EPISODE 577

[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 Brian Dally. Thanks for being on the show again, Brian.

[0:00:33.6] BD: Good to be with you again.

[0:00:35.3] WS: Brian was a previous guest on the show WS140 which aired March 10th of last year so it's hard to believe it's been that long, Brian. But it's amazing how time flies and we want to get some updates from him today on GROUNDFLOOR and we want to just get some updates on how they are viewing the capital markets and how they're positioning themselves and so we're looking forward to hearing that and just learning from them as well.

But a little more about him in case you haven't heard of him or in case you didn't hear the other show. He co-founded GROUNDFLOOR in early 2013. GROUNDFLOOR is the only direct lender offering crowd sourced capital for short-term residential real estate loans. Previously, he led a team within bandwidth.com through a successful product market pivot that resulted in the concept, brand and launch of Republic Wireless.

Brian, thank you again for your time. I appreciate your sharing your expertise with the listeners and myself. But give us a little update and let's jump in to how you all are looking at what's happening right now?

[0:01:35.4] BD: Well, a lot's happened obviously since I was last with you. A few things about last year before the pandemic showed up on the scene. We had a really great year last year, we originated 118 million dollars' worth of loans last year. We signed up new institutional buyers of our loans which for us was significant because we've always been – since we were founded seven years ago, we had been 100% retail capital funded shop. It's very unusual in our marketplace.

And I think that method of syndicating or that method of aggregating capital is really important to where we are in today's capital markets because like, every other lender, certainly in real estate and probably in other asset classes as well, institutional money has disappeared. They have run for the exits. They have fled the scene.

Fortunately for us, although we were proud to diversify our sources of capital and add in institutional capital sources who would buy our loans, fortunately for us, institutional capital only represent 22% of what we did last year.

The rest of that is pure retail capital. and the thing I love about retail investors, individual investors like you and me is God willing, we don't have margin calls. We don't have loan covenants. We don't face redemptions from our fund. We don't have the typical types of problems that you see with counter parties who are financing institutional capital. And if those of your listeners who are looking for capital right now, they know, it's tough.

If you can get capital, it's at very low leverage. We've heard lenders are requiring for something that's usually a 12-month loan or a nine month loan, they're requiring 18 month terms and by the way, 18 months of interest reserve for that loan. At lower leverage. So, when you take all that into account, capital markets have really frozen up during this period and it's very damaging for anybody who is trying to keep the economy moving or keep their business moving in real estate development or real estate investment.

[0:03:48.5] WS: Those requirements definitely knock a lot of deals out.

[0:03:51.6] BD: They do. I mean, some of them just make the deals not even make sense. You know, I've heard talk to customers like, "Why bother? I can't make any money this way, I can't get enough leverage to get a good return on my cash. I think for us, we, like everybody else have paused in this market and said, ""Okay, let's look around." We want to take the time to be thoughtful and not lend bad money out there in this environment. We got to protect our investors and we've taken two or three weeks just to assess the market landscape.

What we have found is that in the markets where we lend, in the markets we know the best with the borrowers we know the best, we are extraordinarily bullish on the medium- and long-term future for residential real estate. And I'm happy to describe why that is. We remain ardent bulls in that sector. And so, as we build up our liquidity during this period, that's what we're doing, we're preparing to go on offense.

Hopefully, those of your listeners who are looking for a real estate investment money that fits our profile, hopefully they'll come our way and we'll be happy to stand by you as the financial markets work themselves out.

[0:04:58.1] WS: Yeah, let's dive in there a little bit. And yeah, I would love to just explain and go a little more in depth and that exactly and even you know, was talking about your markets and it just did elaborate a little bit on why and how you came to that?

[0:05:09.5] BD: Since the great recession, 2008, 2009, the United States of America has under-delivered, under-supplied housing by 1.4 million units cumulatively. 1.4 million units and in recent years, 2017, 18, 19. The under delivery is about three to 400,000 a year. Now, I've heard of borrowers of ours who see this that we're facing right now, we're talking in April, by the time show airs, maybe we may – we're hearing in April, even during what may turn out to be the worst part of this crises psychologically, it is a seller's market.

Multiple bids, multiple requests to lease property or to rent single-family housing because we are under supplied and there's been a supply shock and a demand shock and the question for every investor is, which weighs more heavily? What you have to realize is the demand shock has to weigh very heavily before real estate asset prices really declined precipitously.

