Speaker 1: Welcome to the REI Diamonds Show with Dan Breslin. Your source for real estate investment, jewels of wisdom.

Daniel Breslin: Jacob Vanderslice, welcome to the REI Diamond Show. How you doing today?

Jacob Vanderslice: Doing well, Daniel. Thanks for having us on. Excited to hear.

Daniel: Yeah, for sure. I appreciate you blocking out the distractions and taking the time to do it. So, Jacob, whereabouts are you recording from?

Jacob: I am recording from Denver, Colorado, just south of downtown. Yeah.

Daniel: Okay, nice. Yeah, I'm in Chicago. As listeners probably know. Figure maybe we'll start with the evolution or the reader's digest version. Maybe a little bit about who Jacob is, but then also VanWest and kind of how your personal career and your business model evolved to the point where they're at today in 2022.

Jacob: Certainly. Well, it's all been accidental and I guess unintentional to a degree like most things are. We started investing real estate full-time in about 2006, and we cut our teeth doing lots and lots of residential fix and flips. We did a bunch of rentals. We did buy, fix and sell deals. We did almost probably 1200 of them over a fairly long period. We really started in 06 and kind of kept going in that business until about we had some overlap, but kind of started to quiet it down in about 19 as deal flow constricted and returns kind of went down. So that's how we cut our teeth. Just buying residential homes at the auctions and fixing them up, making them better, and either running them out or selling them. We've also done a fair amount of multi-family adaptive reuse, retail, some for-sale townhome development, and we got in the storage business in 2015. And we looked at storage for a while, and we like the fact that it's historically downside protected.

It's got durable recurring revenue streams. It's scalable, repeatable, defensible. So we researched it for a while and we kind of jumped in head first on our first deal. We did a ground-up development project here in Denver, and then we did a few other development projects locally, and then we opened up the Milwaukee market starting in about 2016 just north of you. We did a handful of deals out there. And over time, I mentioned accidental earlier. Over time, I just kind of evolved to becoming our main line of business. The residential business is great. Fixed and Flips is a great business. But one of the things we didn't like about it is it was I guess overly transactional, meaning you're buying, selling over and over and over again. And to make money, you constantly have to be buying a deal, making it better than selling it. And we wanted to shift to a business that was more cash flow focused versus a quick reversion focused. And that's why we landed on storage. And through today, we've got 38 storage facilities, about 275 million in asset center management all over the country, Midwest, southeast, south, got some stuff in Denver, and we're buying more and we're building more.

Daniel: Let me peel back to the 1200 or so single-family transactions. Was that geographically concentrated in one market or several markets? That's big, right? That's kind of like a scaled operation that not everybody's going to get to that or even dream of getting to that size. And I think running into the deal flow and then your described transition into storage to have that monthly recurring revenue component, that's very difficult to get with single-family houses. You kind of get it on a small scale, but not like a $6 or $7 million storage facility at 200,000 square feet. You're going to get a little more out of that one location. It's easier to get that kind of scale to 38 deals versus, I don't know, 600 single-family houses to do the same thing.

Jacob: Right. So to answer the first part of your question, it was a variety of target markets. Obviously, most of our deals were in the Colorado front range between Fort Collins, down of Colorado Springs, and of course, Denver. We did a bunch of deals in Phoenix, Las Vegas Kansas City, did some stuff in Florida, did a fair amount in the Central Valley of California around Stockton, Merced, Fresno. Quite a few deals out there. And nobody knew what this market was going to do, and you can't constantly be beating yourself up over decisions that were made years ago. But had we held on to most of these or even more than we did, it would've been transformational. Nobody knew how much values would go up. Nobody could have quantified how this would've unfolded. So the majority of our deals, as far as volume were done in 13 and 14. And that was kind of the perfect storm of the market recovering, but also being a fair amount of arbitrage out there. A lot of our deals, I would say most of our deals, were sourced at the trustee sales, the foreclosure auctions.

Even though we were coming out of financial crisis, it was kind of years after, there were still quite a few foreclosures. And we would buy seven or eight deals a week, in some cases just in the Denver metro area. And another reason for our big volume in those years was that's when the institutional players started getting into the single-family rental space. And at the time, it was fairly bifurcated. A bunch of them were going at it at once, and we ended up cutting a JV structure with one of the earlier players to buy basically everything we could. Our buying box was wide, we had a minimum yield on cost target, basically, stabilize or cap rate target which was pretty easy to hit. So we would buy almost everything that would come up that fit in that pretty wide box. So those were fun years. But yeah, the single-family component, it's good cash flow. We still have a bunch of rentals around Denver. We love at SFR, but the evolution of that industry and that strategy just changed so much. There just wasn't much arbitrage left I think starting as early as 17 and 18. Deal-flow kind of dried up. We did a fair amount of direct-to-seller marketing. During that period when we were still doing single-family, we were getting into the storage business, and as I mentioned earlier, it was just kind of an evolution moving away from one asset class and getting more committed to another.

