EPISODE WS1601

[INTRODUCTION]

Stewart Heath (SH): The hyper-focus is really for me, I'm not saying that I will never do anything in other markets. The Tennessee Valley is fairly target-rich, and I like to be one hour away from our deals. And one of the things that Harbor Grace does is we manage our properties.

We do the property management, we could do a whole show that I think the property management model is broken. And so we sort of do that as a loss leader, we take a customary fee for that, but trust me, we're losing our shirts doing that. But to me, it is so important to do the boots on the ground management to deliver on the pro forma that has been sold to the investor. And that's okay, I do enjoy it. It's not that big of a burden.

[INTERVIEW]

Whitney Sewell (WS): This is your Daily Real Estate Syndication Show. I'm your host, Whitney Sewell, What's your philosophy on being hyper focused on a market or hyper-focused on an asset class or not? Well, our guest today may surprise you in his thinking behind, you know, hyper focus on one market or numerous markets or how he thinks through the asset class. I learned a lot. I know you are going to learn a lot today from our guests, Stuart Heath. He's the founder and CEO of Harbor Grace Capital, a private equity real estate firm that helps people build wealth faster through a hands off real estate investing that generates passive income, reduces risks and maximizes tax efficiencies.

He's a certified public accountant and has been for over 35 years and 35 years in real estate, has experience that encompasses multifamily, and commercial property development, construction management and investing. Stewart elaborated on numerous pieces of their business and I love hearing that that's really the timeline on the unfortunate collapse of his real estate business early on in 2006 to 2008, during that time period, but then what he learned from that and how he's applying that moving forward. I think it's crucial that for you and I, as we are building our real estate businesses right now, right, you know, as the market seems to be taking a shift, and lots of things happening, and I hope you listen closely to what Stuart learned and are applying those same things.

Well, I know on the show, many of you have heard many different philosophies about being focused on one market versus many markets, or one asset class versus many asset classes. Our guest today is an expert in just that he has done this. And he is hyper-focused in a market, but not so much one asset class. And so I'm looking forward to diving in and figuring out why that is, and just the thought process behind that. And so our guest today, Stuart Heath. Stuart, welcome to the show.

SH: Whitney, thank you so much for having me. It's, as we discussed before the show, it's quite the honor, you're well known in my circles.

WS: I appreciate that and honored to have you on. So let's dive in, give us just a brief intro sort of who you are, how you got to this path, through your path of real estate. Let's do that quickly. I want to dive into your expertise in your market and asset class.

SH: Yeah, my name is Stuart Heath, I am from Brentwood, Tennessee, just south of Nashville. I'm a CPA and have practiced as a CPA for more years than I'm willing to admit on the show anyway, still licensed and still have a small practice. But around the year 2000, just really got heavily into rental real estate and pursued that with a passion, built up a personal residential portfolio, did some development and homebuilding and, you know, went upside down in the 2009 financial crisis.

And then I was able to get back on my feet and started pursuing real estate. I like to think in a smarter way now pursuing everything primarily in a geographic area that we call the Tennessee Valley. Right. But it's actually a little bit more focused on that.

WS: Yeah. Awesome. I appreciate that. You have been in a CPA for many years, no doubt, I feel like there's so many things in that field that help you in our field, you have a leg up, I think, in a number of ways there. But I will also want to mention, you just said you went upside down in 2009.

And would you be willing to elaborate on what that means exactly? What happened to some degree, but then you mentioned coming back now in a much smarter way. I'd like to hear more details about that. Obviously, I want the listeners and I to be able to be doing this in a smart way, like you're referring to. So elaborate a little bit on what happened in 2009. But what changed now, how you're doing in real estate?

SH: Yeah, so long story short, so I bought my first duplex in 2001, a small duplex in Franklin, Tennessee in the hood. Then nine months later, I bought a group of 14 duplexes north of Nashville and so suddenly I was in the property management business and along the way purchased a property management company and so mainly so I could have the staff to take care of my own properties. And from there, I started investing with a client on building homes. in Williamson County to see which is a fairly well-to-do county in the country, homebuilding going crazy. And it still is.

