

Distress and Opportunity in Real Estate Today: Cash-In Refinancing, Rising Rates, and Smart Investing

Chris Litzler: Ep #537



Chris Litzler:

The overarching theme is quality, so that's quality. On the sponsorship side, your jockey, your gp, your manager is experienced, capable, strong. That's the first way to de-risk any deal. And then you have quality on the underlying real estate side, better, bigger markets, newer assets. Those are kind of the key ways to de-risk your deal. And then the third is, I guess you could call it quality on your loan assumptions, longer loans, lower interest rates, those sorts of things de-risk your deal.

Dr. David Phelps:

Decades ago, I hustled to grow my dental practice and real estate Empire Society patted me on the back and every new deal and patient reinforced the success they said I had. Then my daughter Jenna was diagnosed with leukemia. Nine years, several intense chemo treatments and years of epileptic seizures. My daughter was given one more miracle, a life-saving liver transplant in that hospital. I realized I wasn't successful. I had money, I had real estate assets and a business, but the only thing that mattered was time with my daughter. In that hospital room, I decided to sell my business, leave active income, and sustain my lifestyle with my real estate assets. Now Jenna is healthy and all grown up and me. I am teaching others to do what I did and I continue to uncover the principles, strategies and lessons we can apply in business and investing to create ultimate freedom for what matters most to each of us. Welcome to the Freedom Founders podcast.

Today's episode is for real estate investors and business owners who want to know what's going on behind the scenes of the financing world. The goal is not just to survive the current volatile market, but to thrive. Our guest is Chris Litzler, a senior managing director at Marcus and Millichap, a real estate finance expert whose strategic insights have helped countless investors successfully navigate refinancing challenges, distressed asset opportunities, and capital market shifts. Chris brings a rare blend of ground level expertise and macro economic vision to the table making complex financial trends easy to understand and to act on. In this episode, Chris and I dive deep into the current state of the real estate capital markets interest rate impacts, refinancing hurdles and the rise of private credit, and most importantly, what smart investors should be doing right now to protect their money and take advantage of the opportunity that will emerge.

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Please welcome Chris ler. Hey Chris. It's great to have you back. It's been a little while since we've had a conversation, but I figured it was far time part past time probably, and certainly we've had a lot of disruptions and dislocations in the marketplace. I mean, we've had them all along. We've had 'em going back to before Covid, we had dislocations there. There's always dislocations of different levels and different frequencies and different depths, but I think all things considered we're in a pretty volatile period right now. I would just have to say, would you agree just in general, pretty volatile right now?

Chris Litzler:

Definitely, yeah. David's good to be with you and with the group, definitely volatile. So what's today, April 17th, 17. So we're sitting here two weeks after liberation

Dr. David Phelps:

Day. I was going to ask you how liberated are you,

Chris Litzler:

Right? What is the saying? We've been liberated from all of the gains in the stock market, right?

Dr. David Phelps:

That's one way to look at it.

Chris Litzler:

Yes, yes. Liberated from having to pay capital gains tax, not because they reduce the rate, but because we don't have any more gains.

Dr. David Phelps:

There you go. There you go. Obviously you go to a very micro level, but as an investor, as more of a passive investor today, which is a lot of my tribe, we want to be in the alternative space. Real estate's always been a big part of that. We'd like to kind of hear through your eyes because you have to look at the same things just at obviously a more in depth level. What do you got your eyes on? What are you looking at? And then we'll just go from there.

Chris Litzler:

So my core business is arranging financing. So whether that's acquisition, financing or refinancing. Historically, 50% of my business has been refinancings and 50% of my business is acquisition. Let's start with refinancing. There is very little elective refinancing happening. So the only situations where refinancings are happening is where there's some type of event, whether that's a maturity, that's a covenant breach, equity

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needing to be repaid, et cetera. So inherently in those events, it's probably not going perfectly. So we're usually solving problems, right? Because if it was going great, well they probably would extend or they would what? A sell or something.

