Ep #112: Leverage Plus Real Estate - The Perfect Storm with Caeli Ridge

Full Episode Transcript

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Dr. David Phelps

[Dentist Freedom Blueprint](http://www.dentistfreedomblueprint.com) with Dr. David Phelps and Evan Harris

Ep #112: Leverage Plus Real Estate - The Perfect Storm with Caeli Ridge

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

David Phelps: Good day everyone. This is Dr. David Phelps of the Freedom Founders Mastermind Community and the Dentist's Freedom Blueprint Podcast. Back to you today with what's going to be I think a very interesting an educational interview today with a person who's become a good friend of mine. She, Caeli Ridge is her name, I'm going to spell that for you because you wouldn't spell it right if you tried a hundred times I'll bet. It's Caeli, that's C-A-E-L-I, last name is easy, Ridge.

Caeli has become a good friend of mine. She's in the real estate space, has been there for many years both as an investor and also as a financial conventional mortgage lending operation out of Ridge Lending. Let me give you a little bit more of the background on Caeli. She is the owner and CEO for Ridge Lending Group. She spent the last 18 years as a Nationwide lender and loan officer in both residential and commercial type properties. She's also an established real estate investor.

That's what I love about you, Caeli, you're not just in the business but you are also one of us. One of us that invests and that's why you speak so well to investors because you know what it's all about from both sides. You do a really great job of that. In fact I'm just going to interject here that Freedom Founder's members who have utilized your services for lending purposes to acquire their investment properties have really given great accolades to you and your team on walking them through the processes involved in financial lending. I just want to toss that in here as I'm talking about you. You're very humble and if I don't say it I know you're not going to say it, Caeli, so I want to make sure that people understand that you really know what you're doing here.

You've had up to 42 investment properties yourself at any one time across the US. You've worked with literally thousands of real estate investors and home owners all over the country. You've got a proven track record of helping more families realize their dreams of financial independence through real estate investing than any other mortgage lender in the country. I truly believe that. You maintain and serve your real estate investor database of 30,000 strong and growing. Ridge Lending is the preferred lender for over four dozen investment networks nationwide, making you Caeli, the true leader in real estate lending.

I think Caeli what really separates you and Ridge Lending from any other lender is your extensive knowledge and experience in all aspects of real estate finance and your continued commitment to being a leader in both the technology and as an educator to your clients and within the lending industry. Caeli, you and I first met through another Mastermind Group, the Collective Genius, a very high caliber group of real estate investors. Just through recognition of who you are through that group it quickly became apparent to me that you are very astute and well recognized in the industry. Caeli, welcome. Thanks for taking time today from your busy day to be with us.

Caeli Ridge: It is always my pleasure, Dr. Phelps. Thank you so much for having me again. I love this time that we get to share and helping educate our fellow clients. The evolution of real estate investing as related to lending is not always an easy path, so I'm so happy to be here and offer whatever information and advice I can.

David Phelps: Caeli, let's make sure that we're clear on exactly what you do. Is your financing specifically towards investors day and specifically towards investors who are investing in single family residential?

Caeli Ridge: Yeah, I would say that primarily yes. Ridge Lending is a second generation company. I'll start with that. We focus almost exclusively on the non-owner occupied side of lending. We're fully functional of course. We can do everything, the VA, the FHA, owner-occupied, all in, but it's that investor or non-owner occupied space that we've really carved out our strongest skillsets.

That coupled with the education piece that you touched on, Dr. Phelps, I think really sets us apart. Then of course the fact that I am a fellow investor provides a fairly unique perspective in all of this. Yeah, the conventional lending and then moving into kind of specialty loan products passed what is allowed or available in the conventional lending world is really where we shine.

David Phelps: Caeli, acquiring property, collect capital assets, in this case real estate, one of the great benefits of real estate as an investment class is that one can acquire or control quite a bit of real estate with a relatively nominal amount of their own capital. We call that financial leverage.

