EPISODE 966

[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.

0:00:24.4 Whitney Sewell
This is your daily real estate syndication show; I'm your host Whitney Sewell. In real estate business, whether you are managing your own property, investing on your own deals, or whether you are syndicating large projects, you need to know about insurance. And, you need to have someone on your team who knows insurance inside and out. Not only it is important that you protect your own capital but if you're syndicating deals like we are, we may have 150-200 investors in one project, and we want to ensure that we have the correct insurance for every asset that we have. We want to ensure that we thought of everything that we can think of to have the proper insurance. That's why you're gonna hear the highlights of the experts today talking about real estate insurance.

[INTERVIEW 1]

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Whitney Sewell
our guest is Darrin Gross. Thanks for being on the show, Darrin.

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Darrin Gross
Thank you, Whitney, glad to be here.

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WS: When should we contact you? I like having just a relationship. I mean, we're consulting

with insurance brokers very early on. If we feel like it's a property we're going to pursue, we're talking to them about the property before we have it under contract even just so we can be that much more accurate with our numbers. But when do you say we should contact you?

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DG: Well, I would follow Whitney's model, your example there and have a relationship with a broker and if you've got something that looks attractive and you're running the numbers before you run a letter of intent or you know, write a letter of intent. Just have a conversation quick, you know, a couple of things to know the age of the properties are usually kind of a starting point.

What your plans are for the property, if it's going to be a heavy lift or if it's more a matter of its fully occupied and you're just going to continue to operate it. But those are just two things and then I think probably the thing that people don't realize that I would – if they take nothing else away from this, is if you're buying an older property and you are in that letter of intent and you understand that you're going to need to know what the seller's experience has been with that property.

So, you want to get a loss history and that's not something that they have at their ready. They usually have to go request it and depending on the level of service of their broker provides, their insurance broker provides, could be delayed and that could delay you getting competitive quote for your insurance is. It's a surprise. You know, if god forbid, there's a horrible loss that nobody – "yeah, I forgot about that." And you know and you've gone past your due diligence period and you didn't press that they had to give that to you or you didn't ask for it, could be a surprise, it could upset your numbers.

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WS: We think we have, you know, one number in mind for insurance and then we get much closer say to closing and then we find out that that seller had some other history or had some claims and that really affects our numbers for insurance.

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DG: It can. It can. Depending on what it was and if it's been rectified, you know, if it's something that is electrical fire because they had some sort of a problem that has not been mitigated, you may find out you can't get insurance, you know? Or at least something that would be affordable.

But yeah, I think just knowing the few things that you're going to need and pressing that and adding that to your due diligence list and put you in a better position to have actual numbers so that you can hit your mark.

One of the things that I hear and I read sometimes in some of these Facebook groups and stuff is that, people have this a number that they put in for underwriting per door and I got to tell you, you're in Virginia, I'm here in Oregon. The weather which is primarily the driver of insurance claims, it's dramatically different across the US, okay?

In Oregon, we have rain, okay? It's not going to boil your roof off, it's not going to blow your house down, it's rain. If you got a good roof, you're probably in good shape. If you go anywhere to like the Gulf States or you know, the coastal, where there's more wind right in the Midwest, where you have tornados, hail, all of these different factors that they all affect the rate for insurance.

If you listen to this and we threw out a number, number I've heard is like 250 or $300 per door, you could be way off the mark, you know? Either pro or con. I mean, for out here, you may totally miss the number because you put too big of a number in your expense. Whereas you know, down the southeast, along the Gulf Coast, you may lose your – you may find out like, "My god, this stuff's expensive."

All I can say is start that process early and get the information, communicate with your insurance broker and you know, get an actual number.

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WS: I would think it, I mean, it sort of goes back to that relationship. I know, if we were moving into a new market, that's one of the things we're going to do is contact our insurance broker and say, "You know, these types of properties." Or maybe even give an example what should we expect, how would you handle that or suggest?

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DG: Absolutely. You know, start with our relationship and local is usually going to be your best option, you know, somebody that's familiar with the territory. I mean, they're kind of the eyes and ears of the insurance company. Having said that, we write – I think it's like 43 of the 50

states, we have clients that have properties out and about and stuff and the Internet is the World Wide Web so we need to get opportunities and we just try and be focused and provide service to those, our customers.

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WS: Nice, we mentioned a few minutes ago about getting this history and finding that there's been problems that could affect our rates for insurance. And maybe you know, if we didn't ask for that early enough, could be late in the due diligence phase of buying this property and it really turn our numbers upside down. Could that ever happen say after closing?

