EPISODE 1372

[INTRODUCTION]

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 Debbie Bloyd. Thanks for being on the show, Debbie.

Debbie Bloyd (DB): Hi. Thanks so much for having me.

WS: Okay. Let's focus on that a little bit as far as an investor looking for their first deal or types of financing that they should be thinking about right now. I know lots of listeners are still – They're looking for that first deal there and they're – That first deal is so important, and financing is such a big piece of it. I know financing can just make or break a deal, right? I mean, depending on what type of financing.

DB: Yeah. I mean, I'm not an investor myself, so I buy and flip properties, and I buy properties, and I've held them. Right now, I took out a hard money loan a couple of years ago to buy a little house. We tore off the roof. We added an extra 1,500 square feet. Now, it's up for sale. It's almost finished. That was a hard money loan, so those rates are going to be in the nines. You take what you can get, and there are a lot of different ways to do it. There is a construction loan that you can get. You just buy a regular loan, a 30-year fixed rate mortgage on like a duplex or a fourplex or a single-family. Then you're going to need your cash to make improvements.

There is one loan out there. The thing is if you're an investor, you don't buy it as your primary. FHA has a loan product that you can do some rehab on but you have to have it as your primary. I know a lot of people build up their investment portfolio by going house to house to house as their primary. You buy something. You move in it. You fix it up. Then you sell it and you do it all again. That way, you're always borrowing money at least at the lowest rates.

WS: Can you speak to that construction loan a little bit. I think that's a popular thing that people need when they're getting into the business, but then you mentioned you need your cash to make improvements. Tell me a little bit or let's talk about that just a little bit.

DB: Sure. FHA has a program. A 203(k) I believe it is. I don't do that many of them because their requirements are kind of hard. If you buy an FHA house, it has to be a primary and you have to call it your primary, so you've got to live there. A lot of people don't like to do constructions loans when they live there.

WS: Is there a certain length of time you have to live there?

DB: No, but you just have to buy it as your primary, so you have to either take whatever you're living in now and call it an investment and move there. FHA is pretty tough. They're going to make sure you're going to change your address and do your stuff that you're really moving in there. Then you have to provide them, when you first get the loan, you have to also provide them with a set of plans and what are you going to do to it. If it's just lipstick, if it's just wallpaper paint, new cabinets, you've got to have an estimate, and they have to approve that estimate. It has to come from a real builder that they can vet.

The problem for most of my clients is if they buy a house like that, they're going to fix it up themselves. This loan doesn't allow for that, so you'd have to hire a contractor. You'd have to – They would have to have insurance, and so it's a bigger process. Most of my people that want to buy a house, live in it, and fix it up, and flip it, they want to do all the work themselves, and so they simply can't qualify.

WS: What about multifamily properties or something? If I'm looking at, say, a four or a fiveplex. I know one's going to be residential. One's going to be commercial. Maybe you can tell us and talk about that.

DB: Yeah. If you buy a fourplex, you can still buy a fourplex on a one-time like a primary if you're going to live in one of the units and you're going to renovate the others ones. If you buy it strictly as an investment, the way it works is you buy the property. You're putting 25% down at current day. With COVID, it's really put a kibosh on a lot of transactions because what used to be 20% down is now 25. What used to be a 680-credit score is now 700. Or we used to get into houses at 620, and a lot of lenders have their FHA loans to 640.

But as a broker, I'm signed up with a lot of different companies, so I could still go down in the fives. They're just called alt-A loans, and not every bank has them. I had a client in last week that she was denied at one of the bigger banks, and it was because her score was 613. But I can do those all day long, so you just have to know where to look.

If you buy a fourplex and you put your 25% down, you're going to need to also have money set aside for the construction of it, the improvements. Remember you're going to do that after you

buy it, and there is no way to roll that into the loan. You either have to have an equity line of credit at your bank or you have to have the cash to do it.