And from there, you know, I kept pursuing more and more deals. And so come along about January 2006, and I've got almost 200 residential units under my belt. And I had acquired all of the units of one particular condominium unit in Nashville and said, 'Alright, I'm gonna, I'm going to flip these things.' So that year, we did our planning, put our financing together. And so by the end of 2006, we were rolling into January of 2007, we were going to sell some of those condo units that had been rentals that we'd refurbished.

They look great, I'm still proud of what we did there. And we had a grand opening and the whole bit and I had 24, ready for market. And in our grand opening weekend, we sold 26. So I got all those finished up, we closed on everything, and sold to pre-sales. And then we just went on with the rest of the building. Well, 2007 was an interesting year, that's when we started to see all kinds of issues happening financially with great big financial institutions. And so I didn't sell another unit for another year.

And so the market just turned and banks started changing up into that point banks were, they were just allowing us to do anything that we wanted, we had an idea they issue, credit to go and do it and buy one property, have it for a year, refinance it the next year, take cash out of that one, go buy something else. And so just stair stepped all the way up to what really became $20 million of gross of appraised value of real estate in 2008.

Then in a 90-day period, you know, all the wheels just came off Countrywide Mortgage didn't fund, announced on July the 27th of await that they weren't funding mortgages. At the end of the month, everything just came off. So like say, when I pulled a financial statement for the bank on June 30 of 2008, I had a net worth I spent appraisal of a little over $10 million. Ninety days later, I figured that I was probably underwater, because everything had just collapsed at that point. And so then I spent the rest of 2008.

And most of 2000, unwinding deals, trying to get out of deals, giving deals back to the bank and just basically going back to zero if you would so I think Warren Buffett was famous for saying, you know, now we're gonna see who's been swimming with or without any trunks on debt in real estate go hand in hand. And if there is no debt, the value of your real estate is a lot less than it was. And so when the credit markets ceased lending, then, you know, all you had was a bunch of real estate and people getting laid off and nobody paying rent, or half your people paying late, it was just a mess. Just a complete mess.

From there, I ended up having to get jobs, real jobs back in industry and became CFO for several companies after that point in one CEO position that had a good career since that, but my love is still real estate and getting back into, alright, what do I not want to do? Again, I said, 'Well, I don't want to do this again.' Without any reserves, because that's really my big lesson, I could have saved a $20 million portfolio had I had a half million dollars in cash to carry things for up to two years.

They didn't need to be carried in onsite, they didn't need to be carried for two years, maybe a year until things started getting back to normal. I was doing all that on debt, no reserves. And you know, when you got to the end of your rope, there was nowhere else to go. So these days, I do syndications, not only to give other people opportunities to get into real estate deals. But it's also risk diversification.

For us as well, we make sure that there are plenty of reserves in all of our deals from the get-go. And I realized that that diminishes my IRR over time because you've got capital you're pulling in that you're not deploying and putting to work, but it's there if you need it. And because you don't

know what's going to happen. And from there, I've also focused completely on cash flowing properties. Usually everything we bought today is 100% occupied with good lease structures in place doesn't mean there's not any upside. Because there always is if you're trying to get property but with recurring cash flow and proper reserves. And then when you do that you do a nice as long of a fixed interest rate as you can get you've pretty well de-risk the asset and to me that's what investing is about. It's about recurring cash flow. Other stuff is what I like to classify as trading. We've all heard about day traders.

You got fixers and flippers, nothing wrong with any of that stuff. It's just a very different risk profile. If you're investing if you're putting money or lending money to a fixer and flipper that's a quick in quick out and to me that's trading and it's not investing but have gone beyond what you're asking.

WS: No, I wanted you to elaborate there just like you did, because you gave a great timeline there of like, this is what happened, and this is what happened, like you bought one duplex, then all of a sudden you bought 14 more and no doubt all your life just changed your nights and weekends. Just got crazy.

SH: I had a property manager in the beginning for that. But that didn't last very long.

WS: Yeah, I mean, I even bought a property management company then to manage, you know, all these units. And it's interesting, you mentioned, you know, in January of '06, you have 200 units, you sold 24 condos. You know, it was like, Man, this is going amazing, right? I mean, you know, at the top of the mountain there, but man, you know, things change quickly, right? At that point, you know, and I just thought one, you mentioned there, hey, you got a net worth on paper of 10 million, within 90 days, ultimately, you were broke.

