EPISODE 420

[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 Paul Winterowd. Thanks for being on the show Paul.

[0:00:32.8] PW: Hey, great to be here, excited to chat with you today.

[0:00:36.0] WS: Paul specializes in multi-family debt solutions for investors and syndicators. The owner of multi-family real estate as both a general partner and limited partner, he's working on playing 500 different golf courses and is 200 in the books thus far. Paul, thank you for sharing that as well and I'm looking forward to getting into this conversation about debt solutions because that's such an important part of this business.

But give the listeners a little more about who you are and what your focus is?

[0:01:05.6] PW: Yeah, definitely. Just to correct you briefly, 280 golf courses is how many I've played so I do deals all across the country, work with people all across the country so it gives me a good excuse to get out and play a new golf course or two if I can come visit a new client. But I'm based in Salt Lake City Utah, I work with a company called Bonneville multi-family capital. We really specialized in multi-family finance and I know there's a lot of different ways to syndicate but that's the area of focus that I'm in is the multi-family finance side and we're not a balance sheet lender per se. Really that mortgage broker capital advisor, we've got a lot of different sources of capital and resources and loan programs.

That's really where I live and breathe every day, it's understanding the different loan programs and really understanding what my clients are trying to achieve and accomplish and bring those solutions to bare.

[0:02:04.5] WS: Nice, you know, you and I were talking briefly before this and I like that you're expertise is in the debt and financing side and I know a lot of listeners are – we don't have the – always have the knowledge or the understanding of that part of it to really think strategically about how we can use different types of debt in these deals or think differently than maybe what most of the industry does but I'd love for you to just explain or elaborate on some different types of debt a little bit and let's get in to maybe some strategic ways of thinking about the debt and how we can use that.

And other ways that the industry's using right now.

[0:02:42.4] PW: Sure. I get it, right? You want the best terms, you want the lowest rate and lease fees and all those sorts of things and there are tradeoff space on different programs and what you're trying to achieve and certainly a syndicator's leverage is a tool to create greater returns, show higher IRR's and those sorts of things that help promote the deal certainly.

We get very focused on the front end of that acquisition financing and you know, your typical syndication is that five years whole. Hey, let's get in, let's add the value, enjoy a few years of cash flow and then bring that cash register and move on. Well, there are consequences to that and we met a couple months ago, had some nice conversations and after you invited me to be on the show, I started thinking, well, how can I value or how can I have a unique perspective here and not just talk about different loan programs but more on a strategic basis.

What really resonated with me is actually thinking of debt on that back side and how can we think strategically at that five-year mark rather than just sell. It's not going to be right for everyone, I get that. Just food for thought and a different way of thinking of things. What came to mind was actually one of Aesop's fables?

Aesop was a Greek philosopher and storyteller that lived 600 BC. These ideas and these concepts have been around for not only centuries but millennia and so there's a reason that some of these stories endure and one that came to mind was the goose that lays the golden eggs. The story goes and most of us are familiar with it but a farmer and his wife have this goose and it's laying golden eggs. How cool is that to have a goose that lays golden eggs, right?

What do we do in a syndication? We buy a goose that we work on and we nurture it and then it starts laying golden eggs and right when it's laying golden eggs, you know, we start just like the farmer and his wife were laying these golden eggs so there must be full of gold inside. Let's kill the goose and get all the gold right now.

I think we can fall into that same trap as syndicators and say okay, I want to extract this gold but you know, the moral of the story is they killed the goose and then there isn't necessarily that gold inside which doesn't translate 100% in most syndications because there unusually is that bump on the back end but then there's no more golden eggs.

How can we look at things to preserve that goose and to create that ongoing value and those golden eggs well into the future, does that make sense?

[0:05:25.9] WS: It does, I really like that analogy as well. You know, even that fable, I mean, we killed a goose because we want all that now but then it stops, right?

[0:05:35.5] PW: Yeah.

[0:05:35.6] WS: It's done. Really, just thinking long term and I was creating a book, I was flying on a trip over the weekend and I was reading this book and even talked about most successful people, you know, are long term thinkers, they're thinking long term. Whatever decision they make, they were thinking, long term, how's this going to affect me now but how is it going to affect me 10 years from now. I like that analogy a lot.

Can you elaborate on five year hold, I mean, that's like the industry standard it seems like? Most people were thinking about this five year hold but you know, maybe some ways that we should be thinking differently about that and the depth for that.

[0:06:14.8] PW: Certainly. Just to echo your thought there. Go back to Warren Buffett, right? Everyone's familiar with Warren Buffet and he's not necessarily big into real estate, certainly in equity and aa stock guy but he does not necessarily invest for value, he wants to find something that can create that cash flow and provide great returns on a cash on cash basis rather than just buying a company and then hoping it goes up in selling it and getting the games that way.

