EPISODE 334

[INTRODUCTION]

[00:00:00] ANNOUNCER: Welcome to The Real Estate Syndication Show. Whether you are a seasoned investor or building a new real estate business, this is the show for you. Whitney Sewell talks to top experts in the business. Our goal is to help you master real estate syndication.

And now your host, Whitney Sewell.

[INTERVIEW]

[00:00:24] WS: This is your daily Real Estate Syndication Show. I'm your host, Whitney Sewell. Today, our guest is Alan Lewis. Thanks for being on the show, Alan.

[00:00:32] AL: Hey, my pleasure. Excited to be here. Thanks, Whitney.

[00:00:34] WS: Yeah. I'm honored to have you on the show. I know we've had some conversations and I know you're a perfect guest just from your wide range and just very thorough experience in this industry. But a little about Alan, he's a chief investment officer and co-founder of DiversyFund, a financial tech startup dedicated to providing everyday Americans with the same investment opportunities as the wealthy. He's earned his law degree from Columbia and spent nearly a decade working as a corporate lawyer and investment banker on Wall Street.

In 2014, he transitioned to real estate development, focusing on multi-family and master-planned residential developments. In 2016, he co-founded DiversyFund with his partner, Craig Cecilio, to pursue his goal of democratizing and wealth-building through making alternative investment accessible to everyone. Alan has worked on transactions totaling and now create over $41 billion.

Well, Alan, thank you again for your time. It's been a pleasure to get to know you a little bit. I'm looking forward to this interview. Tell the listeners a little more about who you are, and let's dive in.

[00:01:35] AL: Sure, yeah. I mean, I'm a simple guy. I grew up in the Midwest in suburb Chicago and was the oldest of six kids. My mom was a stay-at-home mom, busy keeping us out of trouble for the most part. And my dad was an ice cream taste tester. He worked for Duggar and Häagen-Dazs and Ben & Jerry's. A little bit of everything, which is quite interesting in a career. What I realized when I went on to law school at Columbia in New York was just this whole new world. Fellow students who are trust fund kids and who had parents who had wealth that I couldn't even imagine.

It was a big eye opener to me to go from there to having clients such as a young attorney and investment banker who were private equity firms, making hundreds of millions of dollars. I just realized there was a whole different set of rules when it came to building wealth that my family didn't know about. And so it was really my mission to like, okay, I have to figure out what these rules are.

And then more importantly, start taking action to make changes in my life so that I could start participating in those same wealth-building paths." And the commercial real estate, cash flowing real estate is one of the obvious ones. So a lot of us have gotten into, and it's been a great, great fit.

[00:02:47] WS: Nice, I pretty much didn't hear anything after your dad was an ice cream taste tester. It's an amazing job, isn't it? Now, that's awesome. But you noticed these things, and then you determine how to take actions to realize that for yourself as well. That's incredible. But today in this business, what is your specific focus and what are you doing in this business for today every day?

[00:03:13] AL: At DiversyFund, we started this company and our big goal is just to create an online investment system so that people can into the website with an SEC qualified REIT and structures of REIT for tax purposes and that fund invest in multi-family cash flowing, multi-family value at properties. And we have a very little minimum. It's just $500. So someone can start with

$500, and all of a sudden be invested into a portfolio of cash flowing real estate. And so that's been a big part of our mission is just to completely equalize access so that no one has an excuse anymore. Everyone can get started with real estate.

One the other side, and this is not in our website, but I work with some of our higher network investors who want to be part of a syndication directly into one asset. Instead of going through a fund structure, we have some investors who are writing bigger checks who say, "Look, I just want to invest in this 200-unit apartment deal in Dallas, this 300-unit deal in Austin." We're doing a lot of deals in Texas right now because we like those markets." So I'm working with those and having conversations and even work with some of our family office partners and then institutional partners that want to write the whole check as a limited partner in going through that process.

[00:04:24] WS: So doing this business, you're having these calls with investors just all the time. I loved how you used – I mentioned this before we started recording to your unpacking the complexities, so they're comfortable writing checks. They're comfortable with the knowledge, gaining this knowledge that you're able to give them about real estate and why it's important to own real estate and helping them build that wealth that you were even talking about in the beginning that you learned as well.

So I'd love to dive into that a little bit and how you unpack that complexity. So when the listeners or myself are talking to our investors, we can be at that same level you are and really understand how to speak to them in a way that they are comfortable writing the checks. They are comfortable with this investment and that we're being as transparent as possible.

