EPISODE 519

[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 Bethany Babcock. Thanks for being on the show Bethany.

[0:00:33.0] BB: Thanks for having me.

[0:00:33.8] WS: Bethany started in commercial real estate at age 18 and worked in property management and leasing and later investment sales at a publicly traded firm. Started her own firm at 29, after having her first child. Grew to one of the fastest growing commercial brokerage firms in south Texas, now managing a million square feet of retail, selling and leasing properties nationwide with a team of 18.Named by *San Antonio Business Journal* as a 40 under 40 in 2018.

Bethany, thank you again for your time, appreciate you sharing your expertise with the listers and myself. Give them a little more about your focus right now, what you're doing and we're going to jump in.

[0:01:14.4] BB: Thanks, yeah. The primary focus of the firm that I run is retail. We buy, sell, lease and manage retail shopping centers. I think a big thing that's a little bit different about us is that each of our agents specializes in one of those three things. We are a full-service brokerage firm but none of the agents are a jack of all trades. Each are specialists and kind of stay in their own lane and expertise and cultivate those relationships.

And so, our focus is mostly on retail though we do a little bit of office for our clients if they have both product types, the vast majority of all of my clients are syndicators themselves and we add value in any way we can and keep the in value and focus in all the decisions that we make on the day to day side.

[0:01:57.0] WS: Nice. You know, before we started recording, you know, you mentioned just about being a first-generation real estate person. You know, career. You didn't come from lots of family members who are in real estate and let's just jump in to that a little bit and it's going to speak to lots of listeners as well who are you know, trying to get into this business that maybe don't have a lot of experience. But you know, you've had great success in real estate and maybe you can speak to that a little bit.

[0:02:24.2] BB: Sure, yeah. I think that one of the things that's interesting when I was starting my own firm, one of my clients/competitors, because we sell and lease and manage stuff for other commercial real estate brokers. He asked me, he was like, "Tell me about your background, your connections?" I said, "Well, what do you mean? He goes, what do your parents do? What does your family do? What does your husband do?"

I was like – "If you're asking if they're in real estate, they're not. He's like, "Do you consider yourself well connected?" I said, "No. Not at all." He was like, "Well, when that doesn't work out, you know, you have a job here." And I'm like, "All right, thanks, you know?" He didn't mean that in a bad away but the value was an emphasis on the connections and the history within the family.

I didn't have that. I'm a pastor's kid. I'm a missionary's kid, I grew up overseas and came to the States and nobody in my family come from the commercial real estate background at all. You know, I think it's one of those things that a lot of people think that you can only get into it if you're super well connected.

They look at it and they say, "Hey, you know, I've got this uncle or this fraternity, sorority connections and that kind of stuff," and those things are definitely helpful, don't get me wrong, definitely helpful. But you can cultivate and create those with a lot of hard work and by adding value in everything that you do and over delivering in everything that you do and pretty soon, you'll build your own relationship in your own network.

[0:03:44.5] WS: Nice, I mean, network can't put enough value on network but everybody had to get started somewhere, right? What were some ways that you started doing that though? Maybe right off, cultivating those relationships like you were talking about?

[0:03:57.7] BB: My first job in commercial real estate was age 18, I got sent on the wrong job interview and this temp agency sent me to a guy that owned a bunch of office buildings and shopping centers here in town as a family office. It was an administrative position and they ended up being like, "You know, just go ahead and stay for the interview."

And we hit it off and they hired me and I was doing everything from basically, we're supposed to just answer the phones. There was a great opportunity, I don't think there's any better position for someone to break into the industry than be upfront answering the phone because you get all the market information and you have a little bit more free time to take on projects and add value to all of the departments. It was just really fun to be like, "Okay, what does everyone need and how can I get that for them?"

I tried to do that for accounting and I became the guru for Excel. And then property management, I became the go to person to make their lives easier and give them really good records. The same for leasing, you know? Just tried to add value to every single department and quickly got promoted several times before even graduating college because I was going to school at night.

That created a reputation which was the most important thing I could get with the – by the time I graduated college to be able to move to the next step. But that didn't come from family connections or anything. You had to create it from scratch and it's totally possible.

[0:05:18.3] WS: Wow. I find creating that network has been difficult but it's so worthwhile. It's just neat how you though, you used your expertise to provide value to so many people in your network grew and things happened. Really thinking a long term, I think. But you know, let's jump into your expertise now and you know, in retail and why retail as supposed to other asset classes?

[0:05:38.6] BB: Well, it's kind of an interesting story because originally, I had started in office and I was managing office and leasing office and I really enjoyed it and I thought for sure I'd do that. But when I had the opportunity to go work in investment sales, I didn't know how to do investment sales and I knew that the long-term success of my career and my investment sales hinged on my ability to identify a good mentor.

