EPISODE 1158

[INTRODUCTION]

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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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Sam Rust (SR): This is your daily Real Estate Syndication Show. I'm your host, Sam Rust. Joining me today is Richard Randall. Richard is the Chief Executive Officer of Navitas Equity Solutions, sustainable infrastructure investment firm that works with real estate owners to lower their utility expenses and reduce their impact on the environment. Prior to founding Navitas, Richard served as the VP of Asset Management at Cardinal Group Investments, where he actively managed a portfolio in excess of a billion dollars of commercial real estate holdings, and has a sorted background from Xavier and is a CPA in the state of Colorado. Richard, welcome to the show, thanks for joining us today.

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RR: Yeah, thanks, Sam, thanks for having me and thanks for that great introduction.

[INTERVIEW]

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WS: Well, you've got a storied career already, a lot of folks look at your background, I would imagine, an asset management, VP of Asset Management for a relatively large investment firm. You and I have known each other actually for a little while now, so I know a little bit more of your background than the intro. But how did you get into real estate and what prompted you to leave Cardinal group where you're running over a billion dollars, you'd grown with the firm, give us a little bit of insight on your background.

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RR: Yeah, sure, I'm actually a CPA by trade, and worked for a large public accounting firm called PWC. And a lot of my clients were real estate investors. And I really fell in love with the industry and capital raising and deals, and different funding sources and whatnot, the whole capital structure, and I decided I really wanted to be on the investment side of the business, and so I made the switch to Cardinal Group, which is where I worked for five years. I started out as an analyst and worked my way up to running the platform. But it really started, I was on the outside looking in with a public accounting firm, really wanted to be in the business and made the transition. I learned a lot there. It was a great firm. It grew very, very quickly while I was there, I think it was one of the first 30 or 40 employees. And now they have over 300 in the headquarters office and 2500 nationally. And kinda long story short, how I got into this business as I was running this large institutional real estate portfolio, was one of Cardinal's like first funds. It was doing okay, but I was looking for ways to improve the performance and started focusing in on the P&L and saw utility expenses as a massive blind item, and I didn't know anything about utility and energy efficiency or infrastructure investments in the real assets, 5-million-dollar utility expense line across our portfolio, and I thought that even if I can cut those expenses by 10% a year, the material win for the investors and the material win for us doing cash flow and active valuation.

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RR: And so I started with a large deal in Atlanta, hired a couple of consultants, they went and did their analysis and their audit, it kinda came back, picked a little bit from each proposal, and in the high level summary, and this is all a very long story short, but we identified an opportunity to invest $1.6 million back into this asset to cut expenses by what we thought at the time was $400,000 a year across water, electricity and the upgrade just high level or HVAC controls, HVAC optimization, water efficiency, lighting, irrigation controllers, kind of the whole game. There's eight or nine different things that we did. And kinda long story short, we made this investment and we started saving a million dollars a year at a five cap, 20 million dollars in exit value, and the deal went from a nine cash on cash with 25. It was absolutely insane. Of course, our investors said, Go do this to everything else we own together, which I did, and learned a lot about space and saw an opportunity to really help other real estate investors do the same thing. And I also felt like the impact that it had on the environment was the most important thing that I could have done. And I really enjoyed real estate investing, I do miss it a lot at time, but I get to work on hundreds of assets a year with all different owners across the space.

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RR: Saw an opportunity to really create a full and turnkey end-to-end energy efficiency solution where we do the audits, the implementation, the ongoing measurement verification, and even the performance contracting. It's really just seeing an opportunity through execution. It was very hard for me to do these projects because I had construction managers and different technology providers and different installers and different rebates, and it was incredibly time-consuming, and I felt like if there was just a way to make it easier and turnkey for owners. So, I'll kinda stop there, Sam. That's the long-winded. Back story, very compressed. But there's kind of a lot of history to it.