Daniel: So how many deals were closed? I don't know. The transition was 2019. Let's go back two years, not like the final year, just to get an idea of volume needed versus being at scale and the volume needed of storage to kind of replace and be more exciting than that single-family was maybe in like 2017 or 2016.

Jacob: Well, if you look at the last bigger year that we were operating, which was I would say 2019, the trustee sales and the auctions were gone. The MLS was inflated. You couldn't buy anything in the MLS that made sense. So we had an acquisitions team and all of our deal flow leading up to 19 and during 19 was direct-to-seller marketing, postcards, PPC, all that stuff. And we were spending, I forgot the numbers, but we were probably spending 40,000 a month in marketing. And if you're not getting a lot of deals, it just doesn't make sense anymore. Like if you get two deals a month that make $20,000 each, you break even, right? And that's 24 deals a year. And you might think 24 deals a year, that's a fair amount of volume and it's just not enough. And it was profitable, but just the whole dollars that the business was kicking out just started to make a little bit less sense. And maybe we just weren't good at it. There's a ton of operators that we still know, they're still actively in the space making money, doing volume these days and even after 2019. But maybe we just didn't concentrate on enough. We're mainly auction guys and weren't as good at the direct-to-seller marketing aspect, I guess. So that's why we shifted.

Daniel: Okay, and so was it like, I don't know, maybe it was 20, 30 deals in 2019 and it's like-

Jacob: Yeah, it was probably a bit more than that. It was probably closer to 40 or 50.

Daniel: Okay.

Jacob: And I think our biggest volume years ever, 13 and 14, we did collectively about 400.

Daniel: So those were the event sale?

Jacob: Yeah, that was the event. Yes, that's when the stars align with the availability of deal flow, but also a pretty strong retail home buyer market and increasing values.

Daniel: We're looking at 38 assets I think you had mentioned in 5, 6, 7, 8 years, or maybe you own them now. What is a good acquisition cycle year right now for VanWest Partners? How many deals or square feet does that look like?

Jacob: Yeah, we look at a number of deals to give you context in 2021, which I think if 13 and 14 were kind of the alignment of the stars with single-family, I think 21 was kind of the stars aligning with storage. There was still arbitrage. There were still discounted acquisition opportunities. They're still out there, but not like they used to be. So in 21, we bought 14 facilities totaling about $100 million in gross capitalization in a variety of different target markets. 2022, we closed on eight facilities, and those sold about $65 million in gross capitalization. 2023 so far, I can't believe it's already April. Time flies when you're having fun. It was a slow start to the year. We closed one $5 million acquisition at the end of February. But in the pipeline, we've got six value add acquisitions in either under contract to purchase or late-stage contract negotiations. And then we have a $25 million development project that we're closing on here in Denver in about two weeks, towards the end of April. So deal-flow is picked up. We're beginning to see evidence of some duress in the market, not just in storage, but in general. There's a wide bid-ask spread, I think in all asset classes between buyers and sellers. And what that's translating to is two things. It's reduced transaction activity just because sellers are not going to sell. But on the other side of the coin, deals that are trading are a little more, I don't want to say discounted, but they're more attractively priced than they might have been about a year ago.

Daniel: Interesting. I want to go in a couple of directions there. Before we do, I'm going to put my own cap on the observation of the transition that you guys made. So we are in the direct-to-seller space at Diamond Equity Investments. And we did what felt like an event year for us was 2021 also. So we had our interest rates and we had the COVID cycle occurring, and we did 355 transactions in 2023. In 2022, which in our business, being direct to seller, we have that bid-ask spread occur as the interest rates separate it when the market shifts. Same kind of deal happens and the sellers are way up. And the buyers who we might be arbitration or selling to or even as investors are going to be way down very quickly. So that was always a moment I feared since getting into business in 2006 because I lived it in 2008, 9, 10, and 11, the same kind of thing happened. I didn't know how to function and operate, right?

Jacob: Me too.

Daniel: Yeah, we did 324 deals I think in 22, which was down. It wasn't dramatically down.

Jacob: Not by much. Yeah, it's 25 less. That's not bad at all.

Daniel: Any income was almost the same exact number. We literally sold the same $58 million worth in transaction volume in both of those years. Within $60,000 of each other were our transaction sale prices. So we were happy to see that. And we're at like 80 for the year now. But as you describe that transactional nature, and it's like, am I going to do this for another 20, 30, or 40 years? Maybe my team counts on me and we have a really good thing going and like we're going to keep it up, but we're also at the same time building out some of the resources to figure out, I don't know if it's going to be like we're going to accidentally find ourselves into the next hopefully something like self-storage where we can also get more scale and some of that monthly recurring revenue and now there's like a benefit to long-term proper effective management of the assets, right? Doing the value add, increasing the cash flow, and maybe hanging onto them for the long term. So it's not quite as transactional as the 80 or so deals that we've actually cycled through so far this year. With all of that, right? We can leave that aside. But I guess the next question I'd love to pull apart would be what's the value add strategy for VanWest? Now, you've been in the business eight years or so. Is it going to be a long-term hold pretty much forever or is there going to be sort of the five to 10-year exit cycle like a lot of the funds and operators out there kind of have a business model of?

