EPISODE 1631

[INTRODUCTION]

Whitney Sewell (WS): This is your daily Real Estate Syndication Show and I'm your host, Whitney Sewell. Today we have packed a few different shows together that we call #Highlights to help you to get the most bang for your time and educate you on the topics that you want to learn from. We would love to hear from you. I am grateful that you are with us today. Have a blessed day.

[INTERVIEW 1]

Whitney Sewell (WS): Our guest is Sam Giordano. Sam, welcome to the show. What turned you off about a specific sponsor versus one that made you ask more questions and want to eventually partner with them?

Sam Giordanio (SG): Sure, that'll make sense. Well, the great thing about it is often the sponsors that endear me the most, it's hard for them to do anything about that. They either have it or they don't. Meaning, you have to get a "feel" that somebody actually cares about what you're talking about as opposed to they're just focused on selling you something. It's almost as if — not to talk bad about car salesman or anything like that, or people who call you like telemarketers – but there are some people you just get the "feel" that they're really trying to sell you something and they're not really interested in you at all. And trying to see, is there a bit here? Is there a relationship here? And people ask me whether it's in the business realm or physician realm. Similar types of questions because this kind of skirts across all fields. But it's almost like you can't fake it. So, I think the biggest thing I would say for sponsors to try to help with that, is to really focus on what I can do to show that I really care about the investor as a person. "What I can do to provide value?", as opposed to focusing on "How do I get this investor to sign up for my deal?" It's a mindset thing that some people can or can't do. So, from that standpoint, I think the biggest negative is there are some sponsors that I spoke to, and right after the conversation, I'm like, I'm running the other way.

SG: There's no way I want to invest in this sponsor's deal. I just felt dirty after the conversation, and I just felt like I was really being sold something. And that to me, it's just maybe me personally, but it just kind of turns me off a little bit.

WS: Did they just jump into a deal or jump into trying to get you to invest right away? What was it that they said? Is there anything that you could highlight there that's like, "Man, they just handled this so poorly" or "I felt this way because they did this"?

SG: Generally, when you start a conversation with the sponsor, they ask a little bit about you. Some people, while you're doing that, they let you go, and then some people kind of interrupt you throughout the process and bring up things about their organization before you even had a chance to kind of give some background on yourself. So, they're really not listening. They're just waiting for opportunities to say something to you. In all conversations, it's always harder to be a listener. But I look for the people who are good listeners in that process because I think that generally shows confidence and comfort in what they're doing. They're not as on edge on that. So, I would say trying to interrupt you when you're talking initially to give a little background on yourself, and then they quickly veer towards what they would do by you investing in their syndication. It's not as much about seeing if there is a true fit there.

WS: I'm listening, I'm kidding (laughter). That's awesome. I feel like that's such a good example. Sam, you know, I got two calls yesterday. One of them, as soon as I answer the phone, says, "Did you know your car warranty is about to expire?" (laughter) That's what it made me think of. I'm like, What? Who is this?

SG: And that's kind of the way you feel, right?

WS: Right. I'm like, nope, thank you. Block that number, right? And so, yeah, we don't want to be that way as operators for sure. I just think that's a great example of just how important that conversation is. Here's a thought, because this is something I've had to do personally. As we have more and more investors that are wanting to talk to us or work with us, we want to have those conversations with them. I would love to speak to every one of them individually, but guess what, I can't. I have to groom someone on the team to do that right. And I waited as long as I possibly could to do that because I want to have those conversations. I like those conversations and getting to know the investors. However, it's just not possible for me to do them all, right?

WS: So how would you feel about, when you schedule a call or you finally get to talk to the team and you're not getting to talk to the main operator? What are your thoughts around that as a passive investor? I wonder that personally, and I know many other operators that are listening, wondering the same thing. How is that viewed as a potential LP or passive investor when, well — I didn't get to talk to the main operator, but I got to talk to such and such on the team?

SG: Yeah, and there were a couple of operators that was the case. One of them I did invest with, so it's definitely not a red flag for me. And most passive investors, especially if they've looked into it and got some education, they realize there are certain groups of syndication teams that are just large enough to the point where it's just not logistically possible to talk to every new investor. I think if there's a way to have that sort of investor relations person, reiterate that. If you want to or if there are additional questions that I can't answer, then you can have access to Whitney. Where there's a possibility, you may get a third or maybe 10%, 15% of investors that you can take. It's like when you give your cell phone out to somebody. Most people handle it, a patient or something like that, most people handle it pretty well and don't abuse it. There are some people that will but it's not the majority. So, I think if you offered something like that, where the investor relations person is the one communicating, that first communication says, "You know what, if I can't answer anything, you have the ability to reach out to Whitney himself." That you just can't speak with every investor, but we can certainly make that happen if that's the case. So, they feel like you're not trying not to speak with them, but it's just that there are logistics involved. I think something like that may be able to offset it. But like I said, there was one sponsorship team that I spoke to the investor relations person multiple times. They were very good. I was satisfied with the talk, and I never spoke with the actual head sponsor of that team, and I invested with them anyway.

