SMK's Investment Philosophy & Strategy For 2018-2019

The U.S. real estate market and economy continue to change and nobody truly knows what lies ahead. In order to invest intelligently for the future, we must first focus on the past.

Looking back at the market trends up to 2006, we were experiencing significant market price increases across the U.S. coupled with low supply and high demand. In 2008 and through the Great Recession we saw many real estate markets plummet in value, some down near 50%+ from just a few years prior. The market supply of distressed assets was abundant and demand was low which paved the way for many great investment opportunities.

Fast forward about 7 years later and the market has changed yet again. Property valuations have increased year over year for several years straight, supply has again become very scarce, and demand continues to push pricing up.

At SMK we believe we are approaching the tail end of this current cycle. With this belief we hold true to our core principals, and focus primarily on value-add investment opportunities and creating a truly diversified portfolio that is recession resistant. Our investments often have a value-add component where we focus on several measures to increase income and reduce expenses which in turn increases the value of the asset.

We anticipate a market correction in the coming 1-3 years and always keep this at the forefront of our investment selection process.

Asset Classes We Are Currently Targeting and Why

Forecasting a market correction, we are very bullish on specific asset classes that have historically performed well during market downturns:

Mobile Home Parks

- During times of recession when the economy is down, **the demand for affordable housing and Mobile Homes increases**. It is estimated that $20M people live in mobile homes in the U.S and more than half of workers in the U.S. earn less than $30,000 per year. Many of the parks that we source have waiting lists from prospective tenants.
- It is extremely difficult to build new mobile home parks in desirable areas. Most cities' zoning restrictions do not allow for new parks to be built as the majority of mobile home parks were built in the 60's and 70's. Mobile home park supply is **flat or decreasing and when coupled with increasing demand,** this creates an extremely favorable investment structure for the long term.

Self-Storage Facilities

- **Demand for self-storage increases during volatile times.** It is common during a recession for more people to experience foreclosure, change in employment, downsizing and moving home from college, all of which increase the demand for self-storage facilities. Historically speaking, during 2008-2009, self-storage facilities were able to increase rents due to higher demand.
- Once a tenant moves in it is **relatively easy to increase gross rents** because the cost to move their belongings is much higher than the rental increase. A 6% rental increase is not uncommon and often will not deter tenants since the average monthly rent for a 10x10 climate controlled space is in the neighborhood of $105/mth. A 6% rental increase for a self-storage facility results in a significant increase in asset valuation all without much risk of vacancy.

Residential Single-Family & Multi-Family (value add, buy and hold only)

- Acquiring distressed residential property has become more difficult as supply continues to decrease and margins are squeezed. We have performed well in this space for many years and continue to source great opportunities where we acquire distressed property, renovate and hold rented for cash flow for 3-10 years.
- At this stage in the cycle in order to consider a residential property investment, we need built in equity at the onset of the investment. **We are not buying for speculative appreciation, we are targeting opportunities where our total cost after renovations and tenant placement is 15-25% below present market value**. We also are only seeking opportunities in specific markets that are experiencing growth and that have not yet fully recovered since the previous downturn.

Multi-Family Apartments

- The demand for apartments in desirable locations (good schools, amenities, access to transit) often increases during a market downturn as many tenants living in single family homes look to downsize to apartments and **reduce their cost of living**. Many aspiring home owners are forced to continue their tenancy as the access to financing can often tighten, making sourcing a home loan difficult.
- **The home ownership rate of Millennials (born between 1981-1997) in the U.S. is at a record low**. This generation continues to seek tenancy over home ownership. Many have high student loan debt making it hard to take on a mortgage loan. In addition, Millennials saw first-hand how the Great Recession negatively affected friends and family and the demand for apartments from this generation continues to increase.

Benefits of Passive Real Estate Investments

At SMK we have been creating real estate investment syndications and investing as a group for many years. For many of the larger commercial asset classes we focus on creating investment opportunities and partnerships with the “sponsor” or “operator” and invest in a passive capacity. This strategy is common in commercial real estate opportunities and has many benefits that allow us to achieve our long-term investment goals:

- Investing in a group allows us to participate in larger deals that normally wouldn’t be available to individuals. The deals we source typically have an acquisition price between $5m - $25m+. We partner with some of **the best people in the industry** who have bought and sold hundreds of millions of dollars of real estate and often are currently managing millions of square feet of space, they are true experts and specialists in their niche's.

- Investing passively means we don't get involved in the day to day operations and management of the tenants/rent collections/property maintenance etc. We pass this responsibility on to the experts and in turn, we are able to achieve our **overall financial goal of being truly diversified.** We focus on multiple asset classes, in multiple locations, with varying investment durations, and we focus on recession resistant assets that will continue to perform well during an economic downturn.

- Investing passively allows us to **avoid being exposed to credit or liability risk.** We do not personally guarantee multi-million dollar loans and avoid the liability that often comes along with real estate.

- A typically SMK passive investment opportunity provides investors with a predictable steady stream of passive income paid quarterly for 3-10+ years. Many of our investors create **multiple streams of income** through multiple investment opportunities.

The Structure of Our Investments

Although each investment structure is unique, the majority of our commercial property investment syndications are often structured with the following features:

- **Preferred returns** are distributions of cash flow that are paid to investors prior to the operator receiving a distribution. The benefit of preferred returns is that they **create an incentive** for the operator to perform. Investors must receive their preferred return before the operator gets paid from the cash flow or equity. We target opportunities with a preferred return of 6-8%+

- **Targeted rate of return** = 7% average yearly cash flow from rental income and **10-15%+ average annualized ROI** after disposition taking into account sale proceeds

- Investors receive **quarterly distributions** of cash flow along with updates on the investment performance

- We run **full background checks** on all of our sponsoring partners

- Additional cash flow above the preferred return is **split** in the range of 50/50 to 80/20 in favor of investors

- When there is a **capital event** (refinance or sale) the typical split of the proceeds is between 50/50 to 80/20 also in favor of investors

- Our planned **investment duration** is always clearly noted and is often 5-10 years which provides investors with consistent passive income

- Although there are ways to withdraw your capital from an investment by offering your shares to others, we always like to ensure our investors invest with the mindset that the invested capital is being used to buy and renovate property and therefore **cannot be easily withdrawn**

- In today's marketplace it is becoming more and more difficult to source quality investments that can be purchased as is, that provide high rates of return. Our focus is on **value-add investments** where we are going to reposition the property by increasing income and reducing expenses. This often includes performing property renovations and upgrades which may take 1-2 years to complete. This strategy allows us to increase the net income and the value of the property

- The majority of our investments have **low interest rate** financing with conservative loan to value percentages. For example Multi-Family apartment loans are often Fannie Mae financing in the in the 3-5% range and 65-75% loan to value

- We have a **very selective process when choosing an investment** and operator. We analyze countless opportunities before finding one that meets our buying criteria. In addition to the previously noted items, a few general aspects we look for in an investment include:
    - Operator track record of consistent long term success over many years and projects
    - The value-add component of the investment is only a portion of the strategy and not the majority, this allows us to begin receiving distributions in year 1
    - We look for conservative assumptions in the pro-forma, a few include: annual rental increases, vacancy factoring, property tax appreciation, capitalization rate increasing to offset potential interest rate increases, expenses increasing annually with inflation

If you think that you may be a good fit for our investments and are interested in learning more, please let us know and we'll send you our **investor qualification questionnaire**.

We look forward to working with you.

Mark Khuri

SMK Capital Management LLC
c) 310-344-1970
e) mkhuri@smkcap.com
- www.SMKcap.com
- LinkedIn Profile