EPISODE 1084

[INTRODUCTION]

[0:00:01.6] ANNOUNCER: Welcome to The Real Estate Syndication Show. Whether you are a seasoned investor or building a new real estate business, this is the show for you. Whitney Sewell talks to top experts in the business. Our goal is to help you master real estate syndication.

And now your host, Whitney Sewell.

[INTERVIEW]

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Whitney Sewell: This is your Daily Real Estate Syndication Show. I'm your host, Whitney Sewell. Today you are gonna hear experts talk about their development business. Development is very different from your typical value-add business plan of multifamily, or self-storage, or some other asset class. I hope you learn a lot from these experts today!

[INTERVIEW 1]

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Whitney Sewell: Our guest is Edward Orassi. Thanks for being on the show, Ed.

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Edward Orassi: Thanks, Whitney. Thank you for having me.

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WS: : I'd love for us to talk about the 160-unit project that you and I discussed a little bit. I don't know many developers, many people that are developing deals in Vegas, so this is a great opportunity. Could you give us some details about that project, maybe early on and what the plan is, and we'll dig in a little bit?

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EO: Okay. So I had a group of developers from California looking for an opportunity here in Vegas. So right now in Vegas, the up-and-coming area is the southwest part of Vegas. We found a track behind a development that sells for about $600,000 a unit. We found a five acre track that was entitled to build 160 condos on it. So we're building 160 condos. 109 are going to be two-bedrooms, 41 one-bedrooms, and then 10 two-story all-glass enclosed three-bedroom units overlooking the strip. They have a direct view of the strip, the new Raiders Stadium. We're taking this development from the dirt, all the way up.

So it's been a little challenging, because it's a new venture for me as far as the development world. I know the multifamily world, but I definitely am learning as we go on this part of it.

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WS: So what are some of those challenges that you faced going from multifamily to developing a project like this?

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EO: Well, the challenges are that you have to surround yourself with a good team. I think in anything that you do in real estate, whether it's investing, whether it's learning, it's — surround yourself with a good team. So some of the jargon and some of the conversations we have with the developer himself, with the architect, with the contractor — you're finding out like, for instance, one thing I didn't even know existed was wrap-around insurance. Wrap-around insurance is what the contractors require on the development, that's condos, not apartments, because it covers them for all the units for an insurance policy for 10 years.

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WS: Wow! So wrap-around insurance. I haven't heard of that before. Anything else about wrap-around insurance that we need to know? Tell me again why that's important.

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EO: Well, wrap-around insurance, it's — when a contractor is building apartments, it's one owner that owns all of the apartments. So if there's a claim, you deal with one owner. When you build 160 condos and they're all individually sold, now you're dealing with 160 owners. So the wrap-around insurance is an insurance policy that covers any construction defect for the first 10 years of the project. So it's important. If they were building an apartment complex, you'll never hear about that, and they'll never ask for that. It's only on the condos, because the liability is much higher. Now, you're 160 potential owners.

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WS: Wow! Okay. That's a great piece of information there that I wouldn't have known. Otherwise, I would ask you about. So I appreciate that. Any other challenges that we can elaborate on that you've experienced going from multifamily to development?

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EO: Yeah. The biggest thing in getting the right team in place, because there's things that come up that we take for granted as investors and as people that look in real estate is — now you're putting in a project of 160 units. Is there enough electricity? Is there enough water coming in? Is there enough sewer? If not, how much is it going to cost to change that infrastructure now so that you can actually build those units there?

The same thing goes with multifamily. Sometimes, you start remodelling multifamily units. Do you have enough power if you're adding units, if you're doing certain things? It's those things that we take for granted, and you have to dive deep into and try to get the answers to, before you start.

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WS: Okay. So, I mean, having the right team, it doesn't matter what kind of business it is. It's so important. I mean, our team is just crucial. You couldn't do any of this without them. As far as the local governments or permits — anything like that that you've learned or anything that's a bit different maybe in Vegas that we should know about?

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EO: Yes. So the permitting process in Vegas is, you get your plans ready for construction. You submit them. Then it goes like an advisory board. They now look at it, and they start going to the individual departments. So the key is to have an architect that has connections within the city to speed up the process. Right now in Vegas, permits are about six months out. So it's quite an undertaking to get into permits. If they return it, we're going to add another six months, because they don't start where you left off. You start all over again.

