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

Dan Breslin: Brandon Cobb, welcome back to the REI Diamond Show. How are you doing today?

Brandon Cobb: Hey, I'm back on the show, so I'm doing fantastic. Thanks for having me.

Dan: Nice. In preparation for today's episode, I'll reference that buyers can go back and check out your previous episode. The title was Nashville, Tennessee Real Estate Development, and that was in June of 2022. Rather than have you do the origination story and how you got to the place that you're at today, that's all on that original episode. But what we were talking about at the time, you were very excited about new construction. You guys had some projects going, and I believe we were in the papering engineering design phase of a land development deal. I don't remember how many lots it was 10, 20. It was not like a three-lot development, but you were essentially going to put the curbs in here. For the listeners, this is like the Nashville, Tennessee market, Tennessee market in general. You were talking about putting the curbs in and then selling off those pads, I think to individual builders or maybe the national builders. But maybe you could pick up where we left off last time and give us a report on maybe that early or those early development deals with the curbs and the build-ready pad sites went, Brandon.

Brandon: Yeah, it was one of the best deals that we did. It was funny. We accidentally got into doing land development. We originally wanted to build that deal. It was for 36 townhomes. We had the lot across the street that was slated for 34 single-family homes. All in all, it was about 70 homes total that it was slated for. We got a knock on the door while we were going to put the curbs and everything in. It was basically getting ready to be finished from a national builder and they said, "Hey, we want to buy this from you", and we're all ready to go vertical on these townhomes. We're like "No, it's not for sale. Sorry". They were persistent and like, "Well, what if we offered this for you?" We said, "It's for sale now". That's how we got into doing the finishing pads and selling them to builders. Those turned out fantastic. Since then, we've really doubled down on that specific strategy because it's been working really well. Any land that's slated for entry-level housing, first-time home buyers has just been really hot. We've been working with the LGI Homes, the Lennars, the D.R. Hortons to move entitled land or contract develop and sell land to them. We're still building houses, but if I'm being honest, with everything that's gone on with single-family houses and interest rates right now, that inventory has just not moved at the pace that the development has been. It's been a huge success. We've got probably 600, 700 units currently in the pipeline that we're either rezoning and titling or developing right now.

Dan: Nice. Can we go through play-by-play? 36 townhomes and the 34 single families. Which city was this?

Brandon: This was in a suburb right outside Nashville, probably 30, 40 minutes away called White Bluff, Tennessee.

Dan: Okay. Did you guys have sewer or were these septic lots?

Brandon: Everything we do is always sewer and septic, though I will say we're looking at one in Murphysboro that we're willing to do septic on just because everybody does septic in that market, you almost have to and every national builder's in there. But up to this point, we've only done density where we can put in the sewer, in the water.

Dan: You have sewers here, you got 70 townhouses. Did you guys buy that land outright in those instances? Were there two separate deals there?

Brandon: There were two separate deals. Two separate sellers, literally right next to each other. It was just in a really good spot close to downtown, access to city sewer and water, easy grating plan. It was super straightforward. Whenever you get these big blank lots like right in the middle of the city, you know you're in a good area. That was one of the things that attracted us most to it, was we had been there and had already done some builds in the area. We're very comfortable with it and we're like, "Yeah, let's do this".

Dan: How much did you think you were going to sell the townhomes in the early phase of your development? If you built these out, went vertical, and built those townhomes, what do you think you would've sold the first one for?

Brandon: We had them penciled at $250,000 per townhome originally, I want to say it was like $250,000, $265,000. The builder we sold it to, which was LGI Homes, they built it and sold it to one build-to-rent buyer, which was I think Avenue One was the one that they sold it to.

Dan: Do you know what they got per door on that?

Brandon: Yeah, it was a little under $300,000 per door. So it was in the $290,000s.

Dan: Okay. Did you know they were going to get that amount when you sold that to them? Was that like a question you asked?

Brandon: No. I did not think that they were going to get that amount. It was pretty surprising. I'm like, "Dang man, we could have gotten an extra $50,000 per house if we build". But now it was a great deal. It exceeded our IRR expectations and again, in this environment where it's getting a little bit harder to raise money, people are stepping back, they're being more conservative. It's a strategy that we stumbled into and now we've got a lot in the pipeline that are slated just for this right now. I've always thought that it's not my job to tell the market what it wants. It's job is to tell me what it wants. It's my job to give it to it.

Dan: What was the purchase price when you bought and maybe the size of the lot that you put the 36 townhouses on?

Brandon: I want to say that it was two, three acres. It wasn't huge. Townhomes are great because you can put density in it. It was only one road, it was like a little L and we just threw them up on each side and it wasn't like the slope was already there. It was the perfect site to do this development. Let's say we bought it for $500,000 and I want to say we put somewhere around $36,000 per pad into it. So bought it for $500,000 put $36,000 per pad into it and then we ended up selling it for $68,500 per pad, I want to say. Somewhere around there.

Dan: Okay. You delivered the finished pads to that builder then?

Brandon: Yes.

Dan: Okay, interesting. When they approached you to sell it, Brandon, were you already under construction for those pads or was it still in the paper approval stage and they were like, you need to build it out and then we'll close on it.

Brandon: It was already putting roads and curbs. Everything was slated. They could tell that there was something going on there and they came and knocked at our door.

Dan: Nice. Maybe it's like what? $30,000 per door profit, something like that? Or per pad, I guess I should say.

Brandon: Man, I wish I had a calculator right now. That's why I gave you the numbers. I don't know off the top of my head. It was a really good deal. I remember we were excited about it like, oh my God, we need to do more of this immediately. Immediately after we closed that deal, we're like, "Do you want the one across the street? Because We're about to do the same thing". They were like, "Yes we do". We go, "Well, let's do the same deal". We ended up getting more prepared for that one because It was single-family detached homes and not townhomes. Higher sell price for them, higher pad purchase price for us.

Dan: Nice. What year did you buy that land? Do you recall? It was '21? It must have been '22, right?

