EPISODE 1015

[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.

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Whitney Sewell: This is your daily real estate syndication show. We are introducing a new segment called The Real Estate Syndication Show Highlights, where we're bringing you a look back at episodes focused on a specific topic that we believe added a lot of value to you in your syndication journey.

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[INTERVIEW 1]

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Whitney Sewell: Our guest is Vinney Chopra. Thanks for being here again, Vinney.

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Vinney Chopra: Thank you, Whitney. It's such a pleasure to be with you always.

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WS: With the market, as everybody says, you're expecting some downturn. As an operator, as somebody that's buying large deals, how are you prepared for this market correction?

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VC : It's like the one we bought, that $52 million we just bought. Because we already had gone through the financials and then we knew we are buying at a 6.10% cap, the area called for 5.75% cap by the way. There is a big equity gain right there when we bought it. The big thing also is then the business plan. We knew that when the loss of lease, what the residents are paying at the current time and what's the market or the rent for similar products and everything, amenities and all. Ours had even more amenities than the other people. We have $100 in the classic units, almost $200 raised that we'll do as the leases expire. That is the big $6 million to $7 million increase in the value of the property in the next one year.

That's a given because that is the loss of lease for the people's affordability, which they'll be able to still stay at the community and pay higher rents. You've got to mitigate your risks. I call it mitigation. With the downturn coming and again, it's not going to be that huge. When people think about downturn, they think everything is going to fall apart all over the USA. That's not true. It's in pockets that's going to hurt and so forth like that. You've got to look at where you're investing and keep an eye on that market. You should not be consumed by all the negative things that are happening overall.

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WS: It won't be every market all at once.

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VC: For example, Jacksonville, Orlando, billions of dollars have been spent. Why? More jobs are already coming to the Orlando area. I'm giving up my secrets but that's okay. I want everybody to be successful. That's the name of the game. We are in a bigger market, a pretty big market now, 300 to 400 units. My students are in the 15, 20, 30, 100 to 150 units. It's a big pie for everybody. The thing is when I went there, there are cranes all over. That's like a dream for them. It's like Frisco. I went there to Frisco with my attorney, Milton Colegrove. Many years back, look at what has happened north of Dallas. That was like candy to me. Hotels are starting, the restaurants are opening every week, the Starbucks are opening and the big box offices are coming and all that. You know something is up to their sleeve over there.

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WS: From being in this business and going through a cycle already, what will you do differently? What are you preparing differently now compared to maybe what you did through the last cycle or downturn?

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VC: By the way, we bought properties. We started our business in the market crash of 2007. A few of our properties went down and now they've come back up and we're selling them. I've seen the whole cycle of seven years. It took us to go from 98% occupancy to 62% occupancy where we couldn't give. We refinanced the loans on those two properties and then we paid back our investors. They were okay with that, but we didn't give them cash flow in the downturn, Whitney, but now we sold them at the high. One Cornerstone village, we did the numbers. 40% IRR for six years. That was in the downturn, by the way. It went down with the oil price going down in Midland. That said, if anybody wants to check me out, that's Cornerstone, 120 units. We were giving $45,000 per month net. We were raising a 31% expense ratio we were running it. It usually will be counted 50%, but that property was amazing. The good part was with a downturn, we never paid any money at all. We couldn't. We could not pay that. Investors we're happy because we had nothing in that thing. We give them back so much money. For $100,000, we gave $240,000 back. They got their $100,000 back plus $240,000. They love us.

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WS: That was even through the downturn?

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VC: Yes, through the downturn. That's six and a half years old.

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WS: What's different now going forward? How are you preparing differently?

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VC: I would say that we are buying definitely. We are doing a pressure test, as we call it. We have done the pressure tests of a high cap rate, first of all. With the Bentley deal that we closed, that is going to be at a higher cap rate. We are already saying not lower. Some people like to lower the cap rate to make their equity gain larger so that they can average it out for the investors. Ours is the reverse case because we knew that it's going to be coming. We are actually putting a higher number for the cap rate so that the appreciation is not as much. Of course, in five years for Bentley or four years, the market would rebound. It goes down and then it starts going back up. We don't see that happening in the Orlando market, but if it does, we'll still be okay.

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WS: Any reserves that we're going to have this reserve bucket just in case it's worse than they expect?

