EPISODE 1242

[INTRODUCTION]

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Vernon Beckford (VB): Well, many syndicators aren't gonna have a million bucks just laying around for them, and they would love to potentially pursue all five deals. So, what EMD funding would allow you to do is fund that deposit upfront and allow you to take control of that property without having to now scramble and potentially lose the deal because you don't have access to those funds. So, it's really meant to give someone a head start in a super competitive market where you have to move very quickly and I have to have access to capital very quickly.

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Sam Rust (SR): This is your Daily Real Estate Syndication Show. I'm your host, Sam Rust. Joining us today is Vernon Beckford. Vernon is the CEO of Diversified Lending Solutions, a capital advisory firm. Prior to launching DLS, Vernon has got a wide background in commercial real estate, he spent five years on the investments team, at Global Atlantic Financial Group where he helps build out the real estate group, which invested opportunistically in the senior mezz and bridge loans, and he also has worked at CW Capital and Asset Management Firm, where he oversaw a portfolio of distressed loans, served as the negotiating party with property landlords.

Vernon, welcome to the show. Thanks for joining us today.

[INTERVIEW]

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VB: Thanks for having me, Sam. Good to be here.

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SR: Vernon, as I was digging into your background, noticed that you started DLS in March of 2020, there's a few other things happening in the world at that time, you, some would say, best time ever to start a real estate focused service, but at the time, maybe not so much, what precipitated you going out starting DLS, and what were those first couple of months like as you were navigating through a pandemic?

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VB: Sam, I wish I could take credit for starting the business in response to the pandemic, it certainly didn't happen that way. My partner and I started the business with the thesis that having come from the institutional real estate space, that the quality and the access of capital for that demographic was dramatically different than small to medium sized operators. And even though the overwhelming majority of real estate transactions are less than 5 million dollars in size, the overwhelming majority of resources, whether its banking, whether advisory, whether capital market support is all heavily slanted towards large transactions. So, our thesis was to find a segment that has traditionally been overlooked or taken for granted and give them the same attention the larger firms have been accustomed to receiving for a very long time. Just so happened that Covid accelerated the business model that you found small business owners that were even more stressed out, even more confused, even more afraid, 'cause they didn't know what the world was gonna look like and from now, and they didn't have, in most cases, a massive balance sheet that they could just sit on and say, we're just gonna ride this out, and so in that moment it actually turned out to be quite certain for us because now folks are even more interested in understanding how they can be creative and rose to a world that's changing around us day by day.

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SR: That's fascinating. Again, in March we wouldn't have guessed that that would've been the outcome. Really, the appetite for debt continued to pick up, but obviously the government printed a ton of money to try to keep liquidity in the system, folks like you were crucial in connecting those people who really were in need as we were going through the lock with the capital that was necessary to keep the pipes moving. You talk a lot, on your various resources that you put out on LinkedIn on your website about working with syndicators, and I'm curious how you picked that as a niche ‘cause syndicators can be a little bit of a dirty word, particularly when you're looking at the financing realm, as a class of real estate investors, we tend to be a little bit more on the novice end not aware of industry norms, put together deals that are maybe a little bit outside the box, and so a lot of lenders give us the side eye, I'm curious what initially pointed you down that path, 'cause your background is more on the institutional side, what attracted you to syndicators?

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VB: Well, my partner and I view syndicators very similar to how I think a venture capital firm would look at a new entrepreneur. Typically with a VC, if you have an entrepreneur that has a disruptive idea and actually has a really strong plan on how to execute it that you wouldn't stop and say “They haven't done this before, so I completely dismiss them.” They have not had a billion-dollar exit, so I won’t work with them. That would be kind of silly, so for some reason, I think that there's an perception in commercial real estate that the same rules don't apply. Our point of view is that if you're smart, if you're hard-working, if you have the right people around you, everyone had to start somewhere. So the idea is to help folks who are already, by the way, finding great deals and already have done a lot of work to be able to figure out how to take them from point A to point B, how to make them look and feel to a lender that is just so used to things being a certain way. And so, I think the big part of the value we add is to “dust off” our clients, for lack of a better term, who are ready kind of checked eight out of 10 boxes, but those last two could prevent them from ever getting the financing thety want, and by virtue of them having that reputation, assigned to them.

