# Private Money Update

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CLEAR SKY FINANCIAL NEWSLETTER

OCTOBER 2017

## Letter from the Editor

It's October, which means that the leaves are falling, the air is crisp, and the Nats just choked in the playoffs. Being a D.C. sports fan can be challenging, making work a welcome distraction. With that in mind…

In September, we originated six loans for a loan volume of 1.155 MIL. These loans included three first trusts, two second trusts, and a third trust (only our second in four years). Four of the loans were in Virginia, and two were in Washington, D.C. The percentage of total loan volume (LTV) to after repair value (ARV) was about 57% LTV/ARV, which includes adding the senior trusts of the junior liens to the calculation.

## CHUCKLE'S CORNER

"I sold my house this week. I got a pretty good price for it, but it made my landlord mad as hell." –

*Garry Shandling*

### In This Issue:




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# Charlie's Corner



## Mistakes New Real Estate Investors Make, Part 1

Being a new real estate investor can be tricky business. There are many details to keep track of and things to consider, from knowing the market to marketing. In the first of this two-part series, we'll look at four common mistakes relating to knowing the market, valuing properties, estimating repairs, and choosing contractors, and identify solutions.

**Mistake #1: Not Knowing the Market Numbers**
Knowing your market is as important as any other factor in real estate investing. This means having a neighborhood- by-neighborhood analysis of the supply curve and average days on market.

**Solution #1:** Both of these data formulas can be found through a real estate broker using the MLS.

**Mistake #2: Incorrectly Determining Value**
Most new real estate investors use Zillow, or Trulia (or worse, an average of the two) for determining the value of a property. I would not rely on these sources for your values, as their algorithms are flawed. Some known flaws are: comparing houses outside the subdivision, comparing properties over six months or longer, and not comparing similarly-aged homes.

**Solution #2:** You will be better served by doing a "comparable sales" analysis. The best tool for determining a value of residential real estate is the MLS.

**Mistake #3: Underestimating Repairs**
If you have no experience in rehabbing homes, then you shouldn't be estimating repairs yourself.

**Solution #3:** Get at least three different contractors to give you bids. Get these bids in writing with detailed breakdowns of labor and materials.

**Mistake #4: Choosing the Wrong Contractor**
A bad contractor won't have a license, will bill you by the hour, and/or won't work by a written contract drawn by you.

**Solution #4:** A good contractor agreement is essential. Have a local attorney draw one up for you. Make sure you get signed lien releases every time you write a check.

Stay tuned for the second installment in next month's newsletter! There, we'll identify frequent missteps relating to contracts, legal entities, marketing, and scripts, as well as workarounds and ways to avoid them.

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# Sam's Corner

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## What's in a Day

I discussed business with a new borrower recently, who was confronting the complexity of getting organized to finance an investment purchase. Among the documents she was assembling were certificates of good standing for her corporation, corporate organizational documents, insurance certifications, etc. She could not believe the complexity of preparing for the closing, and said she wished she had our business model: just wire money and wait for payments. I laughed, but she was serious. This got me thinking about how much time I spend daily on compliance and administrative tasks as compared to actual "deal-making".

To try to figure out the answer to that question, I looked at the last 100 sent e-mails on my computer. About 5% of my time is spent on deal-making. That's right - reaching out to clarify transactions to prospects and get them comfortable and ready for closing accounts for just 5% of my time. But I'm not lounging on a beach the rest of the day, so what's taking up the remaining 95% of my work time?

The answer (drumroll please) is: administrative accounting, reporting, and compliance. Accounting for income and reviewing invoices takes up about 15% of the time. Reviewing the work of others to make sure that deals are getting documented correctly accounts for another 15%. Reporting takes around 15%, and compliance takes about 50%. Compliance includes licensing requirements for maintaining the business entities, all manner of permitting for our projects, insurance, tax prep, and providing documentation to creditors.

We also have an additional three people internally who support our business operations. That leaves Charlie focused on business development, on which he spends about 80% of his time. It takes a whole lot of back office support to turn a deal into income. Approximately 85% of our work effort is spent handling mundane details. However, if we don't pay attention to these details of administrative accountancy, reporting, and compliance, we will expose ourselves to real business risk. In this way, our internal business operation works every day to manage our business risk and exposure.

## Food for Thought

We originate junior liens, as well as first deeds of trust. This month differed from the norm, because half of our loans were junior. We do this from time to time. Our risk mitigation when evaluating these deals is very similar to when we evaluate firsts. The only difference is that we have to account for any senior liens when doing the LTV/ARV calculation (included in the Letter from the Editor). We earn higher yields on the junior paper. When originating seconds and thirds – thirds are very rare for us - we do the normal evaluation of the asset, and we go a few steps further when evaluating the senior liens. We have to fully understand the senior liens to determine if we are comfortable with the amounts in case we have to step in and take over the property.


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## DEAL OF THE MONTH

I will stay on the topic of junior liens for the deal of the month. An investor friend of ours bought a house in Manassas, VA. The house came with a vacant lot, as well, but the lot had not yet been subdivided. The house and lot were purchased for $110,000 (with a $100,000 first trust). The investor had difficulty getting someone else to lend him the money to perform necessary renovations on the house. Enter the LOLR (Lender of Last Resort). This investor is a builder/contractor by trade. He needed $100,000 to renovate, which we loaned him in March. We knew that we were in second position behind the original $100,000.

Since March, he renovated the house and subdivided the lot. The first house is under contract for $399,999. Our second loan covers both the renovated house and the newly subdivided lot. He came back to us for a construction loan for a house on the newly subdivided lot. This house will also be worth close to $400,000 when complete. He needed another $150,000 to finish the second house. We gave him the $150,000 so he could finish the second house, thus creating the rare third-position lien. Once the first house sells, he will pay off the first trust of $100K, our second trust of $100K and then our third trust of $150K will become the first trust on the new house. This trust will eventually be paid off, as well.

## SEPTEMBER DEALS

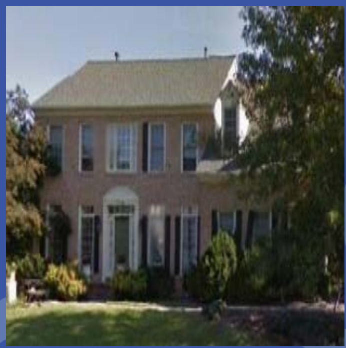
4142 2nd Street SW

5310 Kansas Ave. NW

5589 Shadybrook Dr.

7601 Poplar Street

1200 Market Street #476.



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