EPISODE 1432

[INTRODUCTION]

Michael Zaransky (MZ): I wish I would have known some of the due diligence and some of the investigative techniques that I outlined in this series of interviews years ago. A lot of it is learned from mistakes and trial and error. And, you know, I maybe would have made decisions a little differently or postured the deal differently. But I've also found that sometimes the best way to learn and evolve in this business is to make mistakes and mess up and recognize those mistakes and just not repeat them.

Whitney Sewell (WS): This is your daily Real Estate Syndication Show. I'm your host, Whitney Sewell. We're back again today with our guest, Michael Zaransky. He is the founder and managing partner of MZ Capital Partners. He specializes in ground-up construction development that caters to by-choice renters and workforce housing. So, Michael is going to dive in today to one of the most important topics around ground up and almost any real estate investment, and that is location, right? How do we pick that market or submarket? What has worked for them? What has not? He lists out many things that you need to know. Whether you're active or passive, you want to know these things about that development that you're investing in.

[INTERVIEW]

WS: Michael, welcome back to the show. I'm just thankful to dive back into development and what does that look like. And one crucial piece, and it's so important that I know what we're going to dive into today is selecting those submarkets. And obviously, we want the greatest likelihood of success for us. Not only us but for our investors as well. But then we want to ensure it's a great place for our tenants too and that's going to ensure the satisfaction for them and ultimately, the success for our investors and ours. So, let's dive into what do you all consider, what are the things you all are looking at or considering when

picking those markets that you are going to be willing to risk those chasing costs? Or years of time before you can even start on a project? And that's obviously something you all have dialed in. What does that look like?

MZ: All right. Well, for us the key or starting point is economics 101 of supply and demand. We look for markets where the demand for rental housing seems to be exceeding the available supply and kind of the benchmark to look at is we do our research on occupancy rates. A 5% vacancy rate is kind of the norm of a market that's in balance. And where we see a vacancy rate, as is the case in many markets today, that's below that number, sometimes as low as 3%, or even a one point something percent range. We know that there's not enough product in that market that people are staying for then they need to stay in the existing apartment communities which tell us there's demand there.

MZ: Second step we'll take once we identify those markets that appear to be supply constrained is we check out the rent levels. And we look for areas that have a growing history of rent growth over the last couple of years. And you can kind of project from there that rent will continue to grow or its supply constrained and rents been growing. And then we apply the existing rent level to a model we've developed internally to see if we can efficiently build and kind of have a feel for what it takes to be able to build in today's environment and breadth levels.

MZ: From there within this site selection in the submarket review, we look at the amenities in and around the site, such as transportation, the number of jobs that have been created, if there's sufficient number of jobs to support an employment-based system, if employment's been growing. And we also look at transportation, the roads and public transportation, and how those things are. And also for good retail infrastructure, certainly nearby grocery store, crucial. And then from their entertainment districts such as quality restaurants, or nightlife, or other quality entertainment. And retailers coming to the area that have done their own due diligence which kind of is a proxy for us to know. For example, a Walgreens or a CVS location, or major bank location tells us that someone that

does a lot of good demographic research has decided to go into that area. That's always a good sign for entrepreneurial companies like us to kind of attach ourselves to their tail, to what they've created by their presence. That's how we kind of narrow in the area and we identify the area and then from there, we try and find a site for development.

WS: Yeah, and many great things there. I was just making a list of notes. You know, you mentioned, even researching occupancy is one of the first things and 5% is the typical or normal, I think, you said market rate and then you know 3% or maybe even down to one point something you know is lower than normal and that tells you hey, you know there's the demand here, right? I wonder where do you find that or would you suggest the listener find that as well?

MZ: Data today, which is great, which makes business just about much easier to operate, especially in markets that are not in your hometown is available from sources, industry sources, such as Costar, Axio, or some other one of them, Yardi Matrix is another one that provides it and that data is available. Those are subscription services. But for someone just starting out or looking in an area, the brokerage firms that are active in commercial brokerage, or in multifamily development brokerage have access to that data. And we'll make it readily available to a prospective client who has purchased in a community where they're active.

