EPISODE 1413

[INTRODUCTION]

Whitney Sewell (WS): This is your Daily Real Estate Syndication Show and I'm your host, Whitney Sewell. Today we packed a number of shows together to give you some highlights. I know you're gonna enjoy this show. Thank you for being with us today!

[INTERVIEW 1]

WS: Our guest is Ian Walsh. Thanks for being on the show, Ian.

Ian Walsh (IW): Thank you for having me.

WS: You know, you mentioned like helping us think like a lender and what that should look like and you know, analyzing a project, you know, how a lender would analyze it and we can understand what that should look like.

I'd love for us to dive into that Ian, break that down a little bit and so you know, help us to get started though or maybe where you know, most people make their mistakes in doing this but yeah, get it started.

IW: Yeah, without a doubt, I would say, don't overthink it, right? People send me spreadsheets and stuff and I'm like, if you're putting, a lot of times they're overcomplicating a good deal. It's got to just work on a few fronts typically. Just take away an easy example of like a single-family flip or an investment property that might be a single-family flip or even a small piece of commercial, that's buy it, fix it, renovate it and then lease it out. Is that – you make your money when you buy.

I know it's the oldest saying in this game but it's the real answer, it breeds you either room for error or profit but if you buy too high, you have no room for error and you'll make no profit and a lot of people lose before they even get to that point because they're buying it too high, they don't understand really what a project or a deal looks like in their market and really where they should be buying, you know, a property of 20 or 30 cents on the ARB dollar versus you know, 60 or 70 cents in the dollar there that I see a lot of times because they don't know how to analyze the property, to begin with.

That's where a lot of people go wrong I think. From a simple numbers perspective or a simple outlook that you've got to buy deep enough, you've got to then make sure your construction or renovation costs if there are any which almost all the time are to bring that property up to value are accurate.

A lot of times people like to pay too much, and put too little in, and in between those two things, there's no profit there. I see that and that's really like if you're going to think like a true private lender, that's what the focus should be, the asset, where you're buying it, how much you're putting into it, and what's that potential value.

Everything in between in terms of like credit, tax returns, all that other stuff, if you're using that, you're really not a true private lender in what you're doing and you don't really know what the asset's worth, you're trying to actually end the bar or to offset your risk.

WS: Don't overcomplicate it, don't overthink it, it's hard, right, I mean, it's hard not to want just to analyze it to death and just I mean, make it this big ordeal but I'd love for you to elaborate a little bit on you know, thinking about getting our property cheaper or maybe the actual steps of the way that you're going to underwrite something. To know that we're not overpaying it because it is when you buy, I mean, the money's made in and making sure you're not overpaying.

What are some tips or things that you use then to make sure you're not overpaying?

IW: I'd love to tell you there's a shortcut to this but there's not. It's screen time, it's so – I'm always in front of my local MLS systems. MLS is your multiple listing services, you can't really do this with the free sites out there, they're not going to name any because you know, you really have to have the data and insight into your local MLS systems and then it just constantly, you know, nowadays, the technology, you have a map view of just like Google maps or whatever when you bring it up, you know, you can see exactly where the house is or do the street view.

You know, you can do that but with sales data, square footage data, all that kind of stuff. Very quickly you can identify when you know, if the deal comes in, it may or may not be in a good range just based on maybe you're filtering criteria of however you're answering it butt let's say it's something worth looking at, you should be able to bring that up in your MLS system and know within a minute that hey, there's something here.

Maybe it's not exactly the right price right now but this is worth fishing, and then from there, you can basically in a map view just determine extremely quickly, you know, is this area hot, are properties selling it the right price, are these only investor pickups? You know, is there something else here like this, like sometimes I'll see with like huge commercials, like a 10-million-dollar commercial deal, on paper, on spreadsheet looks fantastic and maybe if I was underwriting it based on you know, a lease, a rent role, maybe this works but you know, that

type of underwriting to me is really scary because if I don't have a comparable sale that I can pull up in a map right away and look at –

Having to deal with the rent roll, it really is saying okay, the guy operating this thing is really the business owner of this building and because of that, however, he decides to you know, whatever type of operator he is really what I'm investing in. That's not all the leases and the building and they certainly helped, obviously to have rent in place but a bad manager or a bad owner operating-wise can destroy the inside of a leased building quickly.

What I have to do then is say as an underwriter or somebody who is looking at a project, okay, what's my potential out value? Well, I don't have something I can pull up on a map and go, this is the value, and then I'm just speculating. I don't like to speculate as a lender. That's not what I do, I look at the data and go, this is what I have.