That's especially true if you're investing as we are in first quartile, below the median, past price in markets like the southeastern US, where we're predominantly based and predominantly doing our lending where all the tail winds are behind us. Even if there's this disruption and closings can't happen – By the way, we returned 10 million dollars in capital during the first month of this pandemic. We're still open for business. We're still flowing capital. Now, if you invested in a REIT instead of directly in loans, you're being told that your redemption request will not be honored.

All of the non-traded REIT right now have shut it down. There's an article in *The Wall Street Journal,* and I don't think they're going to be able to open it up for a very long time, right? That's not true if you're a direct lender. If you're $10 at a time on GROUNDFLOOR, $100 or $1,000, wherever you're in vesting for a loan, you got a portfolio of hundreds of loans. We're still repaying a million or two a week, we're still repaying loans because the business is still functioning.

Sellers are still getting a premium, sometimes even more of a premium for the property and that's hard to believe, that's a counter intuitive insight about the market but I'm here to tell you on the ground, in the trenches, it's happening.

[0:07:25.4] WS: Wow, okay. You're talking about the demand has to weigh so much heavier than the supply. Could you elaborate like okay, what happens at that point?

[0:07:33.7] BD: Yeah, we're aware that in certain markets, demand could be disturbed for a very long time, right? IN a very depressed level and we're running stress tests now on our portfolio to say, "Okay, well, even though we're in the first quartile or below the median house price, what happens if out of the 800 loans that we have in our portfolio, a substantial portion of them see a 10% drop in house prices relative to what we would have expected when we made the loan six months ago?"

"What happens if you see a 20% drop? What happens if we see a 30%drop and what if we have to bear the cost of foreclosing on those properties because of those steep price points. What will the impact be?" We haven't published that analysis yet but I've seen early versions of it? It shows all of the benefits of being broadly diversified as a direct lender in direct investor in first residential debt because even if a 30% disaster scenario with very high cost of foreclosure happening, what used to be a 10 and a half percent rate of return might look something like a seven and a half or an eight and a half.

Who is not going to take that in this environment? Instead of nine months to get your capital back, okay, it's going to take 14 or 15 months on average. I personally, as an investor, I think that's more than acceptable. I think it's exciting. I think it's uncommon to get that kind of exposure in an investment market like this. And I think it's a real opportunity.

We're actually starting to think in ways to play offense for that opportunity and how far investors on our side to make you more money.

[0:09:06.9] WS: When is that going to happen and how do you foresee doing that?

[0:09:10.9] BD: Well, because we partnered with institutional capital providers, we now have a huge backlog of loans to work through on our balance sheets. We stacked up all this inventory because they asked us for it, right? Somebody that puts an order in for a bunch of goods and then they just withdraw the order, right? That's what sucks about dealing with institutional capital providers.

We have to unpack that, we are taking matters into our own hands as an issuer, our investors are taking matters into their own hands and saying look, "If Wall Street won't do it, we'll take over."

And so, we launched the GROUNDFLOOR stimulus program in April. It adds a 4% extra rate of return, 4% per year, extra rate of return for 90 days during the term of any loan that you invest in during this period. We have something like 60 loans, funding on the site right now.

We're offering between five and 10 more loans out of inventory on the site every week. And you can earn not only 10% returns but 4% on top of that for 90 days. And that's us sharing some of the bounty of being an active lender in this type of environment where we can really cherry pick the best credits, right? The best properties. We have it lower leveraged. We don't require interest rate reserves. We don't think that's fair to the good real estate investors that we're serving but we are still out there.

We're chewing thorough that back log today. We're rewarding investors for participating and we're going to play our role, our part in getting the economy back to work as we sort of head out of this valley, whenever we do head out of it. And I think we're going to be one of the leaders in the real estate markets where we serve at getting people back to work and facilitating transactions.

[0:10:54.5] WS: I love that mindset and that push and we're going to be one of the leaders. And I love hearing too just you all are still active, you're still working, you're not shut down.

[0:11:02.7] BD: We have five loans closing this week, it's the back half of April, how many lenders can say that? I got five loans closing. And like hey, before the pandemic, I might have 15 or 20. But we got five, that's a non-zero, right? That is making progress, just chipping away. I would encourage your listeners to think in their business how they can chip away.

[0:11:18.8] WS: How are you prepared for this in a way that you all are still this confident and still able to keep performing like this?