He's looking for that and so, he's done pretty well. If you look around the industry. Real estate can be a generational business, right? The families, the companies, the groups that really build something substantial have that mindset of simply holding on. They keep that asset and may not be as sexy or as exciting but certainly over a long term basis can really be significant and substantial. Yes, coming back to the question, how can we u se debt on a strategic basis after that five years or maybe three years or maybe seven. We go in, we add the value and we make it happen.

One of the things that we do in here at Bonneville is a HUD map lender. There's aa lot of different thoughts and ideas around HUD financing in the market place, there's, if you dig right into it, the terms are very appealing to almost everyone and there's some tradeoffs in working with HUD and we'll dig in a little bit after that but what we can do with a HUD loan is we can go in and we can do on a cash out basis to 80% loan to value based on a market appraisal, after you've owned it for three years. You can go in, add that value.

You know, you're looking at an 80% loan too value at that point and it's very easy to extract all that equity that you syndicated on the front end of the deal and so, that's when it becomes really compelling and sitting in that limited partner seat, if you look at that, what do we want as limited partners or investors in syndicated deals?

I know from my perspective, I want a return but more than anything, I want that money back, I just want to know that I didn't lose, right? We hope for a great returns but it's a limited partner, we want to see that money come back so let's look at this HUD program. We're five years into a syndication and we have an ability to 80% of the value of the property after you've done the improvements.

Hold that out and return that cash to the investors and then now, you're holding on to this asset and you're really in that infinite return space, Robert Kiosaki talks about this in his books, what could be better than the infinite return and that there's really no risk at that point. Well, investors are certainly going to be happy and they're definitely going to be inclined to do that again but by going that refinance route, you do avoid those capital gains, that tax obligation and there are transaction cost to financing but typically, they're a lot less than the actual sale of transaction cost and so you're preserving some capital there as well.

Also, as a syndicator, if you're disciplined, you're looking for the right deal where you might have a deal come to fruition and that investor needs to redeploy that capital and it may go elsewhere and that's okay, we're all in this together and it's not have a scarcity mindset but a couple of other things that's nice about the HUD loan, we actually do those on a 35 year term and amortization. Your typical fanny Freddy is on a 30 year amortization but you have your five, seven or 10 year terms, you have this forced balloon payment or some sort of action that needs to happen.

Well, that 35 year Am is going to increase your cash flows but also, gives you complete control of when you recapitalize or refinance down the road. Most agency is on a yield maintenance prepayment structure, prepay that early, that's a pretty hefty bill but on a step down, that's what the HUD loans are, it's a step down prepay, it's a lot smaller. It just gives you a lot more flexibility to choose when you recapitalize or maybe you just keep it indefinitely and you don't have too – You can set it and forget it.

[0:10:53.3] WS: Let me think about this just a second so the listeners are onboard as well and maybe simplify just a little bit. You know, instead of having, say that five year hold, we may plan to do a refi, near two or three and really pay – their capital back. But then planned, they have their capital back like you said, you know? You want that back so you know you're not losing.

However, but then, don't plan to sell in your five but plan to just hold the property and then like you said, investors are getting that return, just forever in, as long as you hold the property and then you control when you do another refi or like you got to recapitalizing the property, is that correct? Am I following you?

[0:11:34.0] PW: Absolutely. Generally we're in good times, right? We've had a nice, long run in the markets and there's the debt markets have been robust, there's a lot of capital out there but what happens to your syndication when your note comes due in February of 2009, right? Horrible time, right?

Cap rates have gone up, there's no debt solutions and all of a sudden, you're forced to do something and that's where we've had a couple of clients that really got decimated at that time because their balloon can't deal at the wrong time. It's something in the back of your mind and not necessarily always at the forefront of syndicators because we find the deal and we've got to do it and we're not necessarily trying to time and we don't know when the markets are going to correct in that sort of thing. Whatever we can do to take back control of that, I think is just a wises approach from a syndicator standpoint to be safe.

Because again, the worst thing you want to do is have it go bust and lose the investor's money.

[0:12:39.9] WS: Of course. You know, thinking about, I guess changing this mindset a little bit from this five year hold that everybody's kind of stuck on. I hear like five to seven years. How do you approach that conversation with investors, you know, maybe some typical concerns they're going to have?

[0:12:58.1] PW: Sure. I think you really need to just sell the vision that hey, we're going to look at multiple exit strategies, they're not – there isn't just one exit strategy. Selling may be the primary one, that may be the one that makes the most sense and the one you move forward with but communicating with your investors which is always a good thing no matter what.

About hey, we're exploring different options and want to do what's best for you and for us and explaining this concept. Well, if this makes sense, it does have to make sense at the time, we have an opportunity to create something that to create this goose that lays golden eggs and see how they respond and just gauge their feedback.

