EPISODE 1449

[INTRODUCTION]

Whitney Sewell (WS): This is your Daily Real Estate Syndication Show and I'm your host, Whitney Sewell. Today we have packed a number of shows together to give you some highlights. I know you're going to enjoy this show. Thank you for being with us today.

[INTERVIEW 1]

WS: Our guest is J Scott. A lot of you have probably heard of J Scott. He is a big contributor to BiggerPockets and he has written many books about the real estate business and industry and negotiating, and he is an expert in many facets of Real Estate, I'm so pleased to have him as a guest on the show, be someone that I just enjoy learning a lot from. He built an amazing single-family rental business and flipping business, he wrote the book on Flipping Houses, but recently he has transitioned into multifamily syndication. And so I encourage you to think about that, listen to this show, who he is, he's an entrepreneur, an investor and advisor. Over the past 12 years, he's bought rehab, sold, and he held over 70 million in properties.

He has an advisory role in numerous companies, I know you are going to enjoy the show. He goes in-depth about what he feels is happening in the economy, and what he expects over the next six to 12 months as well.

J, welcome to the show. I've seen you around for a few years now, J and I were joking before the show, I said it took me over a thousand shows to get him on the show. He's well known in our industry as a real estate expert in many facets of real estate.

So J, pleasure to have you on, give us a little more though, maybe about your path to where you're at now in the syndication business, and then I wanna dive in there a little bit.

J Scott (JS): Absolutely, and thanks for having me with me, I've been a big fan of your show for a long time. I've been following you for a long time as well. So thank you. So I started in real estate back in 2008, I was a tech corporate guy for a long time, I did mergers and acquisition and some product stuff, offer some big companies like Microsoft and eBay and 2008. My wife and I decided to get married, we didn't wanna work the 150-hour weeks anymore in the tech world out in Silicon Valley, so we left the tech world, we left the corporate world, we kind of fell into a real estate. I've talked about my story a number of times, so I won't rehash it here, but we just kind of accidentally fell into real estate and we fell into the single-family flipping. Over the next 10 years, through pretty much 2016, ‘17, we did pretty much everything in the single-family world, we did construction. We didn't flip in. We did rentals. We didn't know it. Lending a little bit of this, a little bit of that. Back in about 2018, for various reasons, which I'm happy to talk about, decided to switch my focus to multifamily.

And so there was somebody in the multifamily world a woman named Ashley Wilson who I had been friends with for several years, she and her husband were doing a lot of multifamily investing. And I basically (inaudible) I knew her well and she seemed to be killing it. I asked her if she would help me out, teach me the business and show me the ropes. She was very kind, took me under her wing for about two years now. She's been teaching me the business and we've started doing deals together. And we've now officially partnered looking to grow and scale the business. So I'm relatively new to multifamily only about two years now we basically took down our first deal last year and hopefully pretty close to our second one now, but she has about 800 units. I have 150 units and just looking to make my mark in multifamily, hopefully, like I was able to do in single-family with a lot of hard work and a lot of studies and taking my lumps.

WS: No, that's awesome. I appreciate you elaborating there. But you know, in case a listener, you know, hasn't heard of J, which they probably have I hope they have anyway. I mean, J built an amazing business around single-family homes, wrote the book on flipping houses. I mean, he just an expert, no doubt about it built an amazing business there. So J, would you just elaborate, like why move from that business model in real estate, you know, something you had obviously spent many years on and very successful at to moving into the syndication business now?

JS: Well, I'll be honest, the very first reason and probably the biggest reason I started thinking about multifamily was after 10 years in single-family, I had amassed some cash, and I was looking to deploy that cash. And it was very difficult in the single-family world back in 2018, as it is now to deploy large amounts of cash. It's hard to find deals and so I sat down 2018 I said I've got this cash. Real estate is my preferred vehicle for investment. I know real estate, I understand real estate, nothing against the stock market, but I'm just not a stock market guy. I like the control over my investments. I invested with a couple of syndicators, operators as an LP, a limited partner, and nothing wrong with that. I enjoy that but I'm a control freak. So I said to myself, "How can I deploy large amounts of capital where I actually have control?" And what I realized was operating syndications myself would allow me, one, to maintain the control but putting money in on the LP side as a GP would also allow me to deploy my capital. So I originally considered getting into multifamily and the reason I originally got into multifamily was because I was looking for a place to put my own capital.

