Ep #60: Real Estate Note Investing with Dave Van Horn

Full Episode Transcript

With Your Hosts

Dr. David Phelps and Evan Harris

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You are listening to the *Dentist Freedom Blueprint* podcast, with David Phelps and Evan Harris. Navigating you through the uncharted waters of a turbulent economy with straight-forward advice to, transform your practice into a self-sufficient cash machine, compound your net worth assets, and multiply, multiply, multiply your passive cash flow streams.

David Phelps: Good day everyone, glad to have you back. This is Dr. David Phelps, the host of the *Dentist Freedom Blueprint* podcast, also the owner and founder of the Freedom Founders mastermind community. Glad to have you with us today.

You're going to really enjoy this segment because if you are a doctor, a dentist, a chiropractor, a veterinarian who has always wanted to be involved in real estate or maybe you have been involved in real estate and you've had some fun in the management of tenants and you've dealt with contractors and you've looked at *Flip This House as* something you've always wanted to do.

I've got to tell you, there's another side to real estate investing that can be absolutely as profitable but without all the moving parts—what I call the brain damage. So if you've been brain damaged or hurt in the past, you're going to love the call today.

My good friend is the president and manager of what's called PPR Note Company. That's PPRNoteCo.com. His primary responsibility with his company is in raising capital. He's also been a realtor. He's the founder of the Clearview House in Pennsylvania, which is the new beginnings for those entering drug and alcohol recovery.

He’s also dealt in construction. Has owned, and still owns I believe, a pretty solid portfolio of rental property. You’ve done painting. You’ve been involved with insurance products. He knows a great deal about the financial arena overall. That’s why it gives me great pleasure to introduce my guest, our expert today, Mr. Dave Van Horn. Dave, how are you doing today?

Dave Van Horn: Great, David. How about yourself?

David Phelps: Perfect, perfect. Well thanks for spending some time. You're a busy guy but you're always so great to provide your insights. You come to a lot of our Freedom Founders meetings. So thank you for what you do. I know part of what you do for your company is raising capital. You're good at that. I think that’s something that everybody likes to know about, but can you just take our listeners back to how you got started in real estate? Then we’ll bring it to current today and what you're doing with PPR.

Dave Van Horn: Well, it was pretty simple. I got out of college, went to school originally to be an accountant and I hated accounting. I switched to management. Got out of school, couldn’t get a job, and moved home to mom’s and was working in construction through college and was pretty depressed. Mom was like, “Why don’t you try real estate?”

So when I was like 26, I went and got my real estate license and started selling while I was still working in construction. I started to buy houses. I hate to say it today, but with credit cards. I would fix them and I was handy, so it was good.

But I had access to a lot of properties, and you're right, today I still own 19 properties believe it or not. I used to have 40. You know, I started out just being a regular realtor at first and then eventually got into the investment side as I was working towards my broker's license. I was taking investment courses and then I kind of got into the investment side. I want to build wealth as opposed to just earn commissions, that type of thing.

David Phelps: So what got you involved in the raising capital and particularly in the, what we can call the mortgage industry, the note or paper side of real estate. We'll define that in a minute, but what was it that took you in that direction? What, was it some eight, nine years ago?

Dave Van Horn: Well, actually it's been longer than that. It's probably, believe it or not, it's close to 15 years ago now. But what happened was I was doing my real estate business and I was in my own little world so to speak. I was running out of capital. Like I was capital constrained. I joined a local REIA group, a real estate investor association, and I was really going there to look for money. That was where I first was introduced to notes, the likes of Donna Bauer and Pete Fortunato. In fact, the first speaker I saw when I joined the group was Jimmy Napier.

David Phelps: Is that right?

Dave Van Horn: So I got introduced to notes and I got introduced to private and hard money. That's how I really first got into the note space. Then years later, I was raising capital, I started raising capital for commercial real estate. I was doing mobile home parks and storage centers. Then later on, commercial office condos.

So I was familiar with private placements of raising capital but I learned that because I went to work for a company where I was raising money for that company. So the company was paying me. So it was a unique way to learn how to raise capital. It would be just like somebody that went to work for JP Morgan or something to raise money or something like that. So you're kind of learning on their dime type of thing, which was kind of a neat way to learn.

Then when it came into notes, I just started my own companies and I already knew how to raise capital.

