EPISODE 996

[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]

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Whitney Sewell: This is your daily real estate syndication show. I'm your host, Whitney Sewell. It's that time of the week again where my partner Sam Rust takes over the show and interviews our guest. I hope you enjoy the show.

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Sam Rust: This is your daily real estate syndication show. I'm your host Sam Rust. With me today is Martin Saenz with the Bequest Fund.

Martin is the managing partner of Bequest Funds which is a $50 million 506 C Reg D Income Fund. Martin has written four books on the mortgage industry and speaks at conferences around the country and holds an MBA from Drexel University, and MS in Project Management from George Washington University. Martin, thanks for joining us on the show today.

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Martin Saenz: Thanks for having me on, Sam.

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SR: Well, I'm excited to dive into a little bit of 'bout real estate notes which I understand as a specialty of yours. Maybe we could start by sketching out what real estate notes are? Some of the specific niches that you guys cover, and then I'd love to quiz you a little bit on some of your

backstory how you got into here as well.

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MS: Sure. Sure, absolutely. So the best way to kind of look at real estate notes from the perspective of our business model is, if you take a lending institution or some type of bank originator and you have a bar, and they're looking to purchase a home, and so they go into this bank or lending institution, and they apply for a mortgage loan. And through the process of underwriting and approvals, you know, the outcome is going to be that they are going to go to the closing table, and they're going to sign a promissory note, which is a promise to, you know, borrow X amount of money, and they're going to pay it back given a certain set of terms. And they're also going to sign a security instrument slash data trust or mortgage document that's going to tie that promise to the property in case of default. And so over the course of time, the lending institutions going to collect or build a portfolio of these performing mortgage loans, and a portion of those loans are going to go into default. So the borrower will stop paying for some reason. Typically it's based on love, there's a divorce; unemployment they, lose their job; or health, something happens in their health. And so through that defaulted status the lending institutions going to bundle a number of these default in mortgage loans, and they're going to sell them off into the secondary market. So the secondary mortgage market is essentially like a flea market whereby you have hedge funds and other banks that are buying and selling these defaulted mortgage loans. And so this is where my company, this is where my background lies in that secondary mortgage market space where I have one side of the business that purchases these non-performing mortgage loans, and another side that purchases, what we call re-performing mortgage loans, or you can just say, performing mortgages.

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SR: That makes a lot of sense. You guys focus on the performing or re-performing notes, you're not in the non-performing space, at least as of this juncture.

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MS: Actually we're large buyer of non-performing mortgage loans throughout the United States. So, just to kind of give you an example, my company has purchased about $25 million worth of non-performing mortgage loans in the past 18 months. So, we are very active buyer in the non-performing mortgage space. However, for the purposes of Bequest Funds, which is what I'm representing today, it's an income fund that only houses a portfolio of performing mortgage loans.

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SR: Gotcha. What are some of the unique risks on a performing note? What do you see is some of the things that you caution investors about or things that be good for people to know as they're investing in these funds?

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MS: So, you know, the first thing I would say is that the underwriting guidelines need to be the same for performing mortgages, as they are for non-performing mortgages. So, you are taking the worst case scenario into play here. So you're saying "What if the borrower stops making payments on a performing mortgage loan?" So if you vet that mortgage loan like a non-performing mortgage loan, then you're going to be prepared for whatever needs you need to be prepared for. So that's kind of step one - having your underwriting guidelines in place, and your team have good systems and you have all the resources like credit pulling, a skip tracing, title report pulling and so forth. So that's kind of like square one.

The other component that often gets overlooked with performing mortgages, is the monitoring process. So, you still need a team of asset managers that are going to monitor the performance of these mortgage loans. And you really cultivate relationships with the borrowers, so that if there is a delay in payment, the asset manager can get on the phone with the homeowner, and find out what's going on and how they're able to assist that homeowner, you know, keep on track with their mortgage obligation.

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SR: That makes a lot of sense. You know, we've spent some time here Martin talking about what is a note, you know, the whole industry. But we're also on the Real Estate Syndication Show where we're we spend a lot of time talking about raising capital, you've got the Bequest fund which is I understand it is an 8% annual more of a yield fund. How do you go about attracting investors to that sort of an instrument? What are some of your best strategies for attracting new investors?

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MS: So, to be boring, I'd have to say, you know, someone paid us the ultimate compliment last week when I was speaking to them and it was a capital raised pitch that I was making, and he told me flat out he goes, "You're boring, and I'm looking for boring" and I'm like, "Praise the Lord," like that is the best way I've never thought of summing up my fund that way, but that's what we want to be. We're a place where people want to use us to create additional streams of income and not have to worry about the ups and downs, the volatility of that investment in just knowing that they place, you know, $100,000, they're going to get $667 of monthly income paid to them for the rest of their life because it's set up as an evergreen fund, or they can let it compound. But that's exactly what we want to be known as, as just a tool for building additional streams of income in one's life.