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SR: No, I love it. It's a classic entrepreneur story, you get into an industry, you learn it backwards and forwards, you find a problem, you solve it, like what if I could scale the problem-solving essentially, it's what you're doing. Now, there's a lot of companies out there that offer utility savings as I've seen some water consultants and electricity consultants, you started off working with some of those consultants. What makes Navitas different from other companies, consultants in the space. What sets you guys apart?

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RR: So, I think one, we have the real estate owner mindset, and so Mike, my business partner, Jason and I, he run acquisitions at Cardinal I run asset managements we're kind of the one-two punch there. So, you have that ownership mindset. I think we're really able to communicate well with owners, help them understand the value proposition. But the biggest thing is that we do the full, whatever is possible, like anything that we think would make sense for an asset that we owned or used to own, Cardinal group is how we approach this. And so, if there's a lot of lighting companies or thermostat companies or irrigation companies or whatever, then they're all great, but they're selling their individual solutions in a vacuum, or we come and we say, "Well, we know all the players in the space and we know what's possible and what's going to make the most sense." And we don't look at everything through the same lens, and so if you're a lighting company, it's kind of like if you're a hammer, everything is a nail. We kind of look at it and say there's different solutions for every asset, and it depends on vintage location, HVAC equipment, we're not married to anything. We are able to propose solutions that we think make the most sense.

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SR: That makes a ton of sense, and you guys working with real estate owners, reducing utility expenses, but there's a lot of different lease models out there, and the one that maybe folks are the most familiar with is the rub system, that utility bill back where you're trying to ratio out your utility bills, full disclosure. Life Bridge Capital works with Navitas on several of our assets, we've loved the results so far, but maybe talk about how you guys are proposing to owners about changing their lease structure to take advantage of these benefits more fully.

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RR: And we work across a lot of different asset classes, but you're right, and multifamily market rate, non-deed restricted, affordable and student housing and senior but called Workforce Housing and Market Rate Multifamily. And in the most markets, or in a lot of markets, the utilities or a large portion of them is passed through to tenants on just a percentage basis, and it can capsize the cap in like 75%, if there's a irrigation, it's not separately metered or whatnot. There's a large range of ways that an owner can capture the value, and I'll start with the most conservative, easiest to do all the way to the most work, but it's not that much work and the least conservative. Most conservative is you just say, If I can cut their utility expenses, which sometimes is $100 a month, and you're looking at rents that are $700-800 a month, that's a huge portion of their overall cost of living, so if I can cut that in half, then I can get bigger rent-ups in the future because my residents have more room to pay me more money, and we know, especially in workforce housing, a lot of the renters are totally maxed out. And I think that there is, if you reduce their ongoing expenses, it gives you more flexibility to push rent hire and get closer to an overall percentage of their gross income. On the other side of the spectrum, we propose that a lot of our owners do a flat rate utility fee, and you have to be careful about what you call it based on state regulations, but we like to call it an amenity fee, and we say it includes access to the amenities, common area utilities, parking, trash, or bed pest control, all the things that you might already include for free are wrapped up in other charges consolidate them into an amenity fee, and let's say that's $100 per month is what the average utility usage was, lock that in on the rent role so you can get rid of conservice and any sort of rub system, and then you go in and you reduce your utility expenses by 30%, 40%, 50%, depending on what the opportunity set is, and that arbitrage, let's say I have 100 units and you just created $50 a month in income, that's a huge increase in your negative cap and ongoing cash flow and with where deals are trading right now, it makes a lot of sense.

