EPISODE 782

[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 Jack Krupey. Thanks for being on the show, Jack.

[00:00:32] JK: A pleasure to be here.

[00:00:33] WS: Jack has been investing in real estate since 2001 and is part of a large PE fund, purchasing distressed mortgages since the 2008 crisis. During that time, he was also personally investing as a limited partner in various syndication deals. He recently launched his own Reg D fund, the diversified real estate fund focused on aggregating capital to provide investors a diversified investment into multiple syndications with a diverse portfolio of multifamily and various markets with a select group of experienced and well-qualified operators.

Jack, thank you again for your time being on the show. I'm looking forward to getting into that and this model you've created because I know it's something that I've heard people talk about a little bit, and I know there's listeners who are wondering how that works a little bit and just the fund of fund models. But give us a little bit about your background in real estate and getting into the fund type of business.

[00:01:27] JK: Sure. So I actually started in 2001 shortly after college, buying single-family and small multifamily properties in Rochester, New York. I was there until the 2008 crash. Then during that time, I was able to land a job at a private equity fund that was buying large portfolios

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of distressed loans. They needed someone with real estate experience to handle the incoming short sales and just the other side of the business. So I was there for a few years then launched my own small fund. Then we ended up partnering with a private equity group and bought over two billion in loans between 2015 and 2020. I actually still maintain a minority ownership in the platform but I left in 2019. I'm more of an entrepreneurial guy.

Then during that time, we bought over 30,000 loans, and I was personally investing in a number of syndication deals and I just – you know, there wasn't a lot of diversity of choice. I had a buddy that was doing deals in Charleston, South Carolina, so I had to choose between putting money. Do I put money in Charleston, South Carolina with one operator? Do I put money in Texas with another operator? Just me personally, I was looking for a little more diversity. I didn't really see a lot of other options, so that led me to create the diversified fund.

[00:02:37] WS: Nice. Well, I'm looking forward to getting into that. Why don't we just talk a little bit about it? And I'm sure you can speak to this very well, just like some pros and cons of having them fund versus investing in specific deals like you were talking about.

[00:02:51] JK: Sure. Obviously, with a specific deal, you get to dive in a little further and know exactly what you're getting into. You may have more comfort level with a personal relationship with a certain operator. So that's the main pro of doing a direct deal. Doing this fund of funds model, you're getting a diversity of operators. So if one operator runs into challenges, it's not going to take down the whole portfolio. You're also getting a diversity of markets. So far, and we opened the doors late September, we're in three deals already just with my own personal seed money, as well as a few friends and family that came in. So far, we're in a 104-unit in Augusta, Georgia. We're in a 266-unit in Jacksonville and a 286-unit in Phoenix. So if there's a hurricane in Florida, it's not going to affect Phoenix. If there's fires out in the West Coast, it's not going to affect Florida. I think the diversity plays a key component of it.

The other aspect is, although we're charging our own management fees, even really, really strong successful operators — you know, when you have 45 days to raise five million dollars for a building, even guys with large databases and great investor bases are always looking for larger check sizes. And we often get better deals, better returns than if somebody were to put 50,000 directly into a project. So it may not offset every dollar of our management fees but it can

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make a big difference. Whether we get a piece of the GP or whether we get a higher preferred return, there's a number of things we can do to offset to make it a better return for coming in through our aggregated capital than just going directly into a deal.

[00:04:28] WS: Yes. No, it's awesome. I mean, everybody talks about diversification, and this is a great way to diversify, like you said, amongst operators, but not only operators but also markets as well. Tell me what are some of the biggest concerns that investors have when investing in a fund like this?

[00:04:45] JK: Well, right now, in addition to the fund itself, I mean, there's a lot of investors worried about just political risks also with the COVID situation and what happens when the government stimulus slowed down. Those are generally the conversations we're having right now. I'm overall still very bullish on the residential sector. There's just not enough single-family housing supply across the deals we're in most of the operators are within a percent or two of rent collection that they were last year. I don't – of the tenants that have reported COVID-related issues — just in this workforce housing sector, it's not that I don't believe the bottom's going to fall. It seems like the majority of people still have jobs or they're essential workers and they're not all only employed because of the PPP funds.

