EPISODE 1515

[INTRODUCTION]

Rob Beardsley (RB): Because there's now a very big incremental cost associated with leverage, it actually makes more sense to take less of it. Whereas a year ago, whether you were borrowing 80% or 65%, there really wasn't much of a difference in the interest rate. But today, there's a big difference in interest rate, potentially up to 2% or so, which is a big difference. So it actually makes more sense now to be at lower leverage.

Whitney Sewell (WS): This is your daily real estate syndication show. I'm your host, Whitney Sewell. We're back on our final day with Rob Beardsley, who's become an expert in structuring deals, and underwriting deals. He has dove into this and written a recent book that you're going to hear us continue to talk about.

But we're gonna dive more in today to those pieces concerning our current economic climate, how have those things changed, how's he looking at deals now versus 12 months ago, and putting these pieces together to structure the deal for our investors on our team that with the least amount of risk possible with the debt and equity that we have to work with in today's climate, even what does he expect to happen over the next six to 12 months in the in the economy and just the real estate market, he shares that as well, in great detail, which I was very grateful for, I know, you're gonna learn a lot from that.

I hope, again, that you have liked and subscribed to the show, hit that button, subscribe to this show. I hope that you are sharing it with your friends as well.

[INTERVIEW]

WS: If you're buying a large project, and I even argued in the last segment, even a duplex, you need to know that you're structuring the deal the best you possibly can. And there are so many ways to go about this and think about debt and equity and what kinds of debt. Oh, my goodness, it can seem quite overwhelming. And I shared with our guest that I wish I had these resources years ago that he created that would help me to think through different types of ways to structure a deal. Rob is back with us again today. Welcome back. Rob.

RB: Great to be here. Let's do it.

WS: Yeah, let's dive back in. And I want to hone in more on, you know, the current economic climate, right, maybe what's changed and structure strategies that how you've adjusted, you know, as the debt markets have changed because they have changed a little bit for the last, you know, really few months and six months, you know, compared to a year ago, a lot has changed. So let's dive right back in. I know the listeners are, That's a big question too, right? You're like, "Well, how should I be looking at deals right now?" How is Rob looking at deals right now as these things have changed a lot?

RB: So just to give a recap where we are today, where we came from a little less than a year ago, we had one of the hottest commercial real estate markets in history, a lot of transactions really cheap, debt that was fueling the transaction, market cap rates were low, you know, things were tight. But the numbers were still making sense, essentially, because of how cheap debt was. And then all of that began to unwind in the first couple of quarters of 2022.

As the Fed really switched its stance completely on inflation, they continued to say that inflation was transitory, and that was its reasoning for keeping rates low. And then they quickly switch and said, "Okay, this inflation is actually not transitory, we're very concerned about this becoming persistent. And we need to stomp this out." And so they raised rates at the fastest pace in over 20 years.

So we had the highest inflation in 40 years, and then they were raising rates at the fastest rate in 20 years. And that is a dramatic move in the market. But it was even more dramatic in relation to expectations, you know, and that's what really shocks markets are not when things change, but when they change differently from expectation. So that all occurred. And that's what brings us here to this new market where interest rates are way up and cap rates, which is the way you know, the typical way to value real estate has gone up as well a little bit, you know, in my estimate, and you know, I just read a research report from Green Street, they were in line with me saying that cap rates are up about 50 basis points. However, that is up much more than that.

So we're in a much tighter and more compressed environment. And that is putting a big strain on the availability of debt capital and to extend equity capital. So on the debt side, we covered this in previous segments, but we're seeing leverage come way down all across the board, whether it be an agency lender, who is limited to loaning based on the in-place income, well, if the in-place income, which is your cap rate is much lower than your cost of debt, that's really going to exacerbate how much the agency lenders able to lend.

And then on the bridge side, they've also come down on leverage as their underwriting metrics have tightened up. So there's leverage down across the spectrum. I know in the last show, we got into the fact that this is a great opportunity to now consider preferred equity because of this gap and lower leverage in the structure. And the really fascinating thing about the equity side right now is the fact that there's a lot of money out there people by and large, and when I say people I mostly, yes, households have wealth, but also family offices and private equity firms are sitting on a lot of capital.