Jacob: Yeah. Well, let me make a comment before I answer your question. As it relates to creating value in real estate, you guys are doing a ton of volume obviously. And really, you're figuring out three things. One is you're figuring out what's it worth when I make it better, what's it going to cost to make it better, and then you back into what you can pay for it, right? And those three fundamentals, I think transcend asset classes. Whether it's a $25 million storage development or $100,000 fix and flip, I'm oversimplifying it, obviously. But those are the things you got to understand. What's it worth stabilized? What's it cost to get it there? And then what can you pay for it? And we applied a lot of our single-family knowledge and what we learned doing many transactions crawling through flooded basements, bidding at the auctions, dealing with evictions, hoarder houses, meth houses.

We learn real estate by being real estate operators. And we applied that to what we're doing now in the storage space. As far as how we create value in our storage facilities, in our whole period is all of us listening probably, now single-family does this to a degree, but commercial real estate trades on a multiple of the income stream it produces, right? Or a cap rate. So you're growing net operating income over time and you're arbitration cap rates. Cap rates have an inverse relationship between values, right? Higher the cap rate, the lower the value, and vice versa. So what you're doing is you're arbitration cap rates is you're targeting stabilizing your deal to an above-market yield on cost and then monetizing it at a market rate, yield on cost, or cap rate that's lower than your stabilized yield on cost. That's the game, right?

We're arbitration cap rates. So how do we grow NOI in our business? Well, it depends on the deal type. We're buying deals that are highly physically occupied. But with below-market rents in place and above-market expense loads, we're buying a lot of deals from fairly unsophisticated owners who maybe fell into the business but stopped with one or two deals and it's kind of their retirement. They just run it and enjoy the cash flow. So on a deal that's more heavily occupied to a degree almost like a multi-family project, we're bringing below-market customers up to market rates. We're layering ancillary revenue streams like tenant insurance, late fees, administrative fees, boxes and tape, truck rentals. And then we're normalizing and optimizing expense loads. And we can control certain expenses and other expenses we can't like property taxes.

And as we're growing revenue and controlling expenses, we're growing NOI, and at the same time, we're increasing the value of our asset base. On deals that are either development projects or early-stage lease-up acquisitions, we're still doing all those same things below market customers up to market rates, ancillary revenue streams. But our primary objective in our business plan in the first year or two of operations on a lower occupancy deal is purely physical occupancy growth. And that's leasing up units. Somebody paying something is better than nobody paying nothing in a storage unit or an apartment unit or anything for that matter. So those are really the two ways we create value and those all translate to just NOI growth. As far as our whole period goes, and when I was mentioning single family earlier, I was by no means knocking your business or that business, it's a business we had a lot of success in. We enjoyed.

The market made more sense. We might be doing that right now, at least in Denver, but it doesn't. As far as our whole periods go, one of the main regrets we have on many deals over the years is selling them too quickly and too often, right? And we designed our storage syndications and our storage funds to be longer-term holds, not perpetual holds, but longer-term. So on a development project, we'll generally underwrite a five-year hold. And on value at acquisitions, we'll underwrite hold periods anywhere between seven and 10 years. Now, depending on how you're executing on your strategy, we raise institutional and private capital. A lot of people don't want to be told, "Hey, if I invest in your fund, I'm going to be stuck forever." Right? So our primary objective beyond executing the business plan is within reason returning capital to investors as quickly as we can without a sale.

And the two ways you do that are excess cash flow and a refinance, simply replacing investor equity with bank debt. So even though we might be holding these for five, seven, or 10 years depending on the deal type, again, within reason, we're endeavoring to return capital as quickly as we can inside of that whole period through a variety of different liquidity events and mechanisms. And as you return capital, you're de-risking your partners, right? The less equity they have invested, if things take a turn for the worst, for the worst, rather, they've already gotten a big chunk of their principal back and sometimes all of it. So that's what we're underwriting too.

It's possible if we create scenarios in our portfolio where we can have a complete return of capital, that hold period could stretch out a little bit. The problem with selling, as you know, is you're paying taxes, right? You're either paying ordinary income or cap gains depending on how long you hold the asset for. The second issue is you're having a cash drag event, meaning you're getting a big chunk of cash back into your bank account and now you have to redeploy it.

