Private Money Update

CLEAR SKY FINANCIAL NEWSLETTER

February 2020

Letter from the Editor

Thank you to those who attended our annual party on February 16. We hope you had fun!!

We will be getting out the new updated Notes sometime this month.

We want to welcome three new investors into the Clear Sky Financial B fund. Welcome Rudy and Ashlee Shaw and Mitchell Shaw.

January was an incredible month considering both Sam and I were on vacations at different times. We originated 8 loans (all firsts!!!). Four were in MD and 4 in DC. Loan volume was over 2M. February looks to be another steady month.

CHUCKLE'S CORNER

"Never be limited by other people's limited imaginations."
– Dr. Mae Jamison

Food for Thought

We will be participating in our 5th THINK REALTY conference in Baltimore, MD. The event will take place on Saturday, March 21, from 8:30 a.m. to 7:00 p.m. at the BWI Marriott. We will have a booth and will also be hosting a breakout session. Our presentation is entitled "WHERE TO FIND THE MONEY". Our session is scheduled from 11:15 AM to Noon. Please join us!
https://thinkrealty.com/think-realty-conference-baltimore-speakers/

We were also on a Think Realty Podcast at the beginning of January. Below is the link.
https://thinkrealty.com/podcasts/think-realty-podcast-96-sam-jacknin-charlie-einsmann-clear-sky-financial/

In This Issue:

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6 Considerations to Determine Your Residential Real Estate Investing Strategies

Most people simply do not understand how hard money loans work or what a hard money lender (HML) will and will not fund. A lot of our business is spent on what I call the "education process." The following are the most common examples of loans that we will not fund as hard money lenders.

1. Loans Against Soft Assets

Hard money lenders make loans against hard assets. The word "hard" in the term "hard money" implies that a lender makes a loan using a hard asset as collateral. By definition, a hard asset is a tangible, physical asset such as real estate. In contrast, a soft asset is an intangible asset such as a stock or a patent. In practice, hard money lenders will not fund a loan against a soft asset like stocks due to risks associated with unpredicted changes in the stock market or patents whose actual value is not easy to monetize. Hard money lenders just tend to avoid loans against a soft asset.

2. Loans with No Exit Strategy

A loan with no viable exit strategy is another prime example that will yield an immediate decline from a hard money lender. A hard money loan is short-term in nature and comes with a higher interest rate and points. The exit strategy is very important to the lender in order to determine how the loan will be paid back and when. Before originating a hard money loan, we have to understand if the project is a fix/flip, buy/hold/renovate/refinance, pay back directly (this happens more often than you think), or simply a refinance. When a hard money lender asks a borrower, "What's your plan for paying this loan back?" and the borrower has no viable exit strategy, the lender will certainly decline the loan.

3. 80% to 100% LTV of the ARV Loans

ARV is simply the After-Repair Value of a property. Have you ever wondered how a hard money lender assesses risk on a project? Well it is simply the Loan to Value of the After-Repair Value. Most HML's lend up to 70% of the ARV. We will even go up to 75% of the ARV on newer assets that do not need much renovation.

Why won't most hard money lenders make 80% to 100% loan to value loans of the After-Repair Value? The reason is simple. These loans are just too risky for a hard money lender who makes lending decisions based primarily on the asset itself. Unlike a bank, which takes tax returns/credit from a borrower to prove an ability to repay, a hard money lender can only rely on the asset to repay the loan in the event of a borrower default. Some HML's do not even pull credit or check income of the borrower.

4. Consumer Loans

Hard Money Lenders primarily make loans for business purposes like flip and fix or renovate and refinance. A consumer loan generally implies consumer purpose or "household use." A loan on a residential property that is occupied by the borrower falls under the category of consumer loan. Recently, consumer mortgage lending laws have become cumbersome and compliance due to complex disclosures and other requirements is difficult. For this reason, even the big banks have turned their focus away from originating mortgages and have instead opted for funding other types of consumer debt as a business model.

With these tighter lending laws in place, borrowers who can't qualify with traditional mortgage banks are seeking other options for home loans. These borrowers are starting to seek business with hard money lenders. However, they quickly discover that there are very few options available to them from hard money lenders. This is because most hard money lenders simply will not make consumer loans because of the same regulatory compliance and licensing requirements that are faced by big banks. Consumer loans are just too overwhelming for private hard money lenders who have limited resources.

5. Terrible Contractors

We turn down loans all the time because we do not feel the contractor is up to par. Most of our loans are either fix and flip or buy and hold loans where there is extensive work required on the asset. We typically vet out the contractor more than the borrower. First and foremost, the contractor must be licensed, insured and bonded. We also REQUIRE contractor recommendations. Next, we have to see what I call "MLS-able events". This means there must be pictures in the MLS of their work. Finally, we need a realistic renovation budget and draw schedule along with a timeline to complete. Contractors also need to understand the permit process in the local jurisdiction where the property is being renovated. We feel the contractor vetting process is very important because not only does it protect us, but it protects our borrower as well.