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WS: Definitely. We raised almost $1.2 million. We were thinking about $850,000 but we had so many people wanting to go into it. We put in our PPM $20 million raised. We only needed $16 million and so we were able to raise more than what we needed.

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WS: Any other ways that we can see the market changing ahead of time, Vinney? Maybe some key indicators that you watch for? I know you talked about interest rates. Anything else?

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WS: I would say the stock market is a good indicator because the stock market is always six months in advance. If you think what is happening now, it's the market movers, as we call it. We are very small people. We invest here and there. We already have heard the news, but the market movers are the ones who plan ahead. That's where we need to be thinking about keeping an eye and also the economic report of the area. The Chamber of Commerce, the local government and the jobs you've got to keep an eye. That's a very good point what you just asked me. This is amazing because in Texas, we see in certain cities less traffic. When there is less traffic coming to the property, when you're having some difficulty in asking the people to decide on it and when you are thinking, "I have to give some concessions or some specials," that is the time you've got to rethink and look at it. What's happening to the approximate in the vicinity of your community? What are the other people facing too? You've got to catch that a little bit quicker. If that is happening, you should start digging into more reports.

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WS: Do you secret shop other operator's properties at all to figure out what they're renting for or vacancies and things?

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WS: Totally, every month. It's called market-rent study. Our community manager is supposed to do it and it's all documented. We keep that, archive those every month on the month. We like to make sure there's a lot of great other ones. We have real page reports. We have a CoStar reports. They also do quite a good job of giving us all these great market comparison reports. That's important. We do a secret shop. We love our community managers, the people. Many times when you're there, you already know the other managers too. They call us, our property manager. Most of the people, I think they fudge it. They didn't want to look that bad. I've seen that happen. I think it's good to know what the competition is doing. That makes a big difference in our advertising. Apartments.com is an amazing source. I think I've told 87% of the people, when they're looking for an apartment, when they Google it, Apartments.com comes first. That's a great way to do it. Craigslist and other places, as your readers probably know.

[INTERVIEW 2]

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WS: Our guest is Spencer Hilligoss. Thanks for being on the show, Spencer.

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Spencer Hilligoss: Whitney, thank you so much. It's an honor to be with you.

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WS: What's changed for you, say pre-COVID-19 to now?

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SH: Yeah. We actually started six months before COVID hit. I had no idea it was coming. No one did, clearly. I mean, those of us in the space of real estate and economists and finance years, they all knew, we all knew, there's probably a recession coming, because we were over a decade into a bull market, into a growth cycle. If you study history, you know that that cycle is going to end. It's just, it has to happen. Something has to give.

No one out there knew that COVID-19 was going to hit. I certainly did not own that crystal ball. If you know anyone that does, I would love to meet them. We didn't know that. What we had started though was we started deliberately shifting strategically within our business, preparing to pull a figurative lever. We're going to basically pull the lever and say, "You know what? If this comes, let's be ready. We're going to go and lean harder into certain asset types. We're only going to work with a select few partners and we're not going to say yes to working with everybody and we are going to be selective about who we work with and the asset types we go into."

We started saying no more often to deals. We started saying no more often to sponsors. We went harder into a couple places that we're already fond of and we've done deals. We looked at things like self-storage. Multifamily has been and will continue to be a primary focus for us, but we also started looking into self-storage. We also started looking into mobile home parks. We've done that really sparingly over the past three years, but now we're going heavier into it because there's certain things that just align very well within that space, within those asset classes. That's the stuff that gearing up for pre and post-COVID, we were planning for. I don't know what's going to happen six months from now. I don't claim to have any answers. I will say though, out of all the opinions that are flying around out there, Whitney, it's amazing how the doom and gloom — I'd say, fortune tellers that were saying, "Buy now, while we're sitting here in June 1st," we were expecting to see rent collections from multifamily bought him out by now. I think nationally, we almost saw not only flat, but depending on A Class, B Class, C Class, we're actually seeing it up a little bit.

It's not necessary for people to go out, I think, and be so darn doom and gloom about things. We're just taking the data as it comes in, making thoughtful business assumption decisions. I will say this, we have done one deal to date, this year. That one deal had, on paper, really strong counter-cyclical, I would say, recession resilience baked into it in the numbers, like a really great breakeven occupancy. Meaning the thing could be half-full, the apartment could literally be half-full and still profitable. Those are the types of things that we look for and I think pre and post-COVID, or more like pre-recession and then mid-recession. By the way, we're not post-COVID. We're in this thing. We're in this thing for a while in my humble opinion. I don't want to insinuate that we're actually done with it. There's still people out there going through hardship right now and that's a fact. Those are some of the things that I would say have shifted for us and we're focusing on now.

