EPISODE 1111

[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. I'm your host, Whitney Sewell. Today, your co-host is David Robinson. David is a client of mine and he is doing big things in the real estate syndication industry. I know you are going to enjoy today's show.

[INTERVIEW]

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David Robinson: Hey guys, this is your daily real estate syndication show. I'm your host, David Robinson. Today, our guest is Paul Shannon. Since 2018, Paul has invested heavily in real estate, completing dozens of rehabs on single-family and multifamily properties, from fix and flip to holding his cash flow rentals or selling turnkey. His most recent acquisition was a value add for the unit apartment building and Evansville that is currently wrapping up repositioning. Along with being active in his business, Paul is a passive limited partner in over 1,400 multifamily units and industrial offerings around the country.

So Paul, that's obviously a very brief bio. And we want to hear a little bit more about your experience in this space and what you've done to get to where you're at today, investing in over 1,400 multifamily units. But if you can, let's back up and let's just talk about how you got started in the business and give us a little bit of insight into what you're doing today.

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Paul Shannon: Sure,. Thanks so much for having me here today. I'm excited to be on the show. This is a podcast that I've listened to quite a bit, so to be a guest on it is kind of surreal and I'm looking forward to sharing my experiences. And talking to me today, I've always been somebody that was interested in early retirement and kind of having time freedom and the ability to control my destiny as far as where I spend my time, I wanted to work, when I wanted to work, I wanted to spend time with my family, when I wanted to spend time with my family and my friends.

So, I had a strategy going into my early 30s that I was gonna try to save as much as possible. I was gonna utilize the 4% rule, if you've heard of the Trinity Study, where you can withdraw 4% of your capital and basically live off that indefinitely, using the 60% stocks, 40% bonds split and grind it through for quite a while and was successful in saving a decent amount of money. But as I got closer to the finish line, I realized that my strategy was kind of flawed, if you look at bonds today, which would account for 40% of that portfolio, interest rates are so low right now that really, you're kind of guaranteeing or locking yourself into a loss with where we are with inflation today.

If you're getting a 1.6% on a bond, and inflation is running at 50% when you're a real turn is negative. So you're in the hole there, if interest rates continue, the state of saying You're gonna hear preloaded interest rates rise because bonds move inversely and price two yields, then your bond values are gonna go down. So there's where that guaranteed loss comes into play, and when you look at it, when the bonds have been in a portfolio over the last 40 years that really balanced out stocks, they provided capital preservation, they provided income for investors diversification away from the markets or a hedge against the markets they offer appreciation as interest rates have fallen, but in my view, that is an unlikely scenario to continue, just because something is working on the past doesn't mean it's going to continue to work in the future.

So I felt as though I needed to kinda shift gears and I'd always been interested in real estate investing. And I saw real estate investing has kind of a void that could fill the way that in some

tradition you played in a portfolio. Now, by the way, it's a good inflation hedge and it also has positive leverage, so for all those reasons, I knew I was gonna go all in, so I had to find a place to put that 40% of my capital.

I was also a little bit disenfranchised with the corporate world and wanted to kind of take a chance on myself in something, and I saw real estate, a sort of an easier business to get into from a non-entrepreneurial standpoint and many others, it's fairly simple. Improved topline sales, that standard form, the way you think about any corporate company, you rent in this business, reduce expenses to improve the bottom line, which in multifamily is net operating incomes, so I can get (inaudible) around that. That's pretty easy to handle. Let's go ahead here.

So, in starting small, I got involved in single-family homes, and to basically allow for some opportunity for appreciation, I really latched on to the BRRR where you buy, rehab, rent, refinance, and repeat. And really, you are able to continue to recycle that tape indefinitely and create cash flow along the way.

So that was kind of my entry point into real estate, I did a few deals that were successful, and after a group of concepts, I went all in myself and my job and the way I went.

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DR: Alright, that's great. Just to give our listeners some contacts, roughly what time frame, maybe year, did you start investing in your first deal, your first real estate deal?

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PS: 2018. It hasn't been that long.

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DR: Yeah, yeah, this is great. So 2018, you invest in your first deal, and was this a bird deal right out of the gate, single-family deal?

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PS: The first deal I ever did was actually a duplex that was filled with tenants, it was an older home and he needs some good experience and managing tenants and building kind of a relationship as a property manager with them. I ran into some issues with this house. And so they wanna solve them, relationships and contractors. So I know it wasn't a BRRR deal, but the catapults, the law of the first deal is real. You can actually pull the trigger and take action, it's funny how things kind of snowball from there.