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6. Deals under 100K

This might not apply to all hard money lenders, but it certainly applies to us. The smaller the deal; the bigger the headaches. Most times; deals in this range are very RISKY because the underlying asset is at risk. Also, these loans are much more expensive as far as interest rate and points go which generally leads to borrower complaints. We do not like to be in that space. Happy borrowers become repeat customers. We also service all of our loans. Servicing costs on small loans are the same as for larger loans, so we feel that we may as well be in the higher loan category.

It is very important to understand what deals a hard money lender will not fund. I cannot tell you how many times I get calls regarding deals that we will not fund. Education is key.

Sam's Corner

A Financial Journey – Part 2 of a 3 Part Series

This month's article is part 2 of a series that is designed to help you conceptualize where you are on the roadmap to wealth in residential real estate investing. I've renamed this series from a "Circle of Wealth" to a "roadmap" as I think the word roadmap better describes the process. Whether you are starting out and have a zero net worth or you are working with millions of dollars, you are on a financial journey.

Home Valuation - Distressed Asset Acquisition - Investment – Property Management – Contractor Management – Direct Contracting - Capital development – Note Origination – Fund Development – Fund Management

If you are interested residential investment real estate, you can find financial and professional rewards in any point along the path.

In this month's article, we examine Property Management, Contractor Management and Capital Development.

Property Management is an essential part of residential real estate investment for the buy and hold investor. Your effectiveness at property management helps control expensive long-term maintenance costs, reduces physical and financial risk and impacts your rate of turnover/vacancy. Vacancy is a big driver of costs in your cash flow model, having a plan to reduce it is essential. If you aren't responsive to tenants needs through a well thought out property management plan, that will increase your turnover rate and reduce your profitability. Assuming you have 1-3 assets, you are in a good position to do the property management yourself. This means that you are in charge of collecting the rents, paying taxes, insurance, and HOA payments. If there is a physical problem with the property, the tenant is going to call you day or night. Assuming you have stepped into this role, you need to have a list of great responsive contractors who are available to fix problems. Since your tenants know you and you are efficiently solving problems, your personal relationship with the tenant is going to decrease vacancy rates. The tenant is going to enjoy living in the property and is going to stay a long time. Don't be surprised to find a tenant who will live in your property for 10+years if you are doing a great job managing the property. When you have 4-20 assets, managing these properties becomes a couple of days work each week. Keeping track of these properties on spreadsheets is a viable option but it is better to consider hiring a professional property management firm to stay on top of the assets. Property management costs approximately 7-8% of the gross rents. Paying the property management company is a financial burden, but it lets you spend time finding additional assets. Once you exceed 20 assets, you can consider bringing all of the property management in-house with a full-time property manager. This is your most efficient management price point. Through an in-house property management, you can be in close touch with your tenants and also manage your leases efficiently.

Contractor Management is a necessary part of any flipping or buy and hold business. Long term relationships with contractors are important. A lot of contractors will offer you discounted prices on your first project and then will steadily increase their pricing as your dependence on them increases and you move from project to project. You have to avoid this trap. Knowing what market prices are paid for services in your area is the first step. Ask other people in the industry what they are paying for services. Take the next step and research pricing with contractors and reference guides such as those produced by the American Institute of Architects.

In addition to contractor pricing, project elements can significantly impact the cost of a project. The elements listed below significantly impact building costs. Understanding your project in detail is critical. You want your contractor to make money, at the same time you want to be sure that you aren't paying too much. Be sure to evaluate: • Scope of work • Geographic and site factors • Security • ADA requirements • Design factors • Qualitative and performance factors • Delivery process, legal, and administrative factors • Market, competition, and economic influences • Risk factors

Further attention should be paid to make sure that the contractor isn't leaving you with extra liability. Know the answers to questions such as: Are they fully insured? Do they have worker's comp? Do they perform their work by obtaining permits when needed? You need to check on these things before they come up as problems when the project is nearing completion or after it is sold.

Capital Development is essential if you are going to buy multiple houses to flip and fix or buy and hold. Where do you get the money to buy and hold houses? You might qualify with a traditional bank for a single investment property loan relatively easily. However, as you add more properties to your portfolio, the bank's scrutiny of your portfolio will increase. They will start measuring your debt service coverage ratios to see if your rentals are performing well enough to cover your debt by a factor of 130% or more. Furthermore, they will want a very detailed accounting of your finances including personal financial statements and three years of tax returns. If this is too much for you to deal with, alternative financing through a hard money lender is going to be a great option for you. A hard money lender is going to be looking primarily at the asset and giving you an asset-based loan without looking at everything in your real estate portfolio or your personal finances. This gives you greater flexibility than a traditional bank loan. Of course, that is where Clear Sky Financial can fit into your financial needs.

Next month we will explore the remaining stops on the roadmap to wealth in residential real estate investing.

January Deals

3124 Fait Ave.

6322 Mary Todd Ln.

15477 Baden Westwood Rd.

25 Akin Ave.

7615 Greenleaf Rd.

2926 W Street

4655 Hayes Street

212 54th street

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