EPISODE 972

[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.

0:00:24.4 Whitney Sewell
This is your daily real estate syndication show, I'm your host Whitney Sewell. You know, there's always a need for affordable housing and it's definitely not going away. And, one way that we serve that need is through mobile home parks. And so I hope that you enjoy the Highlight show today that focused on some mobile home park operators, who shared with us how they grow their business and how they operate the mobile home parks to be successful.

[INTERVIEW 1]

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Whitney Sewell
Our guest on this episode is John Jacobus. Thanks for being on the show, John.

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John Jacobus
I'm happy to be here. Thanks for having me, Whitney.

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WS: I wanted to ask you, if somebody that says, "John, you laid all this out. I'd really like to think about mobile home park investing myself," but your first deal had 70 homes on it. It seems like a big deal. Is that something I should consider? I hear it with multifamily all the time. Should I start with duplex or 100 units or more? I imagine it's a similar philosophy. What would you tell to somebody who's like, "That's 70 units. I don't know if 70 homes, I don't know about that." Is that

similar to mobile home parks as well?

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JJ: It is. It's the benefits of scale. You benefit from scale and your occupancy doesn't take as much of a hit on 70 units versus 70. You can spread your fixed operating cost across a wider base. For many of the same reasons that it makes sense to go larger initially in multifamily, it also makes sense to go larger initially in mobile home parks. Financing is easier. It checks all the boxes on simplicity.

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WS: In 70 units, you've seen the value add. There was a place to add more units. What was the business plan initially and how has it gone?

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JJ: There are a couple of value levers that we saw that we could pull. The lot infill was one. The twenty vacant lots infill over the course of a three-year period. We think it's a drag in our feet but we like to be unreasonably negative on our projections. If it's a low hurdle, we like jumping over one-foot hurdles instead of ten-foot hurdles. Under market rents, we saw about a gap of $15, $20 a month on the lot rents that we thought we could very easily push. We validated that by running some test ads in the markets, so we had some reasonable assurance that we can achieve those rents.

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WS: $15 to $20, is that a big loss to lease? Is that a big amount in mobile home parks?

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JJ: It's not huge but keep in mind that may not be meaningful at all in the apartment space, but apartment rents are quite a bit higher. $10 to $15 on a $1,000-average apartment rents is not that meaningful, but the average lot rent across the country is somewhere around $300. Your $10 to $15 of a much lower number is much more meaningful on a percentage basis. We were looking at 10% to 20% gap in where we were relative to market in what we thought is an escalating market. There's not a huge opportunity on a rent bump, but a material and a core component of our business plan. We also saw bloated expenses. The owner of this particular park had owned it for quite a while and it had just consistently deteriorated over time.

We saw that in the financials. We also saw it and we were boots on the ground doing diligence and talking to the manager. It's right across the street from the fire department, so we talked to them. We were able to validate that this park has been neglected over the past couple years and we don't know what's going on and it's run into disrepair. Introducing some professional managements, not only from a cost perspective, but paying attention and doing things and taking care of deferred maintenance was another major lever as well.

The last thing was this is the thing that at one point rappelled us and triggered us to run away from it, but at the same time represented the reason for a lot of the value that we saw. That was a contaminated water well. There was an issue with the infrastructure, so the private utilities and such that the water levels were not up to the code of the state. That killed the interest of a lot of prospective buyers. The more we dug into that and more than we could get comfortable and we're able to use that as a problem that scared a lot of others away. We used it as a negotiating tactic to get a price that was appealing and attractive to us.

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WS: Did you find that through your due diligence?

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WS: To round out that question, fixing that was a core component of our business plan. Once we resolved that, then a multitude of financing options with much more attractive terms opened up, which would allow us to take out capital and do great things. Those four things constituted the framework for our business plan. Yes, we did identify this issue with the well during the due diligence. Our due diligence is similar to multifamily. We look at the market, we look at the financials and then we look at the physical infrastructure. As part of our physical due diligence, we go to the county and state websites that keep track of health violations.

