# Strategies for Capitalizing on Multifamily Investing

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## A discussion with six major players leading multifamily development and acquisitions in the Western region.

Demand for multifamily housing is at an all-time high, as are rents and occupancy rates. Paired with an infusion of capital and a shortage of available assets, this environment makes for a strong seller's market.

From investment criteria and market selection to pro forma development and asset repositioning strategies, six major players leading multifamily investments in the Western region share how they are making the most of their stakeholder's capital.

## Capital Origination

As multimillion-dollar transactions conducted by publicly traded companies and private equity firms flood public news feeds, much less is said about how these companies sourced equity. Outside the institutional investors, the majority of equity continues to originate from existing, established relationships with high-net-worth families and trusted, accredited individuals.

"We syndicate our equity deal by deal," says Sam Blake, Vice President of Acquisitions at New York-based Quad Property Group. "It's typically coming from an investor base that's largely made up of friends and family; often people that the partners had gone to law school or business school with and probably 80% are repeat investors."

Says Dusty Eddy, Senior Vice President of Southwest Acquisitions for Chicago-based 29th Street Capital, "Our company was founded with syndicator raised equity through high-net-worth individuals, friends and family. Today, we have about 700 individual high-net-worth investors across the country as well as in Canada and internationally. In the last couple of years, we've built up some relationships with some institutional partners as well as some family offices. So, our investor relationships are very diverse. At this point, it really depends on the type and size of the deal."

Despite the pandemic, strong occupancy, rent growth and steadily compressing cap rates further confirmed the resilience of the multifamily market, spurring changes in investment allocation from the larger institutions and private investment firms alike. The shift to remote work and the likelihood of its persistence post-pandemic exacerbates the shift in investor appetite away from office, retail, hospitality and other asset types and gives rise to new partnerships in the multifamily realm.

## Crowdsourcing

While the murmurs of crowdfunding options for non-accredited investors wanting to break into the market might give rise to curiosity, none of the individuals in this story deal directly with this type of equity. The hesitation seems to be trifold, because trust, ease and education levels are higher for institutional and accredited investors.

“We always use accredited investors,” says Blake. “We don't raise money on the Internet or crowdfund or anything like that. They're pretty straightforward people that we know, have worked with and can count on.”

Though Matthew Zisler, VP of Acquisitions at Denver-based BROE Group knows a lot of the crowdfunding companies out there, such as Crowd Sources, Crowd Street and few others, he says he has never raised money from unaccredited people.

“I've just found it easier dealing with institutional investors than individual investors,” says Zisler. “I think as long as [nonaccredited investors] have the right disclosures and they understand the risk it's okay, but there's always an issue of governance. I would worry Reg A investors do not truly understand the risk and structure of their real estate investment. On the other hand, the reason why they came up with Reg A and these internet platforms was to try to break some barriers so that more people can invest in real estate private equity.”

Rue Bax, with Phoenix-based ABI Multifamily, is also familiar with crowdfunding and believes it is becoming more common. “My partner runs a company called Neighborhood Ventures, which is a crowdfunding group for non-accredited investors,” he said. “I think in his last transaction he had 88 different investors and I think it was a $1.6 million acquisition.”

## Off-Market Deal-Making

With increased investor demand, locating and acquiring the most profitable assets has become an art. Interestingly, relationships play a key role again here, as evidenced by the prevalence of off-market deals.

Denver-based Grand Peaks tries to provide as much proprietary deal flow as it can. “It's highly valued by our investors and we know that it creates strong relationships. A lot of times, they're hard to find at the institutional level but the more of those opportunities that we can bring, the better.” says Matt Lyons, Senior Vice President of Acquisitions, Mountain Region.

Since off-market deals are harder to come by and can be touch and go in a desirable market, the prevalent trend is a multifaceted approach combining a mix of proprietary and brokered deals, with an emphasis on working relationships.

“We reach out to everyone we know,” says Bax. “Obviously, Phoenix is a very competitive market and there's a lot of great brokers, so it's not like there isn't a plethora of people and groups to choose from. We just try to differentiate ourselves we're always talking to everyone that's out there. The [potential sellers] sometimes reach out to us and, obviously, we're making the same type of effort to them.”

29th Street Capital prides itself on finding off-market deals, but, “It really depends on the individual market,” says Eddy. “In my market [Phoenix], for instance, the brokers do kind of manage and control a lot of the transactional process, but there's still off-market opportunities going through brokers. Having built up relationships with those folks where they know 29th St. can execute might give us the opportunity for a first look at a deal before it gets fully marketed."