[00:05:06] AL: Yeah, and that it really depends on the investor and where they're at. If you're working with a very new investor, you may have to start all the way at the top, which is the story of cash flow and real estate. Here's why we like it. Here's why it's a low correlated asset. You don't have to deal with the stock market volatility. Here's why there's some of the tax advantages with depreciation covering your rental income coming out of the asset and so that you may have to start at that level.

But for someone who's now ready to get involved in commercial real estate and they're looking at you as a sponsor, they're looking at you and a particular deal, a particular market. Then at that point, I really like to help them walk through, “Well, how do I look at the deal? How do we get comfortable with it,” and really go through the story of how we found the deal, why we like it, what are concerns are. I think investors really want to see, “OK, help me see the upside. And that's the easy part. Now, help me understand the risks and how we’re going to mitigate them and deal with them.”

And I think having a balanced story really helps you establish that credibility. So if I'm in a tertiary market and there may be some risks as far as occupancy rates go, I really want to get into the story of the comps. Here's a comp that’s crossed the street, and here’s how it’s performing. And we went and visited it, and here’s what we saw. And here’s where we think we can duplicate their success. And here’s why we think we can match their rent per square foot and really go through exactly how we think about our asset.

And the other thing too I found is a lot of your new investors have what I call analysis paralysis. They don't know what they don't know. So if you have all this information, they just don’t even know, “Well is this enough? Should I be doing twice as much due diligence?” Then there are four other secret questions I should be asking. So as I kind of walk on through like, “Here’s I look at comps. Here’s how I look at pro forma. Let me help you understand why we think you’re looking at the IRR.” And the cash on cash yield, withholding, and the equity multiple are the three big economic drivers on return that we focus on.

Then the other thing too I think is a lot of investors don’t want to admit what they don't know. No one likes saying, “Hey, can you explain it to me? I have no idea what you’re talking about.” So I just always check in with them as we’re having a conversation, “Hey, as we’re talking about this 18% IRR net to investors, I assume that you heard it before, but happy to go through that. Would that be helpful if we can walk through that?” Mostly will say, “Yeah. If you won’t mind going over that again and kind of walking me through the details.” Even if they’re really familiar with it, it’s still good to have a refresher and have that conversation.

[00:07:39] WS: I think one of the first things you said there was so important too. You said it depends on where the investor’s at. And I think you have to be listening closely, so you can understand. Do they have some experience, do they not? Where are they at, like you mentioned? So you know how to share this story. You don't want to insult them, but you do want to be as transparent and explain those details, so they are comfortable with investing in that deal. As far as developing the story or – I want to back up though. How do you understand where the investor's at? Maybe what are some questions that you lead into when you're in that conversation, so you can understand exactly where they're at?

[00:08:13] AL: Yeah. And then that's exactly it. If you want to know where an investor's at, you just have to ask. And it's that simple. I know sometimes people are little gun-shy and feel like, "Okay, if I'm just having an initial conversation with the semester, it's probably too early to start asking some personal questions about past investments." And I don't think that's the case.

I've always found investors this point are talking to you about a particular deal. And I think they understand that it's a very frank conversation about what they're comfortable with and what they've done in the past. So I'll just ask and say, "Hey, help me understand so that I can do a better job, presenting this deal to you and focusing on things that are relevant to your questions. Help me understand what you've done in the past. Have you invested in real estate before? Have you done your own vacation rentals, fix and flip? On the residential side, have you ever invested in an apartment building? Tell me about that deal."

Then what will happen is they'll tell you their story. And if they've had a deal gone wrong, that's super helpful because now that's a concern that you have to overcome. So if someone's invested and done fix and flip and had a terrible experience, I want to make sure I help understand why that went wrong and what the difference is here so that they're not worried about dealing with the same issues.

So it's really helpful to hear about their deals gone wrong and then help them to see why this is a different scenario and how we dealt with those risks and don't expect to have the same issues.

[00:09:35] WS: That's awesome. Now, again, it's asking good questions to mean you're a good listener, isn't it?

[00:09:35] AL: Yeah. And people really are willing to share. And I'll even ask them just to help me understand kind of where you're at in your investment's profile. What's a typical size of check that you tend to write for a real estate deal, if they've invested in real estate deals before. And people will tell you. They're like, "I'm at 50K or 100K or I start with 25K for a new sponsor." And that gives you a lot of information that's helpful for both sides.