Right now, of course, cash is king. So, if you have cash, then you can do it yourself. You can hire subcontractors that aren't licensed. But if you are putting into some type of loan that a bank has to approve, everybody has to approve. It's really cash is what you're using to fix it up.

WS: What happens then if we are going to finance a five plex or something larger? How does that loan change?

DB: A commercial loan, right now, a lot of them are asking for 30% down instead of the 20% down they used to, and your investors have to have financials. Yes, you can buy it as a person but you can also buy it as an LLC. If you've made an LLC, that's a commercial loan. Anything over a four-unit is a commercial loan. They also vet your company. Certain banks don't require any seasoning on your LLC, and you have to have money in your LLC. That means when you're first setting up the company, you're going to deposit money on that account for the LLC, and they're going to have to see money in there to make you legit. Then they go on vetting you, so they have to see are you the primary sole contributor and owner of the LLC or are there other people in play?

I've got a lot of clients that have gone in with siblings or business associates, and they make an LLC. They all throw money in the pot and they think that LLC is going to be able to survive on its own merit because it's brand-new. No. They've got to pull financials from all four people or all two people, whoever makes up the LLC because if an LLC is less than two years old, they want financials on everybody. It's got no track record. I'm afraid that most investors don't know all these things. They get all excited to buy a property and then they find out that they haven't had the company long enough and they have to go hard money at that point.

WS: Could we buy it, say, on contract with an established entity and then have a new entity that we put that property and when we close?

DB: No. It has to be vetted. If it goes through the bank, you can't flip it. You can only flip a property. Where most of my deals go, it's their personal name and they buy as an investment property, but they're just stopping at fourplexes. They're not ever doing commercial stuff because once you stay commercial, you have to stay commercial.

Once you buy it as an individual like I could buy something as Debbie. Then when I close and it funds and I own it now, I can on the paper move it into an LLC so that liability goes into the LLC, but the LLC has no track record. It has no money in it. It's just kind of an empty shell, so I have to buy it in my personal name. You get a much better interest rate when you buy in your

personal name. Commercial loans can be 5 and 6%. When you buy something like a fourplex in your personal name, you're down at 4%. Underwriting is much easier, so people buy it.

You've got to be a real established LLC to buy it commercially. Most people don't know that, so they just start out the paperwork and they think they fund it; they put a hundred thousand in the account; they're good to go. No, they've got to have a track record.

WS: What does that track record look like? What does that consist of? Is it just doing numerous deals or –

DB: It's having money in the bank. It's having them pay rent. It's having rental checks come into that bank account. It's to show that they're real but it's just not a friend for something else. I think half of the legitimacy is not money laundering, and the other half is just knowing that they have the money behind it. The more properties you buy, the more you have to have in savings in a 401(k) or an IRA or cash to qualify. You always have to show with your rental properties that you've got six months of principal interest, taxes, and insurance for every property. It's easy for the first one.

The second one gets a little tougher. By the time you've got 10 properties, you've got to have a lot of cash behind you or you don't get to buy the next one because it all adds up every step of the way. You've got to have six months of every single rental you have saved up. Not that you have to have it liquid but you have to have it. It can be invested in mutual funds or an IRA, but you still have to have it somewhere that they can see it so that if you – If something happened like this, which no one ever thought would happen, this pandemic, people can't pay rent. How many months can you go and float without being bankrupt yourself? If you have no cushion, you're going to go under yourself. The banks have added those requirements ongoing just to make sure you have enough and you don't upside down.

[INTERVIEW 2]

WS: Our guest is Eric Johnson. Thanks for being on the show. Eric.

Eric Johnson (EJ): Whitney, thanks for having me.

WS: Why don't we talk a little bit about just debt strategies and just how they align with different types of investment niches?

EJ: Yeah, absolutely. So, I will try to make this super concise and just super digestible. If we're just talking investor financing here. I mean, let's look at the main strategies. You have fix and refi, or we fix refi, and hold, which is essentially, BRRRR. And then you also have five plus, so

five plus units or multifamily, and at that point, it's a different game in terms of the debt. So, let's tackle the fix and sell and fix and hold since that's probably what 99 investors are doing on one to four-unit properties.

