Dan Breslin: Welcome to The REI Diamonds Show with Dan Breslin. Your source for real estate investment, Jewels of wisdom.

Welcome to The REI Diamond Show. I'm your host Dan Breslin, and this is episode 196 on investing in 200 unit multifamily apartment buildings with Ken Gee. If you're into building wealth through real estate investing, you are in the right place.

My goal is to identify high-caliber Real Estate Investors and other industry service providers, invite them on the show and then draw out the jewels of wisdom, those tactics mindsets, and methods used to create millions of dollars and more in the business of the real estate. Ken Gee is a multifamily syndication operator focused on buying and improving complexes and the 200 unit unless B and C markets throughout the United States. Ken and I in this episode discuss the timing and order of renovation of a large multifamily asset and how that's critical to the repositioning process. Spend money on the wrong items or in the wrong order and your target tenant population will ignore your property, damaging your returns. We also cover Tax Strategies, Market Selection, and how to vet a syndication operator through a third-party financial review. Please enjoy this conversation with Ken Gee.

All right. Welcome to The REI Diamond Show, Ken. How are you doing today?

Ken Gee: Doing great. How about yourself?

Dan: Fantastic. Good time of year here in mid-summer and things are going well. The economy still holding together and stock markets up, right?

Ken: That's right. Yes, sir.

Dan: At the moment. Cool. So, Ken. Can you give our listeners a little bit of background history? So, what your career was? What has it developed into now in the real estate space?

Ken: Sure. So, my career is actually taken a number of turns over the years. I initially got my finance degree from Toledo, Ohio, and became a commercial lender for 5 years with a small Regional Bank, or well, at the time was small, it's large now. And then, after about 5 years of that, I decided I wanted to be a CPA. So, with that, I got my CPA license and spent 7 years at Deloitte, in their tax practice, do an MA work. Working with a lot of private Equity Funds, had a lot of fun doing that. And then, at some point here, I bought some Cessna Pilot Centers. Most people don't make the jump from accounting to flying airplanes, but I did. It was a lot of fun. We owned 3 Cessna Pilot Centers for a number of years, and really enjoyed that business. But all through that time, I jumped into real estate back in 1997, and have not looked back since.

So, it's all we do now -- a hundred percent apartments. We were a vertically integrated real estate company. We do our own investments. We raise money syndications and funds, as well as do third-party management.

Dan: All right, sounds good. So, tell me about the flying. Do you still fly yourself at all? You must, right? And I mean, it's something...

Ken: Actually, no. I have other people fly me. So, no. I fly commercially now. I have my private pilot's license. I wasn't the one that actually instructed. I own the company. So, I haven't done it in a number of years. I miss it, but it was a lot of fun.

Dan: Yeah. I briefly got into flying and took a couple of lessons and was thinking about getting a license maybe, I don't know, 8-9 years ago. Moved far far away from that Airfield so I kind of moved on from that idea myself. But yeah, being up in those Cessnas is a completely different experience than flying commercially.

Ken: It is. But you know what? The word becomes a smaller place when you do that. It's really interesting how it changes your perspective.

Dan: Nice. All right, cool. So, let's talk about real estate investing. What is the asset class or classes that you are primarily focused on now as a company?

Ken: Sure. As a company, we do B and C Class Value-Add. Right now, we're in Central and Northern Florida, but we stick to that asset class. We always have. We have always been a B and C Class Value-Add investor. For lots and lots of reasons, I mean, first of all, it's the value-add concept that we really enjoy, we have become pretty good at, but it's also the B and C class asset, which I think is really important because it's the stuff that normal everyday people need, right? It's the largest part of the housing market and it gives us the most opportunities to take a property and make it much nicer after we're done than it was when we started.

Dan: Nice. What are the average ages of these properties that you... I guess an important thing to be like, what's the number of units under maybe management or already invested in own? Just to kind of give context of experience.

Ken: Yeah, great question. So, our senior management team has managed about 15,000 units. So, we're pretty deep in the experience. We currently manage about 2,000 units in Central and Northern Florida. So, we're still pretty deep. We're spread out in Tampa, Orlando, Jacksonville, Daytona, and soon-to-be up into the Panhandle, and we'll continue to grow from there. No question about that.

Dan: Nice. What was the average age of these B to C unit buildings in those markets?

Ken: Yeah, so typically '70s to early 2000s.

Dan: Wow, they get to that new, huh?

Ken: They do, yeah. We actually have one asset built in 2001 that is performing very well for us.

Dan: How about those construction materials in Florida? Is this all block filled with concrete construction there?

Ken: Not all of it. Nope, not all of it. Some of it is frame, some of it is black, some of it is stucco. It's a little bit of all of the above.

Dan: Okay, got you. So, your real estate firm, primarily you're looking for passive investors, I believe, but I think you're kind of known. I believe you wrote a book and talked about real estate investing being like an active thing for most people. It is for me. Certainly, flip a lot of houses and own a lot of rental properties. I'm constantly emailing and calling and checking management statements and making decisions. And if I were to put my head in the sand and try to treat it passively, like I was actually sold on the idea in Florida in 2006, when I went to the seminar to get into the business. I'm sure I would lose and the deals would not be anywhere near as profitable as they are today. So, what's the difference between active and passive investing?

Ken: Yeah. So, what happened to you is what I see happens to a lot of people. People generically refer to what we do, it's a passive investment. Well, what you and I do, there's nothing passive about it. I've long held that we run a business, just like the CPA firm I used to work at, just like the bank I used to work at. This is a business that just happens to be apartments. Everything that you do in a business, we do in the apartment world. We have employees. We have maintenance issues. We have customers. We have sales. We have reporting... everything. So, it's always comical when people refer to any type of Real Estate investing as passive, because most of the time, it's not.