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SR: Yeah. I've been doing some research myself into funds, there's so many different varieties, I mean, it really is designed your own, but there's closed funds which except funds for certain period of time and they have a sunset on them and then you referenced the year fund is an evergreen fund. Why did you pick an evergreen fund? And what are some of the unique advantages that you see by picking that direction?

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MS: Sure. So I have to kind of take it from my non-performing business arm, so we have a team of asset managers, and we have an entity whereby we purchase non-performing mortgage loans, and we work with the homeowners to keep them in their homes with payments they can afford while making a profit for our company. So what we consider a social good is to contact a homeowner who hasn't made their payment in a few years, find out how to be compassionate with that individual, find out what they can afford and match it with our return expectations, so that we can grow our business. Now, from that point, once we have that loan that's performing, what we would normally do we might sell that off in the secondary market, recapitalize and kind of go after larger purchases.

But what me and my partner realized is that we needed more of a legacy play. We need something that, you know, we can hand down to our children at some point. So we said, we have these cash flowing assets that are 20, 30 years in duration, and it's going to outlive us as we're buying more and more of these, you know, on a monthly basis, and creating more and more with our asset management team. And so, hence the name Bequest Funds, which is, you know, synonymous with legacy. And that's why we set it up as an evergreen fund, we put in a million bucks just to kick it off. And that's really what we wanted to send a message to say we're here for the long term, we're not one of these, you know, one of the funds and I'm not knocking anyone but we're not like a lot of funds in the mortgage note space that are going to, you know, term out at three years and then liquidate and, you know, cash everyone out. We want something that's going to be there for decades, and we want to have just make it a legacy play.

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SR: So diving into a little bit of the details there Martin, is some investors want to place money forever? Their idea of a best investment is something that's boring and something that gives them a very predictable return for a long time horizon. Some people, may be a little bit on the younger side, are looking to grow faster maybe they're looking for a place to park some money for a time but they want to have access to it, how do you guys give access to investors if they don't want to be in the fund for the full duration?

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MS: Sure, absolutely. So we're set up with a, with an 8% annual return in only a 12 month lock-in period. So there's only a 12 month commitment period to earn the 8%. Now we also have in 9% press that we pay, it's a different class shareholder status, but it has a four year lock-in period. So we have a few different options but our staple is the 8%, it's only a 12 month lock-in period. But if one is on the younger side or someone's entrepreneurial, whatever age bracket they're in, they should just consider this as a diversified play. So in other words, they can park some money in, let it generate cash flow for them as they go and go about and learn a new skill set, or invest money in a riskier opportunity.

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SR: Sure. Now, in our business and the multifamily side, we're pretty tied to market cycles, and it's maybe a little bit more obvious and where the markets going good maybe have a harder time finding deals, maybe capitals a little bit easier, and you have to maintain your underwriting standards and then when the bottom falls out deals are easier to find but maybe capital isn't quite as readily available. How does the economic cycle work in the notes business? And how do you handle economic downturns and start preparing for them now?

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MS: So, I'll answer that two ways because it depends on whether we're talking about the non-performing side or the performing mortgage side. So from the perspective of the performing mortgage side, our portfolio sits collectively at a 61% investment value ratio. That's extremely significant because that's really the foundation for our whole fund. So I'll give you an example, so if you have a home that's valued at $100,000, Bequest Funds will have a full investment not to exceed $61,000 in that opportunity. So that gives a $39,000 cushion in the event of a market downturn. Now, why we're able to do that, how we're able to do that while paying an 8% return, is because these mortgages are re-performing mortgages. So, if you take the example of the bank selling off a non-performing mortgage loan to a hedge fund for let's say 30 cents on the dollar. And that hedge fund gets in contact with the homeowner, and works out a payment plan to get them back on their feet. And now what they'll do is, they'll sell that asset that they paid 30 cents on the dollar for...to Bequest Funds at 70 cents on the dollar. So the coupon maybe seven, 8%, however we're buying those assets into Bequest at a 12 to 14% yield so that cushion between which is essentially the third, right. So if we buy it in at 12% yield, and we're paying out eight, we have a third that operates is our cushion. And that's how we operate the fund. There's no fees associated to the 8%. It's a very clean, smooth transaction, and we use our excess funds, the buffer between 8% and 12% to operate the fund and to purchase more loans to create more of a security for the investor.

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SR: So rather than distributing that, in your example the extra 4%, you're reinvesting that essentially back into the fund and further growing the investors money, is that the right way to look at it?

