EPISODE 866

[INTRODUCTION]

[0:00:00.0] 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]

[0:00:24.4] WS: This is your daily Real Estate Syndication Show. I'm your host Whitney Sewell. Today, our guest is Drew Maconachy. Thanks for being on the show Drew.

[0:00:33.0] DM: Whitney, thank you for having me.

[0:00:34.7] WS: Drew is a real estate insurance expert, insuring thousands of units across the country, he breaks down complicated insurance concepts in an easy-to-understand manner. He provides insights from a due diligence stage through the divesture of asset, acting as true partner to his clients.

Insurance is such an important piece to this whole real estate investing business. I like having experts on like Drew because they are such a partner in our space, you have to have somebody like Drew on your team, it's just a must. What are you going to do when something happens to your property? Obviously, you're going to have insurance, I know listeners know that. But there's some things I want to talk about today and Drew and I were just briefly talking before the show about some current things that are happening to some clients of his or that he knows of, one or the other.

That you need to be aware of. As you are underwriting properties, things you need to plan for, that potentially, you know, some of these operators may not have planned for. It's very unfortunate. I want you to know about those things as the listener but I want to go through some things that you need to know about insurance with Drew and we're going to drop into some of the current issues that you need to be aware of as you are moving forward and hopefully already have been thinking about. Drew, give us a little of your background and let's jump in to some of these issues.

[0:01:52.4] DM: Yeah, sure. Thanks for having me on, Whitney. It's going to be a fun talk. Obviously, insurance isn't something that everybody wants to talk about but it's kind of one of those necessary evils, kind of like you said, I view myself as a partner to all of my customers, right? My job is to be your back stop, as you're growing your business, as you're growing your portfolio, right? You get to a hundred units, you get to 300 units, I want to make sure that you don't have to go backwards. I'm your safety net to make sure or insurance, any insurance should view themselves as your safety net so that you don't go backwards, right? I want to help you keep leveling up and create a failsafe in the event that you have an issue, truly protecting you from catastrophic losses. That's my goal.

Real estate's kind of in my blood, my family has invested in real estate for a long time and it always attracted me, my first job out of school was in the real estate business but then I figured out I could do both, right?

I can be an insurance guy and a real estate guy. It's been something that I've been attracted to for a very long time. I've got some buddies who are in the space aggressively so it was just kind of a natural step for me to take to get more involved in this space.

[0:03:00.0] WS: Drew, again, thank you for your time and you know, just being willing to help us understand these things better. Let's talk about some basic coverages just that each of us as investors should be considering or whether we have them or not, some things we should be keeping in mind, go over some of those for – or maybe you're helping clients with currently or maybe things that even clients don't always know that you're helping them with.

[0:03:21.6] DM: I mean, there's the very obvious ones, right? All of your investors probably have a property policy that's going to cover them, first party, right? It covers them for losses to their property, very obvious, right? Second one would be general liability, somebody comes on

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to your property, slips, trips and falls. A tenant sues you for whatever essentially, any sort of lawsuit, that's when it's going to get picked up again relatively obvious. That's what pretty much everybody's going to have.

Most people are going to have an umbrella policy, which is going to put an additional limit of insurance on a lawsuit.Let's say you have a million dollar per current general liability policy, an umbrella policy is going to give you another million and two, a million three, million four, depending upon either lender requirements or personal risk tolerance.

The first two pretty much 100% of people have, an umbrella probably 90% of people have. Some of the other coverages that people aren't thinking about that I would – I'm not telling you to buy it, I'm telling you to think about it. First and foremost, would be directors and officer's coverage. If you're taking money from outside investors, you desperately need a director and officer's policy because what it's going to do is it's going to protect you from lawsuits from your investors.

Let's say you go out and you say, "I'm going to make you 7% on this deal, you're going to get a small kicker by way of equity." Whatever happens, right? The deal doesn't go as you planned as your proforma said it was going to go, they sue you for not living up to your expectations and first of all, you're going to have to pay for defense cost, right? You're going to have to hire an attorney to help yourself and second of all, you might lose and pay a settlement. As long as you're not acting nefariously, right? If you're cheating them purposefully, the policy's not going to respond. As long as it was something that was out of your control, right?

