EPISODE 399

[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]

[0:00:24.1] WS: This is your daily Real Estate Syndication show. I'm your host Whitney Sewell. Today, our guest is Josh Sterling. Thanks for being on the show again Josh.

[0:00:33.4] JS: Hey, thanks for having me back Whitney.

[0:00:35.4] WS: Now, if you're a long-time listener, you've heard of Josh before. But believe it or not, he was on a show number WS35. So, almost a year ago. I would encourage you to go back and listen to that, especially because of our topic today. I would like for you to listen to that and then come listen to this show. If you didn't listen to him then. Because he has experienced lots of growth over this last year and we're going to talk about that transition that he's made and how that's happened, what's happened and even some growing pains.

Just his success as well on this past year, but a little about him. He's the owner of Epic Property Management LLC as well as several other real estate entities based in South Gate Michigan. After a career in Aviation, he shifted into real estate in 2009 and is focused now in his own medium and large sized apartment communities in the Midwest.

As of September 2018, that's probably as of today, right? You own 650 house - that's part of an old bio but as of today, you own 650 units and worth about 70 million dollars and also has 150 16 that's under contract. He has added over 430 units in the last year to his portfolio and I'm

looking forward to hearing about this. Josh, you know, let's dive right in and I look forward to hearing about how you've done this.

Let's back up a little bit, you know, a year ago, what happened then to transition from where you were at to start building this larger portfolio.

[0:02:06.4] JS: Yeah, you know, from we got started really good time back in September of 09 and started with single family and you could probably hear that background on the old podcast but it was very organic to growth. Mostly a lot of my own capital, occasionally private money, mostly on the debt side, not usually on the equity side, very few of those deals. Made for a little bit slower, again, more organic growth.

You know, a year ago, I think our unit count was around 350 or so. Right about the time of that podcast, maybe just before we make the decision, I wanted to shift into a little bit larger projects and start raising more capital for that. Obviously, it's a capital intensive business and so you're going to need some money to close these deals. So, sat down and you know, I realized my struggle to bigger and bigger growth was going to be the capital to close those deals.

I knew my network was probably going to be a challenge for that. I always believe you need three things to close a deal: you need the deal itself, you need the capital to close the deal and then you need the management of the deal. You know, we had the management kind of on lock down, that's what we do and we had some deal flow from some broker relationships but I didn't think I had that network necessarily to raise that capital.

Got to talking with a buddy and an ex colleague of mine that had a good, strong network and was comfortable out raising capital and we teamed up and decided a way to divide up the GP, the equity split and start growing that way. As that led to something just under 450 units, we've added here in the last year, mostly through the syndication model raising capital, we raised about 10 million dollars during the last year and added a quite a few units.

[0:03:45.2] WS: Okay, well there's so much there we got to talk about but I go back though to – you realized the pain point of, Okay, if you're going to grow and grow faster, or do bigger deals, you got to have more capital, right?" You increased your team, right? You added somebody that

could specialize just on that and now, probably even lessened the burden on your plate, would you say?

[0:04:09.7] JS: Yeah, absolutely, you know? To be honest, one of the things that I didn't like was going out raising capital. I've done it a little bit. I wasn't all that good at it and I really didn't like doing it. I'm much more of an operational guy. I'm happy to talk about and share what we're doing but the act of you know, going out and not everyone's going to say yes and I didn't really like that part of it.

So, I found somebody that had the connection and had the network that I think we needed to, to be able to present, really, these are great opportunities as you know, anyone who is passive invested in one of these deals knows. I had found somebody who is comfortable presenting that to a network of people and then handling that investor relation side which was just you know, it was something I wasn't necessarily great at. And something I didn't really enjoy doing. It's a really great fit.

[0:04:52.1] WS: Nice. Yeah, growing your team, I would agree completely, you got to find people and you got to be able to bring them on board. Otherwise, you can't do everything can you?

[0:05:00.7] JS: No, absolutely not. You know, I'm sure you've heard it a thousand times but two minds are much greater than one or than the sum of one and one, right?