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MS: Yes, because at this point there's no leverage in the fund. Now the PPMs calls out that we can have leverage but right now we're just match investing, so we're going after a trade for 2 million, we're going to raise 2 million that's kind of the philosophy. We don't have any leverage or cost of capital, you know, at work. So, you know, we're able to operate the fund at that four point spread in. To date, just so you know we haven't pulled out any money out of the fund but that's going to change, you know, at some point we might. But, yeah right now we're just, we're just creating cushion for our investors.

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SR: And so you outlined a lot of facts and figures there on, you know, different spreads, 30

cents on the dollar then flipping it from a...to a performing note and selling it at 70 cents on the dollar. How does that change, you know, in a bad economic time? You know, right now we're in kind of a weird spot where certain sectors of the economy are running really hot. There's a lot of investor confidence, there's a lot of consumer confidence, but we also are coming out of the weirdest 12 months any of us have seen. From a macro economic level, how does a downturn or affect your pricing levels and potentially your profit margins on new business? Not necessarily just the stuff in your fund.

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MS: So what I'll say first is if you look at, like DOA crisis and whereby banks were originating ninja loans and, you know, doing all types of chaotic arms and whatnot. Underwriting loans - they had no business underwriting in which caught borrowers in a really bad spot, you know, once everything started to unravel. So, a lot of those loans, a lot of the banks kind of learn those lessons, but with that said, we are going to have an economic downturn. There was about a 20% depreciation and fair market value during DOA crisis, and so, given that we have a 61% investment value which gives us a 39% cushion on our assets, we feel that we are protecting our investors with that. But I'm going to say one thing, what's more significant than that, is this is a portfolio of mainly, I believe all the assets and they're currently are owner occupied properties, there might be one or two that's, but I'm pretty sure that that we've kind of held true to that. And so there's emotional equity. These are homes where the homeowners have raised their children, kids go to school, kids play with the neighbors, and so there's emotional equity, and then couple that with a well trained asset management team that works very closely with the homeowner. What that equates to is that we're first in mind every month, when a borrower has to cut checks for payments. So we feel like if we keep those two capital preservation and we keep, you know, collectability percentages where they need to be which it's 96% for the fund as I'm talking to you now. You know collectability, you know, we feel we're going to be pretty secure.

Now market downturn, right now there's a shortage of inventory in our space because cost of capital so low and in a number of other factors. But when there's an economic downturn, both on the non-performing and performing notes side we'll see an increase in inventory. So actually asset prices will decrease as a result of a market downturn, so there's actually going to be more purchasing involved when the market downturn occurs. However, with that said, keep in mind that equity coverage of these assets will also decrease. Right, so you're paying more now, but you're getting more value.

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SR: Yeah, they're moving in parallel to each other, essentially. So you have a very interesting, almost completely vertically integrated system where you're taking in non-performing notes at the top end, you're getting them performing, you're working with the people, and then moving those performing notes or re-performing notes into the Bequest Fund.

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MS: Actually very seldom where we set it up to do that exactly what you're saying is to make it a funnel into Bequest. But what we've been doing for the most part, by and large, is purchasing the performing mortgages in the secondary market third party, and using our non-performing fund to just accrue a collection of notes and reserve, if we ever had to move them over into Bequest. So what we intentionally thought to do it that way, but we actually found that we're buying enough from the secondary space.

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SR: Okay. So I guess a question either way, whether you're funneling them from your own organization or you're going out into the secondary market, I would assume that you're buying at some level of scale. What level of underwriting can you do on even just the markets that you're purchasing? And do you have the ability to say "Hey, we don't want to buy non-performing notes in North Dakota," or in certain counties? Or do you just have to buy an entire bundle and sift through it and that's part of the squeeze necessary to achieve the juice?

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MS: Yeah, so we'll buy all or nothing pools. And you know, once you move away from the retail setting, you really got to take down the entire pool for the most part, especially on the performing mortgage side. So we have a thorough underwriting process where we look at property valuation, will look at credit reporting, will look at the invalidity, will look at skip tracing. And so, we can actually determine with confidence, you know, how much equity coverage we have, and who the borrower is in their ability to pay us on time or continue to pay us on time. We can make that determination regardless of what state their home resides in. I's really about the borrower and their ability to pay, so we're not as territory specific with...with purchasing.

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SR: It makes a lot of sense. I'm kind of zooming out a little bit, Martin, in what way have you recently improved your business that we might be able to learn from?

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MS: Implemented sales training in our company. So we do it a tremendous amount of motivation and team cohesion practices in our company. We have an 8:05 meeting that we've been doing since, gosh...I mean when I had my prior company as a government contracting company, we would meet at 8:05 when everyone gets in and we all have metrics that we're responsible for. And we all relay our metrics and celebrate our winds within a 10 minute time period. And we keep our metrics up on a board where it's been updated all throughout the day. So we're very metrics driven, we're very goal oriented as a company, however, I'm... as of this year, implementing sales training to everyone in the organization, as we're all sales individuals at the end of the day. So I'm trying to improve sales from our asset management perspective, from our investor relations, from our controller who has to talk to people who are in operations etc, etc.

