

Letter from the Editor

As we transition to fall and welcome the kids back to school, we want to wish you a happy September! We hope you had a chance to enjoy some family time, and catch up on rest and relaxation over the summer.

August was a reasonably strong month for loan originations. We originated four loans for a loan volume of \$1.2 million. All of the originations were First Trusts. Two loans were in Virginia and two loans were in Maryland. To date, September is also looking strong: by mid-month, we have already closed 5 loans.

CHUCKLE'S CORNER

"The safest way to double your money is to fold it over and put it in your pocket."

- Kin Hubbard

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Why Most Real Estate Investors Fail

I see many new real estate investors at the various Real Estate Investment (REI) meetings that I attend regularly, as well as at conferences throughout the year. I estimate that only one to two of every 10 new investors will actually complete deals. This does not necessarily mean that they are succeeding, but simply completing deals. Below are four reasons why many investors fail to reach their goals and/or fail to produce adequate returns for the amount of time and money invested.

1. Concentration on Technique (Lease Option, Subject To, Foreclosure, etc.) Rather Than on Property

Most investors new to real estate get mesmerized by a technique for acquiring control of real property and or a technique for turning a quick profit. These "techniques", often taught by "gurus" at \$5,000 - \$10,000 for training, workshops and tapes, emphasize no need for extended time and financial commitment (lease option, subject to) or emphasize quick turn profitability (foreclosures, flips, over financing).

Successful real estate investors concentrate on the property itself rather than on a specific technique. This not only allows the investor to concentrate directly on where most profitability resides, but also opens a much wider array of potential "deals" for the investor to consider. Furthermore, the investor can concentrate on the much more reliable profitability formula of "adding value", rather than on the more suspect and ethically questionable formula of finding a naive individual to work the other side of the real property transaction.

2. Plan on Doing Many Deals Each With a Small Amount of Profit Rather Than a Few Deals Each with Substantial Profit

Many investors both experienced as well as new are thrilled with a small profit on each deal. We call this a "base hit" or a "single". We are always trying to hit home runs but most of our deals are singles and doubles. Since unexpected expenses always seem to creep up when least expected in real estate investing, the actual profitability of these transactions range from half the expected profit to no profit. In order for the investor to earn enough income to warrant the time commitment, monetary commitment and risk involved, he would have to participate in a large number of deals annually. And since it always takes many negotiations to produce a single deal, and many property inspections to find a single property worth negotiating on, real estate investment will become a full time real estate business.

In my many years investing in real estate, financing real estate ventures, and observing successful real estate investors, I have come to the conclusion that participating in a small number of highly profitable transactions not only produces more monetary success but also leads to a much more leisurely, less stressful and more satisfying experience.

3. Having No Sustainable Plan

"I want to make a lot of money" is not a sustainable business plan. "I want to specialize in foreclosures, lease options, and subject to" is not a sustainable business plan. "I buy property for cash or terms" is not a sustainable business plan. Enough said. If you don't know how to develop a workable plan for real estate investing buy a book on business plans, attend REI meetings, attend conferences etc... Beginning investors will more in likely need a full time consultant available to coach them.

4. Trying to Do Deals with No Equity Contribution

Yes, it's possible to purchase real estate with no money. Yes, it's possible to flip properties for large profit with no investment. Yes, it's possible to option property for \$100. That being said, it's infinitely easier to successfully participate in real estate transactions when you as a real estate investor have an equity contribution in the deal. When you put some money in a deal three great things begin to happen. Conventional lenders become interested in financing your transaction and 20 % hard money rates or 30 % equity shares become 6 % conventional financing. Life becomes easier and the deals are much more profitable.

Buying distressed real estate at an auction can be extremely profitable and also a lot of fun. However, it does require a little more than just common sense. If you are interested in bidding at auctions, I suggest you attend a few first. There are many different categories of distressed real estate and a different auction format for each auction. Go learn who the usual bidders are and who is there to just buy one or two. As long as you are not bidding that day, talk to the other buyers and ask questions. Most buyers will not share their strategy, but they will be happy to talk about all the other buyers' strategies.