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RR: I think one reason why I really like that strategy the most is it's a win for the property owner, so you have more cash flow and your asset’s worth more. It's a win for the tenant because they know what their monthly expenses to live somewhere going to be, and they're not used to the ups and downs and whatnot of fluctuating utility expenses in the summer, there's a bunch of irrigation, there's a leak, people are getting unexpectedly high bills, and I think it's really also win for the onsite property management team. I think any property manager in the country that's on rubs, tell you stories that when there's a high water bill that comes through or a high common area electric bill or something like that, or a gas bill, and people aren't expecting it, tenants coming in and complaining, it's a huge headache. And I think on the leasing side as well, the competitive advantage to say, we have a fixed rate for you, you pay $1000 a month, and that's everything across the street, $1000 a month. Plus, you're going to get hit with this fluctuating rubs bill and you don't know what it is, you can't control it, your neighbor's using a bunch of water and you're not; like you're going to pay for their water bill and whatnot, those are kind of like the two ends of the spectrum. And then there's some little nuances in between that I think are also options, but I really like the most aggressive option, and that's what we did at Cardinal, all of our multifamily, we converted to flat rate, you have to be careful about what's legal locally, but there's always a way through that with a good lease attorney.

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SR: I appreciate you going into some detail on that, Richard, and for our audience's benefit, we've looked at both those options and we opted to go the more aggressive route on two properties in particular, it's been surprising to me how big of an advantage it has been on the leasing side, you kind of alluded to that, Richard. But a lot of the tenants that we have that are out in the market looking for a place to live are really attracted to that flat rate rent, they don't want the surprises, they don't want two bills a month, it’s just this one bill that comes, very predictable, they can build a budget around it. And like you said in today's market, rental rates have pushed, I think the national average is over 15% almost across the country. Year over year, people are at the limit of what they can pay, and so building some certainty into their housing budget is really, really helpful and has been a competitive advantage for us, not to mention that's the best way to achieve the most value for your investors on the back side.

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RR: Yeah, absolutely. I kind of look at it and say, “Why would you just pass costs through? Find a way to turn that into a profit center.” And that's great, Sam, that it's worked so well for you. And I think that's another area that really sets us apart, we can advise our clients through those things, where irrigation company or a lighting company like (inaudible) can’t.

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SR: I would imagine that there's a broad spectrum of properties that you get asked to come on and audit and see if there's possible utility savings. A lot of our properties are in the 70s, vintage, a little bit older. Usually, there's a lot of room for improvement. Where do you find that this strategy is the most effective, both in geography, as well as type of asset?

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RR: We work in a bunch of different asset classes, not just multifamily, so we do a lot – student housing, hospitality, office, senior, industrial – so we work across anything that uses utilities we’ll work on. We don't do any single-family residential, it's just kind of too small for our business model, but really anything large in commercial that uses utilities. From a geography standpoint, the best opportunities are in the areas with the lowest cap rates and the highest utility expenses, which tends to be the coast or areas where water, for example, is scarce. So, in Colorado, Sam, that's why it works so well in the spring, is because the cost of water is very expensive, it's scarce, and the city is trying to encourage people to use less of it, and so they push pricing significantly. It seems like cap rates are low everywhere these days, but coastal California, Eastern Sea Board, you have very high utility expenses and very, very low cap rates, and so the arbitrage of what's possible is the largest in those areas. In terms of asset class, we like to say that our strike zone is somewhere like mid-60s to 2016 or so.

We work on newer assets and we work on older assets, but that's kind of a good sweet spot between is the building compatible with modern fixtures. If it's older than that, there's a good chance that there's a lot of incremental costs that are incurred to install new technology. New technology isn't being designed for the building stock that was built kind of pre-60s. And if it's very, very new, there's a lot of local code that's required on development that takes out some of the opportunity, but there still is opportunity even on brand new B class assets and we've worked on some like that.

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SR: That's fascinating. So, a lot of folks that are listening to this podcast have executed deals and maybe they've gone through the agency that route. They're familiar with a green program. Can you guys help facilitate a Green Program, you guys, your scope, broader, narrower, compare and contrast that if you could, cause I know our audience has some familiarity with that.

