EPISODE 1163

[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.

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Whitney Sewell (WS): 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]

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WS: Our guest is Dave Van Horn. Thanks for being on the show, Dave.

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Dave Van Horn (DH): Hi Whitney, how you doing today?

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WS: Let's talk about this billion with a B dollar business you're building.

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DH: In the note business, it's a little different than real estate syndication, and the reason I say that is because we don't have as much opportunity to leverage. And that was similar to mobile home parks as well, mobile home parks, there's not as much bank financing as there is with apartments, if you hear the advantages and disadvantages of both.

So when I see, especially mobile home parks, for example, there's a lot of accelerated depreciation, there's a lot of tax advantages because it's all infrastructure. So you can accelerate a lot of the depreciation. Whereas apartments, that's not the case, but there's actually more financing for apartment and there's more buyers of apartments. It's a little more sexy than mobile homes are, so it's more bank-able, and that's one of the things I do like about it, but I think I like, this is gonna say on a little hokey, I like a lot of different alternative investments, I don't like any one arena, and I had originally started out in the single-family space, but I do like the scalability of larger complexes II playing the role of sponsor... I like being able to bring my experience and expertise to a deal, so I've been in a lot of negotiations over the years, so that I think is an advantage that I can bring for someone, so I enjoy the art of the deal, so to speak. But I do believe it's good to be in multiple verticals, and I actually run a group called Strategic Investor Alliance, which is for high net worth folks, and one of the things about that group is, it's not just about nodes, it's not just about multi-family, it's not just about insurance funds and different things that we invest in, I like these different vehicles because they all have different returns, they have different timelines, they have different market volatility, so there's a lot of advantages in being involved in different asset classes, is what I look at it.

So that no matter what the market's doing, you have something that's there, and I think it's good for people to sweep some of their profits off the table into state for vehicles and buckets, whether that's qualified plans and IRA accounts or insurance contracts, as well as other businesses. And other types of funds and investments. So I like to spray (inaudiblea) around a little bit, if that makes sense.

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WS: And looking at so many different investment vehicles, you're so experienced, how do you educate yourself about so many different asset classes or ways to invest?

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DH: That's the biggest challenge because there's only so much time in a day. So in some ways you're trusting other folks for their expertise, and it's really being able to network with the people that are experts in their areas that you can trust, so that's a little more challenging but you are correct, because a lot of these investments have different advantages, my note fund doesn't really have tax advantages, whereas your apartment fund and your apartment fund might be a long period of time, it might be five, seven or 10 years in laying... My note fund is one to three years, and now we have a liquidity fund that's very liquid, well notes or liquid apartments aren't or mobile home parks are or storage centers aren't, especially development projects, there tend to be a little riskier where there might not be as much cash flow in the beginning, so there's a whole array of different things that investors like and it could vary in their time horizon as well, like you're a young man and I'm significantly older, whereas my appetite might be different than yours and yours, you might have more time to ride out a longer project, then there's also a real short-term funds too that might only last a year, and it could be a hard money fund or something like that. So there's a whole variety of different types of funds, I do like the real estate backed assets, I do like having collateral, but there's a whole variety of

different ways to stay diversified where different markets aren't impacting all of your investing, and there's still opportunities for you and you're not completely wiped out as something where to go sideways on you.

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WS: So Dave, with all your experience in this many years in the business, you've seen so many people come and so many people go and say they wanna do real estate or they wanted you notes and then they wash out, right? But somebody comes to you and says, Hey, I really wanna do real estate syndication, I really wanna get into this business, and you got a minute to spend with them. What's your advice for them?

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DH: Well, at first, I think my advice is, don't be afraid of syndication. When I look back, I've been singing a long period of time, and I look back, I realized that I don't know how I raised capital Without syndication, and I quickly realized that syndication is a big fat insurance policy, basically for everybody, for the investors and the fundraiser, because if there is a liquidation, it's done through somewhat of an orderly fashion through the private placement docs, because that's what it does, it expels out all the risks, it spells out what happens in a liquidation or wind down, and it does protect all the parties involved, because if you don't have a syndication... Well, who gets paid first? When things go sideways, is it the guy that sees first, is it the largest investor is a diverse that came in last, is it the person that got out first? It's a big crap shoot, so syndication protects a lot of parties that way, and it also protects the syndicate because all these things were done properly and disclosed, and hopefully you have high net worth folks that it doesn't like those people out.

So it's kind of like a pre-nuptial agreement for business or something, so there's a lot of advantages, specification, and I think it enables you to scale. I think scalability is a big advantage and it allows you to do bigger projects and that scale... You do have to put together a team. I think that makes sense, focusing on what you're good at and what you're not, and just come into grips with that that's important, but I think not being afraid of syndication is critical.

