EPISODE 417

[INTRODUCTION]

[00:00:00] ANNOUNCER: Welcome to The Real Estate Syndication Show. Whether you are a seasoned investor or building a new real estate business, this is the show for you. Whitney Sewell talks to top experts in the business. Our goal is to help you master real estate syndication.

And now your host, Whitney Sewell.

[INTERVIEW]

[0:00:24.1] WS: This is your daily Real Estate Syndication show. I'm your host Whitney Sewell. Today, our guest is William Bronchick. Thanks for being on the show William.

[0:00:32.5] WB: Thank you, it's my pleasure to be here.

[0:00:34.3] WS: I'm looking forward to this conversation and I know, William is the host of legalwiz.com and is a nationally known attorney, author, entrepreneur and public speaker. He has been practicing law and investing in real estate since the early 90s. Having been involved in thousands of real estate transactions. His bestselling book, *Flipping Properties* was named one of the 10 best real estate books of the year by the *Chicago Tribune*.

He's also the co-founder and past president of the Colorado Association of Real Estate Investors and the executive director and founder of the College of American Real Estate Investors. William, thank you again for your time being on the show. Give the listeners a little bit more about just who you are or maybe where you're located and let's dive in to our topic today.

[0:01:20.4] WB: Great, originally from New York City. Live in Colorado for 26 years. Mentioned earlier, I started one of the biggest real estate investor associations in the country and just founded a new one called Colorado Landlords Association which launches in January which will

be focused on people with anywhere from single to big multifamily apartment buildings investing in managing and financing and putting together deals.

I'm a deal maker. Most attorneys will give you just enough advice to keep them from getting sued for malpractice. That's why they say lawyers are destroyers. They kill deals. I'm not that type of attorney. I figure you're an adult, if you understand the risks, I'm going to explain them to you and it's your choice.

[0:02:07.2] WS: What I like those, you've been in real estate for a really long time, you're an investor yourself, you've done syndications as well. You know, it's nice to have an attorney on your team, that's an investor as well and has done lots of different deals, not somebody that's just looking at the legal jargon. You know, on the documents but you've actually been out in the field yourself. I like that expertise, that you bring.

But you know, I think today, we're going to talk about a recent syndication or a couple of syndications, really get into some creative financing that you've been a part of. Maybe get us started on a recent deal where we can dive in to that how you've worked a creative financing?

[0:02:39.6] WB: Yeah, one deal I had a seller who had an existing Freddy Mac, low interest rate, 30-year loan. He was asking about six and a half million. He owed about three million, seven hundred and fifty thousand and he had agreed on a price of a million above that. 4.750. One of my clients was negotiating with him. You know, that's some pretty good deal from 6.5 to 4.750. But I said ask him if he's got an existing loan, what are the terms of it and everything? We found out, it's a low interest rate loan, it is an adjustable but it was currently at 3.75 or something like that, adjusting every five years, on a [inaudible 0:03:27].

I said, "Ask him if he's willing to wrap the mortgage?" Meaning, we basically give him a million cash and then we take the property subject to his mortgage and just pay the bank. Now, though we looked at the mortgage and his attorney and I said," Hmmm, if we transfer this, there's an acceleration clause. The bank can call the loan in."

I said, "Ask the seller's attorney, does he own it in an LLC?" They said, "In fact, he does." "Is he the sole member?" "In fact, he is." I said, "Okay. How about we transfer the membership of the

LLC to our LLC and work our way around the acceleration clause?" And we actually structured as such that the lender signed off and said, "Yeah. That's okay. You can do it that way."

Basically, we ended up giving the seller about 600 at closing and then convinced them to take 400 later. And then subject basically wrapped around existing mortgage of three million seven hundred fifty thousand. The appraisal came in at 7.1.

[0:04:29.8] WS: Wow. He was first asking six million but then he had come down for it to a million over of what he owed.

[0:04:35.3] WB: Yeah, not only that but the appraisal came in seven one, pro forma. It was close, it was about 75 percent occupied. But you know, screaming deal.

[0:04:46.8] WS: That's a good deal. Yeah, it's a good day right there. Instead of assuming the loan, you transferred the membership?

[0:04:52.6] WB: Yeah. Mortgage said, if you don't do the following, then we won't pull the loan. Or if you do the following, we will call the loan. We just – the seller's attorney said, "Let's just do around what it says you can't do." And that's how we structured it.