[0:05:06.9] WS: I guess, how many times have you seen someone actually be sued by investors, where this coverage would kick in?

[0:05:12.5] DM: Lots. Not in the last five years because an interest rates are so good that it's relatively hard to screw it up, bad enough to where you're losing a bunch of money. But my concern is, when the interest rates eventually flip and you can't refi your way out of trouble, that's when I think these lawsuits are going to go through the roof.

Now, the insurance companies will respond to that and raise rates on it, my suggestion would be to buy early, lock in the low rates and then you have at least some leverage as rates start to increase to say, “Hey, I’ve been with you for 10 years, I’ve never had a loss.” You built some history with the insurance company to help keep your rates down.

But to be honest, it hasn’t been something that in the current interest rate environment has been used a ton but it’s because of that, its’ cheap coverage and it is a catastrophic type of risk. My goal is always to get the catastrophic risk off of your books. It would be probably number two behind literally like a fire burning your building down of catastrophic type of vents that could take you to zero.

[0:06:15.8] WS: The directors and officer’s coverage, is that something that would cover just you as an individual, you know, then it wouldn’t cover all properties or you know, what your – things you're working on or is that property specific?

[0:06:28.8] DM: It will name you individually on it, right? You would have to disclose which LLCs or whatever, whatever entities you want it to cover. They’re going to have a list of all investments that you are active in and seeking coverage in. Usually, the common denominator of that is investments that you have kind of managing control over.

Another way to put it would be to have like common majority ownership. 50.1% or more ownership in, you can put all of those on to one policy. You can get a little cute with that as well but that’s a good rule of thumb.

[0:07:06.3] WS: Okay, any other types of coverage that are kind of unknown that we should know about, just like directors and officers coverage, that’s not something I’ve heard many people talk about and so that’s a good one, I want the listeners and myself to know about. Anything else?

[0:07:20.9] DM: It’s actually the coverages contained within the other policies that I want people to pay attention to, more than different policies, right? I’m just giving you four policies to pay attention to or five really, if you count pollution. Pollution’s going to get you mold coverage so if

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you’re in a wet area, pollution would definitely be something to look at because mold and fungus is excluded from all policies so that it would be a way for you to buy back coverage for that.

With inside like a property policy for example, if you’re buying a B or C-class building that is 30 years old. It used to be really easy to get ordinance and law coverage. That has totally changed in the last two years, 18 months, two years. Because there’s been so many losses based upon the building being way out of code.

It’s been grandfathered into code. Now you’ve had a loss, it’s a 30 in a building, you’ve had a fire that affected six units. Now, the county or whatever you're in, the township, they bring their inspectors out to make sure that everything went well with the reconstruction to bring the building back up and they come in and say, “Oh wait, your electrical system’s out of code, your plumbing’s out of code” your everything that was grandfathered in as soon as you have a loss and need your building to be reopened, its’ now a blank slate. You could have ordinance and law coverage will pay for you to bring your building up to code.

It can be extremely expensive, I had a customer who ate a $900,000 loss because they didn’t have ordinance and law coverage on a 110-unit building so not even a massive investment. It was an $875,000 claim that went uncovered because they didn’t have it.

[0:08:59.9] WS: You have insurance to replace the building but it may not include bringing it up to current code?

[0:09:06.2] DM: Yeah, none of that stuff was affected by the fire at all but it was in other parts of the building that had to be brought back up to code in order for the county to let them reopen the building. That’s so far down the line of what you're thinking about covering but it can be a massive claim and it’s very important now, your lenders are probably going to require it so they’re going to help you on that.

To kind of check that box but some don’t. I mean, I see it probably 50/50 depending upon the size of the lender. The more sophisticated the lender, I mean, if you’re getting into Fannie’s and Freddie’s, they’re going to require it. If not, if you’re going with a local bank, they may just say, “Ensure the property to the value that we have into it and we don’t care what else you do.”

