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Understanding Creative Commercial Deals

Hosted by*:* Joe McCall
Guest: Paul Moore

Joe: Hey everybody. Welcome! This is Real Estate Investing Mastery Podcast. You're in for a cool treat because we've got a special guest. His name is Paul Moore from Wellings Capital. We're going to be talking about creative real estate, one of my favorite, favorite topics.

Joe: Okay, if you're listening to the audio of this on iTunes, I want to thank you for doing that. Please leave a review. Go subscribe to the show in iTunes, leave a review. We'd really appreciate it and I always do something special for people that leave reviews. If you leave a review on iTunes and you send me a screenshot of your review, I will send you the PDF of my brand-new book called REI Secrets. Did I just say that? I did. I'll give you the PDF.

Paul: Are you actually doing this?

Joe: I am. Yeah. Well, this is a physical book. I'm going to tell you guys in a minute how you can get the physical copy of this book. If you go to REISecrets.com. If you want a free PDF version of this, I shouldn't even be saying this, but I want some reviews and I'm willing to bribe you even if it's a bad review. I don't care. Leave me a review in iTunes, send me a screenshot of your review. Send this, send this screenshot to support@joemccall.com, support@joemccall.com with a screenshot of your review and I'll send you back a PDF of my book. Cool. Alright.

Joe: And if you want this book, it's called, I just released it this week, Paul. And it's called "Daily nuggets for real estate investing wisdom to help you get more leads and close more deals" and just short little two, three-page chapters, giving some daily inspirations, stuff like that.

Paul: I think I need that because I have a show on Bigger Pockets and I actually do this Q and A for an hour. It's exhausting, man. People throw at me all kinds of stuff and I could probably benefit from your book.

Joe: Well, okay, I'll send you one. We're going to get into this too, guys. Paul is a special guest here and he spends a lot of time on Bigger Pockets and Bigger Pockets has a fantastic podcast. They probably have 300 million times more listeners than we do, but that's a

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really good show. There's a lot of really good investing podcast out there, but if you want this book really quick, get it for free. Just pay shipping and handling. It's eight bucks. Shipping and handling. It costs me about $10 or $11 to print and mail this thing. I just wanted to keep it affordable, but I'll send it to you for free. Just pay the shipping of seven bucks at REISecrets.com. REISecrets.com. Okay, cool.

Joe: Paul, welcome to the show from Wellings Capital. Hey, how are you, sir?

Paul: I am so happy to be here. I'm doing great.

Joe: Awesome. Thank you. Thanks for being here. You were recommended from a friend and I looked at your bio. I looked at your information. You've been in the business a long time. You've got a lot of experience. You're active in the Bigger Pockets community, which is an amazing community. And I'm honored to have you on the show. I'm glad you're here.

Paul: Hey, it's great to be here. And you know, I know you've been involved a lot and I see you on Bigger Pockets almost I guess probably every week. So, it's, it's an honor to be here. Thank you.

Joe: Hopefully they're not saying anything bad about me.

Paul: All good.

Joe: Alright, cool. So, Paul, what do you do? Talk about how you got started in real estate a few years ago.

Paul: Yeah, so I sold my company in 1997. And once I sold that I had way more money than I had sense and I thought I am an investor now. And I actually was a speculator now. You know, investing is when your principal is generally safe and you've got a chance to make a return. But speculating is when your principal is not at all safe and you've got a chance to make a return. And speculators are some of the wealthiest people in the world, but they're also some of the brokest. Is that a word? And some of...

Joe: I was one of those guys at one time.

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Paul: Yeah. And so there's nothing wrong with delivering pizza by the way. But anyway, seriously, it's a, it's okay to speculate as long as you know you're speculating, but it's probably better to invest. And so we can talk a little bit about that today. But I made a lot of mistakes early on. I ended up, you know, I speculated a lot and I invested some and I ended up two and a half million dollars... I had a million and a half in the bank in 97. Exactly 10 years later I had two and a half million in debt and that was going in to the great recession of 2008. And had a lot of fun with that whole process and I ended up completely debt free, even paid off my house 13 months later. But that's a story for another show. So I have...