Now, we generally invest alongside our passive investors, right? We've been doing this for a long time. So, we will do typically what a syndicator does, or a fund manager. We're doing funds now, but we'll go find a deal or raise the money and put our own money in the deal as well. And that way, our passive investors, historically, they've earned 15, 20, 30% annual returns, right? So, it's really, really fun to be able to do that for folks that are just legitimately passively investing and have nothing to do with the operations of the other property.

Dan: So, was 1997 the year that you began owning and running these syndication and apartment deals?

Ken: Yeah, I believe... In the beginning, we didn't syndicate. We didn't because in 1997, I bought my first property. It was in Cleveland, Ohio. It was a whopping 28 unit apartment building, but what was important about it is it was big enough that I could kind of run it as a business. By today's standards, it's small, but I could still hire someone to do it because at the time I was still working for Deloitte. If you know anything about the CPA World, they work a lot. And so, there was no way I was going to go turn apartments myself and everything like that.

So, we bought a 28 unit building. It was all with my money and family money. And the first, I don't know, 6 or 7 or 8 deals, I don't remember now exactly, we did it with our own money. We did that because I don't think it's fair to learn on someone else's dime. I just don't think that's fair to do. So, we've tracked. It never does that to me. We're still learning today. So, there's probably a little bit of that still going on. But the big mistakes I made early on, I did it with my own money, in that way, I didn't have to worry about losing someone else's money in making a big mistake.

Dan: Yeah. I feel like that's where I am. I don't take outside investor capital. I mean, our main business is buying and selling houses and we've done, I think, 179 so far this year. So, we're really, really busy doing that main business. So, for me, rental property, multifamily buildings, these are like savings accounts and I buy them for a variety of reasons that we probably already know. But I was asking because I'm looking to try to put a timeline together of market cycles that occurred from like '97 to where we're at today, but I think a market cycle in Northern and Central Florida is going to be a little bit different than in Cleveland, Ohio market cycles. So, maybe you could give us a timeline of when the Ohio portion and then when the Florida portion was added in, and then we can talk about how those cycles happened and exist in maybe where we're at today.

Ken: Yeah, that's a really good question. So, we the company originally grew up in Cleveland, in Northeast Ohio, and we bought properties for ourselves and we did some third-party management. That area generally doesn't require a third-party management industry because most people that invest in Cleveland live in Cleveland. So, it's an owner-operator town. 10 or 15 years ago, I felt like we were doing quite well in Cleveland, but I felt like we could do so much better if we had a basic economic structure that was better than what it was in Cleveland. So, we began the process of looking in Central and Northern Florida. And that economic picture that I'm referring to is demand and supply. If you think about Cleveland, generally, Cleveland is not growing in population and the housing stock, and what we do is generally stable. So, that puts a sort of downward pressure on prices. Now, compare that to Florida about a thousand people are moving into Florida every year and they're not building B and C Class Assets in Florida. They just can't because they can't afford the cost of construction or do I.

So, now we're in a situation where we really are in a bull market. We have increasing demand and stable supply that's going to put upward pressure on rent. It just will. That's how economics works. So then, when we put our value-added strategy on top of a bull market, it just explodes. And that's exactly why we're in Florida. That's why we made the transition to Florida and that's why we're there. We've really wound down generally what we do in Cleveland. There's nothing wrong with Cleveland. You just have to be more careful when you buy because you're not going to have the growth prospects in front of you like you do in Florida. In Florida, you can make a little bit of a mistake on the buy-side and you're going to earn your way out of it. Why? Because unless somebody thinks that people are going to stop moving to Florida, which I don't see that happening. I mean, it hasn't happened for decades now. I don't see that demand breaking down and that's really what drives that whole market down there.

Dan: Interesting. Do you remember what year it was you entered the Florida market for a steal?

Ken: Yeah. That's a good question. We actually bought in '14 or '15, something like that. It might have been '13. I don't remember exactly what day or what year it was.

Dan: Okay.

Ken: But it was post-'08-'09 recession. We couldn't get in prior to that recession. Nothing made sense. And so, we just sat on the sidelines because it was just obvious what was going to happen. We didn't fully understand why all those things were happening, but we should understand that it was going to happen.

Dan: Yeah, I got it. Are we at a spot like that now, do you think?

Ken: I don't think so. And the reason is, I went through the '08-'09 recession. Being a lender, a CPA, I really got into the details about why. Why did this happen? How did this happen? And there were a lot of things that came together. 1) a lot of speculation; 2) people, they were able to walk into a bank and tell them they made a million dollars a year. Tell them, they had 5 million dollars in assets. I think they called it a no-doc loan I think.

Dan: Ninjas or something, right? NINAs, no income, no assets.

Ken: Yeah. No income, no assets. There you go. Yeah. Although that's not what they said. So, you have that going on. And in markets like Florida, you had people buying properties because they just knew that they could convert it to a condo, right? That whole condo conversion thing was going on. So, they were buying properties that now when you look back at that property, no way would anyone buy a condo in that building. It just doesn't fit the mold. But people were speculating. So, they were buying 4 and 5 of these and holding them for a couple of months, and selling them again.

So, the bottom line in that '08-'09 recession was the banks drank the Kool-Aid as well. So, usually what happens is lenders hold the line on lending criteria, right? They don't like to lend and situations with a debt service coverage is below 1.0. They just typically haven't like to do that. But they made those exceptions in '07, '08, '09. And they did it because they felt the need to be competitive. Now, compare that to now. I mean, deals that we're looking at, lenders are holding the line under debt service coverage ratios, which is critical. So, they're keeping everyone honest. They don't care what you pay but they're only going to land acts on the property. The way it is now, they know there's an upside, but they're not going to drink that Kool-Aid like they did back in '08 and '09. If you want to pay up, you have to use your own money to do that. And so, that's the safety net that's in place right now.