So equity has liquidity, but they're being selected right now. They understand what's going on in the market. They're just looking at the deals and going well, these look very tight. If we have the luxury of waiting, we'll wait. So it's an odd market where there are a lot of people with money in effects sitting on the sidelines, but they're eager to do deals. So who's going to blink and make the first move is kind of what we're waiting to see as the next six to 12 months unfold.

WS: No doubt. A lot of capital waiting and even people preparing more capital, you know, just holding on to it. And I like to use that who's going to blink first, he's going to make the first move. And, you know, thinking about, you know, just, you know, what has changed over the last year, I appreciate the recap to you, I think that's helpful for all of us to think through why some of that happened at a high level.

And, you know, it's kind of a knee-jerk response right? There, what we didn't expect, potentially. So what has changed for you, though, as you are structuring deals, you know, maybe dive into that a little bit versus, you know, a year ago to now and then maybe, you know, some challenges, or you know, because of what's happened to

RB: The biggest change is on the debt side again, and that's just leverage. So we were borrowing at, you know, 75 to 80%, leverage a year ago, because the capital was available, and it was cheap, plentiful, and cheap. And today, it's the exact opposite the debt market is fragmented. And it's, it's hard, it takes a lot of work to really find the optimal lender for your deal. And because there's now a very big incremental cost associated with leverage, it actually makes more sense to take less of it. Whereas a year ago, whether you were borrowing 80% or 65%, there really wasn't much of a difference in the interest rate.

But today, there's a big difference in interest rate, you know, potentially up to 2% or so, which is a big difference. So it actually makes more sense now to be at lower leverage. So the last few deals that we've been doing this year, have been around 60, 65% leverage, which does a few things. One, it allows us to access the optimal interest rates available in the market. And number two, it greatly reduces our risk in the deal, because we're just simply at a lower leverage point, we have more equity cushion, and we're less strained by the debt service for the deal. Those are the biggest changes that we're seeing in the market.

WS: And how does that affect the rest of the deal? Like as you change the loan to value or, you know, what does it do the rest of the deal? What should we expect as we're trying to make that work?

RB: Yeah, so you can expect that your levered returns are going to be lower because you're simply using less debt. Alright, and debt magnifies projected returns. So with lower leverage, you need to be somewhat willing to accept lower total returns. However, with that in mind, you know, cap rates have gone up a bit. So now we're seeing that we're actually able to project and solve for similar returns than before, but with lower leverage. So that's actually a much healthier and a much better place for us as we're moving forward.

So, we're optimistic about the future because at the end of the day, financing is temporary, and your price is permanent. So if you can find situations that are coming in the next 12 months, where, yeah, maybe the debt isn't the most attractive in the world, but you think you're getting a great price, then you might be in a position to execute your business plan, and then in two, three years, refi into a much better loan and find yourself with a really strong deal.

WS: Yeah, I love that, quote, the finance is temporary, but the purchase permanent, that's something to keep in mind as you're making offers, right? Or maybe you're getting a deal under contract and thinking through the type of debt.

So you mentioned though, maybe we need to be able to be willing to take lower returns. Is that something you think we've mentioned in the last segment? May you all do not typically change that? And most mostly the most common scenario? Is that a consideration then?

RB: Yeah, well, we have to recognize that everything should be evaluated on a risk-adjusted basis. So I can't look at a deal that's opportunistic in that it's, you know, in a risky area with high debt and half vacant. You know, I can't evaluate that deal with the same returns as a new asset that stabilize, is well-performing at low leverage, right? Tey should be evaluated on different return criteria.

You know, we essentially do the same thing, while we're not changing the deal structure or offering a different preferred return or anything like that, we are willing to say, Okay, well, this deal is actually really low risk, and we're really are excited about its potential. So we are more willing to accept, let's say, a 14% 15% return, rather than shooting for a 16, 17% return. You know, that needs to be taken into account.