[00:09:35] WS: In developing the story, I've heard numerous people talk about you have the story. Your property has a specific story and you got to develop the story when – What does that look like to you or when you're talking to an investor or maybe even the story about you all's company or the story about the property? What are some things we should think about when developing our story or property-specific story?

[00:10:18] AL: Yeah. I think this story covers three main areas. They have to like you as a sponsor, so you got to tell you story as a sponsor, why you're doing this, what you've done in the past, what your internal team looks like. Then you go to the asset itself, the story behind the asset, and then the market it's in. The story behind the market and why you like it and why you think it's a good place to be investing money both short-term and long-term, depending on the whole period.

So I think in each of those, the sponsor story, you really start telling the same story every time. So you want to make sure you're trying to keep that story a little fresh. But with the asset story, I think it's starting with, "Hey, here's how we found the deal. It's an off-market deal or we are bidding against others. And here is, we are on the road with this price and we want the highest price, but they had confidence in us that we could close. So that's why we got the deal and we're still happy with the price we got."

And then the market, I think this is a really challenging one for people who are outside the state. For example, we're doing a lot of deals in Texas. So, if I'm talking to an investor in Texas about a Dallas property, I don't have to really talk about the market like, "Yeah, I'm living in Texas. I see the headlines, so I know it's a great place to be." I may have to spend a little time in that particular city. I mean it's a tertiary market. Here's the occupancy rate. We went toward the comps. For example, as an investor, we toured the comps, and all three comps had 100% occupancy. And with it, too much waiting list for the property manager.

I just tell them that, “Hey, we picked up the phone. We walked in the door.” They like to hear that. So you can kind of take them along with you on your due diligence journey and really help them to see what you see on the lens you have on the deal. Then at that point with the market and the deal, it’s helping them understand the opportunity. For example, if I'm showing people pictures of the class C plus building, a lot of investors don't see opportunity. They see a beat up old building that needs a lot of help. And we help them to see, “OK. Now, here's a picture of what we are expected to do on the renovation side.” And we’ll be able to take it from a $500 rent a month to, say, a $600 rent a month based on the comp across the street that just did a revelation a couple years ago. And I know I can match those rents, if not beat them.

So now, you’re helping them see opportunity in the ugliness of an asset, in a neglect of an asset and the fact that it's been mismanaged by a team that it's not leased up as well as it could be. That there's a loss to lease factor on the current rents even before you renovate and really helping to see each of those opportunities to the story you tell.

[00:12:55] WS: Incredible. So a story so important, and I appreciate, you’ve elaborated so well in all of those points, and even seeing how they see it like yeah. They don’t know how to see the value at first, do they? They don't understand – Like you said, they see this beat up building, and they're probably going to run from it. They don’t see the value there or the opportunity.

Are there any other ways that you are educating investors maybe outside of that first call? Now, you told your story. We’re talking it. We’ve told them about the property, the team, the market. What are ways that you’re educating them after that first phone call?

[00:13:28] AL: Yeah. I mean, we’ve made a big investment into social media content and just content on the website. So we’re doing whether it’s a blog post or record videos where we just do just a real estate 101, where today, let’s talk about for five minutes what’s a cap rate. How do we use a cap rate? How do we understand the cap rate? And these are terms that a lot of investors that heard time and time again. And they kind of know what it means but not really.

So if you can be successful at taking a complex term and repackaging it in terms that are accessible and understandable to an everyday investor who's not a professional real estate investor, that helps you really earn some credibility with them, because now you are positioning yourself as an expert who not only understands the stuff but can make it accessible to investors. They can overcome some of those fears of what they don't know.

[00:14:18] WS: You're creating more content. You're putting this stuff out, so people are becoming more educated. And then anyways like even to the people who are already on your lists, you're connecting through all these people through social media in any ways that you're reaching out to educate them to a higher level, I guess, so they understand. Or maybe they're more prepared when you do send out that offering or another fund or anything like that.

[00:14:42] AL: Yeah. I mean, it's really just the content and the emails. DiversyFund, we're actually pretty sophisticated when someone signs up for our site. We're able to do a pretty good job of predicting their demographic based on their location. Are they close to retirement? Are they 30 and single on the San Francisco downtown and can tailor some of our content that we send to them through the automation process.

And that's been really helpful so that we're really trying to understand the different personas of investors that we're dealing with and tailoring our content to them through data applications. So that's something that I think all of us will have to get better at overtime as to almost create – At some point, you're going to create individualized content for people. And that's a few years out. And I think when people feel like, "Okay, this is addressing the concerns, the needs, desires, the goals I have as an investor," and you're doing it without voicing those things, that really is helpful.

