Ep #166: Dave Van Horn Pt. 2 - The Best Place to Start Real Estate Investing

Full Episode Transcript

With Your Host

Dr. David Phelps

Dentist Freedom Blueprint with Dr. David Phelps and Evan Harris

Ep #166: Dave Van Horn Pt. 2 - The Best Place to Start Real Estate Investing

Dave: I have a coach and he's like, "What's going to really catapult your business this year or your investing this year or your life this year? What leverage are you going to use to really catapult yourself?"

You are listening to the *Dentist Freedom Blueprint* podcast, with David Phelps. 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: Good day everyone. This is Dr. David Phelps with the Freedom Founders Mastermind Community and the Dentist Freedom Blueprint Podcast. So, if you're with us last week, you got a chance to hear a really fun interview with my good friend Mr. Dave Van Horn. Well, good news is I've got him back again for a second go around. So, Dave, welcome back.

Dave: Nonstop notes David.

David: Nonstop.

Dave: It's all I talk about.

David: We're just going, going, going here. So, if you missed last week, I'll give you a basic up to speed but you want to go back and listen to last week's episode because that will give you the full story and lead us into today. Dave Van Horn has been a good friend of mine. He's a part of the real estate arena. He specializes and he and his company PPR Note Company specialize in residential notes particularly distressed or nonperforming. We'll talk a little bit more about that today. Last week you can hear about Dave's evolution into where he is today. It started like a lot of us in an active business, been changing more of an investor and financier using capital arbitrage, some really cool things that I'm a huge believer of in estate.

Today we're going to talk about how our audience particularly professional practice owners that are busy and doing the thing they do but how they can also enter the arena of real estate and specifically into note investing which Dave I always tell people if you're just going to start in real estate, you want learn how to get some of your different buckets, invested buckets being like retirement account buckets or your tax paid money buckets, but get started in note investing because the principles are all basically all the same, the due diligence, the evaluation but you don’t have all the moving parts of "management".

Even if you're not the manager of your real estate ownership, your rentals or a multifamily, you need to manage the managers. In this case, knock on wood, the "management aspect" a lot of it is done for you. The downside, the risk, it's really mitigated and the protection is there. So, note investor if you do things right, so let's dive into today a little bit Dave. I want to first with let's define some of the documents so that people understand what is to be a note investor. Let's just start real basic. So, when somebody buys a rental property. With rental property you get title or you get a deed, right?

You get a paper that says it's a deed. It's recorded in the public records. You're on the title. It's your name. It's your company. It's your LLC, however you take title. You've got a deed. It's in the public records. If you are financing that property and you go to the bank to get institutional financing, great rates today, 30 or fixed rates. Awesome. A bank will now have a lien which would be a combination of a promise to pay which is the promissory note, a contract, but in the real estate arena, that note, that contract of obligation to pay also has a security element. Talk about that Dave. Talk about how it's different versus unsecured credit cards, other types of personal credit.

Dave: Well most notes that are unsecured, it's just a promissory note. It's just a promise to repay the loan. So, with credit card debt, you'll sign a promissory agreement. You'll sign a note with the bank or your credit card just like you would. Now an auto loan is a little different the car is collateral. You'll have the title to the car and oftentimes dealer holds the title until you make your final payment or something like that. There's other types of debt as well whether … You could be buying furniture and that's a promissory note as well that's secured by some used furniture. With a house, there's a mortgage. The mortgage is collateral.

So, there's two documents. You have the promissory note which is your promise to pay and then the actual mortgage or deed of trust gets recorded and that's what perfects the collateral that backs that promissory note. So, it's a secured loan, a secured promissory note. That's what's different about real estate. You hit on it in the beginning. I have a friend that I run a fund with out of San Diego. He always says that everybody should have one goal in life and that is to have as much passive income as possible as soon as possible by retirement at the latest and have as much tax-free as you can. He goes, "That's it. It doesn't matter what your job is. It doesn't matter what your passion is. It doesn't … because that should be your focus regardless of what you were good at in life."

