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

Dan Breslin: All right. Welcome to the REI. Diamonds Show. Doug, how are you today?

Doug Faron: Good. Thanks so much for having me.

Dan: Yeah, for sure. When the booking request came through, I was personally most excited about the operator, developer. You guys have a huge background, Shoreham Capital of very large projects. It seems like from all the research that I've done, I probably can't do as much justice on an introduction as you, so why don't I give you the floor, allow you to give an intro on kind of your career, [inaudible] capital and what the trajectory of you work guys investment strategy looks like today.

Doug: Sure. Perfect. Well, again, thanks for having me and happy to introduce myself and then tell you a little bit about Shoreham Capital. My name is Doug Feron and I've spent most of my career on the institutional investment side of the real estate business. I started my career in investment banking. I then went to work in corporate private equity for a number of years and then transitioned after business school to real estate private equity, working with a firm called the CIM group based out in Los Angeles. I spent about 10 years at CIM, had a really great experience and ultimately was a managing director on their investment team and running their East Coast investment practice. But I had shifted from corporate to real estate really looking at one book, being very interested in the asset class and also being interested in trying to do something entrepreneurial.

One day I felt that in real estate there was a much bigger opportunity for that than corporate private equity. So after about 10 years with CIM, I was doing some family events and otherwise decided it was the right time to take a look and looking for a seed to that thesis or a seed for that business. One of the areas I've been really interested in at the firm and we'd been working on a white paper on was single-family rental. I had been pursuing that and through a friend was introduced to one of my partners, Nick Zumas, who's a sizeable home builder in both New York and Florida. In meeting Nick, we sat down and had the opportunity to sort of flush out a business plan to shift a lot of his forward pipeline from for sale to for rent but along the backs of that, build a larger real estate developer operator investor that would do both traditional multi-family, both ground up and value add, alternatives like build to rent single-family rental senior student, and then also still have an allocation for special situations and the background I had of doing different asset classes, debt and equity, wherever the sort, the opportunistic opportunity is.

So that was sort of how Shoreham came together. Since inception which really started in the beginning of 2022, we're currently in construction on about 700 units mostly in Florida. We have a large multi-family project in Fort Myers. We're working with the Bridge Investment Group. We have a 175-home community in Orlando that we structured a forward sale that's attached three and four-bedroom homes. We're forward purchasing from a national home builder project in Naples. And then we're working on entitling some land sites. So across all that, it's about 700 units in construction, about 1200 units that we're currently entitling and contract on, and probably building sometime next year. And then we're pretty focused today a lot on existing assets as we've seen the trade from development move to existing assets. And today looking at a lot of traditional multifamily and townhome product that's currently built and operating and has value add opportunities, they're spending a lot of time there.

Dan: Tremendous number of projects. I lost count as I'm taking notes here of everything. Can you give us just an overarching broad number? Is there like an assets under management number, something of that nature that kind of puts the scale of Shoreham where it is for the listeners?

Doug: Sure. It's 700 units under construction and 1200 units in entitlement in preparation for construction. So they'll call about 2000 units that we expect to have in development or stabilized in the next two years and then working on a number of large existing assets. So I think the goal here would be to have somewhere between three and 5,000 units in operation in the 24 to 36-month timeframe.

Dan: It seems like it's off the charts from my perspective. I get to talk to a lot of operators and normally, we'll hear the operator has, let's say 300, 500, maybe they even just got the first 100 in or they have 2000 here. I am taken aback in shock right now myself because it's 2023, interest rates are high, inflation's through the roof, and yet you're setting out to build this portfolio of 2000 units in probably the worst development cycle in most of the people's listening real estate career, certainly since 2010, 2011, no one was building much of anything and building became much challenging in 2022 and 2023 because of the inflation and because of the interest rates. How the hell are you doing that, Doug?

Doug: Well, I mean, I think there's of two questions in there. I mean, the first piece and sort of thematically and from sort of a thesis perspective, I've always sort of I think being contrarian if you're smart and strategic about it can be well rewarded. So I think the fact that most people are shying away from development and construction now is precisely the reason that we're focused around it. I think we think of the projects we had and the ones we're talking about in instruction are all capitalized now. So those projects we have the debt and equity for, we're moving forward on. And what's great is we think we deliver into a moment when there's very little competition. I think the fact that it's very, very difficult to get financing now, it's very, very difficult to make sense of construction given the cost of capital, given nagging high construction costs.

So we have projects that we know are underwritten to high enough yields that they sort of survive the current environment both in terms of cost of capital and where exit cap rates have moved to. One of the projects we're working on is an opportunity zone deal. So again, that's a bet on the 10-year horizon of a location, not the one to three-year horizon location. Because what I'd say is we're watching the market and feel strongly that there are real headwinds and I think there's very likely or recessionary environment that we're walking into, we're not really focused on that, we're focused on the other side of that. So we think if we're sitting on the other side of that with this pipeline of new construction in what has been a housing shortage for a long time and it's only going to be exacerbated by the lack of deliveries, that we're going to be the product that people really need at the moment when there's no one else out there.

