EPISODE 811

[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]

[0:00:23.8] WS: This is your daily Real Estate Syndication Show. I'm your host Whitney Sewell. Today, our guest is Omar Ruiz. Thanks for being on the show again, Omar.

[0:00:31.6] OR: Thank you, Whitney. I'm excited to be here. Thanks for having me.

[0:00:35.9] WS: Yeah. Omar, was a guest on show. WS387, where we went into just a due diligence and research process. I would encourage you to go back and listen to that show, just to get to know him a little better. But in case you missed that he's the founder of LeRu Investments, LLC, based in Southern California. He's been managing and owning multifamily rentals since 2006. He's an expert at due diligence on apartment acquisitions and purchased properties in three different states and has spoken at real estate investor clubs and been interviewed on several podcasts.

Omar, thank you again for your time. I know, you've recently had a transaction that I think we can all learn from. You learned a ton, I'm sure. And you're more prepared to do it again. You and I were talking about it before we started recording, and it's something that not many of us know how to do or have done, and it's something that so many have questions about. So, I'm looking forward to getting your take on this. Give us maybe a little an update on what's been happening. It's been what, 500 and some shows, or just under 500 since we talked last, so give us an

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update, and let's dive into this specific deal, the structure and some specific things that I know, that's going to help the listener whether they're active investor or passive.

[0:01:49.4] OR: Sure, absolutely. On this particular deal, back in the summer of last year, 2019, we always stay on top of what's going on in our in our market. And this is kind of what led us to the decision to sell this particular building. Well, what's happening there is that there was an apartment complex, almost right next door to us just right around the corner. I mean, you could see it from right across our parking lot there. And I actually put an offer on this on this property. I like the property and I think I only missed out on it by maybe $1,000 or $2,000 per door.

So, close, but not close enough. Anyways, I knew the broker that sold that one was also a broker that had worked with us on an acquisition. And this goes to show the importance of having good relations and constantly staying in contact with with your brokers in your market. I was able to call the guy up, talk about that transaction and find out what it's sold for. And knowing that, knowing how close it was located to our property, it's really easy for me to just kind of connect and say, "Okay, if that one's sold for that, same year built, square footage very, very similar to ours. Okay, I could use that as a comparable to our property." I'm sorry, I misspoke. That one actually sold in 2018. Okay, so two years ago.

Now, in the summer of last year, 2019, another property came up on the market less than a mile away from our property. And I toured that one too. I was planning to put an offer on it, bigger property was, I think, a little over 200 units. So, that really interesting to me. I toured that one. I plan to put an offer on that one. But I decided not to because kind of the direction and the plan that they had for that one, I didn't think was – I was very familiar with my market and I thought what they were trying to do with it was not going to be a good fit for that market. But same thing, I knew the broker very well, had toured many properties with the guy. I actually even ran into him on the flight on the way up to Indianapolis from San Diego to Indianapolis.

So, I talked to him, I found out what that property sold for. So, now I had two comparables in my market that I could use to influence the value on our property. And at this time, we had not really had serious conversations about selling it, but now that the second property had come up, and it was now under contract and on its way to closing, now, I had an idea of value on what we could sell our property. So, we were one year left on a prepayment penalty period. But despite that, my fear was that, I won't say my fear, but my worry was that the property that sold in 2018, the one that was right around the corner from Mars, after two years at that comparable would become stale. You know what I mean? And I was trying to use that, to influence our Valley. So, I said, “You know, I think this is the right time to sell. We can use these two comps. Get good value and we're going to make good money anyways, even if we pay the prepayment penalties.” So, we decided to go ahead and sell.

Now, beforehand, we had told our investors on this deal that we, ourselves, me, my and my partner, Jeff, we had planned to when we sold this property, do a 1031 exchange into something bigger and better. And that opportunity would be made available to our investors. We weren't sure exactly how we were going to structure and all that stuff, but we had the general idea that something like that could be done. So, we started doing a lot of pre planning ahead of time talking obviously to the 1031 exchange intermediary, talking with our CPA to figure out what everybody's tax liability on the capital gains was going to be and she was really instrumental in helping us figure out what that liability was going to be, and of course, the depreciation recapture and all that and we were able to, with her help, come up with a good basic little formula that when we had our next quarterly investor conference call, we shared that information to our investors and told him, “Hey, here's our plan. We're going to be selling. Here's the timelines and then we're going to do this 1031 exchange.” If this is something you guys want to participate on the next leg up, let us know so that we can kind of anticipate how much are we going to have to raise in funds, because we were planning on doing a whole new syndication on this one.