## The Changing Landscape of Hot Markets

The pandemic spurred major changes in the multifamily housing industry, including the landscape of hot spots. To identify these new markets, Quad Property Group starts high level because, "You want to make sure from a macro trend that the market is growing, that jobs are coming to the area and that you know overall there's an economic story that works; that there's a reason you want to invest there," says Blake.

Strong economic fundamentals such as the existence of universities and healthcare systems, employment in a diverse mix of industries, and a younger, highly educated workforce are all key indicators of a potential hotspot.

Since supply and demand directly correlate to population growth, almost everyone in this article mentioned that following migration trends also plays a big determining factor.

A market showing an influx of both workers and employers paired with projections for income growth is ripe for opportunity. "Employment growth, population growth—those types of strong economic fundamentals are our starting point to enter a market," says Eddy.

While it's obvious that market selection is based on some sort of perceived advantage, current relationships and familiarity with a market also play a role in selection.

"We often are starting with our backyard, our local market," says Zisler. "If we are close to it, our feeling is we can manage it a little bit better."

29th Street Capital has hundreds of years of experience not only acquiring and investing in properties but also managing properties. As a result, it has substantial internal metrics to start from. Beyond that, it's about local connections. "Really the way we're structured with local boots on the ground, across the country our team members are all based in their local markets," says Eddy. "A lot of the projections on the income and rent side come from just being ingrained in the market, talking to folks, seeing what's happening and owning deals in that market already."

## Identifying Opportunity

When looking for individual opportunities at the ground level, things can get a lot more granular and the strategies can vary quite broadly. Some overall factors used to gauge interest level on particular assets that resonated with the group interviewed for this article included spending time looking at historical financials, analyzing how the property has been or is currently operated, seeing where the current rents are in comparison to where they should be and assessing the cap rates.

"We spend a good amount of time looking at historical financials and how the property has been operated in the past relative to what we want to do," says Zisler.

Quad Property Group typically looks for properties with rents well below under comparable properties. "You work to bring those rents up to market, and that's typically what makes our transactions successful," says Blake.

After analyzing the basics, the instincts and unique strategies of each investment group come into play.

"We try to approach opportunities where the return drivers are things that we have strong conviction in," says Lyons. "There might be an operating assumption that we believe will have more control over, opposed to relying exclusively on market-rent growth to drive returns. Is the strategy to rise with the tide or find a property specific alpha. We, and our investors, prefer the latter."

For Zisler, it's more building structure and sub-market specific. "A lot of what we look for in multifamily is the much smaller target," he says. "We avoid garden-style apartments and typically look for everything from high-rise to mid-rise buildings, the podium style and wraps in more of an infill location."

29th Street Capital's criteria for their 700+ investors and institutional partners is pretty much value-add and core-plus multifamily properties across the U.S. Drilling down to the individual deal, Eddy says that, "it really depends on the location and the quality of the assets, the vintage of the asset, those types of things."

## Business Planning

On the financial side of things, Blake says that Quad Property Group looks at the big three: Internal rate of return (IRR), cash on cash and multiple. "We have a threshold of minimum returns that will pursue a deal on and metrics that we look at for every deal that if we don't hit them, we won't pursue the particular deal," he says.

From value add plays on distressed properties to purchasing A properties and focusing primarily on manufacturing value on the operations side, there are a plethora of viable business models.

When 29th Street Capital started out a decade ago, it was very much buying older value-add properties it was looking to hold for three to five years. Eddy says that, "in most of our markets, we've been pretty opportunistic in terms of selling maybe a little bit before we finish our business plans. Since then, we haven't pivoted, but we've added newer vintage, more core-plus type deals to our portfolio with the outlook on those being a little bit longer-term hold. It really depends on the vintage of the property, the location of the property and our business plan for each one. We have the ability to do those shorter-term flips, but also in the last couple of years, we've acquired a few assets that we just want to lock up and hold for 7-plus years.

Grand Peaks takes an opportunistic approach from workforce to core. “At Grand Peaks, we like to say that we manufacture value,” says Lyons. “And that can mean many different things. In the traditional sense, we can build value into a property by improving the exteriors, making the property feel clean and safe, as well as upgrading the unit interiors. But we can also manufacture value more uniquely. An example could be a core asset that may have structural issues needing to be resolved or a management team that's not operating at a true institutional level. We're lucky enough to have a pool of investors with the ability to chase opportunities across all the risk spectrum.”