Brandon: We bought the land in Q1 of '21. I want to say. Not Q1, Q4 of '21. I think we bought it in December of 2021, that first one.

Dan: Okay. How long did it take you guys to get the approvals before you could put a shovel in the ground to start your construction?

Brandon: The better half of a year. It took us roughly a year for us to get all the approvals and everything in place on it. We had to jump through some hoops to get that one done.

Dan: Okay. Maybe we're talking Q1 of 2023 that the construction actually started?

Brandon: Let's see, we bought it in Q4 of 2021 and it took a while to get all the struggles in place. We started it in, I want to say the spring. Yeah, it was the spring of 2022 because we had to wait for the winter and everything to pass and it took us approximately one year for us to develop and sell those pads.

Dan: The year included the construction of the pads then?

Brandon: It took us about eight, nine months to buy it. We had to do all the due diligence periods. Eight, nine months, we closed on it in Q4 of 2021 after we did our due diligence, got everything passed and then it took us... we had to wait three or four months through the wintertime to get through the rainy season and stuff. Then we started actually developing it in Q2 of 2022 and then we sold it in Q2 of 2023. A full year to develop the pads and sell the pads.

Dan: Okay, that makes sense. Then the five or six or seven months while you're under contract, am I right in assuming that the approvals from the county and the city and everybody with your plan, all that took place while you were under contract?

Brandon: Yeah, we don't buy anything until we can build the value into the land and the approvals are in place and we've got all our bids in and we understand what the horizontal's going to cost.

Dan: Got you. That makes a lot of sense. The $500,000 doesn't feel as risky because when you first had $500,000, I'm like, man, $500,000 for three acres if I was just stroking the check.

Brandon: No. Number one, do not do with land is, do not buy anything until you've got all your approvals in place. You can go pull the grading permit from the city, everything's done, and you've got your final civil drawings approved and can be bid by all the contractors necessary to get a rough estimate of what it's going to cost.

Dan: Nice. So that's a true land development deal. Then if we circle back and the timelines and why I'm being so specific with the timelines, Brandon, is I'm really trying to paint for myself and the listeners. I'm trying to paint a picture of the various markets that we've been through from say 2020, 2021, 2022, 2023 now in December where we're at, because in my 15, 18 years, since 2006, being in the market and studying the market, going back let's say to probably the '70s, now that we've all looked back at the last super high-interest rate type of market and trying to just build some context of how volatile the market has been during this time period. If we went to 2021 and the interest rates were super low, I see in the comps and I know of people because they're calling me now trying to sell me their deals. They see my TV commercial, they're calling, "Dan, hey we got this such and such acre lot and we paid $2 million for it with no approvals, with nothing. With trees there and current zoning". In 2021, the market was so freaking hot, Brandon, that all over the country there were land deals getting purchased by people with a big checkbook. I don't know if it was willing ignorance of risk or the willingness to take on that kind of risk that they did with the entitlements not knowing what the next step was. But they certainly didn't do what you just described. We went on this deal, which a quarter for 2021 closing and a negotiation earlier in 2021 when the market was red hot. Congratulations. That was a phenomenal deal that you were able to put together with due diligence and approval to then get it closed at $500,000 and maybe $500,000 was a high price. What would you have paid for that land if the seller said it? Now, I don't care what the number is, but give me this number without the approvals. Was there a number or is there a number that pops to mind that you would pay for that same lot? Knowing what you know now, it's obvious, but back then, if you could transport yourself in time.

Brandon: Great question. I know that in that market, we definitely don't want to be over $20,000 per pad. If it's 36 homes is what we could go there, I know I would not want to be over whatever number that was. I know we got a really good deal if I'm in it at $10,000 or less per home on my approvals, our development costs rarely goes over $50,000 per pad. I know pads in that market are going for now $80,000 to $90,000. There's plenty of margin there for us to be able to do something and bring investors in, et cetera.

Dan: If we went to 2021 and it was in Q2 of 2021 and you were talking to the seller or the agent, was this one-off market or was this agent-listed property?

Brandon: Off-market. Most everything we do is off-market.

Dan: Let's say that seller said, "Brandon, I'm not waiting until Q4 to close. I want a 30-day closing". What price is that? And you're going to take all that approval risk on your plate. What number would you have put there?

Brandon: I would have to assume the value in place. Let's see. God, there's so many variables here. Now, we don't do anything unless we've got a contract from an end buyer, so we know exactly what our exit is before we buy it. We've got a contract in place with a builder at a per-pad price. Here, we didn't. For me to go and not have a builder lined up to buy it, which we didn't at the time, and I would not be able to get any of the approvals in place at all. Justify building 36 townhomes on it, that's a question mark. I were to say, Brandon, if you were to buy it as is right now, two and a half acres and number, what would you have paid for it to feel comfortable? Well, you could have only built two homes on it. Those pad prices are going for like $80,000, $90,000. You probably get a premium because you're getting a whole acre. I don't think I would've paid more than $190,000, $200,000 for it without any approvals in place to take all the risk of that because I know that I could at least build two homes on it and the deal was still penciled.

Dan: Yeah. That's coming from a place that you had already done new construction, ground up, paid for the lots, understood what it would cost to go vertical, and had some finger on the pulse of the market. The number I was thinking, I'm like, man, I wouldn't pay. I didn't check the comps, I don't know the numbers, all that. I'm like, man, $75,000, $80,000 times $500,000 with all the approval, $75,000 cash tops today, if I'm taking all the risk. That's probably too cheap. I'm out in left field with that number.

Brandon: Hey man, it can't hurt to ask, always ask. You don't know when they're going to say yes.