This particular park, we knew it had private utilities, so it's septic sewer system and a private water well. We checked it. We went to the appropriate governing body and that governing body keeps records on health violations. We pulled up the address and what we saw there was quite a long history of health violations and notices and there happened to be one outstanding. We drilled into that. I'm not a well operator, I'm not a plumber. I've never owned an asset that had private utilities. This was definitely a learning curve for me. We saw this thing and I immediately was like, "It's got poisonous water. We don't want anything to do with that." The initial thing was, "How bad is this? Is this a deal breaker?" I don't know anything. Radium was the contaminant. I don't know anything about radium. This is six parts per million versus the five parts per million as the max threshold.

How bad is that? Is that instant death as you ingest it or is it a slow burn? All these things are floating around and we had to get our brains wrapped around this. We spoke to some well operators, some private well experts. We spoke with environmental attorneys. We tried to round out and assess how bad is this and is it fixable? If it's a fixable problem, that's great because other people really react negatively to surface level things like this. That can be scary. It's poisonous water. I don't want to hear anything else. I'm not interested, on to the next.

For us it's, "Let's take a look. Is this a fixable thing? How much is it going to cost to resolve this thing? What's the worst-case scenario? If it's really to go bad, what does that mean? Are we going to be on the hook for all the historical issues, all the claims prior to our ownership? Are there some limits on our liability? Can we buy insurance to cap some of that risk?" Those were all the things that we were going through and trying to assess, "Do we know how bad that is and what that would translate into?" We assigned a probability to that and then we look at the upside. On balance, it's the risk reward balance and does this make sense to go forward?

At the time, we did all of that and we ultimately said, "No, it doesn't make sense to go forward." The park was at a price and on terms that were more aligned with a squeaky clean deal. We didn't feel that they properly reflected the risks associated with the well. At that point in time, we're probably six to eight weeks in due diligence now. We said, "This park isn't for us. We did all this work and we had compiled quite a comprehensive diligence package. It's probably worthwhile to someone else who's more experienced and has dealt with these types of issues before. Let's try to wholesale this and shop this around and see if we can get paid for our time and recoup some of the soft costs." We spent about six weeks and from then, shopping the deal around. We blasted it everywhere. You may have seen some of my posts. It was out on BiggerPockets and NHU forums.

Everywhere that we could get an audience, we let them know, "We've got a mobile home park. We've done all the due diligence." We've put an offering memorandum together or something like an offering memorandum. We spoke with about 40 different prospective investors and took a lot of phone calls, answered a lot of question and ultimately nobody was interested in the price and the terms. At this point, it's late October and we've got this deal in our hands that nobody wants. We've thoroughly tested the market and really gotten a sense for the appetite in the market.

While it's discouraging because we're trying to wholesale this thing and make some money, it actually was encouraging because now we had a lever that we could pull with a seller and say, "We spent a lot of time with your park. We know it and we're still interested. Here are our main issues though. Good luck trying to get this price in these terms with the market, because we've just tested the market and there's no interest. If you're wanting to close and wanting to close fast, you may as well work with us." That entered round two of us being back interested and trying to re-negotiate the deal.

[INTERVIEW 2]

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Whitney Sewell: Our guest is Jefferson Lilly. Thanks for being on the show, Jefferson.

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Jefferson Lilly: Thank you for having me, Whitney.

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WS: You were looking for a stable passive investment and that's what led you to real estate. How did you decide on a mobile home park? Why not multifamily, self-storage or even house flipping? Why mobile home parks?

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JL: Initially, I did think that I would buy an apartment building. I was on LoopNet and would do a filter for multifamily properties. I live out in San Francisco. I knew I was not going to find affordable property in San Francisco. I was already looking in Lubbock, Texas and Peoria, Illinois, and the greater Midwest. Wherever I'd look, there would be 99 apartment buildings at an eight cap. This was the pricing from many years ago. There would be one mobile home park at ten or eleven cap rate. The audience can think of that as the return that you would get on your money unlevered. If you paid cash, you'd get 8% or 11% on your money. The first time I saw

that I thought, "That's absurd. I'm not buying a trailer park." I deleted the search results and did it again in Lincoln, Nebraska or Omaha. I probably had to get hit over the head with me five or ten times, but it finally clicked. I thought, "Mobile home parks are multifamily. If they're yielding that much more money, why don't I look into it?" I did that and it clicked pretty quickly why it's such a compelling niche. I began to focus on it. It's the best thing going better than self-storage.