There are there's a lot of money chasing deals in Florida, but there is true upside in these deals, number 1. Number 2, the lenders are holding the line so the people just don't do ridiculous things. So, I don't think it's the same at all. Now, remember I talked about the demand-supply thing. If one of those two things were to break down. I might feel a little differently. I mean, just think the demand side in Florida has not stopped for decades, and I don't see that breaking down and they're not able to build B and C Class Asset. So, I'm looking for a demand-supply issue to cause some concern for me. I don't see that happening and I'm looking for lenders to do silly things and they're not. They're getting aggressive but they're not doing ridiculous. Things like they did back then.

Dan: Yeah, I've even seen them cool their Jets a little bit in the last year. Well, obviously, since COVID, they cooled their Jets significantly. Maybe that was a good pumping of the brakes for the banking industry perhaps, I don't know. But I do remember that post-recession '08-'09. I remember you couldn't get credit. All the banks pulled the construction loan. The construction jobs literally stop mid-job. So, we had this credit crisis that actually occurred to freeze it up. Millennials and the Baby Boomers were at this weird specific age, where the Baby Boomers were done buying houses, done buying the first time, and the Millennials were still in college, like the front end of these two demographic waves. We had like a lull in demand that occurred '08, '09, '10 I guess.

And then, the other thing is, remember the ticking time bombs that were built into the loans. They started at teaser rate and then with the new licensing laws and consumer protections, like those booby-trapped loans are not sitting out there, so we don't have how many millions of loans. I mean, the only thing I think I probably worry about, Ken, is I think I saw a statistic, if I'm remembering the statistic correctly, in like 2010, when we had the highest number of foreclosures. I think it was like 2.8 million throughout the US, and I think there's like 1.3 was either the average or what it was, right? Before we went into COVID. And then, I saw numbers of between 3 and 4 million loans that are in this forbearance program thing. So, we could see an influx of single-family inventory come on the market. Hopefully, it happens over the course of various legal processes and states throughout the country, happens faster and slower in a variety of areas. So, that may take a 3 or 4-year cycle to properties go into foreclosure and hopefully, being consumed by the demand that we are counting on to be in the market.

So, yeah, unique time. I don't know. I guess I don't have a hundred percent answer, but I'm not super worried. I'm also not super [inaudible] either which I think is the consensus among...

Ken: True, you're cautious.

Dan: Yeah.

Ken: Yeah, you're cautious as you should be, and you're specifically addressing the single-family market. It's not really happening like that in the single-family market. Very few people went into forbearance because quite honestly it was brutal to do it during covid.

Dan: Yeah.

Ken: I mean, you could but it was not fun. I know people who looked into it and they just said, "No way, we'll just write it out."

Dan: Yeah, got it. So what about interest rate risk going forward? What keeps you up at night? Maybe other risks that are not as obvious as to demand cooling, if the job claims suddenly were ratcheting much higher. What are the risks that you or anyone else considering investing in multifamily should be aware of?

Ken: Sure. So, ratcheting rate risk is a fair concern. We manage for that. We will buy rate caps. We'll do whatever we have to do to protect ourselves. One of the things that I didn't talk about that happened back in '08-'09 was debt maturities. Dent maturities that matured at the wrong time and the banks, even though that was a good cash-flowing asset and it was fine with good tenants and a good operator, they got foreclosed on anyway because their debt matured happened to be at the wrong time. So, we're always really, really careful to manage our debt maturities and to do our best to stay away from short-term stuff or make sure we have safety nets in place to protect against that. So, a rise in interest rates, when we look at our deals, we're using terminal cap rates that are higher than 3%. Obviously, we go 6 or 7%. We'll test it against that to see what the deal is going to look like.

Probably the biggest difficulty rate now in our business is really on the operation side, and that's the labor pool. That's our biggest challenge right now. I mean, we're paying considerably higher than we ever have for people and that's forcing us to get even more efficient. With our use of technology and things like that to try to be as efficient as we can. Operationally, that's a challenge. Everybody always talks about rising interest rates, but I would remind you that if rates go up, what happens to homeownership costs? They go up as well, which tends to drive more people into the multifamily market. That's generally what happens. Now, so, we're able to raise rents. We still draft off it. We don't want the cost of renting to be higher than the single-family home cost. That doesn't make sense. But we know that rising interest rates push more people into the multifamily, and we also know that the people, the generation below us, they like to be mobile. They don't want to carry around a lot of baggage. They don't want to spend Saturday afternoon mowing the lawn, things like that. They want to be in a maintenance-free kind of environment that multifamily provides for them, plus some of the multifamily properties out there. They're so darn nice. They look like resorts.

And so, they would much rather be in that situation rather than mowing their own lawn and not having a swimming pool and a beautiful outdoor grill and so on and so forth.

Dan: Yeah, I guess you're right. I really thought of the apartment space like that. I pay a freaking multiple for this condo that I live in, which has to pull out there. We travel for a week, 2 weeks. I'm not worried about breaking, like when my neighbor down the hall is going to break into our... you know what I mean? So, there's a lot of benefits there for being in this multifamily property, which is just like a condo that I prefer that to live in and maybe I'm the older end of the millennial. Just outside of the millennial generation. I think that trend is probably pretty strong and will continue to be.

So, I have a lot of guests, Ken, who are on the show and do things that are similar to you. One of the things that stands out as a trend lately, is this probably scaling up to another level and I'm curious what drove the transition from going from like syndicating, I guess, single deals or a small package to now doing a fund and then what is the progression of that scale for a company like yours or another company? Does it ultimately end up in the weak area where it becomes like another level of scale and access to capital and maybe some challenges along the way?

Ken: Yeah, so that's a really good question. Let me tell you my thoughts on that. First of all, we're making the switch. We've made the switch from the syndication model to the blind pool fund model, really out of necessity. So, Florida is a competitive market, right? Syndicators go find the deal then they go raise the money, but in order to find that deal, they have to convince the seller to accept that equity raise risk, right? So, sellers know that if they go under contract with a syndicator, there's that chance that they can't raise the money or something's going to happen and the deals going to fall through. Typically, syndicators are less experienced. Typically, syndicators have that right equity raise issue.