Joe: Well wait a minute. Can you give us the Reader's Digest version then? What'd you do?

Paul: I can, it's not conventional in any way. So I was, I have this practice of morning meditation and it was November of 2007. Now, keep in mind, we had no idea we were about to go down this hole into the great recession. In fact, the bumps we had seen already in 2007 we assumed were the end of it. You know, we assumed all the worst is over. Some people thought the worst was yet to come. And of course, they were right. But anyway, I had this thought, what would George Mueller do? Who's George Mueller? George Mueller is a 19th century guy. He was as hellion in Germany and he moved to England and he became more of a saint. He actually housed 10,000 orphans in total over many, many, many decades. Pretty much all of his life... he lived to really old.

Paul: But he did that doing these, using all these unconventional tactics, including never ever asking anybody for money, but he raised some people think close to a half a billion in today's U.S. dollars. And, anyway, I thought, what would George Mueller do? Well, I knew a lot about him. I'd read a few of his biographies and I realized he didn't believe in debt, so I was already in trouble. Right. But, at any rate, I also knew that he would do some really outrageous, unconventional things. And I thought, well, what would that be for me?

Paul: Well, for me, that might look like giving our way out of debt. So, I sat down with a few friends and they said, well, you know, it's going to be hard for you to avoid bankruptcy, especially now that your partner quit and signed all over the debt all to you, which he did. And I said, no, I want to give my way out of debt. And that's about the reaction I got, you know, like silence. Anyway, our family started giving aggressively to small profits, charities, church things we were passionate about.

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Paul: January 1st, 2008, we gave a weekly amount, a set amount had nothing to do with our income, our success or failure. We were having a lot of that at the time. And a month later I had this light bulb idea that dropped out of nowhere about how to subdivide a five-acre piece of land. I was flipping lots at the time by the way, like a residential lots or vacant rural lots residential lots at a resort. And you can imagine how many people were building homes in 2008 at resorts.

Paul: Well, the chance of me selling these five acres subdividing and selling it were really low. But at any rate, I had this light bulb idea that dropped out of the sky. And, 13 months later, after a lot of toil, blood, sweat and tears, arguments with my bank, even in getting an attorney involved with the bank to try to get this out of, basically to get this loan paid off in the way I wanted, anyway, 13 months later we were completely debt free, even paid off our house, right in the very heart of the recession.

Joe: So, who'd you sell the lot to?

Paul: What I did is I found a really creative way, well, this is creative real estate... I can tell you the story, but it might take a few minutes. I found a really creative way to subdivide into five one acre lots and I sold them for a total of like 1.3 million, right in the heart of the recession. It's still amazing to me now.

Joe: Well, I love the story. One of my favorite books is the Go Giver. And, I am a big fan of being generous and I've seen in my own life, you know, I believe in tithing, you know, I think it's really important, but there's something that happens. I think it's a spiritual law that when you give and when you are generous, God blesses you back. Every single time.

Paul: Right, I agree.

Joe: Yeah. Okay, cool. So, this was... What happened after the market crashed? By the way, a little history of you back earlier, you were a big shot at Ford Motor Company, weren't you, at one time?

Paul: I actually wasn't a big shot. I was on a management development track and you know, there was a chance I would have done well, but I only was there for about four and a half years till I veered off and started my entrepreneurial ventures.

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Joe: Okay. So, you started... Was that your first major job that you had right out of MBA? Okay. So, you got your MBA, went to Ford Motor Company, and then what'd you do after that?

Paul: So, five years into Ford almost, we start a staffing company. I was finalist for Michigan Entrepreneur of the Year a couple of years, and then we sold it to a publicly traded company. Then I spent a couple of years starting a nonprofit, which was an international student ministry in the Blue Ridge Mountains of Virginia. We started flipping houses in 2000.

Joe: In 2000. All right, so market crashed. That's the first time I've ever heard a story like what you just shared. That is cool. Crazy. And that's awesome. So, what'd you do after that?