So, for fix and sell, you have essentially fix and flip loans. That's short-term bridge lending, that's a percentage of the acquisition and you get your construction. That's what enables you to do deals and then whether external investors for the equity piece is kind of – it's a non-factor. But that's where the debt is coming from. So, if you're an investor who wants to flip, that's what it is. It's probably a 12-month bridge loan, 80% acquisition, 100% construction, and then that's what keeps your business rolling from a debt perspective.

For a fixed and refi. So, for a BRRRR deal, you're going to have two pieces. And this is why it's a little more complicated than just a fix and flip, because the fix and flip only have one debt, what I call stage for any deal that has a refi, you have two debt stages. You have the initial front end, which is the acquisition, which will still be a bridge loan because you still need to fix the property. And on the refi side, now you need to make sure that your LTV is lined up with your payoff and the market value of the property right.

So, on the refi side, you're going to be looking at, if you're an investor who can't go conventional, probably an asset-based commercial loan, based on the debt coverage ratio of the property, and that's going to be the two debt stages for BRRRR deals. And I advise investors, to keep your ARV or keep your payoff to 70% of your ARV. Some people push it to 75. I don't usually like to advise on 75, just because it can be tougher, it can eliminate some of your options, especially with a situation like COVID. If a shift in the marketplace happens, you want to make sure that you're protected. But roughly, if you're a smaller investor on one to four-unit properties, those are kind of your end games for debt. Just a very brief overview.

WS: Yeah, I think most of the listeners are going to be doing that the five units or more, they're going to be in larger commercial real estate, and looking for obviously agency debt or bridge debt for larger properties or different things like that. What about, just as they are looking for debt right now, just with COVID, and everything that's happened, could you just speak to that listener right who's trying to get into the syndication business, they're looking for debt, what are their challenges going to be right now in the current market with COVID and everything that's happening?

EJ: Yeah, absolutely. If you're a syndicator, if you're experienced, or a syndicator listening, there are a lot of moving parts right now. One is leverage in the marketplace has significantly decreased. Because secondary market investors are really skittish, therefore, reducing liquidity in the secondary market. So, where those dollars were really flowing, you know, pre-COVID, they're not really. Even Freddie and Fannie are at 75 and they were 80% all day, before COVID.

So, you need to be careful about what leverage you're, you're anticipating. And then the second part is how you're structuring your deals from an investor standpoint and making sure that that's clear, especially in a saturated like this. I know a lot of my clients are, they're not winning deals, they're submitting offers. And there are just four other offers on the property, especially for multifamily.

So, going back to the entity structure, make sure you have all of your LPs and external investors in line, making sure that that deal structure is clear from the beginning. So, there's no time wasted, because depending on that structure, how you set up your entity, and how you set up your investors within that, that entity, usually a single asset entity, then play into the underwriting of the deal, and you may need to switch something. That's why it's the best idea to get it sorted out at the beginning. And I see a lot of syndicators run into that issue, where they're scrambling and trying to figure out their LP or their investor structure, just because there are some things that came up in the process, which is normal, but that's why you need to stay flexible.

WS: So, let's talk about this a little bit. You're talking about leverage has decreased, and how Freddie and Fannie are now 75%. What will that typically do to deals? Are those going to kill most deals? How do you see that on the lending side? What are those barriers? And how do we overcome them?

EJ: Yes, so, I wouldn't say the 5% neck in leverage is in itself a deal killer, right? Because you can still raise that 5% equity. That's not a big issue. Really, the issue is even on agency debt right now, there are COVID reserves. So, that's the big thing. Before, obviously, pre-COVID, there was no such thing as COVID reserves. Usually, you have your net worth and your liquidity requirements, but right now, they're actually having the sponsor's escrow maybe six months of P&I in addition to cash to close.