WS: What if that person can't answer all your questions? I know you mentioned there's an option for you to talk to the operator. However, maybe this person is not extremely knowledgeable even about the syndication business. Is that going to turn you off completely?

SG: Maybe a little bit. Only because that person, if they're in the investor relations position, they should really have the ability to answer most of the questions I ask. They may be slightly more detailed than other limited partners, but they're not coming out of the left field. At least I hope they're not. But they really should be able to answer most of those questions. Like how many full cycle deals, information about the market, what's the business plan? Some of these things I can get from the investment summary but some other things, it's nice to have a conversation especially when you first meet a sponsor. If I've invested two, three times in this group, I already know the group. I know what their communication is. It's really that first communication that you want that investor relations person to be prepared for because that's, just like anything, it's the reflection of the team. If they seem unprepared, then it may reflect badly on the team because that's the only contact you have.

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WS: Yes, I couldn't agree more. I'm grateful just for you diving in on that because I feel like it's a great subject for operators to think about. I've struggled with that because I do want to take those calls, but it's just not possible to take them all out, which is a great problem. However, there are other issues that come up because of that, right? And I know that there are so many things we could get into about the deal in the market and whatnot and unfortunately run a long time as far as doing all of that. But I feel like the operator is the first link in the due diligence of investing as an LP or passive investor. I'm just thankful to dive in. Before we move to some other questions, Sam, anything else about the operator specifically that as an LP, like Do's and Don'ts or if you see this, stay away? Or anything else you want to share about the operator specifically as an LP?

SG: Sure. Some of the objective criteria, the biggest thing is the "feel" you get. I can't emphasize that enough because it's really important and you have to trust your intuition. And whether it's in this field or any field, oftentimes your intuition is correct. It's just a matter of supporting that feeling with the objective information, and that's kind of how I feel about the operator as well. The biggest thing is intuition.

And then after that, I generally look for operators or teams that have at least five full-cycle deals from an experience standpoint. I'm just not looking for home runs. I'm not looking to take excessive risks. I'm looking at the long game as a passive investor, and I want people who have done this before. So, I look at the sort of people who have had five full-cycle deals. It used to be that we had criteria that if somebody has been a real estate syndicator prior to 2008, which was the last main recession. But as we get further and further along from that, there's just not that many syndicators that have that much experience now. Most of the people that have are into private equity space and they're not dealing with limited partners and individual investors and stuff like that as much. So, I don't use that criterion as much. But I would say the five full-cycle deals, the geographic market is something that I'm interested in — where they're focused on. Is this a new sort of investment in a different market? If somebody had deals and all their deals are in Texas and now they're going to Florida. So, I don't generally like to invest in that first deal out just because of the fact that they need to get their feet wet. I'm not really interested in being part of that when that happens. It may be a great deal, but just not worth the risk to me.

And then, is there a succession plan? If, God forbid, something happens to the sponsor, is the deal going to implode, or is somebody there to take over that? Those are some of the variables. There are others but those are some of the big ones that we look at. Oh, what's the percentage that they accept from self-directed IRAs versus taxable investing? As somebody who invests post-tax money or taxable money, if a majority of the investors are self-directed IRAs or pre-tax money, then they may not be as interested in the tax benefits. Whereas someone like me who is, I want to see at least 50% or more of the investors that are investing cash or taxable money. And these may vary from a deal-to-deal basis, but some sponsors have more of a focus on certain types of investors and things like that. So those are some of them.

WS: Those are just great insights for sure. And we could talk about this all day long I know. But I want to ask just a few other things because I love your perspective from the LP side, and just as much as you've educated yourself. So, what about when you're talking to an operator, what do you like to see as far as them being prepared for a potential downturn?

SG: One of my classic questions that I'll ask an operator, there are two usually, and one is, "what makes you different?" I find that it gets to the heart of what they identify with and what their business plan is that may be different from others. Or why they have a competitive advantage in the space. So, it's sort of a broad question, but it gives the operator a chance to give me a feel for where they feel their identity is that separates them.