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WS: Were you looking to invest passively with another operator at that time or were you jumping in saying, "I'm going to do this and I'm going to be an operator?"

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JL: I was jumping in. I knew it wasn't going to be 100% passive, but I was looking to own a property directly, which is what I ended up doing. It didn't turn out to be an apartment building like I thought it would. It turned out a year and a half later to be a mobile home park.

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WS: As far as mobile home parks specifically, how are you picking locations for something like a mobile home park? Everybody says market. With the way the market is, how are you picking locations for mobile home parks and why?

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JL: We tend to invest for cashflow, which means we are generally purchasing properties in the greater Midwest. It's highly unlikely we would ever pay up to have something that's coastal California or coastal Florida. We look for cashflow. That leads us primarily to the Midwest. We then do have a couple of pages of diligence that we do on parks before we buy them. To do a quick and dirty screen on them, we're looking for healthy and at least decent-sized economies to invest in. For us, the healthy part means that the average household income is $40,000 and up, and we want to see the average house price at $100,000 and up. By definition, that weeds out places like Detroit, Michigan, Toledo, Ohio, Youngstown, Ohio. Some of the places that have unfortunately fallen on hard times. They have average household incomes of $32,000 and average house prices of $65,000. We can't compete with that. We look for those economic indicators that means it's a healthy metro. In general, we're investing in metros that are 100,000 people or larger. We do have two pages worth of diligence to get through before we close, but as an initial screen, if you've got those three things going for you, then it's almost certainly a

deal that's worth pursuing.

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WS: How many markets are you looking at the same time?

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JL: We get emails every single day from brokers. We do some of our own prospecting outbound. We cold call mobile home park owners. Maybe at any given time, we're considering eight or ten deals and most of those will pass on by the end of the day or the end of tomorrow. There is always something new coming in tomorrow or the next day. You certainly don't have to do every deal. You just have to do a relatively limited number of good deals.

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WS: Can you walk us through that process a little bit of how you would be eliminating a deal? Mobile home parks are not my specialty. How are you eliminating eight or ten deals that fast? What are some things that we should be looking for?

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JL: In addition to what I've mentioned, we're also looking at the price. We will see some of these deals from brokers, and the broker will manage our expectations that the price has to be that high. The seller wants a five cap on something. It could be the price that we pass on. A number of those deals will be in weaker economies. We pass for that reason. We'll also pass on deals unless there's something compelling about them, for instance, a lower price. We'll pass on deals that have a very high number of what we call park owned homes. Those are pretty much what they sound like. They are the homes that you as the landlord own. We prefer to run this business as a parking lot business. We like to help our residents own their own homes.

We like to buy parks where the residents already own their homes and pay us the lot rent into the ground. Parks with a very high number of park owned homes, we call those horizontal apartment buildings. The implication there where you as the park owner own a lot of the homes is first, all that repair and maintenance will fall on you. All those proverbial leaky toilets and leaky roofs will be your responsibility, the same way as it would be if you owned an actual apartment building. We'd rather have lower repair and maintenance. Secondly, rental homes, not the ones that residents own, but rental mobile homes tend to attract a very rough client base. You'll almost certainly be starting off with people that will unfortunately disrespect the houses and do a lot of damage to them.

It's much more important to buy a park where the residents already owned most of those homes. We'll bring in additional homes to fill any vacancies. That's okay. We won't rent them though. We'll put them out on a rent to own agreement where we work with a partner that's a subsidiary of Berkshire Hathaway, Warren Buffett's large company. They will finance the houses and put a proper mortgage against them. We build communities of owners and we help people become homeowners and get out of apartment buildings. It can be tough to start with a park that is a horizontal apartment building. Unless the price is particularly compelling, owning a lot of the mobile homes would be a reason that we might pass as well as all the other things I've mentioned.

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Whitney Sewell: We hope that you enjoyed the Highlights show today. You can always listen to the full episodes that were featured today by clicking the links in the show notes page. And in the description box, let us know why what you've thought of this episode or you can go to lifebreidgecapital.com/podcast and click the feedback button. Let us know how we can add value to you. Thank you and talk to you tomorrow.

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