There really wasn't one for me available at the time that worked on that product type and I was working at Marcus & Milichap and they require you to specialize. And really, the person that I identified with and wanted to be when I grew up the most was my now business partner, Chad Knibbe who did retail and I thought, "You know, it's more important to me that I'd be successful in the industry and I know that working with him and learning from him I will be," and so I switched over to retail because of him. I stayed in that ever since.

[0:06:29.6] WS: Wow. Okay, a mentor was key.

[0:06:31.3] BB: Yes, definitely.

[0:06:33.4] WS: Yeah, tell me though, you know, about – Let's dive into retail just a little bit. I know one of your super powers is identifying risks. And you know, let's jump into that a little bit on how you look for risks and you know, specifically in retail or what that looks like. I'm not an expert on retail and do not pretend to be.

I'd love for you to just elaborate on that a little bit and help our listeners to know the risks in a retail type of asset.

[0:06:57.5] BB: Well, for me, it really comes from coming from the operation side, right? It's really easy when you're on the analyst side or when you are selling a property or buying a property to look at it from a really high level and numbers on Excel spreadsheet and be like, "Yeah, three to six months for this and this much per square foot for that," and just plug those numbers in into a spreadsheet.

But when you've come from the operation side and you've tried to implement those strategies that someone else has handed down to you, you realize that they're not as straight forward.

I think that going through on the retail side, that operations experience is extremely valuable and that leasing experience is extremely valuable to be able to look at it and be like, "Okay, what's real?" A good example of that in retail, one of the most frustrating things for me to see in underwriting, when you see a deal come across and they're like, it's triple on that and you'll see the way they split that up and they'll say, "Hey, the income is X and then all of the expenses are triple than that," and they get past through it 100%.

When in reality, you got to really get into the leases, not just what the leases say can truly be reimbursed but what's actually getting reimbursed. Because there's so many times where the tenants haven't been paying in the past and from an operation stand point, how realistic is it that they will be in the future? Not very.

You need to be able to feel really confident in not just what the lease says but what has it said in the history of the property. I'd love to get the GL and that is really the only thing that I care about –

[0:08:20.8] WS: The GL, can you elaborate on what that is?

[0:08:22.6] BB: The general ledger and so when I get the general ledger for a specific property, that enables me to see not just what tenants are behind. Because if you get just the aged receivables report that shows the delinquency for each of the tenants, you won't believe how easy it is for an owner to be able to forgive debt five or six months before they take a property to market and you would never know that because it doesn't show up on the aged receivables once it's been forgiven, the property looks really healthy.

But when you go into the general ledger, you're able to see those transactions and be able to look and so I'd love to get two years of general ledgers and dig in and understand what tenants have been forgiven, how late have they been, how many months, and that really helps me underwrite the future, rather than just a quick snapshot in time. It's very easy to manipulate the year to day reports, I'd like to go very far back.

[0:09:10.7] WS: That's awesome, this general ledger, you know, how easy is this to get?

[0:09:16.7] BB: I require it when I'm going through something or I'm going to make some really negative assumptions. And that's why I say it was mentioning to you before that yes, it is a super power but it is also a super weakness because I've gotten really to be a stickler on that and because of that, I don't get as many deals.

Really, the person who is buying something or if I'm advising a client to buy something, the person who wins is the person who overpays and who hasn't evaluated risk the same level as others. Well, I identify a lot of risk, I see a lot more risk than the average person because of my operations experience. As a result, I'm not going to be as aggressive on pricing or recommend my clients be as aggressive on pricing because I don't feel like it's a good buy.

Sometimes, a little bit of naiveness can carry you a long ways and you can acquire more assets. But do you want them in the long run and so – ?

[0:10:10.3] WS: Yeah, that's awesome. Without that operations experience, what are a few things that you see people overlooking?

[0:10:16.5] BB: Overly optimistic exit cap rates are probably my biggest pet peeve. Seeing people buy something and then they're underwriting it at either the same cap or even lower cap rates than what they're gathered at because to get an IRR, it drives me nuts when people are like, "I'm getting such and such on IRR."

An IRR is just a fictitious number based on underwriting in the future. You're not getting it anything, that's just how someone underwrote it. The IRR, a lot of people don't realize, that you can't get an IRR until you've estimated the sale price. That sale price is a much bigger determination of the value of that and the measure of that return than anything else.

