EPISODE 1535

[INTRODUCTION]

Steven Gesis (GS): The particular term here that I'm using is a heavy value-add. So you're gonna have the value-add, which is going to be that 20% kind of that common status quo stuff. And then you're gonna have the heavy value-add lifter and what makes us different in that respect is that from a financial lending component, a lot of debt lenders, they're really not looking to jump over that 20-25% over-door price.

Josh McCallen (JM): Josh McCallen (JM): Welcome back to The Real Estate Syndication Show with Whitney Sewell. Hey, wait a second. I'm not Whitney Sewell, but Whitney Sewell is a dear friend. I love him dearly. My name happens to be Josh McCallen. And as a friend and passionate member of The Real Estate Syndication Show, Whitney and I collaborated and I get to be honored to be part of the team and bring you a few guest appearances, and show hosts. So thank you, Whitney, and thank you the real estate syndication community.
So in earlier episodes, we met Steven Gesis, and we started to understand the journey from single-family to single-family scattered to vertical integration of a big management company of scattered single-family all the way to the ultimate destination we've come to find is multifamily. So Smartland, which Steven is a partner has a lot to teach us. So we invited you back to do a masterclass on a key question, Steven.

[INTERVIEW]

JM: So welcome back to the big show.
SG: Thanks. Good to be back.
JM: Steven, we left off getting to know you a couple of days ago, understanding your great journey, your Ukrainian background coming into this country as an immigrant. Why don't we start there before we answer the value-add question because we're going to answer the pressing question. Why do value-add? Why do they perform well? Why do you do it? And why does it performwell. In Ukraine, you came here? Did you speak English as well as you do now? When you got here? I mean, you are incredibly gifted multilingual dude.

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SG: No English. They didn't know. I learned English off of that.

JM: Well, you did. No wonder your English is so great. It was before we messed it all up. Nicot nights, the 50s shows, in 60?

SG: Yeah, taxi, all that stuff?

JM: And what about Wilbur the talking horse? Maybe I think maybe you learned about that. It turns out there's not actually a talking horse. I know, that was a surprise to many of us watchers. But let's go to they say, it was peanut butter.

Let's go to the key question about value-add. You know, it's a term that's thrown around, why don't you define what you mean by value-add? And what components you believe put the most value into a property?

SG: All right. Yeah, that's a loaded question. So, that you make a great point, because value-add, it's used very broadly, you're very correct. And so, some folks value-add, it's maybe like 20% of the purchase door price or something or 30%, that a lot of cases value-add. For us is actually like 50%, in some cases 60%, which makes it different because when we're talking about value-add, we're talking about doing a much deeper dive. We're talking about the suite upgrades with new kitchens and new flooring, and new trim work, and new doors, and a technology package that will include USB outlets, and they'll include an Alexa, and now our new tech packages include TVs, and we wouldn't have an ala carte tech package. So it definitely has progressed.

But, when we talk about value-add, we definitely talk about, you know, the bathroom, the full suite, the common areas, that lighting package and the commercial common spaces. Then we're also talking about upgrading the common space and giving some sort of new amenities to residents, which may include like pickleball courts, or may include a pet park, or electric car charging stations, which is actually much more common that we're doing it at a lot of our properties. And we've been doing that for now, probably three or four years when when everybody said, you know who's gonna be the car that's gonna park at your building, and oh, look where you're at, and you're in this tertiary or secondary space.

And that gets back to value-add, right? So our value-add look is that we're looking at it from a holistic and complete turnaround of an apartment. So some guys say value-add, it's just going to be the common areas, the carpets, the lights, the signage. No, we're going full gauntlet here.

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JM: So full gauntlet. Let's go back to the math. You said at the beginning, you said sometimes it's just a small percentage of the value of the of the unit. You're saying for you guys, it's sometimes it's 50%? Do you mean, you bought a $50,000 unit when you make out the math of 100-units? And you're going to spend $50,000 per unit? Is that what you meant by that?

SG: No, we're gonna buy it for $50,000 per door per unit, we may spend $25 to $30,000.

JM: That's what I meant, you're gonna spend $25,000 on a $50,000 unit. That is substantial, and it does set you apart, in my understanding, of the community of value-add investors.