Dan: So let's dive through that same... it's been a year and a half, I believe. It was June 2022 when we last talked and you were excited and what happened is you had built new construction, but you had pre-sold the construction. One of your jewels of wisdom, if we shall call it, was don't pre-sell the property because the market went, I don't know, 5% or 10% higher. The cost went 5% or 10% higher. What normally was a good thing, most of the time before COVID, pre-selling new construction was great. You could get financing from the bank. It was a favorable situation to pre-sell completely units. And you're like, well you can't do that because the market's so volatile and the construction costs went nuts and the inflation crushed us as we did that. Where is your heart with the new construction now? Maybe you could talk about what has happened in that year and a half with going vertical, meaning the building of homes on the finished pads because you were really excited about that, I believe last time we talked and now you're at a different place. Would you mind elaborating on that?

Brandon: Yeah, so you've got a great memory. June 2022, so things have changed a lot since then. Back then, you're right, we had crazy construction costs and I was not pre-contracting anything because if you've pigeonholed yourself into an end price and then all of your costs continue to escalate on you, well that's just profit that's getting squeezed. Yeah, it didn't make sense for us to contract or pre-contract anything back then. Today, different story, you've seen supply chain issues, ease, you've seen costs come back down. Lumber's not as crazy volatile as it was back then. It's funny just to see like a 25-year lumber chart and watch it go completely vertical and just bounce back in the 2020, 2021 and I think late 2022 phases. Now, I'm okay with pre-contracting. We've got 10 townhomes that we're looking at building and it's right behind some of the stuff that we already talked about. Similar area. I'm already talking with the build-to-rent fund that bought the 36 townhomes and I'm like, "Hey, you want to buy 10 more? So we're fine to pre-contract out because we feel like the construction costs have leveled out and they're a lot more stable and we're not seeing the same supply chain issues that we had. Still a little bit of supply chain issues, but not near what it was.

Dan: If you were going to allocate your business and maybe we talked about going vertical and new construction and that's some percentage of your business in the future going forward. Then we also talked about doing the horizontal construction and we would say to include in that category, the curbs, the utilities were delivering finished pads. Then one thing I think we might've alluded to a little bit was maybe you are selling a project without actually doing the construction to another builder or developer who's going to do the horizontal construction. Maybe that's a third percentage of your business going forward. Are there any other categories of the business going forward that I missed in those three? We either have paper lots or we have horizontal construction and then we have vertical construction. Are there any other categories that you would see in your own business going forward? Or are those three pretty much make it up?

Brandon: Those three pretty much make it up. We do some one-off deals and some other syndications. I'm a limited partner in a lot of apartment complexes. I like the depreciation. We're looking at some really good commercial deals that are seller-financed. But those are few and far between. We're mostly doing those three that you just named.

Dan: Okay. What percentages, in an ideal world, you wave your magic wand and you can allocate percentages of the business in what you think is maybe lowest risk versus maximum profitability versus maybe the lowest drag on your time or other considerations. What do you think the percentages would allocate if you had that ability in the future for those three categories in your business going forward?

Brandon: Yeah, so here's how we're adjusting. When we last spoke, 80% was vertical construction and 20% was developing and selling the finished lots. Right now, in this day right now, because of what's happened with interest rates and everything else and allocation, I would love to get where we're 40% to 50% entitling land and just selling the land because that's the lowest risk. You don't have a lot of capital tied up. Your risk is putting it under contract spending $40,000 or $50,000 on civil fees and your deal not working, you're not being able to find a buyer for it. That offers the least risk. There's huge returns for the right parcels of land where you can take it from a couple of homes to a hundred homes. There's a ton of value you can add there. Right now, that offers the highest upside with the least amount of risk. I would add that another 30% would be developing the pads and selling them with an in contract already in place by the builder with 8% to 10% deposit release towards the development. Right now we're getting ready to do about 74 pads for a builder, I think our exit on that's like $6.7 million total. I want a $670,000 deposit released to me and they can get a deeded of trust and have a second position behind our investor base and the loans that we put on it. Doing those deals where we already have an [inaudible] lined up for the lots with a significant deposit, with a lot of value add there, I'd like that to be at least 20%, 25%, probably 30% of the business. Then really where we're changing things as we were at 80% on our vertical builds and we're probably going to be scaling that down to about 20% as far as transactional volume goes. I mentioned on this, we're really wanting to get some of our vertical builds to pencil for build-to-rent and if that's the case, then I would look at adjusting that going forward and probably increasing it. Because the transactional volume is so great with the developed pads in the land right now, we don't see any need to increase a longer transactional timeline to get cash into the business. We're good there. If we do do any vertical, it's going to be more build to rent. How do we hang on to this long-term? How do we create cash flow? How do we recapture some depreciation and offset some of our transactional business?

Dan: Is the push, the willingness even to keep 20% of the vertical build, like to go from in a year and a half, 80%, 20%. 80% vertical, 20% all this other stuff for that to have completely flipped and shifted, it would beg the question of, well why bother with any vertical building at all if that's highly risky? That's where I've gotten in any jams. Is that motivated by building high-quality assets and capturing the depreciation because that's like a tax offset mechanism to the other more profitable components of the business? Or there are other motivations that you and your partners have for wanting to even hang on to 20% of the vertical?

Brandon: Really, it boils down to land that we're already sitting on, that is in our backyard. We've built in that area and we've adjusted the product to the market. We were building homes that were in this particular pocket where one of the deals then it's a 10 build, it was $600,000, $700,000 homes, semi-custom, Guccied out, really, really nice downtown views, rooftop decks, lights underneath the stairs, waterfall countertops. I'm like, "Dude, I want to live in this. This is awesome". Really high price point, that really got crushed with the whole rise in interest rates. If I can build a $500,000 home in that same area, cookie cutter over and over again, and get my costs from $179 a foot down to $130 a foot and be at a price point where there's less than two months of inventory and stuff's moving, I'm okay doing that. Because the ROI for me compared to the risk and the effort involved is still really, really low compared to if I just sold 10 lots. We're more motivated to build if it's like a 10-lot deal that's not very big, I don't really want to sell that because there's not a lot of cash that it's going to generate. It's just not a big deal. Versus we're doing 30 to 200 unit developments right now where we're entitling it and getting zoning approval on it. Selling the land, selling the lots. It becomes a lot more interesting when you have that kind of volume that's associated with the land. Whereas if it's just like a 10, 20 unit deal, you got to make it worth your while. To do that, it makes more sense to build because the margins are a lot higher on the homes than if you were to develop it and just sell the pads.

