EPISODE 655

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

[00:00:34] RS: Good to see you again.

[00:00:36] WS: Good to see you again. I always enjoy speaking with Ryan. He's extremely knowledgeable about this business. I just always learn so much from him. I had enjoyed being on stage together at the Best Ever Conference as well and grateful to have you on the show.

A little about Ryan in case you don't know of him, he serves as a Principal of Elevation Capital Group bringing more than 15 years of extensive business experience in market evaluation, property analysis, management system, due diligence, and finance. Elevation through its affiliates has acquired properties worth more than $475 million and has an interest in over 175 assets across more than 30 states.

He's a highly recruited athlete. Ryan was drafted as a high school senior by the Baltimore Orioles and again in college by the Anthem Angels and ultimately made the decision to pursue an entrepreneurial business career. He currently lives in Orlando with his wife, Jamie, and their four children.

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Ryan, thank you again. You want to give us a little update since the last show or what's happening at Elevation and let's jump in a little bit. I know – Just so the listeners know, we're going to jump in a little bit to just COVID and how that's affected Orion's business and their properties. He's into storage and mobile home parks, and I want to hear about those specifically and then just how some things are changing in the industry. Give us an update, Ryan.

[00:01:58] RS: Sure. I guess on the family front the good news is we still have four kids. Kids are wonderful. But that's four and final, so that's a good start. In terms of the business, we're obviously in the mobile home park and storage space. We got into that space some 17 years ago or so because we thought it would be fairly cycle resilient, non-correlated that it would handle upheavals well or disruptions well, and they did for the most part in 2008 to 2010. They're doing fairly well right now in COVID. We have a slight dip in gross revenue in April but May and June an so far in July have been great.

Anyway, everything is going well. Refinanced a bunch of properties this year. We have acquired a bunch of properties or we sold a property on Friday [inaudible 00:02:40]. Anyway, still been very, very active.

[00:02:45] WS: Do you have some specific properties or maybe just in general that we can discuss or about when COVID hit? Maybe some steps that you all took briefly just to minimize any issues, but then just kind of how that's happened or how you've tracked what's happening with those properties and different things you all have learned.

[00:03:01] RS: Sure. I guess across the board, if a bad time hits and there's something you immediately start doing, there's a question of should you have been doing that earlier. To answer your question but before I do, I think it's important to say a lot of what we've been doing for years is still very much the same. We want to buy quality. We focus on buying quality assets and quality markets, and running them like a son of a gun. Constant touch points, constantly walking the property, quality people, a lot of SOPs in place.

But in short, once COVID hit, we're a conservative bunch. To a degree, we evaluated what we thought the worst case scenario could be and we acted as if it was going to be the case. I say this because there are some – especially operators that are also in the capital markets, there's a

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propensity to merge marketing and operations whereby marketing starts driving operations. I want to make an operating decision so that it's still marketable in the future, and that may or may not be still the best decision.

So, our decision was to act as if the worst was going to happen. If that was the case, then we would've been glad to have been early rather than late. Thankfully, the worst has not happened and not anywhere close. In short, we had good cash reserves going into COVID. We had good assets. We don't use a lot of debt. As an example, at the time going into COVID, I think our Fund 7, which owns approximately $200 million in assets went into COVID with about 37% leverage, so incredibly low leverage, a lot of cushion in margin of safety. We had a good cash position.

In response to COVID, obviously in many locations there is a moratorium against evictions or auctions in the storage business. We froze our rental increases. We froze our late fees and some of those things. I think April off of memory I think we had around a 3.5% decline in revenue, which all things considered. Of course, we'd like it to be +3 but it was not nearly as bad as a lot of other asset classes out there. Then May actually grew in occupancy pickups. June we grew occupancy. July is doing fine, and we actually unfroze the freeze if you're following that. We are now starting evictions, auctions, rent in escalations, and charging late fees and some of those other things. Based on what we see right now, we're really pleased with where we are and where we're going.

[00:05:24] WS: It's great to see it thaw out a little bit and start to warm back up, right? What about over – you know what's happened obviously over the last few months. But, obviously, your opinion next six months, your game plan, and what do you foresee happening.

[00:05:38] RS: Yeah. I think maybe 6 to 12 months from now in our industry, we'll probably see a couple of distressed opportunities as soon. As soon as COVID hit, I'm sure you saw the same thing that kind of the immediate investor response, and I'm judging this based on LinkedIn and some other groups I'm a part of — but people went from the sky's the limit — to there's no end of sight to in a day. Now, it's time for distressed opportunities. It's interesting.