I mean, on the development construction side, that's why we've been so focused there. At the same time, for a long time, there was no real interest in existing assets and so these existing assets were two and three-cap and three and a half cap existing multifamily projects. For me, it was hard to imagine how buying at a two-and-a-half or three cap, you could really make a lot of money on that unless rates inverted and went negative. So that wasn't interesting to me. As you're starting to see, cap rates in the five and a half, six range, you're seeing prices in bases in the 150 to 200 per door range where they might have been 400 a door before, you're now 50% of replacement costs. And so we still like what we're building, but we're also seeing opportunities to pick up slightly older assets at a much lower basis that give you a cost advantage. We think that by complimenting all the development we're doing with some of these larger yielding existing assets, that help us weather the near-term recessionary storm and be there to deliver new product into that next environment.

Dan: What is the cost per door on one or two of these projects for context to build out of the ground right now?

Doug: I mean it really varies on construction type, right, and unit size? So we're building in Fort Meyers 700 square foot, sorry, 900 square foot average product, it's a more traditional apartments, one, two, and three bedroom. I think we'll end up in that project in the mid to high 200s door which frankly you couldn't replace right now. We were fortunate to buy a site that had a lot of existing infrastructure on the horizontal side done. So even though it looked like we might have been paying 20 a door, you were really paying almost nothing a door because all this horizontal work had already been put in place and infrastructure on the ground. On the single-family rental side, the construction cost on four-story block and plank is what we're building in Cape Coral is in and around the 200 per gross square foot on the hard cost side. On a comparative basis, the single-family rental product we're building, we're building for between 110 and 130 or 140 depending on where, what quality, what size per gross square foot.

So there's real cost advantage there, but you're often building these bigger boxes, so you're all in that, is still somewhere between like 250 and 350 a door, that's typically where we are. It can extend up if you're doing a higher-end product, but for what we're doing mostly it's in that sort of 250 to 350 a door all in.

Dan: Can you give me the idea of the yield to cost that you guys are underwriting? Let's say, I don’t know if it's year 1, when this thing or year 2, when it's stabilized, what percentage of a return on the investment are you guys going to get?

Doug: Sure. In today's environment, we're spending a lot of time looking at, I mean, what is the base rate, where is it moving and how much spread and cushion to that do we have? Because all this sort of cap rate is directly related to base rate. I would say that when we launched the business, we were seeing people develop to five, five and a half, and that was really scary to us. We were still avoiding that on the multifamily side and we like development of build to rent because you could still build to that six and a half, even six and three-quarters range just out of, I mean, sort of less folks in the space, cheaper cost to build, et cetera. So we've been pretty anchored to building to north of a six and a half.

Regardless, I think the recent increase in rates, it's only pushed that further. So I think today we're only developing to a seven on some new projects, we're looking at, maybe six and three quarters, maybe depending on where the location is, I think we're able to buy existing either at TCO or lease up product relatively newer in the, what we're trying to buy in the call it six range, six and a quarter five and three quarters to six and a quarter being on strength and location. But as cap rates continue to creep up, that five and three quarters to six and a quarter, probably now six, six and a half. So it's a moving target. I think we're triangulating between yield basis new product versus product. And when we're looking at existing, it's also yields can be somewhat fungible because if it's an operational upside or renovation upside, we're a little bit less focused on what are we buying it at. We're more focused on what is the untrended yield, which again, we want in that sort of mid-sixes range. And then we're picking locations that have growth.

So everyone's scared it's absolutely possible that we'll see flat to negative growth in a lot of markets over the next 12, 24 months potentially. But again, we're not looking at investments on the next 12 to 24 months. Everyone we're partnering with, the capital we're going in with is at a minimum 3, 4, 5, 7 years. And if it's a 3, 4 year group, they're comfortable holding for six, seven years. And so we're picking locations that, again, I can't tell you there won't be some negative headwinds in the next 12 months, but over the next five to seven years, we are highly convicted that you're going to see in excess of historical inflationary growth. So we're underwriting three, but our view and using the research tools we do, we're looking at north of 5% projected growth in a lot of these markets. So to us, you're getting an untrended yield in the six-and-a-half to seven range that puts you closer to eight by the time you exit. We feel very strongly that cap rates we think will stabilize somewhere in the mid-low to mid-fives range once the noise comes with rates coming up and eventually rates stabilizing.

Dan: Especially with the quality product that new construction would offer in an instance like that, what is the exit strategy for you guys? Is it a refinance to take out investors, or hold long-term? What do you guys do in the end here?