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SR: I think that's a really smart idea. I've been a part of a couple different sales organizations and the best ones bring that sales training, whether it's in house or out of house to the entire team. Because ultimately, everybody serving somebody whether it's people in your own organization or customer facing. We can all stand to improve in those areas.

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MS: Oh, yeah. I mean I benefit the most right like the person who brings the training to the team I mean I'm learning, as this is all unfolding, so it's wonderful.

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SR: Now, do you have any tips for picking the right metrics to track? I mean you've got a fairly large organization with a lot of different roles. You know, I think it has a strict sale sense, it's easy to come up with those KPIs, it can be harder for some of those softer roles, whether it's in accounting or different silos like that. How do you go about picking the correct metrics?

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MS: So I'll give you a few...I mean we want to look at from an investor relationships, it perspective we have a funnel, just like most capital raise team so we want to see, you know, how many people are in the pipeline, how many people are signed up to attend a webinar that we host monthly, how many of these people have soft committed, how many of these people have soft committed and received our PPM, and sent in their accreditation letter. And so we'll have a process their asset managers we look at the percentage of their portfolio that whereby they have resolutions out. So resolutions are pay off request loan modification options, things like that, things that will resolve the default status with the homeowner. We'll have from a performing mortgage standpoint, we're looking daily at our collectability percentages, the buckets whereby we do have some lateness. You know, what are the buckets for zero to 15 days, 60 days to 30 and so on. So, you know, those are a few metrics that we look at.

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SR: That's excellent.

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MS: We're on it though. I mean, if I can say anything with confidence, it's that we're all over our operation, it's critically important. You know, this is my livelihood. This is my, you know, the team's livelihood and that's where that's at.

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SR: Do you have any resources that you'd recommend for folks that are wanting to implement similar structure into their own businesses and you've been that you've looked to for guidance?

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MS: I think there's a good book. If we're talking about capital raising: Matthew Burk Capital Attraction. Hunter Thompson has written an awesome book and I'm attending his webinar in a few weeks. I'm just always out there. I like Grant Cardone, I know he turns half the population off, but I like his grit. I like how he's just, you know, he's very wealthy, but he's just code red on everything still as if he's broke. Robert Kiyosaki, I mean I credit him for Rich Dad, Poor Dad, I mean to get me even started in real estate because I'm also a landlord as well, and so I kind of get that side of the business.

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SR: Well Martin is we get ready to close up here to ask questions. What's the number one thing that's contributed to your success?

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MS: So finding a relationship with God in 2013. Prior to that, I was all just about earning money. It was about dollars and cents and know what I could acquire. And once I play spirituality in my life, I changed my entire focus to serving others. So, for the past eight years it's all been about service to others, and that's transformed my whole state of being.

The other thing I'll say is that, if for those that are investing or starting up new businesses, you know, focus on control, you know assets, when you're buying them, you know, what can you control and what will cash flow. Because that's so significant, this whole world, you know, focused, buys cryptocurrency and all these things I don't understand, but there's so much purchasing and activity off of appreciation and appreciation doesn't buy groceries. So focus on the cash flow control.

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SR: Appreciate that. And finally, Martin, how do you...

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MS: Anything you do, I don't really know too much about you, so I apologize.

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SR: No, no. I completely agree with you. I mean certainly appreciation is a larger part of the multifamily space, but part of a core principle here Life Bridge Capital is we want to get into assets that are good cash flow, because it eliminates a lot of the downside risk. Development is kind of the polar opposite, the risk reward profile is kind of staggering. You can make a lot of money very, very quickly. You can also lose a lot of money very, very quickly.

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MS: So you're sexy. I'm boring and your sexy.

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SR: Finally, Martin how do you like to give back?

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MS: There's causes I give to financially, you know, that are kind of private to me. You know, I think special needs is a huge, huge area. Give a lot to missions that's important to me, you know, spreading spirituality, spreading the message of God, I think it's important, regardless of what religion or belief system you have. I mean there's a need for us to kind of get connected to something deeper than a lot of the noise that's being perpetuated out in the space, and so I'll kind of just leave it at that.

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SR: Yeah. Awesome, thanks for sharing. Before we close out, anywhere that you'd like to direct folks to if they have more questions or want to get in touch with you guys?

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MS: Yeah, you can go to bqfunds.com, or email me at martin@bqfunds.com and I'll send you a free e-book.

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SR: Fantastic. Well, I really appreciate you taking the time, Martin. Great to have you on the show. Have a great rest your day.

[END OF INTERVIEW]

[OUTRO]

0:25:29.0 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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