EPISODE 1233

[INTRODUCTION]

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Whitney Sewell (WS): This is your Daily Real Estate Syndication Show and I'm your host, Whitney Sewell. Today is a Highlights show that's packed with value from different guests around a specific topic.

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[INTERVIEW 1]

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WS: Our guest is Rich Trepanier. Thanks for being on the show, Rich.

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Rich Trepanier (RT): Thanks for having me, Whitney. I really appreciate it.

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WS: Okay, first, why only value-add?

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RT: Yeah, you know, my brother and I, we've – before we got to Austin Texas, we lived in St. Louis for a little bit and we did a lot of house renovation but also dabbled in investments of two's and four families in St. Louis. Got a lot out of that experience.

We grew up with some construction experience and jumped in, did a lot of work ourselves. We saw a lot of value, in owning those twos and fours, we got to really see the appreciation from some of the residents that moved into those units after we were done. A lot of historic renovation of historic homes in St. Louis.

And unfortunately, when 2008, 2009 came, we had to hurry up and get some jobs so we saw the downgrade in the single-family home but we saw the strength of the multifamily home and shortly thereafter, I moved to Texas and as you know, multifamily is a large strength in Texas as well.

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WS: Wow, you've seen that multifamily was so much stronger or that business model. I guess we could say?

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RT: Yeah. It worked out really well.

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WS: Could you just elaborate or you know, in short, what value-add is and we use that term all the time. I think most listeners have a good handle. However, it's used by so many people, I just love to hear your definition.

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RT: Absolutely. We're in a perfect area between Austin and San Antonio where you see a lot of different multifamilies transact between owners and sellers. And traditionally, as many of your listeners know, when an acquisition occurs, those new groups of investors want to provide value. They want to add to the community. They want to do upgrades. They're adding value, either through interior renovations, curb appeal, exterior renovations, let's just call an exterior paint and carpentry, some landscaping. We do an awful lot of leasing office renovation, clubhouse renovation, fitness renovation.

And so, adding value to the residence so they can A, increase rents but also provide a home to the residents.

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WS: You know, there are so many pitfalls when trying to do value-add multifamily, right? I thought, you know, with your level of experience, I'd love for you to highlight some of those, and let's dig in a little bit.

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RT: Yeah, we often deal with investors, you know? Our goal as a business is to get to the decision-makers who are acquiring these communities and get to them early enough so that we can help them plan their CapEx budgeting.

Some of the pitfalls that we see are as oftentimes, one of the big things that I always cringe a little bit is if you hear people budget their CapEx by doors and I'm a big proponent on those interior renovations, doing it based on square footage and the reason is very simple: You have $5,000 a door. That number works really well for a one-bedroom, one bath, 700 square foot unit but that doesn't translate very well to a three-bedroom, two-bath, 1,200 square foot unit.

And if you have $5,000, it just doesn't go very well, $5,000 might get you flooring and paint but it won't get you that granite countertops, those new fixtures, those new faucets. What I like to do and I meet with our investors that we work with, I like to tell them, "To let's look at it from a square footage standpoint that your money can go the furthest and that you can accomplish your business plan which is, "Let's renovate 72 units. Let's renovate 150 units. We're taking it throughout the entire business plan."

Another one I see quite a bit of is this no one provides contingency against that $5,000 per door budget. Add a little bit of contingency on there. A little bit of whoops factor, a little bit of you know, something will happen.

On my own business, the construction site on Gage Multifamily Services, we always add in between three to 5% contingency on our bid to our customers and that helps us kind of alleviate any issues that we might see that we might not see during the budgeting process.

And the other important one for everyone to remember, another really good pitfall is who manages the renovation process –The renovation project? Is it going to be your asset manager, is it going to be the person with your boots on your ground and the city that you're not located in? Is it going to be your property manager? Property managers traditionally charge between five and 7% roughly to manage your renovation project from start to finish and that five to 7% is calculated based on the gross expenses for the renovation project.