Dr. David Phelps:

So this is not a voluntary gee, it would be nice if we could, and let's just put the obvious elephant in the room here. Interest rates are substantially higher than they were four years ago when oftentimes it made sense to take various terms and valuations were going up. So whether you're refinancing, selling out to another party, things were moving. But as you said now it's not so much voluntary, it's an involuntary event. Probably not a fun event, but you're having to solve that. So yeah, I'd like to hear more about that.

Chris Litzler:

I call them elective refinancing. Nobody's electing to refinance because my could get below rate more IO higher proceeds. So mostly we're solving problems in that scenario and the way we solve them is very dependent on property type. There are some problems that are very difficult to solve right now, specifically office. There's just not a lot of liquidity in office and some other subtypes, sub property types that experienced some fundamental challenges. Storage had a lot of supply, new class, a multi had a lot of supply get delivered. So there's some challenges. Inherently the broad scope is there is still liquidity out there. It's not as cheap as you might have wanted it to be or been accustomed to for the last few years. So we're doing some cash neutral refinances, some cash in refinances, some cash in with new equity, restructuring the equity,

Dr. David Phelps:

Explain what is a cash in, and that's kind of a new nomenclature. It's not new to you, but I mean it's new to. So explain cash in cash neutral.

Chris Litzler:

Sure. Say you bought a property in 2021 and you paid a pretty full price. You've come in, you've created some value, but you haven't been able to create enough value to offset the 4% cap rate that you paid, and at the time you purchased the property, you had a pretty full loan, right? Maybe it was 75% of the purchase price plus a hundred percent of the CapEx. So we're now three years into this plus two extensions into this, and your lender kind of says, David, it's been great, but it's time. It's time for us to get paid back.

Dr. David Phelps:

I've been paying the note. I'm current on the note. I'm making it so the lender's taking a different look, and why would a lender start to feel that way? If I've been a good payer up to date, why would they start looking a little bit of scan and saying That's time to do something.

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Chris Litzler:

You've probably run out of time in your loan documents. Typical bridge loan was three year deal with two one-year extensions. So we got through our three years, we extended once,

Extended another time. Now it's time they were able to work within the documents, but now it would require a full on modification and the lender is sitting there and they're saying, well, I get that your equity might be a little bit impaired, but my first mortgage is fine. If you sold it today, I'm getting repaid in full. So they're coming from a little bit more of a position of strength today. They're kind of saying like, it's time pay us off. So that gets to the cash in, which means your property's performing. We could refinance it and we could put a new loan in place, but given the constraints of interest rates and debt service coverage ratio required, we can't get enough loan proceeds to fully pay off the outstanding first mortgage. So it would require on the closing statement, the borrower to bring fresh equity to rightsize that loan.

Dr. David Phelps:

I'm hosting something I've never done before and I want to personally invite you and your spouse to join me in New York City in June. This is a hands-on minds-on immersion into what strategic investing looks like today. You'll gain frameworks to evaluate opportunities that are insulated from Wall Street volatility and built on fundamentals, not hype.

Speaker 3:

It was so great for us as a couple because it was the first time I think that we finally got on the same page with our finances. Before it was both of us making money, but kind of doing our own thing. And this is the first time we were able to sit down and say, okay, what are our goals and how do we get there?

Dr. David Phelps:

On Friday, you and your spouse will sit down with me for a private strategy workshop where we'll build your personalized roadmap, how to create real cash flow today, not someday. Next, you'll step into the real world of strategic investing. This is where you build real confidence, clarity, and control.

Speaker 4:

There's just so much that you learn from having boots on the ground and just walking the streets and seeing the property, seeing the assets firsthand.

Dr. David Phelps:

You'll enjoy two nights in luxury accommodations in the heart of New York City, share incredible meals, and tap the weekend with an unforgettable private yacht tour around Manhattan and the Statue of Liberty. You'll

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see what's possible and you'll realize you are not alone. We're keeping this weekend intentionally small and highly curated. Once the guest seats are filled, they're gone. If this sounds like what you've been waiting for, it probably is. Let's walk this strategy together. Let's find your freedom on your terms. Go to NYC dot freedom founders.com to register today. That's NYC dot freedom founders.com. Going to have to write a check to put into the basket to make the numbers, the ratios

Fit in the underwriting box of the lender, which four years ago was fine, but today with the higher interest rates and whatever else might be, could be impairing to some degree. The NOI, we don't know. It could be okay. It could be whatever. I mean, property taxes, insurance, I mean there's a lot of things, a lot of friction that could also be potentially impairing the margin on the operating cash flows, and the lender's going to look at all that and the rate that they wrote at four years ago is less than what today. So they'd also like to, if it makes sense, they'd go ahead and rewrite the loan, but they want some fresh equity in and they'd like to have the higher interest rate to make it more nominal for the current state.