David Phelps: So when we're talking about notes, Dave, or private lending, let's kind of spell that out for people. Most people, as I said earlier on the segment today, think about investing in real estate by buying the property, buying a single family house, buying into an LLC that's involved in multi-family. Having an ownership interest. And that's great.

We know there's plenty of benefits in doing that and the reason why we both have portfolios in that arena. But what's a note? What does that give an investor? What are we holding when we hold a note?

Dave Van Horn: Well, it's actually a note and a mortgage combined when it's secured to a piece of real estate, right? So for me, what I was doing was I was looking for a loan to renovate a property or to buy the property and renovate it. The way it works is a typical bank won't give a mortgage on that type of property that needs a lot of renovation. It's a loan that the bank normally doesn't want to give.

So by going to private investors, they see the value in the after-repaired value of a property and they'll lend you typically 65 percent of the after-repaired value of a property. They might have a draw schedule where they release money to you.

So it's a very safe investment. It's usually a short term, it's really a short-term commercial rehab loan on a piece of residential real estate is really what I was getting into. The investor is secured to that by the mortgage and the note. The mortgage gets recorded and the note is the promise to repay the loan. So it's a secured investment for the lender because he has collateral that he could go after if the borrower were to default or something.

David Phelps: I do some of that too, Dave. I consider that to be certainly more passive than if I'm owning a property and managing the contractors and then putting a tenant in place or trying to sell it out on the retail market. But from a more passive standpoint, there's still some active involvement if you're being a hard money lender, right? I mean, there's some things you've got to know. There's some moving parts still there from a lender standpoint, correct?

Dave Van Horn: Yes. The reason being is you've got to go out and inspect the property. You've got to verify, you have to know about construction, which I did. You have to know, well how much construction does it need? Is the guy telling me the truth? Is it really worth this when it's fixed up? So you've got to validate the property values in the neighborhood. Then it's also a short-term loan so when you get paid back, you've got to go run out and find another deal.

But for me, one of the eye-opening things for me when I got into the private money and the note space was that I was doing property management at a RE/MAX at the same time. So I'm managing over hundreds of units and I'm going to court all the time. I'm doing evictions and inspections. Then I had the note business on the other side and I was like, "Wow, this is so much easier than this." That's one of the reasons I drifted into the note and mortgage space.

David Phelps: So is there a more passive component, a longer-term component that an investor who wants to get into the note side of real estate, is there a way for that person to have an opportunity to have a receivable, a note receivable secured by real estate as you said, that might go longer than the six months? Or could go five years or ten years?

Dave Van Horn: Yes, there absolutely is. So for example, there's the whole owner-financed industry. I kind of look at the note world as two worlds. There's the owner-financed world and then there's the institutional world, which is the banks and mortgage and service companies.

On the other side is the private mortgage world where you might see a grandparent hold a mortgage for a grandson on a property that they're buying from their grandparent. Well they might create a mortgage so that the child can buy the mortgage, you know, buy the property from them.

Or you might see a case where someone is selling a property and they hold a second mortgage to help facilitate the sale. I've done that when I've sold some of my rental properties. There were times when I held papers, that's what they call that, where I would create a second mortgage for the note buyer—I mean for the home buyer—to enable them to get in with less money down or something like that. To facilitate the sell.

So there's kind of two separate worlds there but a lot of those loans are much longer. You'll see second mortgages that could be ten and five years long and you'll see first mortgages that could go 30 years, you know.

David Phelps: So how would you from an investor's standpoint, Dave, feel about holding paper, a note, that had 20, 25, or 30 years to pay? I mean with the possibility we might have some relatively high inflation in future years, how does that make you feel as a lender?

Dave Van Horn: Well, you know, it depends. If you're buying the loan at a discount or not. There's a couple ways to look at it. Personally, I like the longer-term loans for certain things and then I like shorter-term loans for other things. Like my son likes the short-term loan that pays his car payment and he likes the short-term loan that pays his student loan. Me, I like some of the long-term loans in my IRA account because I'm approaching retirement age, right? So I kind of like these long-term loans in my IRA account.

The reason I like some of the long-term loans is a couple of reasons. One is it's interest-loaded in the front. So a lot of times when they're paying me, they're paying very little towards principle and they still owe me the bulk of the amount borrowed. Then sometimes you're buying some of these notes at a discount as well. So if you can buy a note at a discount on a long term—so there's advantages and disadvantages to both. Now, some people like to have a shorter-term loan, get their money back quicker and then go put their money into something else. So you'll hear multiple strategies.