One of the great benefits is with real estate as an investment class that one can control or acquire, purchase real estate and put 25 or maybe 20% down payment hard money down and then have a financial institution finance the remainder. That's a real benefit today particularly with what we have today is historically low interest rates. Would you agree that that's one of the great attributes to real estate?

Caeli Ridge: Yes sir. OPM, right? Other people's money exponentially increases our ROI, our rates of return on these real estate investments. Just as a quick correction, one of the more recent updates or changes, the moving target to Fannie, Freddie guidelines, we can actually leverage a single family residence up to 85% now where the individual only has to come in with 15%. That's been kind of a nice boon for that leverage piece.

David Phelps: For some of our listeners who are kind of looking from the outside in, they have maybe just barely got started in real estate investing or maybe they've done a few deals, what are some of the critical components that you help these investors in determining how much leverage they should use based on today's interest rates?

How do you look at the cashflow and the fact that we know with the debt service that they're utilizing to acquire the real estate there's also management cost, turnover vacancy, that kind of thing? How do you help them assess what makes this work for them? Do you have some parameters that you help them with when they're determining is this a good deal for me or not?

Caeli Ridge: Sure. Absolutely. I'm a big fan of leverage to begin with for some obvious reasons. When we take in a new potential investor client, we start by taking them through a fairly rigorous prequalification process. The gauntlet of prequalification as I call it. As a result it allows us to really get a bigger picture, a 30,000 foot view about what their qualifications are from a lending or underwriting standpoint.

Then we take it a step further and I personally have a conversation with each individual that finds value in this and I identify what their real estate goals are short and long term. Is it the long term play of the passive income? Are they more interested in the quicker fix and flip? I take that information, I take copious notes and then we couple that with their particular qualifications as they stand at that point in time and we sort of marry them together and come up with a sequencing of sorts, a strategy that best supports the goal.

Sort of trying to make sure that we put that education piece in there so that we're optimizing their qualifications to meet those goals. Obviously it's going to be subjective to each person's individual goals and what their qualifications are, but I think that that coaching is invaluable in many cases in setting them up for success in the long term.

David Phelps: Completely agree, Caeli. With the somewhat surge in real estate prices across the country since we had the downturn back in 2007, '08, '09, maybe into '10, we've seen values increase across the board, certainly some markets more than others. The more volatile markets, they tend to go up faster when we have up markets and they go down faster when we have maybe a reset, but overall all markets have seen an uptick.

Is there a price point, and I know this is going to be generalized, but is there a price point that you tend to see that today works well whatever market it might be, particularly with the debt financing, the debt leverage that you're able to help investors with and kind of knowing what general rents are relative to those price points? Is there a top level that you try to help people observe or stay within when you're helping them assess whether it's a good deal or not? Do you get into that with your investor clients?

Caeli Ridge: Sure we do. Yeah. We'll take a look at what the ultimate ... What I usually will do typically is I will take the individual and ask them some very pointed questions within that post-prequalification work that we do and one of them is what is the financial freedom on a monthly basis look like for them? With that I can take it and work the problem backwards and help identify which particular markets and which returns we're seeing at that point in time are most appropriate.

I think that in answer to your question though, the sweet spot tends to be that 80 to $120,000 range typically. Now every market is going to be particular or there's going to be some variances in what the real return is after the PITI, right? The principle, interest, the taxes, the insurance, the property management, the vacancy that they're looking at. If we understand what the goal is we can usually help them develop which markets are going to best support some of the primary goals.

Those are going to be the cashflow, maybe the tax benefit, the appreciation, all of those pieces in play. We can usually guide them pretty well through figuring that out. Did that answer the question?

David Phelps: Yeah. That's excellent. That's what I was looking for? Perfect, perfect. One of the other benefits of using long term fixed rate conventional financing, that which you help investors obtain when they acquire real estate, is that down the road, maybe five years, 10 years, certainly 15, 20 years down the road if one has acquired good quality real estate that they intend to hold for long term wealth building and in cashflow building, that yeah, acquired say today at around 5% fixed rate 25, 30 years is going to be paid back with inflated dollars.