So, when we flip to the fund environment, things completely change. The funds are already raised. Now, we go to the seller. We generally stay in under 200 unit space. There are very few funds managers chasing around sub 200 units. Deals, they just are very few. That makes us the big fish in the pond. So, when a seller considers going under contract with us, they know. Well, first of all, you're blind pool funds. Obviously, you appear to be more experience than a typical syndicator. They certainly believe that the due diligence might be more efficient, because of that level of experience, and that whole equity raise risk is off the table. So, there's a lot of reasons for SR to go under contract with a fund manager. We did it for the sole purpose of being more competitive to get deals. It wasn't because I wanted to spend months going out and raising lots of money.

So, our first fund here, we're wrapping it up right now. It's going to be around 11-12 million bucks. It's a small fund, but it's a first-time fund. So, our growth prospect is going to be... Let me talk for a minute about why I say what I'm saying. The next fund, as soon as we deploy this capital, will go on to the next fund and the fund after that, and the fund after that. We're just continued to grow the size of the fund. It commensurates with our ability to grow out our infrastructure to support that. That's important because you don't want to grow to the point where your infrastructure can't support it. Now, you would talk about a REIT as an exit. I mean, REIT is a potential exit for anybody that is recontinued to accumulate units. We typically aren't a unit accumulator because our value-added model means that we're going to go in. We're going to add our value. We're going to leave some meat on the bone for the next guy, and then we're going to sell that property, move on, and then repeat the process.

If you think about the JOBS Act in 2012, which made it possible for us to even have this conversation about also raising funds in a public environment and fall into the SEC exemption. I think that this, I call it, Private Capital Market is going to continue to evolve and grow as a way that people have an alternative, right? They think of this as alternative investing and it kind of is, although it's becoming far more mainstream than it used to be. And so, I think that more and more people will look to this as a mainstream investment over doing REITs and things like that. So, that's my belief. I would be surprised if we went to a REIT structure as an exit. I think we'll just continue to grow our capital's size and therefore, the types of properties that we buy, the size of the properties that we buy, and so on and so forth. So, I think this has a long runway ahead of it in this Private Capital Market.

Dan: Yeah. I mean, a 15 to 20% return on a yearly basis is pretty freaking strong. I don't know if there are a ton of reach that are doing that. So, I guess, in my mind it's like, you build a company and grow it. You go public because you get this kind of ridiculous multiple. So, it's like, is there a the same opportunity for ridiculous multiple if somebody were, not that's your strategy, but could somebody compile their 3,800 unit as 4 different pools and do some kind of public offering, and then the investors benefit from like a windfall at this larger multiple at the public market level or is that just hogwash?

Ken: I don't know why they couldn't. We've not looked into that, right? That's pretty far down the road. 10-15 years from now, I believe they're going to look a lot different. So, for me to plan that exit right now is extremely premature. I mean, we're way too young for that.

Dan: Got it.

Ken: It doesn't make sense. I would really be able to comment on that. But if you think about what we do, when we exit, either we sell or we refinance. Get all the back and now people are earning money on nothing and they reinvested in the next deal. I mean, you're just talking about massive wealth creation. We didn't talk about why I'm here in real estate today, right? And not trying to figure out how to trade stocks and things like that. Real estate is generally valued on its ability to create cash flow, right? It just is. That's the way it's always been. And so, I'm able to affect that cash flow by raising rents and doing things like that. Because I'm able to increase the cash flow of the property, that means that I'm able to increase the value of the property far more predictably than I can't if I just put money in the stock market, right? And that's one of the reasons that I like it. That's one of the reasons that I think people should really have real estate as a significant part of their wealth-building plan because it's just so much more predictable than a stock. I mean, stocks are going up and down regularly. Based on what reason, I don't know, sometimes I have difficulty connecting a drop in the stock market to why. Why did this really happen? The company was the same yesterday as it was today. Why is it worth 10% less, right? Nothing has happened. That really is going to have that impact. You don't get that in the real estate world.

Dan: Yeah, it makes sense. Do you actually invest in any other asset classes or is it personally like exclusively the real estate deals?

Ken: Yeah. I mean, I have idle cash in some short-term investments and some stocks and things like that, but it is not how we create wealth for ourselves.

Dan: Got you.

Ken: Yeah, we're all in real estate.

Dan: I do too. And I guess that's the same thing. It's like, I can blow out all my stocks even if the market goes down 50%. If I needed to access the cash, but me selling my 7 and 10 unit buildings might be an arduous process, especially if the market got soft.

Ken: Right. But what's important is that we invest in our own fund. Obviously, we should. That's what any sponsor should do. Any fund manager should have his own skin in the game. So, we're all in on the real estate side. I mean, if real estate were to completely get destroyed and never come back. Well, then I would I would have a problem, but I don't know. I don't see that happening.

And go back to why. People need a place to live. We're not investing in office buildings. Were not investing in retail. We're not investing in warehouses. We're not investing in a triple net lease. I mean, you've got to find some reason to convince me that people don't need to place to live anymore.

Dan: Yeah. It's a tough one.

Ken: So, that's why we're there. And if I can eke out 15%, 20%, 30% annual returns with an asset that I can't figure out how to make it go away, I like that. Why wouldn't I want to be all-in on that? See that's how I look at it.

Dan: Yeah, I think it's smart. So, as you scale funds, I'm going to assume we have high-net-worth individuals, doctors, lawyers, people who have some cash on the sidelines, or probably some portion of it, maybe on the 12 million dollar fund, maybe on future funds, who are the additional players that would be participating at perhaps higher capital levels, if any, as you grow?