[00:15:42] WS: Since you all started this fund, DiversyFund, I'd love for you to talk about that a little bit and maybe even some pros and cons to why someone would invest in a fund like that as opposed to with a specific operator.

[00:15:55] AL: Yeah. We're the specific operator of the fund, so all the deals in the fund, we're the sponsor, we're sourcing the deal, we're underwriting it, we're putting in our own capital. But the advantage to a fund is that if someone has a thousand dollars to invest and they can put it all into one deal and then have what we call deal concentration risk, if that one deal doesn't perform, that thousand dollars is at risk. Or if that thousand dollars if it goes into a fund structure is now spread across 5, 7, 10 deals.

So if you have one deal that underperforms, you have seven other deals that if they perform as expected, make sure that there's not a loss. Especially for newer investors, I think that's a great place to start is with a fund structure, so you have immediate diversification across multiple cash flowing assets rather than just starting with one asset at a time.

[00:16:48] WS: When in your syndication journey or real estate career were you ready to start a fund as opposed to maybe deal-specific funds or syndications? When was it like, "Okay, this is time for us to have our own fund where we can just fund numerous deals out of one fund?"

[00:17:04] AL: Yeah. It's always a balancing act, right? I mean, if you're raising dollars on a per-deal basis and every time you have a new deal, it's enough. And you scramble. You start having the conversations again. Put the pitch deck again.

If you're able to get to the point where you can create a fund that attracts investors because your track record is sufficient at that point to do that, now you're bringing in dollars and not having to go do a roadshow or go have 20 conversations every time you have a new deal. You really have this pass of capital on the sidelines ready to be deployed, which is a great thing as a sponsor. So you can focus more of your time on the deals, on the asset management, and really getting your investors return.

[00:17:46] WS: So any cons to having a fund. Some things – If I'm in the syndication business and we've done some deals, now we're thinking, "Okay. Alan, this sounds pretty good. Maybe we should start our own fund." What are some things I should remember and be thinking of?

[00:18:00] AL: Then the question is, who are your investors at the fund level? So a lot of your typical funds are you're trying to court bigger high network investors and ultimately make the leap to institutional investors who are writing bigger checks. But the amount of due diligence and the amount of reporting can be overwhelming for some newer sponsors who are new to the fund business. I think that's a big reason that a lot of people just shy away from that world.

For us at DiversyFund, our fund investors are individuals, so we really don't deal with – We have a couple of institutional investors in the fund, but for the most part it's individuals. So we're publicly reporting with the SEC. We do an annual audit, which creates more work, some more expense. But we get the advantage of kind of the best of both worlds.

We're not [inaudible00:18:45] quickly traded REIT on the stock exchange. We don't have to deal with any of that stock market volatility and we're able to get higher returns that way to investors. But then also the advantage of seeing us as a public reporting REIT.

It's really this balancing act of understanding. There are a lot of extra reporting requirements that come with starting a fund, but there are some advantages, too. And you got to look at, "Hey, are we ready to make this transition?"

[00:19:09] WS: So, Alan, in your career in the syndication business, what's been the hardest part for you?

[00:19:15] AL: I think problem-solving is always the hardest part. With any real estate deal, they rarely go according to plan. There's always something that surprises you. And I think for a lot of us in the business, that's part of the attraction is that where a lot of folks would throw up your hands, it's an opportunity to say, "Hey, there's not an option. We're going to get this done. We're going to figure out a way to get it done.

Whether it's create a financing if you're a little bit short on the equity raise and you got a week to go to closing or you got the asset, you now own it, and you're knee-deep in your renovations. And also, you're turning up a wall, and there's a lot of issue that you discovered due diligence. So now, you have to move things around the budget and figure out how to do that with the best return to the investors. And there's always problems to solve. That's one of the challenges but it's also something that I think a lot of us actually really like.

[00:20:05] WS: Yes. It sets us apart, doesn't it? If you are the problem solver, then you're going to make it. So what about a way that you all have recently improved your business that we can apply to ours?

[00:20:14] AL: I think we'll always be focusing on this. We have a big team. We have a big marketing team for online efforts with our SEC qualified REIT on the website. And then we have a real estate team of five of us.

So we're always trying to be more disciplined about our systems, about creating processes. What's the process of when we have a deal under contract? The process of creating the pitch check? Who's in charge of that and how many days do they have to get it done? Who's going give the pro forma numbers and just having this process and system down so that for, example, if I have a guy and he's moving on to a different job, then with the new hire, they just sit down. They have their process manual. And they know, "Okay, this is exactly what I have to do."

