Ep #280: What's Happening in the Capital Markets with COVID-19 - Part 1

Full Episode Transcript

With Your Host

Dr. David Phelps

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David Phelps: Good day, everyone. This is Dr. David Phelps of the Freedom Founders, Mastermind Community and Dentist Freedom Blueprint Podcast. Here, I'm going to have a very interesting conversation with three gentlemen that have a lot of experience, and very involved in what I will call the capital market. And I'll have some idea of what that means, because I think a lot of people probably are confused. I get confused sometimes about all the interchange and what goes on and who controls what and what's happening.

But just to let you know who I've got today, I've got Mr. Justin Bunch, from Genesis Capital, Aaron Chapman from Security National Mortgage, and Mr. Stuart Denyer from Sherman Bridge Lending.

Gentlemen, first question I'd want to throw out is, yesterday, Fed Chairman, Jerome Powell stated in front of the Senate Banking Committee, he said, his words, "There is no limit to the Stimulus Relief Act that we can put out, to deal with coronavirus. No limits at all."

Justin, let me go to you first. What does that say to you? I mean, take any part of that. What does that say to you when the Fed Chairman says there's no limit to the stimulus we can put out?

Justin Bunch: Ah, Ooh. That's an interesting question. Yeah. I don't really have a response to that. That doesn't really impact our business at Genesis. Maybe it affects our borrowers, but we're a little bit different than a lot of the other lenders. They don't securitize their loans, sell in the secondary market. We're a wholly owned subsidiary of Goldman Sachs. So we're just a little bit different in our approach to this whole thing and what we did, which I can go to in a minute, if you want. But I actually don't have a detailed response for how that's going to impact us, so to speak.

David Phelps: Yeah, let me ask it a different way and I will come back and let each of you gentlemen talk a little bit more about your specific dealings in the marketplace. Let me ask it a different way.

When the Fed Chairman makes a statement like that, what do you think he's thinking, about the potential long-term effects of the coronavirus pandemic shutdown? What do you think he's thinking? Is he worried? I think he also, somebody said, maybe it wasn't Powell, but said, "I don't think we're going to go into any kind of, really, like depression." But then he's... So, I mean, just say whatever you want to. This isn't right or wrong answers. I'm just curious what you guys think.

Stuart Denyer: I think I heard between a 30 to a 50% decline in GDP, as you heard that this morning on the radio. And I believe that was referenced by several members of different branches from the Fed, but that's significant. And when you say you have an unlimited amount of dollars for me, that's a pretty scary thing for someone to say, frankly. I understand why he's doing it. And it may be a lot of politics behind the economists, but that's a very scary thing to say, that you can just continually print and print and print and print. I mean, it's an enormous stimulus, enormous already. And I think it's a signal, as much as anything else, to the lack of the unknowns. I mean, again, anyone can say what everyone wants to say. I've been telling everyone in our network, if anyone actually tells you that they know what is going on here, then I suggest you'd be aware that they have probably a big agenda going, because I don't think anybody really knows where this is.

Unless you are on the front lines, you don't see how much of these forbearances are happening. You don't see how many people are planning on paying their mortgage. You don't see a lot of what's going on in the background and how this impacts us on so many different levels. But I also hear, instead of it being sort of a Nike swoosh cone of recovery, maybe now it's more of a steep V and I think the reality is it's a scary prospect to say unlimited. I don't like to hear that, personally, but I understand why some people might.

Aaron Chapman: It was also brought up, the front lines folks can only see what's right in front of them, unfortunately. And like he had mentioned, we don't know what's over the hill. We've never been here before. We've never experienced any of this. And when you see the largest ammo drop ever available coming to the frontline of that battle, the guys up front are like, "What do they know that we don't know? What are we not seeing that's coming over the hill?" In that situation, you know darn well, we got some ugly things that are potentially going to occur. But I agree. That's a scary thing to think of, that they've got that much in reserve, or they're saying, "Listen, we will take all we got and pour it into this one battlefront."