Paul: So, we were flipping houses then flipping lots and we built ground up construction, did modular homes, veered off for two and a half years right after I got debt free, and...

Joe: What state was this in, by the way? I'm sorry.

Paul: All Virginia.

Joe: Virginia. Okay.

Paul: Yeah. Then I spent two and a half years getting trained in copywriting, which helped me tremendously with Bigger Pockets and everything I'm doing now. I wrote a book on real estate investing in 2008. I was on HGTV once in 2011, got into commercial real estate. And Joe, I gotta tell you, if I would've only known at the beginning about the power of commercial real estate to create wealth, I never would have done anything else.

Joe: I definitely want to ask you some questions about that. It's something that I don't know much about and honestly, it's a little intimidating to me but I'd love to learn more about it. So, the copywriting, I just picked up a book. It's some guy that I found on an ad on Instagram, and it intrigued me. It was called The Persuasions of a... No, Confessions of a Persuasion Hitman written by a guy named Ian Stanley. Okay. And I just bought another, it's about copywriting and I just bought another book by a guy named Jim Edwards. Does that name ring a bell?

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Paul: If it's who I think it is, I think he's a great copywriter. I mean, the other guy probably is too. I don't know who he is, but yeah, Jim Edwards is a powerful copywriter.

Joe: He's been around a long time. And it's a book called Copywriting Secrets. Yes. And I just picked it up. So anyway, that's not about real estate, although it does relate to real estate, doesn't it...? I mean, we're always selling things. We're selling ourselves. We're selling our business to private investors to, for raising capital, to sell our deals. Yeah. That's what's been fascinating to me. The whole business of selling, selling your knowledge, selling your deals, selling your skillset. We're all in that business, aren't we?

Paul: Right. We sure are.

Joe: Cool. All right. So, I want to talk to you about the commercial and how you kind of got into that. You're also kind of well-known in the Bigger Pockets world and elsewhere being one of those guys who really understands creative real estate, right? What is creative? How do you define creative real estate? What does that mean to you?

Paul: I would say just using non-conventional, but not necessarily risky strategies to create and sustain wealth. And so commercial real estate, I mean honestly, you know, residential is too, I'm sure in many ways, but commercial real estate's well set up for that because there's, you know, in residential, in real estate, if I'm Chip and Joanna Gaines junior, you know from what's that show called, Fixer Upper or something, you know, I might be able to take a $300,000 house and I might be able to spend half a million on it and you know, I've got 800,000 in it, but if it's in a $350,000 neighborhood, I'm probably not going to get my money out of it because residential real estate is based on comps.

Paul: But commercial real estate's entirely different, Joe. It's based on a formula and that formula is very simple and its value. The value of the real estate is the income divided by the rate of return. In other words, the net operating income, not including debt divided by the cap rate or the rate of return on an asset like that, in a market like this in a time like this. And so, cap rates used to be about 10%... people wanted to get a 10% return on their money. Unfortunately, they've compressed to about a 6% right now. In some places it's seven, but a that cap rate being 6% means that you have to pay almost twice as much to get the same income stream. You know, true wealth, Joe, is... I define it as assets that produce income and commercial real estate's well set up for that.

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Joe: Good. Can you give us some examples? What kind of commercial real estate and what are some deals that you're involved in right now?

Paul: Yeah. So, I'm involved in actually, would it be okay if I kind of give you a strategy and then use a couple examples?

Joe: Okay, yeah, of course.

Paul: I'm writing a Bigger Pockets article right now. I'm going to call, the draft version's called The Grand Slam, which, which is probably a little too cute. But anyway, commercial real estate's best strategy to avoid risk, maximize profits and thumb your nose at the coming recession and basically the strategy, it really does avoid risk. Commercial real estate in general as you know, is an incredible tax shield, accelerates profits. I mean, and it's, we are using this strategy right now in some powerful ways.

Paul: So, first of all, this strategy applies to commercial real estate. We are personally, secondly, using recession resistant assets. And to us that would include self-storage and mobile home parks...