Doug: It can depend on a deal-by-deal basis. I mean, certainly, the opportunity zone up development, we're doing is a 10-year hold and we'll see thereafter. But I'd say on a typical project basis within the build-to-rent space, we do think there's a real opportunity to aggregate a large portfolio. And we think there's large investors that have great appetite for build-to-rent but don't have access to, nor the ability to roll up the 100 to 300 doors per property. So our view is we'd like to buy build those 100 to 300 unit properties, aggregate them together and that two to 4,000 unit portfolio and present them to the large pension fund, the foreign sovereign, and those groups that are the large endowment, the folks that want to be in this space but need someone to aggregate form. And we think there's a tremendous opportunity to do that. Are we still doing some deals on a one-off basis? Absolutely. And does each of these deals have to make sense on their own? For sure, but I do think there's an aggregation play within the space to be done.

Dan: Do you guys use third-party management or in-house?

Doug: To date, we're working with third-party managers. I think for us it's really a question of scale. I'm not sure if we would fully take it in-house, but we're currently interviewing and trying to bring on our own property management-focused personnel, and so they can interface directly with that third party. For now, whether we decide to build our own team or just have more folks directly overseeing these third parties to be determined, but we definitely want to have our own people and focus on the asset management of the deals we build and buy.

Dan: How are you guys dealing with the insurance challenges right now? I mean, we've gotten some of these renewals or non-renewals and it is shocking.

Doug: It's a very big topic and a very big topic, especially here in Florida. I actually had a lunch today on exactly that. I think there's a number of factors here that we have to take into account. There's been massive growth in insurance across the country and part of that is directly related to inflation. If you think about the fact that your replacement cost has gone up two, more than 2x for all of this property, it would make sense that all of these insurers, if they were insuring your house for 1 million and now it would take 2 million to rebuild it, they're going to have to make you pay more because now you have 2 million of coverage instead of one. So that's one piece of the puzzle. In Florida, you have some other complicating factors. You have some recent large storms like Ian last year. You have some unfortunate needed tort reform relative to some legislation that allowed for roofers and some law firms to conspire to create claims against roofs that really may have not been storm-related. That caused a big issue for a lot of insurers. And then nationally you have a lot of large recent claims.

So all of this put great screen in the system. Some of those Florida-specific things drove insurers and providers out of the market completely. And so today you're looking at less providers in the market with limited capacity, and so they're only going to put out a certain amount of capacity in this market. The unfortunate outcome of that is that it really doesn't even matter where you are in the state. If you are placing a policy in the state of Florida, you are going to pay a big premium. Now the good news is that is sort of a through-the-end-of-the-year problem. This market sort of refreshes in January and at the curtain rate the profitability, you're seeing new entrants come into the market. So it's our view that you should see a stabilization or perhaps even some relief into next year, as knock on wood, assuming there's no major claim events where the reinsurance market should straighten itself out, insurers should be there. And then bear in mind as interest rates rise, these insurers are getting much higher yield from their assets on their books. So there's a number of ways that they're able to make up for some of the larger losses they had. Hopefully, that should translate to at least stabilization, if not a little relief to the to the user. But time will tell.

Dan: This isn't the first time. I mean, I might be a younger guy with less experience in the insurance. I'm sure that these kind of problems happened back mid 2000s and that kind of thing and [inaudible] themselves out of the market forces, reach some sort of equilibrium somewhere in there. Doug, you had mentioned, go ahead.

Doug: No, I was going to say I was with a 30-year veteran today and he said, "If I can tell you one thing, it's that the insurance market always ebbs and flows, so it it should correct and at least in the near term."

Dan: Yeah, don't all mark it ebb and flow, it seems like. You had mentioned underwriting and building to like the six and cap originally. Now would the seven cap. Where does the adage in real estate or certainly for the asymmetric risk-seeking investors such as ourselves, is that the money is made on the buy? I've heard a lot of people say, well, you can't buy the land any cheaper. Maybe you can. The projects you guys pulled the trigger on, it was a cost basis in the land kind of a thing, or did you guys find operational efficiencies in the construction that are giving you this edge and this higher yield, or both or some other factor I'm aware of?

Doug: Sure. I think there's a couple of pieces there. I mean the land is a relatively small percentage typically of the total project cost. So to a certain extent, you've seen land come down 50% or more in certain instances. But it may or may not help because your cost of capital has risen four to five-fold. And your construction costs, especially in growth markets like Florida and the Southeast that are still delivering has been pretty stable. Maybe not skyrocketing the way it was, but has sort of have leveled off. So whether or not the land has gotten cheaper, it may not matter. Often also, like landowners have owned the land for a long time, so they just saw their land, they think is worth whatever it was 12 months ago. And if they're not getting that number, they're they sat on it for 40 years or a hundred years or 20 years and they'll sit on it again. So some of it's that I think there is some better flexibility in terms on deals where you can tie something up subject to getting a site plan approval or getting a site shovel ready and that disappeared in the heat of 21 and 22. And so it's nice to see sort of that reasonable level back, which is really better for buyer and seller. You get the land to the point where it can actually be utilized and if the buyer transacts, then they've made the sale. If they don't, there's the land seller, you're getting the benefit of that. So I think that normalization is important.