WS: And I would imagine a number of those things that brokers should be able to help with. And of course, we want to confirm those assumptions, right, and think through them. What about, you know, when you go and visit and when you're, maybe you're going into a newer market? What does that look like, as far as the time spent there, looking at this market, maybe some things that you're doing personally, or your team, you know, when you're looking at a new project, potentially in a new market?

MZ: Yeah, like spend a lot of time in the area at least a day and overnight to check out the potential site. I like to get out of the car and walk the area and kind of get a feel for what's

going on there. Like to check it during the day and at night to kind of get the vibe of the neighborhood and feel for the area. Check out what retailers, pretty quickly, I have kind of little shortcuts on my checklist to drive through an area. And when I see Starbucks, if I see a Whole Foods, for example, and a Starbucks and a Walgreens, you now, I basically, I go through the motions and my due diligence, but I'm pretty much done. I know it's a winner.

WS: Helps to be there and experience it, right?

MZ: Yeah. Yeah.

WS: No doubt about it.

MZ: There's really no substitute for that. But also, there's nothing like, although you can do it online through sources like apartments.com, and actually poke around on neighboring existing apartment communities and getting their rates and looking at some photos. We actually go with our team and we physically tour other properties in the area, get a tour of the common area amenities and the apartments themselves, what kind of amenities and finishes they are, and see what it really looks like and what they're offering and their rental rate.

WS: All right, Michael, well, that's incredible. I just think it's a great list there. And the listener can just go back and listen to the last 10 minutes as well and know many things they need to look at as they look at a market and submarket and think about, hey, should we try to develop something in this market? So I want to jump to a few other questions, though. Michael, I wonder, you know, if you could go back and talk to yourself when you were starting in real estate, what would you tell yourself, you know, what would you say, hey, you need to know this right now; please do this. Or what would a couple of those things be?

MZ: I'm finding everybody who's been in real estate for a while would say they wished they would have bought more, or they wish they weren't as hesitant and wished they wouldn't have analyzed and should have just bought that deal. Because, you know, it's easy to look back. It's kind of like the movie "Back to the Future" when we know what's going to happen. It's easy. But when we all look back and see what's happened to particularly multifamily, the appreciation and the value of pretty much anything we bought 20 years ago, should have bought more. But I think, you know, what I wish I would have known, the contrary to that argument, I wish I would have known some of the due diligence and some of the investigative techniques that I've outlined in this series of interviews years ago. A lot of it is learned from mistakes and trial and error. And, you know, I maybe would have made decisions a little differently or postured the deal differently. But I've also found that sometimes the best way to learn and evolve in this business is to make mistakes and mess up and recognize those mistakes and just not repeat them.

WS: Yeah, no doubt about it. We can learn a lot if we just don't repeat mistakes. What about what predictions do you have or how do you feel about just the real estate market in general over the next, say, six to 12 months? Has anything changed about how you all are looking at projects? You know, because obviously, you're thinking about that, that chase costs are, you know, 12, 24 months, potentially before you break ground on something? Has any of that changed or has the market changed how you're looking at projects moving forward from today?

MZ: Yeah, I am extremely bullish on the future, at least within our end of real estate which is exclusively multifamily. The future is very bright. It's hard to find dark clouds. Inflation, which is affecting all kinds of things in our economy has actually proven to be a good thing for multifamily - rents increase, mortgages become less portable, which means less people buy houses, which means they gotta rent. It's a space that can't be affected by virtual or online shopping. It can't live on the internet, you got to live in an actual physical space. And the number of renters demographically is growing each year and projections are they will continue to grow by a significant amount. And we have, as a country, over the course

of the last 10 to 20 years, substantially underbuilt for the future demand. The National Multifamily Housing Council and National Apartment Association recently came out with a projection that we need an additional 4.3 million units by 2035, to house the number of people that are going to be looking for rental housing. So if you can get a project built and you can bring it to the market, you're going to stay full, and you're going to continue to see rent grow.