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RR: So, a lot of our clients, and it seems like the Green Program has slowed down some, but a lot of our clients did refinancing or new acquisitions with green loans, and they’ve asked us to come in and implement the work, which we're happy to do. And we do a fair amount of that. We're not always looking at exactly the same things as the Green Program is, and a lot of it is shifted because they want to save in unit electricity, which in most multifamily is a separate meter in the tenant's name, and so the owner of the real estate sees no savings, and it's not on the P and L, but we do a lot of green loan work and it's mostly just satisfying the lender requirements, and then we'll layer up, we call it our green up plus. We'll do the green up work and then we'll add in the other things that we think are going to make sense. Then we installed the building that didn't have a green loan in place.

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SR: Makes sense. And you've mentioned several times different technologies that you employ, that you're not trying to turn every problem into a nail with a specific, whether it's LED or replacing toilets. I know those are two big items, but what other technologies are you guys using to help achieve these cost savings?

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RR: So, we do a lot with HVAC, and HVAC, by far, consumes the most electricity and natural gas and multifamily and niche multifamily, central plant type systems where you've got boilers that are supplying domestic hot waters and heat for all the buildings. And so there's a lot you can do to improve the efficiency of the HVAC systems. We do a lot with water in multifamilies – shower heads faucets, toilets, smart irrigation controls – there's actually a lot of opportunity we see and just repairing irrigation systems that are leaking. Usually those are running early in the morning and no one's around and they're just spraying water like crazy. And we see a lot of opportunities to repair leaks. Lighting, as you mentioned, is a really big one. Other water usage would be like washing machines, dishwashers, things like that don't usually have great return of investment capital because the capital cost is very high, but we look at all that stuff. And I kind of like to say that the building that used utilities, they're more similar than they're different. And so, they use utilities in similar ways. HVAC, heating ventilating air conditioning, water usage and lighting. So those are like the primary uses.

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SR: Makes a ton of sense. Generally, I know you guys offer a couple of different ways of working with Navitas. There's the option we obviously pay up front, but if you could elaborate a little bit on the multiple paths that you give owners to achieve these savings.

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RR: There’s actually is something I should have mentioned, really sets us apart and makes us different, we offer a performance contracting model where we’ll front the capital, 100% of the cost, and we'll take a percentage of the savings over a period of time, that percentage depends on the underlying project returns and whatnot, so it's impossible for me to quote what that is, but it's typically 60% of the savings for five years, and we offer that on a shared savings contract, and so there's no leans, no UCC filings, it doesn't do anything in the Cloud title and we kind of do our own credit work and diligence around that. And the primary method of business is niche specialty contractor advisor, where we'll do the audit, the implementation, the ongoing cost avoid supporting and active energy management. But then for our clients that want to leverage our financing and maybe the joint venture doesn't have capital sitting in reserves, or maybe there's no appetite for a capital call, there's no refinance coming up, you still want to get the infrastructure installed and participate in the savings. We’ll front the capital and take a piece of the savings over a period of time. And what we like to say is, every project we put out there we propose financing, and so we're prepared to put our money where our mouth is, and I think that's how our clients can really trust our underwriting and what the results will be, because if we're asked to finance it and it doesn't perform that’s on us.

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SR: As you're basically offering unsecured debt to finance it, that's paid off out of the utility savings, so it's possible for owners to achieve really meaningful savings in a pretty short order without any cash out of pocket.

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RR: Yeah, absolutely. We actually have an owner right now of a hotel who's saving $10,000 a month with no money out of pocket, we funded the entire thing, and it's been a total home run.

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SR: Now, yeah, you start dividing by the cap rate and it's like that's a lot of value that gets driven to the bottom line, not just the cash flow, although that's certainly meaningful as well. So, Richard, what's the process? If a real estate owner wants to work with Navitas, how do you guys get started, what does that look like, and how do they get comfortable with the overall proposal?