[0:05:09.9] WS: Yes, I'm saying that personally as well, that's awesome. I'd like for you to elaborate though, maybe a little more of the transition and any pain points or growing pains that you can elaborate on, you know, because you scale up fast.

[0:05:22.2] JS: Sure, in our traditional model was built on mostly small to mid-sized properties and some sort of a single family. We developed an operation that was basically on mobile management operation. We could – you know, within a 45-minute radius of one of our what's now three offices, we felt that we could service any type of property.

Actually, the management side wasn't so bad as you know, once you're adding properties that are over a hundred units, they'll support on site leasing, on-site maintenance and what not. We actually found that to be a fairly easy transition. I think the bigger transition is behind the scenes now, overseeing those on sight offices and overseeing that team there and deciding how we're going to run operations that didn't fit in to our normal systems such as you know, weekend leasing or such as you know, maintenance emergencies or things like that.

What ended up happening is we had to scale the team quite a bit in the back office, quite a bit more than I had expected originally. That came at a cost and you know, definitely a little bit strain on the overall operations in the initial months of getting that rolling.

[0:06:25.0] WS: Okay, overseeing the management was a pain point. Yeah, can you elaborate more a little more on how did you fix that problem?

[0:06:34.0] JS: Right, initially, as you might picture, you have a 150-unit apartment building, you're going to have someone in there every day, you know, leasing units, collecting rent, the office type admin stuff. Then you're going to have a maintenance person there. What we had taken for granted up to that point is our management operation is really a 24/7 operation.

So, at our smaller properties, at our single-family stuff that we oversee, if a call comes in on Saturday at five PM, we still have someone there to answer the phone, we still have someone there to receive rent payments, that dispatch maintenance. whatever they might do. At those 150-unit properties, you can't staff them 24/7. You need to have a backup to that. You need to have somebody who can be there to respond but also is not going to be on the payroll burning that property the whole time.

To come up with a way to provide those services and provide that level of service that we had become used to across the board but not burden the property with that amount of payroll and that amount of overhead was really the challenge. That's really where we had to work through updated systems that share resources.

[0:07:40.8] WS: Okay, even sharing resources, was that a way that you all – it's helped to grow because now you can share resources, you already have. Like you said, you already have the management model in place, sometimes, that's a burden.

If you're not used to – if you don't understand how to manage and you grow too fast, right? I mean, you're all of a sudden is all kinds of things happening and it's way out of control. But you already have the management piece down, you already had a property management company, right? At this point, you're growing and experiencing that growth but now II guess you're having to hire more employees and now their overseeing has become more difficult.

[0:08:16.1] JS: You know, from the management operation, it went from you know, really entry level type and then a manager type role to really adding a whole other depth, a whole other layer of management so we could oversee those other office managers all about. Just add a lot of depth to the org chart.

That just naturally is going to come with growing pains.

[0:08:32.9] WS: Yeah. Other than management, any other growing pains you can elaborate on?

[0:08:37.0] JS: You know, the management and really the getting the properties on board was really the – I think the most challenging part, you know, I said earlier, I think there's three pillars any deal, there's the management, the operations of that which we just discussed. There's the deal itself and that's naturally a little bit of a challenge in this market, you know, in the last 10 years or say It's gotten a lot sexier, right?

So, there's a lot more competition for the same deal. But you know, I felt that we'll be able to find sufficient amount of deal flow through either the connections we had or through the reputation we had from closing deals. I don't think that was so much of a struggle. And then you know, again, the capital that close the deal, that was a key piece that we really just put in place in the last year. I don't think we would have had the ability to raise the amount of capital we did had II not gone to that team work model where I divided up the GP split a little bit and brought somebody else in.

[0:09:25.1] WS: Nice. Where are your properties located now or the ones over this past year?

[0:09:30.2] JS: So, we're still buying Midwest deals, mostly southeast Michigan and then northern Ohio. Really is a range of about, probably 60 to 70-mile radius from our headquarters.

