EPISODE 457

[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 Dugan Kelley. Thanks for being on the show Dugan.

[0:00:32.7] DK: Hey, thanks Whitney. Hey everybody.

[0:00:34.9] WS: Yeah, I'm honored to have you on the show. A little about Dugan: he is one of the country's leading syndication lawyers. Holds offices in Texas and California, servicing clients throughout the United States in all phases of real estate acquisitions and sales. He structured deals in excess of two billion dollars for clients and is the bestselling author of *Purpose, Passion and Profit.* Dugan, thank you again for your time and being willing to come on to share your expertise with us.

Give the listeners a little more about yourself and let's dive in.

[0:01:04.4] DK: Thanks Whitney for having me on your show, yeah. I am a syndication lawyer. I have offices obviously in the Texas area and California but most of our clients hunting for deals in a syndication space, in hot multi-family markets around the country. Whether you're looking in towards Georgia or Texas or Arizona, we have clients all around the country that are looking for hot multi-family opportunities and we kind of help them. From acceptance of your LOI all the way through to the closing table, that's what I do primarily for my clients.

[0:01:42.1] WS: Nice. Somebody like yourself is such a crucial team member of any sponsor or anybody in this business ultimately is doing deals like we're doing because there's so many legal things that we need to know about but I'm never going to be an expert on the legal side and that's why I'm going to have somebody like yourself, right?

I mean, there's just no way. I don't want to be, I want to be proficient, I want to obviously be certain that I'm operating, you know, as legal as possible. I know the listener does as well. One thing –

[0:02:09.8] DK: Don't sell yourself short, I know that as a seasoned syndicator yourself, you probably know the vast majority of everything that your lawyer tells you, you probably heard it at thousand times before.

[0:02:20.2] WS: I have heard a lot of it. Still, I just want to ask, just to hear it again or make certain, you know? You know, one thing Dugan that everybody has questions about and it seems like kind of a – it seems to be this quote, grey area that a lot of people wonder about is advertising deals and putting out deals and what some guidelines there making certain that we're doing that properly.

Obviously, I see deals advertised all the time whether its own social media or my email or you know, I'm sure you do as well. I would love for you and I to dive in that a little bit and provide the listener a little more clarity.

[0:02:55.6] DK: Great. Yeah, it's a great topic for your listeners, there's a lot of ambiguity and confusion in the marketplace about what you can do and what you can't do in particular on social media. The primary two exemptions, when I say exemptions, the primary two exemptions that we're applying for most syndicators are reg D, under 506(c) or 506(b) of the SEC Act and one of those allows us to advertise broadly.

Solicit, you can put a billboard, radio, do anything that you want, that's 506(c) but the vast majority of private syndication, private offering in the country still are under 506(b) which allows you to do credited investors and then up to 35 sophisticated investors that you have a preexisting relationship with. It does not allow you to advertise.

And so, sometimes when people are posting on social media or they're pushing out on their own profile in LinkedIn or things like that. They may be 506(c) offerings, in which case, there's not an issue. But to the extent that there is 506(b) offerings or the people who are involved in a 506(b) offering and they're posing that out on social media, that's what we would call a noncompliant advertising.

The SEC has a general prohibition against solicitation and the reason behind that and I always encourage my clients to understand the reasoning behind that is very simple. And that is, we don't want to advertise to people that we don't know and it's not a 506(c) offering, we want to make sure that we have a subsitive preexisting relationship with them such that we would be giving them all the information necessary in order to make a determination as to whether their investment is a suitable investment for them.

That's why you see sometimes here hopefully, tells you hey, don't post that or take that down, maybe you crossed the line a little bit. We want to be, we want to follow the rules but we also want to understand kind of the background behind the SEC has a rule against kind of advertising any particular deal.

[0:05:17.9] WS: You touched on their preexisting relationship and that's so important and I just wondered if you could just define that a little bit. What determines that, I've heard different scopes of that from one end to the other and I know some people have standard of, "Okay, I want a phone call with every investor before we ever allow them to see a deal or invest with us." And heard other people say you know, it can actually certain social media channels.

Could be considered a connection to the SEC or a preexisting relationship. If you could just elaborate a little bit on that?

