EPISODE 527

[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 Sam Rust. Thanks for being on the show again, Sam.

[0:00:33.2] SR: Yeah, happy to be here Whitney. Looking good as ever.

[0:00:37.6] WS: Yourself or me?

[0:00:39.0] SR: You.

[0:00:39.5] WS: Thank you very much. I appreciate that. You know, so much happening right now, Sam, as I'm sure all the listeners know and you know, why not you and I just discuss a little bit for a few minutes what we're doing, how it's impacted us, our properties and just some things we're doing to mitigate risk or how things have changed for us and what we're doing to plan for that. What do you say?

[0:01:02.2] SR: There is definitely a lot going on, usually, with economic declines, you start seeing the headlines and in the market reacts, often precipitously, thinking back to 2008. But it takes a little while for the jobless numbers or the job loss numbers to pick up steam. This is something that has been changing by the day and seems to have picked up a lot of momentum just in the last two or three weeks. We went from having a really healthy economy to one on the verge of a deep recession almost overnight.

The impacts for us as property owners are wide-ranging and I think still to be seen. And so, at this point, it's just about preparing, trying to mitigate the human cost, particularly with regards to the virus. And then preparing and putting ourselves in the best position to weather this storm.

You know, I think most property owners, us included are waiting for April one and we'll see what kind of delinquency we encounter at that point in time. We're trying to be proactive by examining the percentage of our property, tenants that are employed in various sectors of the economy. We own properties in a military town and so we have a pretty decent military component, that's going to help us specifically weather some of the storm, that's guaranteed income, that's not going anywhere.

But by and large, many of our tenants, many of the tenants of our colleagues around the country work in service, work in hospitality sectors. And obviously, those sectors have been hugely impacted by the COVID-19 situation. You know, as far as on property, we've closed all of our amenities about two weeks ago, so all our workout facilities, pools.

[0:02:38.6] WS: Any common areas, right?

[0:02:40.4] SR: Any common areas, yup. We're asking people to pay their rent online, we're putting together plans behind the scenes for our tenants to be ab le to pay partially which is not something that we typically accept but want to – at this point, I think it's really incumbent on us as property owners to work with our tenants and understand that this is a true force majeure triggering event. This is an act of god in a literal way that is outside of everybody's control.

And so while we can argue that people should be prepared or this or that, I think we have a responsibility as property owners to come alongside our tenants, to help them as best we can and to sacrifice even on our end if that's what's required to help the economy as a whole, get back up and running which I am hopeful it will do in relatively short order.

[0:03:29.8] WS: Right, just so the listeners know, we're recording this on March the 24th, the earliest I can get this show out is March the 31st in case you're listening to it on a podcast. But we're going to try to put it out before then on YouTube, some other platforms. So, hopefully you're seeing it there and it's very relevant to you right now in your properties.

But also, you know, Sam is – in case you haven't heard of Sam. We've done shows before and he's my business partner and we're working together at Life Bridge Capital. We already recorded a show too, talking about a specific property that were just closed and that will be coming up in just another week or so after you hear this.

You know, I encourage you to listen to that show and it will make even more sense talking about some of the things that we're putting in place and how we're operating right now with what's happening.

And then, we also have some information that we want to share, right Sam? We're going to keep going in detail about some things that have changed as well and just other information that we've gathered that we know that other people want to know right now. Just about lending, specifically.

But let's keep going about some things that's changed about our properties and just you know, how that's – what's working for us and what we're pursuing there?

[0:04:34.6] SR: Yeah, I think we're still seeing relatively decent traffic numbers which has been interesting. I think it speaks to Colorado Springs being a high growth area and people are still looking to find areas to call home. But that is starting to fall off.

So, we're going to be watching that closely. I think we're going to have to be swift to react to changing market conditions on leases and be willing to discount a little bit, potentially offer some concessions.

And I think more than anything, lowering expenses, you know, we've put a halt to all capital projects, re-evaluating your cash flow on a true cash basis. Not just what did we bail out, but what are we actually seeing in receipts, what's hitting our bank accounts and making sure that above all, we're preserving our investor's capital, we're preserving project solvency and then following the order of operations from there.

Obviously, covering debt service is going to be a huge concern, operating expenses, next in the investor payouts as it may be. I think it's still too early to say how widely investor payouts are going to be affected by this.

