LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 267-ALLEN SHAYANFEKR

Welcome to the Lend Academy Podcast, Episode No. 267. This is your host, Peter Renton, Founder of Lend Academy and Co-Founder of LendIt Fintech.

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Peter Renton: Today on the show, I am delighted to welcome back Allen Shayanfekr, he is the CEO and Co-Founder of Sharestates. Now, Sharestates is a real estate platform, they've been around for a few years. I last interviewed Allen back in 2016 and I wanted to get him back on because obviously a lot has changed since then and I wanted to sort of see how Sharestates has handled the changes this year.

They've done a pretty good job, I think, in really navigating the storm, we talk about that in some depth, we talk about how they adjusted their staffing, how they adjusted their marketing and how the investors have performed and which types of investors have really stayed the course. We talk about their loan portfolio and what's happening there, the impact on their borrowers, we talk about sourcing deals and what he is excited for about what's coming down the track. So, it was a fascinating interview, I hope you enjoy the show.

Peter: Welcome back to the podcast, Allen!

Allen Shayanfekr: Thank you, Peter, thanks for having me.

Peter: Of course. So, it's been four years since we last chatted on the show and I know a lot has happened, but maybe before we get started, for those listeners who don't know Sharestates, why don't you just share how you describe the company today.

Allen: Sure. So, Sharestates is a business purpose mortgage loan marketplace platform so we, essentially, have created a marketplace for borrowers and real estate speculators. They fill online, submit loan applications, handle their loan application and loan sourcing needs digitally. Once that loan is actually underwritten and closed by our system, we then make that loan available via our investor marketplace to both whole loans institutional investors as well as individual retail investors and smaller institutions for syndicated investments.

Peter: Right, okay. And what geographic footprint are you working in today?

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Allen: We have lent in a total of about 34 or 35 states with a heavier concentration in the northeast, New York, New Jersey and the metro markets.

Peter: Right, right, okay. So then, maybe you can just take us through the developments in the company. I want to sort of get to this in two segments....so we chatted four years ago, obviously I'll link to that in the show notes, take us through sort of the developments of Sharestates through the beginning of this year.

Allen: Sure. So, when we first launched this business, we came up with a slightly different angle than everybody else, you know, we were not finance guys, we were not technology guys, we came from a real estate background and more specifically, a title insurance background. So, going back to 2015 when we first launched, we had a pretty robust database, speculators and developers that we used essentially as a springboard to launch the business, which enabled us to do a couple of things really quickly and enabled us to get to profitability relatively quickly and which kept us from having to go down the VC route of raising capitals to grow the business, allowed us to control and run the business the way we want to which was fantastic over the last five years.

We were able to scale that business to about $2.5 Billion in origination volume through the beginning of 2020. Pre-COVID, we had gone up to just about $100 Million a month in origination volume, we had grown the team north of a hundred people, we built a ton of technology that pretty much supports our entire business from A to Z which has helped us to scale the business without having to have three or four times the staff and we've been able to do that all profitably just constantly reinvesting, growing the brand and growing the technology and our network.

Peter: Okay, great. So then, obviously things changed early this year. I was listening to an interview you did recently where you shared that you actually had kind of business continuity plans and you actually have drafted up some of the documentation which you said at that time you thought was not going to be useful at all and ended up pretty useful in hindsight so tell us a little bit about that.

Allen: Yeah. It was definitely an interesting transition going from a very office-oriented workspace to pretty much having everybody through today even continuing to work at home. So, part of this technology that we built was....we, essentially, have two different departments that handle all of our technology and IT.

So, we've got one group of developers that's comprised of about 29 or 30 developers that are actually building our Sharestates software so that's everything that you see from our online portals, the vendor portals for title companies, appraisers, brokers, investors, etc. all the way through our borrower portals and all of our backend systems and that's all basically cloud-based which enables us to really be able to work from anywhere.

And we have a separate external group that handles pretty much all of our computer, IT and office needs so making sure that all of our laptops and hardware are secure, that we're using VPN access and dual factor authentication to log-in to our tools and things like that

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just..........you know, not just making security a very big focal point of this all work from home concept. But, the beauty of all these is that everything that we have implemented over the last five years enabled us to transition to a work from home environment relatively quickly and easily.

So, at this point, you know, we have, give or take, 100 people working remotely able to interact with each other and slowly do their day-to-day jobs just through our online proprietary systems. Everybody's tied into each other, there's work flows, there's communication happening through the system, notifications and pretty much everything anybody needs to help move those files along from applications close and then through post-closing and servicing pretty efficiently.

Peter: Okay. So then, let's just take us through the developments from earlier this year. You know, the pandemic hit and you know, sort of every one closed their office, but you're in the real estate space, there's sort of a drying up of capital and I imagine you guys were pretty impacted by that. So, tell us a little bit about how you were impacted and how you handled sort of that initial shock.

Allen: Yeah. So, I think it's important to differentiate the different types of lenders that exist out there and kind of the pros and cons of each. You have people that are kind of playing in the same sand box of our product types so loans access anywhere from $100,000 up to, you know ballpark $7.5 Million covering residential, multi-family and mixed use asset classes and we're all kind of set up a little bit differently.

So, you've got some groups that are purely captive financing so they've got funds, they've got direct capital that they control, that they lend out so they are, essentially, the originator and the investor in one. Those businesses are great because they really do have full control over their capital stack. The limitations with that type of a structure tend to be that you don't have the same level of scalability, meaning you don't have as much capital available to you as you do under a structure like ours, we're dealing with dozens of investors so we're never really limited by how much cash we're managing.

