

EPISODE 410

[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 Ryan Smith. Thanks for being on the show Ryan.

[0:00:32.9] RS: Thanks for having me.

[0:00:34.5] WS: Yeah. Ryan is a highly recruited athlete. He was drafted as a high school senior by the Baltimore Orioles and again, in college by the Anthem Angels. But ultimately made the decision to pursue an entrepreneurial business career. He lives in Orlando with his wife Jamie and their four children. He serves as a Principal of Elevation Capital Group bringing more than 15 years of extensive business experience in market valuation, property analysis, management systems, due diligence and finance.

Elevation, through its affiliates, has acquired properties worth more than 475 million dollars and has an interest in over 175 assets across more than 30 states. Ryan, thank you very much for your time today and being on the show and just bringing value to myself and the listeners as well. Tell them a little more about who you are or what you're up to right now and let's dive in.

[0:01:25.2] RS: That's a complex one. But what we're focusing on I will say is, we focus on mobile home parks and self-storage. Generally buying existing assets that are not as efficient as they should be and adding value from the perspective of growing NOI, operating income over

time. Occasionally, we'll build from the ground up, that's more limited in the more recent past. Anyway, that's our focus.

[0:01:45.7] WS: You had mentioned that we also talked about it before the show about how it all revolves around NOI and I would love for us to dive in to that a little bit and you elaborate on what that means exactly so the listeners can really understand the importance of that.

[0:01:58.8] RS: I think there's a distinction between first and foremost, cash flow which a lot of your listeners may be coming from a former revenue, a job and so typically, you leave that lily pad looking for a similar lily pad. So, you say, "Okay. I've got to make X dollars to pay my bills so I'm going to get in to this thing called real estate and look to it to produce income sufficient to also pay my bills." What somebody may be overlooking is not just the value of the cash flow which is valuable but the value of that cash flow.

Some people aren't clear on the distinction between those two things. And so, our entire focus is the value of cash flow and as a byproduct cash flow. That value of cash flow evolves around NOI, net operating income, and the value that that brings to our business and those who participate both in the cash flow it produces but more importantly, the value, the equity component or the wealth creation component of it.

That defines everything that we do. First and foremost, what type of assets we buy over the last 20 years, the two best performing asset classes for same store NOI growth as told to many public sources that you know, people can find or if you want some of them, feel free to reach out, I'll send them to you. But in short, the two best events, self-storage, there's number one, over the last roughly 20 years, mobile home parks, manufactured housing is number two, and then apartments is number three.

If you really get the value of NOI and what it can do for you, to me it makes to then participate and invest and grow a portfolio in that space. That's our focus.

[0:03:33.9] WS: I'd like for you to elaborate on this NOI thing and even more so of why it's so important and it is, it is so important. I liked how you also talked about leaving one lily pad looking for a similar one and that's kind of where we're stuck at a lot of times when we're leaving

a day JOB and jumping into this real estate game where we don't understand the importance, you know, the big picture or there's the NOI and the importance of that cash flow. Can you elaborate on why it all revolves around the NOI?

[0:03:59.8] RS: Sure. First, I'll take it in pieces because it's kind of a value change so to speak. First and foremost, there's a principle which you may or may not agree and speaking to the listener, you may or may not agree, but I think you'll find, it's very hard to earn yourself rich. The tax laws do not accommodate for you to grow wealthy through income generation and just pure savings and budgeting and those things.

To get wealthy to the extent that that's what you're trying to do, not everybody is that their goal. But if you want to create wealth, you have to do that through equity or value creation, not income generation. The reason why this is so important is then the second kind of principle is this: Let's assume you have an opportunity to buy a property out of five cap, a sustained five cap, not a lofty evaluation, paying more than its worth. Let's say a property today, that will be worth five cap, or valued at five cap 10 years from now. Let's say you're also able to buy a property today, that will be 10 cap today and 10 cap in 10 years.