WS: On that same line of thought there when you're looking at a project like that, and you answered a lot of this, but I still love asking, you know, just how you think through being prepared for a downturn? Or, you know, what are you thinking through when you're underwriting that new project? Any other details around that, that we haven't talked about that you'd like to mention?

MZ: We underwrite higher than typical vacancy, even though in actuality I know it's gonna be probably 1% or 2%. We are underwriting 5%. In the early years, we underwrite as much as 25% vacancy. We escalate our expenses from year to year when we do our underwriting. And we very conservatively estimate rent increases, rent increases, the last two years have been double digits. We don't think that's maintainable. But it does appear by most industry experts and economists that rent increases should be in the 5% to 6% range for the foreseeable future. We underwrite 3%, just to be conservative. We underwrite higher real estate taxes than we think we're going to encounter. And we underwrite substantially higher payroll costs than our actual experience has been in the industry. And we also underwrite an eventual exit cap rate, at a much higher cap rate than today's market is assuming that there might be a change in the cap rate, even though my gut tells me I don't see a change unless there are trillion dollars chasing multifamily deals.

WS: What's your best source for meeting new investors right now or for onboarding new investors?

MZ: Best source for us is referrals from existing investors who because of our track record and the performance we've been able to show brag to their friends, what a great return it is. And probably the best commercial we have on investing in real estate today is when people look at the stock market, and see what's happening in their portfolio. It's a great time to be raising money and sold on the idea of buying an asset that is a hedge against inflation.

WS: What are the most important metrics that you track? It could be personally, or professionally, it could be exercising to how many deals you underwrite.

MZ: What I track on the business side is our equity multiple return. And we go through all the underwriting matrices. But I try and make sure that any deal we do, which we're very patient on, will produce at the investor level, a two times equity multiple over a five-year hold.

WS: Nice. What about some habits, daily habits that you're disciplined about that have helped you achieve success or produced the highest level of return for you?

MZ: Patience and growing with the ability, both maturity-wise and financially, that there's no pressure to have to do a deal. That if a deal doesn't work out, it's fine. That it's not important to do a deal to generate deal fees to cover overhead and to feed the piper. And to be able to, even though we care, to be able to not care enough about a particular deal happening unless it makes a lot of sense. I think developing that discipline is hard. And it comes with maturity and also, frankly, just the financial ability not to be forced to do something.

WS: What's the number one thing that's contributed to your success?

MZ: I think the number one thing, although people take a lot of credit for being really smart, and figuring things out and doing all kinds of the due diligence that we described, if

we're all honest with ourselves, the number one thing is luck. I'm in the right place at the right time. I have a lot of really smart friends that are in the office sector or the hotel business or someone that owns a shopping mall. They really know their stuff, very smart. A lot of trouble right now is they spend their day talking to their lenders about not foreclosing. Multifamily, the stars align, and luck is what made it happen.

WS: How do you like to give back?

MZ: I like to give back a lot. It's really something we do in our company a lot. We have a saying that we like to do good while doing well. One of the things that has become our trademark that we do is in any community where we have a multifamily investment or development is we get in touch with a local food pantry. And we've given them a contribution that is equal to the amount of money it takes to feed a family of four for a year in their community. And I'm proud that we've done that now for five years in a row.

WS: Nice. Well, Michael, I'm grateful for how you've given back to us as well over the last few segments or a number of segments now and just going into development. You've committed a lot of time to us and I'm great very grateful for that. And the listeners have learned a lot. I have learned a lot. Can you tell the listeners how they can get in touch with you and learn more about you and your company?

MZ: Our website is www.MZCapitalPartners.com Or they can contact me directly, the emails are always good. MHZ@MZCapitalPartners.com. Happy to share thoughts or conversations with anyone.
[END OF INTERVIEW]

[OUTRO]

Whitney Sewell: Thank you for being with us again today, I hope that you have learned a lot from the show. Don’t forget to like and subscribe. I hope you’re telling your friends about the

Real Estate Syndication Show and how they can also build wealth in real estate. You can also go to LifeBridgeCapital.com and start investing today.

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