Joe: Recession proof assets?

Paul: Recession resistant, yes.

Joe: Recession resistant. Why is that? Can you explain that really quick?

Paul: Yeah. So mobile home parks for example, they're the last rung on the housing, lowest rung on the housing ladder above living under a bridge. And, there's a real affordable housing crisis. I mean, jobs are paying less and hours are being cut since, you know, since the health care laws and you know, Joe, 10,000 people are turning 65 every day, but six out of 10 have $10,000 or less saved for retirement, which is stunning. And a lot of those people do have home equity though and they're willing to trade it in to buy a used or new mobile home and slash their costs to, you know, $200 to $400 a month in lot rent. And so mobile homes are largely recession resistant.

Paul: Self-storage, you know, they do well in good times cause people need a place to store their extra stuff and they tend to do well in bad times because when people are downsizing

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from their large home to a small one or a small one to an apartment, they need a place to store their stuff. If I raise rent on an apartment in St Louis by... if I have a thousand-dollar apartment I'm renting you and I raise your rent by 6%, you may choose to leave that apartment rather than sign up for another $60 a month for 12 months.

Paul: But if I raise your rent on your storage unit that costs you $100 by 6%, you're probably not going to take a Saturday, rent a U-Haul, gather your friends to move your junk, I mean your treasures, down the street to save $6 a month. It's a very powerful asset class for that reason. So, so we're talking about recession resistant assets. Of course, multifamily fits into that category as well.

Paul: A third part of the strategy is acquire from a mom and pop. You know, I've written a lot about some Bigger Pockets, of the 44,000 mobile home parks in the U S, about 40,000 are owned by mom and pop operators.

Joe: Say that number again?

Paul: About 90% of the 44,000 mobile home parks are owned by mom and pop operators. Yeah. And self-storage about 76% owned by independent operators and the number of self-storage facilities in the U.S., Joe, as about the same as McDonald's, Starbucks and Subway combined. Yeah, about 76% owned by independent operators. Perhaps half or more of those are mom and pops.

Paul: And so, mom and pops don't know how or don't care or don't have the resources to maximize income and raise the value. They're getting older on average, they're mismanaged, they're poorly marketed and they have excess capacity they don't use. Some of them, you know, might be three acres of self-storage facilities on a 10-acre parcel of land, things like that. And they've got a ton of untapped ancillary income potential that can be tapped.

Paul: Now the next step of this, so that's three steps, commercial recession resistant, buy from a mom and pop. Step four is upgrading to institutional quality and basically that means just, you know, maximizing value, adding ancillary income. Here's a quick example: at a self-storage facility without spending any money you can add U-Haul and listen to how it affects value potentially. So, we just invested in Grand Junction, Colorado, a self-storage facility, and we added U-Haul, our operating partner did, and that added $3,900 a month

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to the income. So, $3,900 a month. I'm doing this off the top of my head, I think it's like $45k, $47,000 a year. Divide that... Remember our value formula, Joe; value equals net operating income divided by cap rate.

Paul: So, if you divide an additional $46,000 a year by a cap rate, let's say at acquisition their cap rate was 7%... that's 0.07. We just added over $600,000 in value to that asset! Now, if we paid 2 million for the asset and we financed two thirds of it with debt, that means we only had 667,000, let's say, in cash in it. We just potentially doubled the value of that cash. In other words, we just appreciated the equity by 100% just by one simple operational change. Joe, I could turn around and sell that facility a few months later, maybe a year later. And if I did nothing else, there'd be a significant profit there.

Joe: You can't really do that with houses.

Paul: You can't really do that with houses. That's right. And so now you're starting to see where I'm going. So, let's say you increase occupancy from let's say 70% to 90%. Let's say you increase rates from 30% under market up to 95% of the market. Let's say you added locks, boxes, tape, scissors, late fees, admin fees, insurance, adding insurance alone, $5 per unit times 800 units. Let's say you could do profit sharing on the insurance, $5 a unit times 800 units. That adds about $700,000 to the value of that facility using our happy formula.