Chris Litzler:

That's right. The same thing is with a loan with a community bank where there's a covenant in place. So they made a loan a few years ago, is a five-year loan at 4%, right? Well fast forward to the time when the loan is going to renew and the rate would then go to 7%. Well, if the cashflow hasn't increased sufficiently, you would need to pay down the loan to stay within those covenants. Same situation without fully recapitalizing the loan. You're just paying it down.

Dr. David Phelps:

For some borrowers that may not be really on the table, in other words, may be out of capital. In some cases they go back to their investor pool and say, Hey, we got a situation here. I mean, that happens and they go back to their investors and try to get more equity from their investors at someplace in the capital stack, and I guess sometimes they're successful, so times they're not.

Chris Litzler:

Handful of options, first option, easiest option probably in the operating agreement says we go back and there's a capital call. Everybody needs to put up their pro rata share of whatever the cash in required. This specific scenario where you're writing a check into the deal is a little bit more tolerable than to say, Hey, we can't cover our interest expense, so we need to feed it for that. If you're writing a check and you know that as soon as this check goes in and we pay down the loan, there will then be cashflow. It's a little bit easier to stomach that check. I agree. That said, a lot of these investors are in a bunch of deals that are not going great. So you may have a great story, a great reason, a great outcome. It's still hard to get new money in the door. So capital call second option would be a member loan, right? GP strokes a check. But to your point, if

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you have several properties in the same position, do you have the liquidity to handle all of those? Who knows? You could bring in new money as a loan or you could bring in new money as equity, dilute yourself, dilute others. So there's options. There's options. None of 'em are perfect.

Dr. David Phelps:

So going back to the top of our conversation, you start out by talking about historically in your business about 50% went to new acquisitions, 50% to refinance. You said the refinance has dropped significantly outside of these special situations we're talking about right now. So we're kind of going down that rabbit hole a little bit. So what percentage of your entire portfolio today, what's the percentage between acquisition and these refinance cases?

Chris Litzler:

I haven't run it, but it's probably probably similar. 40, 60, 40, 40, 60. Yeah. I wouldn't say that it's changed too much

Dr. David Phelps:

Because there's still a lot of money out there and something's got to happen.

Chris Litzler:

That's right. We have a lot of clients that are very active because it ebbs and flows. You got clients with big portfolios that you're constantly refinancing deals from, but they're not that active. And then you have clients that are active and that they always want to be buying properties. It ebbs and flows. They're still a great opportunity to buy new properties if you're looking for 'em, if you're well capitalized, if you're well positioned to take advantage of 'em. So we're still seeing a lot of acquisitions, but I will tell you the volume of transactions is much less, but they're better opportunities when they do come.

Dr. David Phelps:

We mentioned people losing a lot of their wealth in the equity markets. Stock market for example, overall in the last number of weeks, actually going back to February. So there's been obviously a big change there. What we hear is that back to what you do is in the equity market, it's the bond market you want to pay attention to because the bond markets where the liquidity is, and if the bond market tightens up, which is analogous to interest rates where interest rates are going, then that's going to affect the equities, your stock market, your companies there and affects them the same way it does in real estate. So a viable comparison. You're in also the credit space liquidity space in real estate, which is, we call it like the capital markets, right? That's the right term. Capital markets and be markets is the bond markets. So is that a fair comparison and you're sitting right there in the middle of liquidity market. What drives the real estate equity

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market? Is that fair?