That’s where you see it get real juiced up and really aggressive to make it look good when really, the numbers probably aren’t penciling out the way they thought. So, it’s more important to estimate the cash flow year by year. To run multiple scenarios but pay close attention to that exit cap rate and that exit evaluation and determine, if it’s not realistic in today’s market, it’s probably not going to be realistic 10 years from now.

Because, cap rates are extremely compressed right now. It’s hard to imagine that in 10 years, when you're evaluating it or in five years that they’re going to be even lower.

[0:11:25.5] WS: Can you tell me how you figure in an exit cap rate when you're underwriting?

[0:11:30.9] BB: Yeah, I usually do it on a spread based on projected interest rates which is another guess, right? Really, when it comes to cash flows, that’s what they are, right? It’s all a bunch of guesses but we tried to make them educated and based them on facts. And so, I’ll usually do it based off of the spread off of today’s spread and then assume the interest rates are going to go up, make a good estimate on where I think they’re going to go up. My exit cap rates are pretty pessimistic, probably too much though.

But, you know, you should be buying it based on the appreciation, based on the rental growth rather than just compression cap rates because that’s the one thing you can do a little bit more research, right?

Is there truly rental growth in that market? is the demand there? Those are the things that you can find out before purchasing the asset. Exit cap rates, anyone’s guess.

[0:12:20.0] WS: That’s awesome, is there truly growth there in that market? and we need to know that, right? Is there demand for these units that we’re fixing a purchase or build or whatever it may be or whether it’s retail or multi-family, whatever it may be, we need to know that. Where would you find that information?

[0:12:33.1] BB: Local brokers. I would call them, I would call all the neighboring centers and develop those relationships, right? Little bit by little bit. Make sure that they know who you are so they'll answer honestly. I think one thing that's really interesting is if you have a broker that's telling you, especially the one that's selling it, right?

"Oh. Yeah, these things will get leased up, three months." Why haven't they? You know? Why are those vacancies there? Is it because the seller was unreasonable? Make sure you're not using the same assumptions, right? Is it because they are maybe they weren't showing well and needs a little bit of lipstick on it that's one thing.

But you don't really know that until you start talking to the local brokers and finding out how long has this been on the market? How long have your spaces been on the market? What's keeping you? How many inquiries are you getting? I think it's really important to dig in to that and one telltale sign is if the person who is selling you the asset, maybe they're not a leasing person, that's fine but if the firm and if you get a lot of brokers who aren't excited about taking the listing and if they're not returning your calls very quickly.

And you know, we're by nature super optimistic people and if you feel like they're already pulling back from that optimism, you've got some telltale signs that that market might not be there if they're asking for marketing dollars upfront. If they are trying to distance themselves from the amount of communication they're going to give you then those are some clear signs that it's probably not that great of a market.

[0:13:53.8] WS: Nice, so we've contacted the brokers and we learn more about the market, directly or indirectly, right? Depending on how they're behaving or the information that they provide. Any other way that they can get more involved in the market or to have a better understanding of the demand there so we know we are purchasing something that we can fill up?

[0:14:12.1] BB: Yeah, in retail the king of everything is sales, right? So, I think that sales can be very, very difficult to obtain even for local tenants. No one is going to tell you what their income is. But you might be surprised just walking in with a clipboard and saying, "Hey I am doing some research on the area, what are your weekly sales?" I am not asking them what their annual sales are but I am asking them what your weekly sales are because that is in the word vendors have in their mind and asking what are your weekly sales and just seeing how many will answer.

Because what you really needed at this term is how healthy of a market it is in terms of sales. If the sales are good then you can get a healthy rent market, all right? And you might be able to find some opportunity there but if the sales aren't good, it doesn't matter. There is a lot of markets even here in San Antonio where we were at but people just assume it is a really, really good market because it is a high-income area and it's right outside of this place where all of these NBA players live.

And that is going to be this great market but we start going to those restaurants their sales aren't good and word gets out and those spaces start hitting market. Well there is a lot of development out there because it is a prestigious area to be but those spaces sit on the market a long time and so it is really important to not do any of those spec for sure but to get into who your tenants are and by and large, retail is dominated by restaurants right now.

So just walking in and getting as much information as you can in terms of the sales of those locations is probably the most important information that you could try to get when you are researching the submarket.

[0:15:36.2] WS: What are some other pitfalls that people make when they are transitioning into retail? Let's say we're coming from multifamily and we say, "Okay, I want to try how I think I like the retail asset class but I am not – so I am going to jump in" I'd contact you, what are some mistakes that I am probably going to make?

