EPISODE 432

[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]

[0:00:27.3] WS: This is your daily Real Estate Syndication Show. I'm your host, Whitney Sewell. Today, our guest is Ryan Andrews. Thanks for being on the show, Ryan.

[0:00:36.1] RA: You're welcome. Looking forward to it.

[0:00:38.2] WS: Ryan is a managing partner of Aerial Investment Management, where he manages the recession resistant real estate fund. Also helps manage the KYC Senior Debt Fund, an offshore fund that invests in private construction debt across the US. Altogether, he has been involved in managing six investment funds that have focused in both debt and equity, lives in Bend, Oregon with his wife and three daughters and is an avid rock climber.

Ryan, thank you again for being a guest on the show. I'm looking forward to this, because we don't have many guests who are experts in funds and managing a fund, and so I'm really looking forward to that conversation. Tell the listeners a little more about what you're up to and just maybe your business a little bit and let's dive in.

[0:01:19.2] RA: Sure. Yeah, happy to. Thanks for having me. Yeah, I often pitch myself as a fund guy, or a fund CFO for projects. My background really started on the investment management side. I always wanted to get into real estate and be a developer. I grew up in Southern California and knew developers and a little bit of what real estate development was.

Then graduated college in 2007 as everything was crashing. There was pretty much zero opportunity to get into real estate at that time.

I just went into regular investment management. I worked for PIMCO, the big bond and investment manager, fixed income manager. It wasn't until several years later that I was trying to work my way back into real estate. That really started when I became an early employee with CrowdStreet and maybe some of the listeners will be familiar with that platform, but it's a crowdfunding platform for commercial real estate. I came on as a really early employee and managed investor relations. That started to get me back from the regular finance side into the real estate side.

From there, actually left that and managed a debt fund or two different debt funds for a period of time. That caught me familiar with how funds work and everything. Then most recently, so what I'm doing now with the recession resistant fund about a year ago, I joined up with a partner here in Bend, named Mark Curry who had a long background in syndication. I saw what he was doing and we got to know each other and I said, “Hey, why don't we wrap a fund around several of these assets, instead of raising capital forum one at a time? Let's raise capital over a year, put seven to 10 assets into a portfolio and hold those assets and manage it.” That's just a quick overview, or a survey of my background and how I got into the fund space and the current fund.

[0:03:10.5] WS: Nice. Why don't you give the listeners a little more about what a fund is and why you might use a fund?

[0:03:18.2] RA: Sure. This fund that we created, this current fund is what's called a closed-end fund. That means we raise money for a specific period of time, about 10 months. Then by the end of that 10 months, or within about 30 or 45 days of closing the fund, it was fully invested. This is a classic way that private equity or venture capital funds work is you raise capital for a specific period of time, you invest that capital and then you hold those assets and you're done. It's very different from a mutual fund, which probably a lot of people are familiar with, which is taking money in and out all the time.

When you think about a fund and what it really is, it's basically just a bunch of pooled capital that we then turn around and invest in multiple deals. The benefit to the investors as they get diversification across several deals with well, they write one check that might be smaller than the check they would had to write to get into all those deals individually. They get a lot of diversification.

Again, similar to a mutual fund, you get diversification across companies in a mutual fund. With this as a private real estate fund, get access to a lot of different deals that are professionally vetted and managed by myself and my partner. We pick the deals and the investors can join our fund at a smaller dollar amount than maybe they would have been able to join those individual deals at.

[0:04:38.7] WS: Smaller dollar amount. There's not like a $50,000 minimum, or a $100,000 minimum. What would be the minimum?

[0:04:45.6] RA: Yeah. The minimum for this one was $50,000. They were able to come in to our fund at $50,000. Then once with their $150,000 check they got access to eight deals, eight investments that we put in the portfolio. Some of those had multiple properties in them. Overall, our fund holds an equity stake in 50 properties in 13 states. They got a ton of diversification with a small check. Whereas if they'd went and found those individual deals, they might have had to write $50,000 checks each for each of the eight deals, or a $100,000 checks for each of the eight deals.