[0:05:45.6] DK: Right, yeah. We used to think, this is years ago, we used to think that there was some sort of magic time limit that either they know somebody or some period of time before you developed this kind of magical substance, preexisting relationship with the potential investors that you can potentially discuss and potential offering with them. That is not the case. The SEC clearly told us through what they call advisory opinions or no action letters that there is no magic timeframe for the development of a subsitive or preexisting relationship with the potential investor.

It really boils down to whether your relationship is subsitive enough so that you know that the potential investors, business expertise or experience that they have enough of that and were to fully evaluate the risks of a potential investment opportunity. If you don't feel like you have enough information or enough contact or enough life history, with that potential investor such that you would even understand that they could fully evaluate the risks associated with that potential investment, you don't have a preexisting subsitive relationship with them.

If you do, you do. It's kind of – I wish that there were – you have to go out to dinner with them three times or you have to sit with coffee with him for five and a half times. The SEC just doesn't come out with that type of guidance. Maybe they will at some point in the future, they just haven't so far.

[0:07:21.6] WS: As far as social media posts, I wonder, you know, between the relationship with you and a client, is that something that you as a client that you would review – if I was sending you, Dugan, we're looking at maybe posting these posts about this subject or our business and just to get out, here's a couple are these going to get your opinion, you know?

Is that something that from your standpoint, that you all do?

[0:07:44.0] DK: I do that for existing clients, long standing clients that have concerns over this or they have a very large or broad audience like yourself or somebody else that has a large social media platform and there's a temptation to say, really figure where's the line between education and just generic information about my company and what it does versus what we call preconditioning the market?

We don't want to be preconditioning the market. Meaning, is the intent behind the post designed to solicit or elicit potential new investors to come to me, that's what we call a preconditioning market and that's another kind of no-no. We don't want to precondition the market but what we do want to do is we want to be able to share, honestly, transparently authentically, share information about the great things that are going on with our company.

The positive things, the things that we do generically so that otherwise how would people ever discover you? Other than just kind of you going and meeting them, pressing the flesh sow to speak at events or meetups or things like that. Sharing information, generic information about your company, what it does, that's fine and being excited about being in the space and the blessings that come from being able to provide for your investors, that's fine.

Talking about specific returns or specific offering or specific property or things like that, with the intent to try to drive more traffic or more potential investors to you, there is a line there that you don't want to cross.

[0:09:35.6] WS: You know, one example is that I see often and I've heard conflicting information or you know, about these types of post is like, we've closed on a deal. And I just wondered your opinion as far as I blast out to our network, you know, because we are excited about it, right? That we just closed on a deal and I've heard some attorneys to say, "No, you cannot do that because your investors already know that you've closed on a deal."

The only reason you would do that would be to solicit more investors and then I heard other attorneys say, "It's just fine. it's already done, it's closed, you can talk about it." I just wondered.

[0:10:07.2] DK: Right, yeah. I mean, I tend to look at it from a pragmatic standpoint, right? People are people, you're excited about closing on an acquisition. I don't see anything wrong with saying hey, just want to thank everybody that participated in helping me or helping our company get to where we're at, we're just so excited that we just closed on another acquisition, there's nothing wrong with that.

I think that's perfectly understandable, that's part of the human condition. Everybody wants to express joy about actually doing that. Many of my clients, you probably know this yourself, when you are doing this day in and day out, it's sometimes you don't stop and savor the victories, the small little victories. It takes a lot of effort, time, money, resources, everything. To close on any one of these deals.

When you close on something, it's perfectly understandable to be excited about it because the massive amount of effort, team work, people, sheer energy and resources that it takes to close these things is crazy. Being able to share that with people that you know, that you love, that you trust, that are supportive of you, totally understandable.

What I think where it crosses the line is when you would post something like, "Hey, our investors are expected to receive 12%, cash on cash, first distribution is to roll out next month." Those sorts of things, clearly are designed the only reason you've theoretically would be sharing that type of information would be to illicit a kind of a further response from somebody that you theoretically don't know and drive them to you.

Now, if you're doing a 506(c) offering, great. If you're historically primarily in the 506(b) space and that's what you just did, that's not, I didn't use the terms like illegal or criminal because that scares people and we don't want to operate with this spirit of fear, right?