I could certainly see a recession or some struggles next year, but I just don't think this sector is going to get hit nearly as hard if you're in a – our core is really we're focusing on class B multifamily. If things get tough, people are going to downgrade from class A or they're going to sell their house, and the single family market is booming. Any vacant properties because of the foreclosure and eviction moratoriums, the exposure we still have to the single-family foreclosure market is anything vacant is selling very, very quickly. So that lack of supply trickles down to the apartment sector where if you can't find a house because there's multiple offers, you're going to stay in apartments.

There's some concern over potential capital gains, tax changes depending on who wins. I feel like that comes up in every election cycle and I can't imagine a scenario where they just completely do away with it. I think cooler heads will prevail even if in a Biden administration where the rate may go up a bit, but I just can't imagine. They're just eliminating capital gains

completely. I think there's enough rich democratic donors that own real estate as well and I hope that some sense will prevail. Yeah, other questions are really just about the operating partners.

So at least at this stage, the partners we're in with I've known for many years. I've had my personal money with them. The group in Augusta, Georgia, also had done non-performing loans at some point in the past, so I actually knew them and did business with them both on the loan side. But the main owner had also had multi-family the whole time as well. So these are long-term relationships that I'm leveraging for the access to at least the initial deals. Over time, I'm hoping to continue to network and find other strong sponsors and strong markets.

[00:07:02] WS: Let's talk a little bit about just a relationship, say, with a sponsor while operating a fund versus just being a LP or limited partner.

[00:07:11] JK: Sure. Obviously, one of the benefits is a lot of the sponsors we talked to are going through hundreds of deals to find the good one. So it's making my life easier because we're not competing in that way. We're not bidding against them for a deal in Atlanta or Charlotte. As the LP capital, the good deals come to us. We're looking for strong operators that have similar mindset to us for the types of asset classes and types of value-add and really just a strong sense of ethics, ability to execute.

I like operators that have been through a down cycle, whether it was in apartments or just been around long enough to have been through the 2008 crisis because, I mean, we've seen things can go sideways. Really, those are the key. There's some more logistical things like making sure the K-1s get out on time so that we can take our K-1s in and just aligning on just the level of value-add and return metrics so that we're – Because we're balancing multiple properties. Some of which are heavier value-adds. Some of which are a little more stabilized. So we're trying to create a balanced portfolio where we're paying quarterly dividends and that we don't have too many value-adds at one time that hurt the dividends. But at the same time, we're trying to still provide a mid-teens return overall, so we want that balance.

[00:08:27] WS: Why don't you speak a little just about creating a fund like this? I know there's probably many listeners who are contemplating creating a fund, especially right now. I've heard more talk about a fund recently than ever, or than in a long time I'll say. But it's just a lot of

thought around there's going to be deals to be had soon. Let's obviously raise this money, so we're prepared. But maybe you can speak to just how you created this fund and some steps or maybe things you wish you had known when you started to create the fund.

[00:08:55] JK: Sure. Although I've been involved with billions of dollars in transactions, this is the first time I've actually done the Reg D. Prior, I had one big private equity backer handle all the fundraising. So I chose to do the Reg D 506(c) because I wanted to be able to do some level of promotion in advertising and I feel like a majority of the investors were going to be accredited anyway. So it limits us to only accredited, and I just feel that's a safer way to go. I have multiple share classes, so there was the balance of keeping it really simple and doing whether it's a 70-30 or with a certain hurdle where the promote can go higher or just doing a fixed return.

So I chose to do both. We have a fixed return share class that just provides 10% with a three-year lockup that in some cases could be better for IRA money. I can't give tax advice. But the way it's structured, it minimizes you bid. If it's just the fixed return and you're not getting an equity, the leverage doesn't affect you as much. Then we have the six or an eight percent referred return with a 70-30 split. The eight percent it just pays if someone's coming in that's more than 250, 000, they get a higher preferred return. So we try to structure it so that it has both a fixed return for people who just want to clip a coupon and then the more aggressive return for investors that are looking for the higher returns.