Five cap you have a 10 cap, if you are purely going for cash flow, which one do you think you would prefer? Well, if you're going for cash flow, you probably go for the 10-cap asset because it stands to make more cash flow. Maybe you can borrow at 6%, maybe six and a half, 7% depending on the condition of the properties so you have a 10 cap, you're borrowing let's say a seven to a three points of spread. You have a little bit more cash flow and maybe a five cap or you're borrowing at three and a half percent.

You have three points of spread versus one and a half points of spread. What somebody is also missing or could be missing maybe is that at a five cap, a dollar, one dollar of NOI is worth 20 times that dollar. One dollar divided by .05 is 20. At a 10 cap, \$1 divided by .1 is 10. For every dollar I can add to a property that's a sustained five cap is worth twice as much as every dollar you add at a sustained \$10.

You have more cash flow maybe which is tax as ordinary income. I have twice as much equity, which is not taxed based on today's tax code because it's not realized. Secondarily, from a risk

standpoint, because I'm buying a five cap, you know, saying as an example, market may be more predictable, more stable. So, I might have a more predictable path to NOI growth over a prolonged period of time. My NOI growth trajectory and maybe a little bit more unpredictable, not guaranteed but more predictable.

And the value of my dollar, assuming all things equal is twice as much and I still have cash flow along the way. That's why number one, understanding the value and I can go in to more that 20-time multiple, you know, maybe we want to go into a little detail on that. But that's why if you're solely focusing on cash flow, it actually dictates your whole investment model, or tends to and kind of gears you to going to lower quality assets, more turn around heavy, more risk, more smart gets, in the mobile home park space. You may be buying in tertiary or worse markets, a lot of park owned homes, private utilities.

You're taking on heaps of risk for this one thing called cash flow where there might be a better way to go about it in the long run. That's a mouth full.

[0:07:10.8] WS: No, that was really good and I would like for you to elaborate a little more like you said or go back and go do that again a little bit or explain a little more in detail.

[0:07:18.5] RS: Sure. I think it's important to talk about everything and in terms of the value of one dollar and I say that because a lot of times, there's a lot of content out there, there's a lot of noise and there's a lot of big numbers and there's a race to the top in terms of hundreds of millions and billions and it seems like a lot of hyperbole. But I run to the office that way. Run to the value of a dollar, okay?

Because you know, it's been said that big things have small beginnings, okay? Go to the small beginning and start there. And then the challenge is over time don't change. Don't lose focus.

But in short, one dollar, let's talk about the value of a dollar. One dollar of NOI, net operating income per month. Let's say you buy a property and you increase, let's say all you do is raise the rent on a net base is \$1 a month. 12 months a year, \$12 a year. The value of that asset, assuming let's say a 10 cap, divide that \$12 a year, annual NOI that you added to the property, the new NOI, divided by .1 or 10%.

That has a multiplying effect of you now have \$120 of value. If you buy a property, you add a dollar a month of NOI, that's worth \$120 in value. I say this, I'll make one point of connection. When I was growing up in this industry and learning a lot and I'm sure you and others have had the same experience, you meet people and you say this, "I work so much harder than them, yet they have a result 20 times what I have, what do they know that I don't?" I think we've all had that, they know something that I don't know or they're just that much better. In most cases, what I have found is they know the value of the dollar, they don't value simply cash flow and that's been the distinction.

Why do I say all of that? Going then back to this example, let's say that \$1 a month, let's say you buy a property, that's a five, sustained five cap, good market, all of that. You think it will be a five cap for the long run. In that case, you have \$1 a month, 12 a year, divided by .05 so you have \$240 of value. So now, the question I would pose to you and you can pose it to your kids, how many of your kids would go into a Walmart and not leave that parking lot until they found a dollar? Well some would, sounds like a lot of work, kind of sweaty mess, the whole deal.

But if that dollar was worth 240, if you gave each one of your kids \$240 for every dollar they found in that parking lot, you need more jars, right? Because it's been said adults, our kids with wrinkles, we're not much different, okay? If you look at a dollar like just a dollar, but if you look at a dollar at 240, for me, that's compelling. Our whole daily focus every day is very simple. Every time we visit a property, every time we buy a property, it's all about buying a property and managing in a way where we add as many of those \$1 a month as possible because everyone we find is \$240 in value and that's imperative. Pretty simple.

