EPISODE 1329

[INTRODUCTION]

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Whitney Sewell (WS): This is your Daily Real Estate Syndication Show and I'm your host, Whitney Sewell. Today is a Highlights show that's packed with value from different guests around a specific topic.

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[INTERVIEW 1]

WS: Our guest is Omar Ruiz. Thanks for being on the show Omar.

Omar Ruiz (OR): Thank you very much, Whitney, it's a pleasure to be here with you.

WS: Yeah, happy to have you on the show, Omar. Omar is the founder of LeRu Investments LLC with expertise in analyzing property financials and due diligence. Been a real estate investor since 2009, that started in property management in 2006. He and his partner realized how important property management was to successfully operating multifamily properties so they decided to start a property management company with the goal of owning larger apartment complexes. Since then, they've owned multifamily properties in three states and also flip properties in California and Houston Texas.

Omar, thank you again for your time and being willing to come on and share your expertise with myself and the listeners. I'd love for us to walk through a little bit of you know – maybe you give us an example of a recent deal you all have completed and then let's walk through the due diligence process that you took. You know, from the time you even found the deal, you know, to up to closing and then maybe even after.

Maybe give us an example of a recent deal and let's walk through that.

OR: To me, there's two sides of the due diligence subject that you got the financial side and then you have the actual building physical property side of it. Both are very important. On the financial side, you know, when you're first looking at a deal, you have financial statements and the rent rules and other documented information that, you know, you're analyzing and putting your assumptions together to see if this is a deal, you know – what you're going to offer and be – and see if this is a good deal that you're going to go forward with. You're not actually able to do the due diligence on a lot of that stuff until after you get them to contract. That's really kind of where the rubber hits the road there.

Same thing on the building, the physical building due diligence. You can go visit a property, do a quick tour of it and look at the inside and kind of get an idea of what it's going to take for you to do, whatever improvements that you want to do or plans that you have in the future but, until you actually – once you get into the property and then you bring in other vendors.

For an example, it was actually a deal that I actually just recently had to walk away from. This deal had very sloppy financials on it. The property itself, I was okay with and I did bring inspectors to check the roofs. I had a plumber guy that came in and he scoped the lines on the plumbing there and that's when you know, you put a video. And one of the important things that came out of that is that he actually found roots in one of the main drain lines.

So, once we discovered that – okay, then we had to go back and kind of figure out okay, how are we going to overcome this? Are you guys gonna take care of that are not? There was a little bit of back and forth in that, but everything else checked out okay and then the other thing that came up is that they had the original windows there and this was out in Cincinnati so they get some pretty hefty winters out there.

There are windows and there are sliding glass doors were the old aluminum style and so those had to get redone so that played a factor in there. But the most important thing on that deal that forced me to walk away – the original financials that was provided to me by the broker were not sound officials. They weren't accurate and as we got into the deal, I had to really kind of pressed the broker and the ownership, especially on the utilities. They had a hard time getting the utility bills.

Eventually they did with a lot of poking and prodding and they didn't even know this but they actually had a couple of leaks in their water bill that was causing the water bill to be excessively. They had some utility issues there, but the main thing was, is that on their income side of the plate and on their expense side, you know, the income was not where they originally said it was. It was lower, and then the expenses were higher than what they originally did.

That's going to affect your return on investment there, and actually, Whitney, I was already in the process of talking to lenders on this deal, okay? I had actually approached like four different lenders on this deal. All of them were just having a tough time with the financials, you know?

WS: The deal was under contract now or it wasn't?

OR: It was under contract, yes, I have – we had earnest money, escrow and you know, this is – it's also why some people may ask, you know, "As a syndicator, why are you asking for fees or this and that?" Well, you know, I went to considerable expense, you know, hiring the inspector, the guy to scope the plumbing lines. I had a pest control guy out there and then I had a guy check out the heating systems in there. That all came out of my pocket. At this time, we hadn't even raised any money at this point.

Plus, I had to fly out. I'm in California, this was out in Cincinnati so I'm spending. I know I spent at least a week, maybe even two weeks out there. Obviously, I got to stay somewhere. Those are all dollars that are coming out of my pocket, you know? I put my money upfront there but that was on the contract. We had earnest money in there. I was already done with the due diligence and now, was moving forward to the financing side of it and that's when I talked to all these lenders and they just couldn't get comfortable with the financials that were being provided on this deal.

