EPISODE 483

[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 Scott Krone. Thanks for being on the show, Scott.

[00:00:32] SK: Thanks, Whitney, for having us. I appreciate the opportunity to talk.

[00:00:35] WS: My pleasure. My pleasure. Scott is a Chicago native whose career in architecture began in 1991. In 2012, Krone founded SSSK Capital Fund, a firm which manages a wide range of real estate, including single and multifamily homes, retail, commercial warehouse and self-storage, and multiuse flex athletic spaces. Currently, the platform of investments is in excess of $30 million.

In 2018, SSSK Capital Fund was rebranded to Coda Management Group to complement his design build firm, Coda Design + Build, an international award-winning design and build firm which specializes in sustainable building practices.

Scott, thank you again for your time and being willing to share your expertise and with us today. Give the listeners and myself a little more about yourself and your focus right now in this business, and let's dive in.

[00:01:30] SK: Well, again, thanks for having us. I appreciate it. Currently, I mean, we have two firms, as you mentioned, Coda Design + Build and Coda Management Group. Coda Design + Build is predominantly our retail company where clients hire us to do design, build, and development forms. We just finished working on our fifth church where we helped the church acquire the property, go through the zoning. We got on with the financing and then we designed and built it for them.

Then on our investment side as Coda Management Group, where we are taking underperforming commercial buildings and converting them into self-storage facilities, predominantly in rural areas throughout the Midwest.

[00:02:12] WS: I think it's a very unique skill. I guess it's becoming somewhat more popular now, but it's not something I think we've talked about on the show. With the large buildings in places where it's like sometimes they can't find tenants now or maybe older buildings, it seems like maybe that's a great option. But I'm looking forward to getting your expertise. Can we just dive into some of the things you all are doing as far as converting underperforming buildings to self-storage, and maybe walk us through an example or a process of what that looks like?

[00:02:40] SK: What it looks like is each market is based from a three to five-mile radius, and so we're very specific about where we are looking. Right now, we're looking in the Midwest, because we the liked the combination of there are areas that are in need of it. Predominantly, if you look at the East Coast, the South, and the West Coast, those areas of the country have a high volume or a high market of self-storage already. So we're looking in underserved markets.

And there are in the urban areas, there are buildings that are large between 70 and 100,000 $ft.^2$. They're not being fully utilized, and so we can come in and reposition. I would say it's a green concept. Rather than tearing down a building, we can reposition and improve it, raise the level of green efficiency, and convert it into self-storage. We like that because in the Midwest, there's a lot of opportunities with opportunity zones where they're looking to encourage development, as well as PACE financing, which is another tool that we can use to enhance our capital stack.

[00:03:45] WS: You mentioned like the size of the building. If we're thinking about trying to look into something like this, what size of building is going to be, you say, too small? Or it needs to be this big or bigger. What are you looking for?

[00:03:56] SK: Like 40,000 ft.² would be too small. What we're looking for is between 70 and 100,000 ft.². That's the most optimal for us. It can be multiple stories. It's preferable to be a single-story. But if it is multiple stories, that works as well as long as we have elevators to service the upper floors.

[00:04:15] WS: Then converting it to self-storage. Let's go back to the – You mentioned green concept. Could you elaborate on why that's important?

[00:04:23] SK: Well, the first component of green is that you can reutilize rather than tearing down, adding waste to the landfills, all those sorts of things. If we're tearing down a 100,000 ft.² building, there's going to be a tremendous amount of waste, even despite the attempts to recycle. If we can keep those buildings out of the landfills and we can shorten the amount of construction time, we can limit the amount of times that we have to expend fuel to bring new supplies in. These are all components that make – Help be more green.

That's actually when you look at lease certification or Green Star or any of those other lead programs, that's one of the first things that they try to do is utilize existing buildings. That's the major factor of what we're trying to do. The fact that we can also get these below replacement cost is also a green factor, because we're not expending money and energy to rebuild the building, which is a lot more expensive than what is already there, which we could buy.

[00:05:24] WS: What about the timeframe from being able to – I mean, you get a property like this under contract or going through that due diligence phase. I was just thinking about like the due diligence process on an older building like this and being able to convert it. There's so many unknowns anyway in any large commercial property purchase. However, I was just thinking about converting something like this. What are some things? Or, first, how long is the process like they're going to take, just the due diligence and to close?

[00:05:49] SK: The recent building we just closed, I mean, we closed it very quickly. We closed it in 60 days. That was abnormal. The seller was very aggressive in terms of the timeframe. Once they learned what we were going to do, then they were going to try to do it themselves. They didn't give us a look of ability to negotiate or to really do a lot of the due diligence.