What does this all mean? Let me make one more point here and then I'll go back and it's pretty interesting. Start with the end in mind and work back. Going back to the concept that we meet people and they must know something that we don't know, right? If you buy a property and you add a dollar a month, net operating income, some people would say, "Well great, I have \$12 a year of cash flow."

And you may have taxes, let's say you pay ordinary income and let's say, 40% of that goes to tax or whatever, not going to the whole appreciation and cost discussion but anyway, in that

case, you may have \$6, \$7 of net after tax cash. Well, the person who understands the value of that dollar has \$240 plus the \$7 of cash flow. They have a huge result, not just the cash flow. Then, starting with this concept, you can start with the end in mind and work backwards, let's do that really quickly. Let's say one of your listeners, let's say if they have a goal of 10 million dollars of net worth, okay?

Just picking a number out of thin air. Your goal may be higher. It may be lower, you may not believe in having net worth goals, anyway, let's say it's 10 million. If your goal is to create 10 million dollars of net worth, at a five cap, you need 500,000 of NOI, of net operating income. If you create \$500,000 of NOI add a five cap, you 10-million-dollar net worth. That seems daunting, right?

500,000 is a huge number, hard to wrap your mind around, okay? Let's divide that into monthly increments. 500,000 divided by 12, you want to just round it out, say 40,000 roughly just like 40,000 a month. You need \$40,000 roughly a month of NOI. I mean, you have a 10-million-dollar net worth. It's still daunting. So, let's keep going.

Let's say your goal is a thousand units, say your goal is to own a thousand units. So, what's 40,000 divided by a thousand. I believe that's \$40, is that right? Let's say it's \$40, I believe it is. \$40 a month. So, now you need \$40 a month of NOI, you need to buy a thousand units and add \$40 a month over any period of time, five years, 10 years, and you have a 10-million-dollar net worth.

Now let's put a time on it, let's add data to the discussion. Let's take the \$40 and let's say it turned out to do this in five years. What's \$40 divided by five? \$8 a month. You need to buy a thousand units and increase the NOI by \$8 a month per year for five years. And if you do that, you've created 10 million dollars of net worth, okay?

This afternoon, the value of, for less than the value of your lunch that you'll spend at Starbucks or wherever you're going to go eat lunch, probably spend 10, 12, \$15 on lunch. If you bought a thousand units and only added \$8 of NOI, found a way too either rent more units, add other sources of income, cut expenses that amounts to \$8 per year for five years straight, you create a 10 million dollars in net worth for yourself. What if it takes you seven years?

[0:13:11.8] WS: Yeah, or 10 years?

[0:13:13.8] RS: Yeah, the point in it is, the value of the dollar cannot be under estimated, it shouldn't be, I'll say. I see it under estimated often, I don't think it should be.

[0:13:23.8] WS: Yeah, just the \$5 you have in your wallet, right?

[0:13:26.3] RS: Right, the only bad added value component and then I'd be happy.

[0:13:30.1] WS: Right. Yeah, I love how you broke that down. You really started at a high level where most people would think, "Wait a minute, that's not achievable." You know, almost sign it off, right? Don't even talk to me about that. But then just really bringing it down to I mean, a manageable way almost to achieve it to actually see a way to get there, I love that.

You know, tell me about though, getting to that 1,000 units, or getting to that – your mobile home park, self-storage that's been your asset class, your avenue to getting to this. I don't know if that's your goal or not, you know, the 10 million dollars' net worth over a certain amount of time. But you know, I'd love to know just some actionable steps too to help the listener to see that thousand units as achievable.

[0:14:12.0] RS: Yeah. This is me, my personality, I'm not much of a, put 10,000 units on the board, although now, we own and/or operate more than 10,000 units, you know? But I see people who advertise the total number of units and that's fine, it's not good or bad, that's somebody's goal for themselves.

To me, my goal is to be the best I can be every day and if that means I acquire more units, terrific. If that means I focus solely on the units I have for the pursuit of the dollar, that's great. But with regards to your question of more of a starting point, you know, like I said a minute ago, I think big things have small beginnings.

