Private Money Update

CLEAR SKY FINANCIAL NEWSLETTER

July 2021

Letter From the Editor

June was a record month for Clear Sky Financial! We did 11 loans for $4.86 million. The loan to value compared to the after repair value was 72%. We like to see this value between 70 to 75%. All loans were first trusts. We closed two in Washington, DC, four loans in Maryland, and five in Virginia. July looks to be a slow month.

We seem to be expanding our private lending business in an environment that is incredibly challenging for those seeking distressed assets due to the ongoing foreclosure moratoriums. As a result, we are increasing our market share % in DC, MD, and VA.

We want to welcome Matt Jenkins as a new investor with Clear Sky Financial!

CHUCKLE'S CORNER

"A budget tells us what we can't afford, but it doesn't keep us from buying it." –

William Feather

Food for Thought

We have launched a weekly podcast called *Basement Tales*. It is a podcast on various real estate investing subjects based around stories that have happened to us in the past. We will have 34 episodes out by the time you receive this newsletter. We also have a Highlight reel from Season 1. Below are links to our podcast.

You can access them on
https://podcasts.apple.com/us/podcast/basement-tales/id1541056033
or https://www.youtube.com/channel/UC0R91IRsAunltHsXN9ygf_Q

IF YOU LISTEN TO THE PODCASTS, PLEASE LEAVE US A REVIEW!

In This Issue:

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Hard Money Is Not Really That Scary

Plenty of times when I am speaking with investors they say, "I want to do a flip, or buy a rental, but I do not have enough cash and the bank will not finance me." The easy solution to this common problem is hard money. The following response I often get is either "What is that?" or "I heard they charge insane rates and are too expensive!" The truth is, hard money is not as bad as many people think. In fact, it is really easy to get financed!

What is hard money?

Hard money is also called private money. The funds do not come from a bank; rather they come from private individuals who lend their own money. Hard money lenders (HMLs) do not have as many regulations as banks do. Thus, it's easier to get a loan. Many HMLs are asset-based lenders where the asset is the primary focus on the loan, not credit or income. The drawback? They charge a higher interest rate than banks, and the loans are short term in nature. The lenders in the DC Metro area are charging 11–15% interest. The primary reason investors use hard money is for the *leverage*. The hard money lender/investor relationship is a team relationship. The investor uses the HML to make money and vice versa.

Below is an example of a deal. I will analyze the benefits of using hard money on one or our recent deals:

The home was a 3 bedroom, 2 bath home for $200,000. The exit strategy was a fix/flip. The after repair value (ARV) was $350,000, but it needed $50,000 in repairs. If you used all cash, you would need $250,000! This might be hard to come by. If you did have it, what would you do if you got another great deal in the door?

Now let's take a look at the deal using hard money:

The hard money lender has the following terms: 3% loan origination fee, 12% annual interest, 10% of purchase and rehab cost for down payment and loan up to 70% of the ARV. So, let's break it down with a purchase price of $200k and rehab cost of $50k. The loan amount would be $225,000 (Simply 90% of $200,000 + $50,000). The origination fee is $6,750 and the down payment was $25,000. So, to purchase this home you would need $31,750.

What about holding cost for the loan and closing fees?

This lender charged $1,200 in total additional closing fees; holding it for 6 months would be $13,500. So, to purchase this home and rehab it with hard money, you would only need a total of $46,450. Keep in mind we understand there are other holding costs such as property taxes, HOA fees, utilities, and insurance costs.

What is better than only having to use $46,450 to purchase and fix the home? It is the fact that once the property is sold, the investor is looking at a *net* profit between $50,000–$60,000 (fees such as selling closing costs other holding costs factored in). This is more than a 100% return on your money. Where else can you get that return? If you purchased it all cash and renovated it all cash, the return would have been between 20–25%. Not so scary after all!

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Understanding Institutional Incentives

Let's examine why real estate prices are high and what Wall Street is doing in the housing market. Everywhere you look, you hear about the high price of housing. I am reading current news articles that implicate Wall Street firms such as BlackRock as part of a larger conspiracy in the housing market. The conspiracy theory goes something like: Wall Street is buying up houses at 15% over their appraised value with the intention of crashing the housing market and taking advantage of the fall in prices through short positions. This simply isn't true. Like most conspiracies, there is an element of truth in it linked to an irrational thought and then to a very unlikely cataclysmic event.

Institutional investors from Wall Street play a very small role in the single-family housing market. Financial institutions do purchase single-family properties for rental purposes. These purchases are generally part of "fund" investments. The funds are looking for similar assets in a geographic region that can be professionally managed for fixed returns. Such funds are designed like mutual funds to invest in a specific sector—in this case it is the residential real estate sector. Since the funds must be deployed into housing, the institutional investor has a strong incentive to buy houses at higher than market rates. Furthermore, since institutional funds can borrow money at an even lower rate than homeowners, they can afford to pay more for the same house than a homeowner. Their low cost of funds and their contractual obligation to buy houses to fill their fund enable them to justify spending 15% or more on the house than a homeowner with traditional financing would pay.

The reason it is profitable for Wall Street firms to buy single-family housing is that preexisting housing is in short supply. Local governments and anti-growth constituents fuel this problem by driving up the cost and limiting expansion of the housing stock. The cost of labor and materials is high and has driven up the cost of new housing. As a result, preexisting housing stock has become more valuable. Since the housing inventory is outstripped by demand, housing is increasingly treated as a commodity. The more housing is commodified, the greater incentive there is for institutions to play a role in the housing market. But as for the thought that institutional involvement is designed to prop up housing only to crash the market—well, that is just fake news.

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June Deals


8333 Wrenford Ct.


3152 Cityscape Dr. NE


34756 Railroad Ave.


223 Peabody St.


1955 Waterloo Ct.


903 Quietview Dr.


9325 Hayden Dr.


12403 Parkton St.


4820 Ponderosa Dr.


904 Blue Ridge Ave.

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