So shortly after that was my first BRRR deal where I bought a single-family property at option, and I think I paid $55,000 for it, and put about $30,000 into it. We financed it for $5,000, so I was able to get all my capital back out in some kind of 75% LTV. And that was a confidence boost that I needed to say, "Hey, you can do this, obviously it wasn't perfect, in fact, it was very imperfect but the lessons learned were awesome," and coming out of the back end of that deal, successful in the financial side of things, I just knew I wanted to keep going. So even though things are not gonna go perfect, you just have to continue on.

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DR: Well, and you mentioned this concept, so I think a lot of listeners are familiar with the BRR concept, buy, renovate, rehab, rent and repeat. But not everybody may be familiar with this concept of recycling capital indefinitely. So maybe just speak to that real quick, and then I'd like to push us forward and talk a little bit about what you're doing today and investing as a limited partner.

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PS: Yeah, so basically, as an example, let's say you buy a property for $50,000, simple math that need some work, so you put in $25,000 at that point, you're into it for $75,000, whether that's your money or other people's money, but hopefully you've improved to the property enough where now it's going to be worth, let's say $100,000. So you go to a bank percent on the deal and you wanna get a 75% loan to value, you're gonna need to leave 25% in the deal, 25% of $100,000 is the equity essentially that you've created through the rehab process, so you're gonna get that $75,000 that you put into the deal back, you're going to then have the Equity you created as the down payment for the property moving forward with the bank, and

then you're gonna cash flow from there.

So you're gonna get that money back and you're gonna do it again, and what I found is that that process was a little too slow for me, when you refinance and you take out along with the bank, your cash flow. It takes a little bit of a hit. So I look to get $100 or $200 a door on these properties, but if you're having a property, it could take three months. So if you can do a couple of those at a time, maybe you can get it done in a year and maybe you can do more if you have the business and the efficiencies in place to really roll with that, but $100 a door times eight is $800.

That's not gonna make you rich overnight, so I wanted to get into multifamily because I saw the ability, one, to drive valuations through improving the property, whether that's through raising rents and rehabbing units and making them nice units to live in, adding amenities, having a washroom where you can do laundry, or you have another component to multifamily where you can actually reduce expenses too. So going back to the business conversation of how to operate a like a business, I mean, you can implement rubs and build back for utilities and maybe you can charge for parents that's more on the income side, I should say, maybe there's a property manager in place where you could ask some efficiencies by putting somebody on site versus having a third party, then you can negotiate contracts with vendors. So, these are just all examples of how you can drive the bottom line, which is net operating income to improve the valuation of the property, where his single-family homes, you really rely on market comps, what other properties are selling for around your property.

With multifamily, you can control your own destiny, which I really enjoyed, and you can implement this BRRR strategy, similar to how you would with a single-family, but you gotta look for deeper value-add properties. But if you can take, basically, if your listeners maybe are familiar with the yield on cost metric, it's one that we really look mostly at when we evaluate these multifamily properties.

If the inflate cap rate in the market is, let's say 6%, and you may buy a property with in place and a way of where equates about a forecast. But if you can turn that property into an 8-cap in

the market, and I created a 200 basis point of spread at the developmental spread, and your yield on cost, it basically takes into account your pro forma NOI divided by the total project costs to what you pay for the property plus the capex. And if you can implement those kind of financials into your model and you can see, Okay, this deal actually works with everything called a value add, statesman, multi-family is a real value there.

So that's one of my favorite mentors to look at, to understand that there really is a value, and if that developmental spread, the bigger it is, the better the value that you can add to the property, if you do your math and you figure out that there's only a 25 basis point spread between the in-place cap rate and what your cap rate will be after the project is complete, then you have to inject a million dollars into the property, well, it might not be work through time to do that, there's really not much value you're adding the proper. You might be fixing it up, but it's not gonna equate to a good deal for you as an investor.

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DR: I think this is a great example of someone who's a student of the market and is looking to deploy funds as a limited partner. And maybe just give us a sense of what your investing looks like today. Obviously start out in the single-family space, you wanted some scale, you like the idea of being able to have more control over the asset and being able to have an impact on the NOI. But ultimately, what does your business look like today as you decided, Hey, you know what, I'm gonna move into this multi-family space?