Chris Litzler:

Yeah, that's fair to say. Think of it this way. A mortgage rate has two components. The first is an index and the second is a spread. So the index, depending on what type of loan you're doing, construction loan is on the short end. A permanent loan is on the long end, and they're all priced based off treasuries for the most part, SFR, like overnight borrowing 31 month term. So RA five-year loan might be priced over the five-year treasury. A 10 year loan might be priced over the 10 year treasury. So that market obviously depends on or dictates mortgage rates. The second is the spread and the spread is a function of risk. So the more risk that's perceived in the markets in general, the wider those spreads are. It's interesting though, because we sit here today with a 10 year treasury where around 4, 3 3, which is exactly where we've been for the last 60 days. It just seems so volatile and silver has been at four 30 for the last six months. Really no real changes in the indexes when there was a lot of volatility. The last couple of weeks we have seen spreads come out a bit, which is to be expected.

Dr. David Phelps:

We saw the tenure do a pretty big jump from under four to about almost four and a half or maybe hit four and a half for a day. It's the rapid rise, I mean 60 basis points to 60 basis points. You don't just sneeze over that. Isn't it the rate of change that disrupts the markets more than the amount? Is that fair? Certainly we can see the bottom market say take the 10 year or five year pick one if it inches up or inches down over a period of maybe a few months. But when it happens a period of maybe a few days, does that cause more potential uncertainty that causes markets to even short-term freeze up a little bit or does it seem to matter?

Chris Litzler:

It's difficult to make decisions when it's moving so quickly,

So you'll just see people pause, right? Is really what happen. You may be in a position to lack a rate, but you see all this volatility, you don't know what the right thing to do, so you just sit on it. The level of rates is not as important as the consistency of rates because if you told any of us, Hey, you're going to have a four and a half percent treasury for the next five years, we could all operate in that environment. It's the uncertainty and the volatility that makes it hard to run and plan your business.

Dr. David Phelps:

That bodes back into what's happened since liberation day is we've got this new grenade that's been tossed into the entire global, what used to be some level equilibrium. I mean it's always changed a little bit, but once again, this grenade's been thrown out and caused serious uncertainty, serious unknowns, where it seems like

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it's really hard for anybody, whether you're an investor, operator, business owner, to try to figure out, well, I was thinking about making this move. I was thinking about acquiring, expanding, or I was thinking about investing some money over here and now it's like, whoa, I'm not so sure. How does this uncertainty globally with all the different dislocations, but particularly with the tariffs being such an unknown right now, such a major shift over in perfect world, at least a world that had some level of known here's how it works, what's your global sense of where this stands and how long does uncertainty in your opinion? I know we don't know how long does uncertainty going to prevail outside of a miracle happening? All of a sudden the negotiations overall in the next two weeks calm everything down and I don't know, us and China somehow figure something out and that could happen. I guess. I don't know that it will, but outside of that, if this whole trade imbalance thing carries on for months, what do you think that does to our overall markets? And then go back to what we're talking about today.

Chris Litzler:

I'm not smart enough to know what they're thinking with the tariffs, but I'll tell you where it comes into play in our world

And that is you have inflation that's still slightly elevated, right? It's kind of on the right track, but it's not quite where they want it to be. So you bring into play these tariffs and that's got twofold issues. The first is they're likely inflationary. So you already have high inflation and you have the potential to create more inflation, which really ties the fed's hands. They want to cut rates, but they really can't because inflation is still a little too high. They're seeing potentially could get worse. The second is it likely slows growth. So if you have a slowdown in growth, that's where it starts to impact jobs and wages. So you have inflation that's not at a level where you need it to be and you start to have some concerns on the job front. And now the fed's in a really tough spot. You throw into that mix tax policy where you want you operating at a big budget deficit, so you got to issue more paper with no real plans on how you're going to pay for it, and you got 9 trillion I think rolling in the next 12 months. So it's a tough spot. It's a tough spot.