[0:15:52.3] BB: That is a good question because that happens a lot. So right now, we are getting a lot of out of state, out of country money from syndicators for multi-family coming into retail because they see opportunity there and they love the idea of triple net leases where they think all the expenses are reimbursed. That is great in theory if your leases are structured in such a way that a 100% is reimbursed. They rarely are, there is usually some slippage and that is only great if the spaces are fully occupied for the whole time.

And the two mistakes that I see that are commonly done are that they don't fully set aside or account for the role over and the roll over is going to be a very expensive commission and it is going to be a very expensive tenant improvements. Those are very big parts of retail on returning and they also don't allocate enough time.

So, in their minds they're coming from apartments and they're thinking you know a month or two, three months let's get crazy and say six. It might need to be a lot longer than that depending on the market and depending on how long it takes to negotiate those leases. Retail leases take probably more than any other product type to negotiate.

[0:16:54.1] WS: So, when you say the time period there, you mean after closing like to get it leased up.

[0:16:58.4] BB: Correct. Yeah generally it's way too optimistic and then they put a lot of pressure on everybody else like, "Why isn't it getting done?" "Well it is not like you just go to the tenant store and bring them out." Retail is not as closely correlated to price as one might think. It is closely correlated to sales. So, you might assume, "Oh, well worst-case scenario I'll just reduce the rent by half."

Well, in retail, you have your rent to sales ratio is generally is eight to 15% of your total sales. That's not that big of a bottom line if your sales are doing great, you are doing fine. But what happens a lot of times is that a retailer won't go into an inferior location regardless of the price. If you gave them free rent, they're still not going to go to it because the reality is they're investing sometimes a million dollars into that space. The rent factor is not the determining factor whether they go there. So that is different for multifamily or office or industrial. You could lower the rent and eventually get a tenant. Retail is not so much the case.

[0:18:01.3] WS: More about knowing your customer isn't it?

[0:18:03.2] BB: It is yeah. The other thing that is probably the biggest frustration when you see one product type to the other then transition over is again with the exit cap rates. They do that. That is really common for multifamily investors on the retail side to do not have a good understanding of how to evaluate those exit cap rates and their expectations of cash flow. So, they do not put aside enough reserves and account for that for the turning of the spaces.

[0:18:28.6] WS: How should we calculate the reserves?

[0:18:31.1] BB: Aggressively. Again, that is one of those things you learn from your submarket, right? So that is one of those things that you need to talk to the other brokers that are out there and find out, "Hey, what are you guys offering? How many dials per square foot are you having to do?" And that is only the contingent on a type of tenant. So, nationals will typically get more than the locals and you need to account for it. So, if you're expecting nationals makes sure you're ready to pitch in. But again, it is dependent on the sub-market. Some are just more aggressive than others.

[0:19:00.4] WS: And Bethany, what has been the hardest part of this either real estate or brokerage journey for you having to operate a brokerage business and selling retail?

[0:19:09.3] BB: Probably right now, we're in such a good market is explaining to those that haven't lived through a recession how to prepare. So that goes for the brokers in our office who is constantly saying, "No, it is going really well. It is also really good for market. Be frugal, stay lean." And you want to be able to survive and stay around otherwise you don't get the benefit from everything you have learned.

And it's surprising to me now, right? We are in 2020. It's been a long time some of the people that are entering the market now have never seen a recession. It seems foreign to them as much as it was hearing their grandparents talk about the Great Depression and so it is really hard for them to relate that that is a very real thing and to be able to account for that in their underwriting and also to be able to account for that in their personal careers and the way that they set up their livelihood.

And so, it is one of those things that was constantly nagging and preaching on but it sounds like a broken record but I think it needs to be said.

[0:20:02.6] WS: And how do you prepare for this potential downturn that everybody is talking about?

[0:20:07.0] BB: Stay frugal and stay lean. I think if you want to find, if you talked to a lot of people that have been in the business and have lived through a few cycles, you'll find that they don't drive the nicest cars, that they don't live in the biggest houses and they save cash because they know that we're not talking about a three to six month. This might be three to six years that you might have to go and be able to fund.

And if you love the industry the way most of us do And you are passionate about it and you want to stay in it, stay lean because it's in my opinion worst that getting fired if you run out of cash and you got a spouse that's like, "We got to move on," and you have to give up everything that you have learned and acquired during that time. So I think it is really important to stay lean.

[0:20:48.1] WS: Great advice, I appreciate you sharing that. So, what is a way you've recently improved your business that we could apply to ours?

[0:20:53.8] BB: I would say use all the tools available. One of the things that is really exciting right now about commercial real estate is that we are getting a lot of technology and we're big on collecting as much information as we can from every single call. So, we actually have a licensed person that answers all the calls and is always asking information about, "Oh, that's neat that you are interested in this property, where else are you guys expanding," and dropping those pins on the map?