The other thing to consider is, if it is a 14% return versus 17, you or us as the sponsor have to expect to make a little bit less money, because we earn more money as the deal outperforms. So you know, it's a little bit it takes, it requires, I don't want to say patience, but you know, to be responsible to think long term and say, "Okay, this is actually in my best long term interest because this is the best deal I could structure for my investors not necessarily for my own profits."

WS: You know, I'm thinking about poor our investors and we were just talking about you know, all the other capital that I feel like people are holding on to right now right, just waiting for the right time to pounce. What about finding those investors now? Finding that that equity that you're that you're raising, how has that changed, you know, as we're, you know, I'm hoping we have some deals to some good deals to buy, you know, over the next 6, 12 months. What does that look like now, though, finding those investors and even just keeping those relationships going in a slower deal flow time or, you know, deal acquisition time?

RB: Yeah. Well, I've been noticing that this is actually a fantastic time to go out and network because people are taking a breather from the hottest transaction market in history, and people have less to do. And so, if you're talking about a private equity firm that's sitting on a brand new fund that they just raised, that's $500 million. They're just like us, they're looking for good deals, they're looking for good partners. So they are more open right now to meet new potential partners than they would be a year ago, because they were just so busy working with their existing network, that closing deals.

So I'm having a lot of great conversations right now, with those types of firms, you know, private equity firms, and family offices gearing up for what hopefully will be some better opportunities in the coming year. So that's number one, I'm actually pretty happy and excited about all the relationships that we're building, and that we're going to continue to work towards building in this coming times. But what you pointed out was, you know, when there's less deals going on, it's in a way harder to build relationships, because you can't really talk abstractly about a deal for very long, right? It's a relationship is really best built through a deal, right? You don't really know someone until you work on a deal together to look at each other's underwriting to understand where they're coming from, and things like that. So it is really important to stay active.

And that's exactly what we're doing. We're underwriting deals every day we're submitting offers every week, and we are trying to keep if we have a deal that we think makes sense, we want to put it in front of potential investors so that we're keeping that communication going and learning about how they evaluate opportunity.

WS: Yeah, no doubt about it. You mentioned building the relationships with family offices. What's your focus level and family offices versus, you know, individual investors?

RB: Yeah, that's a great question. Both are really important to us. And they're big drivers of our business. The focus? I don't want to say 50-50 because that's just right down the middle. And it's probably not true. But yeah, I mean, I think it's pretty evenly split. And what's good is, you know, we've built up process and a team to be able to handle both. And that is really the key of because any sort of raising capital, any investor is very time consuming. And you have to have the right processes in place to handle those types of investors, you know, some firms are really only set up to cater to one or the other.

And so, I'm really proud of the fact that we are actually set up in such a way that, you know, we kind of have enough sophistication and infrastructure to attract and handle large investors yet at the same time, you know, we work really hard to manage our over 300, individual passive investors in our deals.

WS: Before we jump to a few final questions, anything else you'd really like to leave the listeners with or important for any investor to know, remember, before financing debt and equity, maybe relate that to the current economic climate?

RB: Yeah, one thing's for sure is, there's a lot of risk in the environment that we're in. And even more important, there's a lot of conversation about risk. You know, a year ago, the conversation was Go, go go, and it was all about doing the next deal and not missing out on the big returns. And now the conversation is much more sober and about downside protection and staying alive, right? So one thing that I've really learned, and this is, you know, I've really taken this to heart, and I think this is really important is.

At the end of the day, what are you and I providing our investors, you know, they can go invest anywhere they can invest through their brokerage account, the stock market, they can buy gold, they can invest in real estate on their own, they can invest with us. So they have so many options. So at the end of the day, why did they pick us? And why should they pick us. And I really feel like it boils down to the simplest thing, which is providing them a way to sleep at night, because investing is risky, no matter where you put your capital, and it can take your time, it can take your energy, and it can be stressful, and you can lose money.