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WS: Nice. Nice. Maybe highlight just a few things and we're almost out of time, but highlight just a few things as an example of an attractive deal for you. You can say pre-COVID, or now, either one, or maybe it's always the same, but give us a few details of that attractive deal to your team.

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SH: Yeah. A couple things on the who, I already went into this a bit that I would just say, looking for people that have done it before, ideally in a specific market and that they've done it before, they've run that business plan and strategy before. For example, if it's their first time doing a value-add, they're taking, they're buying that asset, they're improving that asset and they're doing it with a A Class, B Class, C Class multifamily property, we don't want to be their guinea pig necessarily. That's the stuff first and foremost that we do look for.

Now we have gone further into places like self-storage. Examples would be right now, storage is appealing to us and to me and for our capital. We have actually invested already very recently in a self-storage deal, and so I could speak to it from our own capital perspective. We put our money in, because there's these D-words, which are not always rosy to talk about, but they are a need that has to get met in the middle of downturns, which is — if there's unfortunately a downsizing at a company, if someone has to downsize their lifestyle, they have to store that stuff somewhere. If someone has an unfortunate death in the family, it's inevitable at some point, they have to typically have storage needs. Those are the types of things that we are looking for.

We're also looking for things that have, as we go into this downturn, slightly higher cash-on-cash returns. I think as you were looking at the later stages of the growth cycle, you can see some of these projects that were banking really heavy on the backend of a project at the sale to achieve those really sexy-looking returns. Now heading into other asset classes at this stage of the cycle, we're seeing some pretty compelling cash-on-cash. That's what attracted us with our own capital to projects like the ones that we just invested in, because you're able to see – really saw the returns. Maybe, I would say even double digits within a cash-on-cash. That's the stuff we're looking for. We're still in some of these markets that we have been in and we're continue to going to be a fan of.

I would say some of them would be like, we've been in Texas, we're going to still be in Texas, the Carolinas, opportunistic in Florida. I would say, Idaho is up-and-coming and appealing. I think there's a handful markets that are really attracted to us, because all those "fundamentals" around migration trends are actually now still playing out, by the way, with — I would say, we don't know yet how much of an impact COVID will ultimately have on the question when people ask "Where should I live now," because and I mean, all the way down to how apartment buildings are structured, all the way that cities are laid out, these are all things that are going to be impacted for years to come most likely within COVID. We'll have to just watch and see.

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WS: What's a way you've recently improved your business that we could apply to ours?

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SH: Well, that is a really timely question. A couple things we materially changed, I should say added to our vetting process, we now do a comprehensive background check on a sponsor before we invest with them for their first time. That's not cheap. We're talking about spending about a 1,000 bucks or something like that. Maybe it depends on the person in the level of depth, but could be 500 to a 1,000 bucks. We're actually putting our own money into that.

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WS: Now is that as a passive investor, or you mean as a co-sponsor?

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SH: Two-part answer to that. Before we actually even become a co-sponsor with an active sponsor, we are now also putting our own money in, first, pure, just as a LP. That was a deliberate step. Those are two deliberate steps that we just segued into, Whitney, which is we are putting our own money in pure just as LPs, before we start working with a sponsor, as a co-sponsor.

We're also now background checking the sponsor to make sure that they are who they say they are and we already believe them. By that point, I've had dozens of conversations with them. This is not like I called and reached out on LinkedIn and say, "Hey, I'm going to go pay for a background check on you. Do you want to work with me?" That would be quite creepy. Instead, what we did was put those two processes in place more recently. There's a couple other things that we're now doing, because it is harder to get on a plane.

There are really, really great services you can do to go and do due diligence and inspections physically in person, if I can't necessarily get on a plane the way that I typically do to go and look at a property firsthand myself, which is usually part of our standard process too. Those were a couple things that we've not done, because you got to get rigorous. There's lots and lots of people doing this stuff for the first time. There's lots of sponsors that are enthusiastic, highly capable people, but they're newer in the game. We want to make sure that their experience doesn't come with any baggage. If there's a felony on there, we want to make sure that we know about it. We want to make sure that at least, they're forthright with their histories too.

[END OF INTERVIEW]

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[OUTRO]

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