So, the borrowers are coming in with pretty much more equity, and in some cases can be nine months. And I know, as of a couple of months ago, it was PI/TI as well, six months PI/TI. And then some people are like, "Well, depending on the size of the deal. If it's a large loan amount, that could be a decent sum of money." So, people and sponsors were kind of backing off and they're like, "Oh, this deal is not too good." So, they kind of pulled the plug, but as far as rates go, I mean, obviously great rates, but it's just getting over those reserve requirements. So, that's really another key thing that if you're a syndicator in this market, and you want to do deals, just expect some kind of additional liquidity or reserve requirements on top of everything.

WS: What's been the process or what you've seen up to this point of getting those reserves back?

EJ: The agencies are essentially holding that in an escrow account and from what I mentioned that they've put out, actually publicly, when the COVID reserves kind of back off, the borrowers and sponsors are going to have to request those funds back. So, if it was a COVID-specific escrow account or requirements for the loan, in the loan docs at funding, when those are backed off in the future, whenever that is, then the sponsors are going to have to go back and essentially reach out and say, "Hey, my property is operating at 95% occupancy. We're good. The COVID guidelines have backed off. I would like to request my funds back from this specific account." And that's usually how you would do it. That's the most direct way.

WS: Okay, so we got to go, we got to request that and like how you mentioned there. We represent ourselves well. I mean, the property is operating this well. This is what's happened over the last year. This is our occupancy. All those things. So, we can just bolster why they should refund the reserves or give those back to us so we can use those or distribute them back out to investors as well if we didn't need that at the moment. And so, you talked also about the importance of structuring the deal correctly and clearly from the beginning. Could you elaborate on that? What does that mean, exactly to the lender as far as structuring it clear from the beginning?

EJ: Yeah, it's going to depend on which program, I guess, the asset or the deal falls into. Because, obviously, if you're going to go something like agency versus CMBS, CMBS is a little more lax, I guess, is the right word. And that's usually the tier below, something like the agency. Agency is going to be more strict, you're going to have to follow what they require and usually, it's a single asset entity. If you have outside, you usually have an LLC just for holding the investors. So, you don't usually put yourself in as a member of the LLC, and then slap in your 20 investors. As members, you usually have one LLC that's maybe you and another general partner. And then you have another LLC in which all of the other LPs are in, and then the LLC that you and your other general partner own, the LP/LLC is contained within the GP LLC, so to say, which is the GP, LLC is the title holder.

So, that's, that's generally a clean, acceptable way to do it. Obviously, it's going to depend, but that's a pretty clean way to just keep everything nice and in its own separate domain. So, there's no crossover confusion.

WS: What are a couple of ways that you've seen people get creative with lending to just help explode their growth?

EJ: Really value-add. So, syndicators are all about value-add. So, in my experience and funding these deals, really, it's going after bridge debt at the beginning. So, if the sponsor really identifies a good value-add asset, and there's a lot of potential for upside, you can definitely

come in with a bridge loan at 75 LTV and maybe 100% construction. It's essentially going to be like a BRRRR deal, but for multifamily, if you want to think of it like that. So, you're essentially fixing it, rehabbing it, stabilizing it, and refinancing. So, if you're a syndicator listening to this, if you can really use bridge debt creatively in addition to an equity raise, and by putting those two together, you can really come into a deal very strong. And by the time that you fix up the property, and hopefully underwrite conservatively, you still have a lot of upsides to capture. But once the property is stabilized, once you refi and hold it, you should be able to capitalize on even a cash-out refi and disperse some of that equity back, and obviously, lower your rate and, and get better terms on it.

But again, you know, on the value-add side, still going to be, probably a 12 to 24-month bridge loan, depending on how big the project is. If it's a 50-unit building, it needs a million bucks in CAPEX, then we'll probably shoot for a 24-month initial plus some six months extensions here and there.

[END OF INTERVIEW]

[OUTRO]

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