Duration comes up a lot, and that's the other thing. For the fixed return, we could do a three-year lock-up, and people can request their money back. But many of these deals will be into these deals for five to seven years so it's – [inaudible 00:10:24] investing. It's fund but you're investing in a business and the reason – If you want to have immediate liquidity, you could buy a REIT, but you're probably going to make a six or eight percent dividend on the REIT and have the ups and downs of the stock markets to contend with. Then you actually – It's not even a qualified dividend because the REITS aren't taxed at the corporate level first, so it's not even the discounted dividend tax.

Versus this fund or any of the funds, you get the pass-through depreciation, which for high-earning accredited investors, the passive depreciation is one of the key benefits. So I guess the

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main point is it's the balance of trying to keep it super simple but also having a few different options for different types of investors.

[00:11:04] WS: Nice. No, that's awesome. Investors love to have some options, depending on what their investment goals are, right? Whether it's growth long term or they need more cash flow now. Like I said, even whether they're investing with an IRA or something else, it may be more beneficial to do one way or the other. But a couple of things you mentioned there that I don't hear very often, you said like an investor that's investing 250,000 or more, they can make a little higher return, right? Could you just elaborate on that a little bit? It’s not something like I don't see many deals structured that way that I think it's neat to encourage those that can to invest more. Just speak to that a little bit.

[00:11:40] JK: Yeah. I mean, it's an incentive. Obviously, as a newer fund, it's an incentive to get a little more money in the door. I think generally people that have more capital tend – In some cases, do have more options as well. There's a fair amount of credit investors that don't have any exposure to this space. But then there's others that might have a choice between doing a direct certification or coming into the fund, so it's just trying to provide a reasonable incentive to the higher net worth investors that can come in with a bigger check and make it competitive against other options.

We do have an advisory practice as well. For select situations, we may have the opportunity for investors to also invest directly into deals alongside us as well as part of a sidecar fund. We're not going to turn into a crowd street or fundraise ourselves. I think we're going to stay more boutique, but there could be situations where the fund is only going to invest a certain amount of the funds capital in the deal, and a sponsor that we are close with has more capital needs than we want to allocate ourselves. So there could be some individual one-off situations as well, and those are customized deals we can put together for the higher net worth investors.

We also can facilitate or discuss 1031 exchange options. Someone owns a building and is looking to do a tenant in common situation and probably needs to be a seven-figure deal to make sense to do all the legal. But we've seen situations where you set up a Delaware Trust and set up a tenant in common situation and those are — because we have so many operators that a lot of them own 10, 20 other buildings besides the ones that we’re even invested with

them, there's going to be the ability to do off-market transactions as they figure out which buildings they've owned for four or five years that they may want to sell or recapitalize. So it just opens the door for just various opportunities, and real estate's a team sport.

[00:13:25] WS: For sure, yeah. One thing quickly, I know you mentioned like a three-year lock up in a fund where like they can't get their funds. They can request their funds after three years. Could you elaborate on that a little bit because I know that that's always a question, right? When do I get my funds back? If it's a single deal or syndication, then obviously it's very difficult to do that until we exit, right? But how does that work with the fund?

[00:13:48] JK: Sure. That part is more of an open-ended vehicle, so it's preferred equity. You still have membership interest in the LLC. You're fully secured. You're paid. Your preferred returns are paid, pursue along with the other shared classes. But after the three-year period, if you want your funds back, you can request them back. That’s sort of a more of an open-ended fund, so we can continue to raise fixed return equity and return capital for those that want out. They also may be able to convert into the longer term equity if they choose at that point because we're targeting – at this point, the deals we're in now, the pro forma is 16.5 return between the three deals so far. The fund's gross returns for the equity shareholders should be in the mid-teens or better. So those that want the cash out or short term, we'll just be continuing to raise fixed return capital.