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PS: The most recent project I did was a 40-unit value add property down in Evansville, Indiana. It was a pretty heavy lift and met a lot of the criteria in the metrics we just discussed. And we're in the middle of doing a cost segregation study and ultimately where we find the property. I'm looking for more stuff like that on the active side. I feel like there's an opportunity in these older assets, call it C-class, but if you can find it in the right locations and areas that have gentrified or are gentrifying, you're kind of on the edge. That's really what we want from a location standpoint.

So I'd say about half my real estate investments are really being directed towards that and funnel towards that. I've pretty much done this with all my own equity at this point, but reached a certain feeling in real estate where you can only do so much, and then I realized also that I've got some certain skill sets that are valuable to others. And then I've got some deficiencies in my skills. That's where if I partner with the right people, I can kind of take what they're good at plugging into a team-type atmosphere and then hopefully scale, one plus one is equal. Essentially. So that's what I'm excited about.

On the active side, I think there's some personal reasons for tax reasons, there's reasons to be in the game on the active side. But I look at where I'm concentrated geographically, and it's Evansville in Indianapolis. I go down in Evansville, a lot of the Midwest is similar, and what you see from a product class or product type.

I want a geographic diversification, and when Covid came about, I saw the work from home tramping up, I saw the migration from areas like New York, England, California into Texas and the south. And I wanted to participate, but I obviously didn't have a team in those areas, so I thought what I can actively participate in these markets easily, I certainly can evaluate other sponsors, find out what others that are doing in the business, well, a network with other individuals that are LPs and find out their experiences, different sponsors, and then diversify that way and get that kind of mailbox money going where you've got preferred returns and you're getting paid to hang on to the asset. But you're participating more in the upside for a guy like me in the Midwest, it's more of a cash flow market. I really need to look for if I want appreciation value-add deals where I can drive the value of the property up through renovations, whereas maybe in the south where cap rates are compressing a little bit faster, where you've got a higher occupancy, more demand, all these things relate to evaluations in driving themselves.

The operator has to be good still, as long as they stick to the plan, the demographics and the fundamentals are there to make that property worth more as reserve over time.

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DR: Yeah, that's a great summary of what's happening in the market today, you have these high growth markets that are really relying on population growth, job growth, and then you have sort of this middle United States, the rust belt that is relying just on the steady income cash flow, a mentality, but you can still achieve some of that upside potential through the value-add component, which is what you're looking for.

So roughly 1,400 multifamily units. I know some of that's industrial as well, but the 1,400 units that you've invested in, just to give us a sense. Where are those located? Is that all in the Midwest markets? Yeah, just give us a sense of where those are located?

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PS: Yeah, none of them are actually in the Midwest, 'cause I wanted that geographic diversification, I want a diversification away from myself as an operator, and I wanted to be in these hotter markets, so I've got assets that I'm participating in in Phoenix, Tusan, San Antonio, Dallas, Tampa, Greenville South Carolina, these are places that I wanna retire to, so it's not hard for me to see why people are moving there.

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DR: Well, this is great, I think with your experience of investing as an LP, obviously now you're moving more into the active side of things and really focused on your local market, your backyard of the Midwest. But you're also hedging yourself against what's happening in your local market and investing in those high growth markets. Maybe talk to us a little bit about these deals that you've invested in and the process that you've gone through to that market operator, and the deal, do you have any type of framework that you're using to vet those deals, is it more about relationships. How does that work for you?

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PS: I think it's a little bit about both relationships, trusting the sponsor, and then vetting the deals, once you have that relationship built with the sponsor, as the deal flow continues to come to you as an LP, you kind of already have an idea of what type of deal it's gonna look like. You've had conversations about what the criteria is, so it becomes easier to check off or

get the green light on an investment.

The first deal is probably a little bit tough, and what I think people get a little bit hung up on, whether it's their first investment as an LP or maybe they've done LP investments in the past, but this is their first deal with some particular sponsor. I'll give a plug to a group called left field investors, I believe he had the Jim Finer on the show before infused it with a few other individuals, and it's a group of LP investors that came together to basically vet operators to understand who they're investing with other people's experience is almost in a word or of-mouth fashion.

And it's not just related to multifamily and industrial, when they talk about ATMs, you can invest in broadway play indication and sometimes have syndicates come on and talk about their strategy, what they look at and what's going on in their local markets. But it's a great way to kinda network, much like a lot of syndicates network with each other, these are LPs that are networking with each other. They have a deal analyzer that they can plug metrics in from forms that are received by operators and it gives a green light or a kind of a caution light as to whether they should proceed with the deal and the cost on might really just that, Hey, this is something you may wanna ask about on talk to the sponsor. This may be a question that you wanna bring up when you're asking about an individual dealer asset.