So, that was how it started. Then I started looking at just the economic indicators. Did I think multifamily was poised to do well, over the next few years, obviously multifamily did well between 2012, '13, '14. And that point 2018. And at the time, I don't want to say that I was skeptical, but I was on the fence and I said, look, I'm gonna give this a year or two, I'm gonna track the economic indicators, I'm gonna look at the data. And I'm gonna see if I really think that multifamily is poised to do well over the next five to 10 years because that's the typical duration of these projects. I was hoping if I can pick up four or five or 10 projects over the next couple of years, I'd be in the space for five to 10 years. So I started tracking the data, obviously, then COVID came along. And COVID kind of changed everything.

And so I kind of had to do a reset last year, probably right around this time. And what I realized is that, regardless of where I thought multifamily might be headed a year or two ago, I am now very, very confident that multifamily is a great asset class, a great vehicle to be investing in right now. And there are a number of reasons for that.

First of all, you just look at interest rates, interest rates are at historic lows. A lot of people think interest rates may be going up over the next few years. Fed just announced this, as we're recording this in late June, the Fed just announced a couple of days ago that they think we'll probably see one, one and a quarter-point rise interest rates over the next two to three years by the end of 2024. If you're a multifamily person, you probably think yeah, that's not really good for us. But think about why interest rates go up. Typically, the Fed raises interest rates to curtail inflation, we have inflation when the price of things are going up, the Feds gonna raise interest rates just kind of slow the economy down. Well, that means if the Feds raising interest rates, that means we likely have inflation. So what does that mean for us as multifamily investors? Well, if we have inflation, that probably means that anything, rents are likely going up. So if rents are going up more than the average, that can often offset the increase in cap rates that can offset the increase in interest rates. We see asset values going up. So we'll probably see compressed cap rates. So yeah, I know the biggest thing people talk about multifamily right now is what happens if interest rates rise. But to me, that's a good indicator because that means we have inflation, that means we're going to make up the loss from higher interest rates in other areas due to inflation, rent, and asset and compressed cap rates.

And the other thing is, I've always been a tremendously conservative investor. I won't do a ton of deals. But from my perspective, if you underwrite deals more conservatively, if you think interest rates are going up, if you think cap rates are going to expand a little bit, be more conservative in your underwriting. Instead of assuming 10 basis point increase in cap rates every year, some 15 basis point increase in cap rates every year. If you're conservative, you're going to find deals, and you're going to do well. Personally, I just really liked multifamily. The other thing is I mean, there's been talk over the last few weeks of a 5 million-unit housing shortage in the US. So everybody's wondering why housing is doing so well? Well, we haven't built much since 2008. There's been under development since 2008. So there's a shortage of housing units. So multifamily is a pretty safe place these days. Where do investors flee when they start to get concerned about interest rates or inflation or other asset classes, they flee to safety. So investors are going to flee to multifamily. And when investors flee to multifamily, we're likely to see more cap rate compression, we're likely to see higher growth. So all in all, I just think multifamily is a pretty safe place to be over the next five to 10 years. I don't have a crystal ball, but all signs point to multifamily being a great vehicle.

WS: No, I appreciate your elaborating on all those points. They're just, you know, single-family to multifamily. And I just think you can speak to that individual that says you know what, I can just go over here and do my own thing in single-family and do just as good. But I would like to ask you that question. And I'd love to move on to you know, just more about what you see in the economy and interest rates. Some of that I think that's a very popular topic and things people want to know about. Well, I get the question often, it's like, well, Whitney, why wouldn't I just go do my own thing over here in single-family? I think I can, you know, just keep buying enough single-family homes. Why would I invest in syndication instead of doing that? I just wanted your thoughts around that. Because I'm sure you get that question also.

JS: Yeah, for me, it's economies of scale. Nothing wrong with single-family. I like single-family, I still invest in single-family. I own dozens of single-family rentals. I'm buying single-family now. But for me, I love the economies of scale in multifamily. But I also love the fact that with single-family, you're at the whims of the market, the values of single-family, you're gonna go up and down based on the values of other single-family in your area, whereas with multifamily, you're still at the whims of the market to some extent you're at the whims of cap rates and you're at the whims of interest rates, but for a large part of the success in multifamily, it's going to be driven by your ability to carry out a business plan. Can you raise the income? Can you lower the expenses?