I want the listeners to hear that. But also, I want them to hear what you said you were doing different now. Or or, you know, the statement you made that you said you could have saved $20 million, you know, or so if you had had $500,000 in cash reserves. And so, you know, I was I've been scrutinized in the past at times, too, for having too large reserves by a couple investors and who said, hey, that's, you know, that hurts the returns, you know, on the deal.

And, and I'm like, Well, maybe you're not our investor, maybe, you know, I mean, however, and I would say to, you know, listeners have heard me talk about this before, but the worst one that was as far as being scrutinized about it was we closed a week before the country shut down, you know, in March of 2020. And you never believe when we, when that happened, everybody thankful we got the reserves we got right.

That was one of our best deals ever. But still, you know, it's like, man, you know, being able to sleep well at night means something. And so it sounds like, you know, you unfortunately learned that lesson the hard way. But now you're able to move forward, and just you've got that like, Daddy, right? Like, that's a pillar, you know, this is gonna happen. And I love that. And so I want to zoom out a little bit.

And let's go through a few things that you've mentioned, and a little more detail.

You know, you talked about focusing on the Tennessee Valley or that market, specifically, you're hunting there, you mentioned, you know, you're not going anywhere else. Give us some thoughts behind that, why so hyper-focused there, why not willing to say look at some other markets or, you know, surrounding markets? Or why the hyper focus on that market only?

SH: Yeah, well, the hyper-focus is really for me, I'm not saying that I will never do anything in other markets, that Tennessee Valley is fairly target-rich, and I like to be one hour away from our deals. So one of the things that Harbor Grace does is we manage our properties, we do the property management, we could do a whole show on that. I think the property management model is broken.

And so we sort of do that, as a loss leader, we take a customary fee for that. But trust me, we're losing our shirts doing that. But to me, it is so important to do the boots on the ground management to deliver on the pro forma that has been sold to the investors. And that's okay, I do enjoy it. It's not that big of a burden. You know, the model is broken, where you can't really hire top notch people without them basically taking on more than they can handle and make that make better business itself.

But the Tennessee Valley, I mean, essentially, that's the Tennessee River Valley, but more specifically, and we talked about this and some are marketing, we focus on the 845-65 corridor. So I-840 is an Interstate loop on the south side of Nashville, and you proceed south from there to 565, which is an interstate connector that's going through northern Northern Alabama. So that is our clever way of saying that's the geographic area we're focused on. But the heartbeat of that region is Huntsville, Alabama. It's 10 years ago. It's a small little city. Bunch of rocket scientists and NASA base there and everything's changed since then in Huntsville is a dynamic city. It was about 200,000 people in 2008.

Today, it's about 450,000 in this Northern Alabama area. That's not all of Huntsville, and it's being driven by a combination of private manufacturing investment and government investment. If you're a defense contractor, you have a facility in Huntsville, Alabama. A large part of the FBI as Quantico, Virginia, facilities are being relocated. They're under construction right now. I hear it's the training academy where every FBI agent will go to train, but there's other facilities the FBI is doing there as well.

There is obviously expansion of NASA and expansion of the Army's footprint here since the Base Realignment and Closure commission in 2008. They relocated three army commands that had been elsewhere in the United States here. So we now have three four-star generals who were fairly used to be one-, two-star generals and that's if you're in the military, you know, that's a major infrastructure change. Facebook has a major data center here but it just keeps coming and keeps coming in. Here's the way I can sum it up.

I've been in Nashville almost my entire life. Huntsville reminds me of Nashville thirty years ago. So to some extent, for me, I don't see why I need to look anywhere else. And I see multiple opportunities in all asset classes. But not just in Huntsville. I mean, our first deal was in Spring Hill, it is inside of that 845-65 corridor. But we bought an office building within eyeshot of the GM, which was the original Saturn manufacturing plant, but it's now the location where they're building their EV assembly plant and their EV battery plant. So just here in the sort of the central South, if you would just lots and lots of opportunity.

