Whitney Elkins-Hutten of PassiveInvesting.com interviews apartment syndicator Shane Thomas, who shares his acquisition of the 290-Unit Avaya Steeplechase in Houston, Texas. He talks about getting this property through a cash-in refinance in 2021, when the interest rates were at an all-time low. Shane looks back on how he utilized a value-add business plan backed by a floating-rate bridge loan to renovate units and increase NOI. He also explains the consequences of not convincing every investor to contribute to the capital, as well as the right way to communicate with them about your real estate strategies.

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290-Unit Avaya Steeplechase In Houston, TX With Shane Thomas, Apartment Syndicator

Welcome to this episode of the show. I am excited to be joined by Shane Thomas. Welcome to the show.

Thanks for having me, Whitney. I am excited to be here.

How Shane Got Into Multifamily Real Estate

Before we dive into Aviva Steeplechase, 290 units in Houston, Texas, tell u57s a little bit about yourself, how you got into the multifamily real estate space, and where you are at today.

I would be happy to. I am based in Houston, Texas, but I will give you a quick summary. I got into the business about ten years ago. Prior to that, I was a former CPA and management consultant. I did that for about ten years. I have been investing in real estate since 2010, and then pivoted to multifamily commercial in 2015 and 2016. I formed Catalyst Equity Partners with my business partner in 2016.

To date, we have done 2,000 units as lead GPs. Our focus is value-add multifamily. We have done everything from Class C 1960s vintage to Class A 2015 vintage. Our focus is on value-add acquisitions and renovations, and we have an in-house construction company that does all of our renovations. We have a staff of about 6 to 7 people full-time. We use third-party management. Our focus is Texas, primarily Houston and Dallas.

Closing On The Property And Setting A Purchase Price

Let us dive into Aviva Steeplechase, 290 units, Houston, Texas. Now, normally, we are talking about a purchase project, but you and I are talking about a cash-in refinance project. Oftentimes, investors might hear about cash-in refinance, and they think, "Something is happening in the market, something is happening in the asset, this is not necessarily a good deal to go after." That simply is not true, and we are going to bust some of those myths. Let us start off and give a little bit of history here about the property. When did you close on the property, and what was the purchase price?

This property was acquired in September 2021. As most of your audience probably knows, at that time, interest rates were very low, there was strong rent growth, etc. We bought this deal, 290 units, Class B. It was in the high mid-90s, a door range for a Class B property there, bought at just under 5% capitalization rate. At the time, relative to what was happening, what was transacting, it felt like a good basis. As you mentioned, a lot of things that we did well on the property. We raised the NOI, but obviously, with interest rates and whatnot, we faced a lot of headwinds. Fortunately, we were able to come up with a long-term solution and protect our equity.

Let us first discuss what attracted you to this deal. When you found the property, put it under contract, you mentioned it was a B-class property. You raised the NOI on the property. What was your initial business plan when you looked at this property?

This deal was owned for about eight years by a group. It had what I would consider long-term ownership. They had done a renovation at the initial full period when they bought their deals for the first 2 or 3 years, and that renovation had gotten stale. We saw an opportunity to come in, put in new capital, both on the exterior and the interior. At the time, we saw anywhere from $150 to $200 rent bumps by spending $10,000 to $12,000, so we would put in new flooring, modernize the fixtures, put in new appliances, countertops, etc.

That business plan for the first year and a half was executed well. This property also had a majority of washer-dryer connections, and the prior owner had not put in any machines. That was a quick win for us. We were able to put in washer-dryer machines and charge $75 per month to residents. That was a great ROI. The business plan that attracted us was that it was a Class B asset in a good location, and it was not a hot potato just owned for two to three years. It was owned for eight years. They had done a renovation 6 to 7 years prior to our acquisition. It was ripe based on the comps for further renovation and rent premiums.

Financing The Purchase And Raising $8 Million

You mentioned that you had financing on this deal. It is 2021. Let us get into the financing terms, but also the capital stack. I assume you raised money for this deal as well. Let us tackle the financing piece.

This deal, as I mentioned, was a value-add. When you are raising rents by $150 to $200, I would consider that a significant value-add. For this deal, we basically got a bridge loan. We planned to buy the asset with this loan, use the renovation dollars that are included in this loan to raise the NOI, and then refinance. It was a bridge loan. We had about 75% LTV, and it was a floating rate.

We had SOFR plus a spread, and we had done about five deals in this similar structure because, as I said, we are value-add buyers. We have always bought a rate cap. The reality is that, as many folks know, a lot of the rate caps that were bought were either not at a high enough strike or not of enough duration. We bought a rate cap for two years at a one percent strike. We had a very tight rate cap. We then also raised money for the third-year rate cap.