Ken: Now, the typical next level for us as we continue to work with wealth management firms who want to put their clients in it, family offices, heavily invest in real estate, because their goals are to protect the downside and just continue to protect the family wealth and grow income. So, that is typical. And then, of course, as you continue to grow the size, you're going to get institutional Investments and things like that. Again, that's a little ahead of our game right now. Because I think things change on a regular basis, I tend to be sort of short-term. My next plan is going to be to continue to grow our family office investment pool, our wealth management investment pool, as well as high-net-worth individuals. There are millions of them in this country and it seems like it would take a long time to exhaust that.

Dan: Yeah, that makes sense. What is the duration typically of the blind fun that you guys have? I mean, a number of deals, years, that kind of thing.

Ken: Yeah, good question. So, typically, we hold on to our value-add fund 3 to 5 years in asset. So, the fund itself is a 6-year fund with 3 1-year extensions. And the idea here is that we want to have time to liquidate the assets that are in the fund and then move on to the next one.

So, yeah, one of the things that are critical with a value-add investment fund is it's not our goal to build units. I'm not trying to get 10,000, 20,000, 30,000 units, right? That's not the goal for this fund. I mean, the future fund, it'll be a longer-term play. But one of the things that you learn when you're in our business and you talk to investors, they love to get in. That's the first happiest day of their life. The second happiest day of their life is when we write that big check and they're out because then they know the deal is gone full cycle. They can't get screwed up. I have cash in my bank. You cannot argue with, "Did I make money on this investment?" "Yes." Here's how much I made. There's no way that can change because it's a done deal, right? So, those are the two happiest days of investors' life. And so, we try to balance that against other funds that will have in the future, that will say, "Okay. No, the plan with this fund is maybe a 7 to 10-year hold, where we're going to get your money back after 4-5 years, and then continue to hold the asset for a while and let you earn money on. No investment at all. Nothing wrong with that. But again, what's important is that we communicate carefully the objective of the fund so that the investors have an expectation as to what we're going to do because I don't think that's fair to do it any other way.

Dan: Yeah, that makes sense. I'm blessed to make decent money, but that comes with a large tax bill at the end of the year. So, for me, some of it's like, I don't ever really want to have the big capital gain come down the pike with the stuff that I bought personally, small or real estate. And I've stayed away from the syndications for that reason just because it's like I did all the work to park the cash and I don't really want to have to pay the tax on that later on. That said, my mindset probably differs from a lot of people who are listening right now. Is there a tax strategy portion with your deal? Is it accelerated depreciation? Just a straight line? How do you approach that aspect?

Ken: Yeah, we'll do cost seg studies. I'm sure you've heard of those and acquisitions. So, that accelerates a lot of the depreciation. We have to be careful with that though because that can generate recapture when you sell. People don't necessarily always understand that. So, we want to be really careful with our investors so that they understand what that means. What's happening on the tax side, will people prefer to have capital gains over ordinary income? Yeah, right now, absolutely. The marginal rates are half. So, you can't beat that. Now, for someone who does want to be able to get their money back, continue to earn income on that next fund or a future fund, it might be a longer-term old fund. That would probably be more consistent with your tax objectives, right?

Dan: Longer-term.

Ken: Right. Other things that people do, they'll hold this stuff inside an IRA. There's some ubid[?] issues and debt-financed income there. You're still saving on taxes, but a lot of people invest in our fund through IRAs, which is a really good idea. Because IRAs are long-term by nature. Real estate is long-term by nature. So, you still get some tax benefits. You don't get a hundred percent of the tax benefits because of the debt that's involved in buying real estate, but you at least get a significant break on the sale, on those capital gains taxes.

Dan: Yeah, it's not bad. I mean, 15-20%. You're probably doubling your money every 5 years, maybe?

Ken: Yeah.

Dan: Yeah, cool. So, back now...

Ken: So, imagine if you're in our fund and you earned a 30% annual return. We just sold a deal in Orange City. We're in it for 2 years and a month. The annual return on investment was 38%.

Dan: Nice.

Ken: So, that's capital gains. Take 15 points off of that 20 points. You still did very, very well.

Dan: Yeah, you're not getting...

Ken: How many 18%, 20% after-tax returns are people earning?

Dan: Yeah, not many. The problem is now you set the bar super, super high. So, everyone's going to be disappointed from here on out.

Ken: We're going to continue to try to get close to that.

Dan: I like it.

Ken: We'll do our best.

Dan: So, Ken, how do you mitigate risk when it comes to turning over, doing this value-add, construction, improvements, things of that nature? How do you decide what to do? Is there some other strategy that you can highlight in that aspect?

Ken: Yeah, really good question. So, first of all, we're vertically integrated. That means we do everything ourselves because execution is really, really important. I can't tell you how many times I've watched people screw deals up at a great plan going in but they didn't execute it very well. So, we always execute our own plans. Now, we set our plan when we go under LOI. We revise that plan after due diligence. And then, we do something really weird. When we take possession of the asset, we sit on it for 30 or 60 days. Why? Because we want to learn about all the things the seller didn't tell us because you know they don't tell you everything. So, we revise at a final time then, and then, as we're going through the process, we're constantly asking ourselves. Is this still the right thing to do based on everything that we know today? So, we're constantly re-evaluating that plan. Now, the plan generally starts from the outside and works its way in. With our size properties, I love to create amenity packages and make them as nice as I can because think about how you would sell anything, right? Perspective runner shows up. You need to impress them, right? It's curb appeal. It's not a new concept, but we always want to make sure we focused on that. Believe it or not. A lot of people think, "Start on the inside," because that's where people live. They don't live outside. They live inside. So, let's focus on the inside, but I'll tell you why you don't want to do that.

So, if we start on the outside, we want to make sure the curb appeals good. Then, we get them into our Leasing Office, which has to be nice. And then, our tours always start with our amenity packages. And we like to be able to show off our pools, our nice pool furniture, our outdoor kitchen, our outdoor TV, our dog park, or whatever it is that we have. And what we try to do is we try to tell that story of you, your family. Imagine mom, dad, and the kids coming to the pool. Dad can cook lunch on the grill right there, kids can swim all day, mom and dad can take turns working out in the fitness center which is right there. Oh, and by the way, they don't have to miss the football game because it's on the outdoor TV, right? So, this is how people live in a well-amenitized property. And we can do this would B and C Class Assets. It's really not that hard. So, we focus on that.