But I guess for me in our space, we're not seeing a lot of distress for the underlying fundamental reasons we got into this space. But we think maybe 6 or 12 months from now, there might be some distress — primarily in the storage sector where there was a lot of overbuilding going into COVID, and we think we'll up accelerating the trend, which is a decline in new construction and SEO deals. That's going to be great for those who currently own storage facilities but that may also bring the market some who their original model fails. That's something we see maybe 6 to 12 months down the way.

I think in the interim future, I think with new acquisitions, I think there's a lot of opportunity. There's a lot of assets we see that we like that we can add value to in good markets. I think the retail investors will probably have to shift their mindset a little bit in terms of what they think is achievable for the rest they're willing to take to derive it. Anyway, I see that as probably a shift on the horizon.

[00:07:02] WS: You mentioned – I want to come back to the retail investors having to shift their mindset a little bit. But distressed opportunities coming up, how are you preparing for that just so you all can take advantage of that?

[00:07:14] RS: In our space, I'll say it this way, distressed opportunities — where let's say you can buy a dollar for 80 cents — we always like that. But for the most part, the outcome that we're looking to derive from an asset is in the future. It's on taking an asset from where it is and to where it can be growing it and then realizing that benefit over time. We think there's going to be some distressed opportunities. However, we're going to be pretty picky on the ones that we buy in that. In many of the cases, they're going to be not cash flowing. Otherwise, they would likely not be in distress. In many other cases that we're seeing today, there are some distress in terms of you're able to buy them below cost but they're still a drag on cash and they may be a drag on cash for a year or two, plus or minus.

Over the next couple of years with new funds that we launched, we're going to be very picky on the allocation to distressed assets. We're still going to buy kind of the bread-and-butter quality assets that are performing in good markets that we can make better but also add an allocation to distressed assets, but not so much so it's a drag on the overall performance and kind of balance that out.

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[00:08:23] WS: Why do you think these properties are going to be distressed? What was the mistake that, say, those operators did to now have a distressed property during this time?

[00:08:33] RS: A good question. There's a number of aspects to that, and I'll pick a couple examples. There's a property we sold recently in the Denver Technology Center, the DTC in Denver. It was built from the ground up by a gentleman who'd never in storage before, so the market got so frothy in people's cut — to a degree irrationally exuberant that first time operators would go and deploy a lot of capital in the hopes that they pegged it right. In short, the way he built the product, it looked like an office building. You would drive by and not even think it was storage.

From a design standpoint, a layout standpoint, the physical infrastructure was wrong. Then when you look at his underwriting expectations in the last couple years going into the end of last year, we saw expectations in some cases that people thought they would build a new storage facility and lease it up inside of two years, which is incredibly optimistic and not, in most cases, practical. A lot of times, they overpaid. They designed the building. They built it wrong or they had unrealistic expectations. For a while, lenders were going along with it. I think that'll be less likely in the future — in terms of workouts.

[00:09:39] WS: Sure. Let's elaborate a little bit on the investors' expectations and how some of those need to probably change in the future. But you talked about retail investors will have to shift their mindset a little bit. I'd love for you to elaborate on that a little bit.

[00:09:53] RS: I guess starting with the public markets, and this is all just [inaudible 00:09:56] and round. I'm just going off information that I saw a couple weeks ago. But I want to say going into the end of 2019, the average dividend yield for an investor in the public markets was in the 4%. Let's say 4.5% just to talk about something. Today, I believe it's around 2.

In most cases, many investors are now coming out of the public markets, earning a lot less from their investments than they most likely built their lifestyle around. There's a lot of holes in people's income models. They need a lot more income, a place to live up to their standard of living. You have investors needing income. You have investors kind of getting bit by volatility in

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the public market, so they're probably going to have a propensity desire and lower volatility. With all that in mind, I think they're going to – most likely, there's going to be a lot of people who look at real estate and other alternative investments. But real estate will certainly get an allocation of those.

You have an increased amount of people looking in a confined space for income. At the same time, you have 10 years. Call it 50 basis points. I haven't looked at it today. You have interest rate is historically low. You have low inflation, at least for the time being. When you bake it all together, I think the earnings expectations in the short run will be – when you're buying income-producing real estate, I think cap rates will remain high. I think yield will remain under pressure because more and more people are trying to get a bite at the apple. They're almost bidding down their yield, so to speak.