It's very important for me or somebody, they should be able to pull up, look at recent sales, you know, within the last year, call it, of very similar property types and if they don't have a very comforting, easing, obvious answer, right then and there, they're probably in the speculative zone which they want to remove themselves from and bet their own money on a deal.

WS: Where are you going to find those recent sales?

IW: I find them in my MLSs. I'll go into my MLS and I go okay, this is search criteria, pretty easy and you know, last zero to 360 days and I'll put a geographic bubble that I'm comfortable with, typically the last small other people think it is, you can't go – most regions, you can't go miles outside of where you are, you're usually within one-tenth of a mile of where you're trying to buy to determine where those other properties are.

I'm going to go in my MLS and pull a geographic and time area that's all similar and then look for houses, commercial buildings, or whatever that I'm looking at that are very similar. If I don't have any, I don't have the value I'm putting on guessing is what that is, I don't feel comfortable guessing.

WS: Il couldn't agree more, you can't guess in this game, that's for sure. Can you share where you're getting some of this data? Because the data is so important, right? And then we're going to make their best decision based on this data but I know a lot of people are saying well, where do you find the best data?

IW: The data I have is all just from multiple listing services, fortunately, I'm in a market that has like, from what I can see or have seen an exceptional multiple listing service that it's very

user-friendly when I say that compared to the other ones I've seen, there's about maybe like nine or 10 in my local market that I essentially am part of.

Easily, there's two that are the biggest and then one that is fortunately in my market, the biggest that I deal with is also the most user friendly and you know, if you had to like – put yourself in a position, you can have different outlines and different ways to display something but ultimately it needs to be visual, I find it needs to be visual and easy to hover over and move around very quickly. If you're in an MLS system that's like archaic in its data or the way it displays, only displays maybe a list of properties and you can't visually see it on a map, that kind of stuff makes picking a value out difficult.

Mine's very user-friendly and very appreciative being in that. I would say, if people are looking, first thing, do yourself a favor and get comfortable with your MLS system locally. Every area will have its own MLS system that they –

WS: Sure.

IW: Yeah.

WS: Help us to think like a lender. You know, what should we be thinking about and what does that need to look like or maybe ways that we wouldn't even know that things that they were thinking of?

IW: A lender, you know, a private lender, I can't speak from a bank's perspective. If you go to a bank, there's nothing wrong with banks, banks are fantastic but usually when you go to a bank as a borrower, the bank is really – we're all asking how much are we risking. We're all saying risk. That's all we're concerned with, we're not concerned with profit, we're concerned with risk.

Minimizing risk is what our game is about, go to a bank, they're going to offset their risk with you being a borrower or like what your skillset is in terms of credit score, tax returns, all that kind of stuff. They don't really know much about the asset. True private lenders are going to be focused on the asset. The way I as a lender, do want to think like a lender and really feel like flippers should think this way, commercial guys that are retail or commercial guys should think this way.

Because if you think this way first, it's all gravy for you, you know? If you think then, what the upside is. I'm always thinking how much am I going to lose if you die tomorrow, you buy my deal, you die tomorrow where am I and then 30 days in, if I give you construction money and you botch it all up or you just fly to the Bahamas and disappear, where am I. Constantly

thinking throughout the entire project from day one to day 90 to close essentially or until it closes out, where are we in terms of you know, how exposed am I on this project assuming you do nothing right.

Now I have some fantastic clients that are exceptional executors at what they do and there is never an issue but if you are on the other side of this, you should be thinking, "Okay, if tomorrow my entire…" if I am flipping the house let's just say if our entire crew leaves me how much is that going to set me back in holding cost tomorrow, everybody leaves, my number one crew, boom. The guy gets arrested, goes to jail, and contractors, it happens right?

So if that happens tomorrow where I am? Okay, can I afford another $5,000 of holding costs on this project while I find another GC that is built in here? Is there a 10 or 15% buffer that I built in? So you walk yourself through all of the what ifs that could go wrong because everybody what I have noticed is that they come in thinking everything is going to go right the entire time. Every contractor is going to get paid the exact right amount that I budget, every this, every wall you open up is going to be –

Nothing is going to be back there, you know every tenant that I release for is exactly to be this much money when in reality it never goes exactly in. So you really want to be buffering all the time and then go, "Okay, I do all of these worst-case scenarios, am I still left with a good profit at the end" and if you go, "Yeah, I have checked every box and I can't lose here" you've probably been bought it for the right price and you probably budgeted the right amount. Don't trick yourself into thinking it is going to go smoother than it is.