Dan: So in a sense, some of the motivation is you've got these 10 lot, I don't know what they are, acre, three acre, four acre and it's too small to really make a meaningful profit by putting it through the other 80% now. So you're building that out so that it's a reasonable profit to make that deal.

Brandon: Yeah, building it out and looking at maybe even doing a little small test run on build to rent because it's a newer strategy. We haven't done it before and it's great to test it on a small little portion. I really like it because dude, if it doesn't work out, you just sell the homes. It's different than an apartment complex. You got to rent those things out. You've got one exit strategy. We're looking at maybe trying it on a much smaller scale and just seeing how it works.

Dan: Some of the things that are interesting is the adjustment of your product to the market. I don't know if a lot of investors pay as close attention as I do personally to the year built of the vintage. What I mean by that, I grew up in a house that was built, I believe in like 1933 or 1934. And there's other houses on the same street that were built in like 1925 and 1927, the 1925 and 1927 houses were built with these nice, I think they're granite. We had granite quarries, I think right in Drexel Hill outside of Philadelphia. Big thick stone facade all the way around the side. Then the house that we grew up in that was built in the Great Depression, 1933, it was the lowest lot on the street. The street had some hills and there must've been like a creek or something running through. So we had this muddy backyard that we could never cure growing up. It must've been the least desirable lot, the last one on the whole block to get filled in. Ours was just frame and stucco house, nice house, four-bedroom house, it was a nice house, but there were two or three of that model on the block that were in that era when construction was very likely tight as it just tightened up on us here in the last 18 months. You can see that same dynamic occur from stuff that was built in like the late '80s getting into '92, '93, '94 really tight construction years then. Then when you get into the boot building, boom, we had '01, '02, '03, '04 and that's not going to be the case everywhere in the country because certain markets had a lot more building, let's say in the 2000 to 2007 era than other markets may have had. I think we're in a period of adjustment per your story here, going from the 700,000 builds with all the bells and whistles to something a little less square footage perhaps in the bedrooms, and a little less pizazz on the finishes and the designs. I just find that as a very interesting, it's like the rings on a tree, Brandon. It's like you can see when they had the rainy seasons based on the evidence and those houses are here, the proof is in those houses and they're going to be here for all of history to indicate the liquidity of the real estate market when they were built.

Brandon: It's really funny you mentioned that. I remember when we were flipping a lot of houses, I'd go to these like 700, 800, 900 square foot, like two-bed, one-bath homes or three-bed, one-bath homes and I'm like, "Why in the world would a builder build this? This doesn't make sense. Who would buy this?" Then when you look back and you look at the cost to construct and interest rates and what they were in the late '60s and early '70s, you're like, oh, that's all anyone could ever afford back then, was that kind of home. It's funny to see the parallels as you just demonstrated. I like how you used the rings around the tree concept to go and say, we're experiencing some similar stuff in the past, and hey, here's maybe why you saw so much smaller homes and why you're more than likely already seeing smaller homes be built today because affordability, I'd say is probably the number one driver for new home construction right now. It's a big reason why Warren Buffett, he just made headlines two months ago investing like $900 million into D.R Horton, Ron Holmes and I think it was D.R. Horton, all those guys build entry-level homes. You got 35% of the home-buying population millennials that are at prime home-buying age and they can't afford anything. There's a really interesting chart that shows the difference between your rent rates and your cost to own a home rates. You can see at the times in history where they zigzag past each other and you can tell, that's the best time to rent. now's the best time to buy a home. If you look at that chart now, after this black swan event and interest rates, this historic rise, the gap has never been greater. It has never been more expensive to buy a home compared to rents today in history.

Dan: Yeah. When you see that, so more the context of the current market. I think it was October was like the... I forget the headline, the lowest number of pending sales since 2001 or since they ever tracked it, or whatever the case was. That was when the interest rates peaked out, hopefully, well knock on wood at just about 8% I think. Then the Fed had the meeting and now they're signaling we're going to see a handful of rate decreases hopefully come 2024. Then in November, I saw another headline that said builder sentiment was at its highest since, I don't know, a year before whatever the case was. Then we have the evidence that you already talked about today on this show, Brandon, where you were able to sell this variety of lots, 600 or 700 units coming on and dealing with some of the public home builders and they're coming off the sidelines. I know a lot of real estate investors who fix and flip houses are sitting on the sidelines and are very nervous about what it's going to look like with the cost being so high that the affordability is the challenge. It's like, how much longer can people... are they going to be there? Buy a house on December 21st 2023, is the retail buyer going to be there in March or April when I finish my fix and flip? Or is there going to be another 8% October type of scenario that I have to pay? I lose my $50,000 in profit that I thought I was going to make on my fix and flip. I think that question is on a lot of people's mind, but if we're looking at the home builders and we're looking at the fed signals, and a lot of people are thinking it's at least going to be stable where it's at, but we're starting to see a downtrend in the interest rate. A lot of people are starting to feel pretty good about the prospects of what 2024 is going to look like. Do you have some opinions on 2024? Maybe you could share some insight that you've gleaned in dealing with public home builders throughout your transactions in the past six to 12 months.