[0:05:06.8] WS: You know, if we were in those shoes there and we're trying to figure out, "Okay. Should we assume this loan?" What some maybe some common issues or problems you see that happen when they're trying to assume a loan like that?

[0:05:15.7] WB: Is the interest rate good? What's the amortization? 15, 20, 30? Is there a balloon? Is it adjustable and how often does it adjust and what's the cap? How high can it go? Is there a floor in the ceiling to the loan? You can't assume, go to the bank and say, "here's my credit, here's my financials," and just get permission and that may be worth it. Another deal I did recently was an 18-unit apartment building in Colorado that had two-bedroom, one bath apartments that we wanted to split in to one one's. Sort of my two apartments but not maybe 500 square foot each because there were a thousand.

If we spilt them up into two, we double the number and the parking lot could handle twice as many people. One of the attractive things was, there was an existing Freddy mac mortgage, 30 year fixed at 3.1%. Yeah, we were going to give the seller basically about 900 cash, assume the loan and then spend about 600,000 converting the 18 units into 36 units. It would turn it from a six capping to basically an 11 cap which would be quite substantial profit.

The investor who is putting up the money, we said, we're going to form an LLC and you'll be one of the members and syndicated as follows, he didn't want to do that. For some reason, he want ed to be a lender in second position which doesn't really makes sense to me but that's what he wanted.

When we went to contact Freddy Mac, they said, "Nope. No seconds. No second lean position." So, we went back to the investors and said, "Please, don't be foolish, this is a great deal. Just be a part of our LLC and we'll co-owners, co-members of the LLC and you'll be an equity owner." And he just didn't want to do it. And Freddy mac wouldn't let us put a second loan behind theirs and the deal fell apart unfortunately.

[0:07:08.7] WS: Why were they selling or why was that done for sale?

[0:07:10.4] WB: I'm trying to remember. I think the seller was just moving on. They had bought it a couple of years ago and they got it to full occupancy and market rents and you know, six cap, five cap is about the going rate in Denver for a building like that. But we figured, if we can convert it from 18 to 36 units smaller, obviously, but we would get almost double rent than we were getting from 18 units that were bigger. The parking lot was substantial and would handle the extra parking so zoning wasn't a problem.

We'd have to upgrade some things, some of the electrical and plumbing to handle the extra units but the numbers made sense.

[0:07:51.4] WS: You know, a property like, how long, you say it was 30-year debt, is that right?

[0:07:55.6] WB: Yeah, it was a 30 year, I think 3.125 or something like that.

[0:07:59.8] WS: How far into that loan was the seller?

[0:08:02.1] WB: Four or five years. One of the advantages of assuming a loan is of course, as you're implying here, if it's a 30 or 20-year loan and they've been paying down for four or five years, now you're starting to chip away at the equity a bit where if you start over with a new bank loan, you're all interest.

[0:08:19.9] WS: Any experience or a previous deals recently with using bridge debt?

[0:08:24.5] WB: Yeah. I just put together a syndication for a client of an adult living facility in Florida. And they're going to build it, it's just a piece of land and they got bridge financing lined up for 18 months to build it and then they have the same bank, will convert that debt into permanent financing.

[0:08:46.7] WS: You know, maybe you could tell us a little bit about bridge financing just in case the listener's not familiar with that. And I know you said, this was new construction but there's other uses as well but could you just elaborate a little bit?

[0:08:57.5] WB: hard to get a 20- or 30-year loan on new construction. Now, you could put up all cash for that with partners or private lenders but the rates you might pay are pretty substantial, it's almost hard money rates which can be 12, 13, 14% and four points with a six month to a year balloon which is not good.

A lot of lenders, commercial lenders will do what they call, bridge or gap or mezzanine financing which is usually a one to two-year balloon and you're looking at probably seven to 9%, a couple of points. Probably going to be interest only and that's fine. If you need to do what you need to do too get it into the condition that the building qualifies for long term financing. If you're getting a building that is half empty, you're not going to get a lender who is going to give you a long-term loan on that.

You need gap funding or bridge funding to maybe fix it up and raise the rental a little bit and fill up the place till it's 80% occupied and then it's a lot easier to get financing long term.