We closed and then we created the permit drawings and then submit it. We sat on it longer on the front end than what we've liked to just because of the fact that we had it closed quickly. But typically, due diligence is about 90 days. Then once you get past that, another 30 or 60 days to close, depending on the financing. Then we have to submit for the building permits. That process can take a couple months or it can take quite a while, depending on the municipality, and then about nine months to build it out.

[00:06:39] WS: How long till a property like this is going to cash flow?

[00:06:43] SK: It will cash flow in terms of operations after 11 to 12 months. From debt service perspective, it will be another year after that.

[00:06:52] WS: Okay. Tell me about the type of financing that you all would have to have on something like this.

[00:06:58] SK: Well, the last couple projects that we've done with PACE. What we're trying to do currently with one project right now with PACE is quality it for PACE. We're in the process of getting that done through the local municipality and then we just have traditional debt financing with a local lender.

[00:07:13] WS: Okay. Well, what is PACE?

[00:07:15] SK: PACE is through the Department of Energy. It is a federal program that is implemented by the states where they're looking to reduce the carbon footprint and increase the energy efficiency of buildings. If you have your building evaluated and you can show that you can increase the level of efficiency in a building, the improvements are financed through the property taxes. So, a special assessment is applied to the property taxes, and so there's – You can either go through the local Port Authority or private PACE funders where they create a debt structure that is amortized over the life span of the improvement, and the amortization schedule is applied to the property taxes.

You pay twice a year, and the lenders view it not as a debt structure. They view it as equity, because the cost is above the line item. It's part of the NOI, and so it's part of the property taxes. There's only one lien on the property which is the first, and the PACE instrument is not leaned on the property with the new taxes.

[00:08:17] WS: Why go into the underperforming buildings and self-storage? Why not in a multifamily or original self-storage or –? What is it about that niche?

[00:08:27] SK: Well, I was in multifamily. I began in multifamily. My master's thesis was a 400-residential-unit development on 50 acres that was close to a hundred million if not exceeding a hundred million dollars in revenue. The first part of my career or the first six to eight years was all in multifamily. Then after the crash, I also began buying distressed apartments. What we saw was that the cap rates were so compressed. It is very competitive and hard to get into that field.

On the flipside during the crash, self-storage was booming, because it actually does better in recessionary market because as people reduce the size of their housing units, they put things into storage rather than getting rid of them. Then also, they're looking to preserve. So self-storage historically has done better in a recessionary market than an expansion market. When I was first looking at self-storage, I was trying to find a distressed self-storage and I couldn't find one, and that's how I got into it.

Now, the other side of it is comparatively more money is made in the development process than in the repositioning process. If self-storage is performing and you can only move it from, let's say, a nine cap to an eight cap, you're really not going to make that much margin in there, comparatively to the original class which is called the first-generation class C operations.

What we're dealing with is third-generation or class A, which is all environmentally controlled urban settings where you're driving into the building, the garage door comes down, and you're unloading your car in the building. Then you use a cart to distribute your goods into your locker. It's an entirely different model than the original self-storage operations.

[00:10:10] WS: Wow! You drive your vehicle in the building and unload. That's interesting. Tell me about the risks that maybe an investor would be worried about in a type of asset like this.

[00:10:21] SK: Well, every real estate has risks, right?

[00:10:23] WS: Sure, every one.

[00:10:24] SK: The thing that we like about self-storage is I don't have to worry about color selections, no. Henry Ford was great with his quote that, “My buyers can have any color they want as long as it's black.” For us, our clients can have any color of self-storage unit that they want as long as it’s white. The thing that they get to choose is what size, right?

We eliminate the risk in terms of the finickiness of a buyer in terms of like liking brass or chrome or gold or any of those sorts of things. I mean, when we look at self-storage, it’s apartments without toilets. We’ve whittled this thing down to the most economic basic unit that we could possibly do. The biggest hurdle within self-storage is not the market. It is how much competition you have.

And so, what we look for is when we’re going to areas, we’re setting the three and file-mile radius as to how much competition is in the marketplace. We can monetize that. We can analyze that in terms of what is the amount of self-storage in relationship to how many people. If we begin hitting our approach in a market, that means that our raise are going to come down and our lead times are going to expand and all those sorts of things. We like to go in the markets that have a heavy demand and not a whole lot of supply. That’s how we buffer against competition.

[00:11:47] WS: What are some big mistakes you would say somebody starting to try to do what you’re doing would make as far – I mean, I can just imagine looking at this whole building and trying to assess, “Can we make a self-storage building out of this?”

[00:11:59] SK: I mean, we were asked to look at one building that a person was evaluating in Cincinnati, and they thought an old parking garage is going to make for a good building. Well, in a parking garage, a lot of the floors are ramped so that you can get to one level to the next. The size of the elevator was small. The zoning wasn't there.