The other thing that really hits me when I hear about the ability to print like that: inflation. You know me David, I preach inflation. I scream up and down about how inflation is. It may be the enemy to a lot of things, but also a really huge friend to the real estate investor. And that's where it scares me about what the inflation is going to do, especially the potential for any sort of hyper-style inflation that may come as a result. We can't say whether it will or will not, but we also know that inflation is the friend to the long-term leveraged person.

David Phelps: Yeah, I've heard some of that. So thanks. Thanks for bringing that up. We hit the big one there and we haven't come to a conclusion, but I agree. I think it is a scary prospect. You know, we, the country, the government, throws around the trillion dollar like it's play money. I mean, it's like the concept of how many dollars that is, doesn't come to the forefront, unless you look at a visual and have a comparison to something, to where you can really see what the extent of that means.

So Justin, let's go a little more granular. So back to where you were headed, what do you do in the capital markets and who do you serve and what are you doing differently right, now in terms of your business dealings?

Justin Bunch: Yeah, absolutely. So in March, just to kind of summarize where this whole thing started with us and where we're at now, in mid-March, when this thing hit, it was actually at collective genius when this whole thing really, really broke. We were slated to have our biggest month in March and in April. We had about 400 million of loans, loan volume that we had committed to. And we made the decision to completely go into defense mode. It had nothing to do with the fact that we securitize our loans or lost in any investors in the secondary market, we just went into complete defense mode. We had to figure out how to position our 200 employees and work virtually. And we got a major spike in construction draws. We had to basically re-underwrite our entire book and really focusing on the borrowers that we had a lot of money out with, and a lot of projects out with, make sure that they were good from a liquidity standpoint and capacity standpoint to ride this out, which market are they in? Are they in one of the, what we deem the high-risk markets, New York, Washington, DC? Those areas that just have more people on top of each other.

So basically we stopped lending for March and for April, to do what I just said, to go into defense mode. And we are past that stage now and all the writing. And just to rewind a little bit, we made the decision to maintain our same level of UPB, unpaid principal balance, which was 1.2 billion out nationwide. We made the decision to not exceed that. So basically we wanted pay downs, which provided enough cap space in order to lend on that. And that also included construction draws. We don't want to hold up our current borrowers on their construction draws. So we've gotten a lot of pay downs and we've gotten a lot of cap space and all signs are positive that we're going to come out of this in a good position.

So for the month of May, we have started slowly turning the faucet back on and we're lending right now, only to current borrowers that are approved. We're not lending to new borrowers. That is probably going to happen in July.

We've pulled back our leverage. We were typically at 85 to 90% of total costs for fix and flip, prior to COVID and for ground-up construction. And just to rewind, about 60% of our overall fundings are ground-up constructions, typically north of about $500,000 on the loan amount. We've pulled that back from 85% of total costs down to 75%. And for luxury projects that we deemed to be in a luxury project, wherever it is, it varies, depending on the market on what we deem as luxury, we're at 65% right now during COVID.

So we've significantly pulled our leverage back in the meantime, just to ride out the storm. So, we'll see what happens in July once we get back to full steam, but that's currently what we did.

David Phelps: Justin, who are your borrowers specifically? What projects, what asset class are you lending them to do their projects?

Justin Bunch: Pre-COVID, we had a pretty diverse mix. I'd say what we're best at... Personally, who I go after is spec home builders for single family ground-up construction, that typically build for about a million dollars total cost and sell for about one and a half or 2 million. That's who I go for nationwide. There was a lot of fix and flip lenders, you know, prior to COVID. So Genesis was pretty big in 2017, 2018 with fix and flip. We kind of pulled back from doing that because of how inflated the market was with the fix and flip lenders. So we pulled back from that and kind of focused more on the ground-up single family borrowers. But what separates us also, is we do infrastructure loans. We do subdivisions and we do ground-up multifamily.