Now, after we do that, we then take them to their unit. And now, our job is to just not let them down when we open the door, right? We manage the way it looks, obviously, all the way to their unit, and then inside the unit, we just need to make sure it's consistent with what we've done in the rest of the property. That's important. Now, compare that to somebody who works from the inside out. Think about how hard it is. When the outside doesn't look fantastic, the inside looks really, really cool inside that apartment, problem is what's between that prospect and that apartment and exterior, no curb appeal. All your money is behind a locked door. So, you want to be really, really careful doing that. Yes, residents live inside their units. And yes, they have to be nice but you have to make sure you can get them to the front door. If you put all your money behind that locked door, you might be in trouble. Just be really, really careful with that. I've seen people do it and it turns out to be a mess because they can never upgrade their resident base because that good resident, they'll drive up, they just keep right on going. And it turned into a no-show and the leasing agent doesn't understand why all these people stops. They don't show up for their scheduled appointments. They were there, most likely. They just kept right on going because it wasn't what they thought it should be, and you never even got to show them the beautiful granite countertops and everything else that you did inside that unit.

So, from a high level, that's our process, and that's why we do it that way. And it's so far served us very well.

Dan: Yeah, I think it's smart. I mean, I imagine I'm going out on a limb with the assumption that you could probably get $1,200 for a property that was updated 15 years ago and a building that had the nice amenity -- same apartment, granite counters, outside looks not that great and the insides like Stellar superb, far beats the other one that's not updated. Probably the same 1,200 or maybe even less, because they're so... the first impression, right?

Ken: Yeah.

Dan: Curb appeal. Yeah, smart.

Ken: No, it matters because you can't get that upgraded resident to the front door of that apartment if it doesn't look good, because as soon as they drive up, as soon as they turn in, whether they're doing it consciously or not, they're drawing their own conclusions about what living here is like. Also, remember, and they're not always thinking about this, but they have to invite their friends and their boyfriend and their girlfriend to the property and they don't want to be embarrassed, right? That's the way we look at it and we give them every reason to be able to impress their friends. "Wow. This place is really cool." Then they go inside, say, "Oh, wow. It's cool inside too." Right? That's what we want. That's what we're going for. It's all about selling.

Dan: Creating a full experience there. What would be the budget walking into an average deal? I mean, what do you expect? Spent quarter million?

Ken: It's all over the map. I mean, the Orange City deal, I think we spent three and a quarter or something like that. 350, I don't remember exactly. We did a deal in Jacksonville, we spent 850.

Dan: Okay.

Ken: So, it just depends on what's needed. What's really important though, if you're in our chair and you're doing what we do, is you're constantly evaluating what you're spending your money on and ask yourself that payback question, "If you're going to spend $1,000. Are you going to get more rent for it?" Now, if it's deferred maintenance and some things, you can't apply that logic. You just got to suck it up and do it. But what you want to do is constantly challenge yourself and make sure that if you do something, is it going to lead to higher rents? Because if you're going to make an investment, you need to get a return on it. And the way we get a return in our business is ancillary fees or higher rents or something like that.

Dan: Make sense. Before we get to a couple of wrap-up questions here, can I have a question about your CPA background history? I will caveat this one by saying that this does not necessarily have to be specific to real estate. But I want you to describe the most innovative tax strategy that you've seen executed in the past 24 months by anyone or even any corporation that you know or even read about.

Ken: Yes, that's a good question. I'm not a practicing CPA. So, I don't talk to a lot of external people about what they're doing. I mean, the 1031 exchange people do regularly, that's not extraordinary by any stretch. The cost segregation projects that are done, those are really important. I think there are some folks doing things out there with different types of trust and things like that to help shelter the income. That would be way above and beyond my paygrade to even talk about on this show, but I know there are some folks doing things like that. The thing I would caution people about, just be careful with your tax planning strategy and make sure you understand what it means long term. For example, the cost seg. I mean, I'm nothing wrong with cost seg studies, and we do them. They're going to give you huge depreciation deductions. Well, make sure the sponsor that you're working with didn't specially allocate all the depreciation to themselves because sometimes they do that because they're making the assumption that the investors are passive and they couldn't take it any way. So, be mindful of those kinds of things. I think that's important, right? We'll talk about that in a minute, but that some of the vetting the sponsor kind of things that I want people to pay attention to.

But think about, "Okay, what happens when they sell that asset?" And think that through, because it could generate recapture income. Recapture income means that that depreciation deduction that you took, they might be able to claw that back and charge you ordinary income rate for some of that. It just depends on how the depreciation is taken. I don't think there's a lot of really super creative things left in the real estate world other than what I've talked about, but I don't know how creative you need to be. When you think about it, you invest in a fund like ours, you're going to get a K1. That K1 is probably going to show a tax loss on it because of the depreciation that we take. You're not going to get paid tax when we do distributions. We're not going to send you a 5 grand and hold back $1,000 in withholding. It's not how it works. So, you're going to get that 5 grand. It'll reduce your capital, but it's not going to create a taxable event for you. So, now you're getting money out of an investment that when you look at your K1, depending on how you're going to handle it on your personal tax return, you have the ability to either take the loss or carry it forward to offset it against future income, but you got cash out of that. You got cash out of an investment that you didn't have to pay tax on.