WS: Yeah, what I hear is just that, you know, what, you have a long history there personally, like you've seen this growth, you know, the market very well, it is a good market, there's lots of growth there lots of things happening. And I feel like we did this early on, it wasn't me specifically, but my business partner had lots of market knowledge in the market, we were focused on, and, you know, it had some deal flow, and it was a great market. And so it's like, well, let's just hammer in here, focus in here, you know, as much as we possibly can. And I think we grew really fast early on because of that, you know, it's like, we became a pretty big operator very quickly, in this one market. Right?

And we were, you know, known there, and brokers knew us there, because we had done so many deals, or, you know, very quickly, we had, we had proved that we could do it. And I think it helped us as opposed to, you know, getting started brand new in numerous markets at the same time, right, we're moving into different markets now. You know, it took some time building that track record in, you know, in one market, and then we moved to another one. And now, I think we're about to go into our fourth market, but that didn't happen at all at once, you know, by any means.

And so I just think there's a lot of value in being hyper-focused there, especially until you say you're hiring more people on the team that become market experts, you know, in other markets before you dive in and other places, right. Okay, so, but now, you're not focused on one asset class, you know, and I hear, you know, different trains of thought around that I want to hear your opinion about, you know, what, you know, we're not focused on one asset class, we're willing to do different things, versus, you know, the train of thought that says, you know, what, I want us to be as good at multifamily or self-storage as possible, or we're just not gonna do anything else, you know. So tell me about your philosophy behind why we're not focused on one asset class. So we're willing to do some different things.

SH: Let me first say, I don't think anybody else is wrong. So I think it makes a lot of sense, especially if you're going to be in multiple markets to focus on a single or one or two asset classes, be the expert at that. I've been in property management for a while, I have had experience in a lot of different asset classes.

So you know, our first acquisition was an office building, which frankly, I was managing for one of our clients for four years before we bought it in. So this was not a big leap. The funny part was all the reactions I got around the country, because we bought it in the middle of the pandemic, and you're buying an office building? Are you crazy? Although the building is full, and

let's face it, in the south, we've acted like there was no pandemic from about June 2020 forward, so everybody kept coming to the office.

We didn't have a single tenant miss any rent. And so that, to me, that takes me back to all real estate is local, what's the first rule in real estate, you know, location, location, location. So we've done the office, we just closed a self-storage facility. And we picked a very simple self storage facility. It's 125 big units.

That's all for RVs and boats, and so it's unmanned. And so we don't have a full staff there. We're not selling boxes, or written trucks, or any of that kind of stuff. So it's a very simple operation, we can control the gate if we need to, from our office, it's sort of a credit card business, and you're dealing with a class of people that typically own a half million dollars or more RV, so collections tend to not be an issue there. So I'm located at that facility right now.

Because, you know, we had a tree limb fall in a fence, you know, as I met the fence contractor here earlier today, we're pursuing another office. And so when I say office, we're not talking about the Central Business District office. Some people actually call the kind of office that we're pursuing as retail because they are consumer-facing businesses that you know. One's got a yoga studio in it. The other one is doctors and dentists and salons and stuff like that. And these are services that can never be outsourced or go remote.

So these are businesses that require a physical location for their patrons to come to and we're not we've not done multifamily. I'm not opposed to multifamily at all. It is the leader of asset classes that actually drags all the others behind. I mean, self storage is a great way to play the multifamily movement without the toilets, in to a certain extent, suburban office, you do the same thing, you get a bunch of apartments and houses together well, those people are going to meet new doctors and dentists and State Farm offices and stuff like that.

So you build smaller properties, we feel like being an expert in the community makes it not so necessary for us to focus on asset class expertise. And there is such a thing as asset class expertise.

WS: I like the flexibility to a big degree as well. But I think it even goes back to our first question about being hyper focused in the market that you're into. And so it's like, well, you know, you're gonna have a better understanding, or as you gather that data, you see growth, you're gonna just gonna have a better feel, I think, on moving from one asset class to the other, you know, whether it's self storage, whether it's that retail center, or whatever it may be, you know, where, you know, growth is happening, or where they're where there's a lack of a specific asset class, you know, that's, that's neat. I think you're gonna, you might sense that better than, you know, somebody that's not as hyper-focused on one market. We hope that we're diving in and market as much as possible, but man, you know, growing up there being there for 30 years.

