EPISODE 1508

[INTRODUCTION]

Craig Berger (CB): We obviously listen very closely to what the Fed says because Fed speak is critical right now. Don't fight the Fed. When the Fed says the raising the economy goes down, when the Fed gets dovish and more accommodative, the economy usually heats up and valuations go up. So we pay particular attention to the Fed.

Whitney Sewell (WS): I am grateful that you are back with us again. Today, we have Craig Berger back for this series of shows. And if you haven't listened to the last two days, I hope you will go back. You know, he had 12 years on Wall Street. And he talked about that transition, and ultimately telling you what he did wrong, where he felt like you could do better to help that transition into commercial real estate. Also, some of the key hires that he made early and even more recent, in his commercial real estate, career and path. I wish I had thought about some of those things early on, and it's still helpful even today.

And then we got into deal sourcing, how do they find deals? What some of those broker relationships look like? How do they do that internally, which he was gracious to help us see some of the things that they do internally to make that happen?

But today, the question that everybody has, Craig and I just like everybody wants to know -- what's going to happen, right? And I know you've got the answers for what's going to happen. So you know, welcome back. I'm honored to have you on the show. Grateful for your willingness to do a series of shows, and let's jump into it a little deeper into some topics of how you operate and helping us learn from you.

But you know, I'd love to know, especially your background in Wall Street, and just you know, the market knowledge that you gain to there and how you're applying that to your business. Now. I would love to just hear from you, I know the listeners would as well as what do you

expect over the next six to 12 months? And let's dive into maybe the economy and how's that changing what you all are doing in house?

CB: Thanks so much for having me again, you're a great interviewer, you asked insightful questions, and I appreciate it. So you'll look in terms of the economy. It's a really interesting time right now, you know, 2022 is pretty much the first time in history that stocks and bonds have both dropped 20% or so. Usually, if stocks drop, you have a flight to quality and bonds holds or vice versa risk on risk off, but this year has really been a sort of unique year in the history of the financial markets.

But you know, everybody's talking about inflation, and how long does it keep going? And how high is it? You know, I have a bunch of thoughts on that. So here's a few of my thoughts. First of all, inflation isn't 8%, it's like 30%, and the data is cooked and how they look at it and so on. Secondly, the main cause of inflation has been the Feds Frankenstein experiment gone awry known as quantitative easing. And a lot of people don't know what quantitative easing is. But, you know, during Covid, to support the markets, the Fed started buying bonds from Goldman Sachs and Morgan Stanley and JP Morgan. And what does buying bonds mean? Well, it means that Goldman Sachs wrote on the back of a napkin IOU $50 billion, and gave it to the Fed. And the Fed wired them electronically $50 billion of money that didn't exist 30 seconds before. And so the Fed's balance sheet went from $4 trillion to $10 or $11 trillion. First time ever, that they bought bonds in that manner with quantitative easing.

And so, our end-to-money supply grew by 45%, from the start of Covid, to the end of 2021. And that 45% growth in the money supply means your money just isn't worth what it used to be worth. And that price is skyrocketed. That's an addition to the government, you know, support payouts for Covid, the relief payouts and stimulus checks and the current administration's spending programs, infrastructure program or otherwise. So just a lot of growth between the Fed and the federal government. And that's why we have tremendous inflation.

But today, the Fed has stopped doing that and has reversed it and its quantitative tightening, and they've only sold off or taken those dollars back from Goldman and Morgan Stanley and JP Morgan, they've only taken like 5% of the dollars back, it's been very slow, but it's heading in the right direction. And it's you know, that along with the meaningful and painful Fed rate hikes is, I think, starting to have a positive impact on inflation. And I think, you know, inflation is more or less on its way back down to more normal levels.