So I use that and I like that group a lot

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DR: Is that like a paid networking group? How would one get involved in something like that as it paid or is it just brought together with a group of people that are like-minded?

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PS: I think you can get involved there for no money at all. They have a monthly meetup with a Zoom meeting. I think they initially decided to just have a core group of people that were gonna meet locally, and then when Covid happened they couldn't do that, so they expanded and that's really when things took off for my round ironically, but then there is a paid subscription

model as well, that you can get access to a lot of their underwriting models, a lot of their other data sets and resources that they have, which is great as well.

But for me, I'm underwriting deals, more of how a GP would under ideals. I'm going to brokers, I'm getting on sent to me, I'm getting retrained-T-12, and I'm using an underwriting model that a syndicator would use. So, I kind of see it from that angle as well which I think really helps me kinda snap out things and pull through the weeds a little bit, if you will... Okay, hey, these re-projections, the proforma, the mass is one thing, math doesn't lie, but you can kind of spin math in a way that benefits the storyteller. So that's where I like to kinda look to see, “okay, we've talked about red cups when we go into apartments dot com and check these properties out. Do I really think that we can push rents based on what they're telling us here? Is there really value here? Are we adding a dog park or are we putting a common area in the Clubhouse, and then we're gonna raise rents by 10%.”

To me, there's no value there, there's gotta be some purpose behind the value-add and making it a better place for the resident to live, so that's kind of what I look at a little bit more. And then from a market perspective, we kinda talked about that, it's really all about the demographics and what's happening on a macro basis across the country with migration to the south and jobs being created down there in Florida, in Texas and Manor from the States and such. So all those things come into play.

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DR: And you mentioned early in our conversation, the metric, yield on cost, and you use that heavily. Are there any other metrics that you can look at a sponsor's deal package at a high level and quickly check off boxes that would say, “Hey, I wanna look into this further, or no, this isn't a deal for me.” Is there anything that, any of those quick tip metrics, would be helpful to our listeners?

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PS: Well, you’ve got the big three that are very popular to be advertised in the equity multiple, the IRR, and the cash on cash return, see that on every single pro forma out there, at every

single offering. One that I really like to hone in on, and probably the first thing I look at is the break-even analysis, how low can we drop cities to essentially reach a point where we're gonna hit the red benefits pushing higher than 80%. I get a little generated, I like to see deals that are pretty comfortable where if there's a black swan event like Covid or something else that happens, just that Localize to the property or the market, they can ensure punches of ribs and be, Okay, so ideally, I wanna see break you and cancer somewhere in the low 70s of optimal and a lower or the better better property cash flows, the lower that number is gonna be.

I also look at IRR partitioning on the front end, so this is essentially a look at what percent of the deal is reliable, the cash flow from operations during the whole period versus the sale price at the end, the exit.

So if you have a deal that has, let's say it's a 55% IRR based on the cash flow, 45% on the sale, which is an assumption that happened five or seven years down the road based on many numerous inputs, interest rates, cap rates, etcetera, etcetera. Deman, rent growth, in that scenario, you've got a pretty safe feel because the cash flow is really what's driving the deals returns. Whereas on the opposite end of the spectrum, if you have a deal that's really reliant on a disposition at a high price, and it's really kind of stand on the cash flow, you might see an IRR partition value of 20% cash flow and 80% IRR. In which case, that's kind of a right off for me, that's more of a development deal ground up, and if you want that sort of risk profile in your portfolio then great, maybe I do for a corner of mine, but for the ball of my real estate investment, I want as flowing safer asset.

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DR: Yeah, those are great tips, and I love those two metrics, and thanks for breaking that down for us.

Well, look, Paul, we gotta start winding down here a little bit, but before we do, I've got a few final questions I wanna ask you. The first is obviously, you have this background and getting into the real estate space as a hedge or an alternative to your stock and bond investing. You saw that the bond investing was a little bit of a flawed strategy for you, and so you open to real

estate, you saw the advantages of investing in real estate and the benefits. And you went ahead and started in a single-family and ultimately you realize how I want more scale and I want more control over the outcome by driving NOI. So you move in a multifamily and then you've had a tremendous amount of experience on the limited partner side and investing in deals. And now really starting to be more active on the GP side of things.

What's the number one thing that you would say has contributed to your success at this point in your multifamily investing?