So really, I think the most important thing that we can provide investors is the ability to sleep and feel comfortable and confident in their investment. And that is not easy. And that adds another layer of complexity to when you're thinking about debt and equity structures, right? So how can I structure the deal with those things in mind, and that's something that I think would be really important to leave the listeners with.

WS: I like that, looking at it like that, providing them with a way to sleep at night. And he's talking about that son, when I was questioned a few times, from some operators that invested with us in a project. I won't go into much detail right now. But we had a very large, reserve budget, and I was questioned about this reserve budget. And I'm like, "guys, you know, like, we're gonna sleep better." And it was a project specifically, we closed on a week before they shut the country down for COVID. You know, so nothing else was said about it after that. But, you know, I was just like, I know, it does affect the returns a little bit, but I'm okay with that. We're all gonna sleep better. It's exactly what you're talking about.

RB: Exactly. Right? If you were just to analyze it by the numbers and percentage points, you'd say, well, that's too big of a reserve. We can get away with less and the returns look a little bit better but you Using less reserves that sleep at night factor is big.

WS: Yeah, for sure. We'd love your opinion, I know the listeners would as well, just any predictions you have for the next 6 to 12 months, or, you know how that's changed how you all are looking at deals?

RB: So I think, you know, predictions are interesting to the extent that they contradict the general market view, right. So the general market view is that we are going to see the peak Fed funds, so the Fed is going to raise rates up to May. And so I roughly believe in that market view, where I differ with the market is the market has fed funds, staying elevated for a couple of years, and dropping down a little bit, but staying high into the, you know, into the fours and the high threes. And I really do believe that all of this monetary policy that we've been doing, is going to have a big effect on the real economy. And we're going to see financial conditions really tighten, and that's going to have an impact on jobs, I do think it will bring down inflation.

And in the end, that's going to put us into recession, which is no surprise, you know, a lot of people have been calling for that. And the Fed actually is really okay with that, because they know that a recession is the one and only remedy for this inflation that we're having. However, what I believe is that when we do go into that recession, the Fed is going to quickly reverse course, and quickly reduce rates in order to re stimulate the economy back into a healthy growing environment.

So if you look back at the previous cycles, and look at the data associated with those cycles, you'll see that the market always projected that the Fed is going to raise rates stop and then hold it. And then in reality, every single time, they don't just stop and hold they, they get there. And then things get a little rocky, and they quickly cut rates. That's kind of what I'm anticipating. So I'm anticipating rate cuts towards the end of 2023. And I think that there's going to be not amazing buying opportunities. But I do think that prices will come down a bit further. And that will peak sometime towards the end of next year. And that's the extent of my predictions for now.

WS: Yeah, no, I like that. I appreciate the detail. You've obviously thought that through. And I'm grateful that you're willing to share some of that, what about even and I know, I probably asked you this last time. So I love just hearing how other operators feel about this, maybe this, you know, I'd love to know if this has changed, you know, just in our current climate as well.

But, how you're preparing for this recession, as you're buying a deal right now, like give us some, you know, the listeners and some things that you're strongly considering, you know, so you're prepared for a downturn and recession as you're operating a new project.

RB: Yeah, and that conversation extends the existing portfolio. Because I think that is where the bigger challenges lie. Because if you bought a deal a year ago, with certain assumptions, those assumptions are most likely out of the window by now, right, because the market has changed so dramatically, in a nonconsensus way.

So, on the existing portfolio, we're taking extreme measures and precautions and we're looking at doing a refinancing of the entire portfolio to make sure that we are prepared and safe and ready to weather any potential storm. That is definitely one of our biggest focuses at the company right now. And then on new acquisitions, it's I think it's just as simple as avoiding bridge loans. And that job kind of takes care of itself. Because you when you look at the interest rates on bridge loans today, it's really hard to stomach. So it's not like a tempting thing anymore. back a year ago, when interest rates were sub 4%. On bridge loans, that was very tempting, it was hard to turn down.

