EPISODE 860

[INTRODUCTION]

[0:00:00.0] 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 Brian Hamrick, thanks for being on the show Brian.

[0:00:33.1] BH: Hey Whitney, it's great to be here, thank you.

[0:00:35.7] WS: Yeah, honored to have you on the show. Brian controls over 32 million dollars in apartment, self-storage and office commercial real estate as well as performing and non-performing notes. He's raised over nine million dollars from investors through syndications and funds and he also hosts the Rental Property Owner and Real Estate Investor Podcast.

Brian, welcome to the show, give us a little more about your focus in real estate and let's jump into your superpower and I think we're going to just dive into today to help the listener.

[0:01:05.7] BH: Yeah, absolutely. Whitney, thanks for having me on your show. You know, I'm an opportunistic investor. I invest in apartments, I invest in office, a little bit of retail, self-storage is one of my favorites and performing and non-performing notes and I've also dabbled in some ground up apartment development too.

I've done a lot, I've worked with a lot of great partners and I always like to come prepared to shows like yours and bring my A-game. I actually thought, you know, I've had a lot of conversations in the past couple of months about fund structure because I've started a fund. I spent about a year trying to figure out how to do a fund and if it's okay with you, I'd love to talk about fund structure today. It's not necessarily my superpower, I'm not an attorney but I've certainly gone down that road and would love to talk about it.

[0:01:53.0] WS: No doubt about it, I would love to talk about that and I appreciate you just bringing it up and that you – I mean, spending a year of research learning this, you're going to be so much more knowledgeable about this than I am for sure but just that you've done it too.

I want us to get into what you're talking about versus say, the normal syndication or deal by deal syndication that some people have heard different. They call it different things and you just elaborate on the pros, cons and we'll get into some of that. Thank you for that. Thank you for that, thank you for being on the show but let's jump in, tell us a little about maybe, I guess, I want to back up. I was going to say the fund that you did but back up a little bit to you, even your research for a year.

Where did you go to find research, what were your – what were the main things that helped you, Brian, to learn even most of the things you're going to share with us today?

[0:02:44.7] BH: Well, I looked for books on the topic, could not really find many books. I went to networking events, national networking events and probably, that's the best source to find people who have actually put their own funds together and to talk to them and say, "Why did you structure it this way, how did you structure it? What were some of the considerations?"

Really, when you talk to 10 different people who have started 10 different funds, you get 10 entirely different answers as to how they went about it and what kind of structure they have. It can be confusing and daunting but before I get into that, I mean, let's make sure people understand what a fund is and how it's different from a syndication.

[0:03:22.5] WS: Please.

[0:03:23.6] BH: I have certainly syndicated apartment buildings, self-storage, in either single, asset syndications where you identify the property, you identify the closing date, you go out and you raise your money and once you close, you've got your investors, they're locked in and maybe you hold it five years, 10 years, whatever, but that's a single asset syndication. I know you've done a hundred million in syndication so you're very familiar with that process.

But let's say you want to go out and you're not sure what you're going to buy but you know, "Okay, there's a lot of retail right now because of coronavirus pandemic" and – I'm sorry, "There's a lot of distress right now in the retail area," that's what I mean to say.

Let's say you want to go out and just pick-up distressed retail centers, shopping malls, strip centers, things like that, but you're not sure exactly what the asset is going to be. So you might start a fund that is meant to raise the money before you identify the asset and it could be multiple assets that you would pick up in this fund.

That's why you would do a fund structure as opposed to just a single asset syndication.

[0:04:31.3] WS: Okay, there's a lot to think through there, right? Why we would do this and when and who should do this? I mean, maybe even some of the timeline, people are thinking, "Okay, when am I going to be raising the money or when's it going to be deployed?" and some of those things working or to think through.

Maybe we can start with too, even the types of properties we should be thinking about acquiring or do they have to be the same or can we purchase different types in that fund. Just elaborate on that some.

[0:04:59.2] BH: Yeah, I'm not going to talk about any fund that I may or may not have done because it's a 506(b) but I'll just kind of take you through in general. Kind of from a general perspective because I'm not an attorney or CPA so you should always of course talk to your experts on your team about these things.