So, information was put out there, we put a little Excel spreadsheet to kind of give everybody an idea what their gains were going to be and all that. We kind of did a lot of pre planning ahead of time with that. We sold the property and this property, it was a 77-unit apartment complex. The sale closed on February 24. So, right then and there, the 1031 clock starts ticking, right. And luckily, beforehand, we were already putting offers out there because we we were very conscious and sensitive of that 1031 timeline. You have you have a 45-day period to identify the property.

And then you have the 180 days to look at the new property and then close a deal. Now, some interesting things happen, because on February 24, if you and your listeners can remember, back in that time, the COVID pandemic was still not a major thing on people's radars. I'm here in California saw, I heard quite a bit of it in San Francisco. My wife, she's Japanese and she was planning a trip out to Japan in March. And funny enough, me, my brother and some friends, we're actually planning a trip to China in March also. So, all those plans, evaporated.

[0:09:04.8] WS: That changed, no doubt about it.

[0:09:08.2] OR: Yes. So, we had actually gone under contract on a property out in Ohio. And it was about the double amount of units. But here was a thing, COVID disrupted several things. First, in the lending environment, it was a major disruption where the agency lenders, which are Fannie Mae and Freddie Mac, they instituted what they called COVID reserves. And Fannie Mae kind of stumbled at first because they kind of went way over the top with what they were asking. Well, first off Freddie Mac was kind of the more on the reasonable side, they were asking for 12 months of principal and interest payments, which even that in itself is a lot. But Fannie Mae, they were asking 18 months of principal and interest payments plus 12 months of taxes also, and then 12 months of CapEx reserved. I mean, just they are obviously scared to do deals. So, they weren't doing any deals.

[0:10:21.2] WS: And your time is ticking.

[0:10:22.7] OR: And my time is ticking, exactly. So, on the deal there in Ohio, I had actually finished up all the due diligence when all this stuff just landed on my lap. We've done all the plumbing sculpts. We inspected. It was over 130 units. I paid for roof inspectors. I paid for building inspectors, pest control guys, plumbers to sculpt the lines. I mean, I'd spent thousands of dollars. All my due diligence was done and I was ready to move forward. But then these COVID reserves landed and we had to renegotiate on that deal.

This is also another lesson on how not to do your operating agreement. The 130 units there was comprised of five different locations. So, it was what they call a scattered site deal. And the seller amongst those five, there was there was about three or four different partnerships on that whole project there. So, we said, "Hey, these COVID reserves came. We need to renegotiate the deal, because now we're looking at coming in with an extra and I can't remember exactly what the number is, you know, off the top my head, but I want to say somewhere like in the range of like an extra $300,000 to $400,000 for those COVID reserves now. So, obviously, you it's affecting the deal.

[0:12:05.1] WS: That changes things.

[0:12:06.4] OR: It changes things. Absolutely. But these guys were acting like sellers, except for one guy. So, we renegotiated a price. Everybody was good for it, except on one of those properties and he told me, the seller told me, he said, "Omar, you know, I screwed up on this thing." This was I guess one of his early syndication deals. But what he did, he wrote the operating agreement in such a way where in order for them to sell the property, he had to get unanimous decision from all the investor partners.

[0:12:46.1] WS: Oh, boy.

[0:12:47.2] OR: You never see that. When you start off, you got to do what you got to do, I guess, right? So, everybody agreed, except for that one guy. So, we had an impasse there. We still ended things off pretty amicably, he saw we were performing, doing our thing. He wanted to get the deal done, but his hands were tired on that operating agreement. We had to drop that deal, back out of that deal. So, there was that. Now, that deal, when we backed out of bit, we had already gone past the identification period. I mean, this deal was going to be our deal. We already know. Like I told you, I'd gone through the whole thing.

[0:13:40.9] WS: What happened then with that time or you're past that time period now, what happens in the 1031 process now, now that you've passed that?

[0:13:49.9] OR: Okay, that's a great question. So, here's where COVID now worked in our favor. So, what happened at that time, because of everything with COVID, the newness of it and all this stuff. It was having a huge effect on real estate transactions. And you know, their reserves were causing deals to fall out of escrow just like ours did, because nobody was underwriting deals with an extra 12 months of interest payments baked into the race. So, what the IRS did is they actually extended the identification period. If you're in the middle of a 1031 exchange, now they had extended the identification period to July 15.