To your question how we're achieving those yields, my partner being a home builder and his business Nick, is really critical to what we're doing. So him being able to control costs, us being able to really be certain of hold period and construction period and materials costs, and really deliver to our numbers, I think that's the key to us to being able to continue to develop. Clearly, we bought a lot of this land very well, we think, but being very certain about construction costs, I think that's the difference between us being able to build and some other folks that are unable to do so. I think a lot of what we've put in construction, fortunately, we held to very high yields. It's a hard thing to find. Right now it's very difficult to find deals like that. And so we're spending a lot of time, you got to find that needle in the haystack where you're actually achieving that six and a half, seven yield on an untrended basis. And it's not getting easier in the current capital markets environment. Because we look at untrended leverage, so we're looking at the carrying cost of the land too, which has gone up as a result of cost of capital. But with the execution capability in-house, we think that helps a lot.

Dan: Can you describe maybe the needle that you found in a haystack sometime in the last six to nine months? Because the needles have gotten fewer and far in between. It seems like to me in 2023 for a lot of reasons, maybe, I don't even know what the reasons are, I don't know if it's, the location is primed, the land is flat, it's in a flood zone, it's not in a flood zone, I mean, what is it that makes the needle the needle in the haystack, Doug?

Doug: Well, I mean there's a lot of factors that make the needle needle and then all the things you talked about. Location is critical. I'd say we've always been very location-focused. And what I'd advise everyone is, especially in a market like this, you need to be laser-focused on best possible location. Because the first things to go south in an environment like this, or the secondary and tertiary, I don't mean markets, I just mean like secondary and tertiary locations to a product. So for build to rent for example, like we want to be in that 20 to 30 minute or less commute zone to employment centers, we want neighborhood retail not far, that 45 to an hour drive site that we sort of call edge of the orange grove in Florida, that's a sea of homes. Like that stuff worries me significantly.

And there are certain places that have the population growth support it, but if you're too far out there that's the stuff people can say, oh well rents have dropped. I can now afford the better house that's 20 minutes away from work rather than 40, I'm going to do that. And as much as we believe in the fundamentals of the sector-built rent, one of the advantages for the renter is it's a year lease. So when it's up and if they don't like the location, they can move. So hyper focus on location in an environment like this is really key. But I think it's staying very focused on all the fundamentals, not sacrificing, not stretching to get a deal done, finding those great locations and then being sure if you're buying it, you're buying it the right basis if you're building it, that you can develop it and execute on time and on budget.

Dan: You had described the deal closing subject to the site plan approval or the construction drawing approval, getting the site shovel ready, and you said we're getting back to that now in 2023, and we weren't there in '21 and '22. I have some friends who were selling product to the national home builders and there was that proverbial rich idiot who was stroking the check without the approvals who didn't know what he was doing. He probably got lucky on five deals, now he's caught on the sixth. If he exists, I don't know of a guy exactly like that, more of an avatar. When the money was loose in '21 and '22, there was a lot of foolish money that did go to settlement overbid for the land, took it as is and took all the entitlement risk upon themselves unnecessarily. So the business prior to 2021, it was kind of more the normal way of doing things would be, "Hey, our offer is going to be a million bucks, but we have to get it rezoned and we have to get it approved for hundred 10 units." Is that how the business operated before Doug, in your experience?

Doug: Yeah, I mean, what I would say is you're right. There was absolutely this environment where if you wanted land and especially marketed land that you were taking it as is, you were buying it in 90 days and you had none of that. I think it has served me well in my career to sort of stick to those same fundamentals wherever the market moves. So what happens when the market gets crazy like that is I don't get to buy a lot of land because I'm not willing to take entitlement risk. I'm not willing to go on a lam for stuff like that, and I'm just going to shift to either finding off-market deals, finding partnerships with landowners, with I'll work with you because they're taking so of the upside. I think you shift focus that way. I don't like eroding from some of those basics of why take that entitlement risk, why closing that deal before you know actually what you're getting?

Listen, a lot of people make money that way. I think it can be a high-risk, high-return strategy. I'm not faulting anyone for it. I just think what we've promised to our investors is good risk-adjusted return and solid fundamental real estate returns. And to me, that means putting yourself in a position to do very well when you get lucky, but always be in a position where you make a solid return on your investment. I think we're not trying to take those crazy risks. We're trying to be solid singles, doubles and triples, and the occasional home run is great.

Dan: Can you describe for me the timeline maybe on a real deal that you guys actually already went to settlement on, but was one of the subject to the site plan approval deals? I mean, are we talking six months? Is this a year? Is it a two-year kind of a deal? What is that in what state, what market would that be?

Doug: It really can vary, right? Because it depends at what status the land was when you were able to contract it. For example, we had one transaction in Orlando that we were buying from actually another home builder that was partially through the finalizing of the entitlement and the site plan and we were close site plan approval. So that was supposed to be a four, ended up being a six-month period between sort of contract and purchase because they were further along as we went. An instance we're working on now, the hope is that it's five to nine months depending on how quickly we can move on the entitlement and get our engineer to move and we don't really need the county to move and where we're working. In other instances, it might be 18 months because you have to first get your site plan designed and then bring it up and sort of get it through that process.

