EPISODE 623

[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]

[0:00:24.4] WS: This is your daily Real Estate Syndication Show. I'm your host, Whitney Sewell. Today, our guest is John Blatchford. Thanks for being on the show, John.

[0:00:34.0] JB: Thanks, Whitney. Appreciate it.

[0:00:35.7] WS: With 7 million dollars in his historic tax credits received, 95 apartment units, by the next year, 9 million dollars in syndicated assets and in value by the next year. John is the founder of Kunst, a real estate developer and syndicator in Cincinnati, Ohio. Since 2013, Kunst has syndicated 12 multifamily projects, with 95 total apartments completed or under construction. Kunst has used more than 7 million dollars in historic tax credits to reduce risk, and increase returns, even in an economic downturn.

John believes in historic preservation, good design, and treating tenants as customers or members. John, thank you again for your time. Give the listeners and myself a little more about maybe your business strategy and where you're located.

[0:01:26.5] JB: We started the company about 2013, full-time since 2015. As you mentioned, we've done a lot with the historic tax credits, which is a strong program here in Ohio. Then it's also a federal program that's helped us over time, I think provide greater returns and maybe take a little risk out of the projects, because we get money essentially from the government, independent of the performance of the projects. Of course, we underwrite the projects and we make sure they work on their own, but the historic tax credits really help, especially going through different economic climates and what might happen with the rental market over the next year or so. We've tried to make good use of those programs and learn a ton about them and use them as much as we can, basically.

[0:02:06.6] WS: What is a historic tax credit? I mean, I've heard of that a lot. I think I understand what it is, but just in case the listener has no idea what you're talking about, what is a historic tax credit?

[0:02:16.2] JB: Yeah. I think effectively, and which I think is a great program, the government is trying to incentivize historic preservation. There can be a case is made to tear down significant historic buildings, or to renovate them poorly to save money, and so the government is trying to incentive developers to save these historic buildings.

It's a program that's federal across the entire country and then most states have an additional program, including a strong one here in Ohio. If you preserve the building and you keep certain features of it, they essentially give you a credit for part of that construction cost. The state credit is 25% here in Ohio and the federal credit is 20% anywhere across the country. It depends state-by-state how you can use that credit. It can be a cash refund as part of your tax return, which is really powerful here in Ohio. It's literally cash when the project is done.

The federal program can be used against your federal tax liability. If you’re a real estate professional, like most of us, or if you have passive income, or have investors or something that does, then essentially 20% of the project cost becomes the credit and then they can use that against our federal tax liability. It's really the government incentive, I would say, good historic preservation of significant buildings.

[0:03:24.3] WS: Doesn't it cost a lot more to repair buildings though, that would meet that historic guideline, I guess?

[0:03:31.0] JB: Yeah, it can. I think that's why a lot of people don't want to pursue the program. There's documentation. You might have to save things. It can be an annoying process. From our perspective, to keep an original floor, to keep a old wooden door rather than building a new one, it can often be cheaper if you have people that know what they're doing. You don’t have to custom fabricate things, stuff like that.

It can actually be pretty cost effective, even keeping original windows, things like that, which can be very expensive new. The cost can often be, I think, fairly similar, but then you receive a big credit on the backend, so it becomes totally worth it.

[0:04:04.2] WS: What about finding a general contractor, or a carpenter, or somebody that's willing to work, or have the knowledge I guess, or skill set to work on a historic home, or building, or something like that? Is that a problem or an issue at all?

[0:04:17.8] JB: It can be hard to find people that, I guess, can do a lot of these trades, if it's plaster, or restoring old floors, or custom wood doors and windows, but that's part of I think what we've built up over the years. You find some at the beginning and they don't work out, like any subcontractor, and you get burnt enough and then hopefully over time, you find the good ones. We've found that. I think there are more of those people around than it seems. I think it's easy just to go to Home Depot, order something online. We do tons of that, but maybe it's a little extra energy to find a local carpenter that can build it maybe custom. If 25%, or say 45% of that cost of that is going to be deferred essentially by the government, then it can be worth it.

[0:04:59.6] WS: Tell me about how it takes out risk? You mentioned that a couple times.

[0:05:03.8] JB: In that sense, it’s independent. You have to get the credit and it can be competitive and it takes documentation and things like that. Effectively, once you get it, it doesn't matter if nobody rents the apartment, or if your rents are lower than you thought, or whatever happens with the economic climate. You're going to get that credit.

It's in a sense, 45% of the project cost is taken off the table just by this credit, independent of the performance of the project. Again, you don't want to do a bad project just for the sake of getting the credits. If it's an otherwise good project, it becomes even less risky, because a lot of money is coming out with these credits.