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WS: Wow, some great topics there or at least pitfalls. You know, it's interesting talking about budgeting or CapEx by the door is the way I see it all the time as well.

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RT: Yeah.

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WS: You know, it's interesting how you say, we should break that down by square footage. And could you just give us a couple of tips in breaking that down like that or maybe how you go through that process?

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RT: Sure. For instance, you know, a lot of times, we see CapEx, interior renovation budget, everyone wants to replace the flooring so a good rule of thumb for me when we budget for flooring is usually $2 per square foot to take up and put down brand new flooring.

We often see on a C-level renovation project, we also see resurfacing countertops and kitchens and baths. A good dollar value there is $150 to resurface your kitchen countertops. And then usually, between 50 and $60 for your vanity countertops as well. We usually, a good budget value for interior paint for square footage is right around the dollar traditionally is where we usually place per square footage for the unit space.

We can go even further, we can talk about light fixtures and plumbing fixtures, it just depends on what class level the renovation project is and then how far you want to go. I usually – for the first time investors who usually contact me. I usually tell them, lipstick on a pig, interior renovation for an apartment community, usually runs about $5.50 per square foot and that would traditionally get you a new flooring, interior paint, resurfacing countertops. Maybe a fixture or two but it's really what it describes. Lipstick on a pig.

You're getting in there. You're renovating a unit quickly and trying to get residents back into the unit very fast.

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WS: That's a great rule of thumb there. I guess just when we're analyzing deals to understand –

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RT: You know, usually we see anywhere between 5.50 a square foot on a renovation and then goes anywhere, you can find them as high as $20 is worth of renovation as well.

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WS: Okay, you know, you talked about the contingencies and people not having any kind of buffer.

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RT: Yeah, exactly what it is.

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WS: It just seems to make sense, right? I mean, we have an emergency fund, all those things, you know, that reserve account for just in case something happens that's unexpected, why wouldn't we do that when we're looking at our renovation budget. So, let's elaborate a little bit on that and you know, said you all will add like three to 5%, is there a different amount that you encourage investors to have?

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RT: You know, it just depends on the level of renovation. Three to 5% is usually a good contingency plan. As I said, the bio said we've done over 2,000 value-add projects over the

seven years that we've been in business. That number has worked very well with us, that's what we advise our investors to do as well. What's important is if you don't have that contingency plan, it's going to affect your overall business plan. When you're underwriting these multifamily deals, you underwrite for the full 120 units on the property. You don't say, "Well, I'm going to underwrite for 75 of these." You underwrite for the full 120.

But when issues occur, what usually happens is you start pulling away from the business plans, you might – let's just say, you might not renovate the remaining one-bedroom units on the property because you have to put more money in those two-bedroom, two-bath units because they're getting their most upside on the renovation.

Contingency just helps alleviate that stress. Again, if a water heater, if your boiler goes out, if you got a number of HVAC units that need to be replaced, that contingency helps with that.

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WS: Nice. What are some of the top successful investors you see doing as far as who is managing this renovation process that you're talking about, who do they have managing?

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RT: Well, usually they work with their property managers. Usually, there's a director of construction, historically involved with a fee management company. Oftentimes, you also see asset managers. If and of course, I'm a general contractor but if you have a good relationship with a general contractor, and a good asset manager on your team, they can work directly together. That might be a way where you can effectively remove that construction management fee out of the picture and save that additional funding.

Myself are most successful projects are with the investor themselves. Somebody that can pick up the phone, I can pick up the phone and have a very candid conversation, a very positive or a very difficult conversation. There aren't multiple level managers that you get while you need to work with like on most fee management approaches.

Really work interview your property manager when it comes to time to talk about your value-add plan. Also, talk to your general contractor. They might be a recommendation they might have, there might be an outside consulting firm that could use this well. Use your tools, use your team to come up with the best plan for the renovation.

[INTERVIEW 2]

0:09:08
WS: Our guest is Garrett Lynch. Thanks for being on the show again, Garrett.