Dr. David Phelps:

If you're ready to break free from the conventional financial treadmill, the Path to Freedom newsletter is your roadmap. Every quarter you'll receive my free digital newsletter packed with powerful alternative investment strategies, timely economic insights and uncommon wisdom to help you create more freedom, autonomy, and impact in your business and in life. As a subscriber, you'll also get weekly blog insights from decoding market shifts to building generational wealth, to crafting a business that doesn't run you. It's not just information, it's insight that leads to action. Join a community of like-minded entrepreneurs and practitioners who are choosing the road less traveled. Sign up today@freedomfounders.com slash digital newsletter one and start your path to true freedom. That's freedomfounders.com/digitalnewsletter. One more back to the

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relationships that you do have at do know what's changed in the last six or 12 months between borrowers and lenders relationships. It seemed like since rates started the rapid rise, what I sense and I think through some conversations with you is that banks institutions have not been aggressive about maybe what they did more in 2008, which is like default. We're going, we're taking the property. It seems like the trend has been more like incisions. We don't really want the property. We'd rather work something out, extend, do something we can within covenants or whatever their requirements are to try to let the operator get through this. We don't really want to be in that game. Is that general statement fair and is that changing at all?

Chris Litzler:

Yeah, I think that's definitely where we've been. The problem properties were purchased in 2021 and the first half of 2022, the problem properties had short-term loans on them. We can recall that if we paid the same price in 2021 or 2022, but we borrowed the money 3% fixed for 10 years, we wouldn't have any problems except for maybe office, but you still would be in a better spot. So the problem areas are on these relatively recent purchases with short duration loans, but at this point you're three, four years into those properties or into those loans and the lender has been working with you, has been working with you, and a lot of these people were kicking the can down the road hoping thinking that interest rates were going to go down and save them, right? This most recent batch of spiking interest rates and then even leveling out here in the low-ish, low to mid fours, there's kind of been a sentiment shift that like interest rates aren't going to come drop and save you. It's time to meet the market and transact.

Dr. David Phelps:

Okay, so if I'm reading you correctly, then there may become more distress in certain segments of the commercial marketplace that where it hasn't shown up so much in certain sectors. Again, notwithstanding office, but for a period of time while some of this gets worked through the pipeline, I guess the way I look at it, you can have a backlog that's been sitting there, sitting there, sitting there all of a sudden. Does it start to move more quickly where certain loans are, banks are saying, okay, no more. Is that going to start to happen, do you think?

Chris Litzler:

I think that's exactly the case, right? Because in that scenario where you have to refinance your property, but you can't get enough proceeds to pay off the first mortgage, if you can't call capital, you need to sell the property. And it's finally getting to the point where some of these folks are accepting that that's reality and are trying to meet the market. So yes, I would see say transaction inquiries and listings have definitely picked up because of that.

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We know that in any marketplace, if you're well connected or you're out on the front and connected, that there are always opportunities, always opportunities. But maybe there's fewer and far between in dislocations. What should we as more past investors that like to put our capital with good operators into either equity or debt positions, what might we look for? What signals could you give us? This is going to be broad. What signals will we look for, particularly based on our conversation here a minute ago about the fact there's probably more properties and loans that work themselves through the default and being taken back by the banks and then put back onto the market. What should we kind of look for and historically, what kind of time do we have to maybe dollar cost average back in on the down and on the backup because there's never a perfect time for either side. So what kind of general things would we look for?

Chris Litzler:

The overarching theme is quality. So that's quality On the sponsorship side, your jockey, your gp, your manager is experienced, capable, strong. That's the first way to de-risk any deal. And then you have quality on the underlying real estate side, so better, bigger markets, newer assets, those are kind of the key ways to de-risk your deal. And then the third is, I guess you could call it quality on your loan assumptions, longer loans, lower interest rates, those sorts of things de-risk your deal

Dr. David Phelps:

Based on looking at the quality of the loan fixed rate, longer duration. Would you as an investor, and you can just speak about me, you don't have to talk about yourself. Is there a place today where I would find an opportunity that would be underwritten, underwritten by someone like you who knows what you're doing, where it is more of a new development, a redevelopment where someone will go back and have to take a variable rate loan for that three plus two year extensions to get to stabilization? Is that a game that's still viable today? I know in certain areas it probably is, but is it few and far between? A number of years ago it was like game on, right? Let's go.

