EPISODE 453

[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 Feras Moussa.

Thanks for being on the show again, Feras.

[0:00:32.2] FM: Yeah, no problem Whitney. Thanks for having me back on.

[0:00:34.2] WS: Yeah, I'm honored to have you back on the show. In case you didn't hear his first episode, I would encourage you to go back and listen to show WS446. And just so much great content, I can't believe how many quotes he mentioned alone or like things that we need to hear in this business and just a great operator, Feras and his partner, Ben, just growing done lots of deals now and just really becoming a leader in this industry. Looking forward to this conversation.

And, I encourage the listener to go back and listen to it like I said because we're just going to jump right in and Feras has so much experience and knowledge that he's going to give to us to this show as well. But we wanted to talk specifically about a recent deal that they completed and so many lessons learned. Feras, let's j ump right in to this 99-unit deal that you all, I think you went full cycle on, is that right?

[0:01:22.0] FM: Yeah, full cycle on it and yeah, this is the deal, I don't want to say the deal from hell but it kind of was. We learned everything went wrong that can go wrong and a deal did and you know, kind of, how do you work through it and continue kind of fix those challenges?

[0:01:33.5] WS: Tell me though, you know, when in your syndication career did you purchase this deal?

[0:01:39.3] FM: Man, we bought this deal two years ago. This deal is a deal we sold kind of last year, I guess earlier this year, I guess we're still not in 2020 just yet. But you know, it's a deal that – going back to what I said in the last show, right? We were in Texas. We were starting to get outbid basically from Texas. We knew we weren't going to be able to find the price point that we wanted in Dallas or Houston and you know, we were looking for other markets.

We knew we wanted to get to Atlanta. We identified that and we needed to make sure we had a deal that was a home run. A deal that we could make sure we will home run as long as we execute the business plan, right? This fell in our lap, you know. It's a deal pretty much a lot of people just kind of glossed over. Not as much interest because it was a deeper value-add than most people want. This was a deal that was on paper, 80% occupied, right? The previous owners were just kind of known for poor things.

So much deferred maintenance, more than what we even expected. This deal had, on top of that nine down units, right? If you do the math, 99 units, nine of them are down, that's 10% pretty much of the units were down. A lot of people let's say, it's a rougher deal tenant base, area's kind of an okay mediocre area, right?

It's got down units, so it means bridge debt. All of the things that you know, all of the people shy away from. For Ben and I, whenever we looked at it, "Man, this deal is gold." We knew that this deal could make money, right? I went out there first, saw the deal and I'm like, "Hey, we're going to get this deal." Then you know, we get this deal under contract. Ben hadn't seen the deal and so I bring him out.

It took him about six hours to warm up. At first, he's like, "What did we get ourselves into?" You know, by the end of the day, sun came out, we have a nice picture of Ben and I standing near the sign and you know, we knew that it was a deal that can work. Kind of we hit issues from the very beginning. First problem was really the debt, right. It's bridge debt. We like bridge because it's a tool, right? I think bridge gets a misnomer because people try to use the wrong tool, bridge debt to go buy a stabilized deal.

That's not what bridge debt is for, right? We currently have what? Across a portfolio, probably four deals of bridge and you know, those are deals that we could sell quickly. Used correctly, bridge debt is very powerful. Now, the issue was that, for that deal, a lot of bridge lenders didn't like the deal upfront and then you know, we didn't know what we didn't know, right? It was kind of our first real foray into bridge and we used a lender that I'm tempted to mention the name but I'll probably leave it out.

If anyone wants stop know, please feel free to email me, I will help you avoid the mistakes that we made. But essentially this lender was just known kind of as a loan to own lender, right? They know this deal's deep value-add, right? We're putting in, you know, one and a half million dollars of rehab into it, nine downed units. Our whole business plan is predicated on bringing those units online and getting that money injected into this property.

Now, in addition to that, right, during closing, we have to buy what's called an interest cap, right? When the bridge loan right, it's a floating interest rate, you buy it with cap, that essentially, think of it as insurance, right? That you have an upper ceiling of where the cap is going to be, that's not going to go – the lenders require that.

Now, this deal was not a big loan, right? It was what? I think a four-million-dollar loan, our interest cap on the deal ended up costing us $50,000. We did an 18 million dollar deal last year, that interest cap was $20,000 interest cap. Makes absolutely no sense. From the get go, this lender is just excessive fees and then just kind of the really tight on their thresholds.

The problem is you get into closing, this is something I buy everyone just to be careful of because once you're – two weeks from closing. I mean, the deal's happening, right? One way or another. Lenders, everything will come out of the woodworks, you know. And you can't really do much about it unfortunately, right? Yeah, you could try to say, I'm not going to go with you but you're not going to go find a new lender in a week.

