EPISODE 1102

[INTRODUCTION]

[0:00:01.6] **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]

[0:00:28.5] WS: This is your Daily Real Estate Syndication Show. I am your host, Whitney Sewell. It's that time of week again, where my business partner, Sam Rust takes over the show and interviews our guest. I hope you enjoy the show.

[0:00:01.6] SR: This is your daily Real Estate Syndication Show. I'm your host, Sam Rust. Joining me today is Terry Painter. Terry is the author of the Encyclopedia of Commercial Real Estate Advice, and the founder of Apartment Loan Store Mortgage banking firm that's closed over 4 billion in loans over the past 25 years or so. Terry is numerous transactions all across the country. Welcome to the show, Terry, thanks for joining us today.

[0:01:01.1] TP: It's a pleasure to be with you, Sam. Thanks for having me.

[0:01:03.8] SR: Yeah, so Terry, you jumped into the real estate market a long time ago, the late 90s, it's almost a different universe from where we are at today, and lending conditions, just a few things have changed since then, I think the average cap right back in the day was maybe 8 to 10%, somewhere in that range. In the late 90s?

[0:01:26.5] TP: You would be looking for something higher than 10 actually if you could believe that and people would complain if they had to take it nine or eight cap sometimes.

[0:01:34.0] SR: And obviously, we're in a very different world today, we're value-add multi-family, which is what Life Bridge Capital specializes in, and a lot of what you land on across the country, I think the average for C and B type product is like five and a half, maybe five and three quarters, and with the way it's moved, it may be even lower than that, so definitely a different universe.

[0:01:55.0] TP: We're seeing, which is really an anomaly today, is C-class properties actually dipping down and a lot of... We're based on the West Coast, even though we do lending nationally, we're seeing properties that are actually dipping below a five cap, their C properties that are going for what A properties and even A properties should be selling for today.

[0:02:18.0] SR: Yeah, the amount of spread that you could usually count on between A and B and then be down to C class assets, it's really compressed, and in a lot of the markets that we trade in, it really isn't there, or there's hardly any spread, especially between the B-and C assets.

I wanna talk a little bit, Terry, about the overall landscape, but I figured maybe we'll start with something that's more specific to lending, and we work with a lot of passive investors at Life Bridge Capital. And one of the questions that I get asked all the time is, asset prices have been going up since 2008, and I'm really concerned about something like 2008 happening again, and everybody kinda has in their mind, real estate is cyclical, we know that history doesn't necessarily repeat, but it usually rhymes, we're not gonna be on the elevator train up up into the... Right, forever. But looking back at what happened in 2008, that was a real estate caused recession in many senses, and a lot of that was because underwriting standards seemed to get pretty out of whack with fundamentals, and some of the incentive structures were messed with... I'm curious for your perspective, having lent through that entire environment and still in lending space today, where we're at just from lender underwriting standards, are we starting to see those relax or where are we at in relation to 2008...

[0:03:34.4] TP: Prior to the great recession of 2008, we used to joke in our firm that we could make a loan to anybody with a 640 credit score and a pulse, and that was pretty much true today, actually, the experience of the sponsors that we're talking about, syndicated transactions, and the financial strength of the entire group is really king, it used to be that we made loans almost solely related to the quality of the property, especially the income of the property, the location of the property, of course has always been important, but today, it's really the quality of the experience and net worth in liquidity and the financial strength of the team that's putting together the syndication.

[0:04:22.0] SR: And so you're seeing relatively similar standards over the last 10 years for debt coverage ratios and loan-to-values and some debt yields, a lot of those metrics that lenders look at that, we're not seeing a relaxing of those?

[0:04:33.0] TP: With the exception of having recently gone through the coronavirus recession, and during that what happens is that initially banks started raising their debt service coverage ratios higher to lower their risk. They also stopped doing cash out refinances and just doing other things as well, actually, our business really picked up because we can make a lot of loans with the banks could not do, but we are saying now that things have tapered off, and the biggest problem we have in lending right now, which is the same problem that investors have in any type of income property, is that real estate professionals, real estate brokers are actually pitching deals based upon proforma, not based on actual income, that's because there's such a scarcity of properties on the market, the inventory is so low, and that is just like in my book, what I talk about as I say, Would you ever buy...

[0:05:24.5] TP: Let's just say you're buying a tire shop, would you actually pay something for a suits future or any potential... Well, of course not. So what is it that the real estate brokers installers today are selling properties so often based on potential... So by the time we get the actual numbers into crunch, it's unfortunately waste of everybody's time. A really good syndicator will do that. They'll get the acts together for us before the, sponsors will get their act together before we even see the deal, which is really great for us.