SG: That's correct. So we'd be considered a heavy value-add lifter, right? So the particular term here that I'm using is heavy value-add. So you're gonna have the value-add, which is going to be that 20% kind of that common status quo stuff. And then you're gonna have the heavy value-add lifter and what what makes us different in that respect, also, is that from a financial lending component, a lot of debt lenders, they're really not looking to jump over that 20-25% over door price. So you do getting back to kind of the previous episode where I said, you know, you have to consider that the entry barrier into multifamily is quite high simply because you have to have a closing track record with some sort of brokerage. And you have to develop that over a period of time.

And so, the same applies here with banking, you have to develop both. And so, you can't just go in one without the other. So you have to have banking, that's going to also get and support you to do that heavy value-add, right? Because common status quo is going to be 20% over door price. And everybody's comfortable in banking with that. So, you have to have all the right components in place. And that's what I was saying earlier is that it takes time to develop.

JM: So I think our listeners, some of them are so sophisticated, have thousands of doors. And so they're listening to this and saying, you know, our model is the normal 20% model. Let's talk about some real answers, detailed, specific. So you've been really great on telling us about how much you're willing to invest. There must be an indicator in your mind, in your research that says "This one's worth it." It's not just that it's a beat up building, ever, if there's a lot of destroyed buildings that you could easily spend 50% on, you're saying "We're willing to buy this one, because we saw this statistic." What makes you say this one is worth 50% investment?

SG: Honestly, Josh, it's a great question, because some of it really just has to do with our discipline underwriting. So it's not necessarily like we're picking this. I think I said earlier, you

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know, we'll look at 500 deals in a year. And, part of it what we really have to focus in on buying, there's a lot of things that have to go right. So it's not only area, we do focus in on secondary and tertiary sub markets, we are looking for 100 plus.

So actually, you know, does slowly begin to whittle down, opportunities are not as robust. The other thing is that, you know, a lot of folks, they have to be prepared to sell. And as a buyer, we have to maintain our discipline in the various to what our investors are looking for as a return. And so the way that we hunt, as what you're asking me, has to be very particular.

And so, some of the accommodations is not necessarily areas, a lot of people will say, "Hey, that area suks." Well, what we do is unique from the heavy value-add. So yes, we're always location, location, location matters, sure. But we're also doing a very, very large transition of an asset. And so, when we're doing that we're looking at, you know, currently, we're gonna be probably taking it to a new market rate rent, it's probably we're buying at below market rate rent, it may be in a tertiary submarket. But we're only having to replace 100 or 150 residents that are prepared to pay slightly more, live in the best of the best in that submarket, right? And so, so we're a market maker anywhere we're going.

So, for us a lot of things that have to align is not only price. It has to have the capacity to be able to do the uplift, then get the appraisal value on the backside, right? So I mean, there's got to be a lot of it's not just one or two or three. I mean, when you're asking me, how do we hunt, there's 100 components that go into this hunt. And so, do we have to hit 100, checkboxes? No, but you know, we're probably hitting 90, 95 of those checkbox on that checklist.

And so some of it is driven by location, price, opportunity, all those things have to collide, right? So seller has to be willing to accept that we're willing to pay for it, we have to be willing to kind of come to terms with that. Banking, as you saw banking, that (inaudible) and flows occur. last few years have been really simple banking. Now we've entered into a more complicated banking environment. So the way that you're looking at deals and the way that we're hunting for deals will slightly change.

But in the same respect, we stick to a simple discipline, right? We're looking to do a heavy value add, we want to be proud of what we do. Unfortunately, we're not very good at the status quo, just coming in doing the bare bones, the signage and doing the common areas. Can we do it? Sure. It's just not who we are as an operator. And there's a lot of operators that are very good at that. And we don't not that business, you know.

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A lot of things that we purchase, are also coming out for generational ownership. You know, so generational portfolios. We operate in the Midwest. So we're out of Cleveland, we're out of Akron, we're out of (inaudible), we're out of Columbus, Ohio. We also have a few assets out of South Florida. Our main headquarters out of Miami. We set that up about a year and a half ago. But in the Midwest market, we're shopping for forced appreciation thourgh that value-add, doing that heavy lifting. And so it's a heavy value-add and it's a forced appreciation, right? So, we're building a lot of appreciation, because we have the cash flow in Midwest. In that Sunbelt region, you're getting a lot of appreciation a little bit less cash flow, right? So, you do have to trade in some areas. And so how you hunt and what Do you hunt for, for us what stimulates our hunt is really a lot driven by what our investor partners are looking for. We offer a pretty large return. And so, not only do we have to be disciplined on what we buy, but we have to meet those return hurdles. And so, yes, I'm sorry, I didn't have the best answer. But there's so many hunting parameters.