WS: Okay, now, that's helpful. I say in that right there, you can choose your experience from Wall Street and on the knowledge that you gained from there and how you're able to apply that to what you're doing now. You know, some insight there that I that I've had to like struggle to learn some of these things, you know, that you are just living in, I think in that time.
I'd love to know, you know, what are you watching right now, like what's important to Craig You know, on a maybe day-to-day basis as you're leading your company and growth as you're "Hey, you know, we're we're looking for more deals." But what are you watching right now in the economy?

CB: Well, we look at the 10-year Treasury on a daily basis. I do have one bridge floater, where you know, we have a cap on that deal. The rest of our loans are our agency fixed, fortunately, but we look at the 10 years as a proxy for where cap rates are going. We obviously listen very closely to what the Fed says because Fed speak is critical right now. Don't fight the Fed. When the Fed says the raising the economy goes down, when the Fed gets dovish and more accommodative, the economy usually heats up and valuations go up. So we pay particular attention to the Fed.

We're obviously looking at all the inflation readings, and CPI wholesale data. We want to know where's this inflation thing going. Right? I think last month, you know, apartment rents, which had been one of the causes of inflation grew point 2% month over month. I don't care about the year-over-year, that's just math. But I do care about month over month, because whatever, this month over month, times, 12 months, is gonna give you your year over a year.

And apartment rents grew point 2% across the country, that's a 2.4% annualized rate. And it bodes well for the future of inflation. And so we're really looking at, "Hey, where do we think borrowing rates are going to be a year from now? Or 18 months from now? Where do we think cap rates are going to be 18 months from now?" You know, based on all of that data? And how do we play that?

WS: Even like, practically, where do you find that information? Or what do you watch every day? Is there a couple of websites? Because I get that question, too. If we're waiting, where do you we know we might need to look at some of these things, or we try to but where do you trust, you know, find and trust that information coming from?

CB: CNBC.com is probably where I spend most of my time just for financial news data, etc. You know, there are some others. But CNBC is a great source, thorough, and probably the best around. Some people look at Bloomberg also.

WS: What about as your underwriting changed, or maybe your types of deals you're looking at, or from what's happening in the economy right now, and what you feel is happening, or going to happen, any of those things, how's that changed how you all are looking at projects and moving forward on deals?

CB: Well, our underwriting is always changing. It's always in flux. There are some things that are always the same, but there are other things that are always changing, right? Obviously, we're underwriting less rent growth, less rent, pop on renovations, and higher exit cap rates, obviously, we're underwriting the current debt market conditions, which are totally different than they were a year ago. You know, on Freddie floaters, we use the forward rate curve. And, you know, the forward rate curve a year ago was really wrong. And, you know, that's just some of the risks of forecasting, but our model is constantly in flux.

And we're underwriting to higher cap rates, less rent growth, and higher interest expense, and we need to hit higher IRR. So 15, you know, is at the deal level and isn't really going to work

right now we need an 18 or 19. So that we can be attractive to potential investors and get them to part with their money during an economically challenging time. You know, in terms of deals, we are probably looking more for A's and B's, just because I think, you know, the really lower-end workforce stuff is you know, folks are spending more of their money on gas and food, and things have gotten a lot more expensive. And so I think it's harder for the class see communities to pay rent right now. You know, it's unfortunate that the Fed has put us in this position, but it's reality, and I sort of, you know, have to be dialed into reality. So that's some of the things that, you know, have changed and sort of how we're looking at properties right now.

WS: Yeah. Now, that's some great information right there. I get the same question all the time. Yeah, definitely history and growth. And you talked also about debt being very different right now, it? Could you elaborate on that and what that means to your underwriting a little more, as far as the type of debt you mentioned earlier, you know, staying away from bridge day out at the moment. And when would there be an option to do bridge at all right now? Or why would you or is it just like completely off the table, and some thoughts behind that?

CB: Well, buying a five cap and borrowing at 8% means you're bleeding terribly. I don't like to bleed. Nobody builds a business in this industry and moves forward unscathed. Through time, all operators are going to take some punches and deal with adversity, but I don't want to take more punches than I have to and borrowing an 8% on a five-cap deal or a four-and-a-half yields total costs going in doesn't feel good. We would buy a bridge deal if it's a home run basis, if there's some reason why the assets not performing, but it has to be exceptional. And I personally do think rates are going to come down.

