Episode 1606

[INTRODUCTION]

Jason Baik (JB): I think the easiest way for you to get over analysis paralysis is honestly through education, as cheesy as that sounds because you're never going to know what you don't know. But the more you understand the nuances and intricacies of something, whether it's real estate or business or any industry, the more confidence that you have. And I think that's the solution. If you're paralyzed by fear, it's because you don't have confidence in what you're doing, which is understandable. Because you're not you don't know what you don't know. But the more you can educate yourself and borrow from other people's experiences or you know have more experienced people on your team that might be able to guide you, I think that's what really helps that paralysis part kind of fade away.

[INTERVIEW]

Sam Rust (SR): This is your daily Real Estate Syndication Show. I'm your host Sam Rust. Joining me today is Jason Baik, former director and vice president of data science turned apartment real estate investor. Jason is the co-founder and managing principal of Compounding Capital Group and the founder of the Underwriting Lab. Jason teaches others how to leverage analytical skills to break into real estate investing.

SR: Jason, welcome to the show. Thanks for joining us today.

JB: Yeah, thanks for having me, Sam. I'm happy to have a great conversation.

SR: Fantastic. You're out in New York City. And your bio on the Compounding Capital Group, where it's introducing both you and your partner says you both are foodies. So, I'm curious. What's the ultimate comfort food for you and why?

JB: Oh, that's an interesting question. I really like fried chicken, funnily enough. It's always been something that you know, as a kid when my parents couldn't afford the time to be able to make a whole dinner they just go to KFC or Popeyes and grab me something. And so, I was actually rather overweight as a kid growing up, but that love of fried chicken hasn't left me, especially now that green fried chicken is very popular. I'm actually like Korean by my heritage. So, it's nice to see like my culture kind of invade my favorite food. So, kind of a win-win.

SR: It's fantastic. If you had to recommend one spot in New York to get just any kind of chicken what's the best spot that you find yourself at regularly?

JB: This might make me sound really trashy. But Popeyes chicken is still like pretty cool. Like not not gonna lie like, I, you know, I've tried very fancy fried chicken across the city. There's a ton of different options in the Upper West Side, Upper East Side. But if you're hankering for just some really good old fashioned classic fried chicken, like Popeyes is solid, like, I mean, I'm a big fan of Chick fil A and stuff like that. But I feel like KFC has kind of gone downhill over the years. But Popeyes has remained as high quality as ever.

SR: That's awesome. As long as you are okay with getting like three days' worth of your polyunsaturated fats in a single sitting. So.

JB: Oh, yeah. Expect to you know, gain two pounds that evening. But I consider myself to be a fast-food connoisseur. So, I've got some very strong opinions on fast food.

SR: That's fantastic. Well, pivoting from the wonders of Popeyes over to real estate investing. Your background is in data science analytics, and have done a lot of different things in that realm. What precipitated the change over into multifamily investing? There's, there's a lot of crossovers, there's several, I've run into quite a few folks who've made that change. But I always find it interesting, like, what's the story behind it for you personally?

JB: So, I think I've always known that I want to be an entrepreneur of sorts, even back in college. I, you know, take baseball cards, or Pokémon cards, or whatever it was in high school, and kind of flip them on eBay or friends and family. And so I've always had a desire to kind of run my own business. But my parents always taught me that life is really about one trajectory about you go to a good school, you get a good job, and you kind of just shut up for 65 years and work until you die. So I was following a path that I think was kind of laid out for me by other people.

JB: And it wasn't until I spent 10 years doing that, that I realized, this probably isn't my cup of tea. So I made the decision to pivot mostly out of necessity. I had a decent job, was getting paid very well. I had responsibilities. But it wasn't the type of responsibility that I enjoyed. I'm a data analyst at heart. So I love analyzing numbers. I love telling a story from numbers. But the higher up that you go in corporate America, the more I deal with, you know about politics, I deal with managing people, I deal with managing clients and expectations and timelines and not really analyzing data. So I made the tough choice to take a chance on myself for the first time in my life and yet decided to make the shift to cold turkey.