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SR: Certainly, found that real estate is an unfair business, the guys who've been playing the game for five, 10, 20 years or a whole career, they just have built-in advantages. They tend to see the better deals first. They tend to get much better terms on financing, their processes tend to be a lot easier, they have all these teams built up. I was actually having a conversation on Twitter yesterday with the guy who was talking about all these hurdles that are somewhat unfair, I think it also serves to weed out some people who can't have it. The barriers to entry are high, if you make it over, there's a pretty good chance that you're a very competent individual, is that generally what you see is folks have that entrepreneurial mindset that you kind of mention that VC background, but generally when they're coming to you, it's a lot of people who are very capable, they need a little bit of help getting started off in their career in real estate, So Vernon, when folks like syndicators are putting together a deal, I think a lot of the focus is on capital raising, and we're going out, we’re networking with investors, in most cases, it's not the largest part of the capital stack, do you see that misallocation of effort having downstream ramifications when it comes time to searching for and eventually selecting a loan product?

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VB: 100% Sam, I see it all the time, even though equity may make up anywhere from 20-30% of the cap stack, I find that sponsors tend to spend 80% of their time on the equity. And I understand why it makes sense, right? Because if you don't have the equity, you'll never get to the debt, but what that means is that 65-70% of your cap stack, you're kind of taking for granted that you'll be able to get it over the finish line by virtue of spending that first 80% on equity. What I find is a lot of folks end up then looking into debt and realizing late in the process it is going to take a lot more time and effort than they thought, and that the terms they took for granted that they were, of course, gonna get because then they're deals are so awesome, in many cases aren't there, so I see it all the time.

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SR: And I'm curious, you're very intentional in your language, Vernon to talk about DLS and the fact that you guys are a capital advisory firm. You're not a broker. What's the distinction there? Why do you distinguish between those terms and what should we care on our side of fences – customers, what's the difference for us?

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VB: Sure, that's a great question. So, the way that I would describe it is that every advisor acts as a broker, but not every broker acts as an advisor, a broker, from my point of view, is someone that may take your deal and give you access to a whole set of lenders and cross the two of you. But how much time they actually invest in looking into your business plan in helping you refine your business plan, how much time they actually spend in the negotiations of the loan and structuring it in such a way that's advantageous to you, how much time they spend in helping craft a plan to help you grow, not just on this deal, but the next deal are all functions of an advisor, so when you think of a company that goes into Goldman Sachs or goes to any major bank and says, "Okay, Investment Bank, help me think through how I optimize my capital structure on this deal in the future, that's a much larger role than just simply calling up five or ten lenders on your behalf to see what loans you potentially get, so it's a far more expansive role, and I think that's why we're so effective taking someone who may have 500 doors under management and in a year's time, bring him to a 1000 or take someone who has a thousand and take them to that next major point in their career where they're managing 2000, which is very hard to do because when you start stepping into that next realm, you're dealing with a whole new level of sophisticated parties, and you simply require more unless you're very, very qualified on your own to have an advisor next to you.

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SR: For a lot of syndicators, the agency loan is the Holy Grail, non-recourse, relatively high leverage, you can get your, it's a menu of options, whether you want fixed-rate or floaters, and there's upsides to all those strategies, but what a lot of people don't realize, at least until they give somewhat down the path is that those agency loans are challenging, especially your first one getting that agency card is not easy, and there's also someone I think of one-track mind that we can get where it's like, well, we gotta figure out a big part of the capital stack, but there's all sorts of different boutique options that are also out there that can help round out the entire capital stack, one of the ones that I had seen on your LinkedIn profile that I've heard about, but I've never had a discussion with someone about is earnest money funding. I was curious if you could elaborate a little bit on that and any other two or three favorite boutique options that you see that maybe layer in with a senior debt piece, but could be helpful as you're pursuing deals.