So I'm thinking of this, you know, next 15, 18 months is a great opportunity. I mean, there is going to be distress coming in the market. We haven't seen a lot of distress yet, but it is coming and it's because of the debt. Right? I mean, you had folks paying very high prices in 21 and early 22. A lot of them did take on, you know very high leverage bridge loans and you know, you get three years and if you don't have strong financial performance, you don't qualify for your, you know, fourth-year extension or your fifth-year extension. And so there are a bunch of folks that took on deals in 2020, that are not going to qualify for their bridge debt extension.

And in 2023, they're gonna, you know, they're gonna have to sell at whatever price makes sense. So we do think there's some distress coming, we want to be positioned for that. Obviously, in debt, the main thing is rates are higher, and leverage is a lot, lot lower.

WS: What about do you expect a recession over there other than what we talked about there? Do you expect a recession? And how do you see that affecting properties or how you're prepared for that for your properties?

CB: So usually Fed rate hikes take like, sort of 18 months to work through the economy. And you know, they started raising six months ago, you know, you just have heard that Facebook meta is laying off. People think Amazon announced yesterday that there are 10,000 layoffs coming. Twitter has obviously laid off a bunch of people, you know, I think Google has a hiring freeze right now. So it is starting to work through the economy.

On the other hand, a lot of parts of the economy are still robust. So I think it's more likely that we could have some soft landing scenario in 2023 than maybe what I expected four, or six months ago. But we'll see how much the Fed over do it and what the sort of delayed impacts are from these aggressive Fed rate hikes, and whether the destruction of wealth in the housing market and in the, you know, equity markets, you know, how much those translate into economic spending impact and so on. But the economy's held up better than I expected. But it's, you know, there is more weakness coming, so to speak.

WS: Yeah. What about even preparing for that if you just closed on a project? How do you say you're prepared for that, or what's coming?

CB: So we have a number of risk management techniques that we employ to guard against potential downside. We try to have a bundle of safety capital at the project level for each of our deals, margin of error at the project level. We try to have a bundle of capital at the corporate level, should our project-level cache not suffice? We try to execute at a very high level and, you know, make the properties perform as as good as as humanly possible. We sort of have to think outside the box on additional ways to market for tenants, screen tenants, do the

background checks to ensure that we're putting ourselves in as good of a position as possible. So those are some of the things that we're doing to protect ourselves, project level cash, corporate level cash, and peak property level execution, but we're on the ride.

And if you own deals and you own a bunch of deals, you're on the ride. Maybe if you own A's and B's, you're in a slightly better position for this downturn than if you own B's and C's. I don't know, maybe some folks that are B, you know, and B properties downgrade to see properties and save money. So maybe there's crosscurrents. Right? But you know, like I said, anybody that builds a business and owns deals is going to face adversity and take punches along the way.

WS: Yeah, no, I appreciate all that. And but you mentioning, "Hey, you got safety capital." You know, reserves and safety capital per deal, and even at the corporate level as well. And then we could keep talking about this for a long time I think and pick your brain. But the last question, before we move to a few final questions, Craig, is there a way that you calculate the amount of safety capital reserves that you have on hand per deal, or even at the corporate level that you can share?

CB: Well, you kind of know it when you see it. There's not one specific metric, but we do try to keep three or four months of expenses on hand. And then, depending on what our sort of institutional investor arrangement might be, any particular deal could influence how much cash we want. From there, of course, you know, there's also the CAPEX.

These properties do require a lot of CAPEX to either maintain them or improve them. And that's sort of we're always on a, you know, five-year look forward type of plans. So there's, you know, CAPEX, safety capital, institutional investor safety capital, there's operational safety capital. I mean, we've got various buckets of money. And, of course, we have to hurdle, all of that capital at the end of our deal. And so, you know, we're paying for that margin of safety as sponsors, but it helps me sleep better at night. So that's how it goes.