I mean, you can't replace that knowledge, just by going and reading, you know, somebody's writeup about a market. Right. And so that, you know, there's a lot of value in that, to say the

least, but, you know, was talking about, you know, as we talked about different asset classes, you had mentioned, you know, minimizing a lot of that risk, because, you know, they're cash flowing from day one, we say that as well, I would say majority of our projects are cash flowing from day one, we do feel that minimizes a lot of risk. There's very few projects where we've had to go in, you know, let's say, We're vacating half of it or something to complete the business plan.

And, unfortunately, so yeah, sometimes, you know, that is necessary, but I don't personally feel like that's the least riskiest, right of investment strategies. However, sometimes there's some big rewards that way, but it does require more risk.

So it's, maybe maybe it's not for every investor, but what talk through your philosophy a little bit on, you know, deals that are cash flowing from day one, and what you're looking for, maybe you know, why some things that are going to break a deal, or, you know, from you all pursuing it, you know, as far as you know, cash flowing from day one, and any other things that minimize risk.

SH: When we're underwriting a deal. To me, it almost comes down, like it's a piece of financial paper, if you will, it's just an income stream. And you can't do that if you've got a major development plan or a turnover plan that you have to implement. And, you know, some of those are awesome opportunities. But as you just said, I'm doing what I like called boring investments. All of these are mature properties, the tenants are, they've been in place for quite some time, there's no build out to be done, what I do like is a mature property that the biggest thing we have to do is to raise the rents, you know, as they come due up to market, which, frankly, we've been doing in the self-storage opportunity.

And so that's where management can actually make a massive impact on the value of the asset without having to have any construction risk or much market risk. And we achieve that by having, as I said before, fixed fixed-rate mortgages. That's been tricky. You know, I'm sure you know, guys, I know guys who are doing capital calls right now, because they did a deal. It was probably a turnaround deal. But they had some floating rate debt. And so then we all know what happened in the last 12 months. I mean, 12 months ago, I closed a deal at 3.25%, fixed for 10 years, well, months ago.

And what are they now telling my investors that those notes now worth more than the building we bought, you know, I don't think that was a bad operation on these guys who were doing the capital calls, because who saw 4% interest rate hikes coming? Anyway, that's a whole nother show. But you de-risk it by fixing the interest rates for as long as you can.

We'll go 10 years where we can, five years is pretty normal, as you know, you buy something that's stable. So there's not a lot of turnover, the market around it is fairly stable, we're looking for high traffic count, and that is not seasonal in any way. And then at the end of the day, it comes down to the purchase price.

And if we can deliver our investors a reasonable return and still have a 1.2X debt service coverage. To us, that's a good deal. And you know, we've seen the last 30-45 days some sellers coming back to reality because we weren't able to write any deals last fall because they still wanted to sell at Cap rates of three and four, which nobody can finance in today's market. And but we've seen some sellers get a little bit more reasonable if they're serious about selling it. And so what a lot of those guys decided to do well, I guess I'm really not a seller at that price. And so they need to wait a little while.

WS: Yeah, I agree. There's been a time period here where we've had to let sellers kind of come to reality a little bit. Right? And, you know, that's included. There's some, you know, some projects, man, we should have sold maybe two years ago, right? Or, you know, everybody can say that now for sure. But there's a time, you know, where you got to get past the kicking yourself a little bit where the sellers, you know, let them get over that hurdle of man, we shot a sold, you know, to this is reality now, right?

This is what it's going to take. And that may take a little bit of time or has taken some time, we've experienced that as well. I just mean, as far as being buyers, you know, we underwrote more deals the second half of last year than we probably have, since we started No joke, you know, increasing team members, and you know, and just having a bigger, more capability to underwrite deals.

And man, you know, we just couldn't make it really anything work. We didn't hardly do any deals last year, you know, we did some but, but nothing like we had been and and so I completely relate to you, you know, as far as that goes, but I'm hoping it's looking up in the near future, you know, as hopefully sellers are coming back to reality a little bit. You mentioned earlier, and we'll do a few final questions here kind of quickly.