[0:05:19.8] WS: That $50,000 investment is not going into one deal, it's being spread across all the deals.

[0:05:24.9] RA: Exactly. Yeah, exactly. When they came in, the early investors came into a blind fund, so they didn't know exactly what the deals were going to be. We basically outlined like okay, this is our strategy and the kinds of deals we're going to pick. They were coming in on faith in us, or their experience or background investing with us before. The investors that came into the fund later could see at least four or five of the deals that had already been invested in. Our pitch to them was, "Hey, we're going to add two or three more just like those." There was some benefit to waiting the early investors got a little bit of a kicker. We gave them some economic benefit to incentivize them to come in early and basically take the blind fund opportunity.

[0:06:09.1] WS: You mentioned closed-end fund, so that means we have a timeline where you're going to say okay, at this date, this fund is closed. Nobody can invest after that time. Is that correct?

[0:06:19.0] RA: Yeah, that's exactly right. That's compared to what's called an open-ended fund, or a lot of times an evergreen fund, where investors can come in and out all the time. There might be a lock-up period on an evergreen fund, where you have to stay in at one year, or two years. After that time if you want your money back, you can ask the manager and they give it back maybe within 60 or 90 days.

That's really common for debt funds, like funds that are investing in debt because the debt turns over a lot faster. There's proceeds to give investors their capital back and then there's proceeds to get new capital from investors and put it in the new debt, new private debt opportunities. With an equity fund like this, all of our properties we invest it in for five to 10 years. If after three years an investor says, “Hey, I want my money back.” We say, “Hey, your money is in this property. We're waiting for this thing to liquidate a couple more years.”

There are a few ways they can get their capital back. They can sell it to other investors and fund, or the managers. For the most part, they're locked up. That's part of a closed-end fund too is you need investors that are willing to stay in the fund for the length of all the deals that are in it. Then when a deal liquidates, we give our investors a portion of their capital back right away, so they don't have all of their capital tied up for the full five to 10 years. They'll start getting it back in pieces as we go.

[0:07:43.0] WS: When do they start getting distributions?

[0:07:46.2] RA: We closed the fund on August 30th and we issued our first distributions right after that, because we'd invested in – we'd started investing in projects last January, and so we had a few that were starting to kickoff distributions. We just made our second distribution for the funds second quarter earlier this week actually. From here on out, it'll be quarterly distributions. Yeah, it basically started around the time we closed the fund, we started making distribution.

[0:08:16.1] WS: Okay. As a 10-month period, if I invested let's say a month one or two, I was one of those first ones, would I have received anything during that time, or would have been after the fund closed?

[0:08:28.1] RA: It was after the fund closed. Yeah, our early investors didn't receive any proceeds for those first six or eight months or so. We were basically taking that capital trying to source deals for it. Then once we even placed capital, it sometimes takes a quarter for the underlying properties to start kicking out a distribution, and so there was a lag time there. Yeah, all the investors were comfortable with that and understood that process.

[0:08:53.3] WS: What was the dynamic, or the type of investors that were willing to invest to say in the blind fund? I mean, it was – obviously, it was blind because you didn't have any properties yet. They didn't know what they were investing in. Ultimately, they're investing in you and your partner at that point, right? I mean, they are anyway. Were these people that you and your partner already knew? Were these people that – how did you get connected to those people?

[0:09:14.2] RA: Yeah, good question. The initial set of investors were all people that we had previous relationships with. They'd either invested in previous funds that I'd managed, so they knew me or projects that I'd worked on, or they'd invested in previous syndications with my partner, Mark. Yeah, especially that first million dollars was all friends and family money that we brought into the project. Then from there once we had a base, we started building new relationships.