Paul: And so, this is a powerful driver to increase income and wealth. So, now you've got the income in our formula increased. Now let's go to the next step and see if we can compress the cap rate. And we do that by selling to an institutional buyer. Now, what do life insurance companies, reeds, pension plans all want, they want to pay large check sizes. They don't want to spend 2 million on an asset. They'd rather spend 20 or 50 million.

Paul: Second, they want it to be stable. They want stabilized assets. Third, they don't want a whole lot of hassle and drama. And they want predictability and they want institutional-like, franchise-like operations policies and procedures, you know, good marketing, all that stuff. And so, our operator takes this poorly run asset, turns it into a great asset. And then to get large check sizes, they put a portfolio of these same assets together, maybe five of them, and then they can get what's called a compressed cap rate.

Paul: So, in other words, the denominator of our formula goes down from let's say 7% to let's say 5%. And Joe, that change alone is a change if you do the math, of roughly 30% of the

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asset value. But with leverage, 30% of the asset value might be 60% to 90% in the value of the equity on top of all the other changes I already mentioned. So, we've got operators, I'm finally getting around to your question... Operators who use this strategy and have done, they have just been kicking butt. Can I tell you that? And so, I'm going to take a breath here and see if you have any questions and then I'll give you a few examples.

Joe: Well, I'm looking forward to the examples. The thing that's coming to my mind is, and I, I'm speaking for a lot of beginning investors and I know you, you know, you're very active on Bigger Pockets in the community there. And so, you're seeing these questions as well. Like, how do I get started doing something like that? That seems intimidating. It seems a little overwhelming. What advice would you give to people who are maybe interested in exploring some of what you're doing? Would it be, you know, being, helping to lend some money? Would it be offering to help raise some money to become, to kind of learn this business?

Paul: Yeah. So, in my Bigger Pockets article I'm saying, you know, you can do this yourself, you could do this strategy, but you're going to need access to equity, access to debt, a team that knows how to do it, going to need to set up an acquisition strategy and have the discipline to follow through on finding these mom and pops. There's a lot of moving pieces.

Paul: So, what we've done is we've created, and I'm not trying to advertise what we're doing, I'm trying to...

Joe: No, please, go ahead.

Paul: We're trying to provide, you know, like you said earlier on the show, commercial real estate is daunting. It's confusing. You don't know who to trust. How do you get in? We've provided an on ramp or a front door for people to invest in these types of deals. We put together a fund that allows accredited investors to invest once with us and then we spread it out currently over about 37 assets their one investment will go into, and many of them, I'd say half or more, are assets like I'm talking about.

Joe: Okay, good, good. I was interviewing somebody else who was talking about apartments and that was his advice. You know, just sometimes the best way to get in and learn the business is one of two ways. Bring some money to the table, you know, but if you don't have the money to bring to the table, find people that do, right? Find the people that have

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the capital and bring them to the deal. And you can partner that way somehow. So, can you give us some examples, Paul, of some of these deals that you guys are working on right now?

Paul: Yeah. Here's a really simple one. I already gave you the U-Haul example at the one facility. Here's a really easy to understand one. So, mobile home park purchased for $5 million. That's 3 million in debt and 2 million in cash, 2 million in equity. Now the asset manager goes in and he looks around and he says, this place is a mess. There's boats and RVs and work trailers and three or four or five or six cars parked in front of some of these mobile homes. We've got to clean this place up.

Paul: And so, he goes in and he paved an acre of vacant land that was part of the mobile home park in the front. And he said, okay, now there's this fence gated area. If you've got an extra car, a car on blocks, boat, RV work trailer, you've got to park it in here and we're going to charge you if you want to keep it here. And then once all the people in the community have done that, they go out on Craigslist to the community and at large and advertised boat and RV parking. Well, once this is full, he's going to be charging a total of $10,000 a month.