[0:11:24.1] BD: First of all, we're very fortunate – this wasn't true when we started to become – you mentioned the top of this, before this, I started Wireless company, right? I wasn't a real estate guy. But we were fortunate as we grew, we raised venture financing. We built up a serious business that last year did 6.4 million dollars in revenue. And that's without really counting gross interest, that's just real true revenue of the business, high-margin revenue.

We built a large enough platform and business now that over a hundred million dollars loaned out last year that we have attracted industrial-strength professional grade, released a talent into the company. We have our Senior Vice President in charge of lending and risk management asset management, this is his fourth market cycle. He was at Prudential for 27 years.

He is the guy that showed up four and a half years ago and his assignment when he joined us and he relished it was, "Hey, take what you do for 80 million-dollar loans and figure out how to do it for $80,000 loans. Take commercial grade underwriting and risk management, asset management and inject it here."

That’s a difference maker. We have people who have been in the hard money lending business for 10 or 20 years around the company who process our loans, underwrite our loans, close our loans, manage the assets and that is invaluable to get into a period like this because we know how to work with our borrowers.

One of the first things we did is we said, “Hey look, we know you’re going to need an extra few months so if you’re on time with your project, if you're on budget with your project, if you’re in good standing, you’re doing the things that you need to do, providing the updates. We’re just automatically, no questions asked and no extra charge, giving you a 90-day extension on your loan.”

We came out of the gate with that. While all the country was going on lock down and I’m sitting on long conference calls with our partners telling us about how they’re going to rejigger their credit box and they can’t fulfill on their purchase commitment and whatever.

Meanwhile, we’re out there saying, “Nope, we know it makes sense to stick by you and give you more operating room.” That’s uncommon but then we’re not uncommonly structured capital market, right? We’re powered by people who are not leveraged, who are not stuck with the types of risks institutional buyers are. And we think that’s motivating, right? We’re going to work on behalf of those people and on behalf of our borrowers.

[0:13:37.1] WS: I love being proactive and we’ve tried to do a lot of the same stuff and just thinking ahead and understanding our tenants just like you're understanding your customers, you know? Showing them ahead of time that, “We want to help you. We don’t want to shut the communications down when you’re in trouble. We want you to communicate with us,” and we’re reaching out and we love that. You talked about reaching out to the borrowers.

Having that plan ahead of time before they’re really in a bind and a big bind, you’re going ahead of them.

[0:13:58.5] BD: We know good people are going to get into bad situations. We understand that, right? So, we are trying to look to the long-term like I said we're bullish in the long term and we are going to behave like it.

[0:14:09.3] WS: I love that. So, tell us a little more about how you are positioning yourself now to move forward in the next few months.

[0:14:14.4] BD: So, the first thing we noticed was in the big downdraft in the public markets. We saw everything from gold to Bitcoin to public equities, bonds I mean everything took a dive right? The whole world woke up one morning with the margin call as that got to its death and its bottom and who knows really whether that is the bottom, there could be another bottom. What I noted was that at first we saw unabated in fact, continued investment activity.

And then as that market reached the bottom, we saw some people start to take money off the table. We saw some investors say, "I am worried about my job. I want to buy the dip. I want to stock up cash. I want to reallocate my portfolio," and that is fine right? The good thing about GROUNDFLOOR is you're always getting repaid on something. We are not a fund so I am not going to say, "Oh no more redemptions, even if you requested it back in December, I am not going to honor your redemption request."

Which was happening out there with REITs. Instead you get repaid. It is up to you. You have the freedom to choose. If some people are taking money off the table, I also noticed a lot of people pouring more money in or investing with us for the first time after just tinkering or lurking.

And so, you see a broad divergence of views. Some people don't understand our thesis about residential housing in the Southeastern United States and that's okay. They can have a different view and they can go invest in a different category.

The other thing we did to position ourselves in this environment, noticing that people would have a different appetite for risk and reward as we started launching more of our short-term note product offerings. So, this enables investors to put money to work for us for 30 days or 90 days typically. Sometimes longer, sometimes we have a longer maturities. But 30 and 90 days, where your investment is backed by a pool of loans that were holding on our balance sheet and we are using that capital to bolster our lending reserves and our ability to go out and lend and we are rewarding people with really attractive rates of return on that.