That's so you create a scalable system. So we're always trying to do a better job at defining roles, defining expectations, putting the process pen to paper, and really writing that out. It takes extra time and effort but ultimately it makes your life a lot easier and frees up your time as the owner.

[00:21:14] WS: Is there any kind of system or software that you all use to track those things to keep that improving?

[00:21:19] AL: Yeah. We use Salesforce as a CRM, which is an expensive commitment, but very powerful in terms of what it can do. We would use different softwares for our content delivery in social media on the marketing side. So, yeah, making those investments in software systems always gives you a little heartburn when you're looking at writing those checks. I think what happens is when your company is there, you know it. It's just like, "Okay, it's time to bump up our CRM and make this investment." Usually, it always pays off.

[00:21:52] WS: So, what would be your best advice for caring for investors?

[00:21:57] AL: I think it's really helpful to create realistic expectations going in, which means you have to be conservative on your pro forma so that you're confident you can meet or beat your numbers. And I like to show investors, here's how we are conservative. Here's the post renovation comps on rents. And we have a range of buck five a square foot to $1.50 a square foot. And I'm showing them how I'm using a dollar less than the low end of the range.

In our pro forma, here's our exit cap rate at seven or seven and half, and stuff is trading at six or less. So a hundred basis points higher on exit cap rate. And helping them see how the assumptions are conservative so the expectations are realistic. And that way, you're not coming in below pro forma where we've all seen this happen, right? You promised an 18% IRR and you deliver a 16%, which is a great return. Someone is saying, "Hey, you guys messed up. What's going on?"

I just learned that lesson long ago coming on conservative on the returns and everyone will be very happy when you make those numbers work.

[00:23:02] WS: Good advice. If you had to pick one thing that's contributed to your success, Alan, what would that be?

[00:23:07] AL: I think [inaudible 00:23:08] the hardest thing. I had a phone call this morning where [inaudible 00:23:11] to ask for an extension with the seller just another week to get the financing in place. And there is the example of that's not a call anyone likes to make. I think a lot of people start thinking of the worst-case scenario and starts thinking doom and gloom like, "Oh, the seller couldn't say – We're not going to get an extension and take your deposit."

And I just fine you just get on the phone. You have the conversation. You tackle the hardest thing in your day first and foremost, just release that fear and just take it head-on. And then you realize everything is solvable in life. There's always an answer. It may not always be the best result that you like, but there's always a solution. There's always a path forward, and you just tackle it head-on.

[00:23:52] WS: I love that answer, tackling the hardest thing head-on. So, Alan, how do you like to give back?

[00:23:56] AL: My family, we go to church and there's a lot of volunteer experiences there. And that's great for my kids just to see that there's a lot of folks who have their own personal struggles. I think helping them see that there's opportunities to serve and give back with time or otherwise is something that needs be part of everyone's life just so you get over yourself and forget about your own problems. So we try to be very active in serviceprojects and things like that and give that way.

[00:24:25] WS: Appreciate you sharing that. Alan, you've been a fantastic guest. I appreciate your time. And it's such an important part of the business, right? Educating investors and painting the story that is very transparent, tells them what they need to know and even if they don't know what they need to know and getting those things across. I appreciate you elaborating on that and telling us pros and cons of managing a business like yours. But tell the listeners how they can get in touch with you and learn more about you.

[00:24:51] AL: Sure. They can always reach me at our website, diversyfund.com. I'm @alan, A-L-A-N, @diversyfund, D-I-V-E-R-S-Y-F-U-N-D.com.

[00:25:02] WS: Awesome. Thank you, Alan. Great show.

[00:25:04] AL: Awesome. Thanks, Whitney. You got a great job, man.

[END OF INTERVIEW]

[00:25:06] WS: Don't go yet. Thank you for listening to today's episode. I would love it if you would go to iTunes right now and leave a rating and written review. I want to hear your feedback. It makes a big difference in getting the podcasts out there.

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[OUTRO]

[0:23:04.3] ANNOUNCER: Thank you for listening to The Real Estate Syndication Show, brought to you by Lifebridge Capital. Lifebridge Capital works with investors nationwide to invest in real estate while also donating 50% of its profits to assist parents who are committing to adoption. Lifebridge Capital, making a difference one investor and one child at a time. Connect online at www.LifeBridgeCapital.com for free material and videos to further your success.

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