We talk about words like compliance and noncompliance. The law is there to help us. It's there to help us provide a guide and bumpers. So that we know that we play side of this space and we don't want to be noncompliant, we don't want to violate the statutes. But we want to also not be so fearful about just the blessings that we've had and the acquisitions that are coming or maybe the potential sale, might want to blast out, just basically say, "Hey, we're just so glad that we actually sold one of our assets," right?

I think those things are different, right? Intending to draw investors to you as supposed to just sharing the good things that your company is doing.

[0:12:54.8] WS: You know, that social media post, it's okay to put, "We closed. We're excited!" However, some at the – I say, if you want to get on the next one, contact –

[0:13:03.7] DK: just drop that last sentence off. For those of you that didn't act quickly enough, call me, right? Yeah, we want to – that's where the editing tries to be there and that's – listen, understandably, that's also part of the human condition, right? You want to be able, when you've done something great, you want to be able to try to encourage new people to come in.

The problem with that is it runs afoul of the compliance aspect of it and that is, we want to only be talking to people that we already have a preexisting relationship with. About a potential offering. If you have a potential offering and you do not have a preexisting, be it an existed prior to the offering in live, don't share that information with those potential investors.

[0:13:54.9] WS: Of course, I follow some other operators that I feel are operating at a high level and I know others do this to me as well. But you know, get on their list and potentially maybe invest in some of their opportunities like you know as well. A lot to learn from them. I know people that do that with me as well.

I noticed that the bottom of a lot of email correspondents, it will have that, the 506(c) statement or regulation or something about all their offerings are 506(c) or something like that. If we're doing a 506(c) offering or producing something like that, should we have some kind of statement like that on our emails?

[0:14:26.5] DK: Again, it's not a matter – there's no magical requirement for you to do that. But I think that's just best practice for you to tell potential investors, especially seasoned investors. Seasoned real estate investors that invest over and over again, they know what 506(b) is and they know what 506(c) is. If you're a young operator and maybe you've crossed the line or you started to push out or unintentionally advertise or potentially make some mistakes in that area, a real estate investor who is seeing that, maybe potential little warning sign with them that they may not want to necessarily invest in your deal.

Not because it's not a great deal, but because if you don't understand some of the basic framework and the basic rules associated with this, how could they theoretically trust you with the bigger things, right? The bigger management issues like do they select the right PM, is there preformat, the projections that they have in the offering, is that legitimate or this kind of like, made up of whole cloth, those types of things is kind off an erosion of the credibility potentially with your operators and your passive investors. I tell people best practice is, if you're going to do a 506(c) opportunity, take advantage of the fact that it is a 506(c) opportunity, you know?

Tell your potential investor of which will be potentially maybe new investors that have never invested in multi-family before that you'll be able to kind of evangelize to so to speak and then the others will be seasoned investors and when they see that 506(c) opportunity they'll know, "Hey this is totally legit." This is compliant and your advertising is fine.

[0:16:16.2] WS: Are there any examples that come to mind of either really good ways that people have promoting themselves that you really prefer or maybe improper advertising that you have seen that maybe some people might feel is okay that just that you've seen that you know that we should be aware of?

[0:16:32.0] DK: Yeah man, I think that there is some – I think some of the – I know that you had partnered with and you are top flight operator yourself but some of the ways that people promote when they are doing a 506(c) opportunity, they take advantage of all of their diversified channels of distribution if you will to potential audience. Whether it is a podcast, whether it is your LinkedIn page, whether it is Facebook advertising or whether it is your personal Facebook page, whether they create a new Facebook group or whether they are advertising a meet up where they theoretically would be discussing a potential 506(c) offering. Those are some of the diversified channels. You are really only limited by your lack of creativity, right?

So, some of the operators that are more creative or that they have team members that are gifted in that or so inclined in that area, they have thought of lots of different ways in which to get out their message and the potential legitimate 506(c) offerings.

And then you've got people that are young, maybe potentially a new operators that don't fully understand 506(b) 506(c) they are really excited about. They've got their first deal or whatever and maybe they are pushing things out on their social media that they shouldn't be pushing out. So, I have seen it all and I think but being attached, right? I would say this is a team sport, nobody does this themselves. The reality is we are syndicating. We are pooling other people's money in order to get to the down payment, in order to acquire the loan to buy the apartment building, that requires other people.