Sometimes people feel compelled to get to a big goal and they skip over the small details and the most important details of, "What am I building? What foundation am I laying for the house

that I'm" – you know, they're going to that design of the roof and they haven't even dealt with the foundation yet. So, to me that's why this NOI concept for us, for me is foundational. It then dictates what asset class I pursue, how I manage. So, if the dollar is really as valuable as I am posited here, should I be in the field walking the properties regularly or should I manage from an office? If I can find a dollar that's worth 240, my feet need to be in the field.

You know I need to be looking at property finding ways, every time I visit a property that we can add value. So, to me that is the simple beginning of what the business is built on and then dictates how then you should live and everything else. Not helpful at all to somebody who's just starting because everybody wants specifics like, "Do this. Like do that." But I would get really clear with what you are going for. If you are starting by saying, "Okay, I get value of NOI, I want to create NOI over time."

Then from there all the follow-on questions and answers come. You know, "Well. Okay what asset class do you want to pursue?" Well, look at historically maybe the best in terms of what has produced NOI growth overtime, what is projected by experts and what do you think might be the best going forward, the most resilient cycle, resilience all of these things. And then from there putting together an operating model that really take the properties from where they are and where they need to be from an NOI perspective.

If you have 200 units or 500 units, going back to the example a second ago that was a thousand but if you were able to add \$16 a month of NOI for five years, well now you only need 500 units to do the same outcome. That is why the units don't really matter. It just depends on you could do more than you ever dreamed in life with 200 units if you do it well. It just depends. Sometimes it may take 5,000 units if you do it not well. It just depends.

[0:16:47.7] WS: Finding ways to add these dollars to your properties, what are you doing? You know you even mentioned like sitting in office versus actually going out there and looking for ways to increase your NOI. What are some ways that you have done that?

[0:16:58.3] RS: Yeah, so every property is different. You know there is a general theme of what we are doing, which is NOI ideally growing it. Then there is the sub themes, which is switching rents to market. We are adding other revenue streams to property, which I will give you a couple

of examples and then cutting expenses. So just to pick a property to give you an example, we bought a property about nine months ago in Katy, Texas and what by me I mean one of the funds that I'm a manager of called Fund Seven.

So, we bought this property about nine months ago in Katy, Texas, which is a suburb of Houston. Very simply it is a three-story storage facility. They had an occupancy issue that we identified was due to the way the building was constructed. So, they had this novel idea that wasn't – didn't work, where they put these giant fans on the second and third floor. The thought was if you blow air fast enough to the second and third floor it will somehow equal cold or cool or climatized.

Where in Houston you are just blowing hot air at a high rate of speed, it just makes it really fast-moving hot air. It didn't work out well and the fans were really noisy. So, they had a really tough time leasing the second and third floor. So, we bought the property. Put it under new management. Did what we normally do but we climatized the second floor, climatized the third floor. We've owned that property for about nine months and what we thought that it was roughly 60% occupied now, it is over 80% occupied.

So, when you look at that, you say okay 500 units, 20% occupancy that is a 100 new units of absorption. What is the NOI? Well it is higher so that is an example. Now on mobile home parks a little bit different. So, we regularly actually take a mobile home park and add a storage solution to it. Kind of an independent storage where we put in like a traditional storage solution in it as another line item of revenue but that wasn't there before.

And then what we do to create demand for storage is we manage the property as well and that we don't allow for junk to stay in the yard. What makes a mobile home park look like a trailer park, typically there is a long list. But one of the things is the stop that should be on the inside, left on the outside, couches, chairs just stuff where the grass grows around it. It just looks horrible. I wouldn't want to live in a community like that and we don't want our residents to tolerate that.

So, we have a very strict policy over that and so the stuff has to go somewhere and we find that it doesn't all of that. But the point is that we give you a place for that stuff to go. So, we manage

well, we make you move the stuff and then we give you a place to put it if you want to keep it. If you want to keep it on your property, we'll also bring in tough shed, covered parking, whatever it is and most of the residence can't afford for that cost.