So, you can go out and invest in real estate loans on individual projects that are 12 months long in this environment, who knows? It could take 18 months to pay back instead of 12 or nine which is typical. Or you can choose shorter term. And struck us is how as we ramped those up sales of those short term note products really took off.

So, we positioned ourselves to have a broad range of choices for investors. And if you believe in residential real estate and you are willing to take on three months of exposure, we got a product that depending on how much you are willing to put in, pays five, six or 8% in your return fee. If you want shorter exposure of 30 days, we got a product that pays four or five or 6% for you on an annualized basis, which in this environment when money is free, you know when the fed is paying zero and treasuries are managing double digit basis points, I mean this is pretty damn attractive investment opportunity. And of course, comes the risk but it is backed by residential real estate which we think is very strongly long term.

And if you are willing to go out there and play a longer maturity game you can earn even better yields, right? I mean 10, 11, 12, 13%. And so, we are just trying to position to give people a lot of flexible options to where they want to put capital of the work and how they want to do it. And if people share our long term-thesis or even our medium-term thesis, it is a very productive low volatility use for cash to the extent people have it.

[0:17:38.5] WS: I love that how you are also having different products because some investors aren't going to want to invest right now over five or seven years. They might have to in a lot of apartment deals like we might do. But then there is a product like you all have.

[0:17:48.5] BD: The other thing we did is we changed up our investments page on the site, not only the products but also the investments page to share exactly how much time is left to maturity on all the loans that we offer. So, we will often do like a 12-month loan but in this environment where we have a long backlog, it might sit in our warehouse for three months, right? So, some investors may like to know I rather invest in one that has nine months left as opposed to one that has 10 or 11 or 12 months left.

Or some people they want to keep their capital locked up so they want to pick the longer ones, right? They think the economy is going to be better in the longer term. So, we are just trying to give people more information and more choices, the shorter term, longer term, more data that they can use to make decisions and it has a lot to do with how we are positioning.

On the lending side, we decided to focus on the five states that we know the best in the south-eastern US. We have traditionally had a concentration in the mid-Atlantic in the Mid-West, a few western markets never California but we've peeled that back and said, "We are just going to focus on the southeastern US." You know Florida, Georgia and North Carolina and South Carolina, Alabama. We are going to stay on that market for the time being. But we are going to still focus on more experienced borrowers.

So, people who have not had a successful real estate transaction before, we are going to ask them to wait. Wait for more and favorable market conditions. Let the people with the track record of two, three, four successful transactions completed have their moment here. And I think those people are going to have a lot of inventory and a lot of investment opportunity to pick from over the next six to 12 months. I think it is going to be a good time for real estate investors to make some money if they are smart and selective and experienced.

[0:19:27.9] WS: So, we need to be ready to buy, huh?

[0:19:29.4] BD: Everybody's going to have their own outlook based on what they're doing in their own strategy, in their own liquidity needs and tolerance for risk. But in a world where we can diversify you $10 per loan, we think that positions us to allow people to take on more risk than you could otherwise as oppose if you were investing a $100,000 or 200,000 or your in equity risking the property. Yeah, we think for this type of environment, this is a purpose-built kind of product to get people through this period.

[0:19:57.5] WS: All right Brian, well I love just hearing your view point because you all are very active in the real estate space, no doubt it. What is a way you have recently improved your business that we could apply to ours?

[0:20:07.5] BD: We have done a few things with our staff. And so, I realize not all of your listeners have lots of people working with them or for them but I think this goes for partners of yours whether they are financial partners or operating partners. It is little painful for everybody to think of because everybody has their own time schedule but we started in 8 AM daily company stand up during which all of us and it is faster than you think, I was a skeptic when I first heard of this idea. But it was passed along to me by somebody else. And operationally we love it because we are all working from home. It gets us out of bed. We are not watching *The Today Show.* We are up and going. Sometimes people are there in their pajamas and coffee and sometimes I am sweaty from my work out on my Peloton, but we are all there at 8 AM reporting on 15 seconds per person typically, what do you got scheduled for today. What are you doing and is there something you need from somebody else on the team?

It is just a great heartbeat for us as a group that I think other people could use with anybody that they are working with. It doesn't have to be at 8 AM. But I think everybody could use a little bit more connection. And we are all on video. So, we are all on Google Hangouts and checking in with each other. It is actually been good for us the last few weeks.