I mean, miscellaneous fees, all this nonsense, great, we kind of suck it up, bite the bullet, get the closing. We get this deal closed. That's kind of the first awakening with this lender, all right, "Who are we getting ourselves in bed with, really?" Because you're stuck with them, right? You know, we buy this deal and we take occupancy down from the first three months or four months from 80% down to 40% occupancy, right? Cleaning out all of just the riff raff, getting a nice base to start with.

Again, that's painful, because now you're operating in the red, right? Now, property's 40% occupied, we need to get money out and you know, get this thing going and it's just you know, chaos ensues on this deal, right? Maybe I'll pause there because I know I talk fast, I talk a lot, pause there. If you have any questions before I kind of continue through this story.

[0:06:11.3] WS: Yeah, there's so many things. I know some of the stuff got bridge debt, we've covered before and I want you to have time to elaborate a little more. You know, and some other things. But bridge debt, it's a tool, it's a great way to get a deal done when it's used properly.

You know, even you mentioning that, it's not something you use on stabilized deals and so, when do you see that and what's the problem there?

[0:06:30.1] FM: Honestly, people use it for stabilizing whenever they can't get their numbers to work and so, with bridge, they can get a little bit better leverage, a little bit more and they can squeeze a little more juice from that turnip. But the problem is, you're essentially setting yourself up for failure because now you're taking on short term debt that has unknown you know, kind of risk tolerance for the interest rates. Yeah, it might look good now but what's your exit? And. again, people really forget to think about the exit.

Exit means, who am I selling to? What is their situation? What is my cost to do that? What timeline am I doing that in, right? Am I going to have my NOI where I need it to be? All these things need to be accounted for on the exit and I think people are going to bridge and they're like, "Well look, I can get three years and I can buy two years, I can get into this deal for five." But there's costs associated with bridge.

I mean, bridge is again, it's tool for us, we like it for deeper value-add deals, right? If a deal that we need to buy but we can't because it's not stabilized, we can get agency. Great. We'll but the bridge, do our work and ref-fi that deal into a permit.

[0:07:25.7] WS: What do you wish now you had asked that lender or the questions you had asked or what would you have done different?

[0:07:31.2] FM: The mistake we made was just not knowing the lender. They are notorious. They are, like I said, a loan to own. Maybe I'll get into the story but every time we went to ask for money, it was just you know, moving field goal post, right? They were intentionally trying to see if we could default on that deal. That's really fundamentally what they were trying to do. I mean, it was just lie after lie.

It's not, you know, I'm on the bad end of it and I'm just complaining. I mean, it was legitimately like documented things to where we just have to escalate and escalate. I'm like, "You guys are just wasting all of our time." And you know, my best example was whenever our asset manager there, she basically said, it was the best turnout she had ever seen but we're not going to approve any of this.

It gets to the point where maybe back to the story, right? We're operating in the red, 40% occupancy, there's not much money coming in, you're losing money, right? We need to get units online, get things that you upgraded and you know, if the longer we take, the more money we're slogging and so you know, that model, we just self-funded the thing just to get – it's a bunch of pipes, right? You got to get all the pipes unclogged and once you do that, money comes in, then you can start to get things going, things get leased back up.

You know, for that deal, maybe back to the initial thing, right? The deal had nine down units and the reason they were down is because it was on a slope, there was a pump that had to pump sewage into the city sewage, that would run every few hours. What happened is that pump had failed that head back to the nine units and that's why they've been down for years. Whenever we went out there, we thought, this must be like a $300,000 system to kind of fix, it cost us $30,000 to put this brand new – the previous owner had put in residential grade, one pump versus –

We put in commercial two pumps so they take turns, if one fails, there's a siren that goes off so you can know to get that fixed. $30,000 cost. Now, how much value did we add by bringing those units online, right? It's crazy to me how short-sighted some owners are and so this guy was cut up for $30,000 cost and he did it for 15, right? He did it or poor boyed it, which is why it kind of backed up and failed, a $30,000 ride that we thought we were going to – originally, we were going to budget, like $200,000 for it, right?

Got that fixed, got this unit online and you know, we quickly, on that property, once we unclogged all the arteries, right? Because we just got to a point where dealing with the lender and the drawn, maybe that's, yes, no. But the last show was the hardest part of this business. First, six months to a year, is a hard part of this business. The second hardest thing is dealing with lenders draws.

I'm sorry to all lenders, I've not had no one lenders like, "Man, these are the best in class." And I think there's an opportunity for a lender to be best in class on draws, because for us, I'm mean, that's half of my asset manager's time has to be spent babysitting draws, right? It's such a painful part of you know, some of this go quick, some don't. With this lender, it was like a two month process to fight for any draw and so once we kind of said screw it, we're not going to just sit here and deal with it.