Paul: Now he spent only a hundred thousand to do this. So, $120,000 a year income, which is really pure profit on $100,000 investment. It's 120% annual ROI. And that sounds really good on that piece of the business, but it's better than that because let's go to our value formula. $120,000 in income divided by a cap rate of let's say 6%. 120,000 by 0.06 is $2 million in additional value. Well, hold on. He only has $2 million in cash in this. He just doubled the value of his equity.

Paul: And that doesn't include raising rents to market. That doesn't include filling up more vacant lots, charging back water and sewer to the residents, setting up internet for the residents, charging late fees and all kinds of other things that they'll do. They treat these residents very fairly, but they also treat them in a way that's, you know, it's a business. It's not a mom and pop operation anymore. And so that's one example.

Joe: Okay, cool.

Paul: Another one is a self-storage in central Oregon. I'll tell you this real quick. There's 300 units on 10 acres. It was acquired at a 7.25% cap rate, which is very fair to the seller. It was

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acquired for $1.7 million in January of 2018 we invested in, it has a net operating income at acquisition of $123,000. It was sourced off market by one of the phone team, the acquisition team, the gross monthly income at the time of acquisition, the potential I should say, was $20,095. It was raised almost immediately to $27,000. Rates were raised by 26%. Basically, the trailing net operating income was raised from, let me find my notes, 123,000 up to $203,000 and now the annual cash on cash return is 23%.

Paul: Now, the value of the facility at this time, remember it was $1.7 million at acquisition. Now it's $3.25 million. And so, by selling it next month, which we intend to, but there's no guarantee it'll go through, it's under contract for $3.25 million. That's providing a 104% IRR and a 3.7X return on invested capital... in other words a 270% return on the equity in less than two years.

Joe: It's amazing. I mean, these are big numbers and I just want everybody to understand this formula. It's a really simple but powerful, incredibly powerful formula. The net operating income divided by the value of that asset equals the cap rate. And that net operating income is your revenue minus your expenses with, and excluding debt. So, you're getting $100,000 a month in rent and you've got $50,000 of management, maintenance, vacancies. Are vacancies included in your net operating income? Do you take out money for vacancies?

Paul: Yeah, I mean it naturally comes out. Yeah. In other words, if there's a vacant unit, it's, you know, it's naturally not going to be part of the income anymore.

Joe: Yeah. Well do you in a big deal like that, we do it in houses, right, we... At least you're supposed to, you save some money every month of that rental income, right, in a savings account for vacancies and maintenance, repairs and capital, future capital expenditures. Do they do the same thing in the apartment business world, commercial business world, they save money of that income?

Paul: You know our cap ex as a percentage of revenue in the self-storage business. So, apartments average 12.5%, self-storage’s average is 4.6.

Joe: So, cap ex is capital expenditures. That's future repairs. Right.

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Paul: And then 4.6% I think for self-storage and under 3% for mobile home park cause you're just renting dirt. Okay.

Joe: So, what about vacancies and repairs or is repairs like cap ex as well?

Paul: They don't have to be, no. Technically they're not. They're more under, you know, their current annual repairs and there are certain percentage of revenue.

Joe: But you budget for that. Right?

Paul: You budget for that, absolutely. In apartments it's much higher in apartments of course. And of course, mobile home parks, as long as you don't own the mobile homes, it's very low. If you own mobile homes... Well good luck.

Joe: Okay. So, your, your, your cap rate is determined by taking the net operating income, which is your revenue minus all your expenses, not including debt. Alright? That's your net operating income divided by the value of the property. That's your cap rate. So, as an example too, if you know apartments and their cap rates are 7% right now or seven... To determine the value of that commercial business, you take the net operating income divided by 0.07 divided by 7% and that'll give you the value of the property.

Joe: So, what we're talking about here is if you just increase... That cap rate stays the same, but if you increase that net operating income just a little bit, it has a huge impact on the value of that...

Paul: It has a huge impact on the value of the asset and a larger impact on the value of the equity.