[0:09:44.7] WS: Okay, all within driving distance?

[0:09:46.9] JS: Yeah, it's within driving distance. And we run it with three different offices now. So the way we view our model is that once we're done with about 45-minute bubble of any of the driving time bubble of any of those offices we can help supplement that operation. It leads to what I talked about earlier, supplementing night and weekends and also in periods of high demand.

To get real technical, just one aspect of the management, you know, we found a niche and it's mid-sized, 150-ish that properties that a lot of times were buying them in the past ownership is running them with two leasing and two maintenance staff. So, it's quite a bit of payroll and that's a little bit over kill we find for 150 units, maybe for 200 units, that would be appropriate.

We're able to go back to one leasing person, one maintenance person and that's supplement with that management company and periods of high demand, again, less overhead on the property, it helps improve that property performance drastically and we find that the property runs very well so with just the added help when needed.

[0:10:45.0] WS: If you had to go back and do it again, would you have your own management company or would you suggest to other people to have their own management company?

[0:10:52.6] JS: You know, it's tough. I really believe that management is key. I think it's the most important part of running the deal once you actually get the deal closed, that's all that matters, right? That's all you can – I've seen operators get in trouble because they don't control management and so for me, I think I wouldn't do it any other way.

I made the decision to get into management not because I wanted to but because I felt like I had to way, way back and probably about 2012. I couldn't find an operator, I thought could run what

we were running, the way we wanted to run. Now, that was mostly again smaller and midsized buildings where they wouldn't support an on-site staff.

Now that we're doing deals where they will support on site staff, I think you could probably get away without the management if you needed it. But it's definitely a key, I think we can – that example I just gave, we can really make our returns much stronger just because we have that control, that day to day operation of it.

[0:11:41.6] WS: I couldn't agree more on how important the management team is. No matter how good the market is, if you don't have a good management team, whether it's third party or whether it's creating your own, you're asking for trouble.

[0:11:53.5] JS: You know, guy starting out, I get asked that all the time if they start throwing management company and you know, I think that's tough. It's a lot to put together just like we talked about in the beginning of the call again. You know it is a lot to put together all those systems and procedures. And then trying to really invent the wheel and if you are also the same time trying to figure out how to get into your first deal, it might be a little bit too much. You know it is very easy to get stuck in the analysis phase if you do that. But I think over time, I think if you really look at the most larger operators they are going to run their own management in house.

[0:12:22.8] WS: So, you know taking a little transition to some of the capital raising side, what's been the key difference in being able to raise that kind of capital this year?

[0:12:31.7] JS: Also, it really came to having somebody focus just on that. So, when I brought Barry on, he started ex-colleague, I know him from a previous job I had and then really became a friend over the years and when I brought him on and that is really his focus, he handles all investor relations and all capital raising. So you know I had an investor, a list of guy and gals that I have gone to in the past and you know I had them either invest dead or equity and in deals.

And then he had a network of people and just having somebody to work on that day in and day out it was huge. It made all the difference in the world.

[0:13:05.6] WS: Nice, so we'll have to have him on some time as well just to elaborate on some of that.

[0:13:09.1] JS: Absolutely, it would be great to talk to you about it.

[0:13:11.2] WS: Yeah, so tell me now or let's talk a little bit about that management piece a little more in depth and you know how do you – so you are growing that team, you are growing that management team, what type of or how quickly is your team growing compared to the properties that you are buying or the unit count. And you mentioned that a little bit but how quickly are you growing that team and how does that relate to the number of units that you are buying?

[0:13:36.0] JS: You know so every aspect of the team on the front-line measure is pretty systematized. For example, we look at needing one maintenance person for about every 150-ish units give or take. It is a little bit less if they are all at one property, a little bit more spread out say among several small buildings. But about a 150 units per maintenance person. We find that with leasing we could run more like four to 500 units per leasing agent and sometimes even more than that.