But I wanted to ask you, you know, you mentioned, you know, as far as these properties, taking a lot of risk off the table, we talked about reserves earlier, and how important that is. And I always like to hear you when people are saying it reserves, because we're the same way. Yeah, I just want some reserves, in many different aspects of the business. Is there a way that you calculate that Stuart?

Is there a way that you also, you know, what, because I've heard a lot of members say I want one month of expenses, or I want six months or 12 months? Or, you know, I've heard it all over the place of expenses, you know, in the bank at all times? Or? Or maybe there's different ways they calculate it? Is there a way that you think through that,

SH: We typically have gone through nothing real scientific, but we want to bank six months of the main mortgage payment, I'll usually round that up to include all the operating expenses, but six months of, you know, the outgoing requirements on assuming zero income, which is an extreme assumption, you know, when you're dealing with multi tenant properties, I mean, really, are they all going to quit paying all the same time?

No, but it's just a number. So six months, and I make the point, I calculate the way that's going to drag on the IRR. And I point that out to the investors on the front end, but you know, we're still able to deliver 10% cash on cash, even with the reserves in place, I think, I'm pretty proud of that. I would

WS: be too. I would be too. No, I appreciate your just willingness to stick to that. Right. And no matter, you know, I've invested in length and are being brought down a little bit because of that, it's just, they need something a little more risky to guess.

SH: Right. I have a list of friends you can talk to.

WS: Yeah, you know. So all right. A few final things: what's your best source for meeting new investors right now,

SH: Honestly, my own network is still the best source. In our last deal. I had one of our existing 30-year old relationship, but he brought six of his friends into it, which equated to almost a million dollars into our last deal. That is our best source right now. We are gearing up. And it's really our first half goal of rolling out a pretty sophisticated outreach digitally to try to generate some contacts with investors, we're supposed to turn that on in March. So we haven't seen it yet. But I've heard a lot of probably the names that you know, to build this forest and I'm pretty excited about it. I shot a bunch of videos for it yesterday.

WS: That's awesome. That is exciting. I wanted to mention and highlight that, you know, that one investor that had a relationship for 30 years that you mentioned, that brought numerous people, you know, raised almost a million dollars for this one project. But I think it would be neat for you to track steward over over numerous projects over the next say, four or five years, like how much that one connection brings, you know, from those six, and then, you know, how much do they invest over that period of time, but also the connections that they make for you, I've just seen that happen for us.

And it's like, Man, when you you take care of these that you're already servicing, you know, like that starts to happen in the snowball, you know, in ways that you didn't expect early on, you know, and so, anyway, I just hope you'll track that, you know, in some way, so you'll know that. But then how do you like to give back?

SH: I like to give back in multiple ways. I like to find things that some of my tenants are interested in and participate in. In one of our properties. We have a church and even though they're building a new building, they're going to be gone by August. I like to help them, I let them break the rules a lot and, and use the property in ways that benefit them and I make sure to frustrate other tenants.

I myself am very active in church and in teaching. And I participate in some faith-driven groups like that. And I'm always trying to figure out a way that our properties can outshine some others in the same area and that points to better things.

WS: Awesome. super grateful to have met you and had you on the show. I know our networks connect in numerous places and you know a lot of the same people so grateful to have had you on and the willingness to be hyper-focused in the market, but not hyper-focused really on one specific asset class, you're just thoughts behind that. But even just eliminating as much risk as possible, we all say that we're about that. But when you dive in, we're not all as about it as maybe some right and inside just encourage investors to ask those questions with operators you're investing with.

So I'd say you can determine the amount of risk that operator's willing to accept and determine if that is in alignment with your willingness to accept that much risk or not. And so just appreciate you bringing that to the forefront as to our desire to eliminate as much risk as possible and sharing how you've done that. Tell the listeners how they can get in touch with you and learn more about you.

SH: Best way to get us is to go to our website, HarvardGraceCapital.com. You can find links to our resources there. You can find a link to book some time with me or just join our mailing list. We would love to have anybody who's interested in. I'm serious. Book with me if you just want to talk because I can talk real estate all day long.

[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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