Those are the situations where you really need the lean on your insurance advisor to help you through it.

[0:09:54.5] WS: Nice, that's another really good one that I don't hear talked about very often. Just asking your insurance provider like you said, you know, what about the ordinance and law coverage, what happens to my older building when there is some kind of disaster? Any other types of coverage like that that we need to be aware of that's included or not?

[0:10:13.6] DM: That's the big one. I mean, your business incomes, loss of rents coverage, we also call it. Of course, you want to make sure that you have that if you've got same example, right? You've got a 30-unit building, six units are gone for – then it takes six months to bring it back. If you have lost rents coverage, they're going to pay you for those six months of rent even though it was down, right?

That's going to substantially help your numbers as the building gets brought back up to code, right? Worst case scenario, it takes all 30 units down and then you've – it's like you're building didn't have any issues from an income standpoint, so long as you have it.

Another big one that we see issues with is water back-up coverage. Not a lot of water-related claims are covered under an insurance policy but water back-up can be. It's an endorsement on to the policy, it's not a standard coverage. A lot of times, it's getting pulled off now because there's been a lot of water back-up claims.

It's an area to pay attention to and water back-up and flood is not the same. Flood is water coming in from the outside, water back-up is water coming out from the inside. Both of those are not standard coverages, you have to make sure that they're on your policies.

[0:11:18.8] WS: Great to know, I want to move on though so we don't run out of time. Are there a few things during due diligence, we don't have a ton of time to spend on it but I thought you could highlight some things that are maybe commonly overlooked or not thought of, you know, to be aware of during due diligence or just during the acquisition process.

[0:11:34.8] DM: Yup, number one, without a question is getting five years of lost reports. What claims has the insurance company paid in the last five years. If the seller is not willing to share that information with you, run for the hills because the insurance company, your insurance company as they're doing their due diligence on it is going to need that or it's going to cut your efforts or your insurance agent's efforts to bring your quotes by 90%.

If we can't show five years of lost history on a building on an address, even though you didn't own it, right? You weren't the operator at the time but they want to see it, right? Make sure that you're getting that. I am of the belief that lots of these B and C-class buildings are being put on the market right now because of a bad loss, right? We got a building that had a million-dollar fire, I've got one. I'm working on one right now. 550-unit building in Texas that just got put on the market and conveniently, they had a million-dollar loss last year.

I'm guessing that they talked to their insurance agent, their insurance agent said the premium's gone up 50% on this, it's going to screw your numbers up, get out now before we can show last year's insurance premiums as we're selling the building.

When those insurance premiums double that just shrinks the multiple, they're going to be able to get on the building. Be very mindful of that as you're doing your due diligence. I would say, if we're going to do one thing there, right? One start to look at, that's where I'm telling you to pay attention.

[0:13:04.2] WS: Great information like you're just talking about that organization that's selling a property right now and they are in a hurry to sell for a reason. What about not relying on your lender requirements to protect our investors anything you can add there?

[0:13:17.8] DM: To a thought exercise, right? What does the lender care about? Does the lender care about your equity in the building or does the lender care about them getting their money back? You should be answering that question pretty quickly for themselves. They don't care about you; they want to make sure that they get their money back. Let's say you buy a $10 million asset, you are putting 20% down, let's make the math really easy on me.

They are going to require that you get replacement costs coverage for eight million bucks. If the building goes to the ground, $8 million gets spit out. It goes to them and you're out your two million bucks. Don't just rely on the lender requirements because they don't have your interest at heart. They have their own interest at heart. And that's not them being greedy, it's a business, right? Don't let those requirements be the end all be all because they don't necessarily care about you. They care about their investors and themselves.

[0:14:04.6] WS: Also, what about just some examples maybe that you could tell us about of just some claims or things that people missed just to help open our eyes and our listener's eyes a little bit just the need of having proper insurance or even having somebody like you on our team but any examples recently that you could share and also you know, getting into what we were talking about earlier just some current issues that have happened and how that's affected different groups.

