EPISODE 1355

[INTRODUCTION]

Dean Ofer (DO):

The more deal volume every syndicator has, the more flexible each institution will become in terms of deployment because everyone's in the business of creating long-term programmatic relationships because time is all of our biggest assets.

Sam Rust (SR):

This is your daily Real Estate Syndication Show. I'm your host, Sam Rust. Joining us today is Dean Ofer. Dean is a senior originator at Harbor View specializing in all government insurance loan products such as housing and urban development, Fannie Mae, Freddie Mac. Prior to joining Harborview, Dean led an originations team at a prominent infrastructure REIT with a multibillion-dollar portfolio in the industrial and advertising spaces. He also has experience underwriting multifamily office and industrial investment opportunities across the United States on behalf of another national real estate investment fund.

[INTERVIEW]

SR:

Dean, welcome to the show. Thanks for joining us today.

DO:

Great to be here, Sam, what an introduction.

SR:

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You've got quite the resume. So you're in Manhattan, the heart of it all. And I'm curious, you know, Manhattan is not a market that I look at, or just New York City, let's go a little bit broader, New York City as a whole. In many ways, they, some people would say it's the center of the real estate market for potentially the world. It's one of the most sought-after markets. I read a ton of headlines 18 months ago about the death of New York City and all these people are moving out and how the city may never recover. And then quietly, as I've been doing a little bit of follow-up on that it seems like the city is actually rebounding much like it has after every crisis over the last 100 years or so. I'm curious for your perspective as somebody who's there on the ground in that market, what you see.

DO:

So, if we can backtrack to March 2020. Not only was I living in Manhattan, I was living on Columbus Circle on the 33rd floor of a residential building in one of the most densely populated zip codes in the US just to give a little bit of perspective. March and April, I remember going to Whole Foods and Trader Joe's to buy the basic necessities, like toilet paper, toothpaste, a lot of things that were off the shelves, hand sanitizer, which were more valuable than any US dollars than a piece of fine real estate than a piece of Bitcoin. I couldn't find the basic necessities. But it was a scary time for everybody. We're all Washington news, seeing daily deaths recorded rise each day over a steady month and a half. There's a lot of fear, there's a lot of panic. Concurrent to that there were a lot of riots and a lot of damage that wreaked havoc, downtown Manhattan, over the course of the summer, as well as other neighborhoods across the New York City, played a large role in creating one of the best opportunities over a 12-month period, which was for that contrarian investor with a long-term mindset and a little bit of operational know-how and expertise to take some calculated risks. Prior to this point over that six-month, eight months period, the Federal Reserve injected $6 trillion or so into the US economy. A lot of that has went into creating a massive wave of demand for New York real estate there's only a fixed supply. Condo prices, rental prices, with the exception of the luxury condo market are at record highs for renters in New York City looking for traditional one, two-bedroom apartments, not luxury condos, not luxury apartments by any means are at record highs right now. Demand is at an all-time and New York is back.

SR:

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It's interesting, man, the naysayers, the rush for fear, the paranoia, the lack of confidence. It's contagious, that more contagious than COVID, which is saying something. And yet, as you said, the contrarian investor or the investor with a longer time horizon, the opportunistic investor has a lot of opportunities. It's been that way for hundreds, if not thousands of years, and will continue to be.

DO:

Absolutely, and we're seeing that across the country as well.

SR:

So, if we're at a moment in time where you're highly involved in the debt markets, placing whether it's agency or bridge debt, which has certainly gained its moment in the sunshine over the last six months as the tenure has run up significantly, but if you're looking to kind of play against the crowd, where are you seeing opportunity right now for folks that fit that description? They're contrarian, they have a longer time horizon, they're willing to maybe place bets against popular opinion. What do you like right now in the marketplace?

DO:

That's a good question. I need to think about that. It's a deal-by-deal basis. You can find great deals in urban, secondary, and tertiary markets Class A assets, B assets, mixed-use depends on a lot of things depends on the business plan. But something that is contrary and at this point, it's, it's tough to say because I used to think that contrary was urban infrastructure that's in densely populated areas, a lot of these walkup multifamilies mixed-use and mixed-use buildings. And neighborhoods like Chicago, Boston, and New York, which weren't necessarily receiving the investor attention it once did relative to Florida's and the Texas' of the United States for the last two years. So, it's tough to say, case by case.

SR:

That's spoken like a politician almost, Dean O. That's a good answer.

DO:

What kind are you looking for?

SR:

Yeah, yeah, everybody wants to know the secrets, right. And it's hard. We want to tease those out on this show. But right now, where do you see opportunity in the debt market? Maybe more specifically, and maybe that would be more helpful for our listeners as well. If we're honing in on multifamily as an asset class, that's what most of the folks listening to this podcast are invested in, are investing in, considering investing in? You know, I mentioned earlier that the 10-year has run up, I think you'd said almost 200 basis points since Thanksgiving, one of the fastest increases in recorded history. You know, there's a lot of people who are afraid of floating debt right now, and maybe don't love bridge, but yet they're also looking for leverage. What are you seeing is interesting debt products out there in the marketplace that are helping folks put together winning business plans in these somewhat uncertain environments?