As far as identifying the asset, if you're an apartment investor, you might say, "The assets that we're going to go after are distressed assets that are in the 20-to-40-unit range. We're going to pick these up from a million to a million and a half each. We don't know what they are yet but we're going to raise enough money so that whenever we see those opportunities, we can close quickly because we've already had commitments for the funds to close. We may not even need lender financing because we'll be raising that money from our investors."

That's from the asset side, you want to identify what the asset is going to be. Is it going to be apartments, is it going to be retail centers, is it going to be crypto currency? Whatever it might be, identify that but then also think, "Well, what if we're investing, what if we're only going after retail but we come across an office building that's distressed that we can pick up and it makes sense?"

Do you want to widen the parameters of your fund and make sure it's transparent to your investors in such a way that you, as the operator, have the leeway to include office in your retail? You have to take these things into consideration when you're putting together your fund.

[0:06:30.2] WS: Any kind of timeframe restrictions or the duration of the fund, things like that we should be thinking about?

[0:06:36.9] BH: Yeah, that's always important because if you're – let's say you're buying apartment buildings. What is your window of time that you need to be able to acquire these? Is your fund only going to be open for a year? You're going to acquire these assets, achieve the upside value and dispose of them within three years, five years, 10 years? You need to figure that out.

Because you're on kind of a staggered schedule, you don't know when you're going to find the asset, you don't know when you're going to close on it, you don't know how many assets you're going to find and over what period of time. You need to build that flexibility into your fund to say, "You know what? This may not be your traditional three-to-five-year fund, this may be a seven-year fund or a 10-year fund." You have to really think about it in that way as to, well, how are you going to get your investors in and how long do you need to let them know that they're going to be in that fund?

[0:07:30.3] WS: They definitely are going to want to know, right? They're going to want to know when all these things are going to happen. You better have an idea about this time period that you're projecting. Thinking about those people that you're talking about, those investors, you have to project some kind of return, right? How do you do that, the returns you'll be offering to investors?

[0:07:50.3] BH: That's – I always say that's a marketing question. You have to know your investors, what are their timeframes? I mean, I have investors who are in their 70s and they've told me, "I don't want to invest in something for 10 years because I may not be around for 10 years." Does that mean I need to make it a five-year fund and is that – would that even work with the type of asset that I'm buying under the parameters which I'm buying them?

The returns are always different. Like I said, you talk to 10 different fund operators, you're going to get 10 different answers. I've talked to operators in the note world who basically – their fund is, "You invest with me and you're going to get a straight up 8% return. If you invest over 150,000, I'll make it 9%." That's it, it's just a flat, there's no equity upside to that.

And then you have other people who structure their fund much like we might structure our syndications where you have a cash-on-cash preferred return each year. Then IRR, an internal rate of return or annualized return, that's 18, 20%, once you liquidate.

The problem is, because it's kind of a blind pool, you don't know exactly what asset you're buying so you're not able to run the numbers really completely before you raise that money. You don't know exactly what the returns are going to be so you have to make sure you build in all kinds of cushion and take into account all kinds of variables to be able to get to a return that you know your investors will get excited about because again, it's always a marketing issue. You don't want to come out with 4% preferred return and 5% annualized return because the investors will just say, "Well, I can go to Whitney and do much better." You want to make sure it's sexy enough for your investors, but not overly sexy in which you can't deliver.

[0:09:40.5] WS: Are there any other things about just specific ways to provide those returns or that you're providing them to the investors?

[0:09:48.9] BH: The easiest way is just a straight up preferred return. Eight to 12%, that's what you're going to get and you know, it's a five-year fund and we'll get you your money back at the end of five years. That's the easiest way because it requires very little bookkeeping.

As you get into more detailed returns with preferred return, cash-on-cash, annualized return, once you dispose of the assets, then there's a lot more bookkeeping and you know, it's very easy with the cash-on-cash return to say "All right, when this investor invested on from this date, their cash-on-cash return starts there. They get a certain percentage, prorated for the amount of time they've been in."