[0:05:40.1] WS: Are sellers going to want more for their property, because you're going to get these credits?

[0:05:46.1] JB: They might drive the price up, you mean?

[0:05:48.2] WS: Yeah, that's right. Just they'll know, they're going to say, "Okay, you Mr. Buyer, you're going to get these credits, so this is what it's going to cost."

[0:05:54.3] JB: Right. Yeah, we might not want to advertise it too widely that we're using it. We're lucky here, almost every building in the neighborhood we're operating Over-the-Rhine here in Cincinnati is eligible. A savvy buyer might say, "Oh, it's tax credit eligible," but there is still a process to get the credits. It's not really automatic, so I think it's hard to include that maybe in the price.

[0:06:13.2] WS: Are there specific types of buildings that are going to get this credit? Or what are some typical guidelines, I guess, when you're looking for properties? Are you focused on properties that are going to get this tax benefit, or on historic properties? Is that your main thing?

[0:06:28.2] JB: That's certainly become our niche. I would say, we're in a great city, a great neighborhood for it. I think it's such a great program that we probably wouldn't do a building right now that you couldn't get the tax credits. Yeah, we certainly evaluate. If a building comes available, that's the first box that we need to check off, that the tax credits are possible.

[0:06:46.8] WS: Where do you learn about something like this? Somebody's in Texas right now and they're thinking, "Oh, wait a minute. I wonder if I could get some of these tax credits." How do you learn that?

[0:06:55.8] JB: The federal program is administered through the National Park Service. I would say their resources are good if maybe dense. A federal program is the same across the country. Then state-by-state, it's administered by some group in your state. For in Ohio, it's the Ohio Development Services. Their resources I would say are quite good. They'll tell you how much the credit is for, what it can be used against, what are the guidelines, what's the application look like, all that. It does vary a little bit state-by-state in terms of how good that program is and what's required to go into it. It's pretty much a national – the federal standard is pretty consistent across the country.

[0:07:33.7] WS: What about just the requirements, or the documentation and paperwork like you've mentioned a couple times? Could you elaborate on that a little bit, just so we know what we're getting into?

[0:07:42.0] JB: Yeah. Essentially, you start with the building, you apply for the credits. The main part of that application is documenting what's currently there. You take a photo throughout the building and different angles. You put that on a photo key, so that the reviewer can tell what they're dealing with, what you're dealing with. Then you say literally in a text document what you're going to do. You can see in the third floor, all the original floors are there. We're going to keep those. There's six original doors that are there, those we'll keep. The 10 new doors, we're going to do a new door, which looks like this.

It is quite detailed, I would say, in that respect. The one good thing is it's the same from building to building, so it's pretty painful the first time. Then after that it's like, okay, you keep the original floors, you keep the original doors. That part of it actually stays fairly consistent. Yeah, so you document each treatment, they call it, and that's just a text document stating what you're going to do. Effectively, that gets reviewed and approved. At the end, you just have to do what you said.

There's a certification at the end of the project too, which you submit and you say, "Hey, we said we're going to do this and we did it," and there's some back and forth at that point too, but hopefully you don't screw it up.

[0:08:50.9] WS: Do you know all that, say before you close on a project? Can you do some of that during due diligence as far as figuring out everything that's going to have to be done and if you can actually get the tax credit or not?

[0:09:01.7] JB: Yeah. You could probably informally see, because I can imagine and sometimes it comes up with like, "Okay. Could you put an elevator in the middle of building?" Maybe that would really be required for a project, but that could come in conflict with the tax credit. Those things, you can approach informally and just ask the state reviewers what they would think.

They have the same incentive that you do, that the project gets renovated and it's done well. Until you formally submit it, you don't know for sure. That part of it can be tricky, especially if it's a building that may requires something big, or a new addition, or something that might be outside the historic bounds.

[0:09:39.5] WS: Can you just elaborate maybe on a previous project about how you use this?

[0:09:44.8] JB: Yeah. For example, actually the building I'm in right now is three-bedroom apartments and we got a $70,000 state tax credit. We finished the project last year. This tax season, the investors will get $70,000 as a cash refund on their returns and that was on a $100,000 invested. Effectively, 72% literally of their initial investment is coming out of the project two years into their investment and one year after the project is complete. That's pretty powerful and then that's in addition to everything else that's good about real estate, and depreciation, and now we're making money on rents and all that, and the asset appreciation.

Effectively, 75% of their money came out when the project was done, and then we actually did a cash out refinance earlier this year, so they're going to have all their money, plus some out pretty quick, and still own most of the building.

[0:10:35.4] WS: That sounds pretty good.