DO:

I think a big change in today's marketplace, relative to a few years ago, is the emergence of private debt funds, and even foreign endowments and investment companies playing a role in the US credit and lending markets, which is further creating a lower spread traditionally to a few years ago. So, it's still pretty competitive across the board between conventional banks, the agencies had these foreign investment lenders. So, it depends on the property. I think that everyone is making sacrifices in relation to the spread. I think lenders are taking smaller spreads to make deals work because the ramp-up in both Sofer, as well as the treasuries, has gone up so dramatically over recent months, anything to push us over the finish line, no one saw this coming. And no one saw this, this fast.

SR:

The combination of so many factors, the supply chain issues that are still lingering from COVID, additional supply chain issues being caused by Chinese lockdowns. And then, of course, the big elephant in the room, the Russian-Ukrainian war, kind of just a perfect storm of events that really has hit consumer markets over the head.

DO:

Yes. And I'm reading conflicting information. The rumors are that Vladimir Putin is suffering of some sort of cancer-like symptoms. And apparently, he doesn't have too much longer left. So, there's tons of rumors circulating all the time. And none of us really know what's happening on the ground, day by day in Ukraine, on main markets domestically, and across the US. There's so much circulating information. And as consumers anything can change in a blink of an eye – markets, the new cycle, it's a wild west out there.

SR:

So if I were to tell you that, hey, I've got some money that I'm looking to invest into commercial real estate. But boy, this seems like a volatile time. I'm just gonna sit on this cash and wait to sort this out. Good idea. Bad idea. Why, why not?

DO:

That's a great idea. Cash is king. Real estate is a relatively rigid asset class, it will likely take six months to a year for many of the landlords who have floating rate loans who may underwrite certain annual rental increases by turning over and renovating units and achieving a certain premium. Once they're under the gun and may realize that those initial projections are a little too opportunistic, there's going to be some more pressure to sell in order to meet certain target returns. And when there's more, there's a larger pool of sellers in the market that will push down prices. So, if I had a lot of cash under my pillow, I'd be holding that sitting patiently.

SR:

And what would you be watching for that would tell you hey, now's the moment to go into the market and deploy that capital could be on a deal-specific basis. It could be on a macro state basis. But what is that thing or things that you're watching closely?

DO:

I want to see vacancy go up I want to see the problematic buildings that are selling based off actual income at a healthy ratio above what the current interest rates are trading at because to make deals

work today, landlords are purchasing properties at cap rates under the current interest rate projecting certain annual rental increases, often between five and 15%, depending on the market, and that's not sustainable over the long term, I think prices need to go down per unit at a more justifiable cap rate to consider getting into the market if I was an investor.

SR:

So I'm curious with that, because we've had a tremendous run-up, right? If you look over the past 10 years, aside from about a six-month blip during COVID, valuations have just run up to historic levels. And a lot of that has fundamentally been driven by a supply-demand imbalance, we just don't have enough housing. So, is it realistic to look at vacancy rate and expect that to materially change across the country? When we have, I would still what I see in the statistics is we still have a supply-demand imbalance, do you think that we will actually achieve higher vacancy? Though I think in some markets, we might, as they come back down to earth, but just broadly as a country, is that going to happen?

DO:

Not necessarily, with interest rates going up the demand for single-family home purchases, it has been going down slightly over the last 60 days and will likely continue to do so that will put more renters in the marketplace, which in turn may continue to keep vacancy low. But though the point I was making was the drivers need to change, I wouldn't want to purchase something based off a three-year projection at a very low in-place multiple it's everything's forward-looking almost like a lot of these tech valuations six months ago prior to the dip. And that's not the way to purchase real estate, which is why would you wait.

SR:

I think that's something that we've seen and why we've been pretty quiet on the acquisitions front is for a while, we've always looked at that spread between debt yield and cap rate in place. And for a while we were happy if we could get 100 basis points, then COVID happened and we broke and closed a bunch of properties at a 200-basis point spread, you make a lot of things work. And now

we're at a negative spread on a lot of properties in the markets that we're buying in. It's really hard to make things pencil unless to your point, you're underwriting significant rent increases in years one through three kinds of front-loading that and assuming that cap rates are going to stay anchored down in the lower end of the range. I'm not sure that that isn't true, but that's not what I'm going to underwrite too and that just makes for a pretty challenging environment to be able to execute purchases.

