# The World of Private Transactions: What, Why and How - Larry Pino (Part 2): Ep #392


## Full Episode Transcript

**With Your Host**

**Dr. David Phelps**

**Dentist Freedom Blueprint with Dr. David Phelps**

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Welcome to the Dentist Freedom Blueprint, a podcast about freedom—freedom from expectations of society and the traditional path to success that has been ingrained in us from our early years, I'm joined by mavericks, renegades, and non-conformers to discuss an anti-traditional path to financial freedom, freedom of time, relationships, health, and ultimately freedom of purpose. My name is Dr. David Phelps. Let's get started.

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Hi, David back. This week, we're resuming with the podcast episode from last week on private transactions. If you missed last week, you'll want to go back and catch it.

This week, we're going into some details on some particular private transactions that we've put together in the last few months, the ins and outs, what the motivation was, and how it was a win-win for both parties. I think you'll really enjoy this particular podcast. Jump in, I'll talk to you soon.

I think your order is absolutely correct. As you said, the economics comes way down the list. All the other criteria or considerations need to be looked at in advance.

And that's where people get tangled up, I think, many times. They come across or someone sends them something or they hear about something and they want to jump into the mix of it too early before assessing really does this merit an upgrade-

Larry Pino: Does it even make sense?

David Phelps: Does it even make sense? And this is just something like, well, you just gain experience over time with this, but that's why you need somebody on your team. If you're going to be involved in some kind of a private transaction, you've got to have somebody there by your side, preferably someone like Larry or someone who has this kind of experience to walk you through it.

Now, you do enough of these things, and you'll develop kind of a gut for it. Just like our doctors, after they've practiced enough years, they can do a pretty quick diagnosis and assessment pretty quickly, to see, well, where do I go next with testing, which is part of underwriting. So, a lot of similarities here with what you're doing.

Larry Pino: And it's funny. So, on this particular one that I just mentioned yesterday and today, so we do two things on the underwriting side. Obviously, you're very familiar with IRCs; the IRC opinions that we do (Investment Review Committee) for Freedom Founders.

And that's sort of general terms, it's specific, it goes to all the members so that they can review and so forth. We also do something very similar to that, which is called Investment Review Opinion.

What I don't do, I stop short in an IRC because I'm not making a decision or an opinion that says, “This is worth doing, or this makes sense to do." I just say "Here it is. Is it market clearing economically? Is it market clearing structurally? Is it sound legally? Okay. So, there it is. And this is what it looks like."

In an IRO, I go further than that and say, "Therefore, based on all of that, blah, blah, blah, blah, blah, blah, blah, blah, blah, blah, blah." And I give all the attributes of it. And I actually form an opinion as to whether at the end of the day, there is a supportable thesis that just makes sense.

And that's really the language that I use, David. And it just says, "Does it make sense to invest in based upon these particular considerations." So, all of that comes from the underwriting.

So, let's talk about this was a particular one that I know you were familiar with, because it's a Freedom Founders transaction, which was a Unit Investment Trust. And this was a group of individuals that were partners and they wanted to buy a parcel of property and to be able to entitle it for the purpose of building rent units on it.

And it was intended to be a bridge loan and so therefore, for that reason, it was 180 days and it was a $2.5 million loan at a very, very nice interest rate. I think I said it, it was 18% interest rate. But it was a relatively short-term loan.

It eventually went from 180 days up to I think it was an additional, if I'm not mistaken, maybe 60 days, 30 days, something like that. I think it was like 60 or 90 days.

So, there was an additional extension fee to be paid on that and so forth. And so, on that, the documents which we took, we took the Secured Promissory Note, Mortgage and Security Agreement on the property. We did personal guarantee of the primary material members of the bar.

And then we did a collateral assignment. And if you'll notice, that's a very common thing that you're going to see across the board because when I've got an LLC as the actual title holder, obviously, I want that LLC as a borrower.

But I also want the extra redundant security of getting a collateral assignment of their membership interest, so that I have both the possibility on behalf of my client or in some cases, myself.

I have the additional security over and above a mortgage on the property that I can actually do a replevin action against the collateral assignment, against the membership interest, which are actually easier to do than a foreclosure, plus it gives me everything. It gives me everything on top of it.

Well, that's the case, why I get a mortgage on the property. Well, number one, you don't want it sold out from under you. And secondly, one aspect of the difference between the membership interests and the mortgage on property, is that a foreclosure wipes out everything else.