[INTERVIEW 2]

WS: Our guest is James Eng. Thanks for being on the show again, James.

JE: Thanks for having me back, Whitney. Love being here. Listen to all your stuff, so I appreciate you having me on.

WS: Grateful. James was just telling me how he listens to every show. No, I'm just kidding. He is a listener. I'm grateful for that and grateful for his time. He's definitely an expert in this space and somebody you as the listener most likely need to get to know. He has originated over 800 million dollars in multifamily loans over 125 properties since 2015 as a senior director at Old Capital.

Before joining Old Capital, he underwrote over 750 million in loans over eight years for the acquisition and refinance of commercial properties at GE Real Estate as a senior underwriter. He has invested in 26 multifamily properties totaling over 7,500 units. Current portfolio is 20

multifamily properties, totaling over 6,000 units. Welcome, James Eng, to the show; the professor of multifamily financing.

James, thanks again. I am grateful to have you on the show. You're definitely a perfect guest and can provide so much, just up-to-date current information to the listener and myself of what – I mean, what we need to know if we're active in this space. Maybe if we're not active, you can help catch us up as well. Let's jump in. Maybe you can give us a little more background on yourself in case the listeners haven't heard of you before and then let's do it.

JE: Yeah. A couple things not in the bio, I would say is born and raised in Houston, went to school in Austin at UT and really was a corporate guy for 10 years. Then really started looking at multifamily investing in 2015. At the time started originating loans as a mortgage broker, but then at the same time investing. I think that's why I read so much and try to figure out every little nuance of multifamily from the general partner side, to the limited partner side, to the lendering side. Just understanding all the facets is what I do day in and day out.

WS: I think it's an interesting perspective that you've underwritten that many properties over that length of time. You're a passive investor in so many deals as well. I just think you have such a rounded knowledge base and experience. Let's jump right in though. Your expertise is lending, right? I mean, you're an expert in that. Let's just jump into what's happening right now in the real estate market, what's changed and just help the listener and myself get a better, or more clear picture of what we need to know right now.

JE: Yeah. I mean, I would say beginning middle of March, once Trump made that announcement that no one can fly here to the US anymore, Fanny Freddie, they basically put in these reserves and they said, "Look, we're going to still lend, but if you're going to do a multifamily deal with us, it's going to be 12 months of taxes, insurance, replacement reserves and 12 months of PNI." That ended up being about 10% of the loan amount in additional reserves that you had to put up. That put the brakes on a lot of deals and put the brakes on bridge loans, and recourse bank loans.

Everybody just went to only if you had to close a deal did you get it done, Fannie Freddie in March, April, May, I would say. Then in June, collections had been good, so Fannie and Freddie took off the taxes insurance and replacement reserves. Now you just have anywhere from nine to 12 months of PNI, depending on the size of the deal. That's about 5% of a loan.

What we saw this summer, probably July, August into September is that now all the deals that were put on hold are back on the market. Here in Dallas where I live, I would say January, or February when a lot of deals come out, there might be 25, 30 deals on the market. You are back to that number now. Everybody has come back on the market and whether it's because

people are scared of the tax rates changing, whether people are scared of I wanted to sell this deal.

Now I've held the deal longer for six more months and my investors want their cash, there are a lot of deals on the market. What we're seeing is there are a lot of buyers who have come back in as well. I would say more of the buyers are local buyers though. It is harder for people to jump on a plane from California and come to Texas. We're seeing a lot more local buyers at these tours. There might be 15, or 20 tours on a property, 5 to 10 offers, but a lot of the guys are local.

WS: Nice. Those people just aren't traveling, you think? I mean, they're just not as willing to travel now as they were six months ago, or well, or even longer than that now.

JE: I would say, yeah, so a lot of the institutional guys, let's say if they were in California, New York, Chicago, they would typically just fly in, see a property or see a couple of properties and fly back. Now they're not doing that. If they are coming in, it is if they are already under contract, or they have a very, very high probability of winning that deal.

WS: You see a lot of properties going under contract and the operator's not even coming to see it until then?

JE: Well, I mean, usually they have hopefully somebody on the ground here and those is the people – Yeah. Not until people are getting under contract. The brokers, from a listing broker standpoint, they're saying, "Look, when you fill out the best and final questionnaire, all the decision-makers better have seen this property," because I don't want to award you the contract and then you fall back after seeing it.

