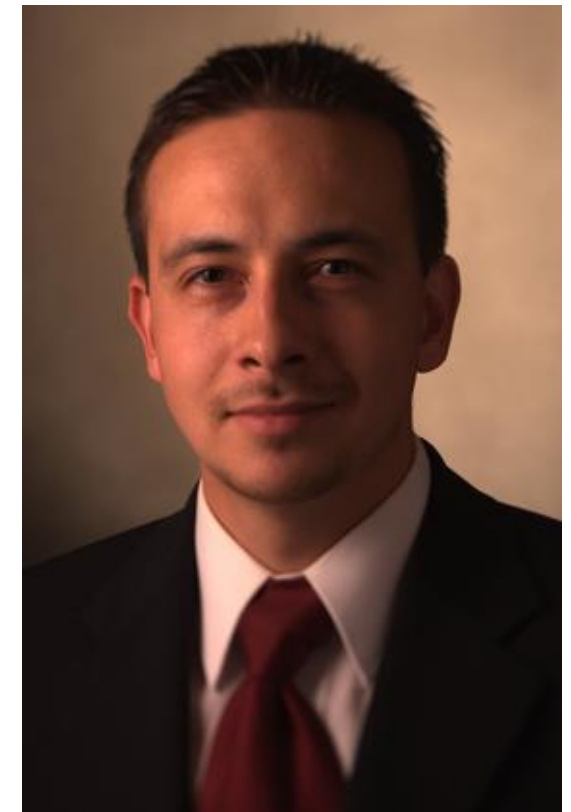
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Austin-based The PPA Group ranked No. 11 on *Inc. magazine*'s 2010 fastest growing real estate companies nationwide, with more than \$200 million in commercial real estate acquisitions across the U.S. Founded in 2005, the company has diversified into new markets and has worked with strategic partners to acquire commercial property.

Last night, I caught up with [Monte Lee-Wen](#), the company's president and chief executive officer to pick his brain about the state of world's economy, where investors should put their money and his thoughts on the Austin market.

ABJ: We keep hearing about financial uncertainties in the Euro zone. From Greece to Italy to other countries, there's been worry of a domino effect that could impact the U.S. economy. How concerned should we be about events in Europe and does this present American real estate investors with an opportunity?

Lee-Wen: We should be concerned with the events taking place in Europe. There is the potential of significant damage to the U.S. economy and major concerns that it could derail our economic recovery. I see U.S. exporters and banks as being the most at risk. U.S. banks have a lot of exposure. They are essentially tethered to European



banks and are exposed as a result of having billions in loans to European nations. America's largest financial institutions have billions in credit risk to the five most imperiled European nations: Greece, Portugal, Ireland, Italy, and Spain.

Weak growth and unsustainable sovereign debt in the Euro zone could impact the United States in several ways. First of all, credit exposure to U.S. banks could result in a greater tightening of credit and higher unemployment. This issue should be on the radar of investors as a potential risk to the cost and availability of credit. Secondly, it is a potential threat to U.S. exports. The worry is that this crisis could lead to a broad recession that could dampen the appetites for U.S. products. Finally, the Euro zone is the biggest market for U.S. companies with direct foreign investment. As a result, U.S. companies are exposed to potential losses. If U.S. institutions sustain losses from the Euro zone crisis, it would almost certainly impact growth in the American labor force.

Uncertainty is the big fear factor right now and because of this there are still many investors sitting on the side lines, afraid to risk their capital. There is a silver lining in all of this though. The economy is still weak and the markets are volatile. You can't turn on the television without hearing almost prophetic warnings about the global economy. However, capital is shifting into commercial real estate investments and low interest rates are bolstering investor confidence. Investor sentiment seems to be on the rise with an increasing bullish outlook across all property types. The bottom line is that there is capital available for the right deals and interest rates remain very low.

ABJ: How important is money from outside the United States to the domestic commercial real estate market?

Lee-Wen: Foreign capital tends to be pretty important. However, most foreign capital tends to gravitate towards high profile markets such as New York, Washington D.C., and San Francisco. Office buildings and high profile retail centers have traditionally been more of a focus for foreign investors. It is currently not a major factor for multifamily, although, earlier this year we did see significant foreign capital pursuing class A residential high-rise opportunities in the Miami area.

