EPISODE 926

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

0:00:32.2 Freddy Johnson: Thanks for having me Whitney. I appreciate it.

0:00:34.0 WS: Yeah. Honored to have you on the show, and you definitely have a lot of skills and knowledge that we need to know and we need to know somebody like yourself, so we can ask a lot of these questions that we're gonna go over today. And just to better understand many parts of the environment at our industry, but a little about Freddy as an interesting path to real estate, you started working for the wealthy investor in mobile home parks, multi-family tax lanes, and then started covering banks and reads at a hedge fund and a proprietary trading firm.

Recently is working as a Capital Advisor for a New York start-up out of New York City, advising clients on how the best finance their commercial real estate investments and sourcing their debt, so we need debt, right? We're buying a project as many, many, many millions. Most of us are gonna need some data on that to make that deal happen, and with everything that's been happening, we can't get enough information about current debt markets and different things we need to know about what's happening.

So we're looking forward to the conversation. Freddy, welcome to the show. You wanna highlight anything else just about how you got to where you're at Freddy and let's dive in.

0:01:34.0 FJ: Yeah, for sure. So yeah, as you mentioned, I worked for an investor out of college, got many years ago, and it was really interesting to work for someone like him because I was really focused on in knida his returns, he didn't really care about the asset as much, and this is back in the early 2000s or mid-2000s, you know, as its like mobile home parks and single family rentals, which are really hot right now, back then people were more, you know, as far as the investors go, they were more interested in large multi-families or most of the time office properties.

So it was kind of interesting to work for him and then went to grad school and in grad school intern for Brookfield Properties, work for this guy, Paul Shulman, who could have been more interesting guy to work for me, I would go to these kind of all hands meetings, and he would know... He would go around the room to each department and working for a guy that knew every department pretty much as well as every head of that department was pretty impressive, and so gonna go work for Brookfield Properties after grad school, but the market had different plans.

This is during the recession, and I graduated in 09, and my internship ended in 08, and Paul had gotten tapped just then to go be the COO of all US operations, but for Brookfield and then... So I interviewed with them, but about two weeks after my interview and after I had basically gotten that verbal commitment, Maryland just absorbed by both Maryland as their biggest tenant women, I think had already gone under, but it was just... The world was turning upside down. Especially for Office Properties, and Manhattan wasn't doing too great either.

So I came back and worked for an Equity Options Group. It did had a hedge fund and a proprietary trading shop, and the thing about equity options is it's definitely a very high intensity work environment, but I got a job as an analyst for them, and I think we're kind of turned me on to them was just one, I had an MBA in finance, and then two, I had spent a little time in the real estate world working at a reit...

They needed someone to cover mortgage, REITS, property reads banks, basically interest rate-driven stocks, which is what I do right now, is just pay attention to the debt markets, so for them, it was kind of interesting time coming out of the recession and paying attention to things like the Fed dots, if you remember those, or just kind of what the FOMC was doing, and now we're paying attention again to that, right?

And so covering property reits was very interesting, whereas these stats are generally very low volatility, back then, we were seeing some volatility in them and just kind of told... See how they move. So...

0:04:31.6 WS: Yeah. It's a great background and understand so much about our industry that we need to know, and one about why don't you jump in a little bit to just lending and covid and post-covid environment and let's talk about some of the things maybe that's happened with lending because of covid, and maybe we can get to even just what you think about from here on out about lending, the lending environment as well.

0:04:52.6 FJ: Absolutely, so when we were heading into covid, you saw a ton... I would say probably 60%, 70, 80% of all banks in the US started tightening their lending standards. So we’re used to see 80% LTV? You would see 75%, 70% LTV, where you used to see a 10-year term. With a 30 AM, you would see a five-year term, and sometimes you still see that 30 year AM... But a lot of times they might decrease the amortization as well, so those are two major factors that could affect, you know...

Definitely, when it comes to the LTV could affect your returns as an investor, but what you also saw was the banks really paying attention to the sponsor or the investor themselves, and so what they would want is they would wanna see not only a high net worth, which is your assets minds, our liabilities, but really a lot of liquidity, and it seems kind of... I don't know, it doesn't make a ton of sense, but they wanna see a lot of cash in the bank, and that's what they wanted to see during covid.