JM: All right. Well, we love how experienced you are. So for the listeners, we're going to use this as another kind of deep dive here for a moment. Let's run through, try to grab a case study in your mind, if you don't mind, like "Oh, A, B, C Main Street, or 1, 2, 3 Main Street," I should say, perhaps even use one if you could, because we'll run through the key question. So can you think of one really good property that you can help us understand the breakdown? Would you mind grabbing one?

SG: Of course. Yeah.

JM: Which one would it be? What one can I ask you a few specific questions?

SG: Yeah. How about this? So we bought 112-unit tower three years ago. Right now it probably be about four years ago.

JM: How big was it again?

SG: 112-unit tower, seven storey.

JM: Well, that's big. Yeah.

SG: That was a good sized tower.

JM: Seven storeys.

SG: So, we bought it. And, we've already gone through the full cycle. So, we bought it, we renovated it, and we refinanced it.

JM: Then you kept it or did you liquidate it?

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SG: No, we kept it.

JM: Okay, so this is great. Let's start there. All right. We're gonna take off a bunch of quick questions, this will be turned around round. So there was a day when you found it. Can you just say broker or off-market?

SG: This one was through a broker and off-market deal.

JM: But through broker. Got it. Through a broker, brought it to you guys. What was the bid process like? Was it competitive or did they just start negotiating with you?

SG: It was not very competitive. We kind of had a number in place. So this was 2018. Different multifamily market then, 2008, 2017, 2018. And so yeah, we paid then, I may be getting ahead of you. I think we were paying about $28,000 a door.

JM: Good job. So okay, so broker brought it to you because they had known your reputation I'm assuming. That hit your criteria. Seven stories is surprising. A lot of people love garden apartments. Was this an anomaly for you to buy something that many stories?

SG: Yeah, it was a tower.

JM: Okay. Okay. So, the hunt here was it was handed to you, it ticked off your criteria? Because you bought it at a low basis at $28,0000, what did you believe it would be worth after you did your heavy value-add in your pro forma?

SG: I think we had it pegged at 5.6.

JM: Per unit?

SG: Yeah, It was around maybe $50,000 a door.

JM: So, you could double it basically, that was where your head was right? So you then said we're going to invest, what was your ratio to invest? What were you willing to invest per room?

SG: We're putting a million dollars, I remember into that building.

JM: So 10k a room? But that 10k room, so to get to there, you thought oh, well plus 10k equals 38k. The difference will be 50k. And then what? How did it go?

SG: We're gonna see if we can sell it.

JM: Oh, you work on this. You're gonna liquidate?

SG: Yep.

JM: Okay, perfect. That's your business plan. I love it. So you're going to sell it. Now, here's where it gets interesting for us professionals out there. You had to get somebody to give you some debt. Right? Or did you buy it all cash?

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SG: No, no, we got there. No, no, we got a regular lender.

JM: Regular non bridge?

SG: No, we got a bridge loan. It was a two-year interest only loan with a three-year principal and interest behind it. It was a five-year total term loan. And, I don't remember what the going interest rate was but that was 2018. So it was maybe around 5, 5.6, something.

JM: Very reasonable for construction projects.

SG: And so we had, it was really simple that it was 20% down. It was a bridge loan. And so we needed another million for the construction. So even with the construction, and then we were off to the races.

JM: So you needed a million dollars from private investors?

SG: A millio dollars.

JM: Okay. Did you do this with friends and family? Or did you do the traditional syndication or did you do crowdfunding, the other model?

SG: No, no, we did a small syndication, it was a 506 B.

JM: Yep. Friends and family. You're not going to market it on the internet at that time. Got it.

SG: Yep. And we had 30, 27 investors that came in.

JM: Okay, great. Nobody had to put too much up.

SG: I think we had $100,000.

JM: That's great. That's nice. So, they sat there and said, we totally believe because your track record is going to work and it did work. But, let's talk about what you said would happen for their money at that time. So your original pro forma look like what for them, and how long they have it out?

SG: I think I just sent somebody a summary on this. So, original pro forma, we were planning on paying, I think it was 8% preferred return on the money plus, it was an 80-20 waterfall to like 16. And then it went to 20 AD. And then we put a kicker in, we said, if we don't sell it, and if we're gonna refinance it, we're gonna leave 20% of the equity, get all the principal back to all the investors plus any accrued, you know, interest. Right? And if we get to refinance it and keep it, the deal was that we'd leave 20% of equity for the investor pool.