SR: Oh, that's fantastic. So cold turkey, you move into real estate. What's the genesis behind the underwriting lab?

JB: That came out of a lot of conversations with other aspiring real estate investors who are data driven like I am, you know, most people reach out to the people that resonate with them. And because I have a background in data, I'm pretty introverted. You know, I'm kind of like straightforward. A lot of people that reach out to me or analysts, engineers, IQ people, and they always asked me how I got started, and I would send them all the free resources that I use to start off with, but there's nothing really out there, in my opinion that gets you most of the way there, you kind of only start you off in the right direction, but a lot of it comes to trial and error.

JB: So I decided to create a product that I think I would have wanted myself when I was first starting off, that shows you more behind the scenes look at multifamily as a business, about real benchmarks and real assumptions that you have to make and tough calls that you have to make, instead of just teaching people how to plug numbers into a spreadsheet, like I've been doing that since I was, you know, 18. So I

can teach anyone how to plug numbers into anything. That's easy enough, I can train a VA, I can train a parakeet braves it's not that complicated, but I figured I'd take it one step deeper and try to really go over the nuances of multifamily as a business because at the end of the day that that's what it is.

SR: I was browsing through your LinkedIn profile, and you had a post that stuck out to me, you talked about a lot of people that you run across, either have analysis paralysis on one hand, or you have the fear of missing out. It's kind of like people fall into one of those two buckets generally, when they're starting out whether that's coming in on the GP side, like you and I are or even LPs, people who are just looking to invest passively. There's kind of fall into one of those two buckets. I'm curious, which bucket do you see the most of? And then how do you help that avatar of a person move forward into actually either investing in a deal or slowing down and picking the right deal?

JB: That's actually a really interesting question. I think for me personally, just based on my personality, analysis paralysis is my go-to vise just because I'm very, I love numbers I love over-analyzing. And that often leads me to inaction. And a lot of people that reach out to me because they're data driven, and you know, analytical has tend to have this the same problem. And I think the easiest way for you to get over analysis paralysis is honestly through education, as cheesy as that sounds, because you're never going to know what you don't know.

JB: But the more you understand the nuances and intricacies of something, whether it's real estate or business or any industry, the more confidence that you have. And I think that's the solution. If you're paralyzed by fear, it's because you don't have confidence in what you're doing, which is understandable. Because you're not you don't know what you don't know. But the more you can educate yourself and borrow from other people's experiences or, you know, have more experienced people on your team that might be able to guide you, I think that's what really helps that paralysis part kind of fade away.

SR: I would agree that I see that more often than fear of missing out. Fear of missing out is a man, I would say like 20% of people that I run across. And they tend to be people who have been sitting on cash for a long time, maybe just found out about syndication and like, I need to get in and you know, send me three deals and, and we'll probably invest in all three of them. So that's a little bit of a rare problem. But the analysis paralysis, I completely agree it is fear based for a lot of folks.

SR: But there also comes a point where I mean, you can go through as many courses as you want as I mean, there's a ton of courses out there, you can have all that head knowledge. But ultimately you have to start applying that. And that doesn't necessarily mean like, hey, we're going to go buy a deal tomorrow. But I find that often people will get stuck at kind of the base level of knowledge required properly evaluate a deal and not be able to move forward from that, whether it's on the LP side deciding whether they're going to invest or on the GP side and deciding, hey, what's my first deal going to be?

SR: At some point, there has to be a first one and you're not going to know everything. So you know, on the LP side, I tell people a lot of times to focus on the

operator, especially you tend to be working with successful people who have made money in some other industry and, and have some people reading skills like know the basic math. So you can fact check but really drill down more on the person in the operations team. But you deal more with GPS and helping people who want to get started on that side. How do you help that type of person who wants to be more active, wants to get their first deal done? How do you help tip them over the edge to take the first swing?