It's a simple concept and he's like, "We should be taught that in fourth grade." That's his you know and he's right. The sooner that we do that, the better our lives will be. So, with private practitioners, I often refer to my cousin who's an eye doctor in Connecticut. It's the same thing that business revolves around her. Whereas with me I have all these passive investments whether that's real estate or notes or other vehicles. Yeah, I have my business too and some things do revolve around me, but after I had one business where I got hurt, I was a painting contractor and I had gotten hurt and that business did revolve around me. Then when I started PPR obviously I had 30 employees. This business won't revolve around me. I purposely set it up more like the eMyth or something. Now, I get it if I'm a surgeon, that's hard to do. I'm not naïve to that.

David: Yeah. Your point is really … well, taken you're right. This should be taught in school. This should be the focus, but unfortunately, our society teaches get the best education you can. Go get in the career or the profession whatever it is and you're going to ride that out to some mystical "retirement day" which I call someday. So, you're getting there. Your 60s whether it's 62, 65, sometimes people have to push it off until they're 70 because they ride some roller coaster investment strategies so they're at the bottom and they have to stay at it, the active income cycle. That's why Wiseman dictated out. That's the normal. You try to live a little bit as you go along but still this is hard drive, active labor, hope I can make it, hope my body holds out, you know all that stuff. You're right. The focus should be on getting passive income as quickly as possible. It doesn't mean you have ot quit working.

Dave: No, not at all.

David: Right. You do, I do, a lot of people that run our circles we do what we do actively because we just love it. It's fun. We get to hang around with cool people and maybe they'll come up with different machinations of how to be involved in the market cycles which there's always cycles instead of being humbled by the cycles like the tidal wave, you're going to ride it. That's what's fun is doing that, but if you're always busy in your business practice always and head down, literally head down, a surgeon or something like a dentist, it's really hard. It's harder today because even with tax rates. We got a tax rate reprieve for a while, but Dave, that's not going to last. That's not going to last forever.

The ordinary income tax rates in this country particularly for professionals who have an opportunity to make more money, it's going to go up. So, figuring out how to structure your buckets and have that tax-free as our friend has pointed out is the key. So, I always talk about the same thing. I talk about the doctors they say … particularly the young ones, don't get this mindset if you're going to plow through to 65, you can do all that you want to but if you start to learn how to convert your active income into capital assets that will then allow you to free you up, man life just becomes fun and you'll grow. Your assets, whatever that freedom number is that's what retirement is to me it's not a date. It's a number. It's a number.

So, like you said Dave when you finally find out that you can take time off from your active construction business because you got a back injury, you didn't have to go to work. You have a passive income. Today, that passive income, I'm just guessing is multiples of what it was back then, but back then it was enough. So, you're literally free and now you can really focus on "Well, what do I do to really continue to leverage who I am, what I do and have more fun and have more freedom doing it?" Isn't that what it comes down to?

Dave: You said the most important word which is leverage. Most of us aren’t taught how to leverage our resources. So, whether it's people, money, time, technology, whatever it is, I often ask people what's going to … my coach asks me that. I have a coach and he's like, "What's going to really catapult your business this year or your investing this year or your life this year? What leverage are you going to use to really catapult yourself?" It's a good question. I think a lot of us I used to think in the beginning that I would just work harder. I remember working two jobs for 20 years. I remember coming home from shift work and my wife going to work.

I was watching the kids. I was like, "We've been working ourselves silly just trying to come up with a little bit extra money to invest." We didn't know enough about leverage. We weren't thinking there's so many things you can do to improve your world through finance whether it's accelerating paydown and debt, utilizing sweep accounts, things like that. They're just not taught. Sweep account is a simple concept that you could Google. It's like eighth-grade math. So, why aren't we taught sweep accounts? Those types of things where you can really … you can pay off most debts in about a third of the time. People just aren't taught that. It's not their fault they just don't know. It's the same way with investing on the other side whether it's utilizing leverage or arbitrage or different types things to do it safely. We're not talking about doing crazy risky things. I'm sure there's a place for that. If you want to swing the bat with a small percentage of your portfolio, that's fine. You want to be prudent though.