[0:05:24.5] SR: We're definitely seeing that in all of our markets, I think the brokers are almost panicking in a lot of areas because... So much is trading off market, there's a lot more buyers than there are sellers, and we're starting to see more sellers come out because the prices are so ridiculous, we're actually in the process of disposing off a couple of assets ourself, because the cap rates that people are willing to pay on actual is really historic for the type of value-add assets, the 70s 80s product that we've seen in one of our markets.

[0:06:30.8] SR: I just saw a deal that was 95 construction, 100 units or so, and it's gonna go for a three cap or less, it might even be a subtree cap when it's all said and done, and I can't even get close to making that pencil it's unbelievable.

[0:06:45.2] TP: Sure, even though, even though institutional investors, REITS and so on, have a testator just to stay with A and B, quality properties have also pushed the property prices up also is that... Is they have money sitting there and it's better for them to invest it and a lower cap rate today and wait for the rest to go up than it is to have the money sitting there when they're paying investors, but we also has seen them actually looking at high quality CE properties now as well.

[0:07:14.0] SR: Yeah, I think people are expanding their buying criteria because there's not a lot out in the marketplace right now.

[0:07:22.0] TP: One of my passions is construction lending, there are some sponsors that actually specialize in putting together syndicated transactions with round of construction, and that actually is a loophole in the whole system, because you can actually, for the first time, the replacement cost is way below what it's gonna cost to buy a property today, so even with the cost of materials going up, we did a construction on a couple of years ago, and the group... It was a syndicated transaction, the group actually planned on at least a five-year hold, but they built it for around 21.4 million and they got an offer for 34 million at Sub-4 CAP, of course, they took it on.

[0:08:04.6] SR: We're seeing that we're doing some ground-up development, several other syndication groups that I respect or doing ground-up development, there's certainly a risk in element there that you really have to watch, but in select markets, I think it makes sense because as you just noted, replacement costs continue to soar, land continues to get more expensive, and they see properties, the cap rates are just dropping through the floor, it's incredible.

[0:08:28.2] TP: That's the one thing that doesn't really make sense, I'm also do some investing, I'm looking... And I have somebody sitting there, I'm looking to invest. I've also been a passive investor, sophisticated and accredited myself, and I remember times when we were promised 12% returns and it was not that difficult actually, pretty comfortable for the sponsor to pay those, but today, one of the things we're looking at is just these expectations that passive investors have opposed against the reality of the low inventory over-priced real estate market, and I work out to investors, what you really wanna do is also make sure that your sponsors are successful, we really are not as far as the preferred returns... That makes sense. Have to be. It really does, I usually use the cliche when win, but it really does in this instance, do you want it to be a win-win and you wanna work with in the market more experienced sponsor group as opposed to a newbie, because the newbie’s going to promise you a later return that's going to create it. So that they're not gonna get paid. It's like, keep in mind that the sponsors are responsible for every...

[0:09:37.6] TP: From putting the deal together, all the way through overseeing management, everything, they have hundreds of hours involved over many, many years, and you want them to stay on the deal, so if a new sponsor promises you a 12% return today? It means that they don't make money three or four years down the road, it could back out, and that could be dangerous, and so my advice is just stick with more experienced sponsors and also make sure that the return is profitable for them as well.

[0:10:07.0] SR: Yeah, I think that's something that more sophisticated investors realize is, Hey, I don't wanna get every last drop out of this deal, I don't wanna prioritize for just the highest top line return, but let's look at the entire picture and let's make sure that... If everybody wins, then we can do this again and again, and again and again.

[0:10:26.0] SR: And you motivate for proper performance, I think that aligning the interest between your limited partners, between your passive investors and the sponsors is really crucial to a successful syndication, especially as in my opinion, we're headed towards the time where Operations is gonna matter much, much more than maybe it did over the last 10 years, 10 years ago, you buy anything commercial real estate, you probably did great... I don't know that that's gonna be the case for the next 10 years.

[0:10:50.7] TP: Right? That brings the quality of the property management, it's more difficult today to do value adds and they just take longer to pay off, but if you, preferred experience, sponsor, they can actually eyeball the property correctly and realize they could see the value that's going to be there as long as they're buying, the most important thing to mitigate risk actually is to buy a property in a good neighborhood, and they always seem to go up in value as the rents are able to be increased.

[0:11:32.0] SR: The old adage in real estate, location, location, location. It matters, it's pre-eminent. A lot passive investors are also worried about buying into the top of market, which I think is a very fair question in commercial real estate and multi-family specifically, which is what we focus on at Life Bridge Capital. I believe that finding the right value-add projects helps lower that risk a little bit, if you can force that appreciation over the first 12 to 24 months of your project. I tell a lot of folks, I can't predict what's gonna happen in two years, but generally barring something like COVID we can see out six, nine, maybe 12 months. And I'm curious for your thoughts on that.