But when you get to the annualized return, which is once we've disposed of all the assets in this fund, we've paid back our investors and now we're going to pay out the profit, you need to be able to make sure that the people who got in early and the people who got in later are being compensated equally or their compensation is balanced. Because you don't want to have a lopsided fund where the later you get in, the more profit participation you're going to get in the back end.

That was something that I really had to struggle with to figure out mathematically, well, how do we make sure that someone who gets in early is going to have the same annualized return or internal rate of return as someone who gets in late?

That was probably the biggest challenge. Do you want to hear the answer?

[0:11:26.9] WS: Yeah, of course.

[0:11:28.3] BH: Okay. What you have to do is you have to take a weighted ownership ratio for each investor and that, you're basically weighting the number of days, when I say weight, it's weighting. Weighting the number of days that they're in the investment with the number of units or shares that they've purchased.

Then that gives them a percentage of ownership that is then applied toward that annualized return when it comes time to pay that out.

[0:11:59.4] WS: Now, do you use some kind of software? I mean, obviously, we know lots of portals and things like that now that a lot of us are using but is there something that helps you to calculate that?

[0:12:10.5] BH: I use Excel, I've got an Excel spreadsheet. I'd be happy to share my template if anyone's interested, they can go to my website or email me and I'll share it. I'm also going to have a white paper ready by the time this comes out so people can – I'll put down any additional thoughts on putting a fund together.

Again, I'm not an attorney but I have done it and I've talked to many people so I'd be happy to share what I know about the topic.

[0:12:36.1] WS: Cool, I mean, can the shares or the value of the shares change in any way through the life of the fund or does that have to stay the same?

[0:12:43.4] BH: Well, I think that your percentage ownership as an investor is changing constantly because as new investors come in, they're bringing more money that disrupts the change of ownership.

The value of your share can also change as the fund acquires more assets. That certainly happens and you just reminded me of another way that one of the fund operators values the investment, is rather than just have a straight up, each share or unit that you purchase is a thousand dollars each, $50,000 minimum, a hundred or whatever. As they bring in new investors, they will actually revalue those shares. A share that might have cost $50,000 a year ago might be worth $86,000 now. That's a little bit more detailed because then they have to go and they have to get evaluations on all the assets and really make sure that they're clear on each individual asset and its value and how it's changed over time.

That is one way that I've seen people do it is to revalue the shares as new investors come in, much like you see in the stock market.

[0:13:54.1] WS: Are there normally waiting lists for a fund like this or do you have soft commitments, versus hard commitments, how does that work?

[0:14:01.6] BH: That's another tricky part because again, you're going out and soliciting investors, bringing in investors into your ecosystem without having identified the asset yet.

You've identified the asset class but not the asset. It's a delicate balance to get investors excited about that, get them on a waiting list, get them to subscribe to a waiting list and make a soft commitment.

A soft commitment is just that. It's not a hard commitment where my money is ready to go. It is just, "I'm in line. I am interested in investing and when you get to me, we'll see if I actually have that money to invest." The delicate balance is if you get too many investors in line with their soft commitments but you don't come through with the product and the pipeline isn't there for what you're trying to raise money for, those investors might get discouraged and go invest elsewhere.

There is a delicate balance and you have to be very mindful of not over-promising to your investors as to how quickly you're going to be able to deploy the money and that brings up another very important issues where people do get in trouble quite often when doing these funds is they raise the money before they actually have the assets identified and that's a problem because then you are paying a return, preferred return on assets that haven't even been purchased yet or identified.

You want to make sure you set it up or it's preferable at least to set it up so that you're only raising the money or actually bringing the money into your fund as you have the opportunity to deploy that money.

[0:15:36.8] WS: Some of that there, I mean you handed on it a little bit but I wanted to ask you just like when in someone's career should they consider a fund like this? Obviously, I mean you need that relationship with investors, right, before you probably do a fund like this but what's your take on that?

[0:15:52.5] BH: Well, I think syndication is much more preferable. In having done both, it is much better to identify the asset first, figure out the value, figure out the returns and then go to the investors. The reason you would consider a fund is if you have a pipeline of opportunities or you anticipate a pipeline of opportunities that you want to move quickly on.