If we are not syndicating, we are just using our own money. We just show up at the closing table and we say, "Here is our couple million bucks for the 20% or whatever the leverage is that is required of us to get to the loan to buy the apartment building. “But when we are syndicating, we have other potential partners.

Or other partners that are helping us along the way. So, we need to tap into both the creative juices as well as potential warnings that come along with our potential team members that maybe they say, “Hey this is a 506(b) offering let’s not do that.”

[0:18:53.7] WS: From the legal aspect of this business or the syndication business, what do you see is the hardest part for most operators?

[0:19:00.3] DK: Raising capital. Raising capital is the number one thing and it is the most difficult thing to do. The reality though is that most people are better at it than they think because most of us have people in our lives that are potential investors that know, like and love and trust them and people invest with people that they know like and trust us. And so, I think getting over that fear factor, if you are young sponsor or syndicator and getting to that place of being able to ask somebody for money.

Legitimately to have, right? The purpose between by asking a potential investor to invest in one of your deals is not to help you. If that is your mindset then you are always going to struggle with raising capital. But if you have a servant mindset of how can I help the potential investor get to where they want to be you’re going to be much more successful.

So, when I see young operators, they have that shift that mindset that is perfectly natural to think, “How can the potential investor help me, help invest in this deal so that I can actually get and own it?” But the reality is your mindset needs to be, “How can I serve the people that are in my life, the potential investors in my life in order to be able to deliver maximum value to them?” when you get to that point and you get over that fear hurdle of asking somebody and telling them, somebody that you have known that you know I think there is a massive acceleration for most young operators and want to be syndicators.

[0:20:50.6] WS: Are you a real estate investor as well Dugan?

[0:20:52.7] DK: I am, my family has long invested in real estate. My parents were primarily ministers so they did not have the net worth and a lot of money coming in from their day job. They were urban missionaries for the most part for a long time. Dad was very astute early on and he invested in real estate and that has helped primarily paid for their expenses like funded up a light bill and put food on the table was through investing in real estate and getting the passive returns.

And so, I am a big believer because I am a product in part for my parents the benefits of investing not only passively but also owning other pieces of real estate where you don't actually live but commercial real estate that generates income that you theoretically can provide for your family.

[0:21:43.5] WS: And how do you prepare for this potential downturn?

[0:21:46.3] DK: Yeah, so I had get asked that a lot and I tell clients, I said, "You know those of us that have been doing this long enough that lives through 2007-2008 when the entire financial world just changed. I think that if there is a market correction, I am not seeing it on the horizon by the way but if there is one, I think that the vast majority of investing in multifamily is still going to be fine. I am not talking about A-class of properties. We are talking about being C-class.

Most of the syndication in the space is done kind of on value add or B and C-class properties. So, as we see the baby boomer generation, where an unprecedented amount of population of aging adults and millennials that don't necessarily want to buy their own home. They all have to live somewhere, right? You don't have to work anywhere particularly meaning if you are a young professional or even a seasoned professional and you own your own office where you work you don't need that necessarily.

That is not a necessity but you have to live somewhere and so I think the idea that we are going to see some sort of massive market correction in multifamily especially in the B and C-class I don't see it. If anything, there will be a higher demand when the economy tanks or goes downward, you see maybe longer hold times. Maybe you will see longer hold times and not as much liquidity in the marketplace from selling, buying and selling.

But you are going to see a lot of seasoned real estate investors, operators that are cash rich, being able to take advantage of the opportunities and they are still going to be buying. I mean that is going to be the time to buy and be in acquisition mode if you are an operator but because you understand that it is not those properties are still going to have people living in them. So, I think it is still going to be one of the safest asset classes for potential investors in the country.

[0:23:57.7] WS: I appreciate you elaborating on that. I love your take on it and value that as well. What is a way that you have recently improved your business or operation that we could also apply to ours?

[0:24:08.1] DK: Yeah, so I think waking up to the fact that people get information in diversified ways, I have not always been the best student at that. I am not always been the best steward of that. So, when I graduated from law school and started practicing, I practiced law mostly with the Dictaphone. I had a Dictaphone and my admin would physically type my letters and so from that to now, my gosh, your smart phones, podcasts, social media, all of that.