David Phelps: You just talked about buying a longer-term note at a discount. Could you explain why that would be available to you as an investor? Why can you buy a note that say has a principle balance, remaining balance of say $50,000, you could buy that at some kind of a discount. What kind of a discount? And why would the seller of that note give you a discount, Dave? Particularly if it was a performing note?

Dave Van Horn: Well sometimes there's loans that were performing and then they might have gone non-performing for a period of time. Then maybe they're back performing again or have been modified. That's a particular note that can sometimes be bought at a pretty steep discount when you think about it compared to how normal mortgages are traded.

You're right, when a loan is first originated with someone with pristine credit and pristine property, everything's perfect, you'll actually see loans sell for more than origination. So it's in theory you could see a $100,000 mortgage be sold on the secondary market for $105,000 or $103,000 or $107,000. That's hard for people to believe.

But what you've got to realize is when you look at an amortization schedule over 30 years, you'll see that the person that's buying the house for $100,000 is really paying a couple hundred thousand over the period of time. So they're buying the rights to that cash flow stream.

Now once someone has banged up credit or there's something wrong with the property or there's something wrong with the paperwork, you might see that loan sell at a discount. So that $100,000 loan might sell for $70,000 or $80,000. It depends on the situation. But you might see a loan that went non-performing, a lot of first mortgages today are selling probably between 50 and 65 cents of fair market value.

So you could see a loan that was originated at $100,000, well maybe the property is only worth $80,000 now and maybe that loan would sell for $48,000. So you see all kinds of things.

David Phelps: So if you're a savvy investor, a savvy note buyer, you can buy a note at a discount based on the conditions you outlined, based on your due diligence. You not only get the monthly interest return, which as you said, is front-loaded on the longer-term notes, you get a principle repayment. But typically, Dave, what happens when a note pays off earlier than the full amortization? You bought the note at a discount, it pays off early. What does that do to your return?

Dave Van Horn: Well, your yield will go through the roof depending how early they pay it off. So if you bought a loan and it's only been a year and then you were getting paid off, your yield could be 80 percent return or 100 percent. It could go dramatically higher especially if you bought it at a discount because they still owe you that full unpaid principle balance, that full payoff. So the full payoff would include any late fees or missed payments or corporate advances. But the point being is you're buying that payoff.

If you buy it at a discount and they pay you off early, you might be getting a fixed return on the monthly payments but once they pay you off in full early, your yield goes up dramatically. So no, it’s a great opportunity to make some money in a way that you wouldn’t expect. Some note buyers, they get paid off early, now they get to go run out and find another note. But once you get past that, then you realize it’s a good thing.

David Phelps: Exactly, exactly. So I know at PPR Note Company, you guys run a tremendous amount of analytics. We’ll talk a little bit more about what you actually do at PPR Note Company in a moment but all the analytics you run, can you give our listeners some kind of an idea as to how frequently a note is paid off early? Or the people either refinance or they sell and move on and therefore the investor gets paid off.

Is there kind of a range where there’s an average point where a note gets paid off? Again, if we’re talking about not unique property, but you know, run-of-the-mill, single family house, in a good neighborhood. What would that look like?

Dave Van Horn: That’s a great question. I don’t want to sound like I’m dodging the answer but I kind of am, and here’s why I’m kind of dodging your answers. Because a lot of the loans that we get re-performing, we sell. And some we've held for a year to three years, but most of the time, the loans are being sold unless it's a weird loan like that you can't really sell. So think about it, we'll take a non-performing loan, and that's what we do. We have note funds that raise capital.

We go out and buy non-performing loans from banks and then we have asset managers that modify these loans with the borrowers. Once those loans get some kind of a pay history, a lot of times we're selling those loans off. So I wish I had a better answer for you. I feel like I'm deficient here but because the loan gets sold, I don't necessarily know what happens to it, although we warranty our loans.

We do buy some of them back but a lot of them do get paid off. I think you're going to see more and more of that with the economy right now because the real estate values are going up and people are able to start to move again, sell their houses again, and have enough equity to sell the house. So we're seeing more cash outs right now as a business.

For a while there, we probably went through close to a ten-year period of being in somewhat of a flat, down market. You didn't really see a lot of cash outs where buyers where cashing you out. But now that you see some movement in the real estate market where values are going up and some rents are going up, you are seeing some people cash you out. Some people are able to refinance now. There's actually a lot of special programs. The lending is starting to loosen up a little bit again compared to what it was. You're seeing some retention programs and that type of thing. So we are getting a lot of cash outs.

