EPISODE 642

[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]

[00:00:23] WS: This is your daily Real Estate Syndication Show. I'm your host, Whitney Sewell. Today, our guest is Paul Moore. Thanks for being on the show again, Paul.

[00:00:32] PM: It's great to be here, Whitney. Thanks for having me on. It's an honor.

[00:00:35] WS: I'm honored to have you back on the show. If you're a listener, especially a long-time listener, Paul's been on a couple times before. He shares just great wisdom and experience in this business. I encourage you to look him up. He's a big contributor for BiggerPockets. He's just putting out tons of great content, educating lots of people in this business.

A little more about him; after a stint at Ford Motor Company, Paul co-founded a staffing firm where he was finalist for Michigan entrepreneur of the year, two years straight. After selling the staffing firm to a publicly traded company, Paul began investing in real estate, founded multiple investment and development companies, appeared on HGTV and eventually built and co-managed a successful multifamily development.

Paul co-hosts two podcasts, including The Art of Investing and How to Lose Money. He is also a contributor to Fox Business and BiggerPockets, producing live video and blog content on a weekly basis. Paul is the author of *The Perfect Investment: Create Enduring Wealth from the Historic Shift to Multifamily Housing* and *Storing Up Profits: Capitalize on America's Obsession*

with STUFF by Investing in Self-Storage. Paul is the Managing Director of three commercial real estate funds at Wellings Capital.

Paul, thank you again for your time. Always grateful to connect. The listeners may not know this, but I've known Paul for a long time. We went to church together many years ago, it seems like many years ago now. We've known each other long before I had a podcast, that's for sure. Thanks again, Paul, for your time. It's always a pleasure. Give us a little update on Wellings Capital and what's happening and let's jump into a couple of specific things you're going to help us to better understand today.

[00:02:17] PM: Yeah. Well, for somebody who wrote a book called *The Perfect Investment*, it's somewhat embarrassing when people say, "Well, wait a minute. I thought you said multifamily was the perfect investment. You've expanded into self-storage and mobile home parks." I said, "Yeah, we're going to call the next book *The Perfecter Investment.*" I said that on a podcast once and the guy didn't get it. It was really awkward. I'm telling you, did you understand I was joking?

[00:02:42] WS: Oh, I'm taking notes, Paul.

[00:02:43] PM: Okay, good. That's great.

Anyway. No, seriously folks. All seriousness aside, when we realized that we did not have the best acquisition team, we were not finding the off-market deals that honestly, people like you have done much better at, Whitney. We realized that multifamily was largely overpriced, especially the on-market stuff, we decided to expand into self-storage and mobile home parks.

I'm really glad we did, because there are a lot of mom and pop operators and you can pay them a more than fair price, but still get assets with a tremendous amount of meat on the bone. That's what we've been investing in in the last couple years. We've really been enjoying the process. We're on our third fund right now at Wellings Capital.

[00:03:31] WS: Your third fund. Okay. Well, congratulations on that. I know that's exciting. We want to talk about specifically about 1031 exchanges and Delaware Statutory Trust and love to

have your insight how that's working for your funds and why that's important to the investors that are listening.

[00:03:47] PM: Yeah. Whitney, about a year and a half ago we had the largest investor – serious investor who had ever called me. He called me multiple times, talked on the phone for a few hours. He was from Lexington, Kentucky, one of your old stomping grounds, I believe. He was a retiring attorney. He really wanted to play more tennis and do less real estate management and attorney work, but he had this asset he was trying to sell and he wanted to invest the proceeds into one of our funds.

The problem is he had been doing multiple 1031 exchanges since the early 90s. He had basically deferred his capital gains tax, he had deferred a lot of the depreciation recapture taxes that would be due and he was going to have a walloping huge tax bill. He was selling this asset for about 2.1 million. In addition to that, he didn't want to be a landlord again. In other words, he didn't want to put it into an asset that he would have to personally manage. He wanted to start playing more tennis.

We talked to him for a lot, but in the end he decided not to invest with us, because he would lose his 1031 exchange. A 1031 exchange is something that's set up by IRS code that allows people to swap one real property for another. By doing that though, the property cannot be part of an LLC. It can't just be ownership in a business. It has to be a real property. Even though our funds have real property interests in them, he would had to be a Tenant in Common with the GP, the general partners of the fund to make that work and there's all kinds of hassles with that.