When we looked at each of these factors in the column layout, it made it very difficult. It made it hard to put self-storage in there and overly costly. We actually discouraged the person from going in that marketplace. The other one is if you don't pay attention to the level of competition. We see people wanting to do this, and the metric is how many square feet of lockers per capita?

This one woman who we were talking with, she's like, "I own six acres, I'm going to make – I have a property in self-storage. It's going to boom." I asked her how much other competition was around her. She goes, "Oh! There's not that much. There's no other self-storage facilities around me." I just did a quick Google search, and there was like 18 other facilities. Where market tends to supply or supply equals demand is around seven. Her facility was – Her location was already above nine without her adding a single square foot. I was like, "Whatever you do, do not put self-storage. It would be the absolute worst thing you could possibly do."

[00:13:08] WS: Wow! Ultimately, not knowing your market and not knowing your competition.

[00:13:29] SK: Absolutely.

[00:13:30] WS: Wow! Okay. What about return structure for how you're structuring these deals with investors?

[00:13:37] SK: That's the other area of creativity that we like to bring to the table is that we're looking at different ways in which we can increase the yield for our investors, which is either through historic tax credits, which we got on one property. We've also utilized the opportunity zones, as well as PACE financing. These three different components are ways in which we've been able to increase the yield for our investors, while not increasing the level of risk. We see that as much as the creative structure is how we find the property or the design or layout.

[00:14:10] WS: You are in Chicago. But tell me, like are there certain parts of the country you are focused in other than – I know you said Midwest, but are there certain states or cities and maybe why you like those areas?

[00:14:21] SK: Well, right now, we're in with the Wisconsin and Illinois and Ohio. We're looking in Kentucky, Michigan. Surprisingly, we follow a slow sliver perhaps in North Carolina that we're evaluating. But those are the markets that we're considering. We've looked at Indiana. We've looked at St. Louis, the Missouri areas. We've looked in Iowa. It's just a matter of we can find the right conditions to make it worthwhile.

[00:14:47] WS: Then locating a property like that, are you going to find a broker usually that has a property like that listed or is this going to be something that's like, "This building has been vacant for 20 years, and we just got to locate the owner."?

[00:14:59] SK: Both. Some have been on the market that we've identified, and others have been off market where we've had local people reach out to the existing owner and say, "Would you consider selling?" We've done both, and both processes have been successful for us.

When we are working with brokers, it's pretty easy to eliminate things right off the bat just in terms of size, in terms of the layout, the proximity, those sorts of things. We can go through those lists pretty quickly. We have worked with a great broker in Ohio that has found off-market properties for us that has done very well for us. He's now actually looking in the Michigan area. He just knocks on doors and talks with people to see what's out there.

[00:15:44] WS: Scott, you've done so much in the real estate. I mean, you talked about either multifamily. Now, you're in numerous different things we discussed. But as far as different asset classes and now, this seems very niche and it's really neat. I'm very intrigued by your all's business model. But what's been the hardest part of this real estate business for you?

[00:16:03] SK: Well, I think when you're beginning, the hardest part is getting people to believe in you and what you're doing. Fortunately, my background taught me a lot in a short amount of time. I began the process when I was 21, getting my Masters. By 24, I was running a 40-unit $25 million project with two other people for a company I used to work for, in addition to a larger project as well.

I had a lot of experience in a very short amount of time. But even when I began my own firm, I had to overcome the obstacles or questions of, “Do you know what you’re doing? Are you sure you’re going to be able to get this thing done?” Granted I was 28 and I probably looked like I was 18 and I still get carded despite the fact that I have far less hair than I do now. I mean, I had far less hair now than I did then.

The biggest thing is just getting people to understand and believe in what you're doing, and you have to build that track record. You have to build that record of what you’ve been doing. That has always been the hardest thing in terms of when we first went into single-family and then we got into the mixed use and then we got into commercial. It's always the next stage.

Fortunately, I have been able to look back and rely upon the things that I have done in the past and continue to build off of that. I think that’s one takeaway for people when they’re trying to get into this is that it’s hard to start big. It’s easier to start with something that is manageable and then grow from there. Don't be impatient with the process.

[00:17:39] WS: Yeah. It’s hard not to be impatient or hard to be patient that you see the success or so-called success you think everyone else is achieving. But if you never get started, you’re not going to get there.

[00:17:51] SK: Absolutely.

[00:17:53] WS: How are you prepared for this potential downturn that everyone's talking about?

[00:17:57] SK: Well, I think there’s different downturns. I mean, there’s locally and then there’s nationally. As I said, self-storage tends to do very well in a recessionary market. So one of the things that we’ve done is we’ve stopped buying in Illinois, because we feel that that market is a little bit more in fluctuation. That’s why we’re looking throughout the Midwest. We’re also looking at not overleveraging our properties, making sure that there’s a healthy level of debt.