WS: I completely understand. I've been criticized about how much we have in reserved sometimes I'm like, "Hey, you know, I've done best, it's okay." You know, like, we're gonna sleep better along with every other investor.

CB: You're a survivor.

WS: Yeah.

CB: Are there any risk management things that I've missed that are important to you?

WS: That right, there's usually like, one of the first things I mentioned is like, how much reserves you have in place? You know, it's like with no cash, you crash, right? I mean, you gotta like you're talking about you gotta be able to withstand some knocks and when we know that there's probably going to be some knocks that like we didn't have any way to know about when we were planning this deal, right? And so we want to even account for that as the best we can.

And like you said, you know, you can't know everything going on in the deal that is part of the business. But we do try our darndest to know everything possible, you know, not be completely complacent and say, we didn't know everything right about the deal, or we're gonna we won't that reserve those reserves there upfront and say, we raised that upfront. And so it's like, it's there. You know, some people say, "Oh, you know, pull it out of cash flow over the first six months." Well, I'm like, "Well, that's not me. You know, I want it there". Because, you know, at some investors asked about too, you know, I've actually I've had a few investors lately asked me that I've not been asked this before, but how well capitalized art is this deal? Or this project that you're moving into? Right? Or how much are you going to have on reserve?

But even then, you mentioned, Craig to the reserve capital, safety capital, like you said, at the corporate level, and I actually had an investor recently asked me that is first time anybody's ever asked that? And I thought it was a good question. You know, it's like, well, but don't know how bad this gets, can you still pay your employees? You know, how long can you still pay

them? And so, it's been a good exercise to think through that, and ensure, "Hey, we're prepared." And I think it even gives our employees some security to knowing that, hey, we're good for a long time, even if we can't do a deal. Right?

So Craig, what's your best source for meeting new investors right now?

CB: Well, we think of investors in a few different buckets. We've got institutional investors. We've got sort of middle market, maybe family office type of investors, and then we have, you know, individual high-net-worth investors, and we're building relationships with all of those different classes of investors. And, you know, obviously, there are pluses and minuses to working with a large institution. And there are pluses and minuses to working with a $100,000 individual investor.

So really depends on what segment we're talking about. On the institutional investor side, we've got a bunch of relationships we've, you know, pitched a bunch of deals to over the year over the years and 99% have said no, and 1% have said yes. And as we continue to grow and scale and build our track record, we're, we're looking to convert more of those to life partners, that brokers and investment sales brokers have sometimes introduced us to large institutional investors, obviously, you've got conferences, you know, other personal connections, I'd say those are some of the ways I mean, there are a few shops that you know, they're putting out large checks, and we just try to get in front of those folks.

On the individual investor side, it's some of the same stuff, warm leads, warm introductions, you know, maybe some LinkedIn connecting or marketing. I think LinkedIn is a pretty powerful platform. But yeah, look, there's no easy answer.

WS: What about your best advice for passive investors?

CB: Wow, the best advice for passive investors, make sure you choose good sponsors to work with. Sponsors that don't have a crazy fee. Structure sponsors that have aligned interests. Sponsors that have focused on ethics and integrity. Obviously, sponsors that have delivered

and then maybe diversify across multiple sponsors. So you don't have too much exposure to one or the other, and you can kind of spread it around a little bit. I mean, I love real estate, I think it's very controllable. You know, if I was an investor, I wouldn't put 100% of my money in real estate. I mean, it's an important part of a balanced overall portfolio. So little bit of advice.

WS: What about are there any metrics that you live by? It could be personally, professionally could be your benchpress number, it could be how many mornings get out of bed on time? Or it could be something in the business? Like, no, I gotta make sure we analyze this many deals, or what would that you know, a few important ones for you?

