EPISODE 828

[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]

[0:00:23.2] WS: This is your daily Real Estate Syndication Show. I'm your host, Whitney Sewell. Today, our guest is Eric Johnson. Thanks for being on the show. Eric.

[0:00:31.9] EJ: Whitney, thanks for having me. Good morning.

[0:00:33.6] WS: Eric operates Shoreside Realty Finance, a lending company dedicated to working with investors day in and day out to provide streamlined finance services and emphasizes execution and integrity. Eric is also an active investor in the Chicago market. Shoreside's mission is to help investors achieve efficient and effective growth by delivering reliable financing solutions that are tailored to their investment strategy.

Eric, welcome again to the show. I'm grateful to have you on. Lending or the finance piece of any, usually commercial, or almost any real estate deal is so crucial. And how we do that, who that lender is, that relationship, so many deals are are made or killed by the type of debt, that we get, or by the lender we're working with. And so, I'm looking forward to the conversation. Give us a little more about who you are Eric and Shoreside Realty Finance and let's dive in.

[0:01:30.4] EJ: Yeah, absolutely. Again, great to be on the show and just kind of what you just said is so true. Many deals can be killed based on how you source your debt, or the relationships or just really the communication of who your lending partner is. Just every piece is so important. But really, I mean, for my own personal backstory, I got started in investing, actually, in Los Angeles. I lived there for about four and a half years and that was tough. It was it was actually with fixing flips. So, that's kind of where my story began. I teamed up with a couple investors out there and did acquisitions for them, actually. That's kind of how I got into investing and I guess flips was something that I was interested in the beginning. And then I kind of found my niche in finance, shortly thereafter, and I've been doing that and helping investors pretty much just with how they grow their portfolio and how they actually analyze deals, and kind of helping them through the process. And that's really what it's all about?

[0:02:39.9] WS: Nice. For sure. It's awesome. You have a real estate background, or you're doing flipping and then it's kind of evolved into this lending business and what you're doing now/ So, let's just jump right in. I know, many of the listeners, debt is something that is difficult to figure out sometimes. And there's different options and what do we need? What's the best option? So, why don't we talk a little bit about just debt strategies and just how they align with different types of investment niches?

[0:03:08.1] EJ: Yeah, absolutely. So, I will try to make this super concise and just super digestible. If we're just talking investor financing here. I mean, let's look at the main strategies. You have fix and refi, or we fix refi, and hold, which is essentially BRRRR. And then you also have five plus, so five plus units or multifamily, and at that point, it's a different game in terms of the debt. So, let's tackle the fix and sell and fix and hold since that's probably what 99 of investors are doing on one to four-unit property.

So, for fix and sell, you have essentially fix and flip loan. That's short-term bridge lending, that's a percentage of the acquisition and you get your construction. That's what enables you to do deals and then whether external investors for the equity piece is kind of – it's a non-factor. But that's where the debt is coming from. So, if you're an investor who wants to flip, that's what it is. It's probably a 12-month bridge loan, 80% acquisition, 100% construction, and then that's what keeps your business rolling from a debt perspective.

For a fixed and refi. So, for a BRRRR deal, you're going to have two pieces. And this is why it's a little more complicated than just a fix and flip, because the fix and flip only has one debt, what I call stage for any deal that has a refi, you have two debt stages. You have the initial front end, which is the acquisition, which will still be a bridge loan, because you still need to fix the property. And on the refi side, now you need to make sure that your LTV is lined up with your payoff and the market value of the property right.

So, on the refi side, you're going to be looking at, if you're an investor who can't go conventional, probably an asset based commercial loan, based on the debt coverage ratio of the property, and that's going to be the two debt stages for BRRRR deals. And I advise investors, keep your ARV or keep your payoff to 70% of your ARV. Some people push it to 75. I don't usually like to advise on 75, just because it can be tougher, it can eliminate some of your options, especially with a situation like COVID. If a shift in the marketplace happens, you want to make sure that you're protected. But roughly, if you're a smaller investor on one to four-unit properties, those are kind of your end games for debt. Just a very brief overview.

[0:05:44.7] WS: Yeah, I think most of the listeners are going to be doing that the five units or more, they're going to be in larger commercial real estate, and looking for obviously agency debt or bridge debt for larger properties or different things like that. What about, just as they are looking for debt right now, just with COVID, and everything that's happened, could you just speak to that listener right who's trying to get into the syndication business, they're looking for debt, what are their challenges going to be right now in the current market with COVID and everything that's happening?