[0:10:00.4] WS: Yeah. So, if we had a property that was say, 60% occupied or maybe that was because of mismanagement or some other issue that we knew we could fix, we're going to have to get bridge debt, correct? Until you said, till it's over 80%, at least 80% so it's considered stabilized and then we can get a more permanent type debt.

You know, bridge, yeah on older property obviously new construction like you mentioned. I know you used the word like mezzanine. Could you just tell us what that is?

[0:10:24.0] WB: Well, that's just for names for the same animal. It's bridge debt, gap debt. You know, quasi-hard money loan. Whatever you want to call it, it's not your permanent loan. It's a temporary loan to do what you got to do to get the thing either built of filled up or reconstructed or managed better so it will qualify for the better 30 year fixed or 20-year five-year fixed rates that are available out there. Maybe you do it as temporary financing, if you're lucky enough to get an FHA loan which amortizes 35 years or more at very low rates. But those loans can take nine months till a year to get.

In the meantime, the deal's there, you know? You might have to pay a little more in interest rate and cost for that short-term loan but in the long term, it will pay off.

[0:11:13.8] WS: What are the cons too doing in a mezzanine or bridge debt?

[0:11:17.1] WB: Well, first of all, Your cash flow's going to be tight, when you're paying seven to 9% interest, maybe sometimes even more, it's going to affect your cash flow numbers, you know, very substantially so you could expect that you're not going to make much cash flow, maybe even negative the first year or two. Well, you get the thing turned around and repositioned. Your investors have to have enough cash to carry that. There's a balloon on these loans so if let's say a two-year balloon and you haven't turned the thing around in two years, you're going to be in trouble because that balloon is doing, they'll foreclose and take the property from you.

[0:11:52.6] WS: You better have a good business plan. What about the credentials that we need to be able to get something like bridge debt?

[0:11:58.3] WB: Bridge debt is easier usually to get to the long-term financing because it's a lower loan to value. So, instead of getting 80% loan to value and some lenders now doing commercial debt at 85, 90 which is almost unheard of before. It might be more like 60%, 65% loan to value. In that sense, the lender doesn't have as big of a risk as lending 80% loan to value so they're a little softer on qualification. They're more concerned in the building supported, do you have the experience to turn it around and does your plan make sense so that you can get out of this loan before the balloon comes due and refinance it or sell it?

[0:12:38.5] WS: What about the floating rates?

[0:12:40.8] WB: Well, again, in the short term, I'm not that concerned with it. So, if it was seven and mark the interest rate went up and then it becomes eight after a year. This is all short-term financing for a year or two until you get the building repositioned to a point where you can get long term financing or turn around and sell it.

Floating rates, long term can be dangerous if you plan on keeping it long term. If your goal is to keep it five years and you have got a five-year fix and then close to an arm that's fine if you only plan on keeping it five years. If you want to keep them in the long time you probably have given the uncertainties in the world global interest rate market now where interest rates are very low of course but you just never know what Trump does to China and what happens to interest rates and etcetera, etcetera. So, I would recommend getting a fixed rate loan or getting something fixed for as long as you can.

[0:13:33.3] WS: So, I know there is a lot of listeners who are trying to get to that first deal, maybe they've done one deal. They are hoping to get that non-recourse agency dip and so help us to – I guess help them know what they need to be qualified for that first agency debt and maybe some ways to help them to be more qualified for the next one as well moving forward.

[0:13:53.4] WB: Well first I would encourage someone who is just starting out to maybe find a deal where you can get seller financing or partners to put up all the cash so you don't have a complication of that. You may have to bring in a partner who has those qualifications to qualify for the loan. It is different than a single-family home where they are looking at just your credit score and your debt to income ratio.

They are looking at your experience. They are looking at your total net worth relative to the loan. They are looking at the management structure and the income and the cap rate of the property and what is your plan for turning it around. So, there is a lot of factors there in some ways it is easier to get millions of dollars in non-recourse commercial financing than it is on a single-family house in some ways it is true. But if you don't have the net worth that they are looking for or the experience they are looking for maybe bring in a co-managing member of your LLC to be 20% owner, 25% owner and have their qualifications for the loan.

[0:14:59.4] WS: So, do we have to have somebody that signed on agency debt before?

