Private Money Update

CLEAR SKY FINANCIAL NEWSLETTER

MARCH 2018

Letter from the Editor

We hope your springtime is off to a wonderful start. February was a slower month for originations. We originated three loans for a loan volume of 1.115 MM. March is shaping up to be a busy month for originations and for loan paybacks, so stay tuned! We have already done five loans so far this month, and we still have almost half of the month left to go.

CHUCKLE'S CORNER

Sometimes all you need is a billion dollars.

- *anonymous*

FOOD FOR THOUGHT

We will be participating in our 3rd THINK REALTY conference in Baltimore, MD. The event will take place on Saturday, April 14, from 9:00 a.m. to 5:00 p.m. We will have a booth, and will also be doing a breakout session after lunch. Our presentation will be "THE X'S AND O'S OF HARD MONEY LENDING". Please join us!

Additionally, we are new sponsors of TRACTION REIA, a Northern Virginia real estate investment club. TRACTION REIA has monthly meetings with an average of 100 attendees, most of whom are new to the investment space. Beginning in June, we will be the only hard money lender sponsor. We also speak for 5-10 minutes at each meeting. We hope to see you there!

In This Issue:

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The Nine Biggest Real Estate Mistakes and What to Learn from Them

As a real estate professional, you are constantly being challenged. You need to make decisions that ultimately affect your buyers and sellers and, of course, your business. These choices can lead you down one of two paths: success or failure. Mistakes are inevitable, as with any venture, but your response to those mistakes can mean the difference between a successful business and an early exit from the industry.

1. Understand Your Investment Personality
Gaining a deep understanding of your style of investing is crucial with real estate. Some like to be adventurous and flip for profit, others like a steady cash flow. Whichever you choose, make sure it's something you see yourself doing day in and day out. Otherwise, you'll wake up in 10 years having created a job for yourself and not the dream you wanted.

2. Hire A Professional Home Inspector
Spend the time and money to hire a professional home inspector. Even for smaller deals that might be all cash, an inspector can help you negotiate a better price or avoid a money pit altogether.

3. Trust, But Verify
Relying on representation about a property's condition when investing may not always work out favorably. Having independent reviews by licensed professionals can allow you to validate any representations about a property's condition. For example, an inspection report or an appraisal before buying a property can provide an independent opinion on the potential risks that need to be addressed.

4. Don't Be in A Rush
As the old saying goes, "bulls make money, bears make money, pigs get slaughtered." The real estate market is cyclical. If you have the wherewithal to hold an asset long term, you should not be in a rush to sell over market speculation. However, if you are looking to offload an asset quickly, ask yourself if it is really worth that extra percentage point or two by holding out for a specific price.

5. Keep Your Cash and Make Huge Profits
Some grew up learning that you pay cash for everything, including your house. Living debt-free is a great way to live. However, real estate investing is a different animal. Spend a fraction of your liquid cash to purchase 10 homes instead of one. Have the renters pay off your mortgage in 10 years, and now you have 10 homes providing cash flow instead of one. Let renters pay off loans and you will profit.

6. Make You and your Business Scalable
We always have the discussion of what business should we focus on - hard money vs. flipping. The problem with flipping houses is that it is not as scalable as hard money or even wholesaling. Also, as any realtor knows, it is much easier and scalable to just collect listings than to work with buy clients!

7. Stick to Your Criteria
You know that sickness we all get from time to time, called "dealitis?" When you just need ONE more deal or feel excitement around a property so you loosen up your buying criteria? The side effects can be lost money, lost time, frustration, sleepless nights and general malaise. Leave yourself open for better deals. Stick to your guns; an ounce of prevention is the only cure.

8. Make Sure You Hire the Right Contractors
Contractors will make or destroy a beautiful, rehabbed house and investment. They can break the bank or work with it! Find a good, reliable contractor when doing rehabs. This is the best advice that I can give from my experience.

9. Don't Hold on for the Turnaround
We had six rentals that were upside down due to the market crash in 2007/2008. We had to pay the banks money for a capital call. We thought about selling the rentals but would have lost a lot of money. Instead we met the capital call, held on to the houses and both the houses and rents are closing in on record highs.

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Institutional Funding of Alternative Financing Companies

There are many changes taking place in the alternative financing space. Investment companies and individuals are anxious to deploy capital at high rates of return into what they see as a stable real estate market. Most interesting is the entry of institutional money into the space. We recently spoke on a panel with a competitor whose capital comes from large financial institutions. It was a great conversation that gave us an opportunity to clarify our understanding of their product positioning and of how they are funded/capitalized.

While the competitor's lending operation is local, they are selling all off the underlying notes and most likely the servicing of the notes to an institutional investor. Effectively, our competitor is a loan broker for hard money loans. The institutional investor who they sell their loan product to manages risk just like any traditional lender. They run credit and require a 20% down-payment from investors. While this might seem like a good qualifier, it doesn't get to the fundamentals of any flip.

To know if a flip is going to work, the borrower's track record and ability to execute needs to be qualitatively evaluated. How much equity the borrower has in the transaction is important, but not as important as their motivation and how much they stand to make upon completing the transaction. A 20% down-payment helps mitigate risk, but not nearly as much as understanding the marketability of the property after it is repaired. For example, a house that could technically appraise but is located in an area that is moving slowly is a serious risk and could slip through the traditional lender's risk evaluation model.

Nationally funded hard money companies have entered the marketplace for the last 12-18 months, but they are not here to stay. As institutional interest rates rise, our competitors who use institutional financing will find that their margin between their cost of funds and the rate they lend at will be compressed. They rely on scale to make money and a large staff will be a huge burden in a downturn. If and when the market takes a downturn, they will have their funds deployed in areas and houses that are hard to move and their exit strategy won't be locally driven. They won't have a network of local contractors to call on to finish products and their cost of liquidating properties will be higher than ours.

I believe that in the long term, fix and flip lending will continue to be driven by lending businesses who are close to their customers and understand their projects. Having a principal spend time close to a customer may limit the scalability of our loan operations. However, this is the best way to mitigate risk and provide positive results in the long-term for investors and borrowers alike. To that end, Clear Sky Financial is staying close to both our investors and our borrowers.

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DEAL OF THE MONTH

This deal involves our sister company, Clear Sky Properties, LLC. We own and have flipped many properties in this LLC. We recently did our first Contract for Deed (Land Contract). A Contract for Deed is a contract in which a property title is transferred only after the buyer performs on a contract to buy the property. The deed is held in escrow until the completion of the contract. This type of transaction is performed when a buyer cannot qualify for a mortgage, but has a good income and a decent down payment.

We purchased this property as a foreclosure from the courthouse steps for $322,746. The occupant was the former owner who was going to bring the loan current but couldn't access her money to stop the sale. She wanted to stay and continue her ownership interest in the property. We agreed to do a Contract for Deed. About a month later, we sold it back to her in the form of a Contract for Deed for $425,000 with a 50/50 split of any profits above $475,000. The After Repair Value of the house at the time was $480,000. So it is a win/win. We are the bank on this transaction as we are holding the loan for $410,000. Once she pays off the $410,000 plus a 50/50 split of any valuation over $475,000, she will own the house. She has three years to do this. We will help the former owner get her credit restored, as there is a foreclosure on her record.

DECEMBER DEALS

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6300 Dana Ave.

7536 Campbell Court

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