Chris Litzler:

Definitely. So virtually all new construction is variable rate mortgages, right? They're floaters, we call 'em floaters, right? SFR plus some spread because you're drawing on the construction facility as it gets built. There's really no real way to navigate that. I mean you can by doing some forward starting swaps and hedging a little bit here and there, that's a way to mitigate some of that risk. As far as value add deals goes, definitely the preference has been to do fixed rate versus floating rate, but in this environment as of late, we have actually seen people go back to the floating rate loans because they kind of think we're at a higher level and they may be able to capture the downside If there is cutting,

Dr. David Phelps:

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We're at a higher level for what?

Chris Litzler:

For fed funds. So S 'r's at four 30, right? So if you foresee them going to 2%, then you would capture that 2% drop over the life of your loan. So we are seeing a little bit more of that. What solves all of this though, David, is equity. If you just de-risk your loan and you do a 50% LTC or LTV loan, even if it's a floating rate, once you execute your business plan, you likely don't need to bring cash to refinance it because you've already levered it.

Dr. David Phelps:

Yes.

Chris Litzler:

So equity is the solution.

Dr. David Phelps:

Alright, that helps. So it sounds like if I liked a sponsor and operator, it had a good track record and they're bringing me an opportunity to look at something that is a development, they're going to be using floating rate. What I might look for outside of the sponsor having a good track record is that the amount of debt that they're taking on is 50% or less, which means they're going to have be good enough to raise that kind of equity because of their track record and reputation. And if they can do that, I can stress test at different interest rates and see that, okay, even if rates don't come down, where are we going to be in that three or four or five year period? That's probably what you have to do too. If you're going to make that loan, you're doing the same thing.

Chris Litzler:

That's exactly right. I mean even in today's world, even if you wanted a ton of the most leverage you could get on a typical construction loan like with a traditional lender, not kind of like a debt fund is in that 65% loan to cost range because when they stress the stabilize exit cash flows, you need to be able to refinance them out. And at today's rates, maybe with a little bit of stress, that's all you could qualify for. So somewhere in that range would be normal. Less than that would be more conservative. The other thing to think about though, the reason these guys are making these development bets today is because what you're seeing, because the fundamentals are looking really good for a couple years out from now, there has been a lot of deliveries. There still are a few deliveries, but there are virtually no starts and there haven't really been any starts over the last six months.

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Dr. David Phelps:

Is that across a number of asset classes or would you pinpoint some where you could say definitely not a lot of delivery coming on,

Chris Litzler:

No office delivery, right. In fact, there should be demolition of office of office inventory.

Dr. David Phelps:

Exactly.

Chris Litzler:

There's been industrial continuously retail never really, really has a ton of new build, right? There's a saying that we're not over retail, we're under demolished because there's too much of it, but I'm really focused on apartments. So there had been a ton of supply delivered over the last several years, but there's just really not a lot of new starts happening. So if you can power through and you can make your deal work today and you deliver in 24, 36 months, it's likely that you will be rewarded because you will be delivering into an environment with very little new supply, right? There's always going to be supply and inventory, but you would be the new supply.

Dr. David Phelps:

Okay, that's helpful. That's helpful. And something you said a minute ago, we were talking about credit spreads, and so as you said, has been pretty static for six months. The spread has the spread also. So FR plus has that also remained pretty static as well?

Chris Litzler:

Yeah, we actually saw some tightening of spreads towards the end of last year just as the market got a little bit more competitive and it started to heat up a little bit, but since there's been some volatility we've seen spreads blow out, so you're probably net net in about the same place as you were six months ago, but a little bit more spread widening over the last couple of weeks.

Dr. David Phelps:

And that's something that any of us can use as one marker to kind of understand what the market is saying about risk, right?

Chris Litzler:

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Yeah, exactly. I mean if you follow non-investment grade junk bond credit spreads, you're definitely seeing them blow out.

Dr. David Phelps:

Yes. Yes. Chris, give us a little bit of where private credit shadow banking fits in today. And maybe a little bit tiny bit of history is to how that shadow banking market has exacerbated, has grown since coming out of 2008 19 Dodd-Frank regulations that we're trying to prevent that ever happening again. And yet there's always workarounds what's happening there and is there collateral, digital collateral risk out there that really is not regulated? And is there something that could trip or trigger somewhere in the credit capital markets that we should at least have some awareness about?