We knew that there was a possibility that within the three years, we may need to buy a rate cap. We raised money for that. That was the structure of the deal on the financing side. We raised $8 million from our LPs. We have never done anything that I would consider financial engineering. We have not gotten cute with preferred equity and things like that. It has generally been a senior loan plus common equity. It was basically that bridge loan plus $8 million of equity that we raised from our investors.

You had the $8 million raise. I was just doing some quick math. What was the senior debt on the property?

It was about 23.

Twenty-three plus eight, so now you are at 30. You are looking at almost a 25% bump if we just assume 150 a door. If you are going to rehab every single door, 150 a door times 290 units divided by a 5% capitalization rate, that is over $10 million that you are expecting for the NOI to increase. Tell me what happened then.

We bought the property. It was about $1.5 million NOI when we bought it. To date, right now, we are at about $2 million NOI. We definitely increased the NOI. Obviously, some of the challenges that we faced were that, at the time, insurance in general was not as aggressive as it is now. In 2022 and in 2023, I think about this deal, our insurance effectively doubled. We went from like it was like 600 a door to 1200 a door. Over 290 units, that is a huge impact.

The Harris County taxes got aggressive as well. Generally, they had not been as aggressive pre-2021, and then in '22, '23. We are still fighting our 2024 taxes in litigation. Those two headwinds of your regular operating expenses, insurance, and taxes, were well above where we expected them to be. Even though we were able to raise our NOI, it was not to the tune of what we expected because of taxes and insurance. We got to a point in, I want to say 2023, when rents and tenants' appetite for upgrades just decreased.

Avaya Steeplechase: Rents and tenants' appetites for upgrades decreased in 2023. People were getting pinched, inflation was rampant, and rents were not going up as much.

People were getting pinched. Obviously, inflation was rampant. Rents were not going up as much. We were not seeing the ROI, so we decided that we would need to pause our renovation program. Instead of getting through, I think 220 units is what we planned to do. We got through about 140 of those units, and we said, "We're going to wait until the market gets better and the ROI is achievable before we continue to do more units."

This is something that a lot of operators have run into, but the limited partner has scratched their head and gone, "How did you not see all this coming? Why didn't you prepare?" Shane, what do you say to that before we get into the terms of how you are repositioning this project?

Obviously, it is a legitimate question. It is something that you can look back on, and everything is 20/20 in hindsight. The reality is that we have done a lot of fixed-rate debt, and we have done floating-rate debt. I look back, and I say on this deal, with the anticipated NOI improvements that we expected to get. Obviously, looking back, no one thought that rates were going to go from zero Fed funds rates to 5% over 18 months. In spite of that, I would say that this deal was suited for a bridge execution because we had an asset that had a low NOI that we were going to go and improve by putting capital into it.

I do not look back and think that was a mistake. Where this deal and what we could have done better, and I think a lot of people could have done better, is the duration. I had a rate cap that I thought was tight, and we raised money, but I think what we probably could have done is raise more money for a rate cap for the duration of our hold, which we thought was going to be five years. These cap costs, just to give your listeners some perspective, we bought that 1% strike rate cap for a $23 or $24 million deal alone for like $80,000 in 2021.

When I had to go buy it in year three, in 2023, end of '23, for a 2% strike, it was $850,000. We had the money, fortunately, because we raised it, and that is why I think we have been successful, because we had enough runway on most of our deals. We did not buy wide rate caps. For the first two years, we were right at Performa underwriting-wise because we knew what our rate was capped. We just did not expect, and no one expected your point. The smartest minds in the room, the BlackRocks, Blackstones, etc., are basing their data on forward curves or market expectations of rates.

That did not show the Fed funds going above 2% at that time in 2021. Looking back, it is a legitimate question, but right now, bridge loans and floating-rate loans are almost like a bad word because investors have gotten so used to saying, "That's the reason for my problem." There is a tool for every job. Financing is a tool, and a bridge loan versus an agency loan. They are all tools. I just think that we did not have the right duration on our rate cap.

Just to give one last example, a lot of people think fixed rate is the be-all end-all. Yes, it gives you comfort knowing that "I've got a fixed payment." The problem with commercial real estate loans that is different from single-family, as you guys know, is that there are prepayment penalties. I have had fixed-rate loans, a twelve-year fixed-rate loan, on one of my first, second, or third deals, where it was a $12 million fixed-rate loan.

Tweet: The problem with commercial real estate loans is their prepayment penalties.

When I went to sell it in 2022 because we were trying to get peak pricing, I had a $4 million prepayment penalty, so it handcuffs you. Yes, I think there is a tool for every job, and we will talk about it now. Now we have pretty much matched our expected hold with our maturity, so we do not do twelve-year money anymore. We do five and seven-year term money because that is what we think we will hold it for. A lot of lessons learned, but hopefully that helps.

Deciding To Pursue The Refinance

Let us step back in time a little bit. At what point in time did you decide to pursue the refinance? What were the triggers here? Let us get into the lending terms and how you oriented this conversation with your investors, because it was a cash-in refinance, not a cash-out.