So it really does depend and the flexibility of your seller is going to determine whether you have the time you need. Our offer is the same. Listen, it doesn't matter where the land is today, we're unwilling to close until it's at that final site plan approval, until we know we can build what we can build, until we're as close as possible to shovel-ready. And listen, in some instances, sellers aren't willing to take it and we totally understand. But I think in most cases, especially a time like this, sellers are going to work with us because they know, I mean, we're spending real dollars to get there and what you have in real estate is your reputation. So I'm trying to stand behind every time we say we do what we say, we do it. And I think that gets people comfortable and we're happy to provide people with references. I think doing what you say in this business goes a long way with finding folks that are willing to partner with you even sort of as a seller and a buyer, that sort of partnership.

Dan: Are these deals usually done off market or are you able to get some of these approved when there are agents involved? What does that exact presentation look like when you are attempting to get a seller to agree on a subject-to-site plan approval type of deal?

Doug: Often these are off-market or somehow indirectly maybe there is a broker of sorts involved, but the broadly marketed process, especially like we talked about when the market's super hot, like '21 and '22, you're probably not getting a broadly marketed process subject to final site plan approval. However, there are instances where as the market is slowed, you might have a marketed land opportunity where you are able to negotiate those terms, especially if you educate the buyer that someone else may tell you that, but then when they figure out what actually has to happen, they're going to retrade you anyway. So I'd say more often than not, we're trying to do deals direct, we're trying to work directly with owners, but we're certainly willing and work all the time with brokers and working with their sellers and trying to figure out how do we bridge the gap between what they're looking for from a value and a time perspective.

Dan: Usually, if the broker is there, at least in my experience, they know enough about the land to be dangerous to the deal in a sense. What I mean by that is they're sure the square foot price of the per acre price is the post-approval development value as they're listing the property and they kind of don't really want to hear the subject to the site plan approval. And they have no idea a lot of times what's involved in that, that five to eight month, nine-month, 18-month process. Most of the agents are completely unaware of that. So I would think trying to describe that deal through the agent whose nose just enough to be dangerous, who's then going to translate that to the seller is near impossible. As I say that, I guess my follow-up question is, are you insisting, if you were in that scenario where you have the broker who happened to be like family friend to the landowner or whatever the case is, is there some insistence of like, "Hey, can you guys come meet at the office, or can we meet in person?" Or is there a way where you're getting some direct face-to-face to be able to communicate and describe this and have that credibility with the seller, with the third-party broker involved?

Doug: I think in almost all instances in a deal with time like that, you'd want to sit with the seller because I think you want to sit down, look in the eye and explain what that process is going to look like so you don't have any sort of misconception and issues down the path. So I think in almost every case, the broker will eventually say, we're saying the broker, we'd really like to sit with the seller, we'd like to explain the process, we'd like to talk to them about what we're going to do. So we don't want there to be some misconception where they thought we'd be done in three months and we're actually done in 18 months. So I think having that sit down, looking people in the eye and talking through what you're going to do is very important.

I think brokers really varies, right? Sometimes it's like the family friends doesn't really understand the space. But as long as they're willing to listen, that can be helpful. In other instances, I've had brokers be incredibly helpful, again, really brokering the transaction, really explaining to the seller and being a lot of landowners sort of fall in love with their piece of land. And so you need someone sort of in the middle saying, "Well listen, this is where the market is, this is your offer. They said they do this and this is what works." So I think a broker can be a really helpful and important part of the transaction. Sometimes they can be a hindrance. So it's sort of navigating which version you have.

Dan: Yeah, and a lot of times, at least in my experience, the larger the deal, the better. Sometimes it is that there is a broker there to be a third party. At least if the expectations of the seller are beyond what the market price is today, that broker can be the objective third party versus how can I trust anything the buyer's telling me about well, the market is? He's obviously just trying to get a good price. Let me switch gears here for us and let's talk through investors. You guys will raise capital on a deal or maybe a fund, maybe you could share kind of the structure and the expectations that if I were going to invest with Shoreham Capital, what would I expect from you guys, Doug?

Doug: Sure. There's a couple of different ways that we interact with investors. We have a GP fund, which is primarily made up of high net worth or family offices, sort of not huge checks. These are helping us capitalize the GP portion of the transaction. And so those folks are getting diversity across all the deals we do. We bring them into every transaction and they're getting that first look. And for the larger investors in that vehicle, they're actually sharing a piece of the promote. So all of them are enjoying unpromoted returns, so actually better returns than the LP. Then some of the larger investors actually getting pro rata share in the promote so that it should generate very healthy returns for that class investor. They're going into discretionary funds. They're sort of trusting us to do the right types of deals, but they're also diversified across all the deals we do. And we've had some very good interest in appetite in that.