The second is, "Tell me about a deal that's gone bad." So, I don't even ask him if a deal has gone bad. I say, tell me about a deal that's gone bad. I just assume that there's something that's gone bad. So, if they said there's no deal that's gone bad, either they don't have enough experience because there's always something that comes up. Even if the deal winds up good, you can talk about a storm or a fire or something that happened that you had to kind of think on your feet. So, I like to see how the operator responds to that deal.

SG: And then, the follow-up to that question is, "How do you mitigate that risk going forward?" I don't ask them specifically how they prepare for a downturn, but I just want to see what their preparation is, what they've learned from that experience, and what they've done to correct it. To give me an idea into the mindset of how much foresight they're looking for to prevent that kind of thing in the future.

[INTERVIEW 2]

WS: Bronson, welcome back to the show for another day. I'm grateful for the listeners as well who are with us, and I hope that you will go back and listen to the last two days with Bronson, we have talked about many different topics and even his path into multifamily success, which took many different pivots that he probably didn't expect, but I think it does for all of us. They are our path to take many different pivots, but he was willing to step. And alleviate what most would say a very successful JLB to take a chance on himself. And thankfully he did that. But then even yesterday we talked about just the economic climate and different ways that he is funding his deals, even when the appetite investors are softening, but why he still believes in multifamily and why I do as well. But Bronson, welcome back to the show.

Bronson Hill (BH): Awesome. Great to be back, man. I feel like I'm becoming a regular here. I mean, let's just talk every day. This is-

WS: Yeah. Maybe we should.

BH: Thanks for having me back.

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WS: Yeah. I'm honored to have you back and, oh, you know, let's jump in. I know you dove into this investing business and real estate and just everything that's happening in the economy right now, which we talked about yesterday quite a bit. But how are you evaluating syndication deals right now? You know, just in your opinion, or maybe even how you guide passives to evaluate a syndication, maybe you can talk at a high level, but then also, you know, let's dial it into today to this current economic climate if there's any changes there in your opinion.

BH: Yeah, so that's a big couple of questions there. So first of all, when it comes to evaluating-

WS: Just a thought I start off real easy today, Yeah. You just start with like, drop the bomb. Here you go, mic drop, take it over. So yeah, I think when you're looking at deals, there's really three parts I encourage people to look at as passive investors is you have the market.

BH: So that's kind of the biggest thing. What market are you buying in? Then you have the operating group that you have as you're working with, and then you have the specific deal. That you're considering investing in. So I wanna take each one of those kind of, you know, how they look. So if you, if you buy in the right market and it's a growing market where you have, you know, population growth, job growth, income growth, you can do a lot of things wrong in the management of that property and still do phenomenally well.

BH: And why is that? It's because what the rising tide will raise all ships, right? So if you're buying in an area, if you're buying, let's say not picking up people in Cleveland, but in Cleveland, the population is flat or declining, right? So that you don't have population growth, job growth, income growth. You have other forms of growth and people might send me great emails that, Okay, actually can do things there, but it's a different type of market, right? Versus where we buy in Jacksonville, Florida, we see 20,000 new people moving to Jacksonville every single month, right? There's a 97% occupancy in the city.

BH: So we see this market that's growing. We've got jobs, we've got people that are moving because of COVID. They can work remotely. We've got people that are retiring that wanna live in Florida and pay no state income tax. You've got all these things that are here that are causing growth. So if you just have people moving there, you've got more jobs there, you have more income there. That's a great place to be. Second thing is, the operator you're working with. Now, if it's somebody's first deal and there's nobody on the team that has more than five or 10 years of experience, you might wanna say, well, I don't know this, you know, how solid is it that they're gonna be able to achieve this business plan, right? Because you wanna make sure that you, that all three of those things line up, right? The market, the team, and then the deal.

BH: So when it comes to the team, I look for their reputation in the industry. How you figure that out is by going to events, by asking around, by a lot of just maybe even searching online, trying to figure out, maybe talking with other investors that have invested with them and you try to figure out, what are their core values. And I think a great question to ask operators is what's something that didn't go according to plan? And how did you deal with that? And if anybody does not have an answer for that, I would say, do not invest with that group, right? Because all these deals, they don't go as planned. They go to certain areas better than expected.

BH: They go about expecting others, oh, this went worse here. And there's always, there's so much learning that happens. Even people that I know, one of my partners has had 28 years of experience and 13,000 units, right? So my inexperience is not a big deal cuz he's got so much experience with the asset management.

BH: So that's the second thing is just really making sure you got an experienced team where the values line up, the goals line up, the time horizon. You ask them, you know, If this deal doesn't go well, what are the things that you see are the risk here? So when you're looking specifically at the deal, what I would say is does it meet your investment goals? Is it something, is the time horizon right? Is it achievable in the sense this group has done other deals and they have some track record to show that they could do something similar? Does the business plan make sense? Again, I quote Warren Buffett a lot, he says, We never invest in anything that we don't understand, right?

