

**EPISODE 1015**

[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.

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**Whitney Sewell:** This is your daily real estate syndication show. We are introducing a new segment called The Real Estate Syndication Show Highlights, where we're bringing you a look back at episodes focused on a specific topic that we believe added a lot of value to you in your syndication journey.

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[INTERVIEW 1]

**00:00:50.000**

**Whitney Sewell:** Our guest is Dax Ferguson, and thanks for being on the show, Dax.

**00:00:52.0**

**Dax Ferguson:** Glad to be here. Thanks for having me.

**00:00:55.0**

**WS:** So, let's dive into that due diligence process a little bit, and if we hire somebody like yourself, what that's gonna look like? When you're gonna be involved? And just that process of what you're looking at through the studying process and how you all track all these things?

**00:01:09.0**

**DF:** Sure, so when you submit your LOI and you're gonna start your due diligence process before you submit your LOI, you know, if you have a pretty good shot at getting this deal, right. SO, you're pretty far along. I just ask that you engage us at that point, right, so that we can go, "Okay, we have this property and we kinda mark it on our board and set up our team and what not to do that." And then once you do it, you have your due diligence period, I've seen him to smallest 10 days, up to 30 days, you have to go in there and do it. And so we schedule it within that time frame, and we need two days to set it up in the software before we show up, so we need at least two days notice, right, that, "Hey, I'm close and let's go."

But it's pretty easy for us to set up on our end. We've automated as much of it as possible, but we need some stuff from you or what building numbers and what you turn those building numbers, and are they on the first floor, second floor, and then what floor layout, they are... You

may have eight different layout types or floor plans for that property, and we want to make sure that we have each one of them so that when you get your report it is as intuitive as possible for you, you know that for plan A1 is a 1-1 and floor plan A-3 is a 3-2, and we can show you the report just for those. So, if you wanna look up, "Hey, how are my three bedrooms looking," and then you look at which one of those need to look at the picture report on that. So it gives you so many different ways to do it. And look in there, if we have that information, so the two days are important there, and on average, it takes a four-man crew, which is what we send out to do it, they can do 100 units a day. If you have 150 units, we may add six guys to get it done in a day, but typically we try to stay about 100 units a day and come in and come out. And then you'll have your report within 24 hours of us finishing with drone footage and everything, so we put it all together in there for you.

**00:03:07.0**

**WS:** What else is that report going to show us? How is that gonna be laid out, or I guess give us some, you know, so we can visualize that a little bit?

**00:03:13.0**

**DF:** Sure, so with it, it's an interactive report, gets in the cloud, it's not some PDF I'm gonna send to you and you're gonna have to flip through every page, so the great thing about it is if you're a spreadsheet guy, it's a spreadsheet report and you can just look at the spreadsheet report, which is very easy to understand, unit 511, and here's your client section of this report, and here's what needs to be done, here's what's good, bad or needs replacement, or it's missing, right. So, you'll even have those categories on there, and that goes through every unit, but it blocks the units on that report also down in there, where you two bedrooms are together, your three bedrooms together, one bedrooms are together, or every floor plan type... If you have several different floor plants of each, so it kind of breaks it up, so you see it that way, and then at the bottom, bottom it gives you, "Hey, you need 23 dishwashers on this whole property, you need 14 microwaves that are missing, or need replacement." And the other section of this report, which is the cost replacement report, it gives you the price that's associated with those... Right, so we put in there, the dishwasher is \$600 bucks to replace one, and I'm just making up a number here, but \$600 to replace one, and then I extrapolate 24 times 60 and it fits after number, same thing, refrigerators and all the other stuff that's categorized like that one thing you need to know is we price it in a way that if you have to replace one, the number works, or if you have to place 24, it's gonna be high. It's gonna be on the high side.

And the reason we do that is 'cause we don't know how many you need to be your place, so just be aware that we're doing it to protect you guys, not us, so...

**00:04:55.0**

**WS:** Nice, nice. So help us, if we don't have somebody like yourself, let's give a few tips as far as when we're walking a unit, maybe some things that you're looking at or that you're, like you already mentioned this, a couple of things that specifically take photos or maybe a few things that are commonly missed that you all find that I might not know to look for when I'm doing my walk-throughs?

**00:05:17.0**

**DF:** So we start at the front door is kind of very systematic approach, we take the front door, look at front door conditions if it needs to be a place or not, the light at the front door, and then as you walk in, we look at the flooring in the entryway, we look at what's behind the door, has the door knock holes in the wall and nobody has ever fixed it, right, and then we look at smoke detectors, we hit every smoke detector and make sure it's working or not, and that instantly tells you if they're really maintaining the property, honestly, 'cause tenants will never replace the battery, so if you as a sponsor, we wanna make sure your smoke Textron work, and we recommend every six months going in and just as a system for your property, replace all batteries every six months. Because it helps you maintain your property and make sure that if there is a fire, then people are working to get notice. But we look at fire extinguishers, we look at air filters for the HVAC system, are they replacing those regularly, and they just kicked on with a lock that's been there. We look at sink faucets or a leak in the kitchen, in the bathroom...