But today, it's all about lower leverage. And I also think fixed-rate debt is it's somewhat controversial, because some people arguing it's not a good time to fix your rate, because you're fixing into relatively high rates today. And the view is that rates will probably be lower later. So you can just maybe float now and then float lower. But I think going back to that ability to sleep at night, you know, if you're locking in a deal right now, low leverage and fixed rate, it really doesn't get any better than that.

WS: Yeah, if it works, works. All right. That makes sense why you mentioned refinancing the entire portfolio. I know some maybe think, you know, our interest rates are higher right? Now, why would you want to do that?

RB: Yeah, well, the goal there is to do a few things. One is to take risk off the table by going away from floating rate debt into fixed and again, the certainty of the fixed rate is more important than the relatively higher rate of the fixed rate than what may lie ahead. So that is our view. And that's how we want to approach it.

The other important thing and thankfully, we don't really have this issue in our portfolio, but the other strong motivation for those who are jumping ahead of the potential storm and refiling today is to extend maturity. You know, some people have bridge loans that are coming due in the next year or two and they do not like the prospect of having a loan come due at potentially the worst time so they're just getting ahead of it and saying let's just refi now and maybe we're going to refi into a higher rate today but let's get more maturity and and remove risk off the table and that even includes for some a capital call, because they're refunding now into an environment with higher rates, lower valuations, and so they're unable to pay off their existing loan with a new loan and actually need to bring in fresh equity from their investors or otherwise, you know, maybe from a third party source like a preferred equity lender in order to fully capitalize the deal.

WS: Yeah, no, it's definitely some things to consider. I appreciate you even going into depth there, why you all would consider that now, you know, and getting the the value of the long term fixed rate. And even that summer, you don't have to do cash calls to make that happen. But they're preparing, hopefully, for better sleep either way, right? It's hard as that is to even think about a cash call. But what about Rob, what would you say your best advice for passive investors?

RB: For passive investors, I would say, moving forward. There's a lot of chatter right now, right, we talked about, there's a lot of sober conversations, a lot of risks. And so something I'm hearing a lot from passive investors is that they want to sit on the sidelines, they want to wait until the dust settles and things like that. And I totally understand that. But I made that same mistake during COVID, we should have bought every deal in 2020. But we didn't, we didn't buy a single deal after COVID. Because why we were scared. And the best deals are when you're scared. That's just the fact that's the fact of the market.

And it's so cliche, it's so simple to hear the tropes that you know, be fearful when others are greedy and be greedy when others are fearful, right? The reality is to go against the grain is just really hard. So we're going to have some times coming up where it's going to feel difficult to move forward. But you have to kind of trust your gut and make the decision.

And one way to make it a little bit easier on yourself is to not focus so much on market timing, and focus on fundamentals and investing consistently, you know, so like you and I'm sure we both just invest in all the deals that we're doing. I don't cherry pick, I don't try to say, "Well, this one's a better one." So I'm going to invest more into this one and listen to this one, you know, I tried to just keep it consistent, and invest in every single deal. And that means it's going to smooth out in the long run, some deals are going to overperform some deals are going to underperform. And in the end, we're going to do just fine.

WS: I agree, do the same thing. Yes, there are some though. I wish I had invested more than that one. But, of course, but I'm just like you, you don't know that it's time and steal some of that's going back to some of the planning for the operator on the liquidity side. You know, as you plan to do more deals, you can always put as much in a deal as you would like, either. But I agree, just the consistency over time.

Rob, what about the most important metric that you track and I asked this to everyone. So it's not just about underwriting or, you know, it could be anything in your business, but it could be something personal as well, you know, maybe you track I get out of bed every day on time or your benchpress number, you know, something like whatever is most important to you?

RB: I love tracking stuff. So for me, one of my favorite things to track recently, at least in our book sales, I love seeing the book, the book sales numbers, you know, we got to 1000 books sold in just over a month of the launch, which for the first book that I published took us six months to get to 1000 books sold. So it's really cool to see the progress there. That's exciting. I would say for our business, one of the most important things that I like to keep track on is the number of deals per week that my acquisitions team is underwriting. That, to me is a leading indicator of deals.