So, in the event that you have other types of liens and claims and things like that, your best position is really in a foreclosure. When I take an assignment of the membership interest, I get the membership interest, but I also get any claims of the property that the company has against it.

So, if they operate complimentary and that's what I meant by overlapping security, if you will-

David Phelps: Kind of belt and suspenders, right?

Larry Pino: Yeah. Belt and suspenders, indeed. So, this turned out to be sensational. The reason I used a Unit Investment Trust in this case is because I think there were about eight or nine individual investors. It's clunky to use a partnership agreement. So, probably the best way to do it in this case was a Unit Investment Trust.

It had one trustee, all of the members were even undisclosed to each other. They didn't know who they were. They were just beneficiaries. The only one who knew who they … well, I did and the only other one was the trustee. And it turned out to be a really appropriate structure.

So, that was a wonderful one. And you can bet that when you get that type of (whatever it was) nine-month transaction at 18% interest, plus some extension fees, that you have very happy campers on both sides.

David Phelps: So, some people might wonder, “Well, goodness sakes, who's going to borrow in this environment of still low interest rates in 18%?” So, I want people to understand that many times these private transactions are to allow the operator to gain initial control of the value-add opportunity. In this case, it was going to be build-to-rent.

So, in this case, the operators need to gain control by acquiring this land, that was going to be later development. Before they can actually go to the next step, they need to get the land entitled and there's a lot of steps to take.

So, they're not going to be paying 18% forever. In other words, as you said, this was initially six months, it went to maybe eight months. That's very doable in terms of the overall long-term picture they have in mind. They'll get their interest rate back down again when they go to the next takeout lender, if you will, longer term lender or next phase of their development.

So, I just want to make sure people say, “Well, where do you get these 18%?” Well, they don't just pop up, but again, there's purposes in the marketplace where these opportunities come up and they work on both sides.

Larry Pino: Yeah. This happened to be an 18% as a private transaction, but also recognize, it was land. It was development land and they needed to be able to get their entitlements, and they were on horseback to get their entitlements. But try taking that to a bank.

David Phelps: Not going to happen.

Larry Pino: You take that to a bank, forget about it. The LTV, it's not even a question of LTV. For raw land, unentitled raw land, forget about it. The bank's just going to turn that one down left and right.

That's why there are so many syndications that I do primarily for the land developers in the single family, residential marketplace, because getting property entitled is a process. And it's an awful lot of acreage that you have to put under contract in order to do that. So, you use syndications, but you use an awful lot of private capital in the process.

This was an individual private lending deal. And I selected these obviously, because it's a Freedom Founders, Dr. David Phelps Podcast. So, here's another one which was an individual private lending deal.

And this one, unlike the Unit Investment Trust, was within the context of something that was available. And I forgot exactly what this was. I think this might have been 250,000, 300,000 something in that area.

And what he wanted to do is, it was for the purpose of buying a distressed single family. I say multi-family, but I think it was just several units. Maybe it might have been a quad or something of that nature, and to rehab it. And then be able to eventually pursue a liquidity event.

So, we did exactly the same thing. We did a Secured Promissory Note, Mortgage and Security Agreement. We got the personal guarantee of members and then the collateral assignment of the membership interest and borrower executed by the borrower's members.

One thing that I forgot to put in here, David, is that what we also got was cross collateralization. Because of the fact that there was a real rehab that had to be done on the property, I wasn't satisfied that it would create the value until that rehab occurred.

So, there was another piece of property that I took a mortgage on or we took a mortgage on, on behalf of the client. We took another mortgage on another piece of property that was fully functional and was already in commerce and didn't need to be rehabbed.

So, again there was a redundancy factor that came from not only a mortgage on this property, but also the personal guarantee. A collateral assignment of the membership interest. And on top of that, there was a cross-collateralized mortgage on another piece of property.

David Phelps: As you said, very important, when you're the lender on a property that's going through a sizable renovation, there's a period of time where the value of the property acquisition is actually going to be lowered by the time they go through and gut it and tear it apart before they start building it back again.

And you don't want to be the lender in that position, if something would go bad.

So, your point of redundant cross collateralization makes a whole lot of sense. And I don't think very many people even understand that that can be done many times.

Larry Pino: Well, again, you think about the context. You're always thinking about the context of the transaction. There's nothing wrong with doing a rehab, nothing at all. And obviously, that's how you create additional value.