But I want to encourage anybody who is investing, operators, including us we're all looking at this, we want to make sure that these projects survive in our position to thrive when the economy does turn around and when we normalize. I don't even think emerge an expansion again as the bar anymore, it's just, can we have some semblance of normalcy and hopefully we can achieve that here in the next six to eight weeks in the economy at large.

I think on a whole, what I've seen and in talking to lenders and colleagues and brokers around the country and over the last week or so, multifamily is really well positioned to absorb this blow. I think you are going to see potentially some operators that are undercapitalized or maybe were overly aggressive on their debt structures that there may be some concern there. But overall, I'm really thankful I'm involved in multifamily and not in hospitality or single use retail, specifically in the restaurant industry, there's several other real estate sectors that are going to be hit much harder than multifamily, in my estimation.

[0:06:44.9] WS: Do we have an update yet from the management company just about potential job losses or you know, where tenants are employed and things like that?

[0:06:51.7] SR: You know, we have some of those breakouts in a really broad sense of sectors that our tenants are employed in. It's still too early to say on the job loss front. I mean, we've been seeing reports across the nation hundreds of thousands of people have been losing their jobs.

I think it's been such a fluid situation and some of those layoffs are still being communicated to the respective workforces that it's a bit early to conject how many of our tenants either at our property specifically or at properties broadly, in our state or across the nation are going to be affected.

[0:07:22.8] WS: Yeah, I would just appreciated the management company being proactive and trying to get some of those details at least as accurate as we can. Nobody knows for sure but we want to be able to plan the best that we can for delinquencies and potential mass job losses for lots of tenants.

[0:07:37.5] SR: Yup. I think one of the silver linings in this, not to pivot too quickly out of the doom and gloom, but one of the silver linings is going to be a potential reduction in some of our capital expenditures. We've got several projects that we're getting ready to kick off at a couple of our properties and I do anticipate those costs to come down a little bit. I think if we're prudent and yet willing to move a little bit faster than some of our private equity cohorts that we will be able to take advantage of slightly lower labor costs, maybe slightly lower material costs and that will help ameliorate some of the cost concerns that we are seeing right now.

[0:08:13.6] WS: So, what about lending? I know you and I have received some pretty good information today and I thought it would be great if you could highlight some of that because I know that is a big concern for so many listeners as well right now.

[0:08:23.7] SR: Yeah, so the federal agencies yesterday, so Monday, March 23rd, put out an announcement saying they were going to extend loan forbearance to multifamily properties and residential owners, anybody who holds a federally backed mortgage. So basically, Fannie Mae and Freddie Mac. The NMHC released their own press release highlighting the agency's press release. It was very short on details and so I spent the last 24 hours trying to suss out what is exactly being offered.

You know some of the questions I had is this only a need only base program? Or do the missed payments go under your loan balance? Are they skipped entirely? Is this considered an extraordinary event or will taking advantage of this program potentially impact your standing with the agencies? I was able to get in touch with the managing director at one of the DUS lenders that we worked with and it is still a volatile situation with a lot of movement.

But he was able to shed some clarity with regards to the program that the agencies are setting up and so we wanted to be able to share that with you. It will be a need-based threshold of some sort that level has yet to be determined at least as of about noon today. So again, we'll know more in the coming days but the Fannie Mae and Freddie Mac are going to forbearance up to 90 days, three consecutively monthly payments. And if the borrower accepts that arrangement then they are going to waive any late fees or any interest accrual.

The catch is that those payments will be due in the subsequent 12 calendar months. So, it is not getting tacked on to your balance. It is not something that is going to be free money forever. You have to have it completely paid off within a 12-month period. So that is something to keep in mind but it will not be including any additional interest or pre-payment penalties or anything like that. It will be over that ensuing a 12-month period.

In exchange, the borrowers or in our case property owners will have to agree that we will not evict tenants based solely on a non-payment of rent in any situation that is connected to the COVID-19 crisis, which I think could be argued as going to be almost every income-based eviction over that 90-day period. So, it could be caused by illness, job loss, reduced hours or temporary unpaid leave, etcetera, etcetera.

So that is the bargain the Federal Government is trying to inject money into the right places into the economy and offer relief in the right areas to keep people from losing their homes, losing their jobs and this is frankly a measure that I would applaud. I think it's going to help certain sectors of multifamily housing get through a really interesting rough patch that hopefully again will normalize at the end of that 90 days.