He decided to do yet another 1031 exchange. He called me back later and told me, "You know, I really didn't want to manage another property. I didn't want to go out and get another debt in my name." He's going to have to get a million dollars in debt to do this. "I want to enjoy my retirement."

So, he told me about the Delaware Statutory Trust. I hadn't really heard much about that before, but he explained to me that the 1031 exchanges typically have a lot of pressure on the exchanger. They have 45 days to exchange into another property as most the listeners know. That's to choose other properties. Then they have 180 days total to close.

If something goes wrong, the deal I heard about the other day that on day 179, the lender who had been onboard for six full months, on day 179 said the loan is not approved after all. That was after they'd signed all the title work and everything. There's a lot of things that can go wrong with a 1031 exchange. There's a lot of pressure. There's a chance people overpay to avoid the tax. There's a chance they buy a bad asset they don't want.

He explained to me the Delaware Statutory Trust deals with all those things. He didn't invest that time with us, but he's invested with us once or twice since with just cash he had in his IRA. That was my first introduction to the Delaware Statutory Trust.

[00:07:02] WS: Is this something that takes the place of the 1031 exchange?

[00:07:05] PM: It works hand in hand with the 1031 exchange. The way it works is when you do a 1031 exchange, I mentioned all the disadvantages. There's great advantages, but of course a Delaware Statutory Trust is an ownership model that creates a legal entity that allows co-investors to basically fractionally own real pieces of that asset. Unlike a Tenant in Common, they don't have unilateral decision-making authority. They don't have the problem with a rogue investor messing the decision-making.

Managed by a third party. They're 1031 exchange-friendly, which means all the deferred taxes can continue to be deferred, but there's absolutely no management at all on the part of the investor and they don't have to go out and get their own debt. The operator or the manager is the only one signing on the debt, which leaves all that open debt capacity as well for that individual. They decide they want to invest something else. They've got that capacity. Their name is not on this. They don't have a liability; they don't have any hassle in managing it and it's always investing in stabilized assets. They just get mailbox money. It's a pretty cool concept.

[00:08:21] WS: Just like a limited partner, just like normal. There's probably a lot of listeners who don't understand. If somebody's 1031'ing into a syndication, that person, like you're talking about, is on the general partnership side then. They're on the team, ultimately. They're on the paperwork anyway and they have a lot of say in what happens. You're giving up a lot of say in

what happens with that property. It seems like the Delaware Statutory Trust is going to allow you to really treat them then more just like a limited partner.

[00:08:50] PM: It's good for them, except unless they want control, it's really good for them, because they can just again, just sit back and be a passive investor. Last time I talked to my friend, he was playing two hours of tennis a day enjoying his retirement, getting a check in the mail every month. It's very cool.

The cool thing about it too is all the tax deductions of real property ownership, all the depreciation, the accelerated depreciation and everything else and a 100% of the appreciation as well goes right to the investors. It's just like owning a real piece of property, but somebody else is managing it and you're a fractional piece of it.

[00:09:30] WS: Who sets this up, Paul? Or who starts the process for the Delaware Statutory Trust?

[00:09:35] PM: Well, the good news is you don't have to live in Delaware and your property, you're investing doesn't have to be in Delaware either. It's just set up under Delaware law. This would be an attorney, like a syndication attorney. It turns out that a lot of the syndication attorneys that do DSTs for some reason seem to be in Richmond, Virginia right down the road from us. It seems to be the hub of legal work and also promotion for Delaware Statutory Trusts.

[00:10:06] WS: What about on the deal side, though? Is that the operator or the investor that's having to connect with that attorney?

[00:10:11] PM: Yeah, it's the operator. Basically, an operator decides to put a DST together. I'm going to tell you in a minute, an example, if we have time, of how we're doing it. Then the operator contacts an attorney, just like you would as an operator or syndicator and you would get the PPM, the operating agreement, which is actually a trust agreement pulled together, you file all the paperwork needed then you would just do it like a reg d rule 506(c) for accredited investors only, or rule B for accredited and non-accredited investors and you would just run with it just like you would other syndications.