David: Yeah, absolutely. So, when you and John Sweeney, Bob Paulus, your current partners started to put PPR Note Company together back in 2007, you're right about the peak of the market where it's just starting to hit that downturn and you discovered this world of defaulted distressed paper meaning residential. So, let's define that. So, that world is it's institutional notes meaning this is bank originated paper or when we talk about paper, we're talking about notes and the mortgage. We're talking about the documents that secure a bank when a homeowner goes to buy house. They would go to the Wells or Bank of America or Chase or anybody else who originates Freddie Mac paper and then that is taken and in the banks then bundle that up. So, tell us a little bit of that story and then why you guys got interested in the distressed aspect of that.

Dave: Of course, it happened by accident. We were familiar with notes and we are more familiar with it from the seller finance side where you would you hold paper or try to get owner financing that type of thing or you do a private money loan for rehabber. So, I was very familiar with that and the typical Pete Fortunato and all that type of Invest in Debt Jimmy Napier. Jimmy Napier was one of the first persons I ever heard talk about notes or Donna Bauer or Eddie Speed's, his folks. That was all fine and all but when I was introduced to the institutional side, it just seemed so much different. So, there was like two worlds. There was the institutional note world where so most of what PPR does just to get everybody color is we buy one to four family residential mortgages nationwide first and second liens.

We started out in a junior lien business and it wasn't because we were crazy, it was because that's what we were taught by the person that was selling us product. It had nothing to do with logic or sense or lien position or anything. It just happened to be the space that the seller of notes was teaching us. Then later on we got into first liens especially today probably at least three quarters of our business is first liens, because we have a lot more capital under management. You wouldn't be able to get enough consistent deal flow with junior liens for example. So, senior liens are much more prevalent. The strategies on how you work on vary little bit but we do both. I'm just pointing that out.

So, a bank originated loan is much different than a seller financed loan. Seller finance loans seem very … there's nothing wrong with that business, it just seemed like it was very small like you would go out and have to go market to go find one note. Whereas we can call a trade desk and buy 1,000 loans or

500 loans. Well, you can't do that in the seller finance world. I can't normally buy hundreds or thousands of loans that type of thing. So, the more capital you have to deploy, the harder that world is. That was probably one of the reasons. Then the discounts tended to be bigger. I did like the quality of the paper from the banks.

You often hear the opposite story on the street is that the quality of the papers banged up from the banks, but I found that that wasn't necessarily true. It was more of a mythology thing. Yeah, there are cases where it is banged up, but the other side is people didn't teach you how to fix it. I was more of the school of thought "Hey, let me learn how to fix it." It's just like foreclosure. In the seller finance world they do everything they can to avoid a foreclosure. I took the point of view of, "No, let me learn foreclosure and bankruptcy and I'll know how to deal with it if it happens."

As opposed to, "No, I don’t want to deal with it at all." So, I was kind from the school of thought "No let me learn it inside and out and then I'll know how to handle it." Now in the beginning we started out as investors. Then we were very clubbish and then all of a sudden it morphed into a regular business. Today it's more like this enduring enterprise thing. Our 10 year vision is to have a billion under management. So, it's pretty significant goal right now.

David: When you started some 11 years ago, you pretty much use again your own capital.

Dave: Correct.

David: Again, let's go back to the point of leverage arbitrage. Using your own capital, you can go buy a note, a distress note, and we'll talk little bit about how you work those. The point is you had to get some velocity of capital. So, we call that recapitalization, recapitalizing our capital, getting the capital back again. We have an asset, that's great. It's an asset that has value, but if we're going to multiply this thing and get this thing going, we've got to get access to more capital. It's going back to how you leveraged your equity in your rentals, apartment houses. So, talk about recapitalization, how you guys use that leverage early on to build forth what you have today.