We're just going to execute our business playing with cash on hand and then you know, just get out of it. Once we did that, we leased that property. In three months, we tripled our NOI or actually, tripled our collections and more than tripled our NOI because we're actually in the red.

In three months, we literally went from 30,000 in collections or $27,000 up to about 90,000.

[0:10:50.0] WS: II just think that shows the quality of a really good operator too and some is committed to their business. You mentioned you all self-funded, right? To make this happen.

[0:10:58.2] FM: Yeah, for sure. Yeah, I just didn't want to deal with a lender like the lenders holding on to a million dollars. And we just said like, "Hey, this is not worth our time," and then they take two months and I'd rather just get this property humming and now everyone is happy, right? So, we kind of coughed it up and just got the juices flowing and unclog everything and everything started going from there and it was just again, you get past that hump and then it's like roses.

Properties leasing up, money is coming in. Money, yes you are profitable. You are now operating the rent where every day you are sweating. You're like, "Oh man, how much money do we lose this month?"

[0:11:28.2] WS: No, I just think that's great that you mentioned that because not every operator is going to be willing to do that.

[0:11:32.6] FM: No. But I am surprised whenever I hear stories of operating doing that. I am like, "You do know your investors are your reputation and you know, if you burn investors you are never going to continue to deals, right?" So, I mean to each their own.

[0:11:46.2] WS: Yeah and so give us a couple of big lessons that you took away from this deal though?

[0:11:51.3] FM: Man, the biggest lesson is just always have more cash on hand than you might think for these deeper value-add deals, right? I am not talking about deals where all you are doing is interior upgrades, ask people move out. You are only doing two, three, four, five a month, right? I am talking about deals where you are cleaning house, you are doing a lot.

You know have more, as much cash as you think you might need. Have two and a half x that. So that's where we are right now it's just that extra bit of cash. Yeah, maybe it waters down to returns a little bit because you are raising more money but it makes everyone's life easier because cash is king and you can do your rehab much quicker because guess what? Yeah, maybe you save 500 grand because you didn't raise it that extra 500 grand so you didn't have to pay returns on that.

So now returns on the property modeled out are 5% better, right? But now the thing you are not realizing is if I have cash on hand, I can get all my rehab done in a month. Versus taking that at 8th month, which is what I would do at a draw. Well, that extra six months is also more profitable than it would have been. And so, you know it is just not worth the headaches and so it is having more cash on hand that's critical.

Knowing your lender, right? I mean because again, you are tied to them. You cannot do much with them and they can always make up stuff across the board and just being weary of that and again, the other thing goes back to maybe what I hinted at the last show is know the person you are buying from, right? On that deal, we had more deferred maintenance than what we even expected and we thought there is a lot, right? So just know the person.

You know this is where now as we are buying bigger deals, better deals, more institutional or whatever you want to call them, we start to see a difference between something that it professionally run versus not. The difference between semi-professional versus really professional and then that really all boils down to just what's the quality of the asset, right? And so, do half the units have leaks that are really there and some of the stuff you see in due diligence, right?

But a lot of times you know things can be painted over and all looks roses, right? But you don't really know where you go on due diligence and you check in the roof and you realize this guy put five layers down and I guess the recommendation is supposed to be only two. So, knowing who you are buying from. And I think again, that pump speaks for itself, right? The person then needs to know what they were doing whenever you would not spend $30,000 to bring up.

Because again, nine units if you can just say their average is let's just say a $1,000 right rent than weren't but to keep this simple that's making $90,000, what a $100,000 more revenue a year by spending $30,000. It is hard to say that doesn't make sense so.

[0:14:17.6] WS: Well do you all have a ratio, do you have simple way of calculating how much capital like a reserve account over your – you know what do you want in that account? How do you figure that out?

[0:14:25.8] FM: It is all deal specific. I mean it just depends on how much of a value-add we are doing but I mean I would almost say if I was just hogging a good old thumb a third of your rehab needs to be in reserves like cash on hand. That would probably make your life easier and some things take longer or not immediate, right? You don't need a new sign immediately, you can kind of continue to go but other things are immediate and the more on hand the easier everything is.

[0:14:50.5] WS: Okay, so a few more questions before we run out of time. So quickly, how are you all are preparing for this potential downturn that everybody is talking about?

[0:14:57.4] FM: I mean it is about buying deals differently, right? So, for this deal that I mentioned, this was bridged. We sold this deal and I mean home run there, right? So, this deal maybe I guess there's to wrap up that story, once we got it through, this is the one we got the unsolicited offer and we got our investors. We're still dotting the eyes in terms of the exit right now but it's got to be somewhere in that 80 to 100% return in 18 months.