ABJ: Right now, where is PPA engaging in the most activity? Why?

Lee-Wen: Currently we are primarily seeking multifamily investments, so we are actively engaged in markets where we see growing apartment fundamentals. Current and perceived job growth is a major consideration of ours. We also actively watch markets that have bottomed out and are recovering. Some of the markets we are doing business in are Texas, North Carolina, and Florida.

ABJ: What is the secret to effective, profitable property management?

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Lee-Wen: Successful property management begins with an active partnership between the property manager and the owner. There needs to be a business plan in place and adequate capitalization to ensure the success of the plan while preserving the physical asset throughout the investment lifecycle. This plan must be clearly communicated and understood by the property management team. A consistent review of progress and performance is an essential part of this ongoing relationship.

Additionally, having the right team in place is key to ensuring the successful execution of a business plan and the profitability of the investment. An effective team will stay on top of rental rates and concession by regularly examining the competitive market, while balancing expenses and asset preservation. Creative methods to improve the bottom line should be developed through a collaboration of the stake holders and then implemented at the site level by a competent team with effective leadership. The owner should learn to be an effective asset manager, holding their property manager accountable and verifying the successful implementation of solutions. Once implemented, the results should be measured to gauge the overall impact.

Finally, the success of a project will rise or fall on leadership. A successful property management company will establish clear, measurable goals for onsite personnel and create an environment that fosters accountability. Training, operational and maintenance standards, and setting expectations are very important in the development of good on-site personnel. It is also important not to sit on poor performance. In multifamily, poor on-site management can ruin an investment very quickly and it can take three times longer to turn it around. Changes to an on-site team should be made quickly if competency or performance becomes an issue.

*ABJ: What are the
safest commercial real
estate sectors and
demographic sites for
investors to put money now?*

Lee-Wen: In my opinion, multifamily in high growth corridors with real job growth is probably the safest bet. Multifamily fundamentals seem to be on a solid growth trajectory and the lack of new supply has been a major contributing factor. We tend to stay in mature markets or markets showing strong signs of growth. Venturing into smaller markets may be attractive for investors looking for opportunities, but access to credit is much tougher.

As for particular assets, we see B class apartments as some of the safest assets to buy. Fundamentals in this class have been strong and we do not have to deal with some of the tenant-related issues that affect C class properties, especially in today's economy. As for A class properties, buyers will pay a premium. They will also have to compete against institutions that are willing to invest for a much lower rate of return than what non-institutional buyers are willing to stomach. It is tough to compete in that arena.

An area to be cautious with is C class apartments. Due to economic conditions and its overall impact on low-income wage earners, we see increased risk in C class apartments. In general, we see lower income areas lagging the growth in fundamentals. We have seen an increase in credit issues, delinquencies, and crime in lower income areas. Being very well capitalized is important and it takes an increasingly experienced owner and property manager to succeed in this asset class.

ABJ: What are your observations on the commercial real estate market in Austin?

Lee-Wen: Austin is, undoubtedly, on a very strong growth trajectory. We have a comparatively strong and growing economy that has created a very attractive environment for real estate investment. We see signs of renewed development activity with a good number of new projects planned for delivery over the next couple of years. I do believe that the Austin market is strong enough to absorb what is currently in the pipeline and that financing and underwriting constraints will continue to limit the speed and delivery of new supply.

We see this market as a little too frothy, though. Our hot real estate market has attracted an abundance of investors seeking real estate investment opportunities. There are now too few opportunities available for the amount of capital chasing deals here. The result has been a significant compression in cap rates.

Although the Austin market should be able to absorb new supply over the next couple of years, we have concerns with long-term stability. In the past, Austin has not exhibited stability over long periods of time. There have been big swings in the market with pronounced and often lengthy downturns. The supply side needs to be watched here, as we tend to over-build. Development can easily get out of hand if construction capital becomes more readily available in the future. Unfortunately, overbuilding is characteristic of all of the major Texas markets.

Residential, commercial real estate