I am still I think a neophyte in many of those areas but I think that is something that we are making a diligent effort in our space, in the legal space to be able to help serve others. To be able to pour money and resources and time in my firm helped develop those areas of diversified kind of services in the technology space because for the vast majority in my career, most of my clients come to me by word of mouth not necessarily by technology.

But as technology develops, I think it is essential especially for young operators and they are often the best technicians of that because grew up at a different era. It is like second nature to them than the people like myself who are like, "Oh my gosh what is the latest thing that I need to learn how it works and how it necessarily applies and how I might implement it in order serve my clients better?"

[0:25:47.5] WS: So, as an investor and also from your experience as an attorney, what is your best advice for caring for investors in a way that they want to return to the next deal?

[0:25:57.6] DK: Yeah, I mean I think that relationship that key relationship, you would be a better person. To answer that exact question but investors I find if they know, like and trust you and even if you have bad news to impart to them, if you have done this long enough, one of you is theoretically is not going to perform at the level that you project. That will happen, okay? Don't freak out when that happens but be honest.

Be honest, be humble, be transparent with your potential investors. If you are honest and humble even when your chips are down, even when you feel like you've got punched in the mouth or you are lining the ditch or some of your deals goes south that's the time to step up I think and share that with your investors because I don't know about you but I find it personally attractive and personally just inspiring when I see somebody share a challenge that they have gone through and being able to overcome that even if they are in the midst of the challenge and ask for your grace, for investors to extend grace to them that often is more appealing to investors.

Because investors are not dumb. They know that things are that – that investing is no guarantee. There is going to be potential rollercoaster. We all want this kind of curve that goes up but the harsh reality is life is not like that. Life is full of ups and downs.

But if you are steady, you are honest and you are transparent with your investors that is the best key to a long-term success with them.

[0:27:40.7] WS: All right, just a couple more questions before we run out of time. What is the number one thing that's contributed to your success?

[0:27:46.8] DK: Hard work and diligence and listening like honestly listening to I had parents that love me and thankfully blessed with parents that gave advice and I listened to them and I tried to listen to my friends and I tried to listen to the people that the Lord put into my life to be able to inspire me to the next level.

And then I had a mindset that if there is something, if I was afraid or something or not stepping on traffic or something like that. But if I was afraid of something because we are all afraid of something that I would have the courage to step forward in faith believing that through hard work and diligence you would overcome that challenge. I think those components being able to listen and have a great work ethic are the two things that help drive me forward.

[0:28:40.1] WS: And how do you like to give back?

[0:28:41.7] DK: So, I sit on the board, a number of non-profits boards. One of which is The Treasured Vessels Foundation, where our mission is to stop human sex trafficking particularly here in the Texas area. And so, I sit on that board and give back to that organization and then my folks obviously have a number of faith based organizations that I am plugged into that I contribute time, resources, love and affection for people that are associated with the causes that are near and dear to my mine and my wife and my children's heart.

[0:29:17.2] WS: Dugan, great show. I appreciate you so much and your time and sharing expertise because I know this advertising discussion is needed and so many people are wondering a lot of these things what should they do that you laid out very clearly for us today. I am grateful for that and I know the listeners as well but tell them how they can get in touch with you and learn more about your practice?

[0:29:37.4] DK: Yeah, I would love to Whitney. Thank you so much for having me on your show and sharing this with your audience. So, if anybody would like to get in touch with me, you can go to our website. It is kelleyclarklaw.com or you can send me an email at dugan@kelleyclarklaw.com. Thanks everybody.

[END OF INTERVIEW]

[0:29:59.4] 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.

Subscribe too so you can get the latest episodes. Lastly, I want to keep you updated so head over to lifebridgecapital.com and sign up for the newsletter. If you are interested in partnering with me, sign up on the contact us page so you can talk to me directly. Have a blessed day and I will talk to you tomorrow.

[OUTRO]

[0:30:39.6] ANNOUNCER: Thank you for listening to The Real Estate Syndication Show, brought to you by Life Bridge Capital. Life Bridge Capital works with investors nationwide to invest in real estate while also donating 50% of its profits to assist parents who are committing to adoption. Life Bridge Capital, making a difference one investor and one child at a time. Connect online at www.LifeBridgeCapital.com for free material and videos to further your success.

[END]