And who wants to keep cash in the bank earning basically 0%, right? At least just go get a bond, but now they wanted to see 100,000 dollars in the bank and just normal people don't keep 150,000 dollars, just laying there in a checking account, but they wanted to see that, and then they'll obviously consider liquidity as equity bonds, you know, 401k, which you're gonna take a huge hit on if you get out of that, but really it was cash in the bank was something that they always like to see, and then beyond that, what else...

You saw a lot of conventional lenders, more of the private debt funds were still going fine with the out-of-state investors, but out-of-state investors, if you're a guy from California trying to invest in a multi-family in Indianapolis, they weren't really having it very few and far between. So those are a lot of the things that we saw heading into covid in terms of your conventional lenders and a lot of the private debt funds and whatnot tidying up on so...

0:07:18.0 WS: So really there... just the way they look at the sponsor changes a lot, and they're focusing more on the sponsor than ever before. Is that what you're saying?

0:07:25.8 FJ: Yeah, I mean, we work with lenders it, so I worked at this stack source, and we can get into that in a little bit, but right now we'll work with some lending programs that are all about the sponsor, they care... They really don't even care about the asset, it's just a... If you're a great sponsor and you have money, we'll work with you, and more about the property later, but let's talk about you first.

0:07:50.0 WS: And you mentioned having 100,000 150,000 liquidity, could that be spread out between a couple of operators or a couple of GPS?

0:07:59.0 FJ: It can be. Yeah, good question. So as far as the sponsored group goes, a lot of times they will definitely consider if they need... They have to have a certain pre-req like, a lot of times they'll say, we want a net worth of X or they want liquidity of 12 months of debt service, you can spread out you know, between two, three sponsors. That's fine. Yeah.

0:08:27.5 WS: Okay, no, that's good to know. So that might be a good option for the listener who first heard that and said, wait a minute, you know, I'm never gonna get a loan again, there are ways to make this happen, right?. so any other requirements on other things that we... We're talking about that. I'd love to move on to few other things, maybe you can even go into community let's say, community banks versus national banks and how they view that sponsor when they're looking for debt for their commercial real estate deal right now.

0:08:55.9 FJ: Absolutely, yes, so as far as community banks versus the national banks go, I mean, generally national banks are gonna be a lot more kind of cookie-cutter deals, they're gonna stress test the property a lot harder, where you might be modeling in 5% vacancy just as a part of your model, they might be modeling in 1015 vacancy. They're generally gonna have a DCR that's the same pre-req as most community banks, but they're definitely gonna be stress testing it a lot harder.

And one of those things is gonna be the vacancy rate, but as far as community banks go, they're gonna take a little bit more time to kinda understand the sponsor, if you wanna do a re-dev, which those can get a little hairy, they will actually go into it, look at it with you, get input from the GC, get the construction budget, have their construction manager or director look at it. So there's definitely a lot more room to work with the community bank, whereas, you know like for example, like US Bank.

I've heard someone compare them to the Walmart of banks, they're never gonna be beat on rate, but you're gonna get an LTV that's like 50-60%, and that's just something that's not gonna create good returns for whether it's a syndicate investor, whether it's a mom and pop kind of ordeal. So that's kind of the difference between the two. So if you have connections with community banks that you wanna utilize... Great, and if you have great connections at the larger banks, even better...

0:10:39.0 WS: Yeah, no, that's awesome, 'cause I know us personally, we have... It's really the relationships with some local credit unions and banks, one specifically that have really helped us in a big way, and we would obviously prefer agency debt or non-recourse, but we received recently on one note just a lot better terms at a local credit union that really allowed us to pay our investors a lot more as well, just 'cause you think about just a small change in interest rate over a 30 million dollar, 20 million dollar debts.

A very big deal. Right, and so help us think through maybe the central banks and the rates affect caprates, and let's talk about that a little bit as we're thinking through just the entire environment.

0:11:19.5 FJ: Yeah, for sure. So right now, definitely again, interesting time to be in, as far as the FOMC goes, and we've got a meeting coming up today and tomorrow, so if people are gonna pay attention to that, but when you have a low interest environment, obviously it's gonna make debt cheaper and thus, it's gonna make properties more competitive, basically, so that's gonna affect your cap rates naturally, as far as how that is gonna...

The tools that the PMC uses, you obviously have your overnight lending rate, the rate the banks lend to each other, that is kind of a target set by the FOMC, you also have QE, which we've seen 10 plus years ago and are seeing again now and now, Duran Powys basically said, hey, we're gonna have this for another two years, so people now are seeing... And now we have this yield curve that have steeped in, and I think on Friday it kind probably hit...