You know, I know for a general heuristic, if I want to do you know, six, eight deals in a year, which is our goal, then we need to be underwriting, you know, 10 to 15 deals a week. So that's something that I'm tracking, I want to see that those deals are being underwritten, that we're making offers. So we track those things every week in our pipeline calls.

WS: Awesome. What about any habits that stand out to you that you are disciplined about that have produced the highest return?

RB: Well, I mean, I'm sure you've heard this from me before on previous shows, but definitely writing down my goals. It's great. You know, there's nothing like a journal and a pen to just write down ideas, thoughts, brainstorms and goals. And it's also really fulfilling to write them down and then look back at them months later and say, oh, yeah, I got that goal done. Oh, that project. Yeah, we got that. So that is being intentional with where you want to go is so big, because if you don't have a plan, then you know, it's just you're not going to get there. So it's not an easy thing to do. But it's it's really, you know, my opinion, the first step, knowing where you want to go is the first step.

WS: What's the number one thing that's contributed to your success?

RB: That's a tough one, I think the direction is important, right? Because there are a lot of people that are smart, there are a lot of people that work really hard, but it becomes a question of not how hard you work, but are you working towards the right thing. And so I've been very fortunate, in my opinion, to pick the right direction to be going in picking the right partners picking the right strategy, picking the right ways to spend my effort. And so I think that is is really smart. You know, it's not about just working harder than everybody else. You do have to work smarter.

WS: And how do you like to give back?

RB: I do a lot of teaching and consulting and things like that. So I've been asked through various masterminds to provide free guidance and talk about deal structure talking about marketing, talk about that kind of stuff. So yeah, I mean, it's it's a lot of stuff in the business that I like to give back through.

We are launching an initiative here at Lone Star to to develop our own donor advised fund, so we'll be doing some explicit, you know, giving through the company as well, which I'm excited about. But one point about advice and kind of giving things away like that, which is somewhat of a pet peeve on my mind lately is a really discourage people to go out there and ask people to pick their brain, I really don't like it, don't think it's the right approach your success rate on that very low, because not that many people who are, are that you're interested in talking to, are really available or interested in having their brain picked.

So you need to find a way to add value. Adding value is the number one thing having the go giver mindset and adding value. I think that is a huge, huge thing, especially when it comes to a mentor and mentee relationship.

WS: I couldn't agree more. I'm sure you do get asked often, "Hey, could we chat for a few minutes," or you know, somebody's trying to get started or thinking about getting in this business? Or, you know, I would love to in years ago, I took every one of those calls, you know, that I could possibly get on right? You don't know where they're gonna go or who it might be. But, you know, as you grow, it's harder and harder to do that. And as you get more focused, and you just don't have the time unfortunately, I would love to write as I know, you would but but you do have to be focused, like you said, and and you just can't. So adding value. Yeah, makes you want to spend some time with that person. Right?

Well, Rob, honored to have you back on the show. I've enjoyed the conversation. And I know the listeners and myself have learned a lot from you. And looking forward to diving into into your books even further. I know you're gonna write more, I just bet on it. Right? I just guarantee it's going to happen. So but thank you again for your time. Very grateful. It's an a very important topic and appreciate your just willingness to dive in and become an expert in this part of the business and then be willing to share as well tell the listeners again, how they can get in touch with you and learn more about you and find your book?

RB: Yeah, absolutely. So, one last time, you can check out the new book at structuringandraising.com. So that stands for the book titled Structuring and Raising Debt and Equity for Real Estate. But for the website, just structuringandraising.com and if you want to learn more about myself get in touch, you can go over to our website lscre.com.

[END OF INTERVIEW]

[OUTRO]

Whitney Sewell: Thank you for being with us again today, I hope that you have learned a lot from the show. Don't forget to like and subscribe. I hope you're telling your friends about The Real Estate Syndication Show and how they can also build wealth in real estate. You can also go to LifeBridgeCapital.com and start investing today.

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