JM: Meaning you in the business or what did you mean by that?

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SG: Yeah, so Josh would get all his money back, for example, right? You got all your principal back, you got all your interest. That's it. We're not just shaking hands and walking away from one another, we left 20% of the equity for the entire invest.

JM: I get it, I get it.

SG: Yeah. And so they keep a 20% interest in the property indefinitely, and they get cash flow, share of losses, share of gains, all of that.

JM: So fast forward, now, you kept it. Yeah, you could have sold it. But what did it end up valuing that? And then therefore, what did you end up financing that before when you made that decision to hold on?

SG: So, that property did really well. We ended up getting an appraisal at about $64,000 a door at about 2.75 years into it. So just shy of three years. So we cashed out all the investors with their principal, we did a refinance through a Freddie Mac small balance product. So we put a 30-year fixed note on it. I think it was right around 3%.

JM: God bless you. You'll never sell that one. You don't need to. You don't need to. So okay, so that's still how that one sits? If I had been an investor, I would have been recapitalized. And I would have earned my yield while you had my money. And now I still get something every year.

SG: That's correct.

JM: All right. And when you were doing all that work, year one, or year zero, some people call it, did I get a distribution that year? Or did I need to wait until you get it up and running stabilized?

SG: I'm trying to remember a lot of are, they kind of vary. So some deals, I think that one started paying right away at quarterly distribution after the first quarter, after the first six months,

JM: Because you didn't actually, you had high occupancy and you were going one room at a time or how the execution plan didn't need to be kind of shut down or anything?

SG: Interesting question. So a lot of banks actually put covenants on this process. And so if you're doing a very heavy value-add, they don't want you to, you know, kind of chop your head off and go to zero occupancy. So, most of the times when we're buying a heavy value-add property may have 80, or 90% occupancy at the time. And so they'll let us do only 20 or 30 unit tranches of unit at a time. So it is a pretty controlled process. Plus, there's a timing. And

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so, that's one thing I think that really sets us apart. And it's a big differentiator is the complexity and the logistics of real property.

JM: So that is awesome that you can do that. So, while we have you here for a few more minutes, we'll wrap up here, the Smartland Company, how do you design your company? Well, how would you describe Smartland? And what is your core operating promise to investors and operators alike? What is Smartland to you?

SG: Yeah, so look, we're entrepreneurs. And so, what we believe is that we see a lot of things that others simply don't, and what status quo, you know, we're not a part of that. We're willing to do that extra legwork. We have to put that extra heavy value-add. We don't have this generational accommodation.

And so, what we're having to do is that the generation forward, as we look down towards the future, and so a lot of our investors, they may be doctors, attorneys, professionals within their own particular fields. And they've worked extremely hard, and to build that ability to become an accredited investor to be able to be at that platform and participate. And so our promise is that we don't sleep at night, our assurances that investors always come first.

And so for us, everybody's on that same wealth building journey, we're on it together. And so it's critical that we really stay disciplined. And if we look at ourselves as a holistic business, that's why we work so hard in maintaining kind of this ecosystem internally, for acquisition, for marketing, for leasing, for maintenance, we want to have the pulse on it, because they are big ships. And so we want to command that ship to the best of its efficiency. And to do that requires being in the business requiring you to be present, boots on the ground.

And you know, we have that same demand and we look at and we require that from all of our staff, as part of our wealth building journey. And as we look forward to our generations that are coming forward in front of us, or did not come in front of us, I should say and equally how our investor partners have it, one of the critical elements for us is that, again, as I said, moving all in that same direction, but most importantly is that we're doing it for the right reasons, right?

JM: You're beautiful. That's beautiful. We have to keep our investors front of mind. Do you have internal construction management? Or do you outsource that?

SG: No, we have our own internal construction.

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JM: So you'll acquire it with partners, then you'll operate it as a management company. And then Smartland will also do the construction management and they're all called Smartland or are they called different businesses?

SG: No, they all belong to Smartland. We have a few affiliate groups, we have to have an affiliate disclosure for all banking. And then it's the way to keep max control. Pricing is difficult. Logistics are tough.

JM: They're moving parts.

SG: There's a lot going on in this valley.

JM: I'll tell you what, Steven, it's been great getting to know you. I want to get you back on in another episode so that we can ask you the best value-add choices going forward that the things maybe the top four or five best value-add decisions for an investor like you. So, we'll be back and another episode, and we'll dig in deep. Thank you so much for everything you're doing.

SG: Thank you for having me again.

[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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