[0:12:13.0] TP: It’s interesting, I have a client, I pleaded with her to not by this property in Chicago, it was in my favorite neighborhood, right close to the Linkin Park Zoo, and it's just that she was buying it like in a five and a half... Campus was in 2018, Linkin Park is the neighborhood. Hip neighborhood, great restaurants is just the time of place you'd want to invest in, and he was doing exactly what I had taught people to do back then, but the problem is that she was paying a price for this property, that was what newer properties were going forward this one needed quite a bit of work, plus she’s putting a lot of money into it, and so for the first couple of years, she actually only saw a 2% cash on cash return, very, very little, but because she had bought his better neighborhood once she got the unit all turned today, she looks brilliant, and I have to say I was wrong because she brought in a good neighborhood and brought the property up to the level of some of the best properties in the area. She made out like a bandit, and she's already well over doubled her cash investment.

[0:13:15.0] SR: That's fantastic. I think having that vision, like you were speaking to earlier, it's just really important and does come back to some level of experience with the sponsors, there's so many people that rightly see syndication is a path to success and wanna create success for themselves for their friends, for their family, but make sure that they're partnering maybe with somebody who has that experience or in some way is accounting for the variability in the market, because it's definitely a volatile moment right now. Right.

[0:13:41.7] SR: I'm curious to dive in on a couple of things specific to the lending portion of his business, Terry, a lot of folks or more folks maybe are starting to look at loan assumptions, there's quite a few folks that bought properties in the last two years that maybe they put agency floaters on and maybe they're even in their lock-out period, but because values have been pushed so quickly, maybe they're looking to sell those properties, lock in their gains and you have to run through a loan assumption. Do you have any tips or pointers for folks who are looking to take on one of those type of loan products?

[0:14:12.1] TP: We have four products that do have very variable assumptions loan assumptions, keep in mind the commercial banks don't like those, they just don't have them really? And so we're talking about the agency loans, Fanny and Freddie, and then we have FHA, which has put, which has you can assume a loan or have a point... It takes a long time to put those jobs together, but those are so high leverage, they have a lower debt service coverage ratio, and then we also have CNBS Commercial Estate Mortgage Back Security funding that also has a 1% as the agency loans to assumption face what it really gets down to, is that because carts are so low, somebody has to actually put more money down anyway to buy a property today, and that's gonna be true if they want to assume your loan... And rates are so low right now. Of course, they have been for a long time, but actually having somebody come in the future, if your strategy is to hold for let's say two to four years and then... So actually today, get financing with Fannie Freddie or CNBS especially is a good option because it could be very attractive in the rebuild to assume a very low rate of today's rates in the future.

[0:15:23.7] SR: Yeah, it's an interesting conundrum for a lot of folks who are trying to figure out, should I hold through to the lock out or should I take the bird... That's in my hand right now. Let's take that offer and we're starting to bid on some of those projects that maybe require a little bit more down payment up front, but you're getting into a relatively decent loan product, you're taking some of the risk off the table and you're able to execute or maybe some other groups are not.

[0:15:48.7] TP: It really depends on the property is potential to, or it could be... It could have some under-market rents, you have some value as it could be done in expense, just cosmetic onset are inexpensive and can make it worth it.

[0:16:00.0] SR: So, as we look out, you've alluded several times in this conversation, Terry, to the market being all-time highs, it's getting really difficult for deals to sponsor, to pencil for sponsors, for passive investors, people are starting to push out budgets based on investment summaries, based on pro forma instead of on actuals, where do you think we are in the market right now?

[0:16:22.3] SR: From a fundamental standpoint, what's maybe a positive indication in your mind as something to watch?

[0:16:27.9] TP: The thing is that there's one basic tenant in commercial real estate, especially that as long as you can raise rents, property values will go up. So that is the bottom line for making any deal today work. If you're going to buy an overpriced property today, the most important thing to know is that you're gonna have to take a longer period of time, you probably will have to take two years to raise rents and to do some other value adds to where the investment is going to be worth more, and yet we never would have guessed... I'm gonna tell you, we never would have guessed two years ago, the property prices would be where they are today, and just keep in mind also that there's always more earnings from appreciation than anything else in investment in real estate. And so, I think the most important thing to do for an investor to think about today is the equity multiple, which is basically taking a look at your investments. So, if you invest, let's say, 200,000 today. Would you be happy that in four years, if they are to 400000 for you, and that's something that's realistic, we're still seeing equity and cap rates have really stored down even, we still see if we've experienced sponsors groups that they get to double the money for their investors or is the stock market is doing right now, it could just within a matter of days go way down, and that's just not gonna happen with investment in real estate is very unlikely that we would have another great recession.

[0:18:06.4] SR: I know you work with a lot of syndicators around the country, Terry, a lot of times people talk about things not to do as a syndicate, buy the wrong area of town, don't skimp on your due diligence, you find that right. Property Manager, but what do you see as some things that... Good indicators do. What are some patterns that you find patterns of the action that maybe don't guarantee success, but make it more likely.