And so, we are able to quickly visualize what parts of the city have the most demand and for future expansion and we can anticipate that. And so, there is so many fun cheap free tools nowadays. Record and data base everything you can. Use the CRM, use Google Maps, use whatever tools are available to you and most of them are free. And it is so cool because you think you're going to remember something that you have heard in the market.

In reality is none of us are, you get to 20 minutes later, you all have forgotten that information. So, put down into whatever tool works for you, sub-market information and make sure you keep it on hand because in reality is sub-market information is what creates value.

[0:21:54.4] WS: You said you have a licensed person answering the phone?

[0:21:58.5] BB: Yes.

[0:21:59.2] WS: What does that mean?

[0:22:00.1] BB: So, we have licensed real estate agent answer every single incoming call. So instead of it going through a phone tree or something like that, we make sure that whoever gets that phone call it's not going to voice mail because that information that comes inbound is so stinking important and such a quick pulse of the market, right? Because that is how I started, right? Answering the phone, something that's vital. It is how you create opportunity.

So that person is trained to be able to identify and open that caller up to be able to learn what is going on the market and be able to record it for the benefit of the whole firm.

[0:22:29.3] WS: That makes so much sense because then that person just understands the lingo and they understand what the information that's most valuable to you. What about the software that you were talking about? What is a couple of pieces of software or tools like you are mentioning that's been beneficial?

[0:22:42.4] BB: So, we use Google Maps a lot for recording information and tenant demand and all that and that sort of thing. But also, internally whenever we hear a really cool tidbit of market information, we have a regular meetings in our office where we all swap coms and data but we also use Slack in the office. We could just Slack channel just for market and tell them, "Hey, I heard this. Found out about these tenant sales. Found about this" And we just share it internally. So that we can all stay on top of stuff. It is pretty fun and it is free.

[0:23:07.2] WS: What's the number one thing that's contributed to your success?

[0:23:09.6] BB: Over delivering. Yeah. Over delivering when someone asks for steps one through two, figure out a way to go to step 10. Take it a step further everything that you do that does not mean over promise, right? And there is definitely a difference between the over promising and over delivering. But over delivering in my opinion means over communicating sometimes to make sure that you've anticipate needs before they ask for them.

Basically, solve other people's problem of worry, right? Really that is a lot of us are in the business for because we think that it's going to solve income problems, challenges, whatever may lay ahead, our dreams and ambitions for the future, a lot of that is worry, right? So, if you can add value in any way to your investors, if you can add value in any way to your clients by anticipating their needs and communicating before they even ask for it, that is a big thing. And it is challenging to do as you scale and grow but it is important.

[0:24:03.0] WS: What's your best advice for the listener who is hesitant to reach out to that broker to begin that relationship in ways to drive that relationship forward to work together?

[0:24:13.1] BB: Have confidence and just go for it. I mean a lot of times I think some of brokers can – you know some of us can have some ego and we think that we are more important than the other person on the line. I think that obviously flawed but I think when people are getting started in the industry and they are calling brokers they can quickly get put off by the pretentiousness of our industry.

And it is really unfortunate because the reality is we all got started somewhere. But more importantly sub-market info is really important. I think respect to the broker's time understandingly gracious but also add value back is another way too.

So, some brokers may not be super inclined to give you all of their information because that is how they make a living. So, if you have learned something interesting in the sub-market, you're like, "Hey thanks for sharing that info. By the way, I heard this. You probably already knew that." They'd be much quicker to answer your phone and develop those relationships if it is a two-way street.

[0:25:05.2] WS: I love that. All right well, how do you like to give back Bethany?

[0:25:09.2] BB: I am a fan of a few different programs, Adult and Teen Challenge of Texas, which is a drug and rehabilitation program. I am on the board of that and have been for about 10 years and I love that program. I also love my local church and mission. So, yeah.

[0:25:22.8] WS: Wow, thank you for sharing that. It's a great show Bethany, I appreciate you being willing to come on and share with listeners and myself just your expertise in retail and just the risk involved and even developing the relationship with the broker, which is a necessity in this business. So, I am grateful for your time. Tell the listeners how they can get in touch with you and learn more about you.

[0:25:42.0] BB: Sure, you can reach out via email or via our website just www.foresitecre.com and you can find my email address there, my phone number as well. Add me on LinkedIn and stay with us on social media.

[0:26:00.0] WS: Awesome, that's a wrap, Bethany. Thank you very much.

[0:26:02.6] BB: Thanks so much for having me.

[END OF INTERVIEW]

[0:26:04.3] 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]

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