I wasn't very comfortable myself at that point but you know, I wanted it to come from the lender so that then I can tell the seller, "Look, here's a situation, I can't even get financing on this deal, okay? It's because the financials that you're giving us are just not working."

WS: I'd like to back up a little bit and ask you about how you started to discover this and I know you said the seller is as difficult to get some of the utility bills and things like that and sometimes that's a red flag that either there's poor documentation processes that they have, they're not tracking those things, or else they're going to have that readily available; you know?

Or else, they don't really want to show it to you, right? You know, in this case, you know, how did you eventually get that information?

OR: Okay, well, you're absolutely right about all those things you just said. Once we got out of the contract and I flew out there, I was able to really connect very well with the broker and the broker, you know, he enjoyed being there on the site, he accommodated me, and the guy was a total professional.

He liked you know, I was bringing all these guys in. The plumber guys, the H Vac guys, the pest control guys, the inspectors and then it was like clockwork. One, sometimes I had two guys on site. He knew we weren't messing around. You know, he wants to get his commission too, right? He wants the deal to close.

WS: You're under contract at this point and you've already put money. Money's going hard, right?

OR: We were still in the due diligence period. It was crazy, we actually extended the due diligence period I know at least twice and maybe even three times. It went for so long that we had several extensions and the seller was totally willing to extend it because they knew they were not performing on their rent and the story that I got eventually Whitney is that just prior to us going under contract, maybe about – maybe not even six months. Maybe about a six-month period prior, I guess they had this bookkeeper there that they fired because they weren't doing a good job and so they went through some staffing changes.

And in those changes, a lot of their financials and things just got really disorganized and the sellers, they're not – I wouldn't call – they weren't beginners by any stretch of the imagination but they were definitely not what I would call super organized and you know, on top their game. Minding the store so to say.

That's what was affecting them and so when they needed to gather up all this information, my god, it was like they were trying to look backwards to put it all together. I think this bookkeeper that they fired, I guess, did them a lot of disservices there and it seems like they got really loose with the delegation. They weren't really minding the store so much.

WS: What was the biggest reason you had to walk away. I know you mentioned the income was not where they stated or the expenses were also not where they stated but you know, was that the biggest thing or what else, I know you mentioned the windows and then even the leaks and things like that but was it just a combination or you know, was there something that said, "Okay, you know, any time this happens, we're walking away." Or, "This is going to cost too much to fix." What was it for you all?

OR: The main thing was the expenses. Just the expenses were not going to make the deal work. I could, you know, see and project kind of forward, kind of where I could take the rents. That was fine, no issue there. But the expenses – once I got to real information on that stuff, it just was not going to make the returns, you know, to what we needed them to be.

That was the main thing, as far as the physical due diligence, I was okay with everything else. I knew we were going to have to raise some extra money for certain things but there were some programs that I was looking at – and that was the other thing that I discovered while I was over there. This was actually thanks to the brokers. There was a special program there where I would actually be able to do a special type of financing to do the improvements for the windows.

I would be able to amortize it out over many years. That was great but I was looking for a specific lender that can work within that program and there were a couple of them out there but the thing was that they just couldn't get comfortable with the financials that they were – they were just not up to snuff.

WS: Okay, you know, are there checklists or anything you use specifically that help you know that you have looked at everything through the due diligence process that you need to?

OR: Yes, actually, we do use a check list. We have a check list that we use ourselves and basically, it's a pretty involved checklist. It's several pages long but you know, it's got all the broker's information, all the different building mechanicals that we had to look through. The utility companies and all that stuff and yeah, the checklist, I mean, we use checklists for many things. Even for make readies, qualifying applicants. I mentioned to you before the show, you know, my background is in aerospace so we use a lot of checklists in aerospace.

WS: I bet. So I know you all have properties in Cincinnati and Texas and you are flipping properties I think in California as well and you all are self-managing all of these properties is that right?

OR: No, when we go – except for Houston because at Houston our partner is out there. But when we go out of state like I am right here in Indiana right now, we go with third party property management companies. We like to work more with the properties that have a CPM designation or the CCIM designation and it is a certain designation that you get after you have completed a certain amount of educational course work and you've had some on the job experience, and basically those are folks that are more career focused towards the management business.