So having the right architect, contractors that know the city, that know what they're looking for, they can anticipate any changes, any issues that are coming up. Simple rules, like now, they've changed the rules in the City of Las Vegas. Now, they want sprinkler systems in the units. We have to make sure that those are already built into the plans. If not, that's going to start all over again.

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WS: Wow! So it takes six months. Then if you don't get it correct, then another six months. I mean, that's – My goodness, you better have somebody on your team that's done this before.

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EO: Exactly. So the architect we use has been in Vegas doing this type of construction for 30 years. The builder we're using has recently just completed a 200-unit building. Some of the challenges with the building that we're doing is there's going to be some underground parking, because it's so hot in Vegas. So we're doing some underground parking because of the size limitation. So the structure and how – There's caliche underground. So how much caliche? How deep do you have to go?

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WS: Now, what is that? What is that underground?

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EO: Caliche. So it's a type of rock that's very dense, very hard to go through. It has different grades. So depending on the grade, it's either easy to get out or very difficult to get out. So those are some of the challenges. Also, it's having the right team that knows, "Okay, this is what we have underground. This is what we can anticipate. This is how far I think we can go down without running into any issues." So those are all the issues that come up when we are doing a development.

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WS: Okay. Yes. I mean, even the rock. I mean, even things like that. If you're not experiencing this, there's no way that you're going to know that, even if you're experienced in that specific area of the country or Vegas. I'm not sure how far where all this rock is. But if you didn't know that, that could relate to some big problems or setbacks.

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EO: Definitely, definitely. Since Vegas is actually in a valley, there's rock everywhere around us. So the contractor that we're using and the architect, they know where the pockets of the tougher caliche is, and they can almost tell you by the street like, "Oh, from this street, stay over the west of that, because that's where it is or on the east of that is going to be okay." So those are some of the challenges that we come up with all the time.

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WS: So how long will it take to complete this project?

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OE: It's a 24-month project, start to finish. We're currently in the process of acquiring the land and going through our due diligence on the land. Due diligence is the most important in every real estate transaction. It's making sure you get what they say you're going to get.

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WS: So during that due diligence process of the land, that is so important. So that's where you're going to be looking at the zoning and the permits and then the rock and all these things you're discussing, right? So that way, when we can move forward with this, we're ready to go.

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EO: Right. So part of our due diligence, we're looking at the land itself, what's on there? We're doing this phase one environmental, phase two environmental. Making sure we have the environmental studies that we need. We're looking at traffic study because that's going to give projects how many entrances and if you have to have any turnouts for that particular subdivision or the condo units. We're looking at the power grid. We're looking at water. We're actually checking with the neighbors, because it is near a residential area to make sure that they're not going to try to block this project. So there's quite a bit that goes on during the due diligence phase

[INTERVIEW 2]

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Whitney Sewell: Our guest is Scott Choppin. Thanks for being on the show, Scott.

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Scott Choppin: Hey, Whitney, great to be here. I appreciate the invite.

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WS: In your bio, we saw that you're a real estate developer of highly undersupplied multigenerational urban housing. But what does that mean exactly?

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SC: So we have always as a company – So I formed the Pacific group in 2000. So we're going on our 19th year of operation as a pure play real estate development company. We've done different asset types, so new construction condo, market rate apartments. Also, we've done numerous affordable housing projects that are the lifecycle of our company. But we've always focused on urban infill is the term that we use. What that means is that we're working within existing metro urban areas.

I think I've mostly developed not necessarily downtown, but we have done projects in the downtown central business district. But we're not suburban either or even rural. So we're in the existing fabric of the city and looking for assets, land opportunities that we can develop to infill an already existing neighborhood.

We've always been encouraged by that product type, because it's close to transit. It's close to job centers. For our tenant profile and our workforce housing communities, it's also where their social networks are. So kids go to school. Their families are close by. Their churches are close by.

So we've always been encouraged to find the demographic that is seeking to be in that location. In 2000, when we started the company, it was Gen-Xers who wanted to live in cool downtown locations that are urban loft. That was sort of the start of it. Then it evolved from there to millennials now are attracted to that product space. But also now, what we've focused on is existing family groups that are already here in the urban location and serving them with a new type of housing that facilitates their lifestyle.