Joe: So, Paul, here's the question I want to ask you about like, okay, it increases the value, but to who? Like, so what, what does that mean? I mean now your commercial property was 3 million, now it's worth 5 million. But, so what really, like your property is really only worth what another person's going to pay for it. If you sell it, ever sell it, right? Why does it matter? Talk about this... why does it matter if you bought it for a million and now it's worth $5 million, let's say, or you know, $3 million? So, what, what does that do? What does that mean?

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Paul: Well, I mean that provides the appreciation to the holders of the equity. You know, bankers make a lot of money and they're very wealthy, but they don't get to share in this upside. They just get the interest on the loan. And of course, the shareholders, the equity holders, get this leverage return that I just mentioned, 270% in one example and 100% in the earlier example, they get all of this. And this is where leverage works for you. But I want to warn you with a bad operator, it works against you.

Joe: Oh, just equally the opposite way.

Paul: That's right. So, it works exactly the same against you if your income goes down.

Joe: Oh yeah. And you don't hear much about that. Right?

Paul: We need to talk about that.

Joe: Oh, so you know, but let's say now you bought this property for $2 million, you put 500 grand of your own money into it or you raised 500 grand or whatever, and now it's worth double that, it's worth 4 million because you're a good operator and you increased the net operating income. But again, so like, so what... Do you then refinance it? Do you pull out some of your profits, you know? Or, do you do, is that when you sell it and hopefully find a buyer who's willing to pay 5 million for it?

Paul: Yeah, you can do either. So, here's an example. We just invested in a small self-storage facility in Beeville, Texas, a town you never heard of. And this property was, I'll just summarize. Basically, it was $2.4 million in acquisition. They were asking five and a half million, but the kids were all fighting and that price was too high. So, the broker couldn't sell it. And our acquisitions team, our operation, our operating partners acquisition team got a hold of them and they were in a hurry to sell. They got it for $2.4 million.

Paul: Well, basically since March to now, what's that, seven or eight months, they increased the income and they stabilized this property and the value of the property is now up from $2.4 million, they got an appraisal for $4.6 million on it now. So, what they did is they bought it for cash, they improved it for cash and they went in, they got a $2 million debt for the first time on it. Well, guess what? That means they only have roughly half a million dollars in cash in this. If you have half a million dollars in cash and the value of the property just went

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up from two point whatever I said, 2.4 to 4.6, well that half a million dollars in cash just is now worth I think two and a half million, 2.7 to be exact.

Paul: So, you just five x'd or 400% profit on your equity.

Joe: So, they got one and a half million of their...

Paul: They can take their money back out.

Joe: They got one and a half of their million back, that goes back to them because they put 2 million in it.

Paul: They put 2.4 in it in cash and they got 2 million of it back. So, they only have 400,000 net in it, let's say.

Joe: So, then, but now they also have a note on this property, right? They have a debt on that property. So, could they refinance it again? Cause some people do this, they just refinance it every year or couple of years, right?

Paul: Yeah, they could, they could refinance all their cash out.

Joe: That sounds pretty risky to me.

Paul: Let's say they got two point... Okay, so if they take, let's say it's worth 4.6 million a year for now, let's say they can't raise the income anymore. Well, if they now refinance it, let's say they would've not refinanced it at 2 million, but they refinance it 2.5 million. So, with closing costs and everything, they're dead even, they have zero cash left in it. Well, 2.5 divided by 4.6, I don't have a calculator in front of me, but I think that's only 55% or so loan to value ratio. Not too risky.

Joe: Okay, good. What is the downside to this? What's the risk of doing these large commercial properties? I see some people getting into this business, Paul, and I'm a little nervous. Like it seems like the values have plateaued. You know, the cap rates have gone down or up. It's gone down, right?

Paul: The cap rates are at record lows, which means prices are at record highs.

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Joe: Right? So, people are still buying these things and now they're buying under-performing assets. They're going to stabilize them, bring them back up again. But what happens if interest rates start going up? What happens in 18 months, they can't refinance this thing out like they were planning on. Right? What happens then?

Paul: Yeah, so this is one of the advantages to long-term debt. I mean, one of our operators, most of our assets...