JB: So I always highly promote networking. It's a very people-based business real estate, especially multifamily. And kind of to what you said, if you are only learning academically through online courses or books, there's never enough information that you could absorb that gives you the confidence. I mean, I think obviously everything that you read or everything you've watched helps a little bit but I think the the easiest way to get that push, I think is to have a partner or a mentor or someone that's done this before that can give you an idea of what you might be missing out on that has made the mistakes and you're essentially trying to again piggyback off of their experience to kind of expedite your own.

JB: I would say that for someone like me if you are pretty analytical. I can tell a lot about other GP teams investing philosophy from their underwriting because I'm just really used to tearing apart spreadsheets and I always say that I can tell a lot about a person through their numbers, I can't really trust their words all the time. So I think understanding completely bias coming from the underwriter, but understanding underwriting really well, I feel like gives you a leg up in analyzing people as well, because if a GP team comes to me, and they tell me that they're super conservative, quote unquote, I don't know what that means. I don't know if we're speaking the same language. I don't know if we're defining it the same way. But if I see their underwriting, and I see their market rent projections, if I see how aggressive they are , or how many units they plan to do every single month, then that actually gets me on the same page as them.

JB: And part of real estate isn't necessarily like, I don't think you should be afraid that people are trying to take advantage of you or they're trying to hide stuff, because I genuinely believe that most of the time, people are trying to just do right by themselves, their teams and the families and you know, their investors. But there's still a lot of miscommunication that could happen. Just because I define something as risky doesn't mean that you might define it the same way. So I think understanding the numbers behind real estate, I think, in my opinion, is the easiest way to get over analysis paralysis, and also kind of help you get your foot in the door as being a general partner.

SR: Yeah. And, you know, talking specifically, we're going to dive a little bit into some terms here, but a couple of areas that I look at any deal that crosses my desk from another operator, if somebody's like, hey, what do you think of this deal? And they want my opinion, I always look at, okay, what's the incoming cap rate versus the reversion cap rate? That's a really big one. What's your average rent growth across the hold? And where is that rent growth loaded? Because what I've seen with a lot of groups, especially over the last 18 months or so, becoming less common now, thankfully, was they would front load rent growth.

SR: Which maybe was appropriate and 2020 If you were clairvoyant, but the problem with frontloading that rent growth is if you miss it, kind of the rest of your underwriting is screwed, because it compounds over time. So rent growth, and then market rents. Of course, those are kind of the three-legged stool. Now there's a lot of other important factors. I'm curious if you'd add anything else to that is like kind of a first tier do not pass go do not collect $200. Until you've looked at this metric.

JB: I'd say refi. Year and sale, you're also really important today. I mean, two years, everyone was planning for a refund in year three, which is, again, industry standard at this point. Today, if I see someone trying to refund your three, that's one of the key questions that I dig into, because that's just changed, it's flipped on its head in a matter of 12 months. And it's just really hard to assume what the future will be just because it's so uncertain. So that even something like that if someone assumes that they can refine your theory today, that gives me an idea of maybe they're a little you know, riskier than I prefer, they're, they're more optimistic than I would want to be. Also, a lot of deals look better, the longer that you hold on to it.

JB: So if someone you know, gives you return metrics, and they look good, but they're holding it for 10 years, like you can make any deal look good if you just stretch out the whole term. So I typically also like to see deals that are standardized, maybe like a five year old, that way you can compare deals across the board, if you're a GPU NLP kind of choosing between whatever you're trying to invest into. So that's definitely a big one. I, expense ratio is if you're working with an experienced partner, they're able to control expenses a lot more accurately, if you're working with a newer team, and they're assuming that you're one, they're going to have 35% expense ratio, they're just going to run super lean somehow, magically, out of nowhere, that's also a kind of a big red flag.

JB: So that's kind of scales. Also, with experience, if someone has like 10,000 units a decade of experience, and they think they can run 40%, I can believe that. But if you're newer, the lower you go, the more skeptical I become.

SR: And again, that's kind of a next level nuance right. And also controlling because property taxes can make such a difference from state to state, we invest in Idaho and have done a lot of newer like Class B plus A minus deals here and our expense ratio is in the low 30s were like 31 to 34%. But that's probably right in the middle of what people are doing around here. It's not super low, you go to Texas, it's 50%, in large part because of taxes and insurance. I love investing in Idaho, in part because we don't have any natural disasters and in property taxes are really low, those two things can make a huge difference.