Now, fast forward. You do that for years and years. Your tax basis goes down. And so, when that asset is sold, you're going to have capital gains tax. Think about that. You got cash out, reduce your basis, so you could pay tax on it later but at of capital gains rate, not the ordinary income rates, assuming no significant laws of change between now and then. So, I think there's already a lot of tax benefits built into the real estate world for lots of reasons. I think the politicians, probably almost all of them are in real estate so they probably get it and I don't see that changing in a huge way anytime soon. But go back to please don't make real estate investments solely for the tax benefit. Don't do that. You want your transaction to make sense economically first. And then, let the tax be the icing on the cake, right? Certainly, don't want to turn it away, but don't invest in things that lose money so you can get a tax benefit. Don't laugh. People used to do it. I don't subscribe to that theory obviously, but people sometimes, they let the tax tail wag the dog and I don't like to see people do that.

Dan: Yeah, it makes sense. Is it possible to 1031 out of the $200,000 investment that's made with KRI Partners when the time comes? Is that like...

Ken: Yeah, that's going to be nearly impossible. So, what would have to happen? And even with the syndicator. 1031, it's a like-kind exchange concept. And so, when you're in a syndication, when you're in a fund, you're owning an interest in an LLC or a limited partnership, right? So, that interest that you have is not the real estate directly.

Dan: Okay.

Ken: So, what would have to happen? Let's say you were in a syndication and there were 5 Partners in that syndication, that asset probably would have to be distributed up and all the partners would have to hold the asset directly, be on the deed, and when it sold, they could take a look at their share of the gain and a potentially 1031 into another asset of like-kind, right? Another piece of real estate. When we sell a property out of a syndication, the asset is sold, but you own the interest in the entity, you don't own the actual asset. So, tends to screw up 1031s.

Dan: Got it. That makes sense. So, what else do we need to know about vetting a partner before I send off money to syndicator fund, etc?

Ken: Well, a lot of things. First of all, I'll talk about my book here in a second, but probably the biggest thing that's happened recently in improving our ability to vet sponsors is a company called VeraVest. I don't know if you've ever heard of them. Relatively new company. They have some other businesses as well. They exist for the sole purpose of vetting sponsors like us. For example, we signed up with them, pay them a bunch of money and we had to send them 23 years of tax returns, settlement statements, operating agreements. They ran a full background check on me, did a criminal background check, check me out with the SEC and they're going to do that every year going forward. Every time we do a distribution or something like that, they're going to look at our operating agreement and make sure that we followed our operating agreement, right? They're monitoring what we do. So, it's big brother looking over our shoulder.

Remember I talked about this Private Capital Market having a huge runway in front of it? I think it is critical to have a company like VeraVest involved in this environment because the industry needs somebody looking over people's shoulders. So, now, when an investor signs up with me, I make sure they go to our page on the VeraVest site and they look at our track record. They see the buy, the sell, the dates. They recalculate the games. I mean, it's completely verified, right? So, we call it VeraVest Verified.

Now, I have no interest in the company, but here's why I bring it up. I bring it up because I prior to them existing, I can't figure out a really good way for the ordinary person to vet a sponsor. What ordinary person's going to look at 23 years of my tax returns or settlement statements? They're just not going to do it. I mean, it's a massive amount of work. So, the fact that they're here really, I think, reduces a lot of friction in this Private Capital Market. So, I'm thrilled that they're here. We signed up. It cost us a lot of money to do it, but I think it is so critical that if you're sitting in your chair or one of your listeners wants to invest with the sponsor that if they're VeraVest Verified, that should give them a lot of comforts that somebody's looking over their shoulders, and they're third party. They're not allowed in our deals, they can't. That would be an impairment of their independence. So, that is a huge deal that I think is critical and maybe there are other companies out there that do it. If they are, I don't know about them. But I think that's critical to the long-term health of this industry, and we're looking forward to a long relationship with them.

Dan: Yeah, that's decent. It seems the other ways of doing it or vetting the team, this and that. It's like, how do you vet the team? Let's do a couple of podcasts that they did. I mean, sitting on a couple of the earnings calls from prior investments is a very opaque underwriting method compared to anything else.

Ken: It's hard. It's very difficult. That's why I called it friction, right? Because people have this nagging. At least the investors we talked to, they're not sure how much should I ask. We'll even talk to investors and they're apologizing for the questions they ask and I don't ever want them to do that. They should ask me a million questions. We try to be super transparent and we are extremely transparent or we wouldn't have hired a company like VeraVest to really put us under the microscope. So, I think it's critical. I think investors have not had the ability to get access to this type of information that is more accurate, right? Because they couldn't do it before. So, I could put anything they want down on the piece of paper, throw it on the internet, and do you believe it? I don't know. Ken seems like a nice guy. Is he telling the truth? Now, you have an objective way to know that and I think that's huge.

Dan: Nice. All right, Ken. So, book recommendations. Do you want to mention your book and maybe one or two others that are out there?

Ken: Yeah, absolutely. So, my book, you gotta go to kripartners.com/ebook. It's free. So, the name of the book is "Multifamily Real Estate Is a Total Gamechanger!" I wrote the book myself. It is not long. It's 40 or 50 pages long. But I wanted to address 2 things that I find everybody facing. The first is they know people are making a ton of money in real estate, right? But they're just trying to figure out how they fit into it. I suspect a lot of your listeners are trying to figure that out. You said you do a lot of single-family. Is that right for them? Maybe they should be a duplex. Maybe they should do 10 units. Maybe they shouldn't be doing it themselves at all. Maybe they're a physician and they should invest passively. What kind of real estate should they get involved in? Should they be a triple-net lease? Should they be a warehouse? Should they be a single-tenant facility? What should they do? So, I take them through that process because it's a question that absolutely every single person that considers real estate faces. They're trying to figure out, how should they do this? How should they get involved? Because there's a lot of money there. They just don't know how to get involved and trying to figure it out.