[0:15:02.4] WB: Yeah, a lot of times they make you sign personally on the guarantee on a loan. You know the smaller the loan the more they want to guarantee oddly enough. You know 40 million is easier to get non-recourse than it is you know four million in many cases. But again, if it is a deal where you are borrowing a lower loan to value let's say 65, 70% as oppose to 80% and you are getting more partners in to bring in the cash down payment, you may make less but your risk exposure is lower because if it does get foreclosed the chance of deficiency is pretty slim when you are only borrowing at 65, 70% LTV.

[0:15:45.8] WS: Would you advise that new person – maybe this is their first deal we are using agency debt and you know they have somebody else that is bringing in the balance sheet or liquidity or maybe somebody else is bringing the experience or maybe that is the same person but it is their first agency debt, would you advise them to sign on the debt as well so they gain experience?

[0:16:05.1] WB: Well, signing on the debt is nothing but a liability. There is no upside to it other than maybe you could say to a lender in the future, "Here is what I did." But I don't know if that gets you any points maybe just because you signed it personally. So, if you could not sign personally that would probably be a good thing for you in case it goes bad and you don't want to be on the hook because borrowers are jointly liable.

So that means they are going to go after the one with the deepest pocket regardless of how many people signed on it. If you have to do it if they require it and the numbers make sense and

it is a smoking deal, I don't see anything wrong with that. But if it is a high-risk deal, you know if you are going into a boarded-up building and you are guessing what market rents are going to be in two years and filling it up and you are going for 80% financing that is very risky.

[0:16:53.1] WS: When doing a deal like that though and you have other people let's say – and I get this question often from passive investors maybe they are new to the syndication business and even lights out it is embossed, you ask me, "Wait a minute, if I am a limited partner, if I am a passive investor, how much liability do I have?" So, let us use that same scenario if we have agency debt, non-recourse and let's say the deal goes bad, what happens or what kind of issues could the passive investors see and also the general partnership see?

[0:17:24.5] WB: Well passive investors have virtually no risk. If you are not a managing partner, general partner or in the case of LLC, managing member and you don't sign on any debt and you don't manage the property and you are not participating in any of the major decisions, then there is no liability for you. Because liability is based on the failure to do something you are supposed to do and that is where the managing partners potentially have liability.

But if you are just a passive investor putting up money and you are not participating in the day to day operations and you haven't signed your name on any loan, your risk is very, very low. It is not that much different than buying stock in Google.

[0:18:05.2] WS: That's what I told her. And I also added that she needed to talk to her attorney that I was not an attorney. But on the general partnership side obviously there is a lot more liability there and can you speak to that?

[0:18:14.2] WB: Sure, in a limited partnership, a general partner has liability, which is why most general partners are corporate entities but even so, if you are a managing member for an LLC, technically you are not liable under state law for decisions you make in the ordinary course of your dealings. But there is so many exceptions that are carved out for them in the case law where you can be held personally liable for what is called piercing the corporate veil.

Especially if it is a small company and especially if you do something really wrong and someone is really injured financially or physically. There is a lot more risk for those plus you have potential

liability to your investors who can always come back and say, “You misrepresented or you mismanaged or you took the money and use it for things that you weren’t supposed to and so forth.”

[0:19:00.9] WS: I was speaking with another operator this morning and he was telling me about this group who raised I don’t know how many hundreds of millions over a longer course of time but they were found out that they were doing some highly illegal things and now many are in prison and have received all kinds of death threats and I mean it is a big deal, you know. So, let us take this very seriously no doubt about it.

[0:19:20.5] WB: Right, you might want to insist on if I were going to be a managing member on a big deal where I could expose myself to potential liability, I would insist on the company buying me errors and omission insurance as a managing director of the company. So, if the shareholders sue me in alleged wrongdoing, I have lawyers’ fees covered at least. Unless I have committed something grossly illegal and grossly negligent if the insurance is going to cover that.

As an investor you may want to insist on that too because you want to have a deep pocket to go after. It doesn’t matter if you sue the directors or the general partners if they are in jail and they can’t pay the debt then you want to have a policy to go after.

[0:20:03.1] WS: So, errors and admission insurance.

[0:20:05.8] WB: There is errors and omissions.

[0:20:07.1] WS: Omissions. Omissions insurance and where would we go to get insurance like that?