Multifamily is much more like a business than single-family, single-family is very much an investment. But multifamily is in business. I'm a business guy. The reason I've been good at real estate is not because I know how to swing a hammer or know how to manage contractors, I know how to run a business. And for me, businesses are all the same. Your goal is to get the net operating income or the net income, whatever it is in your asset class up as high as possible. So you're looking to raise income, you're looking to make things more efficient and lower expenses. And so I feel like I have a lot more control over multifamily because I'm controlling the business plan than I do in single-family where it's essentially buy and then wait for values to go up, hopefully.

[INTERVIEW 2]

WS: Sterling, welcome back. I know you're an expert in again, 150 single-family homes pivoting right in a big way. You scaled that and that definitely didn't happen without a lot of hard work and a lot of dedication to make that happen. I know very few people who have that means single-family homes, right? I mean, they've built an amazing business, even local, and I mean, local to me here that I know are like, they're the single-family guy. I mean, they know this city, like the back of their hand, you know, they 150 single-family homes scattered all over. But man, you pivoted down and said you know what, I think I have a better path. But I want to jump into that. And maybe you can help us think through some things to consider when deciding, you know, whether an investor should invest in single-family or multifamily? It's a question I get often I'm sure you do as well. So help us think through that.

SW: Yeah, I'd say I wouldn't call it a double-edged sword. But I'd pull from both ends that if I were to go do it all over again because this is a common question I get, would you still start with single-family? Yes, because it has a lower barrier of entry. And that's how I was able to get my foot in the door, and then the snowball effect I was able to get from that. And then I was able to use a lot of that single-family experience, especially at that scale, it was significantly easier when it came to multifamily. So that's what I would say. But then it just comes down to your goals and where you're wanting to go because someone could easily be let's say 5, 10, or even 15 properties, just single families, and be financially free. So that's another thing on that side. If you're wanting to have a more scalable model from that and you're doing syndications, then that's something to consider whether single-family is the right thing to do stress if you're doing self-managing, that's when you would actually more consider or looking to the opposite of multifamily.

WS: Yes. I mean, there's so many things that are, you know, personal things you got to figure out right? What are your goals? Where are you trying to go, it's just assumed that you have to start with single-family, made you feel like you might almost have to start that way. Not necessarily.

SW: But the thing that can be daunting for most people, I'm trying to think at the time is when I started in single-families what my mindset was, or I don't even know if I consider investing in multifamily at that time, but just saying that it can be pretty daunting to purchase multiple units at once. So that could be why, I wouldn't say recommend, but the single-family side is just from a mental standpoint that it's just one unit there, you buy that. And then let's say you buy the next and then you from there. Okay, now I'm starting to get more comfortable understanding the model, it's less risky. Because if you go to 10 units, for instance, that's 10 different residents now that you have on your plate, so that can be daunting to someone versus just one resident. You get familiarized and then you start to grow from there, and say, okay, this is simple. I understand it's not as difficult as I thought, okay, now I can be able to start to go to larger deals.

WS: Awesome. Speak to, why multifamily? Why invest in multifamily and not just stay in single-family?

SW: I would say, why not multifamily for everyone? You're in a space where you're familiar with why but it's just the amount of transaction. So 110, 120 transactions from the single-family side in order to get to about 150 single-families and then bought as of recently, a 156-unit apartment complex which was just one transaction, all 150 units in one location. So there's that. So that's what I would say is the biggest benefit from those two is really just the scalability, and then also the economies of scale. And then I would say the return on time, your ROI on the time is better as well.

WS: I think that's something so many forget about, the time that it's going to take you. They think oh, wait a minute, you know, why invest in this deal when I can go do that myself? Well, you might be able to do it yourself. But man, if you count all the time spent I mean the time you spent finding those 150 units, 150 single-family homes, I mean, there was so much time invested in that versus finding this one transaction still took a lot of time it's still probably a lot less than finding 100 single-family homes to find that 150 unit apartment building.