Dollars that have been inflated, therefore one really has the ability to short the dollar if you will. I see that as another great opportunity here because when are we going to ever see the interest rates we have today? In the future I think they're going to be higher. How much higher we don't know particularly, but they're not going to be where they are today. Do you agree with that?

Caeli Ridge: Absolutely I agree with that, but if I could, let me comment. In my experience, last 18, 19 years in doing this I've been lucky enough to have survived one particular cycle already, and now that we're into this second one. One thing that I've seen or that I've learned is that as interest rates rise the rental income also will follow suit.

Now that's kind of why we've decided to carve out this particular niche in this industry, blending non-owner occupied is a little less subjected to some of the pitfalls of rising interest rates and related directly to how the rents will follow. Now it's not same day, same week, but typically within a three to six month trailing window you'll notice that if interest rates rise a quarter of a point then you'll see the rental markets nationally also take on that same basis.

David Phelps: Is that because as interest rates rise a little bit that that removes some particular applicants from the owner occupied, the home owner purchasing aspect and creates a little bit more demand on the rental side?

Caeli Ridge: Exactly right. Yes. I think there's some other pieces involved there too, Dr. Phelps. I think that we're in sort of a unique place in history where ... There's some different schools of thoughts about this, but the American dream of home ownership is not as pronounced as maybe it once was. I think that a lot of the up and comings saw their parents struggle severely with the crash and the loss of their homes to foreclosure and such. I think that also adds to the conversation that we have a richer or stronger rental base than we ever did before.

David Phelps: Yeah, I totally agree, Caeli. I think that that generation we're speaking of, and we can just maybe broad base with a broad paintbrush, call them the millennial generation, but you're right. Not only have they seen their parents go through in the last eight to 10 years maybe some stress with their home ownership based on where they bought their homes and how much down payment and that sort of thing, but they're also coming out of school today as we all know with a lot more debt than you and I did or some others came out with.

They've got those two combinations. I think there's also a mobility preference for that younger generation. They're not as set to setting up a home and a permanent base and a permanent career. They like the flexibility too and owning a home or property, while it's a great investment, for some people they look at home ownership more of a liability. It weighs them down and maybe they don't want to get involved in all that.

Caeli Ridge: Totally agree. For those reasons yeah, the rental income itself, also another reason why it will follow suit to where we see the interest rates going. You're right, they're going to increase. At what level I'm hesitant to put any predictions on that, but they do follow suit. That's one thing I've learned in almost 20 years' time of watching that cycle.

David Phelps: Caeli, when we talk about cycles and you mentioned you're surviving cycles and that's why I love to bring to Freedom Founders, I love to bring people that have real estate knowledge, experience, they provide services like you do who have been through at least one major down cycle. Certainly you have. You just mentioned that earlier.

What would you say are some caveats or some lessons learned not just from your own standpoint, because you've been involved with so many investors, what would you say today to people who are looking at real estate and saying, "I really feel like real estate would be a good place to invest, but gosh and golly, I talk to a lot of people that were investors previously and some of them, they seem like they lost a lot of money. They had a lot of financial stress." What are some caveats for an investor to look at today? We've probably named some of those already, but maybe just reiterate a few major points that you would call safety tips for the investor today.

Caeli Ridge: Sure. I would say pointedly diversification. It's a conversation that I have daily with my clients in that diversifying both in property type and geographic location would be number one. Not putting all your eggs in one basket. I fell victim to that myself and had some valuable learning experiences as a result.

I might also take the time to point out the profound differences between the last cycle and this one. Just briefly to name a few you've got price points that are half of what they were in the last cycle today. You've got interest rates that are three and four and 5% lower than they were. This particular cycle also is almost exclusively about cashflow versus the last one was almost exclusively about appreciation. It's a very, very different playing field now. I think that this one is a lower risk.