The second way we interact with investors is raising the actual LP for each transaction. So on that side, our typical transaction size is usually like 50 to 200 or even 250 million. So those LP equity checks are anywhere from 25 to 100. That typically ends up being large institutions. So real estate, private equity firms, large family offices sometimes directly with pensions or endowments. And so with that group, the GP fund is diversified across all of our deals. The LP investors are a deal-by-deal basis. So we're bringing them a transaction, we're showing them an underwriting, we're showing them our research, and we're saying we're looking for typically one party who will partner with us as our LP.

Dan: Interesting. I guess that cuts down on maybe reporting and a number of phone calls, but maybe you're doing that in exchange for very favorable terms to the LP. Fill me in on kind of the dynamics of the LP, the profit split with the GP and some of the thought process. I guess it would be a nightmare to raise $100 million from 50 and 250,000 investors.

Doug: Yeah. The reality is those types of investors, those smaller investors are really in our GP fund. For the LP checks, these are $100 million in one transaction. That transaction has to happen very quickly. So we think it would be very challenging to go out and raise $100 million from a hundred or even a hundred investors while trying to get something done timely. So we're going to the folks that can quickly write a 25, 50 or a hundred million dollars check. Fortunately, throughout my career, having lived on that side of the business, been in LP for a long time, I built relationships with a lot of other folks like that. And I also know what that group is looking for when they evaluate transactions. So we try and deliver a package that's very clean, underwrites the way I would've in my old job and having people appreciate some of the clarity and candor. And that's how we've been able to bring folks on board with us.

Dan: So you're doing a deal, I don’t know, it's a $200 million deal and you need $100 million. The GP fund I guess is acting as the manager of this project. So what would be the profit split or the preferred returns, maybe the LPs getting, and then what does the GP get out of a deal like that?

Doug: Sure. As you described, the $200 million transaction, you have $100 million equity check. We're typically doing 95 5 or 90 10. So the GP fund would participate either 5 million or 10 million depending on whether it's a 90 10 or 95 5. The partners of Shoreham are a large percentage of that GP fund or a sizable percentage of that GP fund, and then the GP investors are the balance. So the GP fund is the GP investor in every deal. We're large participants in that. And then the group that comes into the GP fund is in each of our transactions in that tranche. In terms of sort of promotes and splits, the GP investor, if they're a small investor, is getting the deal-level return. So they're not diluted by any promote structure, however the deal does they do which we think people find very favorable. And the larger investors are actually benefiting from some of the promote economics that we've negotiated with the LP. So for folks that can write larger checks, that becomes more interesting.

So in terms of deal hurdles, it really depends on the deals and the structure depends on duration. I think it varies widely, but typically, it's some sort of hurdle rates with a promote split above the hurdle, whether that's 6, 8, 10, 12, 15, and whether that's 20%, 30%, 40%, 50% really depends on the deal structure, risk profile. But I'd say the market tends to stabilize in similar places. So it's not like you talk to three different institutional investors and the waterfalls are that different. They're typically pretty similar.

Dan: I mean, when I hear most of the GPs, LPs that I know of, we're probably talking about deals in the five to $10 million range. Maybe it's a 10 or $15 million fund, and the splits are not 90 10 and they're not 95 5. But if you're doing the math on a $200 million deal and you took a 10% split on the GP, I mean, just simple numbers, I know it's not how it probably shakes out, but we're talking 20 million for the GP and then you're getting this one large investment check. What are some of the other benefits of having the business at that scale? I mean, a $200 million deal, Doug, what are some of the benefits that you're going to enjoy there that the $9 million project that I was talking about on my last episode, it's just not going to have these kind of benefits of scale? Can you give me a couple of examples of things of that nature?

Doug: Sure. No, I think it ends up being fairly simple. The challenges to doing larger deals, it's a curve. So once you get really large, then there's not as many people that can do them. But in sort of the bulk of like, let's call it the 75 to 150 million dollars transaction, it's a pretty crowded space because there's a lot of institutional investors that can write that check largely in the office, institutional investors. So for us, you have to really differentiate from being able to find a deal off-market, or find land off-market, or find an angle that makes you differentiated to really create the alpha you want on those deals. So that's the hardest. With smaller deals, if it's owned by a family, it's forgotten. That's like the nine 10 we saw, we got a $11 million deal yesterday and honestly really compelling, great basis, great location, would've loved to do it, but here comes the rub. We're a small team and it's a growing team, but it's the same amount of work to do a $12 million transaction as it is to do $150 million transaction.

I spent my career doing 100 to 300 million, I've spent a billion dollar transaction in my career, and so I'm very familiar with these larger transactions. Some of the pitfalls, the the third parties and groups you need to work with. And our team is pretty much all comes from institutional backgrounds. So we're all comfortable with deals of this size. It's much more efficient to be doing one $100 million deal rather than 10, $10 million deals. And both are great strategies. I have good friends that have done rollups of these smaller assets and there's amazing returns to be had. We try and less reps, but be very, very specific and laser-focused on the deals we do that are larger so that we can sort of produce those same risk-adjusted returns.