[INTERVIEW 2]

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WS: Our guest is Susan Elliot. Thanks for being on the show, Susan.

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Susan Elliott (SE): Thanks for having me, Whitney.

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WS: Well, tell us, you know, what is note investing? You know, let's dive in there just, you know, to get started. Bt somebody that's brand new to note investing, what is note investing? Are you writing notes and what is that?

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SE: Yeah, it's a good question because even people who have been in real estate a long time don't quite haven't had the opportunity to wrap their heads around the notes. So, the note is the packaged deal. That is the loan documents. And the loan documents, your mortgage, right? We think of it as the mortgage but the mortgage is just one element of the notes. So, this is the paper side of real estate. The lending side of real estate. We've almost all been in a relationship with the notes but typically we're on the borrower side of the note or we're rarely on the note holder or the note originator side. But the notes package looks like the loan documents. Your contract. Your terms your conditions. Your interest rate. All of those that promise to pay. I promise to make these payments for this amount of time. That is secured to the property to physical property with that mortgage or deed of trust. So, the mortgage or deed of trust actually acts as glue that secures the physical property to that loan document as collateral.

And what's really nice in the debt world is that and to have physical collateral is really highly valuable. And for real estate investors, this is an easy leap to make because you understand the value of that physical property. You understand that if this person does not pay as promised, that you have the ability to take that property and make good on your investment. That's note investing. And what we do specifically is non-performing note investing and that's a little bit even harder to wrap your head around because why would you want to put your money in something that's not performing. But we look for the notes where the homeowners are not paying. They're not paying. We do a ton of due diligence to determine why maybe they're not paying, if they have motivation to get back on track with payments, it's owner occupied, they have some equity in there they've tried and stopped in the past, but they just need a little extra help. So, we go in and we work with the borrowers to restructure their payment plan so that then we can help them get back on track with payments and keep their home. And it's a very different strategy than saying, 'I'm going to, you know, go find foreclosed properties so I can fix them, flip them.' That's not our strategy. We do not want to end up with a property. We want the owner to end up with that property at the end.

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WS: To who are you buying that note from? The bank?

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SE: Exactly. Exactly. We buy them from institutions. We buy them from banks. We buy them from hedge funds. These notes are bought and sold quite frequently. And I'm sure many people have even seen their, you know… get a letter in the mail that their bank is…their mortgage is no longer owned by Wells Fargo, announced on by Chase. And to make payments to Chase, that's when your note was bought and so these are…

So, even in a perfectly good note, these are bought and sold all the time. The banks and institutions are constantly rebalancing their portfolio to be able to make certain loan criteria, right? They've got a lot of things to consider with that. So, they're constantly getting moving paper around as they say, and often moving. This what they call bad debt or debt that's not not paying out. They don't want to take the time to talk to borrowers. They don't even want to take the time to foreclose, typically because it takes… it's more expensive for them with regulations for them to foreclose. So, they kind of just want to push that out to the secondary market which is us.

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WS: So, they would rather sell that to someone like yourself and get something for it, as opposed to being a complete loss, I guess.

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SE: Exactly. Exactly. And that's the key there that we're able to buy those notes at a significantly steep discount because they're just trying to get something back for it. And even, you know, even not due to bad with it and in the end, you know, because the interest that they're making on this is huge. The banks know what they're doing in terms of making money. They figured it out. They're not losing a lot of money when they move this around. It's just kind of part of the market. But those of us who have specialized systems set in place to be able to manage these notes can really specifically target the exact type of notes we want. And what's nice is that these lists can even get passed around a little bit.

But every note investor might do things a bit differently so that's a really good tip for those passive investors that are listening. And then if you're interested in adding notes to your portfolio, talk about their specific business strategy because something might align with you and your goals. Are your values a little bit more than something else. You know, we go for first position, non-performing. And we help those borrowers get back on track and keep that home and then we sell the performing note. We were like the fix and flip of the note space a little bit. But we want to keep those fires in there. Other note investors might go for a second position non-performing, first position performing, or you might find note investing opportunities that's just strictly performing, right? You're not getting those. It is steep of a discount but it's the purest form of mailbox money that you can even think of.

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WS: So, let's back up just a little bit. I want to get into that business strategy just a little bit more for the passive investor; things they need to ask somebody like yourself, you know; but what about… just how do we invest in a note? How do we even find somebody like yourself? Or, you know, a passive investor that's listening. How do they, you know… It just seems like, as a person, for many that are listening may be brand new. We haven't talked about notes in a while on the show.

But how do we find somebody like yourself? And then let's dive into how do we know the reputable, you know, those types of things.