## Post-Deal

Once the deal has been made, the next step is to execute renovations. Value-add investors typically focus on three key areas: Capital improvements, deferred maintenance and upgrading units. An expertly performed renovation schedule separates the professionals from the less experienced, since completing due diligence ahead of time and outlining renovation scopes during pro forma development directly affects the projected ROI.

“A big part of a deal before acquisition is figuring out what deferred maintenance needs to be done,” says Blake. “If roofs or other systems need to be totally replaced, that could have a huge impact on the deal. That's all stuff we want to budget for upfront and then take care of immediately. For the interiors, it's totally market driven. If we can remodel a unit and hit the ROI that makes sense we'll do it, but if it doesn't then there's no reason to.”

Bax says it's all driven by where the investors can push NOI. "With rent growth being quite strong right now, you're seeing a lot of folks focus on interior reno. We've just seen the average rent going up on all unit types and the ultimate way to drive return is to push the rents and do it through renovation."

29th Street Capital's renovation scope is all-encompassing where it concerns value adds. "If we get an entirely clean property that's all classic with some deferred maintenance, we'll address the deferred maintenance, but then we'll do amenity upgrades, clubhouse upgrades, exterior upgrades and also interiors," says Eddy. "I know there are some groups out there that either focus on amenities and exterior or interiors, but we do it all. We feel like you add the most value by really improving all aspects of a property."

The timeframe for completion depends on the scope of work and the desire is always to get there as soon as possible while still being respectful to the current residents. The prevailing mantra is to start everything immediately, attacking the deferred maintenance and capital improvements simultaneously and renovating units as soon as they become available.

"We just kind of attack everything day one, deferred maintenance, exterior amenities and interiors," says Eddy. "The exterior amenities and deferred maintenance usually take us six to nine months depending on the amount of the work. Obviously, the interiors take a little bit longer. We don't force people out. We renovate interiors upon the natural turn of the unit and typically it will take us about three years to get through them."

"We'll try and begin renovating the day that we close," says Lyons. "We pride ourselves on the fact that when Grand Peaks takes over a property the residents are going to notice an impact immediately, both from a physical representation as well as a service perspective. We like to get our management company in there so they can make themselves known to the residents, make sure that they understand that we're here to serve them and make sure that all of their concerns are addressed.

“And then from a physical rehab perspective, it depends on the business strategy and the property,” he says. “We'll look to start renovating units immediately so that within the first 20 days of closing, we’ll have renovated units ready to lease. The exterior renovations, whether it's roof replacements, or painting, or [other efforts], we try and do them right out of the gate, but those can take months depending on how big the project is. We try to address deferred maintenance items that some owners neglect, but we believe residents do notice and that can drive a renovation premium.”

## Brass Tacks

When it comes to actually performing the renovations, choosing a general contractor (GC) can make or break the deal. All of the research, planning and forecasting means nothing if you can’t get the work done. Though lack of qualified labor and material shortages are causing delays in construction across the nation, there doesn’t seem to be a shortage of GC’s pursuing these deals.

At 29th Street Capital, they do most of our interior renovations in-house or with local subcontractors in each of their regions. “In my region, I've got a capital project manager that essentially acts as my own in-house GC, but he's out there building the relationships, finding the subs, finding the labor to do our interior renovations,” says Eddy.

Grand Peaks usually self-performs their renovations. “There are opportunities to work with general contractors, and we look for relationships that can follow our business activities to the markets we participate in,” says Lyons. “We plan to continue to do business with the same relationships and look at them from a partnership approach, knowing that we rely on our partners as much as they rely on us. When we're looking for groups to do business with, the quality of the work, the certainty of executing, and the timeline in which they do so are the main contributing factors that influence our decision."

Zisler likens the GC selection to any relationship-building and sales process. "It's a function of identifying the groups you want to work with, reaching out to them and making sure that you understand the deals that they're doing," he says. "We often want to go with the groups that have a long reputation for excellent work. Taking a risk on a new group might have more downsides than anything else just from a standpoint of being able to answer to their investors."

Historically, multifamily has always been a solid investment, with the past 10 years showing steady growth. Apartments are becoming a long-term choice for residents of all ages, and with many Millennials reluctant or completely unable to make large purchases as a result of the pandemic, the future holds a sustained demand for rental housing. As the drive to buy continues, supported by stabilization in the job market, the challenge for developers will be to resist the urge to overextend themselves and instead focus on strategies such as amenity innovation to ensure their investment properties remain competitive.

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