Brandon: Volatility. If anyone tells you they got a magic crystal ball, they're lying to you. What's interesting about this environment, there's so many big forces pushing on each other that it's hard to tell what's going to happen. It's like shoving a bunch of deflated balloons in a box and blowing them all up at the same time. One of them's going to pop eventually and they're all going to shift in that direction. That's what you have right now where one of those balloons is interest rates. You've got another balloon, which is supply interest rates have gone up, maybe they'll come back down. But you've got this supply issue where there's over 65% of homes that have an interest rate that's like less than 5.5%. No one wants to give up that interest rate. You've got a lot of supply that's being kept off the market. You've got a lot of rentals that are going to come due with that five-year mark. There's this big tsunami of commercial debt that's coming due. It's like $2 trillion. We've already seen the cracks on the wall with that. That's going to be a big part of the real estate world because it affects banks, and banks affect all types of real estate because they lend to it. Then you've got this supply shortage right at the same time of homes, depending on who you ask for four to six million homes short across the United States. If you look at just full production, we're able to do like 1.7 million per year. By professional estimates, we're four or five, six, maybe even seven years away from being able to catch up to that.

Any way you slice it, there's like a story for both sides here on what's going to happen. I definitely don't know. I predict a lot of volatility in the real estate market in general. I think single-family has seen the worst of it in my opinion, sellers are coming around to the new reality. We're not going to see 3%, 4% rates anytime soon. I think everybody, there's been so much bent up demand, what I've heard from agents in my market, there is so much bent up demand from buyers. They're just like, I need something, but, man, I just really don't want to pay that rate. They're looking for an excuse to jump in. I think that if we see a little bit more softening with interest rates, especially with the Fed starts coming down, I think you're going to see a huge push from buyers to enter in and be like, "Dude, it's come down, let's jump on it". I think that that's something that you're going to see. It's going to be interesting to see how the commercial debt and how the office space plays out with this new world where most people are working from home than they did before COVID. Is that space going to bounce back or is it going to have to... is inventory going to have to be absorbed by something else? I think you could see this great condo conversion story here pretty soon if the downtown office spaces don't experience some bounce back. My prediction is, I think there's going to be a lot of volatility. It's going to be very difficult to see what's really going to happen.

Dan: Yeah, it's funny you say the volatility, and I remember last year December 2022, we were all trying to get our wind back after we were punched in the gut with the interest rates collectively. It was somewhat a state of shock, but I remember the real estate values, let's say $450,000 house in June same house is probably maybe going to sell exact condition if you were trying to sell it in December. We're probably talking $380,000 for that same house. At the time I didn't think it was going to recover. I thought, oh, here we are. This is 2000 seven, eight, nine, we're back into that same kind of a dip. Luckily, the spring market came, and that same house that was $380,000 in December, that same thing probably sold for $445,000 the following year. Now that's just based off charts on a number somewhat. You look at the real estate sales price overall of history, it cycles up and down every December. It always dips in December. It always does. But it was a dramatic dip in this past December and it didn't quite hit, at least from my view, the high watermark. I also say that based on actual examples of houses that I passed on at a certain point in December, and then when they sold in April, it looked like such an obvious deal. I'm like, how did I manage to miss that deal. I just didn't think it was going to recover or have that confidence that we were going to be able to make that go. So the volatility, I hope that's the same volatility that we're experiencing right now. If the prices get back to $440,000 in an example come March or April, I'll be happy. But one thing you have to consider with the average price report or the median home price itself. The other thing that's going to impact that Brandon, is the median home price was $700,000 on the houses that you built a year ago. Now the median price, you did, let's say five transactions at $700,000. One, was $600,000, whatever. $700,000 you did and they were nicer houses built in a different era like we were just talking about. Now, if we take the next six houses that sell from today through April, six houses, but these are $500,000 houses, so the median house price is effective, but there were still units and there was still new construction moving. So the volume still may occur, but we may be building a less expensive house and that's going to be reflected in that medium home price value. The market may not actually be crashing and we still are very likely going to have a strong level of intrinsic value in houses, I hope in 2024.

Brandon: Yeah, I think you're right. I don't think it's any crash or anything like that. You got to understand 2020 and 2021 and the first half of 2022, the interest rates, it still wasn't a normal market, but those weren't normal markets. From covid yonder, you almost have to just discount those and go back to 2019 because of everything that had happened to get the real picture of how things are going.

Dan: Yeah. I think I mentally was trying to go back to 2019 with the prices and I bought a second home in Florida last year. The interest rate I think is 7.25% or 7.5%. When I bought my other house in Chicago in, I guess it was early 2020, it was probably March, April, June sometime I think in 2020, maybe even December. But that interest rate was probably 3%. But I had to do this mental gymnastics and this humming to grips with reality and it was almost hard. It was almost this mental challenge. I went under contract and I knew the interest rates were 7.25%, but then I had this internal struggle and battle of, "Am I really going to pay 7.25%? Someone quoted me 6.85% and I thought I would get that. That was like the rationalization to myself, okay, 6.85%, it's not 7%. That guy couldn't get the mortgage done and I ended up paying the 7.25 and going to settlement and it didn't kill me. I'm alive on the other side of it. I've made all my payments and I imagine that any given avatar home buyers out there, and they're going to have that same struggle, that pent-up demand. They're right now having some of that struggle. But the one thing that a lot of the pent-up demand does not have is they may not have the recent experience of buying another house a year prior at 3%. So they didn't even know, they don't even know what they missed. A lot of people who are going to be first-time home buyers coming into the market who you're now building these $500,000 houses for. It's like most people when they went to the car dealership and bought their first car, I didn't know what interest rates were. As long as you didn't have totally dinged-up damaged credit and you weren't paying 17% interest or something like that. It was probably somewhere between
6% and 9% and you didn't even look at that or know how that affected the math on the paper. You were like, $385 a month for 60 months, I can do that. No notion of the interest rates. I think a lot of the pen-up demand probably has that, and then some portion of it's going to have the rationale I just described. I think that you're absolutely right. If the rates tick down slightly and get under that seven mark, I think a lot of people will be able to quickly rationalize going out and pulling the trigger and it should sustain at least the demand I think that we have currently in the marketplace.

Brandon: What do you think is going to happen in 2024 onward?