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DG: You know, the insurance companies have written in their policy that there is a – I can't remember if it's 60 days or 30 days but there's a – if they bound coverage on something and then they go out and inspect it and find out it's absolutely not what they were told, maybe the pictures were of the street of the property across the street, just anything like that, it was thought to be this pristine property only to find out it's anything but. The insurance company can send you a letter saying, "Hey, we're off. Here's your notice, 10-day notice, good luck, we're out of here," kind of thing.

Absolutely, you know and even with that loss control, they can go out. I mean, most companies anymore, you've got the Internet, you've got people on the ground, you've got people in the area that they can contact and go out and do an inspection. They're taking advantage of all those tools.

They're getting out and inspecting properties right away so they can avoid staying on risk and waiting for the loss. They're exercising the contract to their benefit so at the very least, you're going to get a list of inspection, loss control recommendations, you know? It could be that the railings are not appropriately, they're too wide or they're lateral as supposed to vertical or trip and fall hazards or the fire extinguishers aren't up to date or you know, just on and on it goes. But the fact is that the insurance company in a sense that they are your partner in a sense that they don't want to have a loss.

If you recognize, that's what their goal is not to have loss and you work to keep them happy, more than likely you're experience will be profitable and you may have to spend some money to update certain things or correct certain things.

But in the end, it should be prevention measure as supposed to attracting perspective loss.

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WS: Is there anything else that you suggest that we collect from the seller just to get that information that we need or everything that we need as far as insurance is concerned?

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DG: Yeah. Just to kind of reiterate the value-add property is probably the ones that I deal with the most. I'm guessing that majority of properties you've dealt with or your listeners that are doing any kind of syndicating or dealing with as well, these properties tend to be older, they have some sort of need of capital improvement. And maybe some deferred maintenance and the insurance companies know that most of the systems and the systems being –

There's four basic systems, you get your roof, electric, heating and your plumbing systems. They have a limited life expectancy. And so, 30 years, most of the companies I deal with and I think nationwide, most companies are looking in and saying like, "Your roof needs to be replaced if it hasn't been."

When you're dealing with a seller, if you can find out these – the most recent date of these four systems that they've been updated, replaced, you'll be much further ahead and then even have your inspector verify that, you know, whether it be at the electrical panel, if they can see an installation date or a furnace. If it is a furnace or a boiler.

I mean if it is a – I am trying to think of? What's the heat deal, electric, I can't even think what it is now, just on the wall there that plugs in this electrical thing and they flip the switch and so on and off? I think even that kind of thing it is not a big deal. But your electrical systems probably weren't the ones that were running into more issues here as of late.

There are some panels out there that are known to be problematic. There is a Zinsco and a Federal Pacific used to be really was worried about the knob or two, the fuses or aluminum wiring. All of this can be problematic.

But knowing those things before you make your offer and then I also have an idea of what it will cost to correct can really help you and position yourself in a position of strength both within negotiation and also with no unexpected surprises.

And also, if there is a period or an insurance company will not accept the property in its current condition but you have bids to correct it and you have a contract with the provider to correct right away, you might be able to negotiate coverage with the understanding that these are going to be corrected right away.

[INTERVIEW 2]

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Whitney Sewell: Our guest is Bryan Shimeall. Thanks for being on the show, Bryan.

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Bryan Shimeall: Pleasure Whitney, always great to be here.

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WS: Who is your typical client?

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BS: We span the gamut with it. We have some clients that have a portfolio as large as 30,000, 40,000 units. I have clients the way down that might have 500, 600 units somewhere in that range. We do span the gamut in terms of size of the portfolio. We work on a national basis from coast-to-coast. I'm doing a ton of work in Texas and California, even though I'm based here in Florida where a large percentage of my clients are. We pretty much work on a national basis. Many apartment operators don't have assets in one part of the country. We've pretty much span coast-to-coast in terms of our expertise and experience.

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WS: I'd like to dive in a little bit about how you support your clients, what that partnership or relationship looks like. You had mentioned the unique ways that you help support clients. What does this relationship look like? When should I be contacting somebody like yourself? Let's go through that process a little bit.

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BS: It usually starts in two scenarios. The first scenario, maybe they're unhappy with their current service level and obviously, we would position how we could address service issues in the client I have. Most often it starts with the acquisition of the first asset. If somebody's looking at a property somewhere, they need to ensure that property. One way or the other, they get introduced to Multifamily Risk Advisors. We come in and help them get from time. They enter their due diligence all the way to the closing on a property. If you look at what's going on in the market place, habitational insurance is in a difficult spot. It hasn't been in for a lot of years. It's the first of the year the market has been undergoing a significant hardening of the market, where rates are going up, coverage is going down. Carriers are being picky. It's a difficult market. We see many of our clients they might grab the seller's O&M, take a look at their insurance number and that becomes their number for underwriting.