Dave: Well, in the very beginning we were just like you said we used our own money first. We wanted to make sure the model worked. We didn't want to go raise people's capital and then fall flat on our faces and then not be able to pay people back or anything like that. We were like, "No, we got to make sure our model works." So, we used our own money in the beginning. Then once we figured out the model worked, one of the reasons my partner John had partnered with me was … because I had been raising capital for commercial real estate. So, he knew I knew how to raise capital. He knew I had a huge network. He was like, "Okay, well you can raise capital for notes if we'd get this model to work." That's what happened there. So we made sure the model worked, but to your point David in the very beginning especially with junior liens, they weren't that popular then.

There was no real marketplace for them at the time. They were just coming into the market. So, think about it. Junior liens haven't even been around all that long really in the history of all mortgages. They're relatively a modern thing especially with HELOCs and almost like where you're tapping your equity like a credit card. Well, that didn’t exist years ago like when my parents were you growing up or even when I was growing up. So, it's a relatively newer concept. So, all of a sudden these second mortgages and delinquent second mortgages and then eventually second mortgages with no equity we're hitting the marketplace and people were like, "What is this odd duck?"

Of course, we were kind of like in the right place at the right time learning how to manage this and handle it. We did quite well with it. In the very beginning, we only bought second mortgages with equity and of course the market tanked. Guess what happened to our portfolio? The value of our portfolio dropped, but we weren’t forced to sell it though. We were able to still work through it. What we did was we actually learned some really valuable information and data was that "No, not everybody runs from their house when their equity falls." You still need a place to live, right?

David: Yes.

Dave: So, there were a lot of data points that we picked up. We found that we were actually overpaying for equity deals. When we learned how no equity and partial equity actually worked, it was the most valuable information and data we could have ever gotten. Now we could go out and buy pools of mortgages at way better pricing, sell off the equity at a premium and still make the bulk of our money in partial equity which is kind of what we did. Now, once you get a note re-performing and now it's like watching paint dry because it's just payments coming in. It's kind of boring. You have a servicer. They do everything for you. You're just watching the payments.

So, how do you recapitalize from that? That was what our problem was in the beginning. We didn't really have any note buyers for a re-performing, once delinquent, upside down second mortgage that was in bankruptcy. You could sell that David. You could sell the Brooklyn Bridge, right?

David: Right.

Dave: You could sell the Brooklyn Bridge. So, what did we do? We had investors that believed in us and invested in our funds and we always paid. Then what we started doing was actually it was an idea I picked up from Donna Bauer's it was a Collateral Assignment of Note and Mortgage. I took the paperwork. Got my attorneys to review it and then started doing them. We started doing hundreds of them and we had a lot of re-performing mortgages, we just had no one to buy them, but we had people that would lend us money and we would secure them with the mortgages with equity. We would do a recording. We'd recording in the county courthouse to protect that lender. So, if you lend me money David, I'd backup your loan with this performing mortgage. If it re-defaulted, I could substitute another mortgage or you could do different things. We probably raised millions of dollars that way. That's how he built PPR in the very beginning.

David: I tell people that real estate whether its equities or note equities, it's the vehicle that allows you to do so much with it because it's financeable. In this country, banks have forever financed real estate. Now they don't finance so much notes but they understand real estate side, but the financing is the key to all this. Pete Fortunato says, he says, "Use what you want, that is the real estate or the note, use that asset to get what you need which is the financing or the arbitrage to get what you want which is that note or the real property." That's what it is. If people get all glossy eyed over which house or which note, yeah you got to use due diligence to get the right deal, but don't fall in love with the actual asset.