So we call it first housing or moderate income housing sometimes. That's how we describe it, but it's very undersupplied. We're in California, which has out of the top 25 most expensive marketplaces in the United States. At least the ones that I saw. Eighteen of the top 25 were in California, and all the top 10 were in California. So rents and housing prices versus incomes in California are diverging, and that is a story across many urban metros. But here, it's the most distinct undersupplied situation that we observe in the United States, and that's a market that we want to be in. That has a social impact story to it as well, which we're – I've always had that. It's part of my career. But it's good to be able to do good by doing well, and we see the space.

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WS: All right, Scott. So what markets are you in exactly?

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SC: So when we started the program, what we call UTH, which stands for Urban Town House, that's our specific branding in the workforce housing model. We started in Southern California,

and the bulk of the actual projects we have are here. So what that means is think of the Central LA County, Southern LA County, and Northern Central Orange County, so the LA Orange County Metro Marketplace.

But we do have designs to move this UTH workforce housing model into other urban markets. So in California, it would be an expansion of the San Diego Bay area. Then we have underwritten projects in locations like Portland, Seattle, and Denver. This is actually a product that's worked in-demand in those locations. So again, the urban portability story, but also the right mix of land pricing, existing zone sites available, and build cost, which is the formula that we have to keep track of as a major variable. If we could track that to make sure we have viable projects. So our long-run picture for this is to expand into all those western urban metro markets.

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WS: So how do you make it to work in Orange County for you all? What are you looking for, and what kind of numbers are you looking for to make something like that work there? I think you mentioned it yourself, the tops of the prices in the low cap rates in a market that you're in. How do you make that work?

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SC: Well, this is the beauty of the difference between buying existing value-add assets and building new construction. But I won't go into detail about what value is. I think the audience is probably well aware. But for us as a developer, we can go into highly constrained markets and find land assets that we can then develop our own product. So we're basically creating new assets out of [inaudible].

Now, we've got a whole lot of technical issues to deal with that are different from a value-add type of environment. But like any real estate developer, we're always searching for new land assets, but we have specific criteria. So one of our criteria is we only buy sites that are zoned, so we don't want to go through governmental entitlements in any discretionary way, where the city counselor [inaudible] can say no.

Our UTH product because it serves working families really only goes in certain locations. But I don't mean to be saying that it's exclusive one way or the other. It's more a function of our tenant base. Working families already exist in the blue-collar neighborhoods is the way we describe it. So there are low income neighborhoods in any city. So whether it's Orange County or LA County, we're looking for those neighborhoods where our tenant base already lives, and we're now just providing them a new housing type that they don't otherwise have available.

So that's sort of the two big criteria, location that serves the tenant base and is appropriate for the tenant base, correctly-priced land and [inaudible]. Those would be the three majors.

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WS: Why the new development model versus value-add?

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SC: Good question. So, one fundamentally, we've always been a developer. Although we have a lot of crossover and overlap of value-add investors and we invest in our own projects, we are not purely an investor per se. So we are a developer, which means that we just look at from the standpoint of our job to create new projects and new assets. We certainly own apartments that we've developed ourselves, but we've never been a pure play value-add [inaudible].

Having said all that, we like the differentiator between value-add and development in this part of the market cycle. So the way I look at it is [inaudible 00:08:36]. I think that's a very common theme that everybody who is in the value-add space would love to have deals with. Except that in this part of the market cycle, which would be when the market cycle is climbing, meaning going up and positive growing in order to have a peak, then value-add existing assets start to become very expensive, which I think everybody in any major urban metro has this as an issue. Returns are being eroded, because they have to pay high prices.

Well, that's the opposite model which I call the above replacement cost value or above replacement cost model, which is the development model. So I'll give you an example. So in a downturn, at the drop, if you could buy a project that was 80,000 a door and it costs 100,000 to replace, below replacement cost, then you would say generally that's good value, right? I'm using very simple examples here, but you'll see the point.

In a rising or upward trending market, those values for those assets will start to rise. Then eventually, they'll flip over. So the value is now above replacement cost. So our motto is build it for 100K a door, and its value when we sell it is 120K. We're the opposite of below replacement cost, and that will always be true. So when a recession comes, which we're preparing for, anticipating, then [inaudible]. That is just vigilant preparation, raising capital differently.