There is a lot of talk about distress in different sectors of real estate and if you have some sort of pipeline to help out in that area, then it's a good idea to maybe start a fund because then you won't be bogged down each time on each individual asset trying to raise money for it. You'll have raised the money for a pool and in this case, it would be a blind – it's a blind pool. You don't know exactly what the asset is, you might know the asset class and it could be an open-ended rolling fund where you don't know when you're going to close it to investors and it is rolling in the sense that you'll bring investors in as you have opportunities to deploy that money.

[0:16:57.4] WS: I wanted to clarify also, I know you briefly mentioned like you were doing a 506(b) fund but I wanted to talk about B versus C just briefly because we've talked about that on the show a lot and so most listeners are going to understand some of the differences there but as far as a fund is concerned, if we are doing a 506(b), you have to have that pre-existing relationship when you start the fund, right? I mean you can't – it's not on a deal-by-deal basis then. It is going to be when the fund started, is that correct?

[0:17:25.5] BH: Yeah, absolutely. Yeah, that is something else to take into consideration too. What is the raise? How much are you raising? Is it a $1 million fund? In which case maybe as a 506(b), you have those pre-existing relationships. Is it a $20 million fund, where maybe you're better off with a 506(c) so that you can go out and bring in investors, accredited investors who you don't already have a relationship with. That's a big question too, what is the limit? What is the amount that your fund is going to raise?

[0:17:58.6] WS: I was thinking too if the hold period was two years or five years for this fund, you may want to be able to bring new people in over that long period of time.

[0:18:07.3] BH: Absolutely and that is part of the calculus that you have to put into the thinking process. Who are my investors of the investors that I have exposure to? Are they going to be able to help me with the $10 million fund? Do I need to go wider?

[0:18:22.4] WS: How soon are distributions paid? I mean I know you talked about that a little bit also but if the investor is listening, he's thinking about investing in a fund, how soon should he expect a return?

[0:18:33.1] BH: Yeah, you have to be very clear on that. You know, if you're buying distressed property, let's say, go back to the retail example, if you are buying distressed retail centers that may have non-paying tenants or vacant storefronts. Well, you are not going to be paying out in the first six months, maybe not even in the first two years.

You have to be very clear with your investors as to what to anticipate and I've seen it where people, you know, we all know people who over-raise and then start paying out as quickly as possible. I think that's a problem when it comes to fund because you certainly don't want to be paying investors out of money that you're raising from investors. You need to be paying them from the asset itself and the cash flow that's coming from that asset but yeah, it's not always possible to start paying quickly and again, that's a marketing issue.

I mean our investors are going to say, "Well sure, I'll wait three years for you to start making money but I am not going to be happy with the 6% return. I am going to want that 20% IRR or annualized return," or whatever it may be. Again, there is no one answer to that but you do have to think through, what is the timeline, what should I set my investors up to anticipate when they'll start seeing some money?

[0:19:55.1] WS: How does an operator like yourself make money in a fund like this versus a normal individual deal syndication?

[0:20:02.1] BH: Great question. There's different ways, it's very similar to syndications. I mean, an equity share; you pay if you pay a preferred return. You get the waterfall distributions after that preferred return is met. I think it's important to make sure your investors know that they're getting paid before you do whether it's a syndication or a fund but I do think that even though I've not done an asset management fee or any sort of management fee on my syndications, on the fund it's a little different because the fund is more work, so that's another way that you can pay yourself is through some sort of asset management fee.

[0:20:40.6] WS: Brian, what's been the hardest part of operating a fund or syndicating a fund like this?

[0:20:47.0] BH: Meeting investor's expectations and that waiting list. You know, I think keeping that balance between getting – keeping your investors excited about investing and then actually having that pipeline of supply for them to invest in. That's been the most difficult part and you really, when you put together a fund, you really have to think about your investors and consider them from every aspect, every viewpoint, to make sure that they are being rewarded for taking this leap with you because it is a blind pool.

They are not exactly sure what they're investing in and nor are you when you put it together. They are really investing with you as the operator and you have to be aware of that and treat it with respect.

[0:21:32.6] WS: What about preparing for a downturn when operating a fund like this?