Even a lot of people with the new relationships said, “Gosh, we love what you guys are doing. Let's see how fund one goes. We'll invest in the next fund.” All because people like to see – they just love to build that relationship over time, and so we certainly saw that too. Yeah, overall after we built the portfolio, three quarters of the portfolio, it was much easier to work with investors that we hadn't met before that were new, they had some confidence because we could show them okay, here's what we've done even in the last six months.

[0:10:11.2] WS: Yeah. Tell me about what was the limit are on this fund, what were you trying to raise?

[0:10:18.3] RA: This was a small fund we raised about 2 and a half million for it. Yeah, we've got 20 investors in the fund. We're basically trying to raise a couple million dollars up to 3 to 5 million and invest it across seven to 10 deals, so we ended up raising about 2 and a half million invested in eight different projects. It was a great a great first fund under this brand.

[0:10:42.5] WS: What about the return structure for these investors in this fund?

[0:10:46.3] RA: Yeah, good question. The return structure on the fund is actually really similar to a lot of the structures on a lot of the underlying deals. There's a management fee, a preferred return that accrues to the investors, even if they don't get all of it in cash at the beginning, the rest of it accrues. Then there's a profit split once the investors have met their preferred return.

The structure is very similar to all the underlying deals. The investors basically come in and say, "Hey, we're willing to pay some management fees and share some of the upside with the management team in order to gain diversification, to get and source deals that we maybe couldn't source on our own and then hopefully have Brian and Marcus professional managers, that this is their job pick better deals than maybe we would have picked on our own. That's the trade-off is we're basically saying, "Hey, in the end hopefully, even after paying our layer of management fees, you'll end up even or on top, because you've got some risk reduction with the diversification and then hopefully some better assets if we have picked them." We'll see, time will tell. Hopefully, we've got some great assets in our portfolio.

[0:11:53.9] WS: Yeah. I wanted to ask you too. 10-month period, some investors came in when it was blind and then others came in obviously later once they knew the types of deals that you all were investing in. I just wondered during that period, when did you see that most investors come in?

[0:12:10.0] RA: Yeah, good question. It was basically a barbell at the beginning and at the end, if you think of two chunks. At the beginning when we launched the fund, we had a lot of friends and family in our personal network that was excited, knew what we'd been working on for several months and jumped right in. That was great. Then the next biggest chunk of investors was at the very end when we basically said, "Hey, we're closing the fund at the end of August.

Last chance. Last call for capital." Everybody that had been sitting on the fence and waiting to see either said, "All right, we're in, or no, it's not the right timing." That forced a decision. It was interesting through those middle months, it's difficult to create the urgency of why now? Why should an investor come in in June? Unless, for them they had some liquidity that they were like, "I want to get this deployed." It was we got people at the beginning and at the end. Yeah, that was how the capital came in.

I think that's more or less common. Fund managers are always trying to figure out ways to manufacture urgency to varying degrees, so sometimes that's deals. We want to invest in this deal and it's closing soon. Any investors that are interested in coming, come in now. Sometimes there's economic triggers, so you can put anybody that invests in the first three months or six months gets a little bit higher pref, or a higher profit split, or something like that. We gave a higher preferred return to our earlier investors, and so that was an incentive for them to come in.

It was interesting. It was actually a dollar-based incentive. We said the first X million that came in got this higher preferred return. Rather than putting a date on it, we put a dollar amount on it, and so everybody was like, "Well, should I come in now or not?" In the future, I put a date on it and say, "Okay, investors that come in before March get X. Investors that come in before June get Y," in order to incentivize people to make a decision and come into the fund basically.

[0:14:09.8] WS: Yeah. I was wondering about what would incentivize an investor to come in at an earlier time, but you answered that. That's awesome. I wonder too though, so are they gaining any return? I mean, I know you said they're not getting a distribution. If I invested in month one or two, am I getting any return until it closes?