There's always risk involved in any investment, but if we're comparing two real estate cycles, this particular cycle is much lower risk in that all the properties that come across my desk from a cashflow perspective, they are cashflow. To varying degrees obviously, but depending on the property and the market of course, but that cashflow, you've got other people making that mortgage payment so with the right property management in place, which is very routinely the case with all the turnkeys that you and I work with regularly, Dr. Phelps, I think it's a relatively low risk investment. Those are some of the comments I would probably offer especially to newer investors.

David Phelps: Yeah, that's a really, really good point, Caeli. Right property, right management. You and I both have seen many investors who have gotten involved maybe when they first got started. I'll say I was one of those. Back when I was first getting started I tended to acquire cheaper properties because that's what I sort of could afford because I could get sometimes creative financing. I could get seller terms so I could take over loans.

Those were properties relatively easy for me to acquire, but they weren't the best properties for me from a tenant management standpoint. When we talk about the range you talked about, 80 to $120,000 price points, a lot of the markets that we are involved in with turnkey providers, that attracts a much better tenant. That's one of the keys to owning and having managed for you good property. You know as well as I do that great managers love to have properties that are in that little bit higher price point because the tenants are not so difficult to deal with.

Caeli Ridge: Yes sir, I agree.

David Phelps: Caeli, let's talk a little bit about regulation. We've had a lot of regulation that has come about in the post last financial downturn and one of the big bills, the Consumer Finance Protection Bureau also known as Dodd-Frank, was established back in 2010, what effect did you see that have on the marketplace? Again, because Nationwide, you've got your finger on the pulse. What effect has that had over the last now seven years on the real estate market if you could say?

Caeli Ridge: Well, I would maybe comment that the government involvement, right, when all of the banking institutions collapsed and Fannie/Freddie were the only industry left in the playing field, CFPB was born and then you've got your Dodd-Frank, some of it in my mind was a bit of a knee jerk. Not to say that reform wasn't necessary, but it turned it into, the 180 result is 10 years ago an individual could fog a mirror and get a loan and now I make a joke about it, but it's as if we have to provide DNA samples to get through the cogs of underwriting for a conventional loan.

There's lots of talk out there that our new president may do away with Dodd-Frank. Since the crash I can tell you that the government agencies in terms of policy and guidelines and compliance, all of that stuff, it really has been a moving target and I've noticed that a lot of times it tends to be one step forward and three steps back. We do our best to keep up with all of that. I'm hoping and hopeful that we're seeing some of the loosening of those purse strings. It seems that there's some promise on the horizon.

One of the examples I've already mentioned, they've allowed us to leverage 85% loan to value on a single family residence and that's all the way up through the tenth financed properties. Prior to that there's been some benchmarks where maybe the first four and then the first six. They are regulatory loosening a little bit. I'm a little hesitant to go into any great detail about the Dodd-Frank and other compliance stuff because of the kind of looming uncertainty with what's going to happen there. Maybe that little snippet is enough to just whet the appetite. I don't know.

David Phelps: Yeah, I think we can say safely that, and you're right, there is always need for some level of regulation by the government, some level, but you're completely right and I agree with you that I think we've seen different crisis occur. One could be in healthcare, the high cost of healthcare so we got a big healthcare bill called the Affordable Healthcare Act. Whether you think that's good or not, it's a big bill.

Lots of regulation effecting the healthcare industry. The same thing happened on the finance and real estate side with the Dodd-Frank bill. There's that 180 degree knee jerk reaction I think that you said well. What I'm seeing Caeli, is that again, not to be political here, just to state what it is. I think with Trump coming into office and being obviously very pro-business and relatively anti-regulatory because he knows what that does to businesses, it stymies business development, I have seen and felt that both in the consumer sector and in the business sector, certainly real estate sector we're seeing it on Wall Street right now, there's a lot of optimism, a lot of enthusiasm.

Again, whether you think that's good or not, I think it is what it is. That's building some forward momentum. Again how far will that carry? What's the crystal ball look like? I'm not going to predict. I know you won't either, but I think it's a positive in general to have some of this pushed back out of the way because business, consumers, the whole economy is dependent upon money circulating. When there's so much regulation that stifles that movement or makes businesses or the real estate sector afraid to expand or take a little bit of that risk, then that's a bad thing. I think opening the doors probably is going to be a positive thing overall for the economy. That's as deep as I'll go into it as well.