So, what we will do as the park is we'll go buy a tough shed, put it down or something similar and let's say it costs \$3,000. We, the park will buy it, we will put the shed on your property and then we charge you what amounts to \$30 a month, one percent of the cost is added to your lot rent.

So, number one, the quality of the park goes up because the stuff goes bye-bye and whether it is through independent storage and on-site storage, it also creates a line item of revenue to the extent that the resident wants to use our capital instead of theirs. There is many other examples but that is one.

[0:20:04.7] WS: That is awesome, wow. Unfortunately, we just got a few minutes left but this has been great. I've really enjoyed this Ryan. But a few questions though, what has been the hardest part of the syndication journey for you?

[0:20:15.2] RS: You know there has just been a lot – I can't single out a hardest one. There is just head wins and tail wins and you learn as you go. So, we are on our 7th fund about probably next year we'll start our 8th fund. And every fund is moderately different than the pre-sticky one because you learn something. There is just life lessons on every fund and structural changes. There is just a lot of things you learn.

[0:20:38.4] WS: And how are you preparing for this potential down turn that everybody is talking about?

[0:20:42.8] RS: Yeah it is a good question. So, we try to manage and mitigate our risk. So, number one we are in spaces that are referred to as cycle resilient or low beta from a market correlation standpoint. Those storage in mobile home parks have historically been lower beta asset classes, meaning they are not as tied to the overall market. If the market were to fall out tomorrow, affordable housing would still be in demand. We like that aspect.

Number one the asset classes that we buy, I am going to speak to that in a way. But then internal to the way we buy, we want to buy in primary and secondary markets. We want to buy a really nice properties in really good markets and be one of the leaders in the market rather than a laager. If there is ever a softening in demand, we think we'll have the product everybody wants and we want to manage it that way.

Then from a financing standpoint, I am only tree topping these. But from a financing standpoint, you know today you can go high leverage, you can then in some cases go 80% leverage. We think that is too high so we moderately use debt. We typically obtain 50 to 60% in terms of leverage. A lot of people who are buying real estate then we'll start backwards in that. They'll say, "Well the higher the LTB I can go the less money I have to raise." We start with what do we think is the best model and then we raise the capital.

We need to do the best model that we think is the best. Anyway, we use low leverage and then we keep our expenses lean. So, we are already there now and that was in responses to what we think might happen. That is the way we upgrade in the last couple of years and anyway.

[0:22:05.8] WS: What is a way that you have recently improved your business that we could apply to ours?

[0:22:08.2] RS: I would say overtime just the management approach of flattening our property management structure. Historically, we utilize a process at one point became pretty inefficient, which was where you have the onsite managers reporting to a district manager, reporting through a regional manager. You know you have this militaristic structure that gets pretty bogged down in terms of people talking to people, talking to people.

So, information wasn't flowing that efficiently and so what pivoted to was a flatter structure so that presently we have four VP's and all VP's are responsible for all properties, both mobile home parks, both storage, all regions. And so, each property is seen and walked usually three to four times per year by a combination of those VP's. So that Jeff, who is one of our VP's is very different than Sandy so both properties are managed ultimately by Jeff and Sandy.

They manage the managers and then the other two VP's cycle through. Then in addition to that Jamie, myself and Brian physically walk the properties twice a year. So that is a much flatter organizational structure. We do use technology and I can pull real time reports right now so we can see where things are but I think a flatter organizational structure was a huge group at from a cost standpoint and performance.

[0:23:26.6] WS: I think most people would lean more towards the military structure like you talked about at first. But after you talked about it like that I can see how information up to you is going to be difficult to achieve right? Or it is going to change numerous times potentially by the time it gets there it is all like that and then just having the different perspectives too of different VP's actually being on the ground, different people are going to see different things.

So, it is going to be important to them, yeah great idea. So, what is your best advice for caring for investors?

[0:23:54.2] RS: For caring for investors?

[0:23:55.7] WS: So, they want to come back to the next deal?