[0:14:28.5] RA: They are. Yes. Their preferred return starts to accrue. Right when they invested their preferred returns started to calculate up. They knew even though they weren't getting cash, their preferred return was accruing, and so they get paid out for that later. Yeah, the earlier investors – everybody in the fund will earn the same basic return, but the early investors will end up with more cash because they came in earlier, so their preferred return was compounding faster and more from an earlier date. Yeah, that's the mechanics on that.

[0:15:03.0] WS: Well, what are some of the more difficult questions that investors may have that you have to answer when operating a fund like this?

[0:15:10.3] RA: Yeah, good question. Investors of course want to understand who we are and our background, they're investing in the people, whether they're early investors or the late investors, they're always investing in people. A lot of questions about our background, where our deal flow comes from, then quite a few questions on the structure of the fund and that's something we spend a lot of time explaining to people of how the fee is work and performance fees work and the pref and what's the pref calculated and questions just working through the structure of the fund.

We tried to create what I'd call a very vanilla private equity fund. It's a very common structure that's been used forever, which is management fee, preferred return and profit split above the pref, so that anybody that had invested in deals like this before had a good idea of what they were working on. We didn't build in hurdle rates and flops and full catch-ups and all these different tools that starts to get confusing, because what we didn't want to create is we didn't want to get to a yes with an investor that said, "Yeah, I love your guys strategy. I like you guys. I'm in. Send me the documents," and then they get our structure and they're like, "Whoa, this is so confusing. I don't get what's going on. I'm not going to write a check." We wanted to create as plain vanilla of a structure as we could, so that once we got to a yes with somebody, they were able to come in quickly.

[0:16:31.0] WS: Yeah. If somebody's confused, their answer is usually no.

[0:16:34.5] RA: Right. Yeah, exactly. Although, they won't tell you no, because I'm confused, because it's a little embarrassing to say.

[0:16:42.6] WS: Right. If they can't understand it, they're probably not going to invest.

[0:16:45.6] RA: Yeah. Or they won't call you back, or they won't respond to your e-mails and you'll be like, "Gosh, I lost this investor. I don't know why." Maybe it was too complicated, or they just didn't get it, but they didn't want to ask. Yeah, we try to spend a lot of time with investors explaining how funds work, because not everybody knows in the private space. You can't take it for granted that everybody gets how these funds work and everything. Then ultimately with the calculations, they're trusting the fund manager to do it right and to make the right calculations and to make them whole. That's a big part of it.

Another is really in a post Bernie Madoff world, where there's been fraud and everything, it's building that trust with people, so that they want to know, “Hey, how do we know there really is real estate underneath this fund?” We spend a lot of time, especially my partner jumped on several planes and flew around to assets in our portfolio and we took videos and talked on site, to just at least show or investors here's the assets that are in the portfolio. There's real real estate underneath this, and inspire that confidence and get to know people. Because again, it's trust when people are wiring you big chunks of funds. It’s important to them.

[0:17:58.5] WS: How do you get paid for running a fund?

[0:18:01.4] RA: The management fee is basically what covers our “overhead,” which is us for managing our fund, receiving checks, turning around, sending out distributions, maintaining our relationships with sponsors and all that. We've got a management fee that's ongoing, that's paid out quarterly at the same time as we pay out our distributions to investors. Then we've got a profit split on the back-end. My partner and I as the managers, we’ll get some of the upside if our projects perform well.

We won't see that for five, six years probably, because even the first couple of properties that liquidate, the proceeds will really just go to catching investors up on their preferred return, that maybe we'd been lower than their 8% preferred return for the first couple years from a cash standpoint. Really, our upside is having picked good deals and it's deferred to the end of the fund. It's a real long game for us as managers.

It's also a great tool and you have a lot of guys that are syndicators obviously, that listen to your show and everything. Maybe not a ton of them have been exposed to the fund model, or even thought about a fund model. It is a great basically financial tool or financial product that can be that some syndicators can basically use to build and bring in a new investor group, invest across a series of deals, earn some ongoing management fees and build that relationship.