[0:14:31.3] DM: That's a very good example because it will be a hot topic right now is that ordinance or law. That customer will have that $900,000 loss. The year before I had quoted their deal for them, I was a $1,000 more expensive than the policy that they went with. A policy that they went with had a $25,000 limit on ordinance and law coverage. My policy had policy limits, right? You could have gone all the way up. It was like a $9 million replacement cost.

They would have gotten up to $9 million worth of ordinance and law coverage on my policy. They went with the policy that was a $1,000 cheaper. Six months later let's say, they had this $900,000 loss. The insurance company immediately wrote them the check for 25 grand because that's what their duty was based upon the insurance contract and then they walked away from the claim and left my customer holding the bag for 800 grand, where my policy would have paid all 800 grand, so they saved themselves a thousand dollars of premium and it ended up costing them 850 grand.

[0:15:28.8] WS: That was specifically the ordinance and law coverage?

[0:15:32.1] DM: Specifically, that, yeah. They got everything else worked. It was a very simple policy but it was a fire, right? There is no argument on coverage. It was a fire for sure. You are getting the building is going to get fixed. Their policy responded just like mine, would have in that instance but the ordinance and law coverage, they had cut way down and just that ordinance and law loss cost them 800 grand.

[0:15:54.2] WS: Any other examples or even current issues, you know, it is going to affect our underwriting in such a big way and our returns, projected returns to investors if our premium doubles or triples or things like that, any example of that?

[0:16:06.7] DM: Not specific examples. But what I would tell you is be prepared if you have like a wind zone if you're in the Midwest or the southeast coast, if you're in one of those areas that's commonly getting wind or hail claims, be prepared if you have a loss to see your rates go through the roof. I'm working on a deal right now in Oklahoma that's a smaller deal, under 100-units, they had a loss that was ten times their premium last year and their premium because of that is going to go up three times and their deductible is going up ten times.

Just because there's no competition, nobody wants the deal. It's in Oklahoma, it's in a wind zone. It's a frame building with aluminum wiring, right? It's got the triple threat of stuff that insurance companies don't want to see right now. There's literally three insurance companies in the world that will quote it and then you throw on top of the large loss. That takes it literally I have one quote for this person and I have access to the entire market. It's a nightmare scenario and it's going to totally screw up his numbers, right? He's going to have to do something.

[0:17:14.4] WS: Is there anything that he should have done differently when he was in the acquisition process as far as insurance is concerned?

[0:17:21.4] DM: On this instance, the big one would have been when you see an unmitigated aluminum, you would walk, right? I mean that's an issue that I mean it's getting a lot more attention obviously. But the big one that I told you is prior experience on the building. That's the number one factor that the insurance companies are looking at and underwriting to get themselves off of the deal or to charge the hell out of the deal.

One of the next ones would be aluminum wiring. If it's aluminum wiring, during your due diligence, ask what they've done to upgrade the – it can't be – it is not going to be original aluminum right? All of that is out of code and that's almost all circumstances, there is nothing grandfathered in so it's been mitigated in some way. Ask how. Your insurance company is going to eventually ask you that question, so get out ahead of it.

Other than that, it was a wind claim. You're in a wind zone, you are going to get wind claims. The market is just really tough on large claims right now because, put yourself in the insurance company's shoes. They collected 30 grand or 40 grand of premium, you hung a $400,000 loss on them so just to break even, right? It is going to take them 10 years to break even but don't forget, the insurance company has to pay underwriters.

They have to pay people like me. There's a lot of money going out so they want to – they consider themselves profitable at about a 60% loss ratio. It is going to take 18 years for them at 42 grand to make up for that loss. For them, it was a catastrophic event and they're going to adjust their premium accordingly to try and get that back or to get off the deal all together. They don't care.

[0:18:59.8] WS: What's the best action for him right now? I mean ultimately, his hands are – it seems very tied, right? I mean, he has to move forward, do the best with the deal probably then exit as soon as possible.