You have to find a new round of risk and a new investment to put that money back to work in. If you're not selling often and quickly, you can keep accumulating and get capital back out of your asset base through refinances or excess cash flow and not be forced to sell. So I would say philosophically in general, we are laser-focused on cash flow, durable, recurring revenue streams, and growing net operating income. Let's say you're going to buy a multi-family building or a storage facility. You put together your model, you're going to do a five-year hold. And what valuation or you assuming you're going to sell that asset for in five years, right? You're making an educated guess. You have to make an assumption, your model. But whatever your assumption is, is wrong, right? It's going to be more or it's going to be less. Deals never ever go like the model does, right? They never match the model. But if you're focused on things you can control, like growing NOI and there's outside market forces with rents and expenses, of course. But we have a lot more control over NOI and top-line revenue. We have no control over interest rates and cap rates in five years. So our thesis, to sound flippant to a degree, grow revenue in NOI, operate your portfolio, execute your business plan, and everything else to a degree will kind of take care of itself.

Daniel: Yeah, I remember what feels like not so long ago. For me, I was broke at the end of that last market cycle. It was-

Jacob: Me too.

Daniel: It was a slog and a crawl back over broken glass to get back to where I'm blessed to be today, which is to have a couple of bucks in the bank, right?

Jacob: But think about what you learned. You never would've learned what you learned had you not gone through that, right?

Daniel: Yeah, you're right about that. We're looking at this development yesterday and this guy brought us a deal in Indianapolis and it's probably a $60 or $70 million development, 46 acres, I think. And I did some research on the guy. I do my due diligence on him and I figure out that he went belly up in the last go-around and one of the guys on my team who's only been in the real estate business just a few years now, he's "Oh my God. He's the guy who went bankrupt." I'd be suspicious if the guy didn't go bankrupt and he came. But where I was going with that before I went on the tangent there, Jacob is I sturdy Warren Buffett as I'm sure a lot of our listeners do and Charlie Munger and things like my favorite whole period is forever and the power of compounding. And one of the things I remember from reading, I don't remember if it was Warren Buffett's letters or The Snowball, the book or just somewhere along the way, but what he said was most investors don't factor in the, I'm probably paraphrasing terribly, but the cost impact of taxes on their investment. Most people don't recognize that. They're trading when they're buying in and out of assets, right? Maybe its stocks, maybe it's real estate, maybe it's single-family house is like my main business model. We're getting in and out, in and out, in and out. But we're doing this at like a 50% effective tax rate.

So we're having to stay on the treadmill and run really hard to stay ahead of the taxes. So when you do the math on the tax deteriorated investment, it's not 12%, 15%, 18%, even though maybe we bought the deal and then sold the deal in a year and a half and made this big pile of money and returned all the money to investors. I'm hesitant. Like I think it's great that investors on some of the deals that I've watched have made 65% ROI in 18 months, but I didn't invest in that deal and I'm glad I didn't because it's like, God, I would have to, like you said, put the money back to work, find another investment, the potential tax implications. I kind of would've liked that nice income stream to be paying out 10%, 11% for next five, 10, 15, 20 years. Let's do a couple of refis. And I don't know that every investor's going to have the same level of patience that one like me might be looking for in the market. I think the larger majority of the investors are probably looking for this liquidity event to occur at some point. I like the refis as much as the next guy, but the sale and the final, unless it's a market shift occurring and we're trying to get out ahead of something because self-storage is deteriorating as an asset class, whether he just built 200,000 square feet and there are 60,000 square foot class B storage unit, right? There's some existential risk we're getting out from in front of. But if it's just a matter of putting the ROI numbers in the investor report when the distributions go out, I kind of want to be in there for the long term. Am I fool or something?

Jacob: No, I think everything you said's valid. It really depends on the investor and I think the salt are your ones who have been in the game for a while, they also don't like selling. And this environment, obviously your refinance is tough to pull off, right? You're probably paying off cheap debt and borrowing at a much higher interest rate, but that's going to normalize at some point, right? It may not go back to where it was, but it's going to come back down to earth. And the beautiful thing about a refi when done responsibly and conservatively, of course, you talk about paying taxes on a sale. Well, if you create enough value, you can pull most or all of your equity back out tax-free and you're completely de-risked from a cash perspective. Your money's back, you're still getting depreciation and you're still getting distributions from operational cash flow. That personally is my definition of wealth.

My definition of wealth is an asset base that's responsibly financed, that is constantly paying you every single month, every quarter, and you're getting depreciation, you're not paying taxes or very little taxes on that cash flow. But some investors are driven by ROI. And I don't want to get too far in the weeds on IRR or internal rate of return, but it's briefly, IRR, it's a time-weighted return calculation based on a series of cash flows. And most of us listening probably know what it's. But IRR could become so distorted when sponsors and fund managers and operators are buying deals and then selling them quickly for a little bit of profit. But because of that minimal amount of elapsed time, the IRR is to the roof. Oh, we did a 40% IRR deal but we held it for nine months, right? The gross dollar profit that comes off of that is interesting, but it's not like a two or a two-and-a-half multiple. So we are not driven by IRR or driven by cash flow. We speak to IRR and we quantify it. But that's one of those metrics out there that I think can really distort the return profile and a risk profile of a given investment.