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Garrett Lynch (GL): I'm glad to be back. It's a great show.

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WS: I know one place where you add a ton of value to the Nighthawk Equity team is the operational value-add, just that side of the business, which is so important, right? Everybody talks about the value-add business plan.

That's what everybody is doing, value-add. Some people say they're value-add, some people say they're not, but would love to just jump in there and talk about how you all have added so much value to some specific properties in that process.

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GL: Yeah, we're typically looking for is, you know, what's left on the property to really add value. If you're looking at it in a very simplistic term, what we're really doing is, if you think about – we're kind of doing like five-year flips for the most part.

If you think about how you flip a house, like find a junkie house that's not too junkie where you're going to lose money, and then renovate it, and then it's worth more in a very simplistic way. We're kind of doing that over a five to seven-year period, for the most part, most people are doing that.

What we're looking for are assets that are anywhere – you know, even in the late 60s, ideally, the 80s, you know, built in the 80s up to the 2000s, and there's either an exterior and interior value-add component. We've got, you know, classic exteriors or we've got classic interiors or a combination of both.

This last deal, we just purchase two deals back-to-back in Atlanta, a 130-unit and a 150-unit. Both had kind of different needs, but there was a lot of value to add to both in their own way. The first one was complete exterior and interior renovation, we're going and replacing roofs, we're adding siding on, repainting, fixing all the wood on the outside of the building.

This particular building had an interesting architecture where it had these massive 30-foot gables on there, so we had to figure out how to modernize that. We ended up talking to a designer, getting her involved, having her help us come up with a strategy around that, so we're putting windows in all those gables, we're going to take the railings and turn them horizontal, so we're going to put some cedar wood across the railings, to give it more of a modern look.

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WS: That changes the look so much, doesn't it?

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GL: Yeah, that's something that we're doing there, we're also – I like to take spaces that have not been used, like a tennis court or something that's older on the property and an area that's unused, and we'll turn it into a combination of a dog park with turf, a grill station, so people can hang out and they grill out and stuff like that with seating, and then gaming. We're putting in a bocce area and then a corn hole, stuff like that, all in this one section so it's a really cool value-add that you can put any kind of sport you want into it. We just did that on our last deal and it's been a big hit.

We're kind of taking that, piecing it into future properties. Other things you can do, hammock park, it's like hammocks, and that's a really simple and cheap way to add value that not a lot of people are doing.

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WS: What is that? Explain that a little bit?

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GL: The hammock parks, you just get some colored hammocks and you hang them around in an area and people can go and lounge around and hang out.It is something different, it doesn't cost that much to implement, but if you have like a bunch of open space, you can go out there and just throw a bunch of hammocks up and you got a hammock park. That's kind of a cool little value add that we're doing.

I'm a big fan of resurfacing the pools and adding new furniture in those. It's not the cheapest all the time. Pools are one expensive CapEx item that you got to look out for and you've got to budget properly. If you have never done a pool before, it costs a lot, but it's worth it if it's a major amenity on site.

Doing that, I think, has been a big one, I'm in the process of building a gym, which has been really cool. That's been – you get a fitness company that kind of specializes in that and they'll set up the layout, and then you just build the space out, and then you can put your gym equipment in there, so that's pretty nice.

Another one that a lot of people aren't doing that we're utilizing is adding package lockers or electronic package lockers that you can put on even, you know, mostly your B-class property's going to have a ton of value, even C-class you can use it.

It texts people when their packages are ready. The great thing about this is it keeps people out of the office. They don't have to go in, interact with your staff, bug them to get their package, whatever, or lose their package, it's all – and then the vendors aren't coming in.

If you really think about how much time that takes away from your staff on-site, it adds up, and you're losing money because of that. We even go outside with it, there's a lot of them outside and you hit up Parcel Pending or Luxer or one of these companies, and you can buy them outright if you put them in your CapEx budget, and then it – literally, the package shows up, it texts the person, they come to pick it up, 24 hours, great amenity.