I think it was like 30-year hit, like 2.4 percent. And so, all we're hearing about now is inflation, that's all you see in the media, what is inflation and how does that affect the real estate investor? And so it's kind of like you've seen a lot of people pull out of these lower interest earning securities, they've gotta make more in their dollar. The same is true for the lenders, their dollar today is gonna be worth less tomorrow, and thus they have to possibly raise rates.

However, we have the other side of that, where you have Powell saying, no, we're gonna be buying a 120 billion a month in securities, and that is going to keep rate slow and we're gonna do that for the next two years in elective inflation spikes, and we hit 2.5% or even maybe 3%, I'm not sure exactly what he said in terms of the percentage, then that's fine, and inflation is good generally for the economy.

The fact of the matter is, though, is that we're not gonna see inflation like we did in 1970s, we're not gonna see that massive interest rate spike that we saw in the early 80s on... 1988, 82, it's just not gonna happen. We're living in a different world right now, we have globalization, that is completely... Any money that we get from the stimulus, this 1.9 billion times, a lot of it's gonna go back to China, it's gonna be pushing goods back to us, and we have digitization these days that is gonna keep prices relatively low...

The competition out there in the market to... And this race or that we see on marketplaces like Amazon is kind of taken over, and so I just don't see those massive interest rates spike, and especially with the Fed buying all these securities over the next 24 months, I don't really see it. And so I think that a lot of news outlets have kind of dialed back all their top of inflation in the past week or two, but up until then, all you heard with people talking about inflation, inflation inflation. How is it gonna affect us? How is it gonna affect our debt? And are we really gonna be scrambling to find quality, good interest rates, so… Yeah.

0:14:44.2 WS: Yeah. No, that's some great information. And food for thought. No doubt about it. And I know you mentioned yield curve and inflation and I was like, take 30 seconds, so what is the yield curve? Somebody hasn't heard of that before, why is that important to us in real estate?

0:14:57.7 FJ: Yeah. So the yield curve, you can just look at it as all of the… I don't even know what the yield term is the Treasury interest rates, so going from anywhere from a short-term to long-term, and obviously on your short duration securities, you're gonna have less risk and thus less interest that you're gonna earn on those... The longer duration ones, your 30 years, you're gonna be the more in a low interest rate environment right now, so 2-2.5%.

And when you have a steep yield curve is generally a sign of good economic conditions to come when you have an inverted yield curve, and you start to have people kind of dumping their shorter term securities, that is not generally a good sign. So when we saw that at the very beginning of covid, we saw that yield curve kind of turn... Or inverted, turn upside down a little bit. And it was no surprise in what was coming, so... Yeah...

0:16:00.0 WS: Well, on that same thought, but even more in depth, I'd love your opinion about just what you see for the next six to 12 months, just in the real estate market, and then maybe also in the lending as well.

0:16:10.6 FJ: Yeah, so in the real estate market in the next six, 12 months, I think that we're gonna see... And we kind of saw this over the past couple of years anyway, but you have more institutional investors that are going to be hunting for cash on cash, so the guys out there, the scrappy, you know, 30-year-olds that are trying to invest in, you know, a mobile home park with a couple of partners, the guys that are doing the single family rental portfolios outside of Kansas City that maybe work at Google, but they make a lot in tech and they wanna diversify and they're really interested in real estate.

Those institutional investors, they're gone in for those assets now, they're not just all about the office properties in the 250-unit multi-families, there's been a lot of capital that has been flowing into these different assets, and so the competition for those is gonna increase, and that's what I see in the real estate world is just... It's not like an asset has to be sexy to invest in it, it's just... it's gonna be all about the returns from here on out, and people are seeking Alpha anywhere, so...

Yeah, that's what I see in the real estate market as far as the lending market goes, I think that while we have a steepening yield curve, I don't think the interest rates are gonna get through out of hand, I think that has indicated that... Maybe I'll learn different in the next 48 hours with this FOMC meeting going on, but I really just see interest rates staying relatively low, which can be a double edged sword for the investor, it's great in terms of debt financing, but then again, it can make... Finding good quality assets hard to find. So yeah...

0:17:58.5 WS: Yeah, well, knowing what you know or knowing what you expect, how do you like to see a sponsor or someone, it's buying large … being prepared for a downturn...