DO:

Absolutely. A lot of these take-outs are assuming cap rates similar to a year or two ago when in reality if five-year interest rates continue to run up for a three to five-year period, cap rates are going to have to increase not one-to-one, but to some degree higher, which will put pressure on the exit prices that certain syndicators are achieving, which will lower IRR. So, it's time for everyone to get creative. This separates the good from the great, real estate's very cyclical. So, let the games begin.

SR:

What's the creative deal structure that you've seen recently that you admired?

DO:

That's a great question, I would need to think about that creative deal structure. Generally, I'm working with syndicators, who are raising the majority of their funds through high-net-worth friends and family. However, I think one of the best ways to play it if I was a syndicator, with at least 50 to 100 million under management would be to delegate a certain portion of my raise to friends and family, given the returns you're achieving from friends and families a cheaper source of capital than institutions. And I would leave 20 to 40% of the gross equity available to an institutional investor to potentially create a programmatic relationship. And that's something some of my clients have been doing on their deals, not exclusively looking to high net worths or to institutions on the equity placement.

SR:

When can you seek out an institutional partner like that? At what point in your lifecycle as a syndication group? Do people want to see multiple successful exits? Do they want to see a certain number of assets under management? What moves the needle for those institutional partners?

DO:

Every company is different, but the one holy grail, which I hear time and time again, is you need to go full cycle on at least one investment. However, if that one investment is a 5,000,075-unit property, and on your second deal, you're looking to receive Institutional Equity on a 350-unit property. That wouldn't necessarily work it would need to be equal value proving your expertise going full cycle on a similar asset similar market, similar unit type.

SR:

That makes sense. So, if somebody let's just say they've done a dozen deals, they did go full cycle on a small one that their average deal avatar is 200 units, 35 million transaction size, and they have gone full cycle on one of those as well. And they're looking at something that's maybe a little bit bigger, call it 50 million, would they be a good candidate to look at an institutional partner for some portion of their capital stack?

DO:

Yes, the short answer is yes. depends on a number of things. But I will take a look at it. I'll put my cell phone number.

SR:

Yeah, for folks who are exploring that journey, what should they be prepared for as far as like sharing control, you know, fee structures, promote structures, you know, a lot of groups in the space that we're working in, you know, they're raising capital on like a 70/30, split, with maybe a one-time hurdle at like a 17% IRR to a 50/50, and then maybe a 2% acquisition fee. If you were to go with an institutional partner, what sort of term sheet are they going to want to get if they're bringing half the capital to a deal. And I know that this is a very deal-by-deal conversation. But I like to give folks a little

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bit of a broad swath of what is the landscape so that they're prepared when they walk in and have those conversations.

DO:

I'll use some of the biggest LP investors as an example though. BlackStone and Starwood. So, some of the biggest brands, everybody knows and loves, their cost of capital is generally between eight and 10%. So there's usually an IRR threshold or returns threshold that at the very minimum returns, both the institutional partner and the GP, their equity, they're contributing to pursue with a waterfall structure beyond that, and that then it differs case by case, depending on the sponsor of the deal, so on and so forth.

SR:

So for as much as we like to talk about, hey, what's the broad generalities? What are you going to see on a term sheet that is one of the beauties of real estate is it really is very case by case. And if you've had a lot of success, you can drive a better bargain. Real estate, ultimately, I like to say it's a pretty unfair business. But if you work hard, and you demonstrate results, you can make your way into that inner circle much faster than you think.

DO:

Exactly. Because this is, the more deal volume every syndicator has, the more flexible each institution will become in terms of deployment, because everyone's in the business of creating long-term programmatic relationships, because time is all of our biggest assets, we don't want to market everything, go to market receive a number of term sheets, compare and contrast, use redundant attorney and accounting. We're all looking for strategic relationships to bring deals to the finish line much faster.

SR:

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Agreed. You've had a lot of success in your career, Dean, you've done a lot of different things in the real estate world. What's one thing maybe a habit that you've committed to that has contributed significantly to your success?

DO:

Spending time off hours, I think anybody who loves what they do, has a passion, and constantly looking to learn and to grow, they're spending time off hours. As you know, real estate is not a nine-to-five job it takes a lot of time. In the office, late hours outside the office, over the weekends. And slowly but surely, we're all trying to put our left foot in front of our right foot and take meaningful strides forward. And I'm just trying to do it and take it day by day.

SR:

For folks who want to reach out, you mentioned earlier that you do a fair amount of work with syndicators. If folks want to learn more about debt markets, they want to connect with some of these institutional partners or just are looking for debt in general. How can they reach out to you and learn more about what you're doing at Harborview?

DO:

I'm a pretty informal guy. LinkedIn or my cell is usually the best way to reach out to me.

SR:

Fantastic. We'll drop the cell number in the show notes. Dean, thank you for joining us today. Thank you to our listeners for joining us on another episode of The Real Estate Syndication show. This is your host, Sam Rust signing off.

Whitney Sewell:

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