BH: So if it doesn't make sense to you, then don't invest with it. So I think that's a lot of things, and I think some people get stuck at this point, is they look at like five or 10 deals and they just, they can't figure out what to do. But my thought is just, you know, look at five deals and then choose one and invest with it, it'll probably go fine and then you'll learn along the way. Right, regardless. So that's just kind of from a high level.

WS: Yeah. I love to how at many of those things we talked about, you know, as far as evaluating, you know, a new investment for a past investor. But one thing I love that you brought up there is alignment of goals and values. Because they're, I know operators personally that, I mean, they've produced amazing returns for a long time for investors, and I'm invest passively in numerous projects and other operators as well, okay. But my whole point is I know some operators who, they have this amazing track record, but I just personally wouldn't invest with 'em because our values would not align. It almost goes back to the another segment you and I were talking about, just about how tenants are treated and how we care about our communities and those things, right?

WS: And so, I want our values to align. I wanna make sure that, you know, hey, I'm investing in a business that we would have the same, or alignment of goals, right? And values and caring about these people. And so I just love that you brought that up and I do. I feel like the operator's crucially important long before the deal, right? Long before you ask any questions about the deal, any thoughts around just the current economic climate and investing passively or any change of where you would put your focus as far as evaluating, and you'll say all the operators are created equal. What would be the next thing you know as far as the current economic climate that you would focus on?

BH: Yeah, we talked a little bit about this yesterday, just about why I think it's a great time to invest in multifamily just because of interest rates being higher. I think is actually a benefit in some ways to be able to readjust later to lower rates, which will cause valuations to rise. But I continue to, and this is not a popular view, and again, I'm not even sure, maybe this is your business models. I don't mean to be, you know, if there's any, if I say something that you know is different than where you're at, but you know, when it comes to class A apartments that are brand new, I personally think that it's a higher risk type of proposition right now because I think when you have a class A apartment, you're assuming rents are gonna continue to rise, right? There's not, there's no value to add, right?

BH: So if you're buying a brand new or a new construction or new build, there's some risk there that, you know, like in Pasadena, California, where I live, rents are $4,200 a month for a two-bedroom. Well, if there's a serious recession, they're not gonna get 4,200. They might get 3,500, they might get 3000. it's the people that are in class A apartment. Those people move down to Class B or they move down to class C, right. they change or they move down. But when you have a value-added component, which just simply means you're going in, you're doing renovations, you're doing landscaping, you're doing stuff on the exterior, you're doing individual unit stuff. It gives you this margin of safety that really there's a bump in the value because it's different than single- family.

BH: Single-family is based on you know, what did this comp property across the street or across town sell for, right? Multifamily based on the income, how much income is actually coming in from the property. So it's a different way we calculate valuations, right? So if we can increase the rents or increase the other income from laundry or from parking or other things like that, we're dramatically increasing the value of that property. So I think that when you have a valued component, it puts a huge margin of safety in a deal versus something where there is no value to add.

WS: Yeah. What about any specific strategies maybe you've used to protect investors from these market swing?

BH: Yeah, so I think really kinda what you mentioned as well here, where was this today or yesterday, but the idea of just being very conservative on your underwriting, This is a term that people use a lot. It's a core value of ours. But I think what it really comes into that, a couple numbers. One is your rent growth assumptions, right? You can take any deal, that's a terrible deal, make it look great if you just have huge rent growth, right? So, You know, we typically, even in booming, booming markets, we typically never go above about 3%, you know, projected rent growth, even though rents are growing in certain markets that we're in by 20% or more, right. So, you know, being very modest there.

BH: Also the cap rate at exit, so cap rate is just, you know, the value, how much you're paying for how much income you're getting. And as cap rates are, some people project that cap rates are gonna keep going down. Well, you need to project that they're gonna go higher, which would be less favorable when you sell. But just to be prepared for that, right? So our goal is to be modest on our projections and hopefully achieve them or outperform them. And I think it comes down to really investor, you know, expectations and, but I think those are a couple things just on the, on being conservative side.

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WS: Yeah, that's great. Is there any specific opportunity that you could use as an example, maybe to talk through even some of the conservativeness on rent growth or exit caps? It doesn't even have to be your deal or maybe you know, somebody else's or something you've thought about investing in. Maybe you didn't because they had, you know, these assumptions.