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PS: I would say, honestly, it's the support of my wife, my family. If I didn't have that, then I wouldn't be changed in my W2 job and kind of grinding it out and just being placed. That's the bird in the hand. So the only thing holding me back before I left was me, because I had that support and she was all in on me and said, “You know what, if you're not happy, do what is gonna make you happy, and I believe you can get it done.”

So that may not be the technical answer that you may wanna hear, but that's kind stuff that really gets a job done for me. So, if that wasn't there it wouldn't happen.

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DR: Love that. And speaking to those of our listeners that are in that place where they're really contemplating exiting a corporate career, W2 role and pushing themselves into the multifamily space, any advice for those listeners that are looking to explore that possibility?

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PS: I was there for a long time, and I had analysis paralysis for quite a long time. If I had left what I was doing sooner and gotten involved with what I'm doing today, I don't know where I would be, but it would certainly be farther ahead than where I'm at right now.

So I was always looking at things from the angle of, here's the worst thing that could happen, and it's like a two that happened. Even though subconsciously, that's kind of I guess what was

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in my head, but I knew that that wasn't probably wasn't gonna happen, but I was too scared to take a chance. When I started thinking about what is going right versus what is going to go wrong. My mindset shifted in a confidence thing, honestly, and from there it was the way it went, but I would just say what I didn't do was to take action soon, that is what you hear a lot in real estate. But it's so true.

So I would say for anybody that's looking or read some books, get educated, protect the downside, talk to wherever you need to talk to about protecting your principal and mitigating a risk at some point, there's a risk and everything you do in life and there's risk in real estate investment, care to mend it off and get ready, 'cause you're gonna take some jobs, but that's where the real learning happens. You can read 100,000 bucks, but you're never gonna get a real street experience to get started, so do it.

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DR: Great advice. Last question I've got for you before we sign off is as you're starting to move into the active investor side of things, a general partnership, the sponsorship side of multifamily, here we are in the market cycle where we're at, there's a lot of debate about where we're at and what the future holds, but how are you preparing for a potential downturn in the future?

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PS: Well, that's a great question. I'm preparing for any scenario that comes, really. Why? I really liked real estate in the scenario or the market, the word right now is you've heard a lot about inflation and where we're heading as a transitory, if not transport. If you're to say, I believe it's the latter. I think it's going to be elevated from where we've seen over the last 10 to 20 years, and with that, real estate is a great play because rents typically rise with inflation and home values, and right now values have really gone up quite a bit, and rent has not quite caught up.

So, there's still room to grow rents on the top line, so I really do like real estate. I think to be careful and you have to anticipate some sort of interest rate hike from here though with

inflation, if it gets to be sustained, you're going to have interest rates rise, and when that cap rates could potentially follow, they're not 100% correlated, but they certainly are correlated.

So with that, I look at deals, I look at seductive analysis, I look at reversion cap rates from the sponsors, and I underwrite that way myself, and you have to be aggressive in this marketplace to get deals, but you can't completely eliminate the downside risk, you can't not look at a basis point version, cap rate, you can't anticipate for to 5% rent growth consistently year after year for five or six years, at least on my market.

So when a C proforma is like that, I get a little bit turned off. Or if I do, I started playing with my own metrics and my own assumptions to see where maybe we can make this deal work, get in my risk tolerance, it's all about risk adjusted return. So you can push the needle on some deals and others, you need to play a little bit more fun to get this out a little bit.

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DR: Great perspective. Well, Paul, this has been an honor to have you on the show. I appreciate you sharing a little bit about your background and what your outlook is on the market today, sharing some insight with our listeners about how you're underwriting and evaluating deals from a limited partner perspective. What's the best way for our listeners to connect with you and learn more about what you have going on?

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PS: Yeah, absolutely, David, it is a pleasure. It's awesome to be here. Thank you very much. There's two ways, the best way is to get in touch with me through my website, Red Hot investing dot com, and you'll also find me on LinkedIn and I'm active there too.

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DR: We'll have that info in the show notes. Again, Paul, thank you for coming on the show today. And we look forward to connecting with you again soon.

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[END OF INTERVIEW]

[OUTRO]

0:25:54.0 ANNOUNCER: Thank you for listening to the Real Estate Syndication Show, brought to you by Life Bridge Capital. Life Bridge Capital works with investors nationwide to invest in real estate while also donating 50% of its profits to assist parents who are committing to adoption. Life Bridge Capital, making a difference one investor and one child at a time. Connect online at www.LifeBridgeCapital.com for free material and videos to further your success.

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