But there is a time exactly, as you say, there's a time at which when you get the specs on the property, it's kind of like, "Okay, I can buy it for this. And if I put another 75,000 into it, I can rent it for this and then eventually sell it for this." It's kind of like, "Got it."

But in the meantime, here, if something happens here, what I end up with … and I had a similar situation with another client of mine where what they were dealing with was a contractor who defaulted.

And so, you end up with; what's my security? My security as a piece of property that's worth less, not only than what it was going to be, but it's worth less than the amount of money that I've actually loaned against that property.

David Phelps: That's such an important point. Yes, thank you.

Larry Pino: Okay. So, and then here's another one; this is the one that I was talking about before. So, you looked at it and what they've got is they have real estate in motion all the time. They have real estate in motion. So, on an ongoing basis, they always have a capital need.

So, and we have another capital provider who's a client. And the objective in that particular case was to say, “Hey, listen, I just want my money to be making more money than I could make with a 60 or 90-day CD.”

“And as long as it's secure, I don't mind, (I forgot exactly what the amount was. A million bucks let’s say), putting up the million dollars into having that monthly payment come in at interest, because I'm going to just simply treat it like a depository account. As long as I'm secure, it's going to be a depository account.”

“So, in the meantime, do need you to know though, when I want to get my money back, because I have a better offer. I want to be able to call the money in.”

So, he said “Great.” The opportunity who has a lot of real estate emotion all the time said, “Sure, let's do it.”

So, it turned out to be just a moderate interest rate. I forgot, I think it was maybe 6%, 5%/6%, but it was in effect for 60 days. 50% of the money was on call. And then at that point, it was additional notice. So, they have to give back 50% within 60 days and the other. So, for the full hundred percent within the next 30 days.

And in the meantime, in order to protect that, so they had talked about at the time, this whole real estate and giving mortgages on that, but there were no mortgages.

And so, when I got involved, I said, “Okay, so what can we do to make sure?” So, we created some belt and suspenders in that particular case, there was also personal guarantees connected with that also, along with the collateral assignment of all of these scared interests and the specific properties which they gave to the lender.

So, it was a great transaction. And since that time, they've done another transaction, the relationship capital thing that we talked about before.

Let me see if there's anything else. Oh, okay, two last ones, if that's okay. Those were all real estate. So, this one was the purchase of a private mortgage.

So, what you had is you had a particular investor who had a mortgage, but needed capital because he was going to reinvest his capital in another deal. It was coming due in about four months, but he couldn't wait the four months.

So, he found another investor that was willing to put up the money. It was a 12% mortgage on the property. So, this investor over here bought that mortgage at a discount to its face value, allowing him to earn a 20% yield on the transaction.

So, the note itself only offered 12%, but because of the discount, of course, the yield went up to 20%. So, in that transaction, we had all of those loan documents; the Secured Promissory Note, the mortgage assignment, personal guarantee, written consent of the members.

So, it was a very solid loan and it was a solid mortgage. It wasn't going anywhere. We reviewed the due diligence on the underlying properties of the mortgage itself, it was very solid. So, that was secure, ancillary credit enhancement. That was secured.

And then the only issue is, "Okay, so how do I effectuate the deal?" So, you effectuate the deal with a mortgage purchase agreement followed by the mortgage assignment itself, which is going to be the mortgage purchase agreement doesn't get recorded in the public records. It's just the agreement.

The mortgage assignment does get recorded in the public record. The bill of sale does get assigned. So, you have a bill of a sale assignment, and then you had the personal guarantee, in this case, not of the original borrower because we already had that, but the guarantee of the assignor of the note.

So, there's a double personal guarantee involved in that particular. And since that time, that's been paid off, and again, we have two happy campers.

Last one, David, and then-

David Phelps: Before you do that, I always love to get the motivation. So, the original owner of this Secured Promissory Note of 1.5 million had a better opportunity and that opportunity was now. And I think this note didn't pay off for four months.

So, he found somebody who would take this note, but rather than the face value of 12%, assignor wanted 20%. So, the original owner of the note was willing to sell it at enough of a discount to provide that 20% yield, which in this case, was about $28,000 discount on a $1.5 million note.

He was happy to do that because he saw another opportunity and taking $25,000 little discount just to have the money today made a lot of sense for him and still made a good deal for someone who was going to get 20% for another four months or whatever it was.

Larry Pino: Yeah, and that that's exactly right. If you think about it, the person who's buying the note, the note buyer who's the assignee is going to be still getting the 12%. So, they're getting 12% from the borrower.