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RR: So, we like to start with what we call our desktop audit. Where with some basic information about the property, like vintage, unit mix, location, certain other information about the asset, we can give an owner a very high level idea of what you think the opportunity set looks like, and if they're interested, which they usually are, we'll do a site visit to confirm our assumptions, and then we'll also collect historical utility bills and build a detailed energy model and put an audit together. We do the initial underwrite for free for owners, and when we actually do our site visit, what we do is we charge a $5,000 deposit towards the future project. And so, we sign an engagement letter after the owner thinks that there's going to be a good opportunity. We'll go to our site visit, we'll collect 12 months' worth of utility bills, we put together a detailed energy model, and then we'll put a final proposal, one that we'd invest in front of that owner, and if they move forward with it, that deposit goes towards the project. And so, let's say it's a $100,000 project, they pay us $95,000 once we go in and implement it. Reason for doing that is it is obviously a lot of work that goes into these detailed energy audits, travel costs that we incur, but we like to use it as a deposit for the future project because we're not after those consulting fees like a typical energy consultant is. We should be like another kind of tangential competitor to Navitas, but they're not gonna help with the implementation or technology selection, they'll kind of just come sell you a report. We like to partner with our clients. Not extract fees really. That's something that's really important to us, and I think speaks to our background as real estate owners.

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SR: Now you guys have really designed a program that, speaking from an owner's perspective, was really easy to evaluate, and the cost benefit analysis is really quite simple and very obvious, so it really moves the needle. So long term, what's the plan for Navitas? You guys just started out almost two years ago, you guys have scaled very quickly. What's the next five years hold for you?

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RR: We have grown very quickly. At this point, we have 11 employees, we've done business in 20 states or so, based in Denver, so we're really into the energy savings, like the impact that we have on our environment. We obviously really love the cost savings and driving value for our clients in that way. But we're very mission-driven, and we love the end result. We're obviously dealing with some issues in the West in particular right now, and if we can help with that, we're certainly excited. The long-term goal is really to be a preferred partner for the institution, a real estate space with any sort of energy infrastructure upgrades and utility savings, and when you think of utilities, we want you to think of Navitas. And I would say, what we've been talking about lately is, I don't know if you're familiar with Ryan Tax, but we wanna be the Ryan Tax of utilities, it's really what we're trying to do. And I think we're well on our way to doing that. We work with a lot of large institutional owners and a lot of smaller owners as well, and we're having a lot of success. But the goal is to work with every large owner that's doing interesting things and to help them reduce their impact on the environment and save money.

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SR: Fantastic. Well, as we're getting close to wrapping up here, Richard, could you share with our audience the number one thing that's contributed to your success.

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RR: I think for me, it's just being very curious. And having a desire to learn and be creative. I was always willing as an asset manager, which is how this whole thing was discovered, or really think outside the box and push the envelope and not accept the industry standard. That's always something that's just, when I was little I would say why, why, why why. And that's just kinda how I operate. I think what's really contributed to my success is kind of being willing to do something that the rest of the group isn't. If we have our way, there will be no more rubs, conservice will be out of business, and everyone will be on a flat rate and be using the minimal amount of utilities as possible.

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SR: Awesome, I love that. Be curious, so important if you wanna grow throughout your career.

Richard, if folks wanna get in touch with you, how can they find you?

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RR: My email address is Richard@NavitasEquitySolutions.com. That's N-A-V-I-T-A-S Equity Solutions dot com. Or they can call my cell phone at 303-653-5820. And Sam, I'll say by the time this podcast launches we'll likely be rebranded to Echelon energy. We are changing our name and going through a rebrand. We needed something a little more interesting. We'll probably be Echelon Energy and it'll be Richard@EchelonEnergy.com, but my old email address, it still works.

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SR: Fantastic. Well, Richard, thank you so much for joining us today on the podcast. You drive a lot of value for our listeners. Thank you to our listeners for joining us on another episode of The Real Estate Syndication Show. Have a great rest of your day.

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