Then the hope of course is that by launching multiple funds, maybe a fund a year, or every year and a half, over time you build bigger and bigger funds and more relationships and investors invest in multiple funds over time and you grow that fund assets under management.

[0:19:48.7] WS: When should I consider starting a fund of my own, as opposed to doing individual deals, right? I mean, it's like we're doing our individual funds for every deal. When should I consider a large fund like this?

[0:20:00.6] RA: Yeah. I think if there's some benefit in the strategy that you can do, or maybe if there's a lot of specific deal flow that you're noticing coming in, if you're a syndicator let's say, if you're noticing a lot of specific deal flow coming in for a certain type of apartments in a region and you're like, "Gosh, wouldn't it be neat to do five apartments in Atlanta over a year and put a small fund together that holds all five of the assets and basically, you can offer diversification to your investors."

For us when we decided like, "Hey, let's put all these assets in a fund," we did it and then we named our fund the recession resistant fund, because my partner and I were both looking at the macroeconomic environment and saying, hey, we're at the time we're almost 10 years into the longest expansion in US history. Now we're more than 10 years, or about 10 and a half years and it is the longest expansion in US history.

We were saying, "Hey, what would we want to put our parents or grandparents money in to keep it safe through the next cycle? What are good assets and assets that are likely to perform in the next – through the next financial crisis?" We put together mobile home parks, self-storage facilities and workforce apartments. We'd spread them across a lot of states that's all institutional assets, so we're talking a 100 units and more for each of these individual assets.

We wanted to gain a little slice of equity exposure to a lot of projects and projects that we felt were most likely to perform in a downturn. Continue generating income is how we defined performing. We felt there was a lot of benefits from grouping those three asset classes together. Putting as many of them as we could in our portfolio and trying to hold it basically from now through the next cycle. That was why we're putting the fund together.

[0:21:56.5] WS: All right, so just a few quick questions before we run out of time, Ryan. What's the hardest part of running a fund?

[0:22:02.5] RA: Certainly, raising capital is always challenging. You're going out, especially at the beginning and selling a dream, especially if you don't as opposed to a syndication where you have an asset that you're looking at when we're out selling a blind fund. We're selling a dream and a strategy and who we are. Then just maintaining those relationships is super important and maybe not hard in the traditional sense of oh, that's a hard thing to do, but just something you got to stay on top of, spend time with your investors when all of us are busy and you can get on to other things.

[0:22:34.2] WS: Nice. How are you prepared for this potential downturn that everybody's talking about? I know this fund is called the recession resistant real estate fund, so how are you all prepared for this potential downturn?

[0:22:45.4] RA: Yeah. In this specific fund, we were really careful about the assets that we pick. We wanted to pick assets that we felt would maintain civility in a recession. We were looking for mobile home parks have a tendency to do well in downturns, because it's the most affordable housing. Then workforce apartments also can do better, or tend to do better during depending on where they're located, where people will stay in apartments, choose not to upgrade or downsize to an apartment. These are definitely not luxury apartments. Again, it's what we call workforce apartments, which tends to be $800 to $1,200 a month rent, something that a family can afford to live in basically with maybe one job, or blue-collar job, or trade scale.

Then all these assets also have a value add component. It was important for us to feel we could drive some appreciation, even if cap rates went the wrong direction, or there was a downturn in assets or something. Then one thing we looked really closely at is what is the debt structure on each of our individual assets, because debt in a financial crisis or in a downturn can be what kills you and forces you to be a distressed seller.

We wanted to make sure we had fixed debt, or if it was floating rate, had a cap on it. Went out for at least 10 years so we knew hey, we can – we don't want to be trying to refinance in a credit crisis, when everything is frozen and capital markets are frozen and instead, we have to sell our property at a bargain-basement price. The debt structure was something we looked really close at. Then the geography, of course was a place that we wanted to be in places that we felt had a good diversification of jobs. We'll have an asset outside of Dallas, garden-style apartments outside of Dallas, Texas. We feel like okay, that's a strong job center. We want to be commuting distance for families, etc.