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[0:14:37.4] WS: So, no matter where you are in that process, you get until July 15?

[0:14:41.6] OR: Right, exactly. If you had actually either sold, or were already kind of somewhere in the process, that they extended at 40 which was great because that helped us out tremendously. So, now we had some extra time to identify deals and we also know now to underwrite with those extra 12 months of mortgage payments. And so that's what we did.

[0:15:10.1] WS: Can you speak though just to the investor's take during this process. You did that webinar with them, you told them about, we're going to do a 1031. And so, can you speak to like, I'm sure there were investors that wanted to stay in, there were probably investors that that wanted out. Let's talk about that, but then also COVID hits, what happened then to those same investors?

[0:15:34.7] OR: Before the whole COVID, and everybody knew, nobody had made a decision at that point that they wanted to get cashed out. Everybody, they had a good experience on that one, some of those investors have been on multiple deals. So, they were kind of waiting on us to see what we would bring to the table at that point. And many of them already knew about what was going on with the deal there in Ohio. So, they were just kind of waiting the process and getting status reports on the due diligence. We were excited about that deal. They were ready. The majority of them, if not all of them, would have been on board on the 1031. But now, when COVID hit, the investors, some of those that were a little bit more are cautious now. They're asking questions and reasonable questions, "What do you expect is going to happen with COVID? How's that going to affect vacancy? What are you anticipating coming down the line?

The interesting thing, Whitney, and even up until this point, and it's probably due to a lot of the stimulus that's going on, people's rents were coming in. I haven't seen massive evictions happening, drop offs and vacancy. There have been fluctuations, but not as extreme as what I was expecting to see. And the interesting thing is, in some of the vacancies that we've had here in California, when we get put them up for for rental ads, we've been actually able to boost up the rent and it's been crazy, the response, I'm getting on our emails, just getting flooded with with prospects?

I don't know if you're experiencing the same thing on your end. But that was really unexpected. And one of the things that I think is probably happening, just my opinion, just from what I'm kind of seeing, boots on the ground type stuff, but I think there are some tenants that are kind of double dipping.

[0:18:15.1] WS: Of course.

[0:18:15.3] OR: I think what they're doing, they're getting their stimulus money and a certain percentage of them that are also working or working part time, or still have a job waiting for them, I think they're also collecting unemployment benefits, even though they have a job, they're ready and waiting for them.

[0:18:35.9] WS: They'll always be professional tenants, no doubt about it. Could you elaborate a little on just the structure of the deal? And before we run out of time, I'd love to talk about just the TIC, how investors can get out of that? There's probably some that didn't want to invest in the next deal. But then some, in allowing new ones in, just the structure of that, and how that worked with you and your team.

[0:19:00.8] OR: So, the TIC structure, tenants in common, what that stands for, so the tenants in common structure is that you get a deed for your percentage of ownership in the deal. So, once we were closing on the initial property, we had to get our lawyers to write up these deeds, and this applies to the investors that were getting cashed out. So, whether they had 6% or 10% or 20%, whatever it was, a whole new deed had to be written up for their share.

So, they were given that deed, signed off on it, and then they had to transfer that deed to the new buyer. And so that's kind of how that process works. So, it would say, so and so investor or so and so's IRA for 6%, share a deed, conveys this to the new buyer. Now, it's not just me selling our portion, they're selling their shares of that property over to the new buyer. Does that make sense?

[0:20:08.9] WS: It does. Was it worth it to do the 1031? How manageable was that? How difficult was that process?

[0:20:18.7] OR: It was a whole lot easier than when people had explained it, because here's the thing, my CPA, we had huddled, and numerous meetings with our CPAs and the 1031 attorney, because the direction that we initially thought to go with with our CPA, we didn't do that. After we had a conference call, our CPA and the 1031 intermediary's attorney, he suggested we do that tenants in common structure. As he's explaining, it sounds it sounded way more complicated than what I was comfortable with. But you know, he was the expert in that. And so, he said, "Okay, that's the way we're going to do it." What made that a whole lot easier, Whitney, also was that the investors get cashed out at escrow. So, the escrow company, when they disperse the funds, they get paid directly from escrow. It's not like us after the sale, having to distribute their percentage of shares and all that stuff.

So now, we don't have to send extra tax documentation, so that we don't have to pay their capital gains. It goes directly out from escrow. And that's it, they're cashed out, and they got their percentage share of that property with their gains. So, it made that process of cashing out people a whole lot easier. And that's what the attorney said, this is going to be the easiest way to do it. You got some more documentation, but as far as cashing out people, it was a lot easier go now.