The fund does have a slightly broader mandate than just multifamily. My target is at least 50% of the deals are going to be these cookie cutter class B value-adds, which I think is a very defensive and safe haven asset class where you're forcing appreciation. But we have the ability to do bridge lending [inaudible 00:14:54] as we mimic a small allocation into a senior housing development. It’s multifamily-focused for a core of the fund, but there's a few opportunistic opportunities that could generate higher returns as well. And as we build the base of investors, I know a number of groups that have done – they only pay fixed return and don't actually share the upside, so I don't want to give both options to people. But we do expect there's enough interest for people who want to clip coupons that, yeah, that's going to be more of the open-ended fund.

Then the equity side will be we'll probably launch a new fund every two or three years because it becomes unfair to the equity investors if you're continually taking equity. If it's three years in and you put in equity and then you sell a building six months later, it starts becoming unfair to the early investors if you take equity forever. But fixed return side isn't affected by that, so it allows us to keep that part of the fund open longer.

[00:15:41] WS: When operating a fund, how do you prepare for a downturn?

[00:15:45] JK: We're very – One of the reasons we're in this type of asset class is I feel that it's probably the most immune to a downturn. We're certainly not going to be buying retail or office at this point, and my background in distressed debt I expect is going to be very helpful. When there is an inevitable downturn. Banks in many cases are forced to sell loans because the capital reserve requirements that they're required to maintain. Sometimes, it makes more sense for them to sell a loan at 50%, 60% of the current asset value.

So, we could kind of play both sides of the equation. Locking in very low interest rate exposure to a class B multifamily I feel is defensive. If and when there's a more significant decline or even on the class B which I feel is defensive, but some people might have bought with a bad bridge loan and just couldn't execute on their game plan. So, if and when there's a project that's not going well, we're going to be positioned to bail projects out if needed and work with one of the sponsors that we know is a great executor and take over a building that maybe went a little bit sideways and needs a new management team in place. So I think you have to be prepared to pounce on the distress.

But at the same time, I go back to value investing class. I took updated value investing class in business school, and they talked about dollar cost averaging. If you were putting money into the stock market in 1929 one month at a time, the six months before and six months after 1929, you would have been positive within two and a half or three years. There's similar statistics for the 2008 crash in the stock market. I look at that in real estate as well. Even if there is an expansion of cap rates and even if multifamily does decline a few points, we're in cash flow positive projects and we're going to continue to allocate money into deals over the course of a few years, and we don't need to time the market perfectly. But if there is a decline, we'll be averaging in, and it's not going to hurt the fund's returns.

[00:17:41] WS: Yeah. On that note, maybe you can speak to just how you see the market adapting post-COVID or what you see over the next 6 to 12 months in the real estate market.

[00:17:50] JK: Sure. I think it's definitely increased the timing of people moving out of New York and California into secondary and tertiary markets. I don't think that office work is dead by any means but I think a higher percentage of people are going to be able to continue to work from home, whether that's 5, 10, 20 percent more. That’s more people that are going to be able to work from secondary markets for a much lower cost of living. So I like the Augusta, Georgia over Atlanta where you can get a point higher cap rate. The Jacksonville deal we're in, there's a stat that we pulled that had – It’s the highest net population increase post-COVID was Jacksonville, Florida. And, I think it really bodes well for secondary and tertiary markets that have slightly higher cap rates. It’s not to say we wouldn't do a deal in Atlanta, but those are über competitive and the remote work.

It’s expanding on trends that were already happening. People are already leaving California for Phoenix and Las Vegas. Las Vegas obviously has its own challenges with the tourism and the gambling industry but Phoenix – really, everywhere that people from California move. People from California we're also moving to Boise and various other markets — Texas.

So, yeah, I think it's just expanding on trends that were already happening. Interest rates are likely to be low for the foreseeable future. And locking in these Fannie or HUD loans where you're getting a sub-3% rate for either 30 years around the HUD product or the Fannie Mae loan in Augusta that did the Green Program, and the 12-year term seven years interest only at 2.88%. It’s difficult to beat that financing which will be in place for the length of the project, length of time we're going to own the project.