Those were some of the ways that in this fund we tried to be prepared for a recession. That's something that's on my mind. I'm a Austrian School of Economics guy, and so I look at all the quantitative easing that went on, all the unprecedented monetary policy. Even what the Fed did in the repo markets in September by infusing a ton of capital back in the repo markets, there's cracks in the system. I'm just watching that carefully. I'm a bear by nature.

I think it's because I graduated and started finance in 2007. My first experience out in the working world was this massive financial crisis. I'm walking around looking for the signs to see where it'll go.

We don't necessarily think there will be a recession this year, especially being an election year, but when will it happen, would happen 2021, 2022. We'll see. Certainly, can't imagine it going another five years or seven years without a correction.

[0:25:39.7] WS: What's a way that you've recently improved your business that we could apply to ours?

[0:25:45.0] RA: Yeah, great question. We spend a lot of time on our investor communication. We try and send out content pieces. Just earlier this week when we sent out distributions, we sent out a 15-page investor update that included an update of the fund, a two-page macroeconomic update and then a page, or one to two pages including pictures and summaries of each of our assets and where they're at.

Trying to over communicate with our investors, send them a lot of content and touch them in a way that's not salesy, that's not like, “Hey, we're trying to run another fund. We're trying to raise another fund here, where's your money?” Instead saying, “Here's some content, here's how we're doing, here's what we're seeing in the markets.” I just think that's a key way.

[0:26:34.5] WS: How often are you touching them, or reaching out like that?

[0:26:38.6] RA: We're sending our investor letter quarterly, along with our distributions and that's our larger thought piece that we spend a lot of time working on. Then throughout the quarter, we'll send out typically one or two other just pieces of content and rather than sending out weekly blog posts that we put together quickly, we'll spend a lot of time talking through different aspects of what we see in the market, or why we like certain asset classes or types. Send that content out, just we want to be thought of in the minds of our investors as, "Wow, these guys are experts. They're on the cutting-edge of their field." They're seeing great deal flow and keep being – staying in front of the different trends, so when it's time to invest they're like, "Well, I'd rather put my money with these guys, then pick my own deals, because these guys are really looking at what's ahead." Those are some of our key things for businesses.

It's intuitive. Probably your audience more or less knows that, but yet, it's hard to sit down and actually spend the time to do it, because it's work that's important but not urgent. If you don't do it, nothing bad happens. If you do do it, overtime it generates good return on investment of time basically in those relationships.

[0:27:51.9] WS: What's the number one thing that's contributed to your success?

[0:27:56.0] RA: Good question. I think relationships. Again, it's maybe a tried or obvious answer, but I realized at some point in my career, more recently than a long time ago that really, my success and my income potential is directly tied to my relationships, all the deal flow, all the opportunities, all the customers, all the partners that I have are all sourced through relationships. I'm at a point in my career in my back half of my 30s, where I'm just really focused on building, strengthening those relationships and being ready for what's next.

[0:28:36.3] WS: How do you like to give back?

[0:28:38.7] RA: Spending time with family is always super important. Trying to first, basically prioritize giving to my family before I'm even gone from them to give to somebody else. That's a top priority, spending time with my kids and as a start therefore local community. My kids are just starting to enter elementary school and such, and so we're starting to just get involved in the parent activities there and everything in the community.

[0:29:06.1] WS: Fun times, that's for sure. Ryan, tell the listeners on how they can get in touch with you.

[0:29:12.0] RA: Great. Our website is Aerial Investment Management. That's A-E-R-I-A-L. They can also go to recessionresistantfund.com and that will push them over to the site. Anybody can send me an e-mail as well. My e-mail is on our website, but it's Ryan@AerialInvestmentManagement.com.

[OUTRO]

[0:29:28.7] 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. Subscribe too, so you can get the latest episodes.

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[END OF INTERVIEW]

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