BH: Yeah, so I think it comes back to just the idea of really understanding the deal. Like what, you know, what is the biggest risk in the deal and every deal. And again, more than real estate. You know, we do real estate-related stuff, but we talk about, you know, other assets like our ATM machine fund. We do, you know, I do things in the precious metal space or the energy space. So whatever deal you're looking at, you always wanna think about what is the downside, what other risks there.

BH: So I think of some risks are being, the problem is if your projections are too lofty, it's really hard to see are you gonna be able to get that upside? And I've seen there was a deal I looked at recently, you know, being somebody who gets involved in deals, people want you to come and be a part of their deal and raise money or be a part of the management team. And you know, somebody had a deal, I think it was like a 20, 12 build or something. So it was built more recently they called an A minus value add. And I'm thinking, well, it's only 10 years old. Like, how much value really could you add to this, right? But there are ways to add value. I'm not saying it's wrong, it's just, to me, it's just not something that I've done, you know, focused on kind of the newer value add stuff as well.

BH: But I think, you know, I've seen deals where people, their assumptions are just that everything's gonna go perfect, you know. From day one, we're gonna be able to increase friends, we're gonna have all these things or even operators are communicating that, yeah, you know, we're gonna start giving distributions really early or really consistently, and it's like, you know, some of it just has to depend on how the deal performs, right. So, I don't know. I mean, I think it's more of a feel that I get when I read it, and that's the challenge. Or when I look at a deal, is it's not just one thing.

BH: It's like when I really look at, I want to think, do I feel like I have a sense of where this operating group is coming from? Are they looking at the downsize? Do they have anything in there that says, hey, if this doesn't go well, here's what we get. Or maybe there's a sensitivity analysis that, okay, if rates are here, or if our cap rates are, you know, in this area, this is what we'll get paid, or this is, and it just gives more options, right?

BH: So you're looking at it and you feel like at least the operator has a plan for if the tide turns and things go the other way. Cause the longer you do this, Whitney, as you know, the more you realize there's, there are things you can control and there are things that you cannot control. And you can control a fair number of things, but a lot of things you cannot control. So it's really how you manage those things before you get into a deal that's really important.

WS: That's when you can make changes right before you get into the deal.

BH: Exactly. That's it.

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WS: Yeah. I appreciate you bringing that up, cuz it yeah, that's when it's important that you think through as many possibilities as possible and knowing that you're not gonna know them all.

BH: It's like getting married, right? Like the time to due diligence is before you get married, right? It's like once you're married, you're like, oh, you're married. You know? It's like you wanna make sure that you've really taken a good look at everything and that it makes sense.

WS: That's right. That's right.

BH: They need advice there too, for those-

WS: Maybe need to also need a reserve budget before getting married.

BH: Yeah, exactly. Yeah. Yeah. Right. Contingency.

WS: So even something like that, like a reserve budget or anything around that you like to see, or maybe that you're doing personally right now, how do you see those things so you know you're prepared for the downturn? You know when it happens, or worst-case scenario or the unexpected. What are some things that you're important to you to have in place?

BH: Yeah. So I mean, yeah, contingency is huge. You know, how much per door is it? You know, $250 per door per year? How much is it that you want to have in place? You wanna have contingencies in place for, you know, okay, these expenses cost more, these renovations cost more. It took longer than you thought. You know, you're not able to get the income and the timeframe that you thought, and so just that you have a plan. And then, you know, you think through, like, I get this question sometimes. You know, do you guys ever do a capital call and like, no, we don't. We don't. We haven't done a capital call and I'm grateful, but you know, I said there's five things we'll do before we'll get to a capital. I have a plan for this, right?

BH: So we'll take out, hopefully we'll be more conservative on underwriting. We'll have extra reserves so I can remember all five now that I'm on the spot here. You know, if we had something really difficult, we could withhold distributions for a little bit saying, hey, we have this expense, we've gotta do this. Hopefully insurance could potentially cover something if there was something catastrophic that happened, we could make a personal loan from the general partners to the property if we needed to. And then the last thing, then the last thing we would do is a capital call, right? Is a voluntary capital call. So those are things that you know what happens.

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BH: And that's a great question too as a passive investor, is what are the things in place? Have you ever had to do a capital call? Well, what are some things in place that would. Try to prevent that, right? A capital call is just, hey, we need more money. We ran outta money, right? And that's kind of like in any business, you never wanna run outta money. So if there's plans in place that you have enough money, you're well enough capitalized. And it is a balance because if you have too much money, then your returns are lower than they should be, right? Cause you over raised, you raised too much money. And if they're too low, well then you're gonna feel it in the returns or you are, you're gonna be pinched on cash or operations. And neither is good. So, but I think it's, if you're gonna go one side, the other have a little bit more money than you need.

[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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