Just make sure it's a good asset but using that asset to leverage the further growth of your equity, your wealth, your passive cash flow like I can call it cash flow on demand because you can structure your equity growth so that even through your financial circles, your financial friends, you can turn that equity into cash flow really when you want to. In your book which I'm going to talk about in a second, in your book you talk about those different ways to do that. That's what I know about real estate particularly you can do that with any asset class, but residential so darn easy to do that because it's a known quantity. So, let me just mention your book real quickly because we talked about on the last week podcast but we haven't yet today, your new book that you've been working on for like a year, it's now Real Estate Note Investing by Dave Van Horn. That can be picked up on the Bigger Pockets website where you've been a regular blogger for five years. Give that website and a forward slash so people know where to go Dave.

Dave: Yeah, it's biggerpockets.com/noteinvesting.

David: They can pick it up there. Then also you recorded some additional bonus segments that were really cool. One on asset protection, one where you involve Polish, your partner go to some different website platforms and evaluate notes that are for sale there kind of go through that. You did one other segment which was …

Dave: Yeah, the other was an ebook on pitfalls of note investing.

David: Excellent.

Dave: …watch out for you.

David: Yeah, excellent, excellent. So, some really nice bonuses to go along with a really … By the way, Dave a really well-written book. I a free copy and had a chance to read through it in this last month but awesome, awesome book. You made it very complete. So, people that are interested in learning more about this, that's probably today I would say like the number one resource to go and see what this really looks like. The rest of it, I think to fast forward it and get speed to what people want to do particularly given the professional practice owners is you need connections. You need connections. In other words, we were talking just a minute ago about the fact that PPR Note Company you guys decided to go after the bank, originated the institutional paper. Well, me, David Phelps, I can't walk into Wells or Chase or call up Bank of America and say, "Hey, let me buy some of your paper." I can't do that because there's so many regulations or protocols. You have to have a major presence to have that.

So, my access, my Freedom Founders member's access is through our relationship with you. I know you. I've done due diligence I've known you but I actually do due diligence checked out your company. You guys have done this for so long that you've developed some really cool analytics. We were really impressed by what you do to analyze these big tranches, these big portfolios and figure out what the buy rate is because it all comes down to pricing. It comes down to pricing. You guys know what to do with the paper, but you got to price it right based on what's in it. You guys do that very well. Talk maybe just a minute about that and then what are the basic exit strategies for you. In other words, when you have distressed paper, in other words paper from a bank that has not been paid on by the borrower for sometimes months and years, so now what do you do with it to get something out of it?

Dave: Like my partner John always says, "There's no bad notes. There's just bad prices or bad terms or whatever." Even in real estate too. There's no bad houses, there's just bad prices, right?

David: Yup.

Dave: So, with notes, there's two fundamental exit strategies. One is through the property and one is through the borrower. So, if you go through the property, it could be a deed in lieu where you get a cash for key situation where you track down … It depends whether it's vacant or occupied obviously, but sometimes you can do cash for keys or you could do a foreclosure sale or you'll take it back as an REO. That's through the property for example. Then through the borrower, it's usually some type of a modification. It is probably the biggest thing. You could also sell the note. You can flip the note. You can rehab the note. There's all kinds of things that go on as far as exiting. Just like re-capitalizing, there's probably a half a dozen ways to recapitalize notes.

David: The point is if you buy it right, there's multiple ways to exit from that. Okay, here's the scary thing that a lot of people that are newbies thinking about being the bank, investing in notes. You just mentioned let's say we're talking about performing note. A performing note is one that has a track record the borrow has been paying on it for 12 months or more. They got good credit score. It's rocking and rolling. So, this thing is performing. It's ACH. It's mailbox money. That's the ultimate for the passive investor. Passive investor doesn't want to do the work out. That's what you guys do. You default a paper into re-performing and people can buy that.