[0:18:30.0] TP: That's one of the best questions I've been asking a long time, I would say the number one thing is that really good sponsors do say, do not fall in love with the property, which is really easy to do with just investors, let's just say that decide to just try to buy a property on their own and not join the syndicated group, it's just like dating and just taking a look at somebody's looks first and say, Okay, yeah, I could see myself with that person syndicators that are experienced sponsors that really know what they're doing, they only see this as a business and you have a blind folds on when it comes to the beauty of the property, of course, a more beautiful property is gonna click better and photos and so on.

[0:19:10.5] TP: But as far as actually being able to talk about what this property is going to produce as far as income based upon your experience, is really where it's at, and these experienced syndicators also, they really have teams that work for them, that just really do their due diligence they get to three years of financials on the property, they really know what condition the property is really in, and so by the time they're ready to pull the trigger on that property, these are really dynamite properties, even during a low maturity time in Lorient or times today. So not falling in love with the property is one of the best things that sector sponsors do.

[0:19:50.0] SR: Completely resonate with that. I think there's always that tendency when you're the deal-finder, which is my scene for Life Bbridge Capital, that you find stuff that's gonna tage your heart strains. But it has to make sense. It has to make sense on paper, you have to be able to model it, you have to be able to justify it, you can't let yourself buy with your heart, and at least if you want repeatable results.

[0:20:14.0] TP: One of my best clients, I worked for a lot of wealthy people, and he just fell in love in Utah and yeah, it was a beautiful reviews, Carstairs, everything was perfect.

It was like he was gonna live in it, and he ended up paying a million dollars more than it was worth, and think about Plotkin to raise rents. To actually capture that million dollar You ever paid for it? That's an individual, I don't really see sponsors doing that... Yeah.

[0:20:38.3] SR: And I think that's an important note towards a partnership, and I talk through all of the deals that we offer on together, once we've identified him as a target, we're ready to write an LOI, we run through it together just so that someone else can be a check on our underwriting process or somebody outside who hasn't gotten into the weeds and falling in love, so to speak, and you can make sure, Hey, does this meet our original goals for deals that we're gonna offer on...

[0:21:03.0] TP: Exactly, the landing stages, we don't really have any interest in falling and love with properties, it doesn't suit us at all, so we just look at the numbers. There were never crushers.

[0:21:14.0] SR: It's fantastic, Terry, as we're getting close to wrap it up here, what's the number one thing that's contributed to your success?

[0:21:17.0] TP: To be really frank about that, it's something very simple, it's really... The love with a deal. My experience really comes more from looking at hundreds of real estate deals, analyzing them, and I love crunching numbers, and I get excited about putting deals together, and so I would say that just a love of this business, is that something any more than you could be a sponsor during syndication, and if you're just doing it for the money, as you will be able to attest to, Sam, you really have to love the deal, and that's what I have and that's what... I've gone through quite a few relationships, I'm not that proud of that, but I'm not planning on continuing that process when Monday came around, I couldn't wait. I spent the weekend looking forward to going back to work.

[0:22:01.5] SR: I love that aspect of real estate as well, there's even for deals that you won't even do, just trying to figure out what could make this deal work and trying to find that right path and you can get very creative. There are so many different options out there, both in the lending space and your equity side, it's a fascinating puzzle every time. (Absolutely. Yeah.) Awesome, last question before we go, Terry, how do you like to give back?

[0:22:24.5] TP: I have a winter home in the dominator public, and one of the things that I started doing years ago is I actually find somebody, like in a third world country, we have a young man who is Haitian, and he was working on hating our house. I said, you do all this construction work, what is your dream? What would you like to do? And he said, I've always wanted to have a store.

And I said, Well, what kind of store would you have... And you said a semi-athletic shoes. And so, my wife and I actually invested in him opening up his first store, and he's been very successful over the last three years, and that's helping people is what I love to do. I like to see the results.

[0:23:01.7] SR: Well, Terry, if folks wanna reach out to you, learn more about what you do at a business loan store, in the apartment loan store, how can they get in touch?

[0:23:09.0] TP: The apartmentloanstore.com is our website, and we're also a business loan store. Also, my book is the Encyclopedia of Commercial Real Estate Advice, and there's a website for that as well, and also YouTube channel called the Encyclopedia of Commercial Real Estate Advice. The book is great for newbies and anybody investing in real estate, it really gives you all the background you need to understand how commercial real estate is put to the other...

[0:23:34.9] SR: Fantastic. Well, Terry, thank you for your time today, really informative for our audience, thank you to those of you who tune in as well, you hope that this was informative for you. Have a great rest of your day.

[0:23:34.9] 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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