You know, there's lots of different scenarios and another I wanted to mention or at least make note of that we're seeing and I'm doing a couple of loans currently that have taken this strategy. It's really rolling in to a full term interest only play. And so, this isn't necessarily a HUD loan but with the agencies as well as CMBS and CMBS is currently being a little more aggressive here but there are options in both fronts where hey, again let's back up. You go in and you create this value even with max leverage on the front end but you have created all of this upside on the backend and to qualify for a full term IO scenario, you got to keep it in a 65% loan to value scenario.

You got a little higher debt coverage ratio to hit but you have created that value and now, you go into maybe a 10 year or a 12 year full term IO and you are just juicing your cash flows. You are 2X, 3Xing your cash flows by not having that principle pay down every month and again, that cash on cash becomes eight, 10, 12 maybe even 15% and again, very compelling. You do that for the long term. You say okay, "Hey investors, we got this alternative where we think this makes a lot of sense."

"We are going to double or triple your cash flow that is going to continue to grow over the next 10 years. Would it be worth it to you to leave your money in there?" "Absolutely" I don't have to go find another deal. We have already proven this out, we've got this goose that is laying golden eggs, let's just harvest the eggs.

[0:15:28.9] WS: With this full term interest only row be at the beginning or when we purchase the deal or is this something, okay we are going to do a refi in year two and then move interest only?

[0:15:38.6] PW: Yeah, great question. It is tough to do on the frontend. It might work if you are building new construction and that would be your take out loan because typically you are creating a lot of value but with the full term IO we do have a 65% loan to value and so most syndicators that we work with and that I've seen are looking to maximize that leverage, which obviously increases the projected returns in that sort of thing. So certainly a good approach.

I do have a client that is more conservative in raising more capital and it is more of a cash flow place. So it could be either side. What we see more in the market place is this maximize leverage initially and then on the refi, three, four, five years down the road that is when hey, rather than selling we can put a full term interest only on this for 10 years than just I am going to double your check next month or next quarter and that is going to be what it is going to look like, is that compelling?

Well yeah, why not? Let's do it. So typically on the refi side and that backend strategy, more so in the front end but they could work for both.

[0:16:51.0] WS: Okay, yeah because then we paid that principle day on it and we are going to have a lower or a higher, hopefully a higher value by that time as well I would think.

[0:17:00.3] PW: Yeah that's it. You got to create the value for that and you may be able to pull some cash out, maybe not the full cash out like in the Hudson area because you have to hit that 65% loan to value, 1.35 debt coverage rather than a one-two or 125 on your typical loans but it is a great option for the cash flow and really worth considering.

[0:17:20.9] WS: Yeah, what are the cons of doing this interest only type debt? You know I hear people say, "Oh that is too risky or you know we are not paying down the principle at all" what are some considerations there that we need to keep in mind?

[0:17:32.7] PW: That's just it but again, we are looking at hey now you're at 65%. Well your plan is to continue to raise rents over the next five, 10 years and so you are creating more net operating income, which creates the value and so you are really over that projected timeframe. You are going to get to maybe 60 or even 55% loan to value as that value increases and so different strokes for different folks but I certainly don't see a lot of downside in that if you are a whole type investor.

The only real tradeoff is that you are leaving more cash in the deal. So if you had a better place for that or wanted that cash out that would really be the tradeoff but from a risk perspective, we are worrying about not doing any principle pay down. The way that the loan programs are structured and the metrics you have to hit on the front end, there is really not a lot of downside risk on that side of things.

[0:18:38.7] WS: So you know, a few questions before we run out of time Paul but what has been the hardest part of the syndication process especially on the debt side for you?

[0:18:47.1] PW: There is a lot of options. If we are talking about syndication, the hardest part I think and maybe really the key to success in this game is actually doing it. It is actually getting in the game. I filled a lot of calls, I've filled with hundreds of calls over the course of my career people that find us online or referred to us and talk to them and a lot of people want to be in this game and it is so easy to look at the syndication game and be, "Hey that looks cool. That's sexy, there is a lot of money there. I want to do it."

And a lot of people just don't and I've had clients that may have been less sophisticated or didn't know everything but they took action, they jump in and they've figured it out. A little bit of building the airplane in the air and in my own experience, I have done that to some extent as well but getting in the game is really I would say the hardest thing and the biggest factor of being successful is as simplistic and perhaps un-noteworthy that that might be, it is really just doing it.

And I see a lot of people that they poke at it and look at it and really don't do it and never really get those gains in others that have stepped in and have their increasing their net worth, their cash flow, they are growing, they are doing more deals. They are learning and progressing because they are in it.

[0:20:09.6] WS: I love the analogy of building the airplane while you are flying and I can relate to that getting started as well.

[0:20:15.1] PW: Well, we all do right?