Here's the thing, moving forward and brainstorming things for future deals, if we decide to do another 1031 exchange of the next leg up, it gives investors options to diversify. Let me explain that. Let's say we buy another apartment complex on the next 1031 exchange, now an investor that's involved, they can actually go on the next leg up, and then they can take their tenants – we can do a tenants in common thing and they can actually take a portion of their share in the property, put it towards the next 1031 and take another portion of their share, and maybe put into another property. And they could do multiple 1031s and defer their capital gains that way. Yeah, I was really glad that we learned how to do that whole process.

[0:23:00.3] WS: Who was the main person there that was on your team that can help you do that? I mean, was it like your attorney? Was is the intermediary? Was it a CPA?

[0:23:08.4] OR: We had an attorney. The 1030 attorney, we kind of wanted him to do it, because obviously, he's the expert. But he kind of convinced us against it. He was like, "I mean, I could do it. But I'm going to charge you more than some other guys." So, I think it was my

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partner that kind of spearheaded that and we have an attorney. I think it was an attorney there in Texas, that put that whole thing together, even though this was an Indianapolis thing. I think it was a Texas attorney that got all the documentation together and all that, and we were able to get it done.

[0:23:52.5] WS: Yeah, I mean, not every attorney is familiar with that kind of process. And I mean, they're all specialized. So, I would imagine you've had someone that obviously was familiar with it, probably done it many times. But unfortunately, we got to move to a few final questions, Omar. What's a way you've recently improved your business that we could apply ours?

[0:24:11.0] OR: Well, definitely on the raising funds in, I think I've been more proactive on the front end and even beforehand, because once you have a deal on your contract, you really get into fundraising mode. So, that's one thing I've improved is kind of staying more communication more frequently with our current base of investors. And also, the communication with the brokers too. That is so important. That's really how you're going to get deal flow coming in your way if brokers know you're engaged.

[0:24:46.1] WS: So, what's been your best source for meeting new investors?

[0:24:49.5] OR: We have a meetup club. The real estate investment club, it's called the Orange County Investment club. That's a great way to meet investors, but also if you can get out there and share your information, we have a YouTube channel that sometimes it can be stuff as random as, "Oh, geez, how you rehab the certain unit." The topic itself can be mundane or as complicated as you want, but as long as you're talking about what you're doing in your business, what it does is that it shows people that you're in it, you have the background in it, you have the experience, and that you know what you're doing.

[0:25:38.4] WS: What's the number one thing that's contributed to your success?

[0:25:42.4] OR: Definitely staying on top of the trends. Getting educated, but also following the thought leaders out there. Guys like yourself, of course, many other people out there that – in

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fact, I've been reading a lot of books on higher up guys, that have been doing this for decades and decades.

[0:26:11.8] WS: Is there one you can recommend?

[0:26:13.5] OR: Actually, when I just finished this, I got here up in my library here, I've been kind of wanting to learn more about development, and kind of that whole crazy process. This book here by Zeckendorf, this is a really fascinating book. Zeckendorf, he was one of the really prolific developer in New York. He helped bring the United Nations to New York and he was developing New York back after the depression. So, this goes into what he did in New York, Colorado, many other cities out there and very fascinating book. He has his ups and downs and he talked about it in his book. So, this is a great book, if anybody's interested in learning a little bit about development.

[0:27:04.0] WS: Awesome, Omar, how do you like to give back?

[0:27:06.8] OR: Helping people learn more about the process. We do host cash flow games here in our offices in Anaheim, California. We also participate on on a few charity events here locally. So, that's how we like to give back to folks, with education and information.

[0:27:26.3] WS: Awesome, Omar, appreciate your time again, and being on the show and grateful for just really giving many details about your 1031 exchange. I don't know many people who have done it. I know a few, but it's not very commonly done or pursued anyway, because so many details that have to work out just right. And you definitely have to have those those key team members that are very experienced in working all those out, with that many investors and all, it's a lot of moving parts. So, appreciate you going through all that. How can listeners get in touch with you and learn more about you?

[0:28:00.0] OR: The best way is through my website, it's leruinvestments.com.

[0:28:13.9] WS: Awesome, Omar. That's a wrap.

[0:28:15.7] OR: All right. Thank you very much, Whitney. I enjoyed talking with you.

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[END OF INTERVIEW]

[0:28:19.6] 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]

[0:29:00.3] 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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