© 2020 The Real Estate Syndication Show

Yeah, the investors typically hear about this, by the way, through a brokered dealer. Broker dealers typically advertise that. Though there are ways to find these directly without the broker dealer.

[00:11:01] WS: Why don't you go ahead and give us your example of how you all use this? That would be great.

[00:11:06] PM: Absolutely. We're investing with an operator. We decided when we made this expansion into self-storage and mobile home parks, Whitney, we decided we did not want to be an operator. We felt like it was late in the game. We felt like, again, the issue of an acquisition pipeline was staring us in the face and we didn't have that, but we had a lot of investors who trusted us, and so we decided to go out and do a lot of due diligence, operators and the very best in class operators we could find.

One of the operators we've been investing with has a great acquisition strategy and their operating strategy goes like this; they buy from a mom-and-pop operator in the path of growth, they spend the first year upgrading operations, stabilizing the property, doing value-adds, they spend their second year essentially increasing their income statement, their net operating income and then they spend their third year most of the time selling the property.

This three-year time window gives them a very, very high IRR, 60% or more, typically. That is just something that we just love about them. I called the operator one day back in December and I said, "Gosh." Some of the other operators we invest with have 10-year, 20, 30-year holds. You've got a three year hold and I appreciate what you're doing. We love investing with you, but wouldn't it be great if you could find a way to hold it longer, to give the investors the same IRR they are in this three-year-hold, but maybe to find a way to hold it longer. We began to talk.

He and I had both talked to that Lexington, Kentucky investor. We began to revisit that. We realized, what if he could sell the asset? First of all, he gets it stabilized, he gets the operations down, gets the marketing down, gets the financials systems in place, gets the property manager onboard and trained, gets it fully stabilized, maybe gets the occupancy up from the 70s to the 90s, for example and maybe collections up from the 50s to the 90, upper 90s, everything to get it stabilized. Then I said, "Why don't we consider taking the appraised value and then figuring

out what the fund, or what your portfolio as the seller, as the owner of this property, what you would net with a real estate broker and then sell it to the Delaware Statutory Trust, so it would not be an arm's length transaction? It would be a close transaction."

Let's take an example. He bought a self-storage asset in March of 2019. Five kids who had inherited this property, they were all fighting. It was going down the tubes and he acquired it for 2.3 million. Four months later at the end of June 2019, it was appraised by a third party after being stabilized quickly by him. It was appraised for 4.6 million dollars, just three or four months later. Now it's worth about five million dollars based on the current income and occupancy improvements.

Now, what we're going to do is he's going to sell that asset into a Delaware Statutory Trust. That means the fund investors on the front-end get our profits out of it. He's going to sell it for below the current appraisal. In other words, it's about 5 million now. He's going to sell it for around 4.6 million, which means the fund the investors get a great deal, they don't have to pay a brokerage commission and the DST investors get a great deal, because they're getting it about 8%, 6% or 8% below current market value.

Now the DST investors are people who are 1031 exchange people that are coming in, naming this property as their replacement property. Then they will get the benefit of getting a stabilized known entity. In other words, they're not going to be buying a property that is unknown. They're going to be buying a property that already has management, already has marketing, already has the cobwebs cleaned out. It's already stabilized.

There's enough surprises out there these days with COVID and civil unrest and everything that's going on in the economy, Whitney. We don't need a surprise from an asset, especially in a DST, because they're supposed to be very, very stable with set returns. We're going to be able to give investors a 6% stable cash flow, cash-on-cash return every year and then hopefully, we're targeting 4% or 5% annual appreciation on top of that. Not a huge return, but a stable return and tax advantaged.

[00:15:49] WS: Would that trust then hold that property long-term then? That's what you're referring to?

[00:15:54] PM: Yeah. We're getting 10-year debt on it. We expect to be holding this property for 10 years.

[00:16:02] WS: Would the trust assume some debt, the previous debt or new debt?

[00:16:07] PM: Yeah, they would be putting new debt on it and we're planning to get about 50% debt, though that's not finalized yet. We want to be very careful with that. We want to make sure that there's a very nice margin of safety between the income and the break-even point.