[0:20:16.1] WS: Yeah, so many things you have to learn and you got to jump and commit and get it. I love even the analogy of thinking about the commitment, you know like okay you are already flying. You don't want to crash, right? So you got to get that thing right so I love that and so, tell me how do you prepare for this potential downturn or recession that everybody is talking about?

[0:20:36.5] PW: Oh that is a great question. I wish I had that answer. There is certainly the old mantra and we go back to Warren Buffett, cash is king. Don't think it is a bad idea to have some cash reserves but I also think we don't know when it is coming and we are well beyond when it should have happened. I have been to economic conferences for three or four years in a row now and every one of them, "Well, the recession shouldn't be here six months from now."

Well, you know you hear that every year and it doesn't come and then there will be corrections. There are cycles we understand that but having some cash inside on the side but also coming back to what I said before, you want a track record. If you haven't established a track record, if you haven't done any deals, if you haven't been in the game, things go down and you're like, "Okay, now I am ready" you are not a known entity of how much harder is it going to be raise funds when funds aren't as abundant.

You need to have a track record and you know what you are doing and so I think it is twofold. The best way to prepare is don't spend all your money, keep some on the side, have some cash reserves but also get in the game and stay active and build up that reputation. So if that correction comes you are more poised to take advantage of that because I've made money, you've made money, a lot of us have made money over the last three, four, five years but the guys that really –

Guys and gals that made a ton of money were doing syndications in 2009, 2010, 2011 when everything is on sale and people were scared but that's the best way to prepare.

[0:22:16.5] WS: What is the way that you've recently improved your business that we could apply to ours?

[0:22:21.5] PW: A book I have been studying and it is really resonated with me is called the four disciplines of execution and some people may have heard of that but it is talking about leading indicators versus lagging indicators. It is easy to look at our cash flow or our production in our day job but that is a lagging indicator. We need to identify the leading indicators and how to measure those. So if we are trying to build a syndication business, what we need is we need investors.

We need partners so something to track is how many phone calls or how many meetings you are having to build that database and those relationships and that today, it might not look like, “Hey, I got a syndication” but you are doing those things that are going to lead to those results but figuring out those leading indicators, those inputs, the outputs you want and measuring tracking, developing those. It is something that has helped me. It is something I continue to work on and feel is really important to building a successful business.

[0:23:27.3] WS: Who is the author of that book?

[0:23:29.4] PW: A couple of authors, it is Chris McChesney, Sean Covey and Jim Huling.

[0:23:35.7] WS: Awesome, I just wanted the listeners to be able to find that book. It sounds very interesting. So what is your best advice for caring for investors so they want to return to the next deal?

[0:23:45.8] PW: Certainly communication I think is key. I have heard it on your podcast, other syndicators, it is out there but communicating rain, sun or shine what is going on, keeping people informed that’s what we want. You know if investors are going to fill that void, they are going to have questions on what is going on and much better if we are helping them understand that narrative and what is going on rather than leaving a blank slate and it is easy to go to a worst case scenario in our minds if we don’t have that information. So certainly, communication is key.

[0:24:24.8] WS: And what’s the number one thing that has contributed to your success?

[0:24:27.8] PW: Coming back to what I said before, I got to practice what I preach but jumping in and doing it that is not earth shattering but that is the key. Things certainly changed in my life when I took that action that wasn’t necessarily comfortable or easy but taking action and closing that first deal really does change your lives. So it has certainly changed mine so that is my best advice. There is no silver bullet just get in and do it.

[0:24:54.9] WS: I love that and tell me how you like to give back?

[0:24:58.2] PW: One thing I love about the loan business and my mindset is simple the opportunity to visit with people and help people understand their options and educating that way. I love community service, I have been involved in several Sub for Santa and those sorts of things. This is a great time of year since the holidays are approaching for me and certainly through my church. I like to give back and help out.

[0:25:25.5] WS: Wow, well I appreciate you sharing that Paul and just really thinking about the debt and the pros and cons of different types of debt and even thinking outside of this five to seven year hold that seems like to be an industry standard and you know even the book that you recommend and even how I think you mentioned a group using the interest only or doubling or tripling investor returns and that is by using different types of debt and thinking more long term.

And so I appreciate you helping us get out of that mindset or opening our minds a little bit to some different debt strategies but tell the listeners how they can get in touch with you and learn more about you?

[0:26:00.8] PW: Sure, email or phone are the best way. I do have a newsletter and if you email me, I can add you to that. It is paul@bmfcap.com and you can also give me a call at 801-323-1050.

[0:26:28.8] WS: Awesome Paul, that's a wrap. Thank you so much.

[0:26:31.2] PW: All right, thank you for the opportunity. It was fun.

[END OF INTERVIEW]

[0:26:34.5] 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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