SW: And that's another belief and fear, of course, but it goes full circle that also had to remove is the value of time. And one of the things I've learned and it took so long for me to hear, it was Grant Cardone that said this, he would say "rich people buy time". And for the longest time, I did not get that. But this was one point where I was at the amusement park, it was King's Island. And I was with my little brother because I'm a part of a Big Brothers Big Sister where actually get back my time and mentor someone who was actually in the environment that I ended up growing up in. And so I was there with my friend and business partner, Jacob, and he had his little brother and I say, Hey, let's go ahead and get fast passes. Trust me, we'll need those. He's like, I don't know. I said, just get it. So when we were there, the park first opens up, and the fast passes didn't really matter as much, because there were not many people at the park. But then as the day starts to progress, the favorite rides, the top rides were about two hours long for the general admission, but us for the fast passes, it was just 10 to 15 minutes, and then that's when it really just sunk. Okay, that is the value of buying time. And just timing itself is yeah, that's one story I want to share with people when it comes to that.

WS: That's a neat analogy to think through that as well. You could spend a little more money on that ticket, and you gained a ton of time back. Yeah, you're better able to utilize that day as well. Neat statement there. So, return on the time, you know, I had this call, or this investor called me one time and he said, I'll never forget, he and his wife were on the phone and they had owned single-family homes for a number of years, I would say six or eight years, but just the timing in the market, they sell it they make $350,000 on this one single-family home right now because of what's happened in the market. And so during the call, they're like, well, why wouldn't I just go do that again? And I said, how many of those can you find? Do you have the time to go find more single-family homes? And guess what? You bought that how many years ago? That's probably not gonna happen over the next three or five years. Maybe, I don't know. It might but either way, do you have the time to go find those deals? Do you have the time to manage those deals? Do you have the time to take the tenant calls? Just like we forget about that, right? Well, no, I could do it myself and save all the time or save all the money. You know, you don't really think through the time invested. So what about transitioning from single-family to multifamily? It's so common that somebody does start with a single-family home or small multifamily, you know, but especially a single-family home and moving into multifamily. Any thoughts on, you know, transitioning from one to the other whether it's the mindset, whether it's the skill sets needed, or even the team needed? You know, let's walk through some of that.

SW: Yeah, well, luckily, I had the single-family experience at that scale so I was able to build a property management company to manage that many single-family. So, the transition wasn't too difficult to that very first deal of 46 units. It was actually easier to manage that than all the others. But it did come down to different skill sets in underwriting the deals and understanding how they're exactly valued. Because the single-family as an example is, okay that sort of across the street for this is sold across the street for this. It's comparable property to this, it's also a three-bedroom, one-bath, so it's just fine with a detached garage. But on multifamily, you're looking at cap rates, okay, based upon the net operating income, okay, this is the cap rates of properties that have recently traded in this area. Okay, now you can reverse engineer to determine what the value of the property is, which is entirely different from the single-family side. So, I would say that those differences and then also the channels. I was doing some off-market on single-family but did a mix of on-market too. So, it was a mix of on-market and off-market. But then, with the multifamily side, it was just strictly off-market because this was in 2017 when the market was really starting to heat up, was going through brokers, and it was just not penciling out and even close to penciling out. So okay, took a step back. Why not beat the brokers to the punch and actually go direct?

WS: Yeah, you beat them to the punch and go directly. Incredible. You mentioned you know the value and how we value multifamily, single-family. I think that's a common, just misunderstood, right, when you're first starting to think about doing a bigger deal. Speak to cap rates a little bit. What does that mean? Or how would you explain that more on a basic level, what a cap rate is? Maybe how we use that just a little bit without getting extremely technical at this moment.

SW: Without getting too much into the technical side of things. It's just an essence a way to value the property. S,o as an example, I don't have my calculator on me. But if the ROI, I don't know if you're able to pull this up, but if the ROI, not the ROI, but the NOI on the property is let's say $300,000, then you would take that I believe, let's say the cap rate is 5%, then you would divide it by point 05. And then that's how you can reverse engineer determine what the actual purchase price is. So, that's how you would in essence, look at the cap rate.

WS: Okay, so that's 6 million.

SW: Yes. There we go. So, in essence, that's how you look at that.

WS: Yeah, so that cap rate can change things so quickly. Right?