WS: What are the requirements now, the lending requirements? I know you said nine to 12 months of PNI, a principal and interest, just so the listener knows. Anything else?

JE: That's the main thing. The higher reserves is what has changed, but then also January, February, if you went out and got a Fannie Mae loan, or a Freddie Mac loan, you're probably in that 4%, 4.50%, 4.75$ interest rate range. Post-COVID, the 10-Year Treasury has gone down significantly. Correspondingly, Fannie and Freddie have gone down a lot. They might have gone down close to 150 basis points.

10-YearTtreasury has essentially come down to about let's say, 0.7%. That has brought your rates. Fannie Mae, you're probably 275 to three. Then Freddie, same thing. You're in that range, and so we're seeing a lot of people, essentially the price of these deals hasn't changed, but the

cost of your debt has gone down 20%, 25%. That has essentially kept cap rates the same from where they were pre-COVID.

WS: Okay. Could you just dive into that right there just a little bit; cap rates versus interest rates and that just connection relationship?

JE: Yeah. Cap rate essentially is if you bought a deal all cash, that's how much cash flow you would get. Let's say in Dallas, let's say your average cap rate was 5%. That's across classes A, B, and C, 5%. Now the interest rate that you were paying pre-COVID was four. There was only maybe a 100 basis points spread after you paid the debt. What it really means is your cash-on-cash might only be 6% to the investor. Now if your debt payment drops by 20% and it goes down to 3%, now all of a sudden, that spread between the 5% cap rate and the 3% debt, all of a sudden your cash-on-cash to investors is looking like 7%, 8%, 9%.

To the investor, post-COVID as their savings accounts went down in interest rate, now you're saying, "Hey, I can't go out and buy a multifamily property and get 8% or 9% cash-on-cash and I've got five years of interest only," then that is very compelling. A lot of people are back out on the market pursuing deals right now.

WS: Lots of changes, especially in lending in the last six to seven months. How should this have changed, or should it change the way we're underwriting, the types of loans we're getting, what should change on our side because of what's happened?

JE: I would say, the biggest thing is that the forecast for interest rates has changed. What that means is before, if somebody offered you, let's say a fixed rate product for 10 years, or a floating rate product for 10 years, let's say both of them at 3%, which one would you take? Most people would take the fixed rate and say, "All right. Now I can sleep at night. I know I got a fixed rate for 3%."

The problem with the fixed rate is that if interest rates don't move, or they go down, your debt product, nobody wants to assume your debt product, your loan. What you have is you have a 10-year loan. If you sell in years, let's say three, four, five, which most syndicators do, then all of a sudden, you have a thing what we call yield maintenance. Yield maintenance on Fannie Mae loans is a very large prepayment penalty and it can be 10%, 15%, 20%, 25% of the loan amount, depending on how early you pay off the loan.

That has become more difficult for people to swallow these days because they might have a loan at 4.50%, 5%, and then the prevailing interest rate right now is 3%. Nobody really wants to assume that loan. You have to pay it off and that prepayment penalty directly affects your

investor returns, because you pay it at the closing. On the closing statement, you pay it to the lender and that goes to the investors who bought that loan.

What I'm seeing a lot of investors do now is that nobody is expecting interest rates to go up. If you look at a forward LIBOR curve, LIBOR right now is let's say 20 basis points, they're not expecting LIBOR to hit 1% for the next seven years. It's essentially flat over the next seven years. What that allows you to do is go out and actually buy an interest rate cap at let's say, 1% for LIBOR. That might cost you $28,000, $30,000.

Instead of paying that big prepayment penalty, you can get a floating-rate loan and then put an interest rate cap on it. Fannie and Freddie, right now Freddie has a good 10-year product. Fannie's going to come out with something shorter, but that is an option for investors that I'm seeing a lot more people go to is they get a floating rate loan, and then instead of that prepayment penalty of yield maintenance, they are doing this floating rate loan. Then after 12 months,12 months you're locked out, but then after that, so years 2 through 10, it is a 1% prepay.

Compare that, so let's say on a loan of 20 million dollars, you've got a $200,000 prepay versus a 10 million dollar prepay if it was 15%, 20%. It's huge and your interest rate essentially is the same throughout the term, because you are capping that rate.

[END OF INTERVIEW]

[OUTRO]

Whitney Sewell: Thank you for being a loyal listener of The Real Estate Syndication Show. Please subscribe and like the show. Share 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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