So again, a deal that we knew we'd home run and not screw up and it got us into Atlanta but now we start to look at deals where if I am going to do deeper value ad, I still need to have enough meat on the bone just to be a little more resilient because I don't know in a year or two can I do an easy re-fire. Is the market going to be liquid for the next buyer, right? Again, this goes back to –

[0:15:40.6] WS: Are you still using bridge debt now?

[0:15:42.2] FM: We still use bridge but we are making sure that we have a bridge where we can go five years when we need to, right? So that is the first thing. You know we are not interested in this short-term bridge where you get one year and one extension and then it is a bazillion points to get more extensions. We kind of from the beginning, we structure them that way. For a long term holds, the only thing I am starting to like a lot more honestly is going in less leveraged.

I think people to make their deals work, they are going in as max leveraged, as max IO as possible. We all love IO, IO is great. I don't mind IO. But we did a deal in Atlanta last year or early this year where you know, we knew the areas. It is okay but it's fantastic asset and you know we decided to go into 65% leveraged, right? By design we went in less leveraged and got more IO and that is the deal. I mean our note on that deal is unbelievably small.

Guess what? We will always be able to pay something out to investors on that deal, right? I mean there is just so much more buffer there and the IO helps and you know coincidentally last week we got an unsolicited offer for a lot more than we paid for that deal. The nice thing with bridge that people need to be aware of is there's no pre-paid penalties, right? Whereas with the agency debt there is big pre-paid penalties and so we have deals today that we could sell for great return.

But our pre-paid is so high that it doesn't make sense. And yeah, we can try to get a person to assume that but then that it's own problem versus a bridge you know we can make quick exits. And so, we have another deal right now that we bought in April that's humming along a bridge that we realistically might take an exit over the summer because it is bridged, right? Versus another deal that we bought that at the same time it is not bridge. It is an agency that we'll be in that deal for quite a while.

[0:17:21.1] WS: You have to hold it, yeah. So, tell me Feras what is a way that you have recently improved your business that we can apply to ours like one big thing?

[0:17:28.6] FM: Behind Ben and I we also have the rest of our team. I think we are trying to structure things more – I mean A, we try to run our company more like a tech company. So, kind of going back to my roots, giving people flexibility and letting them be their own boss but really, design the company more around that as well where we are tracking goals and the breakdown of the initiatives, the tasks that lead up to that goal and how is that person trending.

I don't care when people work. They can work any time of the day they want, wherever they want, whenever they want. It is more about are you getting things done and are you working towards that goal, right? I think that is a big one. Another one we have been experimenting is how do we get even more alignment with the property management and kind of property management companies, right? And so, getting them into our Slacks and Asanas and kind of making sure everyone knows all the things they worked on.

And then maybe a third one too is trying to – going back to my comment earlier on draws, all of these deals eat money. I mean it is insane to me how much money these deals could eat that first year and how quickly they can eat it. And so, getting – not being reactive to draws but how do you be proactive. So, having it to where – so we submit draws on a schedule and we don't wait for the last draw to come to us before we submit the next one.

I mean it is every month. Everything is getting cued up. How we do even streamline towards a lot as painful and just getting that ball out of our court and onto the next. Those are the big ones that come to mind.

[0:18:52.7] WS: Yeah, no that's good. That's really good stuff. But last question before we have to go is what's the one thing that's contributed to your success?

[0:18:59.8] FM: Honestly maybe my background in tech has really helped us, I think. It is just how do we do things differently? I mean our name is Disrupt Equity so how do you disrupt things a little bit and do things that might be bigger or harder for most people and stand out, right? Even the simplest example of how do you make sure everything we do looks like it's best in class, really polished, really – you know from our newsletters are mobile friendly that people weren't doing before.

To now it's kind of become a thing or our investor updates are best in class –how do you really standout and revisit each one of those? And being a system you know kind of a software guy. I am very systems and process oriented. So how do you put in systems to track and identify issues, to track and identify performance, to track and identify deals, right? So really being able to fall back on – because I left Microsoft years ago with the intention of how do I bring tech to businesses that don't have it.

And so initially in my mind it was how do I bring software to older industries, right? It's kind of changed to really now it's more how do I go into maybe older industries like real estate and bring tech into it, right? So not building a software company like maybe I initially had in mind but it is really leveraging my strengths to accelerate the growth so –

[0:20:13.4] WS: Yes, so you are definitely doing that. Feras, another amazing show, thank you so much for your time and sharing your expertise. I encourage the listener to go back and listen to WS 446 where we went through Feras's bio and asked him other numerous questions that I commonly asked other guests that you may be waiting for me to ask now. But unfortunately, we are out of time but Feras, tell the listeners though how to get in touch with you.

[0:20:35.9] FM: Yeah, feel free anyone, I mean disruptequity.com or feras@disruptequity.com.

[END OF INTERVIEW]

[0:20:47.3] 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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