One of the cool things that we added after that is we take a picture of every toilet, and the reason we do that is if you're gonna go to water conservation, you need to know if it's a low flow or not. Well, typically, we all know these days if it's a one and a half or a three-gallon flush versus a 0.8, so we take a picture to let you know, and just because they do it in a few doesn't mean they do it everywhere, so we take a picture of everyone, so that you can actually go into the report, look at the pictures of all the toilets on the whole property and see, and you can do through and it will label, this is an unit 511, this is in 512. And you can see which ones have been replaced and which ones haven't. It's really getting that detail and being consistent with your team on making sure that you're getting all the pictures and all the detail that you want.

#### **00:07:16.0**

**WS:** Nice. So, the team that you send out to do this due diligence process is someone on the team going to be an expert, let's say an HVAC or our roofs or foundations, all these different components. I know early on when I started investing in real estate, I hired one man to come out and it was a smaller multifamily property, and I just assumed that he knew all this stuff... I just assumed that it was an expert in all these things, and lo and behold, he was not.

And so I didn't get... There was information specifically about the HVAC units that I learned the hard way months later that I should have known before we actually closed on the property, and I felt like he should have found it during that due diligence process. So, tell me about that team. Or am I gonna have to hire somebody else that's also an HVAC, or what do I need to think about when I'm hiring somebody like yourself or somebody else?

#### **00:08:10.0**

**DF:** So that's a great question. We're very knowledgeable, but we're not experts on every aspect of this deal, so if you want plumbing line scope, we're not gonna scope of ourselves, we're gonna bring on a plumber that can scope your lines and give you video and audio of what the shape the lines are in and that's an additional cost. However, on the electrical side of things, if you take a picture of the panel and they have GFCIs in the bathrooms and the kitchen, so you know they've done some wiring work, things are up-to-date or not... Right, so if they're there, they've done some work, it's an older property, if it's not a stab lock or a specific panel, you know that you're probably in pretty good shape on the electrical side. The big push right now is for the HVAC, right, is it 22 or is it 410 on the freon. And obviously, most of these older

properties, they've done some replacements, but not all, and so with that, we take a picture of the condensing unit or condensing unit on the outside, and we mark as best as we can depending on the location, what unit that belongs to so if that unit belongs to unit 510 and it has our 22, we circle it, and we say it's functional if it's working, but you'll know that it's our 22, so we try to give you all that detail that we can give you.

Now, if it's 410, the market is good, because typically those are in good running shape. Some of you guys may or may not know our 22s are going away at the end of the year, and those are condensing you... It's gonna have to be replaced when they go out, freons going away, so there are some freons that are replacement for our 22 that will work in those units, but we've been told and we've seen that they're not as efficient, so what happens is they break down and you can't replace a part, so at that point you're forced to go and replace that unit, so you just need to be aware of that when you're doing the diligence and go from there. Foundation foundation is typically pretty easy, so the guys are trained to walk the units, look and see for foundation issues, and then on the exterior, look for foundation issues, if they've put on vinyl siding and inside has cracks all over the place, you know that they've hidden some foundation issues. So what we do at that point is if there's some damage that we've found through due diligence, we recommend bringing out a foundation company to come and give you an assessment on it. And depending on the market, we have lots of foundation copies we work with that will come out and give you a free assessment and just say, Hey, this is where we're at, or we need to get an engineer out here to give you the real issue, and engineers can be expensive, but they also can save you a lot of money.

Some people are like, I don't wanna go through the expense of hiring in engineering. I said, Well, you have foundation issues, and I'll throw a number at you to give you an idea of what that is, but if you spend a couple thousand dollars to have an engineer come out here, they're gonna give you what really needs to be replaced and it may be half of what I'm telling you. So it's just case by case on that... So my team, we have a lead that's on the team that's going back to what you said, we have a lead that's on the team that's trained in looking at all these things in detail, looking at the roof, looking at everything, and we try not to get on a roof, we fly drone around the roots, take some close pictures, take an overall texture to give you an idea of what that looks like, and we see trouble spots will fly down and we'll take a closer picture, so it's kind of how we assess the ruse and then they leave, will walk all the exteriors because they're the most trained in looking for that, and then we have the other guys that are truly going through the software systematically.

You probably know this as well as anybody. The younger guys really know how to work technology and they know how to look at the detail and take the pictures and do this and do that, so all of our guys that do this are pretty young and we keep it that way, I'd say they're all early 20s, in most cases here that go out, if it's a customer that's looking to do some construction and they need some advice on that, I typically go out with them at least one day walk with the sponsor and say, "Hey, why don't you think about adding a formula? What'd you think about a door kitchen that would really enhance this property." So that you kind of come out of there having a good idea of what you're gonna do when you're done.