SW: Yeah. And what also comes into play is that when you're valuing the one, when you could purchase the property but also forecasting in the future. Okay, what I believe I can sell this property for, and this is the slippery slope that we've been going into in the most recent years. People have been believing which has been the case cap rates have steadily been compressing, but do now, especially at the time we're shooting this, do you still want to bank on cap rates still compressing? Especially with the rising interest rates and some uncertainty in the future. But then you have some people that are still buying deals based upon that, which is fine. But then you just have to protect your downside that okay, if cap rates don't keep compressing, let's say you're buying it today at a six cap, and you're gonna say in the future, I believe I can sell it for four and a half, five cap, and that is your conservative model, that could be a little bit slippery. But if that is your aggressive model, and it still works on a conservative level at let's say, five cap or five and a half cap, then there we go. So, that's, I would say how that factors into on the multifamily side?

WS: Yeah, there's a lot to think about there. Let's say that in the 300,000 NOI, let's just talk about like, say a value add, we all hear that term value add all the time, what might be a typical amount that we're trying to raise the NOI to 20,000? 25,000? 50,000? What do you think would be a good number, just a ballpark? Throw in here so the listener can help think through what we're talking about.

SW: And this comes to the technical side when it comes to the math where this is out of my not having the strength on this, but I would say let's increase it to $50,000.

WS: Okay, so $50,000. So, that $300,000 at a five cap, that's $6 million. So, if we put $350,000 at a five cap, all of a sudden the value is $7 million and so, I just think it's like it's valuable for the listener here. Wow, you know, if I can increase the income, that's how commercial real estate is valued. If we see value there that this previous seller did not capture, we can go in and capture that value by putting in better operations, lowering expenses, and whatever it may be. It may be a dog park, or it may be covered parking, or it may be some kind of trash pickup, all these things right, or just better units. So, we can raise the rent to market rent, like those things. But, a million dollars difference. And that's not adjusting the cap rate at all. But then, I wanted to go back to $300,000 at a five cap, well, let's say, you know, it goes to four cap over the time that you have the project, but we've not increased the income at all. It's $300,000 goes from five cap to a four, all of a sudden went from 6 million to seven and a half million.

SW: There you go.

WS: Right. So that's why we have to know some of those things about the market we're in without getting extremely technical there.

SW: Yeah. And this is the other question that also comes up, where do you get that information on cap rates? And it's one experience that doesn't help for people when they ask questions. Well, okay, I don't have experience. But the second is from brokers. And you just ask them, okay, well, and just doing research, but also having conversations with brokers and saying, okay, what are properties trading for? And then seeing how they previously were over the years, and then how they are now and then you can see a trend, and then you just have to make an educated guess. Because even if we're forecasting the future, we'll say, okay, we think cap rates are going to keep compressing, or maybe they don't keep compressing. It's a guess. Because who knows what's going to happen in the future? I mean, maybe some operators out there. I don't know. You're just making an educated guess in the future. But then you're also just protecting your downside in the situation that doesn't end up panning out in the future. That's the uncertainty that we're facing in today's market, when it comes to forecasting deals in the future, because there's so much uncertainty, that's what's going on.

WS: Yeah, now, that's incredible. I just like that example. Thinking through how we can increase the value or what cap rates do to the value of the project. So, people can think through like your example even that you use, you have that single-family or even a duplex. The value is based on comparable properties. You raise the rent 20 bucks, well, guess what, that's 20 bucks of more income, right? And the value doesn't really change based on that, right? They're gonna still be looking at comparable properties versus if you have that 150 units and you raise each unit by $20, $25, right? It's such a bigger difference.

SW: Exactly. It also varies on your buyer on the single-family side. So, if you have an investor coming in, they'll look at it as more of that but oftentimes the incoming investor of your property isn't as of that sophistication. So, they'll also still be looking at it more as, okay this sold across the street for this, this sort of process for this. But however, multifamily is strictly looked at okay, these are the numbers because it is a business in itself even though with single-family, that also is the same in a way. But still multifamily, it's more predominantly, looks at that, because those are the types of buyers that are actually buying those types of assets

WS: Awesome Sterling, anything else you want to leave us with before when someone was thinking through single-family versus multifamily that the listeners should be considering before we have to close this segment out?

SW: This just goes back to your goals, just figuring out where you wish to be and then from there, you can reverse engineer. Okay, I want to just be in the single-family, I want to be in multifamily. If you're looking for a more scalable model, then single-family may not be the best bet. Then consider looking at multifamily. But if you're someone that is a little bit trigger shy or not as confident and you're working towards your first deal then that could be okay starting with single-family and then you start to get momentum and the snowball effect and you build that confidence and then can shift to multifamily. So, there's a lot of variables that go into that.

[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 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.

[END]