Dan: If we're going to be using a $200 million example to go another step further, could this be the new construction that's a 300-unit, 400, 500-unit kind of a project? And then is that going to take a longer period of time or some longer phased out? I mean, is that like, it takes the same amount of time on the front end, but is the execution a three-year versus a one-year, right? Is there a longer kind of burn on assembling and stabilizing that deal at all, or are they almost nearly the same in your experience?

Doug: It varies to a point. Like if you're building a single multifamily tower, and if that tower is 50, 75, 100, 150 units, it's pretty similar. If that tower is 50 units versus 400 units, you start to get into a real duration difference in the construction and complexity. And again, whether it's a high rise versus mid-rise versus a low rise, if it's single-family rental homes or built-to-rent community, there's a production timing for each home. Now you can scale. So you could bring in more of a larger sub base and try and instead of producing one home at a time, you're producing five homes or 10 homes at a time. So there is an ability to scale and sort of make up some of that timing, but you do hit a certain inflection point.

And then with a single property, one of the projects we're working on right now is a large land site where we are entitled for 850 homes. Now, I don't think we would deliver 850 homes at once. I think that'd be a very difficult absorption lease-up period. I think if you are cannibalizing yourself, so a project like that we would phase. So we'd intentionally probably do one, two or three phases on that project, which will naturally run it out. Then you have to just be careful about you have to take down the land all at once, but because again, the land is five to 10% of the total value, it's not so terrible to buy all of the land for 800 units, but then you just do the horizontal and the vertical on the first 250 or 300 and then do your next 200 and so on and so forth.

So it can add timing, it certainly can add complexity, but for us, the incremental, we'd prefer to do larger transactions. You listen two hundred's, very large I'd say, or more typically plus or minus a hundred in what we're looking to do. But we have the capability to do the larger transactions and we like the ability to scale up and really build scale on the market. So we're looking at a large transaction now in a part of the world. I spend a ton of time and, and we see this large asset, it's a great opportunity to plan a flag there, put our team on the ground there, and then be able to buy some smaller transactions at approximate.

Dan: What would be the expectations for the general partner fund investors? I mean, is that a 10, a 12%, 15% total return? Is it going to be held for a 10-year period? Is this like an indefinite hold? What are the kind of capital return projections on the GP fund?

Doug: The GP fund is targeted as a closed-end vehicle. And really as our first GP fund vehicle, we're really focused on returns and trying to produce outsize risk of different returns for investors. So we're telling folks our target is between a 16 and a 24% return. The reality is we're not looking at anything that's less than a 20 and we're looking in excess of 30% returns in deals we're doing. So because we're delivering a deal-level return to our investors, we're hoping that we're delivering north of a 20% return to our GP fund investors. The idea here is to show folks that sort of our strategy works plan a flag and the goal is to bring on investors who can grow with us and can sort of proselytize for us and tell more people about us because I think we're raising a small GP fund, the goal would be that our fund two will likely be significantly larger operator allocator fund because we sort of talked about in the beginning, not only do we do direct developing and operating, but have a great deal of relationships with other developers.

And I think in fund two, we'd love to be able to help some of those folks and partner and leverage some of the relationships experience they have. But today, the GP fund has had good reception amongst investors because we're promising and we're delivering. The projects, we're starting to transact on and there's one we're going to start selling shortly. Even in today's environment, we've been fortunate enough to structure pre-sale and it's compelling returns.

Dan: Are there any year 1 tax advantages for us high-earning real estate professionals? Do we get a good year 1k1 that knocks our tax basis down or what?

Doug: I mean, we are certainly looking to be efficient and where we can do cost segregation analysis or pass-through losses. All real estate funds aiming to be tax advantageous and create promote rather than just ordinary income. So we are, like many other real estate funds very focused on sort of passing through those savings to our investors.

Dan: What does that look like in year 1? Is that like a one-to-one for this year or no cost segregation, bonus depreciation taken? What does that usually?

Doug: No, I would want to look through our attorney before I quote you exactly, but I would tell you that we are focused on it and definitely going to pass through some of those statements to our investors.

Dan: Okay. Cool. I know we're getting a little late in the hour. If anyone were listening and wanted to try to get maybe the OM or next steps, is that something you would make available to listeners?

Doug: Yeah. I think for folks who are interested, happy to have them reach out and have a conversation. They've been sizable. Like our minimum has been over 500,000 per investor. So it's for those folks that can write those larger checks. We're happy to sit down and explain our strategy and would love to have folks on board.

Dan: Very interesting. You've had a very institutionalized path through the real estate investment career there. It's very interesting. I'm curious if there are any book recommendations that maybe mentors or partners have handed down to you that you felt were pivotal throughout your career.