Joe: Yeah, that's really good... Long-term debt is what we're talking about. Okay.

Paul: But there's more to that than meets the eye. Let's talk through this. So if I'm a long-term holder of debt, let's say I have a fixed interest rate with Fannie Mae or Freddie Mac for 10 or 12 years, which we do on our apartments right now, and let's say that over the next eight years, let's say interest rates go up significantly, well likely, and you know, I can't prove this in the time we have, likely rents, there may be inflation and rents will go up at the same time.

Paul: Now at the end of some time, let's say those interest rates compress again back down to 4%. Guess what, Joe? It's likely rents won't compress along with them. And so, the advantage to somebody who can hold out through that 10- or 12-year period is that now they've increased revenue, their interest rates have gone up and then down again, but they don't care that much. The cap rate has gone up and then down again, and they care a lot because now their income is higher. The cap rate's back to where it started and oh my goodness, huge profit potential over that long-term hold.

Joe: Would you say it's, it's a smarter investment decision when you're buying commercial properties like this to stay in the median affordability index. You know what I mean, by like you're staying with properties that are in medium price rents B and C neighborhoods instead of going out to the more premium expensive areas. Does that make sense? What I'm saying, is that smarter?

Paul: I think it's, it's likely to be a smarter move. There are some assets that are, you know, that, I mean where it makes sense in class A areas, but generally the strategies I'm talking about are the, you know, better in class B. I don't really like class C areas, but unless it's a C plus there that can be brought up into a B.

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Joe: Good. Paul, I lost track of time and we're 10 minutes over and this has been a really interesting conversation. I know you got to go real soon. Can I just ask you a few more questions about your book? You've written some books, you're active in Bigger Pockets. I just Googled you and you've got videos, you have podcasts, you have blog posts and articles on the internet, some really good stuff. I'm looking forward to reading them and where can someone go to get more information about what you're doing, Wellings Capital, and the articles and stuff that they can read.

Paul: Yeah, they can go visit me on Bigger Pockets and check out my podcast. I've got a wealth building podcast called How to Lose Money. Would love to have you as a guest. HowToLoseMoney.com.

Joe: Cool... but is that a compliment? I mean, is it a good thing to be on your show?

Paul: No, not really, but no, it's, it's basically from, it's a super successful people telling us their stories of how they lost money along the path and how they learned from that, but the best way to reach me is at my website. It's wellingscapital.com that's W E L L I N G S Capital, wellingscapital.com. I also have a book called The Perfect Investment and that is on Amazon and I'm going to have a book called The Book on Self-Storage, which will be published by Bigger Pockets next year.

Joe: Excellent. Good for you. That's a big deal. That is a big deal, I would think. I mean their audience at Bigger Pockets is huge. Did you go to the last conference they just did?

Paul: Yeah, I spoke there in Nashville a few, six weeks ago. How about you?

Joe: I wanted to go; I couldn't make it. Was it a good event?

Paul: It was great. It really was. I mean the hotel, you know, the hotel, the facility was wonderful and it was just a fun place to be in Nashville. You know?

Joe: Those guys are good. I've had Brandon on my show before. I've only emailed Josh a little bit. Never really talked to him before, but those, they're good guys. Really good guys. It's a great community that is over there. Paul, thanks for being on the show. I know I've pushed you past your time. I apologize. I was the one who started late, but...

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Paul: No, this has been great. I really enjoyed being on here. It was a real honor, Joe, and we'd love to have you on our show. Let's catch up again soon.

Joe: I'll send you an email, Paul.

Paul: Okay, my friend.

Joe: Hey, it's been good. Thanks a lot guys. Hey, listen, go check out the show notes, the transcripts, all the links that we just gave you for the books and things like that that Paul talked about. They're on the podcast website at realestateinvestingmastery.com or just reimpodcast.com. Get the show notes, get the transcripts, get the links. Okay? And Paul at wellingscapital.com. We'll see you guys later. Take care. Thanks again, Paul. Bye bye.

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