[0:23:57.8] RS: Set reasonable expectations and then perform. I know that is overly simple if an investor asks us a typical question, "What question did I not ask that I shouldn't ask, you know?: You can get that all the time and it is, "Well, I don't think you spend enough time on risks." And by the way, we have section eight of our PPM that goes through a ton of risk and at the end it says this is not all the risks. So I don't think you spend enough time on the risk associated with the investment.

That is not the easy path but it is the right path. And then as you are talking about the business, understating expectations and then making it really conservative and achievable. And then when we go out and we hit those expectations people will say I am going to add several emails that say you have done everything you said you would do. That is the goal.

[0:24:40.5] WS: What would you say is the number one thing that is contributed to your success?

[0:24:44.0] RS: When you get a mile down the road, you know there is always several miles but that was one step further than one step short of a mile, you know? So, you just keep taking the next step and you have that kind of a corny cliché things where believe in yourself and have vision and all of those things. But I would say, the part you can't teach is perseverance and a high pain tolerance. The high pain tolerance most people don't have.

They have a vision and they have self-belief until it gets painful and then they divert. Don't let me lead your belief, it's been highly painful. You know you have times in the business where you're like, "Wow, I didn't see that coming," where you get surprised and what you envisioned as the outcome wasn't the outcome, you know those kinds of things.

[0:25:19.6] WS: Is it Mike Tyson that says everybody has a plan until they get punched in the face?

[0:25:23.7] RS: Yeah, exactly. Things like that. So, I think having a high pain tolerance and knowing why you are doing it. I mean obviously they have a reason beyond yourself, which you tend to believe and maybe faith and depending on the person but anyway, I would say all of those things.

[0:25:38.6] WS: And before we have to go, tell us how you like to give back.

[0:25:40.9] RS: Just really quickly, I guess to me if you like to give back I'll say then everything you should do should be geared to a degree on that. There shouldn't be a part of – this is just me. There shouldn't be a part of your life where you say, "Okay this is where you don't give back and here is where I do give back as a mea culpa for the times that I didn't." Anyway, I think if life is stewardship then the way you earn should be giving to others as much as the way you give.

So, my wife and I have formed, specifically we formed giving circles, giving groups and we have a number over middle Orlando that were involved then and there is more that's we are not involved in, which we love. And if anybody wants to do this, reach out, we have a blueprint, we'll help you with it. But it is 12 people, couples, singles, men, women, however you want to do it

but for example, it is \$2,500 a year. There's 12 people so that it is \$30,000 a year, you meet twice a year as a group.

To get together and decide who in your community to give the gift to. It could be 30,000 it could be two 15,000-dollar gifts. What I realize many years ago when we did our first one is, "Man, we really don't know a lot of people that are in that great a need." That was condemning in a way, we needed to expand our social fabric. There wasn't a lot of vulnerability within our sphere of friends and so that to me is probably the biggest gift we can all give another is to give up.

When you become financially successful to a degree you have less vulnerability and more control. So, to a degree if we can give up some of that control, take on somebody else's vulnerability, I think you can transfer that. I think that is a huge gift. So anyway, within those giving circles that's been life giving for Jamie and I.

[0:27:10.2] WS: That is awesome. Well I appreciate you sharing that. That is incredible, I hope it is inspiring to a lot of the listeners as well. Even you talking about how I'd help you to see your sphere of influence even the people around you or how you need to maybe interact with some other people that are in need and you can help and it is awesome. I appreciate you selling that very much and tell the listeners how they can get in touch with you and learn more about you.

[0:27:30.8] RS: Oh, I think most people are running away from me now like this guys is nuts. But if you do, I'd love to help you out anyway I can. So, my direct line is 407-602-7662. My email is ryan@elevationcg.com. I'm happy to help.

[0:27:46.1] WS: Great show Ryan, thank you so much.

[END OF INTERVIEW]

[0:27:48.6] 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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[OUTRO]

[0:28:29.4] ANNOUNCER: Thank you for listening to The Real Estate Syndication Show, brought to you by Life Bridge Capital. Life Bridge 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. Life Bridge 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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