Daniel: Yeah, to think of how I used to look at those things four or five years ago when I first started to see the OMs, I think the institutional angle, the IRRs to private placement memorandums, my ability to underwrite those to figure out if they're interesting for me to invest has leapfrogged as I've actually had the capital of my own start to put in them. It becomes serious, right? It's not like, oh, yes, someday I'll invest in that. Let me go do a bunch of underwriting there. I'm in a blessed position because I run the podcast. I get to see OMs and have these conversations several times a week and I'm on everybody's email list. But I don't know that the average, LP, limited partner is going to get a chance to see quite so many of these deals come across their desk. Would you mind diving into how you guys raise your money and what may be the fund or the structure, the partnership sort of mindset looks like for VanWest if someone like myself, we're going to invest with you, Jacob?

Jacob: Yeah, certainly. It depends on the deal type. So we're on our third storage fund, fund three creative name. And our capital structure is fairly simple. We have an 8% accumulating preferred return and after pref is current, every distribution thereafter goes to return investor capital. So what that means is investors get 100% of our distributions until pref is current and until their capital account balance is completely returned. And then thereafter, we have three different classes of shares. So investors under 500,000 are 70, 30. Over 500,000 is 75, 25. And over a million is 80, 20. So it's fairly simple. The only distinction in the waterfall is just based on the size of the investor's capital account. There's a lot of ways to slice and dice waterfalls, as I know. I'm sure you see tons of these like you just mentioned. On our development deals, so our fund is only buying existing storage facilities.

We'll do some development within the fund, but only if it's an expansion where you might buy a 50,000-foot facility in say Georgia. There's excess acreage, you build another 25,000 feet next to it, you lease those units up. I don't really look at that as development though, because you're not buying raw land with no revenue. It's more of just an expansion opportunity. So we're not doing development in our fund. We are doing development, though. And our development projects are done in single-asset syndications. And as all of us know, but just to acknowledge briefly, a fund is generally a multi-property asset base and more of a strategy. Syndication is one deal, one LLC. Some investors like syndications more than funds because they want to wrap their arms around the actual asset a bit more versus just investing in a strategy. They want to invest in a specific deal.

They may not like North Carolina, but they like Arizona, for example. So our syndication waterfalls within our developments are a bit different kind of depending on the capital that we put into it, the equity we raised for it. We have a development project that we closed on in September that'll be done in August of this year. And that was a 10-prep return to capital 65, 35. And then we have a project we're closing on this month in Denver, which I mentioned a few minutes ago. That one has an IRR-tiered waterfall and that's a bit more of an institutional-style waterfall than kind of a retail investor waterfall. But this waterfall is a nine-pref. And then from 9% to 15%, it's 80, 20, 15% to 18% IRR is 70, 30, and over 18% is 60, 40 with no catch in between.

So that kind of gives you a flavor for structurally how we're putting together our deals. But our fund waterfall is locked and loaded. Obviously, it's a thumb. We're not going to change that. And our development deals will kind of vary based on the type of capital we're raising. As far as the type of investors that we target, it really runs the gamut. We've got horse jockeys, music producers, the typical doctors, doctors, and lawyers, we have entrepreneurs, we have ultra high-net-worth individuals, we have registered investment advisors, family, offices. We've done some institutional capital deals over the years. We haven't done much on that front within our funds. We're looking at kind of supercharging our capital raising that we really battened down on that in January of this year. So we are sourcing some institutional capital in the coming months and quarters for our strategy. But that's something we're being careful of because you become to a degree. If you don't structure right, you can end up working for them, to a degree versus being your own autonomous shop. That's something we're working on, but we have investors with 50,000 with us and we have investors with10 million with us. So it's all across the board.

Daniel: And the size of that fund that you guys are filling up right now?

Jacob: Our equity target is 150 million and we're very early on. We've deployed about 22 million of that so far. And again, funds and syndications are typically expressed in the amount of equity they're raising and not their gross capitalization. So 150 in equity could equate to 425 in deals. That's the size of our current fund.

Daniel: Yeah, it's a pretty substantially sized storage fund. You guys feel like you guys have the deal flow on the horizon to put all that to work?

Jacob: Probably not. Deal flow is very challenging right now. It's picked up like I mentioned a moment ago. But for example, before I make this comment, as we all know, we're coming out of this era of irrational exuberance, right? Everything worked, cap rates, compressing interest rates, money was flowing freely, and it could not be more different and it's probably going to get worse before it gets better. But what we saw in the last couple of years was a lot of deals, at least in our asset class, and I think multifamily to a degree also. A lot of deals that were getting purchased with what we believe to be unreasonable and untenable underwriting assumptions. So aggressive revenue growth, low exit cap rates, refinance assumptions that return capital and increased the IRR in a short amount of time. In 2022, we looked at 900 storage deals.

We fully financially modeled about 250 and we closed on eight. And had we had a limitless amount of capital last year, we still would've bought eight deals. And the scary thing is that most of those deals that we looked at, at least the ones that we financially modeled, they traded for pricing that was substantially higher than we could pay. In some cases, 30% more than what our offer was. And again, I think they were trading with assumptions where people were kind of lying to themselves, making assumptions that the revenue growth the industry saw during COVID is going to continue making assumptions that interest rates are not going to go up much more. That was very wrong. Of course, they've more than doubled. And also making the assumption that cap rates were going to remain or continue to be even more compressed. And none of those things are going to happen.