WS: Right, okay and so through the due diligence process, you know, how much are ya'll on site? You know, you're living in California. This property is more than half way across the country. So how often were you there? How much time did that take? You know, for people that are looking in other markets out of where they live, how much time were you having to spend there personally, or how time did you just have somebody else that is still in the ground there doing these things?

OR: Yeah, I know on that last deal that I was just talking about, I know I was there for at least a week, maybe even two weeks, and sometimes what I like to do and maybe one of the nice things about the business here is that you do get familiar with a lot of different areas of the country. You know you're going to do a property tour or when you are doing due diligence, I mean, you get the opportunity to actually scout around different marks, I love doing that.

I love scouting different areas. I love seeing how the people live. How the communities are and I really enjoy that part of it but I am there every day to answer your question.

WS: Okay. And then anything else in the due diligence process that you see that a lot of operators miss that you want to bring up to make sure that we know to look at these things?

OR: Yeah, in fact early on, one of the biggest mistakes that I did – and this was back on the California deal. This was a property that we didn't verify rent deposits, okay? And so they were giving us a rent roll and these income statements saying, "Okay yeah, these tenants are paying." And everything looked okay. All right, fine. Well you know after we closed, we find out that like half of the people would not even paying but luckily it was a small deal.

It was only 13 units so once we knew what was going on, we just started just evicting people immediately but that is something that I would really caution people, I've actually talked to people that have had that same experience. Not verifying rental deposits. Now, sometimes that can be a challenge and on one of our best deals actually out in Houston, Texas, the seller – the way he ran his bank accounts, and I would not recommend that anybody do this, but, you know.

He had a construction company but he also owned several multifamily properties, but what he did is that he lumped all the income from all of his apartments into one single bank account. Yeah, so he had no way of separating up – and we weren't buying his whole portfolio. We were just buying this one property in this larger portfolio, and he had no way of separating that out of his bank statements of course, you know? So we had to rely on some of the deposit records that his on-site manager had.

And that we weren't super comfortable with that but you know at the end of the day you have to be – you know I remember an old mentor saying, you know, "Sometimes you have to make perfect decisions with imperfect information."

WS: That is right and I am glad that you learned about the occupancy issue on a 13-unit not a 130-unit or a 200-unit, you know? And that is the difference in the economic occupancy and physical occupancy, right? That is why we have to know the income and – How much should it be making? How much this is actually there, but like you said, when you get into financial statements and the previous sellers mixed it all in with something else that is difficult, right?

I mean like you said, you make the best decision with the information that you have, awesome. So, going forward, how do you prevent that from happening?

OR: Well you want to ask for bank statements, the way to do it, and if your bank statements, they match up, they may not match up perfectly with the PNL, you know, but as long as they are in line, you know, you don't see major diff – you know, you see a big $20-30,000 difference or something like that then you know something is up, okay? But bank statements are really the only way you can 100% verify that the income that is coming in is in fact that income.

Now, just so your listeners know, I have had it before where the seller was not comfortable with “Hey, I don’t want people seeing my stuff,” and all of this and that, and I said, “Okay, no problem. If you want, here is what we can do,” and I went into his office. I said, “Look, I am just going to take pictures of your bank statement and what I will do is I will take a little sticky memo and I will put it right over the bank account number so nobody sees the bank account number and you don’t have to worry about any nefarious activities.”

[INTERVIEW 2]

WS: Our guest is Dylan Marma. Thanks for being on the show, Dylan.

Dylan Marma (DM): Thanks for having me back in the show, Whitney.

WS: Anything else that you all are like, “Okay, we have to look at this.”

DM: So, we have a due diligence checklist, right? And that is extremely important for us because there is a lot of small pieces moving all at once. Especially if you’re in capital, you are working with investors, you’re answering questions, juggling relationships with the lender, you are juggling stuff with you attorneys. You have a million things you’re juggling and it’s hard to stay focused. So, to stay focused and make sure it will be, you need to have some kind of a checklist in place.

So, we are paying attention to everything from making sure we have our survey done, our title work done. If we face one, checking if you need a termite inspection, checking with code enforcement. We are going to scope plumbing lines. So, making sure we have – we always run a camera down on the plumbing lines because that is going to be one of the most costly things that you can overlook, especially if it is an older vintage building to pay attention to that.

I am going to look for your CO’s or your certificate of occupancy checking with you if something is needed. We just want to check the flood maps, usually, you want to do that prior to due diligence but always double-check yourself there to have your insurance in. You are going to want to see capital improvements. So not only do you want your operating statement but what kind of money have they put into capital improvements that are going to materially impact the property.