Dan: I think we're in a stable market. I think there's a lot of markets that I see with my own eyes. So we're in Atlanta, we're in Chicago, we're in Philadelphia. Those are physical offices we have, but we buy houses in... we did one in Florida. I have one I'm going to close on in Tennessee. I have one right, I think it's right outside of Nashville. I forget the name of the town. We just did one in Indiana. So we have deals in a lot of markets and we look at a lot of different markets, but the Chicago, Atlanta, and Philly markets within each of those markets, I don't know what there is 20, 30, 50 little micro markets. There are a lot of micro markets such as the south side of

Chicago where it's not that there's a lot of pain and the values for renovated houses are still higher than they were in 2019.

Dan: But on the low end, when they're beat up and they need the renovation, let's say the house is in the neighborhood are selling for $270,000 all fixed up. When the market got nuts, they were selling for like $135,000 cash, let's say. Maybe $125,000. Now, you're seeing downward pressure on that lower end of the market. So those houses are probably selling for $65,000 to $85,000 and maybe $95,000 or a $100,000 on the top end, and they're still worth that $270,000-ish. Maybe the spring comes and it'll go for $285,000, $290,000. It's a really good position for those neighborhoods which have historically been challenged because at least there's values there where people can capture some of that who are selling at the bottom and who can no longer care for the houses. There's state houses, whatever the case is, so that it is possible to do deals there. In 2019, a lot of those neighborhoods, it was impossible to do a deal there. Meaning the property needed $100,000 and the retail sale was $130,000 and the place had $10,000 in back taxes. You could not even do the deal there. SThe house sat there unrenovate it. I guess where I'm going with it is, I think there's pockets, and I think it's mostly going to be pockets where you would see a lot of cash sale activity happening. There is not a ton of that in a Nashville, Tennessee type of market. It's a younger market. It's quickly matured over the past 10 to 15 years, let's say. Meaning a lot of investors bought and a lot of homeowners moved there to make it their home. So it's not going to be a tremendous amount of distressed inventory. But if you have areas like West Philadelphia, some parts of South Philadelphia, North Philadelphia, these have been challenged for a very long time with a lot of distressed inventory. Same with South side of Chicago. Atlanta is a market that had pockets of this distressed inventory and over the last 10 years that inventory has been bought and renovated. And there's still some, but it's nowhere near like we would see in those other markets. But anywhere that there's, when you pull the comps and you see cash sales in that neighborhood, those cash sales have taken a hit probably 25%, maybe even 30% on the low end, but the retail sales are still holding up. Well, now if you go out into any of the other areas with historically low inventory, those markets really haven't taken much of a hit. Other than maybe the dated house that needs a bunch of work, that's probably taken a 25% hit in value in this market.

I think those same hits in value that we saw here in the last 12 months, I think that's going to carry forward into 2024. Even on the low end, it may even go down a little bit more because construction costs are still higher. They're still much higher than they were in 2019. Even with the stabilization of the building supply chains and the cost of lumber and things of that nature. It's a lot of times right now it's like the labor's still very, very tight. I think we're in a stable market and I think there's going to be some discounting throughout the marketplace. But if we do see these interest rate tick-offs, I think that's going to be enough. Don't think the demand this year is going to equal the demand last year, but I think that the tick down in interest rates could keep that demand steady from last year. I hate to look into the crystal ball and say like a soft landing or anything like that because it's still...

Brandon: You're on recording. People can go back and listen to it.

Dan: I know, I'm going to shut up now. We talked markets and I mentioned a couple of markets around the country and the Tennessee, the state of Tennessee has been on my radar now for, I don't know, two years. We've done a handful of deals in Tennessee. I'm not going to be like the new king of Tennessee and I'm not going to open an office there. But I'm excited about Tennessee. I love when we see a house come through and there's a chance we can do the fix up to it and resell it. Because I really just have this good gut feel about the prices in Tennessee. Now I'm not building three-quarter-million-dollar custom homes. It's not new construction. My ideal house is built in 2001. Let's say, I'm going to put $30,000, $40,000 in it, and it's probably going to sell for $300,000 and change. It's going to fly off the shelf because it's first-time home buyer product. I'll do an older house, I'll do a bigger house, smaller house whatever the case is, if the numbers make sense. But the supply constraint that I've witnessed, almost without exception across North Carolina and across Tennessee, have been phenomenal. I liked Atlanta the way I like Tennessee and North Carolina as states. I still like Atlanta. I think that entire section of the country is still seeing population growth. From what I see in the numbers from doing coms and evaluating deals there, I can't say it's this percentage in this metric. I get to say that my gut feel, every time I check comps and I'm doing a deal in Tennessee or North Carolina, it looks still strong. It's still one of my favorite geographies, even though we don't have offices there when we get a deal, I'm excited about that. Do you have more meat to put on the skeleton of my enthusiasm, we'll call it for the Tennessee market or maybe just the Nashville market that you're the expert in?

Brandon: I'll tell you why we like it because at the end of the day, I can only give my opinion on it. Men lie, women lie, numbers don't lie. There's a lot of different reasons why we like Middle Tennessee. Anything around Nashville. One is because it doesn't have a state income tax. When you are putting money back into small businesses and consumers pockets, they want to be there. So it's a very, very compelling play when you're looking at that. Overlaid with the other demographics, which is a big one that's here recently is, COVID revealed this environment that everybody knew was there, but made it a lot more obvious. That is, you got business friendly states and you got not business-friendly states. The whole goal, when you're looking at an area, in my opinion, the number one thing that I look at is, is money going to continue to pour one, into the asset class that you're investing in? And two, into the area that it's in. When you look at Nashville that it's just this huge influx of people. It's been one of the top 10 fastest-growing cities in the United States. The past six, seven years, money moves to an area, people move to an area, you get insulation. It is incentivizing these larger businesses to move there. So from a local perspective, the local politics has done a good job of incentivizing the Amazons, the Oracles, the Alliance Bernstein to set up shop there. If you look at the downtown skyline since 2011, it's more than doubled. There's a lot of institutional money that's being poured into Nashville because they see the opportunity. Again COVID was a big part of that. From 2011, 2018, you had about $4 to $5 billion of institutional money that was being poured into the downtown core area. Under constructions, that's $5 billion over a seven-year period to date. Right now, you've got over $5 billion being built. So the amount of institutional capital has multiplied that's pouring into. Again, that's because we didn't shut everything down. There was this huge influx after COVID to Florida, to Texas, and Tennessee because we didn't shut everything down. So we're seeing a great migration from these high tax states, these highly regulated states, New York, California, New Jersey, and they're all moving to these business-friendly states with low taxes where it's very easy to do business. So just from that alone, it's compelling. If you look at some of the more microscopic demographics, you've got year-round tourism, it's music city capital of the United States, the tourism literally doesn't slow down. So it's not cyclical and Nashville's just set up for success.