Caeli Ridge: Yeah, I would say that anything regardless of the catalyst, anything that provides that kind of support and business minded expansion, sure, I would agree with you. I won't take any step further into that sandpit. I agree.

David Phelps: Okay, I agree completely, Caeli. I think enough said on that. Let's move on to something else that I think comes up, and I'm sure you counsel your investor clients on this, what would be your recommendation or how do you help a client determine whether they should maybe do a 15 year amortization, 20 year or 30 year knowing that there's a little bit of an interest rate preference or advantage if you take a shorter term amortization? How do you help clients determine that?

Caeli Ridge: I'm so glad you asked me that question actually. I am profoundly partial to the 30 year fixed mortgage for a few reasons. If rapid acceleration is the individual's goal, they can accomplish the exact same thing on the 30 year mortgage that they can on the 15 year mortgage by simply figuring out the payment difference between the two and then applying that difference with the 30 year mortgage. You probably end up crossing the finish line in 15.5, 15.6 years, a few months over.

Overall it accomplishes the same goal. Then in that scenario obviously if you're accelerating the payoff of that debt so quickly you're never paying the higher interest that you would be getting on a 30 year fixed mortgage. If the interest rate differential is, I don't know, a quarter to a half a point, again, the rapid acceleration in paying off that mortgage quickly if you have the discipline to pay that additional principle every month you never end up paying that extra interest.

Most importantly to this topic is this, by taking the 30 year fixed mortgage that longer amortization helps ensure that we're optimizing the individual's qualifications, right? That leads into the debt income ratio. For that and maybe even a few other reasons, I am like I said, a strong proponent of the 30 year fixed option because I think it just gives the individual the most flexibility and it still allows them to accomplish all of those other goals, not paying the extra interest and paying off early if that's part of the plan.

David Phelps: I completely agree, Caeli. I'm glad you stated it that way. The flexibility for me is the key. As you said, with the 30 year you can always accelerate that option and really reduce what little bit of an interest rate differential, as you said is there. I agree. Thirty year for the reasons you expressed, completely.

Let's talk a little bit about closing costs because that's going to be a part of every leveraged, every financed property. What does that look like? Is there kind of a percentage amount of the loan or how do people should they kind of figure that in? How do you counsel them on what that looks like? Are those closing costs, are they part of the loan or is that additional over and above the amount of down payment that's required?

Caeli Ridge: In a purchase transaction the closing costs are going to be separate from what the down payment is. If they're putting 20% down they need to factor in an additional amount for the closing costs. Now a few things to keep in mind. Closing costs themselves are going to be different than say the taxes and insurance that will be due at closing on a purchase.

Now those are also a cost of the transaction, but the taxes and insurance really should be looked at more of an asset than necessarily a cost. The reason for this is you're going to be pre or front loading, prepaying some of those taxes and insurance, right? Those will be held in escrow to the borrower's benefit so that down the road in the event of re-fi or sale of that property, that prepaid amount will then go back to the individual.

It's important that when they're looking at term sheets or fee sheets the bottom line doesn't automatically, it shouldn't be looked at as the down payment and closing costs. There's really three pieces. You've got your down payment, you've got your closing costs and then you've got those taxes and insurance. They should be looked at separately.

In terms of trying to quantify a percentage, just the closing costs now, it's going to be a little bit difficult because different states impose different titles costs. For example, I'm just going to use Florida because it just popped into my head. Florida has something called a state stamp tax that is fairly expensive that another state, say Arizona, might not have.

For that reason it's difficult like I said, to pinpoint a percentage and put it out in that way. I can share with you though that Ridge's model, Ridge Lending's model for compensation, this might be helpful, we charge 2% or $1,500, whichever is greater on all non-owner occupied type transactions of loan amounts 150,000 and below.