You know we keep in this market occupancy is pretty high so meaning turnovers is a little bit less than maybe it would be with more vacancy and therefore we could spread that leasing in general a little bit center. But where I have really noticed that we had to grow is in the management of those. So, office managers, we had an office manager. I find that an office manager can oversee four or five people whether that would be leasing our cleaners or overseeing reception or something like that in our main office.

Then we added a level called a project manager that oversees our maintenance staff. And so again, a project manager can only oversee maybe four or five maintenance guys. And then we found that we needed somebody to oversee even the office managers and the project managers so we added a director level and so it gets deeper and deeper as you grow. But it also allows each of those components of the business – you know we look at ours as a leasing side and a maintenance side of the business.

It allows those to almost run independently but also have a point, a one direct report they could go to so that they can communicate.

[0:15:03.6] WS: What does your communication, as the owner, what does your communication look like with these team members?

[0:15:10.3] JS: So, my day to day is fairly limited. You know to give you a more direct overview of how we operate as a management company. We've got our front level, which is our frontline, which should be maintenance, leasing, cleaners, receptionists, people that are on the front lines every day. They report to office managers on the leasing side or project managers on the maintenance side. That will be our tier two level. And then above those, I was mentioning that the office managers and project managers report to a direct group of admin.

For the leasing side, a director of operations for the maintenance side and then those directors would really report to me. So, my day to day now – we are about 25 or so employees, maybe 26, my day to day is pretty non-involved from an operational standpoint. It is basically if there is any type of catastrophe, I am probably going to hear about it.

But I track mostly our KPI's. We do a weekly KPI meeting where we are tracking anything from days to turn a unit, to collections to occupancies leasing trends, all of these things that give us hopefully a leading indicator for example days that turn a unit is a huge leading indicator on our performance it is going to be months down the road. If we are not turning a unit or our target is seven days, if we are not turning a unit in seven days or less we are going to have an occupancy problem in a month. And so that is really where I come in and I run that KPI check and we have a team leadership meeting with my directors once a week to make sure everything is on track.

Otherwise it is out there mostly looking for new deals and then Barry is out there usually looking for the capital.

[0:16:41.3] WS: Love it. That is awesome. I love the weekly meetings and the checklist and you are following the trends. So important that it doesn't matter what type of business but especially in that business as well the management side. And so, you are able to forecast that or that we

are going to have a vacancy problem and so what would be something you wish you had known let's say 10 months ago that you know now.

[0:17:00.3] JS: You know probably maybe even going further than 10 months. I think it is really key to get out there and identify something that is a weak point for you. For me, it was raising capital and if that is your weak point, I think a lot of people try to improve where they're weak as oppose to focus on where they're strong and get somebody else to improve where you are weak. And so, if I could go back and change it, I would go five or six years and I'd start I'd focus on where I am good at, you know on the operational side that the management operation and I would bring somebody else in that had a stronger capital raising background and go from there instead of trying to over counseling I'm not great at.

[0:17:35.1] WS: So, what has been the hardest part of the syndication process this year maybe other than the capital?

[0:17:39.8] JS: Really besides the management team growth was probably the hardest part, I think. The deal flow is just you're a little bit subject to what's out there. You know we can only, we are very, very strict in our criteria on what we can buy. I probably – I always joke that you know if we pass on ten deals I probably could have bought nine of those deals. You know we pass on a lot of deals that we could buy but you know again, we've got to be sure.

Every deal we buy we are buying off current actual numbers. We are buying off the current rents that we are getting today. We are buying off expense numbers that we know we are going to operate at so almost every expense line item, I don't care what they were running at. There is a few specifics that we will take their numbers at but most of these are run off our projections where we know we are going to run a deal at because we are running other deals in the same market at those numbers.

[0:18:24.2] WS: That is definitely a big plus that you have being on the management side as well. Like you understand the insides of the numbers better than no matter how well I study a market, I am going to know pretty well especially if we have other properties there. But just on the management side, you are going to understand on the efficiencies of being able to run under inefficiencies.