You look at other cities in Tennessee like Chattanooga, where you're limited by the mountains and Nashville was this just perfect storm for development and gentrification where the downtown area and the surrounding spots around it, they were the least attractive. You didn't want to go down there. And recently, since it's been a boom city, you've just seen that change. You've flip-flopped it. The millennial buyers, they want something that's close to downtown. You've just seen this great gentrification, these areas. There's been a lot of money that has moved into it. Whenever money moves into something, that's where I want to be.

Dan: Nice. Speaking of moving money, last time we talked, you were raising capital. Are you still in the business of raising investor capital or have you just switched to a self-fund model?

Brandon: No, we're always raising money. Doesn't necessarily mean we'll always have the deal available, but we're being a lot more conservative with what we're doing going forward. But we're always looking for investor partners.

Dan: So when we talked last time, I think you were raising money for one of the projects, if I'm not mistaken. It may have been off the recording, it may not have been on the recording, but I think you were raising money for one of the projects that was going to be the pad development. Does that sound accurate, maybe?

Brandon: Probably, so. It might have been that same deal that we spoke about earlier that 36 townhomes and the 34 lots across the street from it.

Dan: That's right. I'm like a newer investor, so I've done LPs and stuff in the last couple of years, but not for 20 years or anything. My first thought was, oh my gosh, this it's so risky. I didn't understand the market. I hadn't done the kind of research I've done in the last year around development and paying attention to the national builders and just matured in my underwriting where it doesn't seem like as risky a deal. Now, as it felt like when you were telling me that at the time I mean that could be because we're looking at the $68,500 sale price and we're all 2020 hindsight kind of a thing. But what does a deal look like? Are you able to walk me through maybe what a project on the table now or recently would've looked like for me as an LP if I was going in?

Brandon: Yeah. So one right now that I think I've got the capital done for it, and I'm just trying to lock in the empire. It's 74 pads that we're going to be developing. It's in the same market that we did that deal that you and I just discussed. We've built a lot of houses in this area, so we're very comfortable in it. We bought the land once all the improvements were in place for, I want to say it was $700,000, I think. It was $700,000 or $750,000 approved for 74 homes. We hit our cost basis, $10,000 per pad. That's where we want to see. We got our development numbers back. I think we're at $46,000 on each pad development with all of our infrastructure costs and all of our impact fees from the city. Right now we're getting contracts in place from builders anywhere between $80,000 and $90,000 per finished pad. So when I syndicate these deals, I'm usually doing an 18% pref to investors. Obviously, I can't guarantee anything, but that's what we've been able to deliver on past deals. So that's what's worked for us and that's what we've offered on these types of opportunities. In the past we were doing a 50% debt, 50% equity play on these development-type deals because a lot of the bank financing has dried up. We've had to move to basically a strictly 100% equity model with investors on these types of development deals. If you were looking at just developed pads and that specific arm, that's one of the deals that we're working on.

Dan: Okay. What are the risks in that specific deal? What's the downside there?

Brandon: Yeah. So you've always got the chance that your builder could just up and walk away from you. So your end buyer disappearing, say, "Hey, keep the 10% deposit, we're going to go do something else and you got to hang onto it". So that's why it's real important to be in an area where you've got multiple buyers. In this particular deal, we got like four different letter of intents, and contracts are rolled in. We know that there's been a lot of interest. We've already moved land in this area before. We know that this is growing. We know that there's more and more builders that are moving to this specific market. It's in the path of progress per se. There's always the risk that you could have your buyer walk and you've gotta hang onto it. But when you do deals where it's 100% equity, we got to hang onto it. So what? It's not like half-built house you put everything in the land is dare, tornado comes through. It's not going to do any big damage or anything like that. You just sit and hold on to it. That's really the main risk. Your buyer pool is a lot smaller, but if you do your due diligence and you're in the areas that everybody wants to be in and there's construction, that's your worst-case scenario. If we really have to, if we're hanging onto it, we'll just build and sell the houses on it ourselves.

Dan: Okay. Yeah. So it's $3.5 million in construction costs. That sounds about right? Roughly?

Brandon: So you've got, it's 74 pads. We bought it for $700,000 and our cost per pad is, I think it's $45,000, $46,000.

Dan: Per pad?

Brandon: Yeah. So you're all in cost with everything is, I think you're right at like $54,000, $55,000 somewhere around there and you're selling...

Dan: $4.2 million maybe for total raise there sound, right?

Brandon: Yeah, that sounds right. Somewhere around there.

Dan: Then the 18% pref, that obviously is dependent upon the success. In the worst case scenario a black swan COVID type of event happens, the market crashes and we're like, we're all hanging onto this thing for two, three, four years. In those scenarios, maybe the pref doesn't necessarily pan out, right?

Brandon: Well, of course. That's why you can't guarantee anything. But you'd have to see your pad price go from $80,000 to $90,000 down to what your cost basis is, which in this case it's like $55,000. It's been a long time since we've seen pad prices at that price. So that to me gives me a lot of downside pressure there. ' Because the number one thing we want to look for is capital preservation.That's at the top of the strategy. I think there's too many people chasing IRR and return on capital and not assessing the risks and prioritizing return of capital.