We just had one recently. It was a crazy cash out. They just called us up and they go, "The title company wants a payoff." And we're like, "Okay." I think at the time it was a loan that was like a $20,000 loan, we just got like a $99,000 payoff or something. So we love those when that happens and it's only been a year or something. So they do happen. But if you're not in the game, they don't happen.

David Phelps: All right, well Dave, I felt like that was a question I posed to you as a candidate for the presidency on the debate platform and you gave me a very political answer.

Dave Van Horn: You know what, I can tell you some of the things, like my first lien team, some of the things that they've been working on lately. So I can tell you, with first mortgages, because of the pressure from the government on the banks and servicing companies, you are seeing where they're forcing the servicers to try to modify the borrower's loans, which is something my company has done from day one. That's what we pride ourselves on. We pride ourselves on bending over backwards for the borrower and trying to really work things out and do a viable modification for people. Almost like a form of socially rewarding investing.

But the government has been putting pressure on the banks to do that and they finally are. It's only been ten years or so but they are starting to modify more loans. So we do tend to see a lot more vacant property than we ever did before. But that's okay. We actually have some really good strategies. I'll give you an example on the occupied side. One of the things we're doing is there's about 18 hardest hit states, along with the District of Columbia. You can use that hardest hit program, so that's been a great strategy.

Another one has been, there's an FHA 10-23 loan program where a borrower only has to make three payments after they've been modified. They only need a FICO credit score of 520. It can be 97.5 percent of fair market value. So you're seeing cases where you can utilize the hardest hit in a combination with that FHA program which is something that will knock it out of the park on an occupied property.

On a non-occupied property, like a vacant, we call it an REO, a real estate owned, which is a property that you foreclosed on and now you have a vacant property. So you know some of the typical options there is a fix and flip or a fix and rent. But we'll even do some unusual things, like we'll fund the rehab for the end user. So we'll act as the bank for the guy renovating it.

Another great—one of my favorite strategies lately is where we'll fix up the property and sell it on a non-recourse loan to the contractor in his IRA. We'll actually own the note, fund the rehab, create a note for him on a non-recourse loan, sell it to him for a small fee, and we'll actually hold the paper on that. Because to us, we would rather own the note for a local guy who's a contractor who owns rental properties, than us manage a tenant.

In that case, he's actually got an incentive to keep the repairs down because if he inflates the repairs, the note is higher, then he's got to give us a bigger portion of the payment of the rent if you think about it. So he's got a vested interest in doing a—you know, containing the costs of the renovation. At the same time, if he rents out this house for whatever, $700 a month or something and he's sending us $250 or $300, it's a great win for him. It's a great win for us and he's funneling all that cash into his IRA. So that's been a great strategy for some of our boots on the ground.

One of the things we've developed in the last couple years, we have this tracking software system of our REO agents, which is real estate agents out in the field who will not only list property for us to sell but they'll go out and we have like specialized computer forms where they'll fill in all this data and we can suck that data back into the company to analyze even pre-purchase. So we use special forms through this tracking system.

These realtors on the ground can actually do property preservation, change the locks, cut the grass. Some of them can give us estimates on repairs. But our best deals are in the metropolitan areas where we buy the most product, we actually have boots on the ground. Where they're actually like wholesale or rehab guys who can actually go out to the properties and give us estimates on repairs, pre-purchase.

Well that information is invaluable to us. It's been working really well in the top ten, twenty metropolitan areas where we buy product. So we're getting better every day with this.

David Phelps: Dave, I love that example of holding the paper for the contractor. I've done the same thing in my area. You're right, it puts both entities, if you will, on the same page. As you said, he's not going to inflate the work because his note increases. So it's a great way to work.

So let's capsulize, let's summarize a little bit what we're talking about here because we're talking about a great place to be involved in real estate investing. That's the note side. And as you said, the key here is access. So you can create your notes by being a lender. You can find a network where you can lend money to hard money lenders. Again, something that's more of a business. You've got to know what you're doing. You've got to perform the right due diligence. Not a place to play if you're brand new.