JB: That's awesome.

SR: So big part of underwriting is the specific deal. We've worked through market rents, reversion cap rates, some of those things, but even like, before you ever get to that specific deal, I think it's important to look at markets and analyze what markets you want to invest in. I mean, there's money to be made in any market. I would start out by saying that unless you're in a defunct nation state, there's money to be made in almost any corner of the country. But you have to understand the risk rewards, the

trade-offs that you're making by investing in Baltimore, versus Cincinnati versus LA, right.

SR: Those are three very different markets. You know, I know you help people with market analysis, and maybe we could target this conversation a little bit around secondary versus tertiary markets. I was looking at your portfolio. You guys are in some larger metros, you're in some smaller metros in the Midwest, so you have some personal experience investing into these different markets. So maybe start by defining the difference from a secondary to a tertiary market and then we'll open this can of worms.

JB: Yeah, it's a little subjective. Depending on who you ask, it usually depends on the size of the metro. So finally, markets or major cities, Chicago, New York, LA, San Francisco, secondary markets are typically smaller metros, I mean, I don't want to give specific numbers because everyone will define it differently. But let's say it's 500 to a million people, and then the tertiary will be a lot smaller. I would typically cap that to a bottom, I think there is a, you know, a floor to what I would consider a tertiary market.

JB: If you've got a small town of like, 10,000 people, I wouldn't consider that a tertiary market per se, I wouldn't. So consider that a market that you would invest into. So I'd say anywhere from, you know, 250, to whatever large metros have in terms of population is kind of range. And then depending on your comfort level, I think the returns also have to make sense because they have to be risk adjusted, kind of like what you said.

SR: Yeah, and I think different, you'll hear those terms used in a lot of different contexts. And one of the contexts would be on the lender side, specifically, if you're going for an agency loan, there's better pricing available for primary in some secondary markets versus tertiary markets. They I believe, they define it as 500,000 below is a tertiary, and then most markets 500,000 above our secondary, just to kind of give you an idea when you're going out of debt. But the purpose of this discussion, I think 250 is probably the floor for a secondary market, and then call it 100 to 250 as a tertiary. What are some of the things that you look for when you're analyzing a market at a high level?

JB: Yeah, so the type of advice that I give when you know, anyone's interested in looking at a market is a bit unique, in that you have to also just taking a step back, remember how people make money in real estate, right, it's oversimplified, but you buy low and you sell for a little higher than you bought it for. And if you want to take a look at all of the major metros, stack them up against one another and take a look at the major metrics, population growth, household income growth, job growth, there's only a handful of metros that will meet those criteria. And so you're going to be playing in the same exact sandbox that most of the United States wants to play in.

JB: It's Texas, it's Florida, it's Phoenix. And so if you're choosing a market, as a small investor, if you're just beginning if you're you know, just have a small team, you need to find a price differential, more than you need to focus on macro metrics, because you can't compete on price when you're competing with the black rocks and the black stones of the world in, you know, Austin, Texas. So I always tell people,

when they're asking me, I feel like that's actually also a key point and analysis policies, they just don't know where to begin, like, where should I invest, I want the perfect market. Right. But alluding to what you said before, you can make money in most places, and it's just about finding a market where you personally have some sort of competitive advantage in because that's how you're going to find a price that works for you as a as a small buyer.

JB: And I typically suggest not going to rural areas, like I really do like the 250 as a minimum, maybe 50,000 as like a bottom of the barrel minimum in terms of the market itself, I want it to be close to a major metro. So it could be a tertiary market that's connected to a secondary market or connected to a primary market that's maybe 45 minutes to an hour away. And I want job growth, household income growth, and population growth, to at least be stagnant. I don't need it to be going up in tremendous leaps and bounds, but I don't want to be negative. So I ensure that I have a small market that I have a specific specialty and niche in a competitive advantage and, and make sure that my pool of future renters stays about the same. So I don't have to compete with a difference in supply and demand.