Chris Litzler:

I'm certainly not a private credit expert, but I'll give you an example of where I think it could come into play. So say I raised a debt fund and I'm going to make commercial real estate loans. So you want to buy a property, you come to the debt fund, I say I'm going to lend you 80% of your purchase price plus some of your CapEx, and I'm willing to do 80 plus percent because I'm getting paid for that risk, right? I'm charging you a little bit higher rate. So what I'm going to do is I'm going to close on your loan, but then I'm going to go to my bank and I'm going to lay off 55 60% of my risk at much cheaper rates, and then I'm going to keep the top tranche as my piece. I'm going to service a loan and we're going to stay involved, but we're making much bigger returns on our piece.

Dr. David Phelps:

We use leverage,

Chris Litzler:

Correct? Yeah. Right. Now, where does that come into play? If

Dr. David Phelps:

You're line starts saying, we need to be repaid, the bank that we went to drop off 50, 55% because those terms, what do those terms look like? They're not fixed, right?

Chris Litzler:

Years, right? Yeah, they're floating rate too. That's exactly right. So if they start having problems somewhere else and they need to get their money back, they go to the good stuff, right? Go to my loan's performing right, but they need your line repaid, now you start creating problems. So I think that's probably where it would start. And then of course you probably have guys debt funds like me making risky loans and if some of those

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don't pan out, then investors lose money.

Dr. David Phelps:

Alright, just a couple more, Chris, I really appreciate it. This is really helpful. What are some common mistakes or blind spots that you see passive investors make?

Chris Litzler:

First thing to understand is a lot of, you're really not going to have any, say you're making an investment and you're trusting the sponsor to execute on the business plan, right? So that's the first thing is you know that you really don't have much of a stick. You're betting on the sponsor. So that's the first, just vetting the sponsor is the most important thing. The second is understanding the waterfall and what sort of preferred returns you're going to get paid. Are they current? Do they need to be paid? What happens if they're not paid? Those sorts of things. Understanding the actual economics. And then fourth is, I guess making sure the rewards and the risks are aligned, right? If somebody's coming in and they're taking a big acquisition fee or sponsorship fee or whatever it is, and their co-invest is minimal or non-existent, then are the risks and rewards really, really aligned? So those are the key things.

Dr. David Phelps:

Well, Chris, you've handled a lot of what my questions were today, really helpful and I'd love to have you back again in due time to see what's transpired, but interesting times for sure.

Chris Litzler:

We'll be here. There'll be ups and downs. Any anytime you want to talk, run through a situation we can do to help you or any of your folks, you know, we're here. We appreciate you, appreciate you having us on, love what you're doing for the community, so any way we can be a resource, we're happy to.

Dr. David Phelps:

Thanks so much, Chris.

Chris Litzler:

Thanks David.

Dr. David Phelps:

One of the sidebar questions that came up while we were having this discussion, myself and Chris Lesler was that we've always regarded real estate as being a great inflation hedge, and then as private lending or private credit has been emerging and becoming more popular, are we currently trading off the inflation

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hedging of the equity space, the ownership space for less risky investments perhaps in the private credit space? Is there a way to compensate for the loss of the inflation hedge that came from owning equity? Well, it is a market cycle phenomenon, and typically we as investors like to be in the equity space because that's where the growth comes from. That's where the bigger returns come from, but that only works when the market's going up. We know with market cycles, there's always going to be a down cycle or a correction. Typically it's every six to eight to 10 years, but sometimes they get elongated, sometimes they're shortened, and we have to be positioned not to be able to time the market exactly, but to be able to understand where the shifts are coming and to do some hedging.

So I would say right now, when we're in a disinflationary market where we've had high asset bubbles that have been produced by years and years and decades of debt spending monetary malfeasance by the Federal Reserve in Congress, those bubbles are coming down right now, and this would not be a time to put all your eggs in one basket. That is the equity space. Private credit lower on the capital stack provides a lower risk, a more contractual return. And yes, we do give up the inflation hedge, but I think the inflation hedge in asset prices and asset valuations is not there right now. So I would say wait until we see the correction come, and then it's time to go back in and play the equity game once again. Some people have asked me, David, could you explain the difference between private equity or debt funds versus direct private lending?