Dan: Yeah. That's where people got in trouble recently. I had Rod Cleef on my show last episode, and he and I were talking about the apartment house or the apartment syndicators who used the bridge debt, which had adjustable rates and it went nuts. These guys choose the returns, I don't know what they were in for 10% down. It's 10% down, 90% financing. Well, the 90% financing became the dragon that came and burned down the city, if you will, on those deals. They did, they lost all of the investor capital. Whereas you're in a scenario where at a minimum because there's no debt, you have this staying power other than having to maybe do a capital call for property taxes or something. I'm talking doomsday scenario here.

Brandon: Not even. The taxes are nothing. We could, right? But we're talking like pennies here. I would just probably personally take care of the taxes because it's nothing.

Dan: Yeah. There are people who did these deals in the last runup and lots did go from $90,000 to $10,000 or $20,000 a lot, but they ended up losing a lot of them to the bank. Now a lot of those same people that I'm talking about who did those kind of deals, the bank maybe held onto them or the bank sold them off to someone else. Then within three to five years, they were back at the $85,000 or the $90,000 that they were projected to be at when they were originally developed. So it was a very short window where the debt squeezed that original developer out. But I think that's smart what you're doing about the 100% equity and having no arduous financing of the $3 million, $4 million in construction that potentially could punch the hole in the deal. So you have this projection. I guess it is, it's $4.2, and is that the $6.2 million exit roughly?

Brandon: Well take $85,000, $86,000, and multiply it by 74. Whatever that number comes into that, I don't know, I can probably do it real quick on my phone.

Dan: Yeah, I think it's roughly $6.2 is when I did the math at 85.

Brandon: Then there you go. You know better than I do.

Dan: You have this good target there for the upside, and I feel like you have some good downside protection on being 100% equity as insurance against super volatility in the marketplace. The only other drawback probably, is there any depreciation benefit at all to investing in this case?

Brandon: No, that's why we try to give a generous pref because when you're doing development because of your shorter timeframes, you're not capturing any depreciation.

Dan: Cool. So as we get to the wrap-up here, do you have a website or somewhere if anybody was interested in getting on the list for that next deal? Or maybe another reason people should reach out?

Brandon: Yeah, anybody who wants to look up more information can go to our website, hbgcapital.net. That's harrybobgarycapital.net. I joked that the the .com was taken by somebody, it was over in like Saudi Arabia or something like that. I was like, "Dang, we've missed the boat there. Couldn't get the .com". But they can go there. We've got a free ebook on our website. 100 Questions Business Owners Ask Before Investing. I wrote that ebook because I had somebody reach out to me who, he was a current investor of ours and he was like, Brandon, I have a buddy of mine and he lost all of his money and I realized they deal in California, could you talk with him and just see what his options are? It became very evident on the phone with him that he was green and he just didn't know the right questions to ask questions, reveal what you need to know about a deal. So you can very quickly gauge whether or not you want to be in something by knowing the right questions. And so I was like, dude, if we could just prevent this from happening to one other person, how do we do that? And so that's why I put together that ebook. You can grab it on the website. There's a bunch of other free educational content as well. We've also got our own podcast, Recession Resistant Real Estate Radio. We got to get you, Dan on that podcast.

Dan: Nice. Looking forward to it. So I asked you the crown jewel of wisdom before, but now we're looking back over an 18-month window of yours and my career here. Everybody on the show's probably been in real estate. Maybe we got some people who just came in, but what an interesting time period this last 18 months. What would be the crown jewel of wisdom lean over the last 18 months in your own career?

Brandon: Crown jewel of Wisdom over the last 18 months? Be ready to pivot. It's not my job to tell the market what it wants. It's my job to make sure I'm actively listening to the market for clues about where it's going, and then pivoting as needed. We stumbled into that with a lot of our development plays. So we'll continue to listen to the market and pivot as needed with it.

Dan: Nice. My final question, what is the kindest thing anyone has ever done for you?

Brandon: Man, the kindest thing anybody has ever done to me, I'm trying to think of a moment that really warmed my heart. I remember this guy, when I was in college or just graduated college working for $8.63 an hour, mixing paint at Ace Hardware. I used to tell every person that I interacted with that I was trying to get into medical device sales and ask them if they knew anybody. That was my way of just trying to figure out how the heck to get in. I need to know somebody because none of these online applications are working out. She introduced me to her husband Tim, he worked for DePuy Synthes and Spine, and Tim agreed to take a meeting with me. He was the first guy that I didn't know, didn't know anything about me, agreed to take a meeting. I remember sitting there and meeting him and he gave me a book, now Discover your Strengths. He is like, "Brandon, you just need some experience. I would go and I would talk with materials managers at hospitals if I were you. They know a lot of reps". That one piece of advice is what just completely changed my world. Ended up getting into medical device sales and then getting into real estate and everything. But that guy took a meeting with somebody he didn't know, wasn't going to benefit from it, and ended up sending him a message after I did eventually get into medical sales. He's like, "Dude, it's so great to hear from you. I can't believe this is better than like a whole quarter of hitting quota. I'm so glad that you did well". So that was a moment that stands out to me.

Dan: Very cool. Yeah, it's cool to hear the person who maybe opened the door without knowing it at that point in time. It was the gatekeeper to your career there.

Brandon: Yeah, 100%.

Dan: All right, cool. Hey, Brandon, maybe we'll have to get ourselves in the calendar for 18 months from now and see how things go. It's been a blast doing the follow-up episode. I really appreciate you circling back and coming on the show once again.

Brandon: Dude, I appreciate you having me. This was a lot of fun. I enjoyed it.

Dan: Yeah, you and me both. Good stuff. The REI Diamond Show is sponsored by Diamond Equity Investments, a private equity firm focused on buying and selling residential and commercial property throughout the United States. If you are an accredited investor seeking double-digit returns, you can sign up to review Diamond Equity's passive investment opportunities at www.fundrehabdeals.com. If you're an investor who is seeking deals that you can buy, fix, and flip, please go to www.dealswithroi.com.

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