[0:21:16.9] WS: I love that idea. It allows you all to connect. So, it is really an update on what you have going on today and what you need or do you need anything else from the rest of the team.

[0:21:24.6] BD: Just forward looking. Let's just talk about the next 24 hours, right? What is on your calendar? What are you depending on? What are you thinking about? Just tell is about that. We don't need to talk about what happened yesterday or what we are afraid of happening or think might happen two days from now. Let us just focus on today. Let us get through today. Everybody is quarantined. Everybody is just trying to get through the next day. We found that that's really productive and just give everybody little shot in the arm, get a little running start to the day.

[0:21:48.4] WS: What is the number one thing that's contributed to your success?

[0:21:51.2] BD: Our values have. We thought very carefully from the early beginnings of our company, seven and a half years ago when we were founded. We started developing company values. And we said from the beginning there are company values needed to not be just ideas of things that we want to be, but needed to be descriptive of what we are and what we have to be to be successful in what we do.

And so, we were careful about picking values that were aspirational that maybe didn't strive as, as much yet as of the people but then we wanted to strive for and so we've come up with values that are really important today that we talk about a lot like accountability. We are accountable to each other. So, if I make a mistake or I am late on something or we don't make a good decision, I am accountable for it when I am late to a meeting, I am accountable for it. Why are we accountable? Because we need to build trust.

Trust-building is a really important value around here because we're asking people to entrust their business to us if they are going to rely on us for lending capital. We equally need investors to trust us, right? And so, if you want to be trusted you need to be accountable and that is an example of this values that we do infused into the company.

And there are other ones that are important too, commitment and persistence are two values that are really important around us. I mean this environment, we are bound and determined to persist through this. We're fault tolerant in the way the internet's fault-tolerant. We route around catches in the capital markets. We do that because of the way we're structured because we have this SEC qualified offering that allows us sell securities to everybody and we have a $10 minimum. We are going to persist, right? We are going to be there in Q3 in 2022 and 2025 and we are the kind of company that is not going anywhere. We are standing firm and that's because we are committed. We are committed to our cause.

We are the sort of people that stick to it to a fault if we have to. Those types of values and talking about them and thinking about how to live them and making them real and rooting them in behavior and talking about what behaviors are in line with the values and what behaviors are not in line with values, as a people, has helped us as we scale from two co-founders seven and a half years ago to 50 employees now. That's what's held it together.

It is not for everybody. Our values aren't for everybody. They are for us. We had employees who were super talented people, but just didn't agree with those values or couldn't live up to them.

And so, we had to say goodbye to those people. But that is serving us really well now because we are a close-knit group because of that. And I think that is an important piece of bedrock for getting through times like this.

[0:24:24.6] WS: I appreciate you sharing that. I am in the process of hiring somebody else right now so I am going through that exact same thing. It's like well they have tons of talent but I am not sure we align on many things you know? So, Brian, how do you like to give back?

[0:24:36.3] BD: Well one of my favorite things to do is to talk with younger entrepreneurs. So, I always thought I might be an entrepreneur. I am 48. So, I am older than maybe a lot of people who are in my job as co-founder and CEO of a startup. But when I was first thinking about entrepreneurship it was 1993, 1994 and I was talking to my best friend about, "Dude let's start a business together." We just graduated college and we had jobs in management consulting.

And we're like, "Let's start a business." We had no idea what kind of business to start or even how to start one. And it wasn't until I got to grad school in late 90's, where I was in business school and law school and decided to really go for it and build my own website. And that is where I started to discover my own sense of who I am as an entrepreneur. We have a lot more tools that tell you what to do in order to start a business. What we don't have as much about is awareness about the self-management and the self-knowledge that it takes to be your best entrepreneur, the best entrepreneur you can be.

So, I love talking to and working with younger entrepreneurs who are at that stage and I don't tell them what to do because I don't know what they should do. I just like sharing my experience about that in order to give back. And my son is 14, hopefully if he chooses to follow in those footsteps I'll be there for him to do it, but if not, I want to give back to as many earlier career entrepreneurs as I can.

[0:25:58.6] WS: Wow thanks for sharing that Brian. How can people get in touch with you and learn more about GROUNDFLOOR?

[0:26:03.2] BD: I am on Twitter @brian_dally and people are free to email me as well, brian@groundfloor.us. And of course, you can find my contact info on our website, groundfloor.com.

[END OF INTERVIEW]

[0:26:19.3] 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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