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VB: Absolutely, So EMD funding is actually really, really unique in that funding that allows you to conserve your balance sheet at a time when your balance sheet is probably the most volatile. So, in a competitive market like today, you're making 5, 10, 20 offers, and each of those offers are going to require you to put up a deposit. Now, if every single deal was accepted at the same time, you may have to come up with a million bucks in cash, I'll give you an example, a couple of hundred thousand bucks per deal, and all five deals were accepted, that's a million bucks. Well, many syndicators aren't gonna have a million bucks just laying around for them, and they would love to potentially pursue all five deals. So, what EMD funding would allow you to do is fund that deposit upfront and allow you to take control of that property without having to now scramble and potentially lose the deal because you don't have access to those funds, so it's really meant to give someone a head start in a super competitive market where you have to move very quickly, gonna have to have access to capital very quickly.

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SR: What are the general terms on something like that, I would imagine that's kind of akin to hard money in rate and points.

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VB: And that's what makes it such an awesome product because from our vantage point, we view it as a fairly low-risk investment because we're funding the EMD before the deposit is gone hard, so it's typically a 90 or 120-day product, depending on how the PSA is negotiated and the cost is much cheaper than hard money, be anywhere from one to two points, so again, if you're calling on a $200,000 EMD, you're talking about coming out of pocket, 2-4000 bucks, which is a heck of a lot more attractive than having to scramble and either exhaust your personal resources or go to an investor who may require a fairly significant piece of equity in that deal for being the first dollar risk in the transaction.

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SR: It's very interesting, that is cheaper than I would have guessed, but I imagine that it's heavily contingent on being refundable they're gonna want out of the deal once the money goes hard, typical structure that we have used a lot as we get 30 to 45 days of due diligence and then another 45 to 60 days to close, so we're a 90 to 120 day contract, so we could get a loan on the EMD, maybe the first 30 to 45 days, but once that money goes hard, the expectation is we're gonna replace that money with our own funds maybe that we've raised from investors or our own. We sorted through that, had more time to figure out alternatives and pay the one or two points at that point.

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VB: Exactly, right.

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SR: It's very interesting, any ceiling on that, can you get EMD for larger transactions 1-2 million dollars or something along those lines?

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VB: Absolutely, and that's again, what makes it so exciting because once you're scaling into larger projects, it becomes an even bigger problem, and when you're trying to compete when this is the first deal, for instance, it may be 30, 40, 50 million projects, and those EMDs are going up we can match that as is.

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SR: Are there any other boutique products that you'd wanna highlight that might be useful for syndicators to know as they're chasing deals?

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VB: One of the cool products that I've really been speaking with people recently is about has been PACE financing, and I think PACE is an area that some people are aware of but most aren't, and it

essentially PACE provides financing for either new construction or value add projects to promote energy efficiency measures on those projects, so each state is different, and there are about 35 states that are currently participating in the program, but effectively so long as the operator meet certain energy efficiency standards, they can qualify for a PACE loan that sits alongside their senior mortgage and what makes that interesting is that that can help fill in the cap stack if, for whatever reason, the senior loan is either lower leverage or they just simply need to fill a gap with their equity check. In most states, you can fund 30% of the project cost of a project into the PACE and its non-recourse financing sits alongside the senior mortgage, and it’s usually priced as very competitive relative to senior debt in the (inaudible) five. So, when you think about your blended cost of capital with a PACE loan accompanying your senior loan, that can be a real enhancement to your returns because that's potentially equity at least for some component of that, that you didn’t need to raise.

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SR: When you say 30 you can get a loan up to 30% of the project cost, is that the purchase price or is that the cost of the energy efficiency projects that you wanna use the money for.

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VB: Its 30% of project costs subject to each of those dollars being an energy efficiency, compliant measure.

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SR: So that would generally, I would imagine, come into play when you have maybe a big window project, or you’re wanting to upgrade an insulation in a building or you're upgrading all of your interiors, new plumbing, all that sort of stuff?