We'll know that the development model will basically be less preferred when replacement cost can be or projects can be bought below replacement cost. So that market cycle does influence what deals work best. So we just look at it from the standpoint that we know when that happens. Now, on a long-run basis, we know that a recession will come, and what we're anticipating and one of the reasons we like this workforce housing model is because our tenant base is very sticky is the way we describe it. The social networks that I described before are very strong. What that means in a recessionary environment, people will stick around. In other words, their families are local, their kids are in school, their church is close by. So they're not necessarily going to pick up and move to Austin tomorrow.

My internal joke is when you build millennial housing, and this is nothing wrong with the choice that they make. It's just they don't have that stickness. There's nothing tying them to that market, so they can leave. They got a job in Austin, and they can go, and they'll leave your apartment if you happen to run into that specific profile.

So we see workforce housing as a defensive model, meaning we have a stable sticky tenant base. We know in recession that values will decline. But if incomes stay stable, rents stay stable, and then life stays stable. Then as long as our capital doesn't need to get out when the recession is upon us and we can go beyond that since 7 to 10-year hold is what we're [inaudible] now. Then we think we have a defensive strategy but are still able to be real estate developers.

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WS: Now, that's good. I appreciate you elaborating on that and even the difference in the types of tenants there you were talking about. That's some pretty good information. But you alluded to like the downturn numerous times, and I like to ask most guests that are in your position.

How are you preparing for another downturn? What does that look like when you're especially in a development model, because that's not something unfortunately we get to talk about too often on the show. But I'd love to hear as far as the new development, how are you preparing for the downturn? What is that – How does it change what you're looking at or does it when you're underwriting, you're looking at land, and things like that?

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SC: Absolutely. Yeah. That's a great question. So our preparation is predominantly revising the financial structure of how we raise equity. So typically, when the market is rising and in good shape, and we're looking for a recession maybe two to four years out, we would complete a project, lease it up, and sell it. So build it around itself. That merchant build model is what I call that. How we change now is that we're anticipating the recession somewhere between 18 to 36 months out if you look at the various data points. We don't know that for sure, but we're on the longest expansion that we've had in recent history. So we just know to be careful and anticipate.

So what the houses do is raise equity that is on a 7 to 10-year hold with the idea that we would ride through the recession with our investors with us and then our engagement together, having a defensible, stable tenant base, right? They are the working families who want to stay close to their job locations and their family that as long as the income stays stable and we don't have to have a capital event during the recession, meaning investor wants to get out, we got to sell the property, and then we're out of luck because a sale is forced.

We want to avoid any sort of forced events, because we're under recession. So as long as we underwrite our permanent debt appropriately, we would be the defensive there, meaning, assume push in in the underwriting of permanent loan, underwrite our rents [inaudible].

We can see it a little bit more carefully and raise [inaudible] from equity. We can't, of course, guarantee that that will be perfectly bulletproof in a downturn. But compared to most other new development apartments that I'm speaking about. Specifically, if you're in the millennial market and you have major job losses in the local market that would fit, say, the technology sector, you can anticipate that a lot of those folks who were in your profile would leave. They would go home. They'd get roommates. They'd usually have to go and get another job. Nothing wrong with that, because they're all perfectly appropriate for their life stage or part of their life cycle.

We just say we prefer to be in a different demographic that's more defensible. So hopefully, that answered your question.

[END OF INTERVIEW]

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Whitney Sewell: We hope that you enjoyed the Highlights show today. You can always listen to the full episodes that were featured today by clicking the links in the show notes page. And in the description box, let us know what you've thought of this episode or you can go to lifebreidgecapital.com/podcast and click the feedback button. Let us know how we can add value to you. Thank you and talk to you tomorrow.

[OUTRO]

0:20:32.0 ANNOUNCER: Thank you for listening to the Real Estate Syndication Show, brought to you by Life Bridge Capital. Life Bridge Capital works with investors nationwide to invest in real estate while also donating 50% of its profits to assist parents who are committing to adoption. Life Bridge Capital, making a difference one investor and one child at a time. Connect online at www.LifeBridgeCapital.com for free material and videos to further your success.

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