[00:16:21] WS: How are you finding them and who's that ideal investor for this type of deal?

[00:16:26] PM: This would be somebody who has a 1031 exchange they're already in the middle of. They're in their 45-day naming period, or the extended period under COVID and it'd be somebody who's looking to get out of the management hassle, somebody who doesn't mind giving up control to somebody else they trust, somebody who wants to be part of perhaps a larger investment, maybe an institutional great investment, rather than just going from let's say, a triplex to a four-plex, somebody who wants to defer or continue to defer capital gains and depreciation recapture taxes and somebody who might want to do the swap till you drop strategy and continue to do the 1031s in the future, though that's not mandatory, but that is one of the benefits of this. They can come out with a 1031 on the back side in 10 years.

[00:17:17] WS: Anything else you want to inform us about, specifically about Delaware Statutory Trusts before we have to do a few final questions, before we're out of time, Paul?

[00:17:26] PM: Yeah. There's actually some disadvantages and I think it would be fair to go over those. The one I mentioned is loss of control. Number two is there's not a lot of value add. We can't go in after you start the DST and pave a big parking area and start storing boats and RVs, or we can't add self-storage units. It has to be stabilized according to the legal terms of the trust agreement.

It's also illiquid. Of course, a lot of real estate's illiquid. It's not like stocks and bonds. You're going to hold on for 10 years. There's not a secondary market. There's typically high upfront

fees with brokerage commission, etc., through a brokered dealer, unless you're going directly to the asset, or to the operator yourself and that's what we're providing in the way we're doing it. Last of all, you have to be an accredited investor to get involved in a DST. Those are some of the disadvantages of a Delaware Statutory Trust that people need to be aware of when they get into this.

[00:18:27] WS: All right, Paul. Quickly, a few final questions. What's the way you've recently improved your business that we could apply to our business?

[00:18:33] PM: One way is I have spent and I probably told you the same thing years ago. I don't know. I'm really trying to get hold of my e-mails, so I'm trying to set in addition to doing a meditation, prayer, journaling time in the morning, I'm trying to flow straight from that into a time of creating content, because that's when I'm most creative, that's when I'm least interrupted and I don't get up as early as you yet, but I'm working on that and I'm trying to get that to flow straight into a time of blog content. Today, I wrote a special report on Delaware Statutory Trust and I had not checked my e-mail from when I got up about 4:50 a.m. to about 10 a.m. That was very helpful.

[00:19:22] WS: Good for you. What's the way you are finding investors right now, or the best source?

[00:19:28] PM: Just creating content, just being on podcasts like yours, doing BiggerPockets, live events, which I'm doing one at 4:00 today, doing things like that and just having investors contact us.

[00:19:40] WS: Number one thing that's contributed to your success?

[00:19:43] PM: I really think that that same thing, creating content, just being focused on not chasing investors, never viewing myself as a salesman, but basically a content creator and people come to us.

[00:19:58] WS: How do you like to give back, Paul?

[00:20:00] PM: I got very upset about four years ago when I watched a movie called *Nefarious.* I highly recommend it. It's put out by a group called Exodus Cry. They're at exoduscry.com. It's there, I learned about the horrors of human trafficking. If you took the record profits, not the average, the record profits of Apple, Nike, Starbucks and General Motors, added those together, doubled that number, that's the approximate revenues generated by human trafficking every year. It's slavery and it's a civil right that's been ripped away from tens of millions of people. My desire is to actually promote this cause to fight human trafficking, to rescue its victims and my goal is to raise a lot of awareness and a lot of money to do that over the years to come.

[00:20:53] WS: Wow. Thank you for sharing that with us, Paul. Thank you for giving back in that way. Tell the listeners how they can get in touch with you and learn more about you and connect.

[00:21:02] PM: All right. They can just come to our website. It's wellingscapital.com. That's W-E-L-L-I-N-G-S-C-A-P-I-T-A-L. Wellingscapital.com.

[END OF INTERVIEW]

[00:21:14] 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’re 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]

[00:21:55] ANNOUNCER: Thank you for listening to The Real Estate Syndication Show, brought to you by Lifebridge Capital. Lifebridge 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. Lifebridge 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]

© 2020 The Real Estate Syndication Show