[0:10:36.3] JB: It's annoying, but it's documentation. There's nothing crazy and it's one of those things you just go through it and it's documentation pain. I mean, in a sense, if the government's going to give you 45% of your project, it's hard to turn down.

[0:10:50.5] WS: Yeah, it's developing a process, right? I mean, just making sure all your I's are dotted and your T's are crossed, right?

[0:10:57.3] JB: Yeah. We have documentation from previous projects. We can use a lot of the similar language, and it's a wood floor from one building to the next. It's wood doors from one building to the next. A lot of it is carried over. We know enough about the project and we have a good relationship with the people that administer it in Columbus. It's become a real tool for us. We're not the only ones. There's a lot of people doing it in Cincinnati and certainly in Cleveland and around the country, taking advantage of this program.

[0:11:21.8] WS: What's the typical age of a property like this? What's too new or the vintage?

[0:11:27.3] JB: Yeah. Ours are all typically before 1900 or into the early 1900s. Depending where the building is, there's a – it's like a period of significance. That's the time period in which it was part of the historic character. I don't know exactly what that is for Over-the-Rhine, but I think it probably goes until the 1940s. There's a broad range there. They started in the 1830s and probably a 100-year time span where all those buildings would be part of that.

[0:11:56.2] WS: What happens if you mess up, or you don't do it just like you intended, or you make a mistake?

[0:12:01.9] JB: Yeah. There's a review process at the end. There's always an opportunity to fix it. They would never want to deny you just offhand. Depending what it is, that fix could be really expensive. If you used the wrong windows and there's 50 of them, that can be a $40,000 fix.

[0:12:19.0] WS: There went your credit.

[0:12:20.9] JB: Yeah, exactly. We haven't gotten into too many issues like that. I've heard of some, they get to the final stage and they never got something approved. It doesn't agree with what you basically said in the document and it's – it can be bad, I guess.

[0:12:35.5] WS: What's the biggest investor objections to historic properties like this?

[0:12:41.1] JB: Fortunately for us, we are doing a complete renovation and that's part of the historic tax credit is actually, you have to invest more than you bought the building for. There's a minimum investment. The idea is you're not buying a building built in 1910, maybe renovated in the 60s and everything's outdated. I think that could be really tough and that's I think a criticism maybe of old buildings is everything's outdated.

In our case, we're doing a complete renovation. It's all new electric, it's all new plumbing, all new mechanicals and there's of course, annoyance that goes along with that. But when we're done, we know that everything is good and should last for a long time. In that sense, I think the investors are totally onboard. Part of the pain is it does take time in addition to normal construction time, where you have to apply, it's only in two rounds every year. It adds to the total project timeline, I think that could be a real potentially an issue.

Typically, they're the ones benefiting the most in these projects, because they're going to get the state credit, which is cash, and the federal credit, which might help them pay much less tax. They're I think very pro the tax credits.

[0:13:42.8] WS: Sure. Okay. It sounds like floors, doors, exterior characteristics, things like that, they going to have to stay the same, but you're going to update all the systems. So the electrical and wiring and HVAC, all those things, you're going to redo all those.

[0:13:58.0] JB: Yup, exactly. Yeah, it's heating and air conditioning. We have in all of them now and electric. There's no restriction around that. They want you to modernize the building and you can put in new windows and you can add storm windows and you can certainly add insulation and heating and cooling and all the modern amenities. There's no restriction really around that. They care mostly about the interior and exterior character of the building.

[0:14:20.8] WS: John, what's been the hardest part of the syndication business or journey for you?

[0:14:25.1] JB: I think there's an idea of like, okay, there's money in real estate, and I want to own real estate ,and it's going to make me wealthy and something. I'm sure as you know as a syndicator and probably people listening, well, how do you actually get paid? That's the question, right? Even a fantastically successful project, you're not a millionaire even off of great rents necessarily. It's mostly other people that are investing the money and they're going to keep most of that. A big question is how do you make money? How do you get paid? How do you pay your bills and hopefully get wealthy? There's that.

We're now five years in and I think are just turning the corner of like, “Okay. Now we're actually making some money personally.” We have some ownership in buildings and that's great, but you can't eat that. I thought of recently net personal value, all the cash flows, what that's worth today. You can't eat a net personal value, so you have to figure out a way to get paid.

[0:15:16.2] WS: That was the hardest part for you. You had to figure out a way to get paid.

[0:15:18.6] JB: Yeah, not necessarily romanticize the idea of being in real estate. It's like, okay, there's plenty of awesome things about it. You're investing and donating half of your profits to a cause and I think I'm interested in historic preservation and design, but it's hard not to romanticize it and just say, “Okay. Well, what are the fees? How do I get paid? How does money come out and get to me?” I think that's the biggest learning thing of over the past five years.