If at the end of the forbearance period, the borrower cannot make those payments then Freddie Mac and Fannie Mae will refer it to an asset resolution group or the special servicer and discuss their typical enforcements and payback option.

So, in addition to the lender agreeing to the forbearance, one other note the borrower must agree to a release of any claims it might have against the lender for adverse effects on the property arising from your agreement to not enforce evictions based on any COVID-19 issues.

So, it is a relatively simple program. There is a lot more details that will come out as far as thresholds. That is probably the biggest unknown as of this moment. But I am certain that they are doing everything they can to get this program ready to roll in time for April's payments. I think with something that is fast moving as this crisis, we need to get everything in place by April 1st so that property owners know how to react and whether or not they can take advantage of this program.

One other thing to note is that this taking advantage of this program will not go on your "agency record." It will be regarded as an extraordinary event and won't affect your standing with the agencies moving forward. Again, I think that is a really important thing to keep an eye on. Want to make sure that that is completely understood and in writing as possible moving forward.

So, I definitely would work with your servicers and your bank officers, your DUS lenders and make sure that you fully understand this program before you see it as a savior at this moment in time.

But I do think there is a lot of promising things going on here and I am excited to see these details get fleshed out over the next 48 to 72 hours.

[0:12:50.7] WS: I think there would be many operators that will have no choice but to take advantage of this. You know you and I discussed and we've discussed it many times but even on the other show that will come out later, this is how everybody says they're conservative right? But we are going to see pretty soon who wasn't as conservative as they thought but I feel like it is going to be the saving grace for so many operators and I am thankful for it that it is going to happen.

And yeah, I would say too all of this is subject to change probably by tomorrow depending on what they actually put out. Any other information as far as lending that you have learned over the last day or so Sam?

[0:13:22.8] SR: You know I think generally the agencies are still open for business. I have talked to many different lenders over the last 36 hours and Federal government has stepped into the breach and is creating a ton of liquidity. So, liquidity is not a concern again for product that meets all the underwriting standards. You know I have talked to several folks that have lent in the hospitality space and that space is pretty much grounded to a complete halt.

There is going to be significant ramifications. One operator I was speaking to had occupancy under 10% hotels that were averaging 75 to 80%. So significant fall off there. But for our sector, I think if you can find the right project and get it under contract, financing is not going to be an issue at least in the short term. Although at least as of earlier this week, the agencies were no longer selling rate locks. So, you are subject to market whims until you walk your loan just prior to closing.

So, there is quite a bit of volatility in the market place because of that. The ten-year treasury has been swinging violently and very unpredictable at this point in time. So definitely more cause to be conservative in your underwriting but I think the dollars will be there assuming you meet those thresholds.

[0:14:36.7] WS: All right Sam, we will cut it off pretty quick. But grateful for this information. I hope it helps the listeners in a big way. I know this is a lot of questions that I am getting and others are getting as well. And in mastermind groups and other closed Facebook groups, everybody is wondering what's going to happen and how they are going to pay their bills or is there going to be some kind of forgiving period, you know? Or time where they won't have to pay.

So you know like Sam said, I would encourage you to read those documents very closely before you agree so you know what it is going to mean for you long term and for your property. But anything else Sam before we close this one up?

[0:15:12.6] SR: Yeah, I think it is just a reminder that as a marketplace, we underprice rare events. There is a book called *The Black Swan* by Nassim Taleb, who talks about black swan events. People didn't believe there were black swans until explorers came back from Australia with a couple of them stuffed. And typically, when markets just have a hard time pricing in pandemics or any other natural or manmade disaster. It is not something that we planned for and we minimize the risk so much that we forget that these rare events are still events they still happen.

And so, moving forward, you know this is a cautionary tale for myself and I hope for all of us that cash reserves are crucial and that the most efficient use of capital is often a riskier use of capital. So hopefully that helps you and we'll get through this together.

[0:15:59.6] WS: Sam, how can listeners get in touch with you and learn more about you?

[0:16:02.2] SR: People can reach out to me at LifeBridgeCapital.com. My contact information is there, I am also active on LinkedIn and at BiggerPockets.

[END OF INTERVIEW]

[0:16:10.2] 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]

[0:16:50.6] 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.

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