In short, I think there's a lot of people looking at real estate but I think what they're going to have to do is understand that income yield will be less than what it could have been maybe two or three years ago. That doesn't mean the total return picture may change. Actually, on a total return basis, you may be able to achieve two years from now what you could in the past. You might. You might not. But I think it'll probably show itself in lower income and more capital appreciation. I think investors will need to shift their mindset or not and say, "I'm not shifting my mindset. I'm going to get what I need," and maybe intentionally or inadvertently taking more risk than they might either know or should be. What I mean by that is it might instead go to real tertiary markets, real rough properties that have a lot of hair on them in order to generate the income that plug that hole.

[00:12:16] WS: They're going to take more risk too because they were expecting and used to this kind of income over here and it's not happening. So then we're going to take more risk to see if we can get it.

[00:12:25] RS: Correct. You're already kind of seeing it. When we had funds and call it 8 to 10 years ago, investors would generally want somewhere in the 8 to 10% return in terms of actual distribution rates. Today, I'm seeing a lot of funds go out with 6% preferred returns and 7%, and they're cumulative, which means they may not even achieve that. But the point basically is the investors. But there's a lot of funds that are launching that are distributing in the 5, 6, 7% range,

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which is a lot less. They're still raising a lot of capital because at the end of the day it's very hard to generate 10% yield right off the bat, buying a quality asset in a quality market. It's pretty difficult.

[00:13:04] WS: How are you conditioning your investors to be prepared for that or at least to understand that change when you're putting out your next fund or your next deal and just so that's not a big surprise, and they're prepared for that?

[00:13:18] RS: We're really not proactively conditioning. For us, there's the market and there's our response to the market. Eventually, we're not advising people on where to invest and how to think about investments, so it's more or less. We're to a point in our business where we want to do it what we determine, what we would deem for ourselves the right way. We want high quality. We don't want to take a lot of risk. We want reasonable expectations. For us, we're going to put out what we think that is. If somebody agrees, that's great. If somebody doesn't agree, that's also perfect. For us, it's just identifying what it is that we think we can do well and what we think the market will bear. If somebody thinks they can do better than that somewhere else, then it's a free market.

[00:14:02] WS: How is your underwriting or your deal expectations changed looking at opportunities now versus six months ago?

[00:14:10] RS: First, we think COVID is for the most part in the asset classes we invest in kind of a [inaudible 00:14:16]. We do not think it's structurally going to reshape the industry like it might in retailer or others. For us, there's not any fundamental disruption there. We already buy and underwrite conservatively. We have a lot of cash. We use low leverage, so there's not a lot that we're doing differently presently. There's not a lot. We're actually not changing a ton other than to say the market dynamics of a lot of capital chasing fewer deals. I kind of spoke to that, which I believe will continue. I actually think probably in the next year or two, there's going to be more capital chasing probably fewer deals, so I think that'll be accommodative to cap rates going and staying at least the same and possibly going lower. We'll see.

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But in short, the result of that is you'll have thinner yield because you're going to potentially – If cap rates go down from here and interest rates let's say roughly stay the same, then the margin will go down.

[00:15:09] WS: I love that answer. No fundamental disruptions or changes because you all are already underwriting conservatively. I love the low debt and having some reserves and those things like you mentioned, so you're prepared before this happened. You're still prepared. I love that. What's a way you've recently improved your business, Ryan, that we could apply to ours as well?

[00:15:28] RS: There are so many different aspects. We continue to work on an internal dashboard and continue to find different ways to improve it in terms of operations and data and analytics. On the investor platform side of things, we are implementing a new system that we're working on right now which we're excited about, and so that'll be a great improvement compared to what we were doing. We have about 1,500 investors so that'll be – I think it will be great for them and it'll also be great for us too, because there's some real improvements there. I'd say over the last couple of years, an improvement to the model overall is we made a decision years ago to keep – We raise capital and buy properties and funds. You know this but just in case somebody who is listening may not know kind of what we do in capacity.

Early on, we would have a fund that would be open for maybe a year, and we'd raise and we buy six, seven, eight properties, and a fund is basically multiple properties and one entity with many investors. But what we started doing over the last call it five or six years is keeping our funds open longer, and so the funds are bigger not because we're trying to raise any more money. It's just we kept it open longer. The benefit of that is it can give you a better balance sheet which you can then lever to obtain types of debt that you can use.