[0:19:11.3] DM: If you can find a buyer. At this point, I would say try and find a non-sophisticated buyer who will walk into the deal and look at last year's not just like the deal I'm working on in Texas right now for a sophisticated investor. They're going to change their offer based upon what we come back with for insurance cost but if you could find somebody who says, "Wow, this guy paid 40 grand last year. I'm going to be able to pay 40 grand. I will work that number into my numbers and get out of the deal."

[0:19:36.8] WS: I'd hate to do that to somebody. I'd want to be transparent as much as possible.

[0:19:40.7] DM: Ethically, you are in a very tough spot there. I don't know what he is going to do. That's the sad thing about kind of the current state is all I can do is get you the best number that is available on the market and you need to as a real estate investor make the decision that is right for you. There is no magic bullet that is going to get them out of the situation that he's in.

He is going to have to take on a much larger deductible and he's going to have to pay more premium and somehow, try and find a way to make that work.

[0:20:11.1] WS: All right Drew, well it's been some great information. Just a few final questions before we run out of time. Do you have any daily habits that you are disciplined about that have helped you achieve success?

[0:20:21.2] DM: I would say that I always try and learn, right? Usually, it is based upon my craft, right? I should broaden my scope of what I'm trying to learn about. I read a ton of information on insurance. Would put a lot of people to sleep but I know that, right? It is going to put other people to sleep but it entertains me. It's going to give me a leg up on my competitors that I just am going to have more knowledge about each situation than the people that I am going to run into.

I would say always be learning is to me a key point and then try and find unique ways to connect with people. I mean I'm a marketing business, right? My product is insurance but it is a marketing business, so I try and meet people who are likeminded like me, who are ambitious and want to grow.

[0:21:05.7] WS: What's the number one thing that's contributed to your success?

[0:21:08.6] DM: Surrounding myself with the right people. I've got a great team who works with me, who were likeminded, right? But we have different personalities. My right hand, she's sitting right next to me over here right now, she complements my weaknesses so well that she's totally changed my ability to focus on the stuff that I'm good at and pass off the stuff that I'm bad at. It's a complete game changer when you can supplement your strengths with somebody who could pick up all your weaknesses.

[0:21:37.0] WS: That's a good partnership right there. How do you like to give back?

[0:21:40.3] DM: Stuff like this, right? I don't expect to get a penny out of this deal. I want people to understand, I want your listeners to get a lot out of this and make better decisions going forward, right? My goal is to help as many people and the stuff that I am good at, right? I know more about insurance than a lot of people know. There's certainly people who know more than I know. I am not saying that but I want to share the stuff that I take time on with people who it can help as broad of audience as I can reach to help them understand the insurance market, that's key to me. We do a lot small charity stuff to help our community.

But I want to give people knowledge because I understand this is going to put food on the table for your family, right? If it is avoidable, I want to help you avoid situations that are going to create stress and angst in your life.

[0:22:28.1] WS: Drew, thank you again for your time. It's been a great show, you have brought out so many points about insurance coverage that I hope didn't scare us too much but scared us enough to talk to our insurance provider like yourself and make sure that we're covered properly or prepared for what might happen or the unknown and even thinking about your underwriting as you are going into deals. You know, if you do have a big claim and your insurance rate just doubles or triples, you know having you check that against your underwriting.

To ensure that you can still survive, what happens then? Just some good questions to raise especially moving forward if you haven't in the past when you are looking at new deals. Drew, thank you again. How can the listeners get in touch with you and learn more about you?

[0:23:10.9] DM: You'll find my contact information in the shownotes, I'm sure. Feel free to reach out, we'll put a phone number and an email in there. Please reach out. I am happy to help you answer some questions. Again, I am not going to charge you anything, I am not going to do any of that. I operate in almost every market around the country so some are easier to manage than others. There's a lot more questions in some states than there are others but I can help you or I can point you in the right direction to somebody else that can help you like me if I can't help you directly. Yeah, reach out. I'm happy to help and I'm happy to share as much knowledge with you as I can.

[0:23:44.4] WS: Awesome Drew, that's a wrap. Thank you very much, that was a great show.

[END OF INTERVIEW]

[0:23:47.8] 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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