And we were consistently in that 5 to 10 million loan amount range, where a lot of other lenders couldn't do that. So that was where we were at pre-COVID, but as far as the loan amount size, we're capping at about 5 million right now during COVID. Not really interested in anything higher than that right now. And we've increased our credit scores from 620 to 680. So, some pretty significant hard gates that we're implementing right now, to keep ourselves in a safe position.

David Phelps: Got it. Got it. Stuart, same thing. Let's talk about your market, Sherman Bridge Lending, your borrowers and what changes you've made and a little bit what you see coming down the pike the next few months? What are you looking at? What are metrics? What are you concerned about as you continue to do business?

Stuart Denyer: We've looked at everything. We are still not lending as yet, but we really looked at everything. It's so case by case. Pennsylvania, for example, is a market that we were pretty busy in and they just can't do anything in that market. There's other places that are opening up. So, it's case by case. Our client is anybody. We'll do a full-time professional to a month, tops. And we underwrite everybody to the merit of them, individually. So, we're a different structure in that way. But again, we're still not lending now and we're waiting. And our relationship with the capital markets has been on and off. So, we've worked well with Wall Street at times. And when this happened, we had no real established relationship with many people in the markets.

I think we pulled out of most of our capital markets work a year or so too early, frankly, but we didn't like a lot of what we saw coming. And so, we severed a lot of the ties that we had, not because of anything other than the fact that we didn't enjoy the direction a lot of it was going. The compression was getting pretty intense. And everybody was struggling, not for the quality of the borrower, but for the amount of money they could put out. And that felt a little bit wrong to us.

So as far as the capital markets now, I think everybody's very... Again, I think everybody is looking and seeing what's going on, and there are definitely people back in the secondary world, in my world, which is just fix and flip, basically, there are secondary buyers back in that space.

There are also secondary buyers with big loan tapes out. And so I think that the pain points are shared amongst a number of different aspects. You know, who your client was, you'll learn to cost load to value, however you structured that. I think that if you had a big book that was heavily in one area, and that area was impacted more by construction, the ability to do construction on projects, then there's going to be an impact there. We've really had to break everything out in every localized market and get pretty granular with it.

Historically, what we think when these things happen is there's going to be this huge price drop, which I don't think we've seen. In fact, most of every market we see, prices have gone up. There's a big book of business in California, and everybody had no problem getting rid of those single family assets.

You know, that's what we do, single family. So again, it's just been unusual from a lot of different aspects here for us, but we're just vying for a comeback. And I just think like everybody, we're going to be underwriting with more scrutiny and we're going to be taking more risk in place, but there's definitely not a one size fits all just because it is so different in every space.

David Phelps: Yeah. Very good.

Aaron, So talk about National Mortgage. Who are your clients and what changes are you seeing in the marketplace?

Aaron Chapman: So I deal mainly with the people buying the one to four unit properties using your Fannie/Freddie conventional money. I'd found that that particular part of the lending industry was completely under understood, if that's a way of saying it. Most of the banking world out there, they're looking to people with the W2's, they're buying a house to live in, possibly a vacation home, not really understanding the thought process behind the real estate investor wanting to get started. The people want to do those 10 finance properties. And that's where I started focusing my energy in 2003 and had developed a business centered around that and so targeted, that last month was my greatest month ever. When the rest of the world is coming down and it comes to the real estate investment lending, I closed 134 transactions, took on another 160.

I've got the largest pipeline I've ever had my entire career. And unfortunately, a lot of it comes from the guys that Justin and Stuart may have had, that were looking that direction and saying, "Well, let me see if I can fit this into a conventional loan." They came over to us in droves. We already had a large pipeline, the pipeline got huge, all of a sudden. So we're trying to catch up on all of that. And Fannie and Freddie, they have tapered back a little bit, but it's taken it back heavily when it comes to people buying houses to live in. Because when you think about who's mostly dealing with forbearance and who are the people that are worrying about their ability to make those bills, it's your average American, that's got an average wage that is living in an environment that they barely have any way to save, much less just live their lives. And if one paycheck gets cut off, their whole world changes.