The reality is that the business plan was to hold it for five years, and our goal was within years two to three to refinance, pull out some cash, or sell. The good thing about these bridge loans, if there is a good thing, is that they generally allow you to sell without any major penalty on this one. In fact, we had no exit penalty at all versus that $4 million example I gave. That said, the market turned in 2023 once we were through the majority of our business plan, before we paused renovations, because the market was not in a position for us to sell.

As many people would agree, right now, I do not think anyone is selling right now, unless you have owned deals for ten-plus years. I do not think anyone is selling by choice right now. It is not a favorable market for the sellers to sell. We got Broker Opinion of Values in '23, '24, and we looked at the opportunities there, and just the equity was impaired. Our goal has always been to have multiple options, so we were looking at refinancing in late '23, early '24. This is across all of our deals.

Basically, we ran multiple scenarios. Just to give some context, we had five of these deals, $150 million worth of loans, and we have refinanced all of them in the last twelve months, including this one. Most of them were cash-out. This one was a cash-in, but I think the key here is that we got an opportunity to get a HUD loan. We have done agency loans where it was five-year money, 30-year amortization, we have done CMBS or bank loans, and on this one, HUD actually was not our primary option. It was option C.

When options A and B closed the door on us, we at least had option C. That is what sets us apart is that until you get the deal done, you have to have multiple options. We were not hoping and praying. We were doing whatever we could, weekly asset management calls to move our NOI. We knew that at our NOI, at today's interest rates, we are not going to size to X amount of loan amount. We positioned ourselves, and fortunately, I do not know how much your audiences know about HUD. This is not my first HUD loan.

We made a decision, even though we had plans A and B going, we made a decision in 2024 to invest or commit some money to the HUD process because it takes 9 months to 12 months to get a HUD loan closed. A lot of the fact that we closed March, a couple of days before our maturity, was because of the decision we made over twelve months prior. We communicate with our investors every month, and we have done special calls on different situations, and we have kept them up to date and up to speed.

Tweet: Communicate with real estate investors every month. Keep them up to date and up to speed about all the costs associated with extensions, rate caps, and HUD deposit fees.

For all the costs associated with extensions, rate caps, and the HUD deposit fees, my partner and I, Co-GPs, pretty much put in the money. We had our skin in the game. We will never go back. I am also an LP in several deals, and I have had capital calls. A lot of the capital calls that I was issued were, "We need to buy a rate cap to get twelve months more time. We hope that interest rates will drop, and then we'll refinance." Quite honestly, that was good money after bad. We knew, and my business partner in several deals, that we were not going to go back to investors without a long-term solution.

The HUD is the longest-term solution you could get in multifamily because we have technically 35 years. It is a sliding 35-year term. It is a sliding scale in terms of prepayment penalties. Our prepayment penalty is fixed, and somebody can buy the deal on assumption. When we get into this business, everyone is in the business of returning people's money and making people money. That's our goal. We are never excited about going back and asking for more money.

The reality is that on this deal, my view is that in the next 2 or 3 years, I do not think the equity impairment is going to get any better, but you need 4 or 5 years for things to get better. We have a solution that, based on our projections, protects the equity and then returns on equity after that. We felt good about the situation. It is a testament to the way that we have positioned the business plan because over the last 3 to 4 years, a lot of people have gotten capital calls. When we positioned it to our investors and did the webinar, we got an 87% contribution rate this late in the cycle.

That was A to be able to close on the refinance and then have that capital going forward to be able to hold this deal for what we think could be three to five years. Relatively speaking, I think it was a great result. Obviously not what any of us planned for in 2021, but looking back, I think we made the right call, and now we are positioned to just focus on operations, not the debt part. Our interest rate is 4.9%, and it is fixed, so that variable is now in control.

What Happens When Some Investors Don’t Contribute To The Capital

You have already mentioned that your business plan is to sell in 3 to 5 years. I am curious, though, and I think this is a conversation that a lot of, at least, investors that I have talked to are asking when they are presented with a capital call, they do not want to throw money in, good money after bad. You did not address why that was not the case here with this particular deal. The second question I usually get is what happens if not 100% contribute to the capital? How did you close that? It seems like there were around 15% to 20% that did not participate. How did you orient that conversation with your investor? If they did not participate in the capital call, how did it restructure their waterfall?

Fortunately, we had a couple of things that changed from the time that we presented the webinar to when we closed. We got a little bit more loan proceeds, which filled that gap, and then any remaining gap was minimized. Any remaining gap, the GPs plugged that gap. It was imperative that we had a significant contribution rate, and we are very pleased with the high 80% that we got. Quite honestly, I think most investors who did not contribute were not because we had a lot of guys that are like, "Look, I'm just tapped out liquidity-wise," but they believed in the business plan of what we were trying to do.