[INTERVIEW 2]

**00:12:29.0**

**WS:** Our guest is Matt Faircloth. Thanks for being on the show, Matt.

**0:12:32.9**

**Matt Faircloth:** Thank you, Whitney, it is such an honor to be here, gonna be with you.

**0:12:35.7**

**WS:** We're gonna talk about due diligence today and maybe some items that you've walked through and learned about due diligence on some specific properties, and then we'll move on from there. Get us started.

**0:12:45.7**

**MF:** Yeah, we've had an interesting track record and we got started in super small real estate, duplexes and singles, and as you had said, and then we slowly scaled in the larger multi. We've even syndicated with investor small deals as well, and I find it that you do is it's process changes a bit as you get in a large multi, but in some ways, it also stays the same, in a lot of ways, it just becomes more to look at but in some ways, you're also... You're just really looking at a lot of the same things, just on a larger scale, when you take on a bigger multifamily.

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**WS:** That's great. So from a small multifamily to a large, what is something we should be thinking about as far as how due diligence would change other than just the scale?

**0:13:22.0**

**MF:** Well, let's talk about why before we even go, let's talk about why we do due diligence as investors... Right, the reason why I think is like, I give a lot of Matt Faircloth definitions, so don't call me going at your Webster, I'm not the definition guy, I just have my interpretations of what things mean, the reason why, my interpretation of why we could due delicate, validate, it's the to validate that things are what I thought they were, so I made my offer on a property and I wrote up a contract on a property based on certain performance that I thought the property was, and so during due diligence, my job is to go in and validate that the property really is what I thought it was, and the condition really is what I think it is, and to make sure that things are not swept into the rug, you may be intentionally by the seller, but let's not even get a accusations on that, let's just say that maybe they're just things that I was not aware of. I'll give a quick example. I'm sitting here in North Carolina right now. We own a property in Fayetteville, I'm here in Fayetteville. Here, as they say here, fable, and so I'm here in fable, and we bought a property, 198 units, we were told that the property had aluminum wiring in one side of the complex. Okay, I was told that. And so during due diligence, I need to evaluate the property knowing that that aluminum wiring is there. Now, if I were to buy a property and not be told there was a lime umpiring and one side of the complex, then I could perhaps change the valuation. We can talk about re-trading in a second here, of course, but it changes what the property is because it's a little bit of wiring I was not aware of. There are certain insurance requirements to come along with a row, there are certain maintenance requirements to show up

around a little bit of wiring, but because it was disclosed to me, then I'm not saying I can't, but I'm saying to do things right way in this business, you really only can change your plan for things, different disclosed, and the purpose of due diligence is really to get the whole picture that it is on the property, the purpose of due diligence is really not to re-trade, it's not to get a better deal. Some people view it that way, but it's not an opportunity to try and an opportunity to handle... If it's an opportunity to make sure that what you're buying is what you thought, and that plays for big and small real estate.

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**WS:** Now I like, Hey, you talked about the purpose of due diligence is not to re-trade and also they told you about the aluminum wiring so you're not gonna go in there, "So it's got aluminum wiring. We're not interested." Now, I knew that.

**0:15:42.6**

**MF:** Well, you know that aluminum wiring is actually gonna make my insurance premium go up, and so I'm going and that's gonna make my cash flow go down, and so I'm gonna read back to... After that the property is based on that. And they very likely could say What a... And we told you they had aluminum wiring, you should... When you made your offer, you should have evaluated it based on the aluminum wiring that you already were told was there, so... No, thank you. Would you be adjusting the price based on that, and then we would not accept new price adjustments if I were the seller... No, you were told.

**0:16:09.7**

**WS:** You mentioned re-trading, let's just take for instance, they didn't tell you about the aluminum wiring, then you went in and what would happen though?

**0:16:16.8**

**MF:** Well, what a re-trade is, and it kinda gets a bad connotation 'cause "oh, you're never re-traded or whatever," this is really just a revaluation and saying like, "Okay, underline now is I thought the property is worth X." Let's just say that's \$5 million bucks. I thought the property was worth \$5 million bucks based on my evaluation, and so that is my offer to you for the property based on my business plan, based on what my investors wanna see, based on what I think the market's gonna do, based on all my factors in all my parameters, I'm willing to pay X for that profit. Then I do due diligence that I discover that maybe utilities were higher than I thought, or maybe I give you another example of this property is in a floodplain, you didn't tell me that, and then during my due diligence have discovered that it is now, that is something that it takes maybe 30 seconds to discover where they're not... Properties are in floodplain and that... So I would submit that you should look at that before you make an offer, but hey, let's pretend you didn't find that out to contract, you probably would be turning yourself in by not doing very good homework, but let's just say that's something that comes up then. Okay, that increases my expenses because of flood insurance or experiences my expenses because of the insurance premium that shows up because of that aluminum wiring, it's a better example. Whatever it is, my expenses go up, my net operating and come on, the property goes down, we've already agreed upon a cap rate, that's what I made the offer based on for the marketplace, I've got my cap rate in mind for the property. And so let's just say it's a seven. And that's how I apply that card to the new NI that the property now will perform under based