For example, Fund 7 had a revolving line of credit that we were able to obtain for acquisitions. It was an accordion feature, so we could go in some cases from 10 to 30 million dollars. We can expand and contract it as we need it. But then that way, if we needed to buy a property, we could write a check, put it on the line, and then take it out to permanent financing. The intention to build an appropriately sized fund which Fund 7 was 150 million-dollar raise, and we think that's appropriate. We're not trying to raise more in the future. We think that's appropriate. But

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that allows us to have that balance sheet, and that was a big improvement the way we did things.

[00:17:23] WS: What's your best source right now for finding those investors?

[00:17:26] RS: Well, it's funny. I actually think a lot less about it than I used to. We have about 18,000 accredited investors on our database, people who have requested information from us over the last decade. Every day, we have more and more, and people tell people. When you first started, you have zero in your database. Then it's like that book, *Are You My Mother.* You're going down the street and you're like, "Are you my investor? Are you my –" I've got four young kids, so I apologize for the analogy. But you're really proactively trying to build that out.

But then there's a point where you have a critical mass, and people have a good experience with you. You do what you say. You meet expectations. You put others before yourself. You fight to the death if necessary for the benefit of your investors. You do all those things. You earn trust. People reinvest. They tell people. The short answer is most likely from that database. But also to answer your question, I have no idea.

[00:18:21] WS: 18,000 and you all are doing something, right? I think I don't remember this exactly, but it seems like last time maybe it was around 14,000, and that's the biggest number I've heard yet. Now, we're at 18, so you all are doing something right. That's incredible. What is the number one thing that you contributed to your success?

[00:18:37] RS: We genuinely like people and care about people. It's not feigned. It's not false. People believe that we'll – At least our investors believe we'll do the best for them. If they were a fly on the wall, there's nothing they would hear in our offices that would ever give them concern. In fact, there's a lot that they hear that they'd be shocked about in a good way, so that goes a long way.

[00:18:57] WS: How do you like to give back?

[00:18:58] RS: I hate to say it. It's a good question. I don't think of it in pie chart terms and I'm not – you didn't ask it in pie chart terms, but it's kind of like, "Okay, what percentage of your life

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do you like to take and then what percentage of your life do you like to give back?" To me, the difference between a for-profit and a non-profit is the way it's taxed. The intent should be the same. To me, my goal is to serve our customers. Those who visit our storage facilities, they're going to find the cleanest place in town, priced appropriately. They're going to be treated with respect.

Anyway, the point is we're going to serve our clients really well so much so. Hopefully, they ask why, which is a whole another talk. I would love for people to ask that question. Same in our manufactured housing communities. Then the mobile home parks that we own are so nice. You would be shocked that they're actually mobile home parks and they're run well. The point is we serve people well and derive a profit, and then we give to many different places. But the ultimate intent of our business is hard to distinguish from a non-for-profit. I mean, the only difference is taxation really.

For us specifically, my wife and I, we love our community. We love where we live. We love our neighbor. We think the world could be a lot better if we just loved our neighbor well, and so we've – In response to COVID. It's a shame that COVID is what it took to initiate this, but we started the Neighbors Helping Neighbors Campaign, and we have signs up all over. If anybody drives through our community and there's hundreds of signs that says help, if you need help, call this number. We have about 150 neighbors that we've aggregated. Each request that comes in gets a case manager that's a neighbor who basically are neighbors helping neighbors. That's been a lot of fun. We really love building community and giving within the context of community.

[00:20:44] WS: Wow! I love that answer about the for-profit and nonprofit, and the only difference is how it's taxed. I've never heard it said like that before but couldn't agree more and just what you all have done in your community. That's unique and really I know that's taken a lot of time and effort, and I'm sure it's helping lots of people, so thank you for giving back in that way and just sharing that with us. But how can people get in touch with you and learn more about you?

[00:21:07] RS: To the extent that they even want that, which would be amazing, my website is elevationcapitalgroup.com. Then my email is ryan@elevationcg.com.

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[00:21:19] WS: Awesome. That’s a wrap, Ryan. Thank you so much.

[00:21:22] RS: Yeah, you bet. Thanks a ton.

[END OF INTERVIEW]

[00:21:23] 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]

[00:22:04] 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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