[0:06:18.1] EJ: Yeah, absolutely. If you're a syndicator, if you're experienced, or a syndicator listening, there's a lot of moving parts right now. One is leverage in the marketplace has significantly decreased. Because secondary market investors are really skittish, and therefore, reducing liquidity in the secondary market. So, where those dollars were really flowing, you know, pre COVID, they're not really. Even Freddie and Fannie are at 75 and they were 80% all day, before COVID. So, you need to be careful on what leverage you're, you're anticipating. And then the second part is how you're structuring your deals from an investor standpoint, and making making sure that that's clear especially in a saturated like this. I know a lot of my clients are, they're not winning deals, they're submitting offers. And there's just four other offers on the property, especially for multifamily.

So, going back to the the entity structure, making sure you have all of your LPs and external investors in line, making sure that that deal structure is clear from the beginning. So, there's no time wasted, because depending on that structure, and how you set up your your entity, and and how you set up your investors within that, that entity, usually single asset entity, then play into the underwriting of the deal, and you may need to switch something. That's why it's the best idea to get it sorted out at the beginning. And I see a lot of syndicators run into that issue, where they're scrambling and trying to figure out their LP or their investor structure, just because there are some things that that came up in the process, which is normal, but that's why you need to stay flexible.

[0:08:10.1] WS: So, let's talk about this a little bit. You're talking about leverage has decreased, and how Freddie and Fannie are now 75%. What will that typically do to deals? Are those going to kill most deals. How do you see that on the lending side? What are those barriers? And how do we overcome them?

[0:08:30.6] EJ: Yes, so, I wouldn't say the 5% neck in leverage is in itself a deal killer, right? Because you can still raise that 5% equity. That's not a big issue. Really, the issue is even on agency debt right now, there's COVID reserves. So, that's the big thing. Before, obviously, pre COVID, there was no such thing as COVID reserves. Usually, you have your net worth, your liquidity requirements, but right now, they're actually having sponsor's escrow maybe six months of P&I in addition to cash to close.

So, the borrowers are coming in with pretty much more equity, and in some cases can be nine months. And I know, as of a couple months ago, it was PI/TI as well, six months PI/TI. And then some people are like, “Well, depending on the size of the deal. If it's a large loan amount, that that could be a decent sum of money.” So, people and sponsors were kind of backing off and they're like, “Oh, this deal is not too good.” So, they kind of pulled the plug, but as far as rates go, I mean, obviously great rates, but it's just getting over those reserve requirements. So, that's really another key thing that if you're a syndicator in this market, and you want to do deals, just expect some kind of additional liquidity or reserve requirements on top of everything.

[0:10:04.1] WS: What's been the process or what you've seen up to this point of getting those reserves back?

[0:10:08.6] EJ: The agencies are essentially holding that in an escrow account and from what I mentioned that they've put out, actually publicly is, when the COVID reserves kind of back off, the borrowers and sponsors are going to have to request those funds back. So, if it was a COVID specific escrow account or requirements for the loan, in the loan docs at funding, when those are backed off in the future, whenever that is, then the sponsors are going to have to go back and essentially reach out and say, “Hey, my property is operating at 95% occupancy. We're good. The COVID guidelines have backed off. I would like to request my funds back from from this specific account.” And that's usually how you would do it. That's the most direct way.

[0:11:00.6] WS: Okay, so we got to go, we got to request that and like how you mentioned there. We represent ourselves well. I mean, the property is operating this well. This what's happened over the last year. This is our occupancy. All those things. So, we can just bolster why they should refund the reserves or give those back to us so we can use those or distribute them back out to investors as well, if we didn't need that at the moment. And so, you talked also about like the importance of structuring the deal correctly and clear from the beginning. Could you elaborate on that? What does that mean, exactly to the lender as far as structuring it clear from the beginning?

[0:11:39.7] EJ: Yeah, it's going to depend on which program, I guess, the asset, or the deal falls into. Because, obviously, if you're going to go something like agency versus CMBS, CMBS is a little more lax, I guess, is the right word. And that's usually the the tier below, something like agency. Agency is going to be more strict, you're going to have to follow what they require and usually, it's a single asset entity. If you have outside, you usually have an LLC just for holding the investors. So, you don't usually put yourself in as a member of the LLC, and then slap in your 20 investors. As members, you usually have one LLC that's maybe you and another general partner. And then you have another LLC in which all of the other LPs are in, and then the LLC that you and your other general partner own, the LP/LLC is contained within the GP LLC, so to say, which is the GP, LLC is the title holder.