on that new expense line, and that changes the price and it's Okay, well, now my new evaluation of the property is this, it's really a revaluation... First is a re-trade and it's saying, Based on the information that you showed up, my new evaluation is X on this property, some people view re-trading as a buyer trying to squeeze the seller to get a better deal out of the seller...

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**WS:** Part of the negotiation almost...

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**MF:** But it's a negotiation. It shouldn't be, it should be just a tactic that's there just to make sure that you get more of what you're gonna get... That's it. And again, I've got a smaller asset that I'm selling right now and trying to... a guy sent me an offer today and he over-inflated his expenses. His evaluation was extremely conservative, I'll give you an example in his underwriting, he showed that he was gonna get a 7.5% interest rate and is more... And I just said, Listen, that's not what financing rates are on that size property, you can do better than that, is trying to show me like, Well, my cash on cash is gonna be this.' I'm like, Well, it's actually not because those people are better... On getting better than 7.5%. So there are games that some people like to play during due diligence by inflating the effect of things that come up, that's a game, and if anybody on the other side of the deal is sad that you'd be that the broker or the seller, they will see through the game that you're trying to play, and on the broker side, you're on a reputation with somebody who tries to play games on sellers to get a better deal on the property in just offer what you think is worth and don't try and offer one thing and know that you're gonna try to re-trade to the embryo really want to, and that 'cause you get a reputation to it that.

And you could very easily take the seller off and they can just... unless they're in distress. That'll just say, No, take it off the market. I'm not gonna sell it to you. Go to the next buyer.

**0:19:25.0**

**WS:** Yeah, what about some kind of checklist, do you all use checklists for this due diligence process? How did you come up with one if you do?

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**MF:** We do. We had one for smaller properties, we've just expanded on it for larger properties, there is due diligence that we do, which is we do financial due diligence, so let's... We do an analysis and underwrite the deal before we make the offer, of course, but then once we are under contract, we go and validate the numbers that we have. Okay, let's audit all the leases, send me 18 months, 24 months worth of financial statements on the property, send me 24 months worth of utility bills, if you audit all those financials with, you and your team are gonna just compare that the seller said, "Okay, my monthly electric bill was \$5,000." Well, you're gonna audit the actual utility bills to see, and if you find the average was \$7,000, "okay, we have a difference in expenses," and that's a conversation, let's find out what it is, let's find out why they told us, but where they get that \$5,000 from. And maybe it opens you up with questions first and then not immediately re-trading 'cause maybe they can give you some better explanation, but... So that's the financial evaluation.

**0:20:34.0**

**WS:** Are those documents going to be something that's pretty available or is that gonna be for the seller? Exactly, what are you gonna be asking for, say utilities?

**0:20:41.4**

**MF:** It depends on the seller, if you've got a professional broker, they will... I've had most brokers trying to assemble a Dropbox for you, like a Google Drive, a Dropbox that as soon as you're under Trott, they just geodes your Dropbox with everything in it, that's where the seller that has their act together, if it's a professional seller that now it runs a tight ship, then they'll easily be able to produce all that, and if you get a professional property management company, they can just upload that already, but they have already up into that Google drive, Dropbox and off you go.

**00:21:12.0**

**WS:** Are bank statements something you normally get?

**00:21:13.0**

**MF:** No one may be willing to give it to you and ask for the schedule on their tax returns. Never been able to get that. We always ask for it, but the schedule E is where the real side income and expense gets listed on the tax return, the smaller real estate, it's something to ask for, but it's all my checklist, but we never get it 'cause they would say, No, not gonna give you that never got a bank statement ever. We ask for it, they never give it.

We ask for things like or something called a trailing 12. Trailing 12 is the profit law statement broken down by month over the last 12 months, printed out in the sellers' whatever software they use, QuickBooks, trip manager, Yardi, whatever, printed out in the software. Your rent roll, that stuff's pretty easy to get in, other people always tend to choke on the last 12 month or 18 months or 24 months with the utility bills, I don't know, whoever, they tend to have a problem producing that, maybe they don't keep it or vendor invoices like the bill from their landscape, whatever, we like to validate that kind of stuff, so I wanna see every invoice that any contractor ever sent you for work you did on the site for the last 12 months. That's what I wanna see.

[END OF INTERVIEW]

**00:22:12.0**

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[OUTRO]



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