That's part of the reason why I created Freedom Founders mastermind community is because we have a place where people like you come, and other real estate people who have the deal flow. Then our members, our doctors who are busy in their practice, have the opportunity to engage in these different elements, these different opportunities in real estate investing with people like you who are what I call boots on the ground. You've got your own network, your relationship, your company, PPR, creates the access to a lot of the re-performing notes by what you do, Dave.

So there's a third tranche here and that's where I want to get to. Another way to invest in the same type of real estate, secured notes, is through a fund. That's something else that you offer through PPR. Talk about what that is. Again, you mentioned the fact that PPR buys non-performing notes because you've got this access as a hedge fund buyer, access to all the non-performing, the defaulted paper.

Then in turn, can turn a lot of that into re-performers. You provide a warranty service. But you also have a fund that people invest in too if they don't want to be involved in managing, if you will, the note income stream. Talk about that, if you would.

Dave Van Horn: Well, the fund is something like my mom likes. My mom is 84. She likes the fund because she gets mailbox money. She doesn't have to worry about if the borrower is paying. She doesn't have to worry about the servicer sending her her payment. She just gets a payment from the fund every month like clockwork, ACH'ed into her account. So you can invest in shares of a company, which is what the fund is that goes out and buys these notes.

Then they do all the heavy lifting. They do all the work. They have all the boots on the ground. They manage everything. They go out and buy the product that way. Now one of the things we do with our fund investors is we do allow them to redeem shares to buy a note. Of course, it's upon availability but they can redeem shares out of the fund and just buy a note. Or they can continue to collect the mailbox money.

David Phelps: A great place to go to find out more about the fund is at www.Freedom Founders, that's Freedom Founders with an S, CapitalFund.com. FreedomFoundersCapitalFund.com. We'll put that link on the podcast page so it's available too. Great place to go to find out more information about the fund and how doctors and dentists who are busy can get involved in real estate and really do it the safe way. It's a great place to start learning.

Then if you want to become more active, in active lending and buying notes on the secondary market, great place to learn because you have the opportunity to find and touch base with somebody like Dave and PPR Note Company who have been doing this for years and really have it down to a science. That's the way I love to invest today, Dave.

So listen, Dave, you told me at the first part of this call, before we started recording, that you didn't think I could do this in 30 minutes, buddy. I think I've gotten everything in I think I wanted to. Is there anything left that you would like to add to our great conversation today?

Dave Van Horn: I think there's plenty of opportunities still out there, David. I just saw in November HUD had like 24 non-performing note sales, like 8,300 notes at 1.3 billion. Fannie Mae pushed out 7,000 loans at 1.2 billion. FHLMC put out a large pool of 327 million and we just saw another one go out at 23.9 million just in Cook County, Illinois alone. So as much as the media tries to say the economy is spectacular, we're still seeing a significant amount of product. That's just from the government side. So you're still seeing large quantities that were still being held there.

I think interest rates will be stable for a while, David, but like I said earlier, I think values and rents are starting to go up. But I think the real variable in our industry is jobs. I really think it comes down to, are people making more pay today? I don't know that they are. So that's the one variable that we'll see. We've got an upcoming election.

But when I look at the young folks today, you know, they've got high student loan debt. Are they really taking home more pay? I don't know that they are. They kind of need that take home pay to save up money to go buy a house. That's the one variable I think that none of us know right now, you know?

David Phelps: Yeah, that's exactly right. Okay, I'm going to put your feet to the fire on one last prediction, Dave. This is really going to test you here. Who's going to win the Super Bowl?

Dave Van Horn: Wow, I know Carolina is favored on that. They'll probably win but I'm rooting for Denver. I'd like to see Peyton Manning take one more home with him.

David Phelps: One more.

Dave Van Horn: Yeah.

David Phelps: There you go, there you go.

Dave Van Horn: All right, excellent. Well, Dave Van Horn, PPRNoteCo.com, thank you so much. It's been great just to know you for a number of years, to see what you do, I've been to your offices. You've got great partners. You've got a great culture there. That's how I invest first and foremost, I tell all of my docs to invest with people with whom you like, you know, like, and trust.

You've got to get to know the people. The rest of everything is mechanics but if you can't trust the people you're dealing with, you don't like them, don't invest with them. That's why I like you, Dave, because you're one of those people I can trust.

Dave Van Horn: Thanks, David. Thanks for everything. Just go to FreedomFoundersCapitalFund.com and find out more about us.

David Phelps: Perfect. All right, thanks, Dave.

Dave Van Horn: Thanks, David.

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