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VB: Exactly right. Now, the challenge and where you would incorporate a DLS is that for many senior lenders, PACE is still a product that isn't well-socialized, and the senior lender has to approve a PACE loan, and so while there are some lenders that have gotten comfortable, there are many that either don't know what it is or I've heard the name and just say, I'm scared, I don't wanna figure it out. No, right. So, where we help the client is actually walking the senior lender through that process, working in conjunction with them, so they get comfortable with the PACE funding alongside, their senior loan.

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SR: It's interesting it... We've dealt with that situation a couple of times, you recently were our senior lender, they really get picky about who's gonna be a second behind them, I find the larger the institution, the more cookie-cutter they wanna get. If they're a little bit smaller, they might be a little bit more flexible and you can talk to the guy making the decisions, but having somebody on your side who's walked through that loan process before is really helpful. Kind of along those lines, I'm just curious if you've seen any products that would help, let's say you have an unexpected capital expenditure that you need to make on a property, you do have agency debt on it, but you don't necessarily wanna go down the supplemental path, have you seen any compelling options that would kind of fill maybe you need a loan called 5% of the overall project value and you're under 60% loan to value at the current time with your senior note?

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VB: That's an interesting question, it's a little bit more challenging even though it's low leverage because the senior lender is still going to have to approve that debt, and so in any case, whether it's 60, 70, 75, once you've gone down that agency path, that's usually very challenging to add on sub-debt after the fact, so that's why I always encourage folks when they're thinking about how they wanna capitalize their project, think about that in advance, because you may go into a deal with a very low leverage basis thinking that it'll be easier than it actually is to actually upsize that loan. That again, it is part of the preparation process and thinking through what the end goal for the asset is.

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SR: Just a note for all the operators out there, it's so important to capitalize your project correctly. I've seen so many groups that have been pinched halfway through their business plan because what do you know construction costs were overrun and even on large projects, 20, 30, 40-million-dollar acquisition costs $200-300,000 to make a world of difference when it comes to capital improvements. If you have a boiler, go out, boom, that's your 50k in the hole, it doesn't take very many hits like that to significantly impact your business plan and ultimately that cost to capital, even if you have to raise that additional, call it a half-million dollars, even it just doesn't lower your returns all that much, and it brings so much security to the project, so thankfully, we haven't learned that lesson the hard way, but we're definitely starting out. We had a couple of projects that I wish I had brought even just another 100,000, it didn't make that big of a difference for us at the end of the day, but I'm glad we learned that lesson early, and now we make sure we bring significant reserves that don't have any name on them, they're just there as in the case.

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VB: What I find is that many operators in that bucket become so hyper-focused when they go out to get debt on interest rate and leverage that they don't think through all the structural nuances that may make their life easier in those kinds of situations. It's almost as if you get a term sheet, okay, the rate’s what I want it to be. The leverage is what I want to be, it matches my model. Check, move on to the next thing. There are all kinds of ways that you can work with the lender in terms of how future funding dollars are distributed, when it’s supposed to be made to the operator, things like that, the structure really matter when you have these unexpected issues arise, which inevitably they always do.

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SR: It's certainly true, and so we're in a highly volatile environment these days, everybody's looking at CNBC, in the Fox Business Network and everything else, and just watching the tenure (inaudible) bounce all over the place. You've got rumors of war, you've got inflation seemingly running a mock, you still got supply chain issues, all of that is impacting the debt market for commercial real estate.

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SR: Well, Vernon, thanks for joining us on the show today. For folks who wanna get in touch with Vernon and learn about what diversified lending solutions can provide in the debt and equity markets, his website is dlsloans.com. You can also reach out to him on LinkedIn, and he's got a lot of good content, a lot of short two-minute videos talking about various items in the debt markets, I think you'd find him a valuable connection. Thank you to our audience. It’s been another episode of The Daily Real Estate Syndication Show. On your host, Sam Rust signing off.

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Whitney Sewell: Thank you for being a loyal listener of the Real Estate Syndication Show, please subscribe and like the show, share it with your friends so we can help them as well. Don’t forget to go to LifeBridgeCapital.com, where you can sign up and start investing in real estate today. Have a blessed day.

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