0:18:08.9 FJ: Yeah, don't over stand yourself and definitely do the due diligence yourself, there's a lot you need to do as much homework as you can do on the asset is obviously necessary. That's kind of a truism. Right, but yeah, just ensure that you don't overextend yourself, make sure your debt coverage you are fine with it. Stress test the property yourself, don't just necessarily expect, you know, a lender to tell you what's okay and what's not.

You have to be prepared yourself, and so that's a one piece of advice that I would say, and I think it's probably fairly obvious to a lot of investors, and if that's it, I don't know if that answers your question, what you're getting at, but...

0:18:47.2 WS: Yeah, yeah, just any way that you like to see people prepared for a downturn or things that need to be thinking through, is they're buying a property right now, or whether it's from underwriting or lending, but... Yeah, do your due diligence yourself and don't rely on someone else's... For sure. It's a great tip. Freddy, did you wanna add something else?

0:19:06.1 FJ: Just focus on the tenant top, obviously. That's again, part of doing their due diligence and as far as preparing for a downturn, if we can go into that in a minute, but it depends if you're talking about your office in your resale tenant sometimes, if you can get them to sign a longer term lease. There's a big difference in between a four and a six-year release, there's a big difference in between a nine and 11 year lease or at least what's left on your lease in terms of the lender, because of those five-year terms, those 10-year terms that they're gonna give you.

And that's what a lot of people don't realize and they're just like, Oh no, no, they have six years left on their lease right now, and they don't have a pre-pay balance and interested to low... This might be a good time to kind of lock in a good rate right now, as supposed to waiting a couple of years and maybe the economy is not as great, and then you're trying to get some more financing when you only have four years left in that lease or in a lot of times, if it's a big lease, a tenant will kind of know your situation and they'll use it against you, so that's just one thing to...

0:20:19.1 WS: No, that's some great advice. I appreciate you elaborating on that unfortunately, we got moved to a few final questions though, what about any daily habits that you have, Freddy, that you are disciplined about that have helped you achieve success?

0:20:30.4 FJ: Yeah, so I guess this one kind of matter, if you're more of a morning person or a night person, but for me, I'm probably more of a morning person and I really generally don't like to Look... I don't get on the Slack channels and I don't get an email until I've completed that one hard task for the day that has been removed from email has been moved from Slack. It just is like, whether it's a financial analysis that I need to do some sort of complex model for a client that I need to get out. Whatever it is, I wanna get that done first because after that, everything seems to be a lot easier.

So we live in a world with a ton of distraction right now, social media and email, we've seen... Our phones have become highly addictive, so you have to be kind of disciplined about what's coming at you if you really wanna get some stuff done, and so take your time to the day where you're gonna kinda shut out some of those distractions, get something done, and then move on to those.

0:21:39.0 WS: Great advice, but what's an ever one thing that's contributed to your success?

0:21:42.6 FJ: Just wanting to keep learning. If you're... I think there's a saying it was like, you don't grow old until you wanna stop learning or something along those lines, I don't know exactly what it was, but it just wanting to staying hungry, staying curious and just trying to absorb everything and knowing when to shut your mouth and keep your ears open, and then knowing when to open your mouth and you can contribute, so... Yeah.

0:22:11.0 WS: How do you like to give back?

0:22:13.0 FJ: So I actually co-cue sports, so I'm in the northern suburbs of Chicago. Hockey is big up here. I love to coach hockey, I think it's a great way to give back, and I think that youth sports in general are great for life lessons, real estates, a competitive kind of a competitive gritty sector, I've actually learned lessons in being part of a team that seem maybe kinda tried, but they also do apply to the real world and the working environment, so... Yeah.

0:22:44.4 WS: Awesome, Freddy, it's been a pleasure to get to know you and have you on the show. I'd love to have you back on the show in the future, if you're open to it and let's talk about some more specific things and dive into a few more things that I know you are an expert in, and I think they'd be very valuable for the listener also, but grateful for…

I mean, just talking through debt markets a little bit, and just different lending standards that are changing or have changed and even the focus on the sponsor and some different things we talked about that... Even yield curve inflation, everything that we need to be aware of and understand what they are in our industry for sure, but... Tells how they can get in touch with you and learn more about you.

0:23:20.0 FJ: Absolutely, yeah. No, thank you. So they can email me. It's freddy@stacksource.com. That's F-R-E-D-D-Y @Stack source. And give me a call, I'll give up my phone number to 847-514-1795, feel free to give me a shout any time and you wanna talk about the financing side of things.

[END OF INTERVIEW]

[OUTRO]

0:23:43.6 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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