So I think there's going to be some duress. And as it relates to can we deploy that 150? We're not as concerned about getting to that target. We're more focused on only buying deals we love. And if we're seeing a deal we love, we're going to buy it. If we don't see a deal we love, we're not buying it. With that being said, I'm more optimistic than I was a few months ago with our deal flow kind of picking up. But as we talked about earlier, the model will tell you whatever you want it to, right? You can lower that exit cap by 50 bits and suddenly your IRR and your multiple sing and you convince yourself to buy a deal that maybe you shouldn't, we're not doing that. So we'll see. The stuff we have in the pipeline is more substantive than it was a few quarters ago. So we're going to definitely hack away at a chunk of that, but I think getting to 150 anytime in the foreseeable future is probably unlikely.

Daniel: Yeah, you touched on the irrational exuberance and it's like the market cycle, it probably goes back to like 2010. The market cycle that we're in and it was like you really didn't have to get the perfect deal because the circumstances with just the interest rates alone, not to mention the demographic wave of people from 25 years old today, all the way up to 40 years today. Everything is driving the home market, as we speak. Is driving every other real estate market as well. It has been the land of milk and honey when it comes to syndication.

Jacob: Yeah, [crosstalk].

Daniel: Saw in 10, 15 years.

Jacob: I'm sure you've seen the same. We've seen a lot of peers in the real estate space who are primarily fixing and flip shops and they transitioned to doing multi-family syndicating some years ago. And they're great marketers. They're just like you guys. I'm sure you have an amazing marketing bench depth and system to get all the off-market deals that all you guys do. I'm sure you probably wholesale some and retail others, maybe not. But generally, they're great marketers. So they'd rub together their first multi-family syndication, raise all the capital for it. And what we saw happen many times, which was not apparent at the time but in retrospect it was. So it's their first deal. They're late on construction, they've blown through their hard costs. They spend a lot more on the project than they thought they would. And in a normal environment, this could create a problem, right? Your hard costs have gone up too much. You're late, your interest carrier's going up.

Daniel: Yeah, [inaudible].

Jacob: Your interest carrier on a $50 million project is a big number, right? You're a couple of months late, that's a meaningful difference in your returns. But they were saved during this development period by rising rents and compressing cap rates. And those two things happening at the same time is like crack in real estate. If you increase your NOI a little bit and cap rates are still compressing, you've exponentially created more value with a small increase in NOI. And I think everyone read the tied up and that multifamily syndicator who did their first deal, they sold it in two years and they made a 40% IRR and whatever multiple. They did it again and it worked again, and it worked again. Well, now a lot of those folks who broke ground and are delivering multifamily projects now, self-storage for that matter too. They got floating rate loans, their interest rates have doubled, cap rates are going up, the rate of rent growth is slowing, if not going down depending on the market. And now it's a new reality. So we're going to see some pain and I think we're seeing evidence of that pain starting, but the rate of interest rate increases that we've seen and how fast this shift is, I don't think that that's working its way through to values in an obvious macro way yet. I think it's going to. I'm not saying there's going to be a big implosion. I don't know what's going to happen. I'm always wrong when I predict the future. But there's going to be a lot more pain than we're seeing right now.

Daniel: Yeah, I think you're right about that. We are in a supply-constrained market as far as deal flow goes. And I assume that's part of why a development looks attractive. Did you mention it was a $25 million single project or was that a few projects that you guys are-

Jacob: It's one. It's a big void.

Daniel: Tell me about that.

Jacob: Yeah, I'll answer that question. But as you probably know, there's been a lot more institutional capital that's entered the space in the last three to five years than there was historically. One of the reasons they stayed out of it. First of all, it was kind of an undiscovered country to a degree. But secondly, the transaction sizes were very small, right? These bigger shops, they want to put a lot of money to work. And if the average self-storage facility is whatever, $5 million, we're financing three, we bring two in equity. That's attractive to anybody who has to get a lot of equity out quickly. Well, values have gone up, project sizes have gone up and now the gross capitalization of storage facilities is much higher than it used to be, which has kind of caused more institutional activity because they can put more money out more quickly. In the storage business, a $25 million project on a single asset is pretty big. You're getting to that number like in LA, New York, Portland, Seattle, the big primary markets if you're doing in development. But in Denver, that's a pretty big basis. This deal specifically, it's in a submarket in Denver where the barriers to entry cannot be higher from an entitlement and zoning perspective and also from a hard cost perspective.