[0:21:38.2] BH: Yeah, you know it's the same with the syndication. I mean how do you prepare for a downturn? You don't over-raise. You don't raise money that you can't deploy right away and you try to keep your liabilities limited as much as possible. I think if you do over-raise in order to have operational funds, that's important to make sure you have enough money to operate because there are expenses to keep that machine working smoothly.

[0:22:08.1] WS: Yeah, what about just your prediction for the real estate market over the next six to 12 months?

[0:22:14.6] BH: You know, I've heard all kinds of predictions from all fronts. I mean we're heading into a great recession; the housing market is going to collapse. I don't believe the negative, I mean all that could certainly happen. The negative could certainly happen. I think it's going to be asset by asset, location by location. I've heard about a lot of distress in apartment assets across the country but I have to say here in Grand Rapids, Michigan, my apartments are humming along nicely.

We've worked well with our residents; we've helped those who had trouble and we're doing very well. We are doing as well this year as we did last year before the pandemic but I know there are places where maybe they're lucky if they have 70% of their collections. I think it really depends. I think residential is going to stay strong. I don't anticipate a housing collapse like some do. I think residential would be good.

I think the asset classes that have held up really well like self-storage will continue to perform really well in markets where it's not been over-built. I think senior housing has really hit a lot of trouble, a lot of speed bumps lately but that's going to come back in the next couple of years because the demand is going to be there but I do think there will be some distress in the mortgage world, both commercial and residential. I think that there will be opportunities for non-performing notes.

[0:23:36.0] WS: Do you have any daily habits Brian, that you are very disciplined about that have helped you achieve success?

[0:23:42.3] BH: Just simple daily habits, I try to exercise a little bit each day whether it is just going for a walk or working out. I always have the same breakfast every morning. I always make my bed as soon as I get out of it, so those are my simple habits.

[0:23:56.8] WS: Nice. I encourage you to have something different for breakfast tomorrow.

[0:24:01.8] BH: Well, I try to be creative with the same. You know, maybe I'll add some different vegetables but it's always a fried egg.

[0:24:09.1] WS: What's your best source for meeting new investors right now?

[0:24:12.5] BH: You know, I host the podcast, The Rental Property Owner and Real Estate Investor Podcast. I have met so many investors, I've met partners through that podcast. That is really the best source. You know networking is always great but I haven't done much of that lately.

[0:24:29.9] WS: What about the number one thing that's contributed to your success?

[0:24:33.3] BH: Finding rock star partners, partnering with people who really know their area, the asset class and are real troubleshooters and know how to get things done.

[0:24:45.2] WS: Real troubleshooters not troublemakers, right?

[0:24:49.8] BH: The troubleshooters know how to keep the troublemakers at bay.

[0:24:54.4] WS: That's right. Brian, how do you like to give back?

[0:24:56.9] BH: Well, I think Whitney I know you host your podcast and I feel like we're both giving back to our audience through the podcast because we've had a certain amount of success in this area and it's important for us to share that as much as possible and that's why I prepared what I prepared for you today. I share a lot of information on my podcast with the people I interview and I am looking forward to interviewing you soon.

You know, I am philanthropic. I can't say I'm at the level that you are. I am very impressed with the work you do but I just think helping people get to that next level. That's how I love to give back.

[0:25:37.4] WS: Awesome. Well Brian, it's been a pleasure just to get to know you a little better personally and have you on the show and dive into a fund and things we should be thinking about. I mean I get the question often as well, "Should I do a fund, is this the time?" The big things, fix and happen, right? Where they're going to have all these deals, whatever that maybe and so we want to have all of this money ready and people are asking questions about this.

I am grateful for your time today just going through things we should be considering especially as far as our investors are concerned and our business and things that you've elaborated on when structuring and operating a fund but Brian, how can people get in touch with you and learn more about you?

[0:26:15.7] BH: Go to my website, it's higinvestor.com. You can email me at brian@higinvestor.com and listen to my podcast, The Rental Property Owner and Real Estate Investor Podcast and Whitney, I am going to put together a whitepaper about this and I will include my spreadsheet so people can see how I weight each individual investor, days that they've been invested and the shares that they've purchased and I'll make that available whether it's on my website or you can email me and I'll have that ready by the time this episode comes out.

[END OF INTERVIEW]

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[OUTRO]

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