Well, the real estate investor is different than that. Especially the Freedom Founders Group. I know that they've been affected because of the stay at home order, if you will. And the fact that they have to be hands-on, in somebody's mouth, which is the one place you do not want to be during the COVID virus, of course, that being the situation, they've been affected there. But the majority of people who have put aside capital, that are investing in real estate, they're moving forward. They're moving forward, actually in a very, very big way, because they see the opportunity that is here.

You know, the major opportunity that we've witnessed is the majority of people have to stay in doors or shelter in place. When they're talking about sheltering in place in say, an apartment, a two bedroom apartment with two kids and trying to put them at the kitchen table to do homework, they can't wait to rent a single family residence. So rents have gone up during this process, during this time. Cost of housing has gone up. People are bidding them higher. When it comes to renters, I've talked to a lot of property managers across the country, they're saying they're having a higher quality tenant applicant than they've had in the past. They're collecting more rents they did in the past. Why? Because people know that if they want to be able to upgrade their rental, they got to pay their rent.

So we're starting to see what is a big fear for a lot of people, is actually a big plus for the real estate investor that's buying the one to four family properties. And the real estate investment lending piece of it, for us, has not moved that much. But they, because the needle that they moved for general lending on the conventional side has come up still, just slightly below where they had the baseline for real estate investors. So I've not seen a big change in my side of the world, other than a lot of questions, a lot of fear. And I'm having a lot of conversations. I'm on the phone a lot.

Stuart Denyer: I speak to a lot of people, David, in and around our market here in DFW. And there is, of the three conventional outfits that I speak with, two out of three had the biggest months they've ever had. That seems to run true just about everywhere, the conventional world. And this is something that's another offset that is confusing or unusual. You've got these incredibly low interest rates, and you've got title companies that are insisting that their teams go in because they've got so much refinance business in addition to this alternative business we're discussing here, but you've got a busy market. And so, it doesn't seem as though pricing has slowed at all and refi boom for people that are getting just the cheapest mortgage they've ever, ever, ever got, is pushing things along. Whether you're a purchase or whether you're a refinance client. If you've got the capacity to get a loan right now, borrow money in the threes, that's a heck of a handle and people are going to do it.

Aaron Chapman: Yeah. The only difference we've seen on those interest rates is, right now, since the servicing side of our industry is no longer buying the loans, they're not paying to service the loan anymore. In fact, because of all this incessant refinance, they're losing so much money by buying the loans that they're now demanding, "We're not going to take them anymore and pay you for them. You're going to give them to us and you're going to pay us to take them." So we've seen an increase in points that most people weren't paying before. Keep the rates low.

We did see a window in mid-March where interest rates jumped over, for my investors, 5-3/4% percent with two points. It's trickled right back down into the mid-fours again, but they're charging a point or point and a quarter because they got to pay that freight. Right? They going to pay the servicing side. Then they found that if you raise the rates up, all you're doing is going to perpetuate the cycle. People are going to refinance again, but if you keep the rates in the lower position where it's going to be hard to compete with that rate, and then there's a little bit more cost to get it, the potential of them refinancing again within a year, year and a half, to hurt that servicing side of the industry, is going to be limited. Keep that part alive and get that back on to some sort of track.

David Phelps: Yeah. Well, as you both indicated the historically low interest rates, you're amortizing whatever the cost is, to obtain those, over a relatively long holding period, whatever that may be, then it's insignificant because the cost environment's so cheap.

This concludes part one of my conversation regarding the capital markets and the effect of COVID-19. Next week, I'll have the same three gentlemen back and we'll dive into more of the effect of the overall federal stimulation, the effect of the enormous amounts of debt on the future, and a question I pose to all three gentlemen that I think you'll really want to hear. It has to do with long-term legacy. Catch you next week.

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