Then, now, it's been my experience, most people should passively invest, because they've got legitimate really good full-time jobs, right? I've had physicians want to throw in the towel to come into real estate. I'm like, "Timeout. Don't do that. Are you kidding me? No, stop. It's not as funny as you think." But they should pass them invest. So, I think most people should passively invest. So, then, we get to that issue of vetting sponsors. So, in the second part of the book, I talk about how to vet your sponsors and I try to give them some really good insight as to how this business really works. What makes bouncers tick? What makes them do what they do? Why did they do the things that they do? Give them some things to look for that might be an indication that they're not maybe as investor-friendly as they should be. So, I go through that process and of course, I talked a little bit about VeraVest because I think it's an important part of the process. But that second part of the book helps them understand how to vet sponsors and I really reinforce the fact that you got to look for experience and don't be afraid to ask questions. And if it doesn't feel right, if it doesn't smell right, guess what? It's probably not. So, don't jump in. Don't just assume because the guy's on a podcast or on a YouTube video that he's legit, right? If it doesn't smell right, don't do it. You don't have to be sorry.

Dan: Nice.

Ken: So, other book recommendations. You know what? I read constantly. I mean, the list goes on and on. I mean I'm a huge fan of the Rich Dad, Poor Dad series, no question about that. I would recommend any reader read that. In terms of other recommendations, Grant Cardone has got a whole series of books on selling and really talking about the psychology of a buyer and what we do every day, it doesn't matter whether you're doing what you do or I do what I do, we're selling, right? We're selling to our kids, our family, our neighbors. So, any of those books would probably be good reads. I'm sure there's the 10x and all that stuff. All those books are irrelevant and it really is. It seems like it comes from a guy that started like I did, with really nothing, and it just takes a lot of grit to get it done on a lot of hard work and it seems like that's how he's grown up. So, it's fun to learn from people like that.

Dan: Yeah, for sure. So, Crown Jewel of Wisdom, Ken, if you could go back, let's say to 1997. Now, with everything you know now, 2021, what would you share with yourself '97 when you were getting started multifamily?

Ken: Yeah, good question. So I have this thought that I've developed. I don't know that it's my thought. I can't give credit because I'm not sure if I even need to but I believe that people are where they are because they have chosen to be there. Now, what I mean by that is, early on, I didn't know I could fly an airplane. All of a sudden, "Oh, my God. I learned how to fly an airplane." I didn't know I could learn how to scuba dive. "Oh, my God. I learned how to do that." And I didn't realize I could be a CPA, and now I'm a commercial lender. So, I started realizing, you can do whatever you want. You just got to go figure out how to make it happen. The very first apartment building, I remember the mortgage was $460,000 and I had to sign on it personally. See, I know, I remember this day vividly and I remember feeling what I thought was a golf ball in my throat. I pushed through it. It was really stressful.

Dan: Yeah.

Ken: All of a sudden, I realized, "Oh, my God. I now own an apartment building." And then, I sold it 3 years later, I made a hundred grand. "Holy crap. I made a hundred grand on the side. Are you kidding me?" So, that started making me realize, "Wait a minute. I'm limiting myself."

That is the number one thing I want people to think about is to stop limiting yourself because, you just got to figure out how, you can do these things. Don't think you can't, right? We just raised a 12 million dollar fund. There's no question in my mind that we'll be able to raise a 200 million dollar fund. It won't be tomorrow, but we'll definitely get there if that's what we want to do. We just have to figure out what needs to happen in order to make that happen. So, that's a number one piece of advice. You called it Jewel of Wisdom, I think. That's it. And I see people limit themselves every single day, and I preach this to my kids that you can do whatever you want. It's really, really fun once you figure out that you can do whatever you want. It's fun to actually make it happen.

Dan: Nice. Do you have some contact info, place where [crosstalk] more Ken Gee?

Ken: I do. Yeah, more Ken Gee. So, kripartners.com. You can always email me, kgee@kripartners.com. I don't know exactly when this will air, but we're wrapping up a fund right now. If you're interested in investing, give us a buzz right away because it might possibly still be open. Most likely, you'll at least get a chance to get to know us, put you on the waiting list for the next fund. You can also call us at 813-489-9666 and talk to our investor relations people and I try to talk to every single investor that comes on board. So, at some point, you'd have to talk to me anyway. And I would go back to kripartners.com/ebook. Take a look at this book. Get on our mailing list because then you can... I read a lot of blog stuff that we put out and my goal is to just teach people more and more about this business because it's a fun business and I don't know why anybody wouldn't want to be in it in some way shape or form.

Dan: Nice cool. Go check out the book. Go check out Ken Gee. Ken, I got a ton of value, a ton of notes here myself. Great episode. Thank you for coming on the show.

Ken: Thank you for having me. I really appreciate it.

Dan: Thank you for tuning in to The REI Diamond Show. Remember to review and subscribe on your podcasting app. Just search REI Diamonds and click subscribe. Interested in receiving the weekly big idea email where I provide the most valuable Jewel of Wisdom that I discovered during the recording of the most recent episode? Sign up now at reidiamonds.com. At that site, you can also access the 196 episode archive. Split by categories, easy to find what you're looking for. Again, that's reidiamonds.com.

So, in 2020, last year, my house-flipping business Diamond Equity Investments bought and sold 283 houses. And so far this year, we've done 218. So, we're growing. Well, they're mostly houses. A few were apartment buildings and we currently have a 147 more in our inventory. I share that to share this. Here are 3 ways that you and I can do business. 1) Are you interested in having access to the best real estate deals in your market? In other words access to deals you go buy at low enough price is to actually profit after renovating and reselling. If so, go now to accessrealestatedeals.com. 2) Accredited investors seeking double-digit returns can sign up for private mortgage investment opportunity emails at fundrehabdeals.com. That is how I fund our Diamond Equity Investments deals, and I do not do any other third-party funding from there. fundrehabdeals.com. And 3) Finally, I am always buying houses that I can flip and occupied apartment buildings with below market rents. So, if you have a deal that fits that description in either Atlanta, Chicago, or the Philadelphia region, please send me an email with the details.

We are at the conclusion, my friend. Next up, we have John Austinson. Joining us to discuss investing in franchise businesses. I'll catch you and John next time.

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