SR: Broadly. And this makes intuitive sense when you think about it, but the more sophisticated capital is going to be drawn to the primary markets, right. And that just as a spillover effect, and so what you're talking about and finding a good deal, ultimately is an information advantage that you can create. And there's a higher likelihood of creating an information advantage when you're in a smaller market, you're going to be dealing with ownership groups that may be backed into this deal.

SR: It was an inheritance or they've owned it for 30 years. And it's not a market that has brokers calling everybody you know, on a weekly daily basis. Those types of things, you know, there's a different risk profile, but I really like the concept of chasing after the value at the buy. I think that's really important, especially for folks who are starting off if you have the right basis, you can ride out the wave of inexperience as it were you have some cushion built in that just your margin for error is lower if you're buying in a place like Denver or DC or some of these other areas.

JB: Exactly and ideally you develop some sort of operational advantage. As you buy more units and you know, get experience. But to start off with, I think not overpaying for an asset is one of the only things that you can directly control, at least in that phase of your career, and it's going to be crucial to not, you know, getting involved in a bad deal from the get go. And I like what you said about where it's all about, like risk profiles, where if you see all of these, you know, CBRE articles, or, you know, Blackrock articles on the best markets to invest in multifamily.

JB: They're using macro metrics for the areas that they want to target with their, you know, billions of dollars and their ability to outlast any type of operational inefficiency. But that's not your competitive advantage, like, let's be real here, you're not going to compete with BlackRock, you can't pay $250,000 per door and make that work. Because you don't have the same network, you don't have the same operational experience, the same expertise. And so I love looking at those, you know, top 10 markets to invest in the United States or, you know, top 50, high rank growth markets for 2022. There, it's all great information. But I never suggest anyone focus on that

too much, because you're just not playing the same game that these big institutions are.

SR: And that starts with defining the goal, right? And we've kind of started very narrowly at the end talking about specific underwriting deals, and we're working our way back out. But what is the goal, right? Is it to acquire a piece of property or to you know, if you have, depending on the market between 50 and 200 units and a couple different projects, that's probably enough to retire and live off of that passive income, depending on your lifestyle, and again, those specific markets is that the goal?

SR: Is the goal to build a huge syndication platform and act more like an institutional investor in five to seven years? Then you're going to be looking at a different style of deal. And I think that that goal informs the decisions that are made along the way.

JB: I love that because everyone has their own objective in life. If you want to retire in the next 10 years, and you want a quiet life with your friends and family, why are you trying to syndicate 50,000 units, right? That's mismatched, because having 50,000 units and you know, 1000 investors is gonna be four-day jobs, right, rolled into one. And so I do think I mean, I like that point about how every individual investor sort of has to be self-aware enough to really dig down into what their goals are in life, and try to follow a path that helps them get there. And if you don't know how to get there, you try to find other people that you know, live the life that you kind of want and ask them how they got there and kind of try to follow their path and pivot along the way.

JB: But even today, I know people that have 100 units that are completely owned by themselves, and they're retired. And I know people with 1000 units that they own a very, very small portion of because they're, you know, co-sponsors, and they have two-day jobs. So they're still grinding, they have a bigger unit count, versus someone that a small unit count, but they're actually retired and have the time and financial freedom that most people are looking for. So it really depends on yeah, I think your personal journey and what you want in life.

SR: So what's the goal for you at compounding capital? Where do you fall in the spectrum?

JB: I am pretty low key as a person; I don't really have a big appetite for material things. I think growing up poor, I never had nice things. So, I don't, there's nothing for me to miss. But on the other end, I guess I've never envied anyone with a yacht or a car. Not that there's anything wrong with it. Everyone, you know, likes different things. But I am in real estate just to have time and financial freedom, essentially to wake up every day and decide what I want to do. And I have bits of both today's timing and financial freedom.