So, the only thing that the assignor, the one who is selling the note is going to be paying is the differential between the 1.5 million and what the actual discounted yield purchase price was, which was 1.471. So, like 28, $29,000 is what it was costing the one who was going to sell the note out.

And obviously, he saw in this particular case, his application was, he was going to get a whole lot more on where that money was headed than the final 12% that he was going to be losing — not even losing, but relinquishing the 12%, but it's only going to cost him 28,000 in the process.

David Phelps: And again, this goes back to what we said during this whole episode. It's about relationship capital. People believe many times that real estate is illiquid. Well, sometimes it is.

But in many cases, it's really, you're lacking a network. You're lacking relationship capital. There's always people going different directions. And if you have that network, putting these kind of private transactions together are fun. As you said, they're creative and helps people move to really their real objectives in whatever their goals may be.

Larry Pino: Alright. Last one. So, the last one is actually fun too. So, here's a situation and we'll learn a little bit on it. Here's a piece of property that's worth 2.2 million. There is a $1.8 million mortgage on the property.

However, they need $500,000. So rather than lending $500,000, in this situation, I used my own retirement account for this. I have a qualified retirement LLC. And what I did was I purchased for $500,000, a Pro Rata interest in that $1.8 million mortgage.

So, think of $500,000 as being the numerator and 1.8 million as being the denominator. And it comes out to roughly a 27% interest in that mortgage.

But here's the rub, in this particular transaction, it's called the purchase of a partial on a mortgage. That $500,000 takes precedence as the first priority.

So, whereas the LTV, loan to value ratio for 1.8 million over 2.2 is pretty high at an 82% LTV, but the investment to value of a $500,000 mortgage secured partial, secured by 2.2 million is actually a 27% ITV, investment to value ratio. So, offers huge security.

David Phelps: Yes.

Larry Pino: And at the same time, it was a nice 15% yield on this particular one. The documents that reflected that partial mortgage was a mortgage purchase agreement, just like the full purchase agreement, and the assignment of a partial mortgage, which is the one that actually gets recorded in the public records.

David Phelps: So, real quickly, again, getting the motivation, somebody's holding a 1.8 billion note in mortgage, but I'm assuming that they needed something like $500,000.

And again, they had some use for that. They have use for that money. They're willing to give you in this case a priority lean position. So, as you said, your investment to value, very, very secure, and made something happen for the other party to go-

Larry Pino: David, in that particular case, it was simply they had a pain in the neck partner that they thought it was better to just buy them out. So, I provided the $500,000 to buy the partner out.

David Phelps: There you go. Makes perfect sense. When there's a great enough need, we'll find ways to make that happen and taking equity out of another asset to make that work is a great way to do it.

Nobody had to go to a bank to try to make that happen because a bank is not going to play ball. That's just not their criteria.

Larry Pino: Yeah. That bank would not have had given a loan against that mortgage.

David Phelps: No, just not there. Well, this is the world of private transactions and Larry, that's what I wanted do today, is just open the gate, open the door for people who really, so many people look at real estate, which we love, love alternative investments, but they see it with like one lens. “Well, I got to buy a real property or I need to put my money in this syndication or fund.”

And yes, those certainly can be viable means of investing in alternatives. No doubt about it. But the world of private transactions is; it's not a whole layer. That's really the fun part. That's what I know you enjoy.

And I enjoy it too. I enjoy seeing how we can creatively solve problems or challenge and create new opportunities that the rest of the world, the retail environment can't do, because it's just not their world.

Larry Pino: Right. It’s wonderful to know you can invest in Apple stock. So, you got stock and you have options and how many securities do you have out there to buy? And you could probably go to the Merrill Lynches of the world, Charles Schwabs of the world, and you can get private syndications. I don't even know.

But the bottom line is, this is also a whole nother world that actually gives you control over the strings of it so that you get to be able to create the outcomes that you're looking for, and to really minimize the risk precisely because you're in control of those strings. For me, it's a delight. It's just plain fun.

David Phelps: Well, Dr. Larry Pino, it's always a pleasure. Thank you so much for your time today. You always lay out your presentation so well. You're not only very proficient in what you do, but you're also an excellent educator and that's the world you live in.

So, thank you so much for being with us today. This will be a great episode. I know people will pretty much appreciate it.

Larry Pino: Well, thank you, David. It's always great to spend time with you too. So, all the best, take care, and I'll see you soon.

David Phelps: Very good. Thank you.

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