We did have to structure the capital call so that it would incentivize people to contribute. We structured the capital call where there was a preferred return on the new money, and the new money got placed ahead of the old money. If you did not contribute, you were a little bit lower on the priority list. All investors understood that it was one of those things that everyone had to contribute to. Otherwise, the alternatives, which would have been sold now or whatnot, are a lot worse. That is how we positioned it.

Avaya Steeplechase: If investors do not contribute, they will be moved a little bit lower on the priority list.

This is my last question on the Capital Call piece because I think the majority of the people who tuned in are operators themselves, some of them struggling with similar situations as to what you seem to have solved with this particular asset, and of course, across other assets as well. That investor that you might have that comes to you and is just adamant that they are not going to contribute to the capital call.

That it is not a good legal move for them to reorganize the capital stack on them or the waterfall on them, how would you coach a newer operator who is facing a similar struggle? How would you coach them in this particular conversation with an investor that I would maybe say does not quite understand the initial investment to begin with? I am throwing that out there because I know so many people are struggling with a similar thing.

It is a good question, and it is tough to answer. We have had a few of those situations, and the reality is, like to your point earlier, for some investors, we have investors that have invested in multiple deals. They, even though it's not a fund, look at it as like, "I've done five deals with you, these other four were cash-out, and this one is here." As a portfolio, as a fund, they get it, and they have seen our consistency, transparency, etc. That helps. The challenging ones are the ones that maybe it's their first multifamily or commercial real estate syndication.

Maybe they have only done one deal, so they do not have anything to compare it against. It's a fair question. What we have done is just communicate. Have those calls, show them the different options. Everyone's first question is, "Why can't you sell?" This is what we think it would sell for, and this would be the result. The other thing is showing that as an operator, you have your skin in the game. On these deals, we had to commit a lot of our own personal cash throughout the last 3 or 4 years. I do not think these deals will ever generate a promotion for us.

It is really all of our money is just like LP money, and so we have skin in the game, and we show that by our actions. We have been 100% focused on this asset class and our assets for the last ten years. We have not dabbled. Your actions and how you communicate matter. We have never gone dark on anyone. As I said, I have been doing this for ten years, and any investor of mine would say you get a monthly report from us every month, like clockwork, even deals that we have owned now for 6, 7 years.

Those are the things that you do that you have got to just do from the beginning and do the right thing. You are going to have those conversations with some investors that they may understand, may not understand. It is just to communicate. It is ultimately up to the investor, and they are just going to have to understand the consequences of not contributing versus contributing.

Do Everything According To Your Business Plan

Shane, thank you so much for indulging my questions here. I have one last one for you before we wrap up, and that is looking back since you purchased this property in 2021, what would you do differently, if anything?

Looking back right now, I would say I would have bought a longer duration rate cap. Looking back, it was so cheap back then, and when you are doing the capital stack, when you're buying a deal, every $10,000, $20,000, $50,000 makes a difference to returns. In the grand scheme of things, when you look back, it's like, "I probably could have bought a five-year 1% strike at $150,000, maybe," and so that I think that one of the biggest lessons learned not just through this deal, but in everything is that matching your business plan with the decisions you make, whether it is debt, rate cap, etc., is important.

As I mentioned, I had done fixed-rate loans with too long a term, which also handcuffed me, and I think in real estate, the key is you would rather have more runway, time, and liquidity than not. In '21, everyone was just trying to say, "I want to be able to sell, give flexibility." I still do not think that bridge loans are bad. They have got a bad connotation now because a lot of folks use them as the wrong tool. Buying a stabilized Class A deal where you can only raise rents by $20 does not make sense to go get a bridge loan.

Tweet: In real estate, it matters a lot if you have more runway, time, and liquidity.

A bridge loan is to get you from A to B for a reason, and you just have to know when to use the right tools. That is what I would have done differently. We are fortunate that we are able to get to this spot. For some positivity, there are a lot of deals right now in terms of great prices and great re-entry points. For your audiences, I have not seen pricing like this since pre-COVID in a lot of ways, and when things are tough, that is probably the time when you can make your best buys. In '21 and '22, the reality was that it was not easy, but it was a lot easier. There was a lot of money chasing deals. Now it's the opposite, but the pricing feels as good as it has been.

Discussion Wrap-Up And Closing Words

Shane, thank you so much for being with us here and sharing your insights. If people want to connect with you and learn more, how can they do so?

You could visit our website, it's CatEquity.com. Send me an email at Shane@CatEquity.com, and I am relatively active on LinkedIn, so happy to talk shop with any of your audiences.

Shane, thank you so much for being here with us. We look forward to hearing about your future deals.

Thanks, Whitney. I appreciate it.

Important Links

- Shane Thomas on LinkedIn
- Catalyst Equity Partners
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