How this multifamily investment sponsor finds 'needles in a haystack' in North Texas

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Implementing a capital improvement plan while not pricing people out of their communities? In this economy?

That's exactly the premise behind Odyssey Properties Group's most recent investment in North Texas. The multifamily investment sponsor and private equity real estate firm based in Hermosa Beach, California, has acquired 578 units spread across three communities in the region.

The firm, which operates 44 properties across 14 states, purchased Huntington Meadows and The Dalton in Arlington and The Belmont in Grand Prairie with an eye toward capitalizing on Dallas-Fort Worth's strong job growth, fast-growing economy and low cost of doing business.

Odyssey Properties Group plans to improve through interior renovations 65% of the combined 318 units at the adjacent Arlington properties and 60% of the 260 units at The Belmont as it looks to balance maximizing rental income potential.

"It feels good to bring a level of amenity to these communities that people want. It's difficult to do under your current capital structure as an owner. It usually requires selling to the next guy – which is us – that comes in with another stack of capital that can be earmarked for bringing these upgrades," said Derek Graham, founder, president and principal of the firm.

"It's satisfying to upgrade these communities and give people what they want and still not price them out of the area," said Graham, who gained commercial real estate brokerage experience at Studley and CBRE.

He spoke more with the Business Journal about what's still adding up about the North Texas multifamily market, how his firm is making a challenging market work and more:

Why is now the right time for these deals in North Texas?

When you do what we do – buying apartment communities around the country – you're trying to identify cities with exceptional job growth. There are so many different ways you can measure it, but it's largely about jobs.

The second data point that attracts us to markets like Dallas is population growth. They go hand-in-hand, along with the things that support job growth and population growth in states like Texas, such as business climate and tax environment. Those are very attractive to companies moving from places like California to Texas or Dallas. Then, of course, when they move they bring the jobs.

Those are the factors that influence investors like us to come to places and invest in cities like Dallas.

Multifamily was one of the darlings of the investment community last year, but market conditions are more complicated right now. Why are these still compelling transactions that you can add value to?

We own about 7,500 apartment units around the country. We're in 31 cities in 14 states.

We underwrite 3,000 deals a year, and we'll buy four to eight per year. We're looking for needles in the haystack, and these recent acquisitions in Dallas fit the bill.

They're in exactly the submarkets that we like next to entertainment centers and jobs ... The complexes we bought coincidentally are located in submarkets in which we already own other assets. Familiarity makes a big difference and is a big advantage.

We think we can go into these communities, improve them, bring amenities and upgrades to the units that people will like – and still keep them relatively affordable. We're very sensitive to making sure we don't price people out of these submarkets.

Do you feel like things are harder this year than they were last year?

It's been harder since April when the Fed started raising interest rates multiple times in reaction to runaway inflation. It's difficult because, as a buyer, our debt service or mortgage costs are a lot higher than they were nine months ago. Therefore, in order to hit certain yields or return projections, we can't pay as much for a specific property as we could nine months ago.

The difference between today and nine months ago might mean that we can pay 10% to 15% less. The majority of the sellers don't want to hear that. What's happening for them inside their own portfolios is they're still seeing high occupancies and very high rent growth. We're still in an environment where the majority of sellers don't want to discount their property sales by 10 to 15% because they don't feel like they have to.

What makes it difficult for us is not only am I looking for a needle in a haystack, which is our ordinary course of business, I'm looking for the 20% of sellers that are willing to meet the market and acknowledge that interest rates have caused a change in borrowing costs for buyers. I still don't think that the majority of sellers are willing to do that.

How did you make the choice to shift from brokerage to doing something like that? The risk profile is a bit different, and it takes a lot of guts to start your own company.

I started in brokerage in 1986, and in around 2000, I was selling investment properties to a client of mine. He was a serial investor, meaning he bought a lot of properties that I would present to him. At one point during our relationship, he asked me if I wanted to partner with him. There was a period of time when I remained as a broker and was putting together the syndications with him.

There was a little bit of a transition phase where I was doing both and I found that putting together syndications with partnerships to be considerably more cerebrally interesting. It required creativity. I suspect that the risk appealed to me, but I enjoyed the creativity.

I have an old client who is a developer, and he used to say, "The thrill is in the 'create.'" He was talking about why we do certain kinds of business, and as a developer, he found that thrill was in the creation.

I found that putting together the syndications was a little like being a movie producer. You were trying to corral an idea. You're trying to line up equity and investors; you're trying to line up debt; you're trying to do due diligence. It's a little bit like herding cats, but it was satisfying. That's why I made the shift.

In this commodity pricing and supply chain environment, how are you structuring a deal to address those fluctuations when it comes to construction costs?

You do your best. I tell my kids: Do your best, and then at some point, you have to go for it.

We work with the eighth largest property management company in the country, BH Management, which has a significant presence in Dallas and manages two-thirds of our portfolio. They also have a construction group with whom we work on almost all our properties.

We collectively do our best to get accurate pricing, and we build in contingencies. Invariably, it's not enough, but you do your best to build in contingencies. Then you execute your business plan. If costs continue to run, then you make adjustments in your business plan later.

For example, say we're going to put into this property in excess of $6.5 million of improvements. You can imagine it's going to be a lot nicer property when we're done. If those costs continue to increase, then we'll make some adjustments and maybe renovate 10% fewer interiors than we originally planned to make an adjustment for runaway costs. That's how you do it.

How does the presumed rate hike play into that?

I lock in my debt as soon as I possibly can, and I build in a cushion. If I think that is going to cost me 5% in my pro forma, I'll build in a little bit of cushion, and then I try to lock it as soon as I possibly can – hopefully long before we close escrow.

We're buying a deal in Phoenix right now, and we're in escrow. We won't close for a month. I locked in our debt Sept. 9, which means you have to advance a huge deposit. But I know that our debt is fixed for 10 years and I know the exact rate because I locked it in.

It is a more challenging environment, but that is more conducive to opportunities to be more creative with addressing problems. So, I have to ask: Are you having fun right now?

I get asked all the time by my investors – how much longer are you going to do it? – because I've been in real estate for 35 years. I say: Until it's not fun anymore. To answer your question, yes, it's still fun. It's still fun and it's interesting and it's challenging. I guess that's how I would define fun as being interesting and challenging.

This interview has been edited for brevity and clarity.

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