Is one riskier than the other? If so, does the risk justify the investment? What direct lending in private credit means that I would be the lender to a commercial borrower, somebody who I know as a person, as a company who I can make a loan to who is involved in some kind of a real estate operation. And typically those loans are made for 12 months or less with possible extensions. When I'm doing that as a direct lender to a direct party with direct collateral, it is a safer investment because I have the collateral, I get to make the decisions on how much I loan against the valuation. I can make all the rules on my own and really mitigate risk, but it takes time to do that, and it takes access points. You've got to have relationships to find the right borrowers, and that's not always feasible for people who want to be passive in their investments, don't want to do the work to create those relationships and make their money work harder for them.

In that case, funds or private credit funds can be another place to go where you are giving your money and pooling your money with an operator who specializes in private credit and will take the pooled money and then make specific loans out to their borrowers. You're separated from your money. Shouldn't say you're separated from money, you're separated from the real estate, a little bit separated from your money because you're not making the decisions as you would with direct lending. Someone else is making those decisions for you. So in this case, you have to know something about the operations, the operator or the fund manager, what their track record is, what their philosophy is in life. So there's always a trade off in the risk reward. And I would say in my life, I do some of both because I've got the relationships to do some direct lending, but again,

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I don't want to take all the time to focus on that. It can become a business. I don't want a business, I want more passive investing than I've got to limit the direct lending I do and put more of my money with fund managers who will do that on behalf of my capital base. Again, always a trade off. What decision works best for you is based on where you are in your life and what your goals are.

Speaker 5:

European markets opened way down this morning, a 16 month low. As Trump's tariffs starts to bite, we're seeing a mass sell off of shares as fears grow about a global recession. It was the second straight day of dramatic losses on Wall Street, a sea of red for the Dow, which fell more than 2000 points on Friday or five and a half percent. Remember Thursday it fell more than 1600 points. One big factor is China, it announced Friday it would impose 34% retaliatory tariffs on American goods in response to President Trump's tariffs plan. We have not seen stocks have these big losses over a two day period since the beginning of Covid.

Speaker 4:

While uncertainty remains elevated, it is now becoming clear that tariff increases will be significantly larger than expected, and the same is likely to be true of the economic effects, which will include higher inflation and slower growth. The size and duration of these effects remains

Speaker 3:

Uncertain. How are you feeling about the markets right now? Not great, anxious,

Speaker 4:

Optimistic, worried, terrified.

Speaker 3:

It's not too clear what's going to happen in the future, in the near future, long-term future.

Speaker 4:

Yeah, there's obviously a lot of uncertainty now. Business and politics are even more transparently aligned.

Speaker 3:

We have to understand that there's a lot of implications and all these implications are certainly in the short term, are not good for the economy.

Dr. David Phelps:

Trump's announcement of tariffs has heavily affected the markets. For those who are also rather strongly

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invested in Wall Street, this can be a very painful time right now. It's not a time to be reactive or disillusioned. The truth is the stock market is not under your control, nor mine. No one can guarantee when it will rise or when it will fall. You can however, control your own actions. Keep your money near your own hands, whether in your business or on higher ground. Higher ground, such as treasuries, cash, cash equivalents, precious metals. This higher ground will permit you to safeguard your investments while giving you a higher vantage point. To see the opportunities that emerge in the following quarters and years, those seeking immediate safeguarding and guiding principles to weather the financial storms ahead. I lay out more in-depth frameworks to protect your capital and financial future. In my book, building Your Financial Arc, you can get your free copy@financialarcbook.com. I'll say it again. You can get your free copy@financialarcbook.com and for those seeking a more in-depth analysis and customizable blueprint for their investments according to their needs and freedoms, you could always schedule a call with my team. We'll help you by pointing you in the right direction of whatever you need to do next. For clarity and your future freedom, you can schedule your call at freedomfounders.com/discover. That's freedomfounders.com/discover.

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