So, you got a performing note. So, the investors who's a busy professional practice owner is a dentist and fear in the back of his mind is "I've got several of these. What if that borrower goes bad?" You just mentioned, "Now I got to go through the property." So, now I, the dentist, has to go foreclose or do negotiations to get cash for keys. Now I got this property and its five states away Dave and I'm a dentist. Now, am I going to have to get my car or fly there and go fix this problem? What's the downer to you? What do I do with this?

Dave: Well, like PPR sells performing notes that are typically re-performing. That means they were once defaulted, now they're re-performing and we warranty our note. So, our warranty is investment principle minus payments received. So, we try to give you the option. Now you can still foreclose and take the property if that's what you decide you want to do because sometimes the value of the property goes up dramatically or you could say, "Now I want to sell that asset-back to PPR so I don't lose any money." That's one way to do it. Then the other way is to invest in a fund so a lot of people will do fund investing.

With fund investing is if one note goes bad, it's not the end of the world because typically a fund will own hundreds or thousands of notes. There's also limited liability for the investor. If you own a note and you violated some regulation or compliance thing, you could theoretically be sued for more than the note or fine for more than the value of the note which is not something that's fun. So, it depends on your position but there are ways to incorporate notes even into a private practitioner's business. It's old … I call it the HVAC model. I had a buddy that had an HVAC company where he started to finance the heaters on the installations, just like a dentist could finance dental work and that could be another vertical of multiple streams income that you can incorporate into your practice or your retirement account could own the finance company that finances dental work.

That could be a way where you're doing notes with something that's familiar to you that you might feel more comfortable with starting out. There's even we see the young people in my office still go through a prosper.com or lending club and they can start investing in notes with $25, $20. So, there's plenty of ways to get into the business with a nominal amount of money or to get your mind around it or get started. There's some safer ways.

You're right, re-performing notes are definitely a safer way than to just jump in and buy nonperforming notes. Me personally, I don't even buy nonperforming notes personally. It's too much work for me.

David: I wanted to say Dave exactly. You got people that know how to do that just like ...

Dave: Well, I mean in all fairness, a loss mitigation person I mean it's … trust me all the private practitioners are making dramatically more salary than a loss mitigation person so why do you want to do that test just like why did Dave want to be a property manager anymore. It's a $25 an hour job or whatever it is. So, it doesn't make sense at some point.

David: Yeah, exactly. All right, Dave, we pretty well covered the gamut today. We could do a third, fourth and fifth session but we don't have time to sit in front of the camera and microphones all day. This is really fun. This is really good. I think we got a pretty good deep dive. Your books, a fabulous resource for those who are listening and would like to go a little bit deeper I would highly recommend it. Well done by the way Dave. You can always find Dave at PPR Note Company and find more about accessing investment in the funds or one up buying that one note that comes with a warranty, different ways to do this. It's a great way to get started in real estate. I highly recommend people that are looking at it from the outside, do that first and learn about the paperwork, documentation.

In fact, a good way also Dave is people can JV to by a note. They can joint venture and maybe joint venture piggyback on the back of someone who already knows how to do the due diligence and can ride along with them with some money invested deal and watch. It's another great way to do it. It's what we do a lot in Freedom Founders is our experienced docs will bring those that are just coming in and let them piggyback on some of their deals. It's a fast-track learning how this stuff works and people can be put out on their own to go after it. Just people grow in their acumen or ability to orchestrate their own financial futures, what it comes down to.

Dave: Now it's a great idea. You can always shadow someone else's deal. You don't have to put your money up even. Just watch what they're doing.

David: Yeah, watch what they're doing all day long. All right, Dave Van Horn, thank you so much. It's been a lot of fun. Always-

Dave: Always fun.

David: ... have you here. I'll see you pretty soon and I assume we're going to get you back to Freedom Founders pretty soon as well. Now this one book is done, maybe book two will start soon. We'll see, right?

Dave: Yeah, I'm hoping. Yeah, I look forward to seeing you guys. I plan on coming down there soon.

David: Very good. Very good. All right, thank you Dave. We'll talk to you soon.

Dave: Thanks David. Take care.

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