Before the crash, I mean, lenders were giving us like 90% cost of what we are doing in the extreme leverage on them. We didn’t turn one building over to the bank during that period of time, and it was because we saw the market coming and we began to get out of it and we weren't buying. Those are the things that we look for. We look at the signs. We look at what's happening in the larger scheme process in the local markets and then not overextending ourselves. That's the biggest thing we did there.

[00:18:56] WS: What's a way that you've recently that improved your business that we could also apply to ours?

[00:19:02] SK: Well, we really began implementing a tool called the Enneagram within the company. Not only within the company but also with the clients that we work with in terms of understanding how people – What their motivation is and how they react and feel and communicate. If we can be more effective in understanding where they're coming from, then we can alter the way in which we say something so that we can get a more healthy response or a more timely response and create a better relationship. Those are the things that we've been doing in the office, plus as well as working with our clients.

[00:19:39] WS: What was the name of that tool or what was that?

[00:19:41] SK: The tool is called the Enneagram. It was developed by these fourth century monks. There's a couple books written by them. One is called *The Road Back to You,* and the other one is *Sacred Enneagram*. They're both really good book in terms of presenting the concepts and understanding the tools.

[00:19:58] WS: A book called *The Road Back to You*.

[00:20:01] SK: Right. It's by Ian Morgan Cron. It's a different spelling, so I'm not getting any royalties off of it. Not a relative or anything like that.

[00:20:09] WS: Awesome. Okay. No, I like looking stuff like that up. Tell me your – Say the number one thing that's contributed to your success.

[00:20:17] SK: I've had people believe in me. From the time that I got into architecture you know, I had people support me on that, growing in that path. Then that opened up doors that got me into the company that I was working with. They believed in me and put me in a position to succeed and grow.

Even when I started my own company 28, which is incredibly young to start a company, my first investors really did believe in – After we gave them a 90% rate of return on their investment after the first deal, they said, “Do it again and don't tell anyone.” I’m not going to perhaps be limited by what they want me to do.

But throughout the entire process, it’s just having a group of core people that do believe in me and including my wife and my family who’s just supportive in backing what we’re doing.

[00:21:12] WS: What’s a way that you stand out in your relationship with your investors?

[00:21:16] SK: Well, we do all three things. We’re developers. We do the design and then we do the build, and so we understand the entire process. Typically, you have a lot of developers. We didn’t go and hire an architect. We didn’t go and hire a GC. It’s a three triads. But when someone comes to us with a zoning problem, we can answer it. When someone comes to us with a design problem, we can answer it. When someone comes to us with a construction issue, we can deal with it.

A lot of times, like when we go into a market, when we have a property under contract and we’re finding local people to local contractors to bid out the work, they want to know what the likelihood is that we’re going to get the job as the GC. We explain to them, “Well, we’re also the owner. So you’re not competing against three other GCs to see if you’d get this in five other subcontractors. We already own the property. We’re the builder, and this is how we’re going to do it, and so we can streamline that process.”

[00:22:17] WS: How do you like to give back?

[00:22:19] SK: Well, our family has been to – I know you’ve been to Africa and adopted a few kids from Africa. Africa touched our hearts as well, and so we have been involved with a boarding school in Rwanda that was established in response to the genocide. We took our kids over there to work for nine days when they were from the ages of like three or four to they were like seven or eight.

We've been involved with that school and that community for a good, long period of time. Even just this week, I've been in communication with some of the boys that we met there. They're no longer boys. They're young men and they're developing their own businesses. We're still in communication with them and we're still supporting in terms of like giving them ideas and business tips. Just investing in them. It's has been a real investment back to us in terms of their involvement and just having them in our lives.

That's one area that we like to do. Then also in our local community just in investing in different things that our church has been involved with. Those are the main ways in which we get involved.

[00:23:31] WS: Wow! Thanks for sharing that, Scott. I'm grateful for your time and I've enjoyed. I hope the listeners have enjoyed learning about how you all are converting underperforming buildings to self- storage. I think that's a new one for the show. So grateful for that knowledge that you've shared with us. But tell the listeners how they can get in touch with you and learn more about you.

[00:23:49] SK: You can look at our webpage. It's Coda, C-O-D-A, and M as in management, G as in group.com. That's codamg.com. There's blogs. There's other information that we have out there that you can reference and reach. Then if you click on it, you can also get in touch with us that way. That's the best way.

[END OF INTERVIEW]

[00:24:08] 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. Lastly, I want to keep you updated. So head over to lifebridgecapital.com and sign up for the newsletter. If you're interested in partnering with me, sign up on the contact us page, so you can talk to me directly. Have a blessed day, and I will talk to you tomorrow.

[OUTRO]

[00:24:49] 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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