CB: That's a really interesting question. I don't know that I have any hard and fast benchmarks. We are developing KPIs and metrics for our company, and each of our employees and hires. I'm sort of, I guess, ultimately responsible for hitting our corporate-level KPIs and, and key metrics. But we started most focused on growing and not growing for the sake of growing but growing with quality projects that we can deliver for our investors on.

But, you know, I just sort of I know it when I see it, you know, my days are packed, we're out chasing our next deal or two deals, or trying to engage, you know, a deeper conversation with a bunch of institutional or potential institutional partners. And, in the last 12 months, we've deployed more capital in the last 12 months than we deployed in our first seven years in business combined. We're growing and we want to say the same thing next year, if possible.

WS: What are some daily habits that you have that have produced the highest return for you?

CB: Wow, if you really want to tackle a task, you have to, you know, block off time on your calendar, turn off your email, turn off your cell phone and really focus. Sometimes I do that individually. Sometimes I take my capital markets, and we go and pound the phones together without interruption for an hour, two hours and just block time off. And compartmentalize other things that are important.

Again, sort of I mentioned key performance indicators, key numbers. We have to really know, "Hey, what makes any of our employees successful? What what is success for each of the different roles that we have at the company?" And you know, all of those metrics and numbers, of course, are always under review. But those are just a few of the things that we are focused on to produce results. And if we're closing deals, sales or dispositions and we're delivering for investors, then that's sort of the ultimate measuring stick for whether we're being successful or not.

WS: What would you say is the number one thing that's contributed to your success?

CB: Hard work, persistence, stubbornness, perseverance, not giving up. I cab't remember who said. It might have been Thomas Jefferson, or I could have this quote, wrong. But somebody, one of our founding fathers said, the harder I work, the luckier I get. Sso it's kind of like that, if you don't have the emotional fortitude, the financial fortitude, the risk, tolerance, fortitude, the ability to take hits, and keep going, then it's probably best that you, you know, work as part of a broader team, because there is a lot of challenges to running your own business.

So you know, it's true, whether you're doing multifamily, or you're doing a tech startup business or any anything that you start, it's going to be a long road, right? This is a hyper-competitive environment. There are not a lot of companies that are in business for 12, 18, or 24 months and raise a $200 million seed round from Sequoia or whoever, right? It's just, it's rare. Most people don't live in that type of entrepreneurial environment. So you have to be prepared to do the hard work and to persevere.

WS: How do you like to give back?

CB: We give back in a few ways. First of all, I'd say we're early in our corporate give back efforts. And as we grow and scale, we'd like to do more there. We've been somewhat resource-constrained until 6, 8, and 10 months ago, and we're still resource-constrained. But you know, we do take on interns and train young people that have an intense desire to learn the business and it's a win-win.

If you got some good assistance, in terms of you know, being in the apartment business, we do have the opportunity to help residents in need that are truly deserving of assistance, folks, and maybe we've had a long term relationship with or they've been excellent tenants, and they fallen on hard times. You know, we do have the opportunity at the corporate level to provide assistance to some of those folks. So we don't impugn property performance through those giveback efforts.

We sort of take that on at the corporate level. Obviously, again, for folks that are that are truly in need and deserving, you know, and then there's, you know, obviously, charitable, give back efforts. And I'd say we're earlier in those efforts, but we sort of have our eye on a few.

WS: Awesome, Craig, it's been an honor to have you on the show and just be willing to do a series of shows with you. Another great segment, just on your thoughts on the economy, the market, how that's changed your underwriting. I know that listeners learned a lot from you and are you know, looking up to people like yourself who you know, have grown and scaled and persevered like you talked about. And then in some insight into how you're looking at these things, especially with your experience on Wall Street as well.

Thank you so much for your time and for spending this much time with me and our listeners as well. And being so transparent to share. How can they get in touch with you and learn more about you Craig and your business?

CB: Thank you so much for having me. You asked really great questions and I really enjoyed this. Anyone that wants to get in touch with me just send me an email craig@avidrealtypartners.com.

[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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