Doug: It's a great question. I think I'm going to try and go more non-traditional, like real estate books. I think like I was given in college Rich Dad, Poor Dad, which I thought was interesting. I'm sure you've heard from other folks before. I think that reading The Art of War by Sun Tzu was pretty interesting and Machiavelli and understanding operational dynamics and incentives in some of those classic books are pretty interesting. Then there's something about some like the local books on some of the projects. I tend to like to read about the history of some of the areas we develop in. So there's some great books about Florida and Cape Coral and some of the areas that we've been in, that's sort of been interesting to understand history, which I think helps you as a developer sort of better situate what you're doing with some historical context into the market and with local municipality.

Dan: Do you know what that book was on Cape Coral?

Doug: I will follow up with you in email. I'm blanking the title, but I haven't on my bedside table. I know.

Dan: I appreciate that. There was one, who was it? It was Rockefeller's partner whose name?

Henry Flagler?

Doug: Flagler, yeah.

Dan: Yeah, Flagler did the east coast of Florida with the railroad. I think that he ran down there. And there's another guy whose name's escaped me, who did the West coast over here where I'm which I think would be the Cape Coral and Florida area.

Doug: Swamp Peddlers, that was an interesting deal about the development of Florida. So Swamp Peddlers and then the other one was Selling the Dream. Those two are very interesting.

Dan: I can't wait there. So the crown jewel wisdom, Doug, you could go back and share with yourself, just getting out of college early in your career. Now, in everything you know now, what would you go back and share with yourself?

Doug: I think that there's two sort of pieces of wisdom. I think thinking early on in your career as much as you can, sort of easy to throw up your hands and say, I don't know what I want to do. But trying to figure out what you enjoy and where you envision yourself going early in your career and sort of starting to take steps in that direction, I think is really important. Because I think once you firm up what your goal is, you can start to take the concrete steps to get there. If you don't know what you're doing, you don't start building that. I think people turn around 10 years into their career, decide they suddenly want to do something, and it's tougher to get back. I think the early steps in your career, it's easy to move towards your end goal.

I think the second piece, and especially in real estate, is real estate is such a relationship-oriented business. So I tell all the juniors that never eat breakfast, lunch or dinner alone. Just use the opportunity to have lunch with people at your firm, with counterparties, with brokers, with whoever you can gain wisdom from. You'll learn a lot from the experience, you'll build the other relationships with the people you're with, and it just grows your network. And I think especially the combination of understanding where you're trying to go and then grabbing lunch with those people, and not necessarily asking anyone for anything, just having lunch with them, learning about them, their trajectory, how they got where they are and learning about their view of the market, especially when you're younger, it allows you to start to form a view in the market via a bunch of smart people that's a little bit further along in their career. So grab lunch and dinner and breakfast with people when you can and start to think about where you want to go.

Dan: Yeah, that is great advice. I mean, it's like you're not trying to get them. Early on in my career, I had no money, right? So always my agenda was like, "Oh, can this guy fund my fix-and-flip deal?" A lot of them couldn't, and I probably should have been more curious about the path that they took. And like, for me, it's been a blessing to get to host this podcast because I'm now given that second chance, if you will, to figure out what the path was. And it's this random input of information that like snowflakes falling and accumulating over time on the path of your career to be curious about all that information because I didn't know the questions that I should have been asking or the information I should have paid attention to. So it's like to enjoy that random learning that can occur. And in the context of the breakfast lunches and dinners, I think that's a great, great tip there. Doug, what is the kindest thing anyone has ever done for you?

Doug: Kindest thing anyone's ever done for me? I think there's just been some great mentors throughout my career who've just given so much of their time to help develop my skillset, whether that was sort of modeling, negotiating just learning this business. Again, people taking those opportunities, like having lunch with me when I'm a young guy in my career and they have no reason to sit with me. So to me, I'm constantly trying to pay it forward, take the random email or phone call, grab a whether it's a Zoom or a coffee or lunch with people where I can and share what I can. I think you have to pay forward the sort of benefits that you had in the past. So I think it's a great gesture that just follow-up and people reach out and share what you can.

Dan: Fantastic. You had mentioned people reaching out. Where can listeners maybe reach out if they are ready to cut that 500,000 check, or maybe they just want to explore more about Shoreham Capital and Doug Faron and see what's out there about you? Where should they go to do that?

Doug: Shorehamcapital.com, our website has a ton of great information. It's got our contact info on there. It's got a bit more about the firm and has a lot of what we've been doing. So I would highly recommend people go there. Our emails are on there, so you can reach out to us or just the Shoreham Capital website and we'll get back to you. So I would encourage people to check out our website, see what we're doing, and if they're interested in investing, and reach out. I'm doug@shorehamcapital.com and happy to have a conversation and see if it'd be a fit.

Dan: All right. Sounds good. Well, we're at the top of our episode, Doug. I really appreciate you coming on the show. I had a blast.

Doug: Thanks so much. Great to be here. Thanks for having me.

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