In this market, that is definitely not what you should be doing. There are some people that are getting some significant increases. Having your coverage conformed to lender guidelines, especially Fannie or Freddie guidelines are becoming more and more of an issue, especially with regards to things like roof ages, wiring and things along those lines. When it starts from an acquisition standpoint, we come in and prove our worth how we become part almost of the underwriting or due diligence team that helps get that closing over the goal line.

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WS: What is habitational insurance?

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BS: If you look at apartments in general, anything residential, you could be talking about a senior, student, whatever it might be. If it's a type of property that people inhabit, that marketplace has been undergoing tremendous hardening meaning rates are going up in that area. The big question is what is that attributed to? When you look at your apartment coverages, there are three primary coverages that are in place on almost every property. There's the property insurance, which covers the asset itself. There's the liability portion, which covers things like slips, falls and such that you might be sued for.

There's usually an excess liability layer that sits atop that general liability should you have a bad claim that exhausts the limits of the primary general liability policy. In almost every property, you're going to have those three coverages. Obviously, there are others such as flood and things like that. It could be in place in the property. Those are the three core coverages that are in place. With regards to why is habitational becoming so much more difficult, it's due to the claims that have taken place. Don't hold me to the exact numbers but in general, the industry as a whole expects about $40 billion in losses on a year-to-year basis. In 2017, the numbers that I've heard was the industry took $170 billion in losses. In 2018, it might sound far better than $170 billion, but the industry still took $80 billion in losses, which is twice what they were expecting. As a result, the marketplace adjusts rates. They adjust coverages to try to figure out some way, some path to profitability.

If you compare this market to what's been occurring for a good few years prior to this, the market has been solid. Rates are falling. Everybody sees their renewals go down. I'm in some situation where you need to get some concession from the carrier. The chances are you could probably get that done if it was reasonable. We're finding ourselves in a much different spot, but it's all coming from losses that occurred, catastrophic losses, hail losses across the Midwest. The Midwest keeps getting hammered time and time again with hail. It's all attributed to losses.

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WS: One of my questions are going to be different types of insurance that we need to be thinking about, but it depends on the location. What's been happening there over the last many years and how is that going to affect how we're even underwriting deals? Hopefully, we're going to contact somebody like yourself. We're going to get an estimate to make sure we're underwriting properly. We've had insurance change on a deal drastically from the time we've got an estimate to the time we close. It changes things a lot. Elaborate on that process when we get that estimate, how solid is that and what do we need to be thinking about when we get that?

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BS: How solid and how accurate it is dependent upon who you're working with. Are they spit-balling some estimate that they hope in the ballpark or are they collecting the information on the frontend? They need to give you an accurate estimate. Obviously, we understand when your money goes hard in a deal, your purchase on the estimate that we're giving you. How accurate that our estimates need to be? To get an accurate estimate, you need quality information on the building. What square footages are we dealing with? When was it built? What was the wiring? If there's one thing that the audience takes away from this show, it would be to understand your

roof ages. This is an interesting point that many people are missing. It gets a little bit technical. I would love to delve down into what's going on with roofs right now and why it's important to get the seller or somebody to be able to tell you exactly how old these roofs.

If you look at property insurance, insuring the asset itself, there are a couple of different valuation clauses that will be used. Replacement costs, meaning depreciation is not factored into any claim payment or actual cash value, which means the depreciation is. In this market, if the roofs on a building are older than twelve or fifteen years old, it depends upon the carrier. Most carriers are only going to cover it from an actual cash value basis, meaning depreciation has factored in. If you have a twenty-year roof, there's a claim. The adjuster is going to come in and the adjuster is going to adjust the client payment assuming that there's not much life left in these roofs. The real problem comes in to a lot of your lending requirements, especially with Fannie and Freddie, because Fannie and Freddie will not accept actual cash value clause on a property insurance policy.

Having somebody tell you the approximate age of a roof for something could get you into a lot of problems when you're ready to sit down at the closing table. We had this issue, we were told the age of the roofs all the way across the board. We put the coverage in place. Lo and behold, the lender comes with a PCA that stated they weren't insured. The PCA stated that they thought the roofs were close to twenty years old. It conflicted with the information we had, but the lender was going to go off of their property condition report at which point they saw that the roofs would be valued on an actual cash value basis. It almost costs closing. We were able to get it over the goal line with our clients, but it was many phone calls and a lot of doing to get that done.

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