So, that's, that's generally a clean, acceptable way to do it. Obviously, it's going to depend, but that's a pretty clean way to just keep everything nice and in its own separate domain. So, there’s no crossover confusion.

[0:13:13.4] WS: What are a couple ways that you've seen people get creative with lending to just help explode their growth?

[0:13:20.2] EJ: Really value-add. So, syndicators are all about value-add. So, in my experience and funding these deals, really, it's going after bridge debt at the beginning. So, if the sponsor really identifies a good value-add asset, and there's a lot of potential for upside, you can definitely come in with a bridge loan at 75 LTV and maybe 100% construction. It's essentially going to be like a BRRRR deal, but for multifamily, if you want to think of it like that. So, you're essentially fixing it, rehabbing it, stabilizing it, and refinancing. So, if you're a syndicator listening to this, if you can really use bridge debt creatively in addition to an equity raise, and by putting those two together, you can really come into a deal very strong. And by the time that you fix up the property, and hopefully underwrite conservatively, you still have a lot of upside to capture. But once the property is stabilized, once you refi and hold it, you should be able to capitalize on even a cash out refi and disperse some of that equity back, and obviously, lower your rate and, and get better terms on it.

But again, you know, on the on the value-add side, still going to be, probably a 12 to 24-month bridge loan, depending on how big the project is. If it's a 50-unit building, it needs a million bucks in capex, then we'll probably shoot for 24-month initial plus some six months extensions here and there.

[0:15:01.2] WS: Eric, what's the hardest part of this lending process or working with a commercial investor or a syndicator?

[0:15:08.1] EJ: Yes, I mean, really, it's just about the documents. I got to say that the delay between me getting the documents and me submitting it is pretty much zero. I submit it like it's within the hour. But if people are taking an hour to get, or sorry, a week to get documents back to me, that are critical and I mentioned that in the beginning, it makes the process way more difficult than it ever needs to be. Because, as I look at it, if something goes wrong, and we wasted a week in the beginning, we don't have that week on the back end, when something actually does go wrong.

So, I want to make that very, very clear, especially with large transactions like this, because when you get the appraisal back, that's when the box kind of opens up, so to say, of potential issues to deal with. So, for any syndicator listening, don't lag behind on investor docs or anything else because it just makes the deal much more stressful than it needs to be because now everyone's anxious about the timelines and the contract and losing EMD and all this.

[0:16:16.4] WS: Nice. I appreciate you elaborating on that or just hammering that home a little bit. No doubt about it. You want to be as prompt as possible through the entire process because you need that extra week sometimes.

[0:16:29.6] EJ: Absolutely.

[0:16:30.0] WS: So, how do like to see operators preparing for a downturn when they're presenting themselves for a loan or for a debt?

[0:16:37.4] EJ: Yes. So, as far as a deal package, so to say, or a pitch for either potential investors or for debt, you want to really make sure you showcase the asset and business plan is. So, you have the entrance, the execution and the exit. Those are the three stages. If you can't give me every detail about those, then there’s probably something, a gap in your model or something that's missing. As far as just screening debt, it's pretty easy. Getting and offering memorandum, two years income statements, current rent roll, and then if it's a value-add deal, please explain what that value-add is, what the NOI is going to be, and then what the stabilized value is going to be if an area cap rates, or what you estimate to be your cap rate and your exit, whether it be in three or five years or what.

But if you have those basic documents, it's pretty easy to come in and say, “Hey, is this deal you guys are interested in and this is a value-add, 50-unit in blah, blah, blah, here are the docs.” And at that point, it's pretty easy to screen.

[0:17:55.7] WS: What do you predict is going to happen in the real estate market over the next 6 to 12 months?

[0:18:01.6] EJ: We're expecting a pretty positive outlook for Q1 of 2021. So, we're hoping that some of these COVID reserves and other overlays are going to be kind of coming back. I mean, even here in Q4 of 20, we've seen a resurgence in some liquidity, which has restored some LTVs traditionally. A lot of people in the middle of COVID were at 70, now we're kind of at 70 know across the board on strong deals. So, I'm hoping that some of these COVID overlays will get taken back because they've been on there for a good amount of time and it's made a lot of purchase deals, maybe a little on the unattractive side. Refinances is a little easier because you don't need that extra or the reserves comes from the the existing equity. So, it's not out of the sponsor’s pocket, so to say, and they're still getting a reduced rate. But purchases are a little hard to navigate so I'm hoping that those become easier in the next 12 months for sure.