[0:20:11.4] WB: That is not fairly specialty type of insurance, people who would insure lawyers, real estate brokers, corporate directors that is the type of insurance policy it is.

[0:20:21.0] WS: What has been the hardest part of this syndication process or business for you?

[0:20:24.8] WB: In the beginning, I think that my mistake was not raising enough money. It is better to promise less and have more people in the deal than to promise more and say, "Oh by the way, we are running out of money we need more." Actually, you never but it a bad idea to underestimate your cash flow needs and have to go back to your investors and say, "You got to pony up more money." It is better off raising more capital with and promising a lower rate of return for investors.

I think that is one of the things I learned early on and also make sure you have people invest who have enough experience and sophistication that they understand the risk involved and if someone is putting up a $100,000 it is their last 100,000 that is going to be someone who is going to torture you every day about their money and their investment. You don't want an investor like that. You would rather have someone who is worth 10 million and take half a million because they can afford to lose it and they are willing to take that risk.

[0:21:25.1] WS: How are you preparing for another potential downturn?

[0:21:28.8] WB: Buy more. People thought I was crazy but between 2009 and 2011, I was loading up on properties because they were cheap. It was hard to even get them filled and the rents even barely breakeven and we suffered for a few years. But look what happened over the last six or seven years, the property value has doubled and tripled in some cases. Rents doubled, so it is a payoff. There is money to be made in every market.

A falling market is hard unless you can see your plan through the end of the rainbow, down through the bottom and then back up again and if you could hold on long enough, real estate is a lot of how long can you survive? In the long run, it almost always goes up in value and so do rents but can you survive the ups and downs and between these is really the case?

[0:22:14.9] WS: What is a way that you have recently improved your business that we could apply to ours?

[0:22:18.5] WB: I would say just learning from other people's experience has been good. Meeting other players in the business that can maybe bring some knowledge or experience to

the table for you and maybe you take less of the deal. So, especially if you are a newbie in this and you want to do a deal, maybe bring in a partner and give them 60% of the profit because they have done it 30 times. It takes your risk level way down and your comfort level way up.

[0:22:46.7] WS: What is your best advice for caring for investors so they want to come back to the next deal?

[0:22:51.1] WB: You want to under promise and over deliver. I found that I looked at deals where the cash on cash return if I sliced it up one way might result in 15 to 18%. Some people don't believe that. They think it is a scam. It is too high. So, I am better off slicing it up so I take more and I give them 11% and they believe it more and if I end up giving them 15, they're thrilled.

[0:23:16.7] WS: What is the number one thing that has contributed to your success?

[0:23:19.9] WB: Learn from every mistake. Everything is a learning lesson. If you make a mistake and you lose money it is just an education. Don't give up. You'll always have obstacles in your path. You will always make mistakes. Try to learn as much as you can and employ the expertise of others who are more experience. But there is risk in all investing and you got to be willing to take the chance and stick to it.

[0:23:41.7] WS: How do you like to give back?

[0:23:43.1] WB: I write hundreds and hundreds of articles. I do hundreds of videos on YouTube and I have written six books on real estate investing. So that is my way of sharing my expertise and knowledge with other people so they can follow the path and use real estate to create their retirement or lifestyle that they choose.

[0:24:04.2] WS: Awesome, William. I appreciate your time and you sharing your expertise. It has been a great show and as you dive into some creative financing and just a couple of deals that you talked about. I can't thank you enough. But tell the listeners how they can get in touch with you and learn more about you and even find your YouTube channel.

[0:24:18.3] WB: Yes. My YouTube channel is just YouTube.com/bronchick. My website is legalwiz.com without the H, wiz, legalwiz.com where I have hundreds of articles on commercial and residential investing, videos, podcasts. I have a podcast as well on Apple iTunes streaming on my website and tons and tons of videos on YouTube.

[0:24:46.5] WS: Awesome, thank you William.

[0:24:48.1] WB: Thank you, my pleasure for being here.

[END OF INTERVIEW]

[0:24:49.7] WS: Don't go yet, thank you for listening to today's episode. I would love it if you would go to iTunes right now and leave a rating and written review. I want to hear your feedback. It makes a big difference in getting the podcast out there. You can also go to the Real Estate Syndication Show on Facebook so you can connect with me and we can also receive feedback and your questions there that you want me to answer on the show.

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[OUTRO]

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