[00:19:39] WS: Jack, just a few last questions quickly. I believe anyone that has a high level of self-discipline or anyone that's successful in business has a high level of self-discipline. How did you gain such a high level of self-discipline?

[00:19:52] JK: Sometimes, it varies. I know I have it but it's not all the time for everyone as well. I’ve always been driven. I’ve always been sort of a deal junkie and a bit of a tax nerd too. One of

the reasons I actually relocated to Puerto Rico. So I still keep an apartment in New Jersey but I moved to Puerto Rico for the Act 20/22 tax benefits. I think it's a matter of just doing what you like to do and I realize I'm not a guy who's going to swing a hammer and enjoy it. I'm not. I know I'm not that guy but I've always been the guy that's been a bit of an evangelist for real estate.

In my 20s, I was the guy saying, "Buy a two-family house. Live in the other half of it." Then I was early in the distressed debt, non-performing loan space which really became its own industry in itself. A lot of real estate investors migrated into buying NPL in 2008, 2009. Now, I'm really just an evangelist. I'm in my 40s now and I've got a base of friends, business partners, clients that are started to build a bit of a net worth and are looking for ways to do it. It's really more of a guide and evangelist for being a wealth manager and finding more efficient ways to deploy capital, so you can make a mid-teens tax efficient return.

So the answer is just you got to do what you love, and I've had brief periods of time in my career where I wasn't doing what I loved and was sort of just in it for the money or just to get paid. If you find your skill set where you actually enjoy what you do, it doesn't feel like work and that that makes it easy to just stay driven and just keep producing.

[00:21:20] WS: What's your best source for meeting new investors right now?

[00:21:23] JK: Right now, it's been just putting myself back out there. I had a bit of a database of people I've done business with, whether I sold the Marios or loans. So it's more of an active base. With COVID, it's not been as easy to do face-to-face conferences, but one of my colleagues did a virtual conference last week. I've been speaking on podcasts and just really putting myself out there. It's doing various things. I'm losing my voice in some cases because I'm on the phone five or six hours a day or on Zoom calls. It's just casting a wide net and just being willing to have a conversation.

What's great is, for me, it's a two-sided market. I want to talk to operators and sponsors. I want to talk to brokers and I want to talk to accredited investors as well. So it's not – every conversation is different. You never know where it leads.

[00:22:04] WS: What's the number one thing that's contributed to your success?

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[00:22:07] JK: I think it's really that I'm kind of a shameless self-promoter without being excessive. I think people sense the passion and sense that I love what I do and I'm just always interested in finding deals and opportunities and very generous with leads and referrals myself too. I look at how you create a win-win and I have that. It's a joke. It's like an idiot savant memory where like I'll somehow remember a random fact about somebody I met three years ago, and they're like, “Oh, you should talk to that guy about this.” So I really try to give back to and help connect people, and that's paid a lot of dividends for me over my career

[00:22:40] WS: How do you like to give back?

[00:22:42] JK: I think just knowledge, time, information. Always I'm happy to talk with newer investors too and provide guidance. Just relocating to Puerto Rico, there's some organizations like the Act 20 Society that actually donates to various charities down here. But with what my skill set is, I feel like the best thing to do is actually just help newer investors get into the space and make connections and just grow the community.

[00:23:06] WS: Nice. Jack, I'm grateful to have met you and have you on the show. It's just great to hear more about just the fund of fund type of model. I know that's becoming more popular, and a lot of people have questions about it, and you'll be a great resource I know for many that are looking or considering that type of model. Maybe as a passive investor being able to diversify a little more in a couple different ways there that are important. But then also, as a sponsor, it's neat to know people like yourself that are doing that. Tell the listeners how they can get in touch with you and learn more about you.

[00:23:36] JK: Sure. So we're on all social media. It's JKAM Investments. It's J-K-A-Minvestments.com, and I'm active on Facebook, as well as LinkedIn. We have a company page, a personal page, and the contact information is on the website. Please feel free to reach out through any of the social media. I'm sure we'll put it all in the show notes as well and really looking forward to networking more with the community.

[END OF INTERVIEW]

[00:24:00] 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]

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