[0:18:41.5] JS: Yeah that absolutely helps and you know a lot of our conversations with brokers go something like, "No, we don't believe that we can get the 8%, 10% rent growth you are forecasting." And, "No, we can't run this property for $3,600 dollars per unit per year. We know this type of property. We are going to run it at $4,800 per unit per year." So, it does help but also we end up passing on a lot of deals.

[0:19:01.6] WS: So, a few questions before we run out of time, how are you preparing for this potential downturn that everybody is talking about?

[0:19:09.3] JS: Okay, so you know I think that is kind of a crystal ball thing. I don't know and I wish there would be a downturn actually. That is where great opportunity lies. Something we have always done that I just eluded to with our underwriting. You know we're underwriting these deals off current actual income or less. We are almost never underwriting a deal off a rent growth even if there is a property down the street getting higher rents.

You know my one exception of the rent growth rule is that we call them self-comping. So, if there is units in that building getting a higher rent, we may give a slight credit to the income number for that. But essentially, we are writing these deals as if they were going to produce the same amount of income that they have been producing or less. You know we underwrote one few months back when we projected $75,000 or less per year in income. So that is a nice conservative approach that if something shifts in the market and occupancy or rent start to come down, then we've got a little bit of room there.

And then as oppose had we projected a rent growth you could be in a lot of trouble and then on the expense side, we've got a really good hand on what it takes to operate a building in these markets and so we are projecting a conservative level. You know a good example, we are always thinking dollars per unit per year. But on the property we bought here a few months back, the seller is operating it $6,300 per unit per year on expenses.

We know we could operate it for about $4,800 based on all of our projections and comparisons with other properties. So, we underwrote the deal at $5,400 per unit per year. So, we've got a cushion amongst where we know we could operate it at and sure enough that property is

running about $4,800 per unit per year. So again, I think it gives a little bit of protection on the downside with that conservative underwriting upfront.

[0:20:47.8] WS: Nice. So, tell me a way that you all have improved your business that we haven't talked about but something that we could all apply to ours, some other way that you have improved?

[0:20:56.1] JS: Sure, well I mean I think we're constantly trying to improve on all fronts. You know there is I brought up the very first, the very beginning of the show, you have the management site and we talked about a lot of the things we are doing to grow and add depth to the company that improves the operation dramatically. The capital raising side is improved by going on adding a team member that can go help go raise capital you know if someone is not doing that and they think their weak there that is a huge advantage if you could do that.

And then on the deal flow side, it is really just a constant improvement. You need to be out there and we need to meet with brokers and go to local events and even so national events we go to and constantly be following up with the brokers that we are getting deals from so that the deal flow continues because you need the deal flow to get the deal done.

[0:21:39.3] WS: And what is one thing you would say that has contributed to your success?

[0:21:41.9] JS: You know I think it is hard to say just one specifically. Again, the management operation is the key. If I had to pick one thing it would be the management operation and it would be closely followed by adding a source of capital.

[0:21:54.2] WS: Awesome and tell us how you like to give back.

[0:21:56.5] JS: So, I coach actually on the side syndication for another syndication teacher, a podcast provider. I am sure he is out there and you can find him, I want to give it away. I am constantly meeting and helping the local guys. I talked about it in networking event this week that I find joy in helping other people get started. When I got started doing this, it was in the early days of like the BiggerPockets. I am sure mostly you all know about and there wasn't help out there.

So, I get a lot of joy out of seeing someone who is done a few deals that is out there really looking for how to turn that corner and go to the next level. You can reach out to me and I'd be happy to chat and at least hopefully provide some guidance or clue on some of the mistakes I've made.

[0:22:35.1] WS: I appreciate that especially from your experience and the growth you had. It is great that you are able to provide the value to other people and help them but tell the listeners how they can get in touch with you?

[0:22:44.9] JS: Sure, you can reach me via email. It is josh@newmissioncapital.com.

[OUTRO]

[0:22:50.9] 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 podcast out there. You can also go to the Real Estate Syndication Show on Facebook so you can connect with me and we can also receive feedback and your questions there that you want me to answer on the show.

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[END OF INTERVIEW]

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