So it's about 1,150 units. It's five stories. I'm obviously biased here, but I think it'll be one of the highest-quality facilities in the state. Just great location, affluent submarket, low supply ratios. And I think when it comes time to monetize this, again, we model these for five years. It could be more, it could be less. But I think this deal would be rewarded from a valuation perspective by virtue of the fact it's so big and it's almost impossible to replicate. So that's why we're building there and that's, in general, why we're also building in other markets up and down the front range and we're looking at some other deals outside Colorado. But you might wonder why build right now, right? It's a frothy environment. Interest rates are up, cap rates are probably going to go up more. A thesis in building now is we have seen a plummet in new construction starts in self-storage.

And a couple of reasons for that. One is municipalities have pulled back on their zoning pretty substantially. They don't want storage. So it's hard to get deals entitled. And secondly, our cost remain elevated. They're much higher than they were a couple of years ago. We've seen some give and certain line items like steel's gone down a bit, but elevators and concrete, gone up. So it's still just generally the same price it would've been six months ago. And the third reason we think it makes sense too is it is more difficult than ever to obtain debt and equity financing for development projects and projects period. So I don't think a lot of starts are going to be happening in the near term for all the reasons I just described. And that's a good thing if you can build. And it's also a good story for retaining physical occupancy on your existing projects that you already own because the chances that someone's going to build near you anytime soon. Subjectively and objectively, I think are lower than they've ever been. So that's why we're building.

Daniel: Yeah, it makes sense. I have not done any out-of-the-ground new construction and I have some friends that do and I love the attractiveness of a brand-new site, an asset. And like we kind of mentioned earlier in our discussion, the never-sell philosophy, a lot of the property I own in my own portfolio is like 60, 70, 80-year-old residential property. It's old. It's like really old. And I'm constantly doing the repairs and the renovation and turnover and still, it's antiquated layouts and the whole thing. I've looked at some of the soft storage facilities out there and they function. A few of my friends have built some large new 200,000 square foot size facilities, probably similar to the caliber, maybe not, of what you guys are in the process of building now.

They're nice-looking buildings. If I had to leave my couches and my whatever, it goes in a storage unit, like man, it would feel good visiting the building. This is like a new retail. It feels like a self-storage mall or something like that. So having that asset come online in a year or two and then have let's say 20, 30, or 40 years worth of usable life. I imagine if I'm selling this large institutional-grade asset to someone in 10 years, it's going to have more value than if I were trying to sell a 25 or 30, or 40-year-old asset of the same square footage. Obviously, it costs more to build, but that newer vintage is going to have a level of desirability if and when it decides to trade at some point in the future.

Jacob: Agreed. Newer is always better, right?

Daniel: Yeah, what's the 10 by 10 rent for in the projections on that deal?

Jacob: Let's see here. And you must know the business to a degree because a 10 by 10 is always the example unit. You kind of do one of these when you're first looking at a deal because the math is easy and that's the most common unit size, right? 10 by 10. In our first, during our lease-up period, we show about a 20% discount from market in the first couple years of lease up just to fill up units. But we're showing stabilize per square foot of about $2 and 10 cents on 10 by 10s. And in the storage business, kind of like multi-family to a degree. You're optimizing your unit mix to get the most rent per square foot as possible and you're balancing rent per square foot against gross dollar rent. So let's say, for example, you have a 10 by 30. You might only be getting $1.50 a foot in rent on a 10 by 30, but your whole dollar rent on that unit is pretty high, right? And monthly whole dollars. And you might rent a five-by-five for $3 a foot versus $2.05 or $2.10 a foot. Your rent per foot on that's very high, but your whole dollar monthly revenue is much lower than a 10 by 10 at $2, for example.

So we're constantly tweaking our unit mixes as we underwrite and our revenue streams to kind of optimize extracting the most revenue out of a given building. And most of the time, we get it right, but sometimes we'll get it wrong. We have a deal in Milwaukee that we're selling next month and it was a deal that we bought at [inaudible] but we had some control over the unit mix and we thought the market wanted smaller unit sizes. And after about six months of operations, we realized the market wanted bigger units. So we ended up taking out the demising walls on a number of our units and converting those to 10 by 20s instead of 10 by 10s. And our revenue increased. Our rent per square foot went down, but we had more occupied units, so our whole dollar revenue actually went up. So that's the game is just optimizing that unit mix and having the correct number of 10 by 10s, five by 10s, 10 by 20s, lockers, and infill locations. I always get it wrong to a degree, but we're mostly right.

Daniel: Other than owning the building for a year and taking the phone calls coming in, is there any other way to try to figure out that unit mix? What are you guys looking at or discerning? What's the crystal ball on your $25 million development project as you guys are slicing and dicing the 1150 units that you guys are going to put in there?