JB: But the goal is to keep having more of it or to have more than enough financial freedom to give to others to maybe help my parents and my brother and my wife's family also kind of enjoy time and financial freedom. So yeah, that's sort of my personal goal. But my business partner, we're very similar. We don't necessarily want to have a gigantic company with 50 employees and a ton of units. We like to stay lean; we like to take on, you know, pretty good deals, you want to keep most of the

ownership ourselves so that we can keep the volume low, but still build our net worth over time.

SR: Wow, that's fantastic. The number one hurdle facing your business today. And compounding capital is?

JB: Scalability, probably where we have a good amount of traction. I mean, last year, we took down you know, a number of deals. We've got a lot of stuff in the pipeline. We're under contract, even today for a JV opportunity that I was in Cincinnati for last week, which is why I had to reschedule this, but we are trying to figure out the systems and processes needed to make life just a little bit more efficient. It's just the two of us in terms of partnerships like me and my partner Jay.

JB: We have a virtual assistant but there's still a lot of admin tasks that fall on either of us. And our goal is to try and grow in a smart way. Because we have traction. Funny enough, we have more deals and we know what to do with. But it's our goal to cherry pick the ones that make the most sense for us to make sure that we aren't, what is it like, our eyes aren't bigger than our stomachs where we take on too much and let go of some of the actual, you know, returns for investments. So we're trying to grow slowly the right way. But we're figuring that out as we go.

SR: It's fantastic. As we get ready to wrap up here, Jason, what's a habit that you've practiced on a daily weekly basis that's made a difference and brought you to where you are today?

JB: That's a great question. I used to not do this, but my wife is very good at it. And so I've adopted over the last five years, slowly through osmosis, but it's showing gratitude. And I think it's really easy to focus on the negatives, myself, I was joking earlier with you, Sam, that I'm very pessimistic, and very critical. And so, it's really easy to, you know, focus on what you did wrong, or what you don't like about something or someone.

JB: But I've been making it a priority every morning and every night before bed, I just try to take a quiet moment of reflection and be grateful for my friends, my wife, my family, my health and all the traction that we do have and not necessarily be so down on myself. And I think part of that is the realization that real estate is a really, really long-term game. I'm in this for the next 10, 20, 30 years. And if I don't show gratitude today, if I don't enjoy the journey, right now, it's gonna be a crappy next few decades.

SR: Yeah, I think that being intentional to do that in the here and now is so important. Because I think everybody says, oh, I want to be thankful for what I have, you know, and especially when I get to this, whatever this is, you could be 1000 units could be, you know, complete free time, freedom, you know, whatever. But if you don't practice it along the way, you're not going to suddenly wake up in group be grateful, you're going to be bummed, because you missed out on some of your kids, you know, upbringing or because your sports team didn't win or whatever, you know, whatever the thing is, and so practicing on a daily basis is really valuable.

JB: Just to mention one last thing, as someone who falls into this category to where if you see people, you know, post about all their successes on social media,

everyone usually posts about, you know, all the great units have been ticking down with all their success. Sometimes it gets me down when it feels like we might not be going as fast as someone else. But I think what most people who are listening have to remember is that there's a difference between reality and marketing or social media.

JB: And I think being grateful for what you have currently, or the stage that you are in your career helps you not get down as much and focus on just moving forward every single day a little bit by little bit, instead of unnecessarily kind of giving up partway because that's really the only way that you don't really get to where you want to go.

SR: That's fantastic. Well Jason, really appreciate your time today if folks want to check out more of your underwriting resources or what you're doing at compounding capital. How can they get in touch?

JB: Yeah, so I'm active on Facebook and LinkedIn search for me, Jason Baik, depending on when this comes out. I might have already started my YouTube channel but trying to delve more into content around investing in multifamily YouTube channels also Jason B-A-I-K. Our website is compoundingcapitalgroup.com But if you're interested in improving your own underwriting skills, you can visit theunderwritinglab.com. All one word.

SR: Fantastic. Well, thank you, Jason. Thank you to our listeners for joining us on another episode of The Real Estate Syndication Show. I'm your host Sam Rust signing off.

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[OUTRO]

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