Understanding Demand

When Charlie and I entered the alternative financing business in 2013, we questioned how much demand there would be for our loan products. We thought that our growth could be potentially limited by the demand for rehab loans in the region. Since we observed so many people bidding at the auctions, we assumed that there was broad access to capital for renovation projects. We were partly right - there is capital available for renovation projects; however, we didn't originally recognize the competitive advantages our rehab knowledge would bring to our lending business. Using our rehab experience, we differentiate ourselves by structuring our loan products around our loss mitigation strategies. Our competitors have much higher loss mitigation costs. They have no expertise in rehabbing properties and are not closely associated with real estate brokerages for liquidating houses.

When Clear Sky Financial decides whether or not to lend on an asset and how to price a loan, the loss mitigation strategy for Clear Sky Financial is totally different than our competitors. Where our competitors rely on loss mitigation through quick sales and auctions, we consider what the deal would look like if we took it back as a rehab and sold it through our real estate brokerage. We put on our "expert renovator" hat and determine how much a property would cost us to renovate and how much we could obtain for a fully renovated property. Since we are renovating 6 to 12 houses at any given time in the parent company Clear Sky Properties, LLC, a loss mitigation event like taking a house back in Clear Sky Financial would not require us to develop any new skills.

By understanding the borrower's complete renovation strategy, we can share our expertise with the borrower and add value to our loan products. Beyond information, we can lend in situations where other lenders might not have experience. We understand the risks of rehab and the costs associated with architects and permitting. Our clients are very loyal to us as they know we can deliver a loan very quickly. Deep knowledge and strong service has resulted in our obtaining a concentration of great repeat customers. The better we know our customers, the more likely they are to call on us again for their next loan.

Food for Thought

Our business is all about cash flow! Cash flow is the heart and soul of a business, and some people believe it is more important than any financial statement or tax return. It is the blood flow of a business, and without cash flow, there is no business.

Currently, we have 70 loans in the Clear Sky Financial family. Each loan has a payment stream associated with it. On some of the loans we originate, we collect 6 months to 1 year of payments in advance of their due date. These loans make up about 10% of our loan volume and don't play into our cash flow projections.

The remaining loans generate approximately 60 cash flow-related payments each month, which is a relatively large number of transactions. On the outbound side, we make interest payments on Clear Sky Financial's note obligations.

Earlier in the year, we tried using a third-party servicer to handle the inbound payment processing and ease the burden of collecting payments. This approach proved limiting because the payment processor took 10 - 11 days to remit funds to us. This processing time extended our timeline for collecting and reinvesting cash, which slowed our growth.

Beginning October 1, 2017, we will process our own payments to gain greater control over our cash flow.

DEAL OF THE MONTH

This month's deal was a foreclosure purchase that was made by Clear Sky Properties (the affiliate property company to Clear Sky Financial).

We attend many auctions throughout the month at the various courthouses in the Northern Virginia/DC area. In Virginia, the foreclosure auctions are handled at the courthouse steps through a substitute trustee. The substitute trustee has the authority of the bank to sell the property. In D.C., auctions are done through auction houses such as Alex Cooper and Harvey West.

In Virginia, there are many law firms that are the substitute trustees for the banks. All experienced investors know the most common law firms that do auctions. We call the law firms that do very few auctions "one off firms". The one-off auctions are harder to track as they are not advertised consistently in any one publication or at any one time. Through persistent research, we know about almost all of these auctions.

The real pros are at the one-off auctions. This past week we attended a one-off auction and purchased a property. We were the only bidder there! This does not happen very often; however, this was not our first time in this situation. It takes a lot of work and dedication to find these deals but they do exist! The profit margin on this particular house was much higher than the margins we achieved at our other auction purchases this year.

AUGUST DEALS



8611 Reicher Street



8532 Springman Street



11515 Orebaugh Ave.



7222 Bunker Hill Rd.