Now the reason that we do this, actually there's a few reasons. One, I like the transparency. I have no problems in disclosing to our clients what our compensation is going to be and I like that it's going to be the same across the board for Mr. Smith and Mr. Jones to Dr. and Mrs. Phelps. It will not change. Common practice in the industry is that more often than not the compensation or origination points are hidden in an individual's interest rate.

Now assuming that we're talking about a long term buy and hold strategy, it's important to look at it from that perspective and that's the reason that I have set our compensation that way. Paying the two points upfront will yield you the lowest market interest rate available versus not paying those points, you're looking at yielding a higher interest rate. The bottom line there and the message that I would like to communicate is that it's a simple math problem.

If you look at the monthly payment between the lower interest rate where you're paying those points disclosed upfront versus a higher interest rate where you're not paying those points and you take that monthly payment difference and divide it by the dollar amount of the points, you can factor that you'll usually break even in the first three to five years of ownership. This is assuming that price point of 80 to 120,000. That math is valid. Maybe that's a little TMI for this conversation, but that's how I would quantify for the closing costs and the amount of time that we have to discuss it.

David Phelps: Caeli, that's exactly why I wanted you on the call today, because is we both indicated you are not just a mortgage lender, but you're an educator. Helping investors understand the dollars and sense, what their assets are, as you said, taxes and insurance, even though they're front loaded or paid up in front that's an asset going in. It's not really part of the overall investment. It's a part of the carrying costs that go into escrow. The down payment being the second one and finally the closing costs.

The closing costs, the points to get the lowest interest rate, these are all amortized over the life of the holding period of this particular property and we're talking about finding great properties that I think most investors should think in terms of five years anyway. Many of the properties I've owned, Caeli, I've owned for in some cases 20, 25 years because they were the right property. This is not a flipping process, get in and get out quickly.

These closing costs even though they can seem somewhat significant, they're part of the overall long term costs and reflected in the return on investment, those dollars you put down, they're really reflected in the return on investment which with thee leverage that you're able to offer today is really, really, really large. That's something that a lot of people don't understand, but you're able to educate the investors, your clients very well.

I think help them appreciate that what you do is such a valuable service and you do it so well and you've done it for so many years that that's why you are the leading, I think leading provider for non-owner occupied investor properties today. That's why I am really pleased that you were part of Freedom Founders and bringing that great service to our group as you do to many, many others.

Caeli Ridge: Thank you so much, Dr. Phelps. That is a humbling compliment coming from you. I really appreciate it.

David Phelps: Caeli, for those that are listening, that are stepping out and wanting to acquire more real estate today because they realize the great opportunity that it is, what's the best way for them to contact you at Ridge Lending and find out more about your services and helping them get prequalified and the additional assistance you provide them in assessing what's a good value for them in terms of the properties that they're wanting to acquire?

Caeli Ridge: Yes, thank you for asking. I would say there's three methods. They can go on our website, www.RidgeLendingGroup.com. They can elect to have our Getting Started Package sent to them via the website electronically or they can call us toll free, 855-74-RIDGE is an easy way to remember. Or they can shoot us an email at Info@RidgeLendingGroup.com. Either one of those methods will get to us right away and we'll be able to get them started in the prequalification that I mentioned earlier, then on the path of education and then finally financial freedom. Right? That's what this is all about.

David Phelps: That's exactly what it's about. I always look for people that can help me speed through whatever process I'm going through, Caeli. People that have been there, that have created the pathway. It's all about speed and reducing that brain damage. Everything we do in life has some of that, some of those barriers there. If you find someone that can help you get through it, in this case getting the financing you need for you properties and get it done in a seamless way with people that are professional and know what they're doing, Caeli, you're one of those people. Again, thank you so much for your time today and for providing the great insights that you did. I think this was a very, very helpful call.

Caeli Ridge: It's my pleasure always, Dr. Phelps. Thank you for having me, sir.

David Phelps: Have a great day. I'll talk to you soon.

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