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SE: Absolutely, absolutely. You know, I think that I hang out in the multifamily space. I hang out at conferences. I hang out online. I'm trying to help investors, you know. I'm reaching out to as many passive investors as I can because I do see that it's a hard space to break into. I think that there's a history of it kind of happening, kind of behind the scenes. And maybe with people who weren't so reputable in the past. And I want to change all of that.

So, I think that if you're seeing people pop up into the same spaces where you're finding your deals, where you're finding, where you're meeting operators, where you're doing that as it is, then those are the people that want to show up for you. For the passive investor who is already in multifamily syndications, who's already a landlord in different spaces, and was already saying, 'I need to diversify my portfolio a little bit and I've heard about notes. I think that might be a good option.' So, I think the same ways that you would try to find new operators, new deals, is the way that you find out investors. But it is very important that you vet that, right? We want to see that they have a very specific business strategy and you want to see that they've implemented that business strategy in the past.

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WS: So, why should they consider adding notes their portfolio? There are… Let's say they're already passive, and multifamily or self-storage, or you know, some other type of large commercial real estate. Why add notes?

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SE: Absolutely. That's a great question because I do think that it complements a bunch of different real estate investing strategies really well. So, notes first are great way to diversify into many different markets. So, instead of putting your money into a single apartment building with 50 units, 100 units, 300 units, you're putting your money into different markets across the country and different notes. Now, your $50,000 might only purchase one or two notes, whereas it would, you know, go into one multifamily syndication, in one building, but if you're investing

in a note fund or a note pool sort of, you're bringing a larger capital as a JV partner. You're going to diversify that across different markets. So, that's one good benefit.

Another benefit is that it fits a different role in your overall tax strategy. Now, note investing doesn't have as many tax benefits as investing in real estate like multifamily. There's no depreciation because you don't physically own the assets you. You don't own that physical asset. You own the paper behind it. Now, you might end up owning that asset right in the end if you do have to foreclose. But interesting income is taxed as normal income. So, if you think about it that way, it's a good way to grow savings. Grow that to be able to put into a hard asset. So, it's part of that sort of ramp up strategy, right? And it also might be a better thing for your tax-sheltered retirement accounts because you're not going to be able to take advantage of those tax benefits within that account anyway.

So, put a high yield, you know, investment, such as notes inside your retirement account where you wouldn't be able to take advantage of that depreciation schedule anyways. And then I think that another advantage of adding notes to your portfolio is that it's a different side of the same market. So, you already understand real estate. You understand the value of owning a hard asset. But the debt side of it is just something a little bit new. So, it's not as if you're trying to break into bitcoin. You're not trying to pick stocks. You're not doing something totally new and foreign to yourself. It's something that you understand. So, we're doing the due diligence on that asset in ways that you're very familiar with already. And so, it's a kind of a good step to take in that direction to be able to diversify a little bit with your portfolio.

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WS: If an investor is investing with someone like yourself, what do they own? I mean, what do they have, you know, if they're investing through your fund? Or, you know, how does that work? And what's kind of the… I know we talked about the business strategy a little bit but if they don't say they're investing in a note fund, what are some of the terms they should expect in a fund like that? Or hold times? Things, you know… How does that work as far as note investing in a fund?

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SE: Yeah, that's a great question. Hold times are typically a lot shorter with this business strategy, with note investing. And I'm using that comparatively to multifamily syndications. We typically target to have notes back or capital back in 12 months. Now that could be six months to 18 months, sometimes as long as two years. But it's a little bit quicker of a turnaround cycle. Then investing in the multifamily syndication again, maybe there's a piece of your portfolio that you want to put in. That's another good reason to diversify in a note fund or in a note partnership. You might hear that that quicker capital hold time, you're actually owning the collateral file.

So, these are hard files that we, of course, are very heavily backed up, right? But it's a paper documents set that you own. And that's one of the three elements of the due diligence. In fact, we're doing investigation on the property in ways that everybody probably listening to this show's very familiar with. The market analysis. Rent analysis. Population. That sort of thing. We're doing an analysis on the person, the borrower, as to whether they can perform in that paper trail. We're looking for holes in the recordings. We're looking for mysterious liens that are on there that would impact our expenses or potentially make this just not a good investment in general because there's this just full of holes.

So, you're the owner of that paper. The power here is that you have the house as your collateral to be able to take that back. So, we're always underwriting to the value of the house, as it sits right now. So, we want that to be our minimum return threshold that if we had to foreclose, if we had to go through the foreclosure process, and end up with that house, sell it as is. We still want to meet our minimum targeted returns which are about 10%.

[END OF INTERVIEW]

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[OUTRO]

0:16:04.0 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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