[0:15:41.5] WS: What's the way you've recently improved your business that we can all apply to ours, besides getting paid?

[0:15:47.1] JB: I think one thing is if you're syndicating deals, especially early on, you know how much of a track record. You have to think about what you can do well and what you can get paid for. With all of these projects, we started out not knowing much, not knowing anything about construction, knowing nothing about these historic tax credits and we took it to figure it out ourselves and not necessarily pay consultants and all this.

Now that's an expertise and that's how we get paid. We can get paid to do the tax credits and we can get paid to be the general contractor. I think that's what's improved, especially over the past year of there's real revenue coming into us as a company, not just the properties and not rents and all that, which we may or may not see a lot of.

Now we have real revenue, which is to be the general contractor specifically and to do the tax credits. That's I think something to consider. What can you do really well in the business that provides value to the investors that they're going to pay for essentially, or the project will pay you for?

[0:16:41.6] WS: What's your best source right now of meeting investors?

[0:16:45.2] JB: We've had some luck through our website inbound. I think we're going to put a lot more energy into that moving forward, just trying to get, I'd say more inbound interests. The networking piece is important. One thing I think I've learned is you get money in surprising places, friends who – it's tough to count people's money, and maybe you shouldn't anyways. You don't know who has money and you don't know, maybe their parents do. Okay, I can't invest, but my boss can and he's a bigwig. We've had that experience a few times. I think not being afraid to ask and not judging or expecting that people don't have money.

[0:17:16.9] WS: Yeah. Judging a book by its cover, right?

[0:17:18.7] JB: Yeah. You don't know whether that money exists in their world. It doesn't hurt to ask. I think, mostly people are flattered. Do you think they have money and you want them to join you? All you can do is ask.

[0:17:29.4] WS: What is that asking look like to you?

[0:17:31.7] JB: It's in every form, in-person, phone, text, e-mail. Basically, you should invest, we have a bunch of projects coming up. I can send you more information and that's the lead-in. Then we try to be as concise as possible. It's some documentation, one document that we can send. Maybe it's a one-pager and then more details on a specific deal. Right now, we've mostly gone deal-by-deal. Maybe that would expand to more of a fun structure or something. I think early on, it's hard to convince people of that. We just go deal-by-deal. This is the project. This is what we're expecting the returns to be. Now we have this expertise with construction and with the tax credits that we can leverage.

[0:18:09.5] WS: What's the number one thing that's contributed to your success?

[0:18:12.9] JB: I was just listening to something yesterday. The locus of control, the idea that you can control being internal. You can control the world around you. I think that's really important, because I think it's easy to maybe hire people you think know more than you, or let somebody else try to figure it out. I think for us and for me personally, as much as I can take in my control at least, then it's knowing even if I'm going to mess it up. Then second time is better and hopefully, that improves each time.

I think taking control of things and of course, in construction even, no matter what scale you're doing that at, in our case, we're doing a complete renovation. Stuff comes up all the time and it's easy to throw your hands up and complain, but you could say, "Well, this is in my control," even if it's a supplier can't deliver something or whatever. Okay, we can control a lot of things. You control most things. That's important, I think.

[0:19:02.8] WS: How do you like to give back?

[0:19:05.4] JB: As I mentioned, I think the things I'm interested in is historic preservation. We started a small non-profit here in 2013, just focused on that, for a young preservationist group. Certainly, that's one of my motivators is to have a lot of money and to be able to essentially save good buildings. I think small business in general, when COVID came up, we have a small e-mail list of 500 people, but I try to reach out to them and say, "Hey, this is how we can support businesses that are struggling during the COVID shutdown," and we pulling up a little bit of money to get that started. Yeah, I would say generally, small business, historic preservation, those are my two main interests.

[0:19:47.1] WS: John, I'm grateful for your time and I just think you've made me more aware of this historic tax credits that I probably didn't know were out there, but then I hope a lot of listeners are more aware of them as well, and how you've used them to benefit your business and your investors in a big way. Tell the listeners how they can get in touch with you and learn more about you.

[0:20:05.5] JB: Our company is Kunst. It's a German word for art, the idea of renovating buildings artfully. Kunst. The website is www.kunst.us. That's my e-mail, john@kunst.us. Then text or call, you can put it out, 513-813-1667. I'm available any form that works.

[0:20:30.7] WS: Awesome, John. That's a wrap. Thank you very much.

[0:20:33.2] JB: Thanks, Whitney. Appreciate it.

[END OF INTERVIEW]

[0:20:35.1] 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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[OUTRO]

[0:21:15.3] ANNOUNCER: Thank you for listening to The Real Estate Syndication Show, brought to you by Lifebridge Capital. Lifebridge 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. Lifebridge 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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