Jacob: Yeah, on this development project, another example of barriers to entry, we've had this under contract for 17 months and we've spent $1.5 million in design and deposits before we've ever bought the land. So that's a pretty high-barrier entry, right? It's not easy to find a seller that's going to let you time up for that long and front that much cash before even closing the land. So we've had it for a long time. And during our diligence process when we initially went our contract on the land, we do a lot of academic research at our computers, but we also get in the field. We go into other leasing offices, we ask what they have available, we ask what their occupancies are. You'll get more information from some onsite managers than others. But it's a deep amount of research. And then it's as you're getting into the deal and doing your design work, it's tweaking that unit mix over time to be optimal. And you're optimizing the revenue stream, but you're also being cognizant of the hard costs, right? It's not a huge movement in the model, but the more small units you have, the more doors you put in. And doors are expensive and it's just something you think about. So a lot goes into it. But we're a unit mix that we feel pretty excited about.

Daniel: Nice. Before I get to my wrap-up, my final question is, you had mentioned depreciation. Is there any cost segregation, bonus depreciation, year-one kind of stuff for investors that get into either the fund or maybe somebody's syndication deals when you guys are funding them?

Jacob: Yeah, there is. Of course, during the development period, you're not depreciating anything. So you can't get that on year one while you're building. But once your asset is in service, you can do that. Generally, cost segregation and self-storage, they're appealing and they're attractive and they move the needle. But they don't move the needle as much as a cost sig does on a residential portfolio. And if you cost segregating the multi-family building with 100 units, you get 100 kitchens and sets of cabinets and appliances, and those items appreciate, obviously, fast. So you can really get a nice passive loss during doing that cost. In storage, it's not quite as substantial. We're depreciating overhead doors, security camera systems. We have two bathrooms in 1000 unit building versus 1000 unit apartment building. And we don't have a kitchen. We have a break area for employees, but they're attracted to do and they make sense to do, but they're not quite as substantial as the passive loss savings on a residential portfolio.

Daniel: Got you. So it's not going to be there. The home run like it might be any other asset classes.

Jacob: Yeah, still worth doing, though.

Daniel: Okay, cool. So wrapping up, one or two book recommendations that have made an impact on your mentality or career over the years, Jacob.

Jacob: So, I regrettably am not a great business book reader. I've read the main ones. I limit myself to mostly historic non-fiction, like biographies about leaders, past presidents. I'm a big revolutionary war buff, World War II buff. But the book that really I was so affected by it, I bought copies of it for the entire office and the office read it, and they thought it was awesome too. It's a book called In the Kingdom of Ice by Hamden Sides. And I've been on a few other podcasts that I've mentioned this book, and maybe I should figure out a new one dimension, but this one's just so good. It's a nonfiction account of early polar exploration. It was before Shackleton. So that's the famous one. Everybody knows about the Shackleton story. But these guys thought they could go over the north pole and all the ice would melt and then get over to Russia. And they figured out that they could not and obviously they got stuck in the ice and they walked down into Siberia, a bunch of them died. A bunch of guys walked 800 miles to a town, to try and bring help back, and they were called down by the time they got back. But the challenges they went through were so deep and so profound that it makes your real estate challenges relative. Like, you have a deal. It's not going well. You're whining about it. Well, at least, you weren't eating the leather off your shoes. Right? So that's a good one.

Daniel: It's on the list. That's a first. I appreciate it.

Jacob: Yeah, you'll blaze through it. It's gripping.

Daniel: Nice. So the crown jewel of wisdom, Jacob, if you could go back on everything now, 2023, to let's call it 2006 at the beginning of your career, what would you tell yourself then from all that you know now?

Jacob: Hold on to everything you can is what I would tell myself. Hold on. Just keep accumulating. I would say we've only in the last three or four years started becoming more disciplined on just powering through and holding. But the enticement of selling a deal and having a massive liquidity event is just that. It's very enticing. But we traded out as so many deals, especially in our single-family portfolio. We would push up values as high as we could. We'd sell them and make money. And those same deals today, you can't buy them distressed for less than 25% more of what we sold them for fixed up seven or eight years ago. So there's a time and a place to sell. It creates capital. It creates liquidity. It builds up your balance sheet. But I would've told myself to buy and hold everything I possibly can.

Daniel: Nice. What is the kindest thing anyone has ever done for you, Jacob?

Jacob: Gosh, that's a tough one to think of. There's been so many things over the years. I guess the easy response is my parents. They put me through college. They paid for me to get my pilot's license. They loaned me money that I never paid back when I crash and burn in my early 20s. They're just always there and always supportive. I have an amazing wife. We have two little boys that are four and three. Yeah, I'm lucky. I've had a lot of kindness stood on me over the years.

Daniel: Love it. If anyone wants to get some more information about VanWest or maybe reach out, how can listeners get some more information?

Jacob: Well, we always love to talk shop about real estate. Folks can email me, jacob@vanwestpartners.com. Go to our website, vanwestpartners.com or hit me on LinkedIn, Jacob Vanderslice.

Daniel: All right, cool. Hey, I enjoyed it. I appreciate you coming on the show, Jacob,

Jacob: Thanks so much for having us. I enjoyed it too, Daniel.

Speaker 1: Thank you for listening to this episode of the REI Diamonds Show with Dan Breslin. To receive email notifications of new weekly episodes, sign up at www.reidiamonds.com.

[END]