You also want to catch that because if they have just been everything below the line as capital improvements, you want to know that truly in a big way how the property is being rented. It is becoming more and more common to this day and age. And you want to check for any pending litigation. You want to look at all of the operating statements. You want to check the bank statements and make sure that those match up with [inaudible 0:15:15].

Go through all the bills, all the vendors. You want to see every single one [inaudible 0:15:18] ground and see where you can save money. Often times they haven't negotiated these contracts so this is always where you find your value-add is have they really negotiated on the trash. Is there ways to cut that down? Are there ways to cut out cable contracts? Is there a contract in place that you are going to have to go in because that can make the difference in terms of expenses, right?

So, you want to pay attention to that. Insurance loss runs, any additional maintenance record, those are the big ones I would say.

WS: No that is a great list right there, no doubt about it. Going back to something that we talked about earlier, doing this due diligence process in a week and going into a deal and knowing that from the beginning I think it is a testament to your team and your own ability, how structured you all are. You know everybody can know their lane, what has to be accomplished or else you are not going to even try doing it within a week, right?

It's definitely given you all of that competitive edge and I think it is interesting knowing like this deal being as new as it was, it would have been common on something that new to have went hard day one I think with a lot of teams.

But I think it was wise obviously here that you all didn't do that.

But is there anything behind that decision to not go hard day one? I mean you still won the deal as far as getting it under contract. But anything behind that decision that would help us to learn how to be that cautious as well even on a property that is this new?

DM: So, I think that we could have made the decision to go hard day one on this deal if we were a little bit more diligent on the front end and we knew that, right? We knew we had to buy time to get on there and go through and visit. But if we had at this point, it really is just a matter of you talking seven days versus zero over [inaudible]. It is not a huge difference but if you are going to go hard day one, which is very common on new properties because of the whole –

Often times in multi-family there is a huge as-is clause on the contract, which is you are going to assume every single problem that could possibly be in existence with this property and you are never going to ask us for a dollar again as soon as we close. That's normal, right? That's how it is. And obviously on older properties that are 30 to 40 years old that require due diligence because there can be a lot newer properties the typical thought process is what could be wrong when it's brand new?

Why don't you just put some money down hard? And there is probably a little bit less that could be wrong. I would say if you are going to even consider it, which you might have to if you really want to compete, you are going to be doing newer stuff. But make sure that you give yourself time to get physically out there on the property. If you can get in the units ahead of time and actually do a – it's kind of a fake due diligence but it would be an early due diligence before the contract's actually signed.

If they would let you do that, that would be one off that would be the best-case scenario because you are still getting what you want and you are just doing it in a way where you are doing it before the PSA's technically signed. And if that is not the case, I would have very least make sure you bring someone that's smarter than you or I might be when it comes to the bones of the building out there with you during your initial tour if you will and go through as many vacants as you can possibly get into.

Maybe check one or two that is someone's living in so that you make sure the vacants aren't all pretty and there is something hiding in the ones that people are living in. I'd got into at least a good sample size of unit and make sure that they're looking at everything that they are important that would be a major threat to you. That is actually what we are in the process of right now as after taking this and reflecting and learning, we are going back and we're thinking to our self, "What are the negotiables," right?

Like I said there's you can live with and there's some things you can't, right? So, let's identify what are the things that we can't live with and make a clear list of those? So that even before we even go into due diligence or go into contract we have that clearly spelled out. We have already checked all the boxes to make sure that we could move forward after taking [inaudible].

WS: Yes, you know one big thing that just seems like that's been crucial here is that you have expert team members in specific fields and I want to be very smart in all of those fields however I want to understand that I am never going to be the smartest person. I don't want to be the smartest person on my team about plumbing you know? So, you know that's awesome that that is just the team that you all built but –

DM: It takes time to get there too because for me I am such a big learner. That is where I get my energy. I love – like I want to learn everything about everything. But there is just so many things to learn in this space that you to come to reality at some point and say, "Okay, well this isn't my forte. Let me specialize on the acquisition side. Or let me specialize on the asset management or operation." Let the experts be the experts in this area because it would take so much time that it wouldn't the best use of my time to go and study this stuff to the core.

[END OF INTERVIEW]

[OUTRO]

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