[0:19:06.2] WS: Do you have a couple of daily habits that you're disciplined about that have helped you achieve success?

[0:19:11.3] EJ: I'm pretty disciplined about diet and creative time. So, in a non-business way, you kind of have to take care of your whole self before you can really go into business. So, I'm pretty strict about not eating unhealthy foods. I do like sugar, but I always keep it in the healthy way just because it keeps me energized and that's really what it comes down to. If you don't have energy, how are you going to do conference calls and emails and figuring out deals, negotiations, all that. You got to feel good. So, I always put that. I always put my health first.

[0:19:52.3] WS: Yeah, what's that saying, the unhealthy man has one wish, the healthy or the the healthy man has many wishes, the unhealthy man has one wish. So, I couldn't agree with you more. Health is so important. And one big way to do that is what you put in your mouth. But is there a way you've recently improved your business, Eric, that we could also apply to hours?

[0:20:14.5] EJ: Yes. So, I mean, in terms of our training programs, I mean, we've reduced pricing and rates across the board for our 700 plus co-borrowers, on the one to four-unit side. And actually, some reserve requirements, as I mentioned, in the beginning, they went from about nine months to about six months and in some cases, maybe can get some exceptions, depends on sponsor string. And so, those reserve requirements have gone down.

Again, it's very slow progress. It's kind of like this whole year has been since the outlook of COVID has this kind of, I guess, tapered a little bit. The finance sector has been kind of this slow creep, and I'm hoping for a more exponential growth or I guess, restoration next year.

[0:21:08.1] WS: What's the number one thing that's contributed to your success?

[0:21:10.7] EJ: I would say daily actions, albeit, no matter how small. So, I've always made it a thing. I was always a gung-ho kind of person in the beginning, where I wanted to do all these big things in one day. And slowly, I figured out that that wasn't really sustainable, maybe once or so every week or maybe if you have some emergencies, you got to put in some burn hours, but really just keeping it balanced and being self-aware of your own balance, and just taking consistent actions. If you're a new syndicator, what are those daily actions look like for you? Is it talking to one broker every day? If you talk to one broker every day, for 30 days, you have 30, new contacts. And one call a day isn't too hard, right? But that can add up. So, if you just stick to a little stuff, and the best part about that is if you do one thing, your brain is going to say, “Hey, I can do this.” And you're going to want to do more.

[0:22:07.2] WS: Nice. That is great advice. I appreciate you sharing that, just that consistency is what's so important and you just laid it out there very simply, which is amazing. Just the daily actions and like you said, one call a day, even if you're working full time and have all kinds of things going on, I bet during your lunch hour, you can make one call a day and get the ball rolling in many directions. So, what about, how do you like to give back?

[0:22:31.2] EJ: SRF, it's a service business. I mean, we're a direct lending platform, but really, I mean, investors come to me with questions like all day. And I'm not an attorney, so I don't shortchange them on information, in exchange for dollar bills. But if an investor comes to me and says, “Hey, this is what I want to do. This is my model, how do I do it?” And I will say, “Here's what you need, you need 1, 2, 3, 4, A, B, C. If you have these things come back to me, and we can get a deal done or at least I can put you in the right direction to get a deal done.” And that's really what it's all about and again, I'm not here to shortchange people on withholding information, because there's just a lot to navigate in the commercial finance world.

So, when when investors come to me, I lay it out for them based on their strategy and I’m honest and upfront and say, “Hey, if you don't have liquidity, this is what you need to do. This is where you need to be. If you don't have this money, you need to find a way to get this money to do these deals.”

[0:23:34.6] WS: So true. And it's so important in our business, in the real estate business, we have somebody like yourself that we can reach out to and ask questions of and say, “What about this type of property or this scenario? What do I need to do to make it happen?” You’re at least one of those calls monthly that we're probably reaching out to. So, Eric, how can people get in touch with you and learn more about you?

[0:23:57.2] EJ: Yes. So, my website is shoresidefinance.com. So, www.shoresidefinance.com and I love when people email me. My email is open to investors. My email is eric@finance.com. That's by far the best way to reach me and I'm super responsive.

[0:24:17.9] WS: Awesome. That's a wrap, Eric. Thank you so much.

[0:24:21.3] EJ: Awesome. All right. Thanks for having me. I appreciate it.

[OUTRO]

[0:24:24.9] 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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