All of these things that I'm talking about, all add up to – why are these important? Because people may not even use these. The majority of the people may not even use a lot of this stuff that you're adding in but it's for when you bring people to the property and you want to lease it at the higher rents. Your leasing agent, if they're good, they're going to take them through all the amenities and say, "Hey, this is all the extra stuff, the bells, and whistles that we have. This is why our rent is this," and people are going to have an easier time saying yes to that higher rent because they're like, "I would use that, yeah, I'm going to use the gym, yeah, I'm going to use the pool," and all these things.

Whether they do or not, it doesn't really matter as much. It's all about that leasing presentation and what you're able to provide to them at that moment to get them to sign on the dotted line, or even throw it on the Internet and attract people in. If you have things that stand out that other people don't have, you're going to win those higher rents and you can lead the market in rents.

It's a challenge. I talk to multiple people about them, how do we really monetize it down to the dollar? It's tough. It's really hard to even do that so you want to be so conservative on your underwriting but, man, if you hit it right, that thing – we did just that kind of stuff, just that exterior stuff at a deal that we own in Huntsville, a 276-unit. We were blowing past our target rents by $60, just on the exterior.

Now, we had plans to do both the inside and the outside. Now add the inside and now we're elevating it even further.

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WS: Yeah. I mean, right there, you provided a list of things that each of us, as operators, should be looking at. Will these things add value? How much value? What should we expect? What do the neighboring properties have? Like many things out there, one thing about the package lockers too, we've added that at a few properties, and I know a lot of other operators are doing it.

You talked about just the operational component thereof taking that labor off of your staff there. I mean, you can imagine if you got 150 units, all the packages. I mean, the way people order now online, managing all those packages is a nightmare. The risk of losing something or, you know, who's at fault, all these things, you know? Just having that place where even that delivery person knows exactly where to go. I mean, it's just so much more efficient and secure. That's a big value, I know, to a lot of our tenants as well.

I wanted to mention, what about you mentioned building gyms right now. Are you still looking at building gyms even during the COVID mess and everything that's happening right now?

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GL: Yeah, I mean, we're talking about it. Again, it's more for the shows. Even if people can't use the gym necessarily off the gate or it shuts on and off, I can use it as a sales tool. I can take people, "Hey, look at this awesome gym we just built. Yeah, okay, maybe it's down for a few weeks because of COVID, maybe not, but it's going to be up. You're going to be able to use it."

I'm not only just adding a gym but I want to use the most modern pieces to the gym. I'm adding Peloton in mine. People love that so right away, "They got Peloton's here?" Instead of just a stair-stepper machine or an elliptical or something, you add in more modernized stuff, maybe that mirror thing that people are doing. Add that in instead, where people are really excited to use the equipment that you have.

Because you'll likely have a smaller space, you want to really pick the pieces that are going to allow people to do a lot of stuff. You can talk with whoever you're building that with but cables are good, I think having the dumbbells and stuff like that, that's always really helpful in having a decent size, it goes up, there's a lot of range with that.

Put a cool mural in your gym if you can. That's a really cool thing to do. Carpet squares that kind of offset each other, you can go with that route if you like, or the padded foam. You can be really creative with it and do whatever you can to make that gym look really cool but, again, yeah, it's just a selling tool. Then, there's one other one I forgot to mention that I think is awesome. If you can pull it off, your property allows it, have a mechanical gate that secures it so you make it a gated community because, you do that, you lower your cost in security by quite a bit.

That adds a lot of security, a layer of security if your property has had issues with that in the past or possibly has had issues. It keeps all the riff-raff out for the most part and it makes people feel safer. You can get higher quality staff, higher quality tenants. It's had a profound effect on our deal in Huntsville just making it a gated community. It's like a fortress now and it's awesome.

[END OF INTERVIEW]

[OUTRO]

0:18:32
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