Then you've got companies that are more like mortgage banker-type setups or, you know, originate to sell type structures like Sharestates which, again, also has pros and cons so the pro being that we've got dozens institutional investors, we've got our syndication platform with hundreds, really at this point thousands of active investors, and that creates diversification of capital sources. You know, we can do hundreds of millions if not billions of dollars on an annualized basis without having to go out and actually raise more capital. It's much easier to onboard in an existing investor and grow your investor base than have to go out and set up a whole new structure than to actually raise capital.

And then within that, you kind of have a subset of originators that are really kind of just selling to one or two counter parties, maybe three counter parties. They might have a right of first refusal or some strategic investment by the counter party that they're selling loans to which, again, kind of takes you back to limiting capital sources and in some cases could limit your flexibility or what

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we saw earlier this year, have an originator that's really beholden to a single investor and that investor decides to post pause or shut down their business is shutting down with them for however long that may be.

We kind of sit somewhere in the middle so we don't have direct capital that we control for the purpose of balance sheeting loans long term. We do have a balance sheet that's in the tens of millions, we do have warehouse loans that collect north of a $100 Million in actual balance sheet capital. And then we also have a very robust list of investors that we sell those loans on a forward flow basis. What that allows us to do is kind of get the scalability piece while still having control and capital that we have discretion with and then at the same time, you know, for example in COVID where many of those investors had to temporarily press pause and focus on asset management, because we have diversified those capital sources, we did not go completely dry.

We, definitely felt it, we saw different types of investors react in different ways. The thesis that we have kind of grown our business on was if you diversify capital sources, you should be able to survive a downturn because the likelihood of everybody turning off at the same time, you know, is more remote than if you're beholden to one or two investors. That's basically what happened. You know, probably about a 60 to 70% decrease in all raw capital availability from our institutional partner, but the syndication side of the platform and the smaller unleveraged institutions continued to actually invest through the COVID pandemic supporting existing loans, funding draws and even funding transactions.

Peter: Yeah, that's interesting to me. Obviously, you've got individuals that are making their own decisions and that have been with you for a while, in many cases.....what you're saying is those people really stayed with you and skeptical and just re-investing its returns, I would say, quickly so was that group much more sticky than the institutional group?

Allen: Yeah. So, what I would say is the smaller institutions, the fractional investors and the high net worth credit investors were actually stickier than the larger institutions.

Peter: Right.

Allen: I learned through this experience that it's not a relationship that's controlling that, it's the capital structure and capital sources that's controlling that. So, what I mean by that is everybody thinks that you get into that with larger institutions and that means scalability. That's true with us, but it's not sticky capital and it doesn't matter what that relationship looks like, you can be best friends with the portfolio manager that's in-charge of the day-to-day and you know, what loans they're buying, what they're investing in, but at the end of the day, the overall fund or institutional organization has other levers and limitations that they need to be concerned with.

So, these larger institutions, by and large, have leverage, they go to Goldman Sachs or Morgan Stanley or Credit Suisse, other leverage providers. They have warehouse lines, they're levered up five to one, six to one, four to one, whatever their leverage is, and their ability to invest is

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directly tied to their cash availability from their warehouse leverage when they could be reliant on securitization as an exit.

When those things kind of floats up in March/April where you had warehouse lenders doing margin calls, you know, you could have repo facilities where they're technically non-committed lines and they just freeze the lines so you can't draw on it anymore or, you know, the securitization market blew up then ......those institutional investors are, basically stuck, they can't do anything, it's not their fault, it's just the nature of their capital structure. Whereas the smaller, un-levered institutions that are investing what I call pure equity or, you know, individual investors that might be investing $5,000/10,000/15,000/20,000 a deal, that's their capital, they have discretion, they're not relying on leverage and they could continue to invest.

Peter: Right, right. So, what about the other side of the marketplace for borrowers who, you know… Did demand kind of continue throughout, I mean, how did the demand for deals kind of change over the course of the pandemic?

Allen: Yeah. So, again, break that into two buckets so you've got like your (garbled) which is a guy who's got a day job and might do one or two fix & flip projects or one real estate a year even that often and then, separately, you have your seasoned speculators/developers that are doing half a dozen/a dozen projects a year. We saw the less experienced hobby developers slow down for fear, we saw the more seasoned speculators/developers actually dive in deeper because they see this as an opportunity. If they see people that might be out of a job that might be looking to sell their home, you know, stress situations that are an opportunity for them to make money.

Second to that, the overall pie size of the lender community shrunk overnight drastically, I mean, I don't have any way to quantify that, but, you know, this is just a random number, but I would say probably 90% of lenders just kind of shut down overnight, not permanently, but temporarily, to see what the market was going to do as a result of, you know, that institutional capital issue. That, for us, made the pie smaller, but we were one of the few lenders that was still active.

So, our borrower demand was just exploding, far beyond what we could even facilitate. So, there was a ton of borrower demand, much less supply and demand, right, kind of borrower demand, less investor demand which also make the loan programs a little wacky, sort of the investors that were still active in the space wanted super low leverage, secure product, at 50 LTV and higher coupons which also just made it a little difficult to do business so if some loans were happening, some deals were happening, but the volume of those transactions dropped significantly.

Peter: Right, okay, that makes sense. So then, where do we stand today, do you feel like this is kind of worked through, are you getting back close to your $100 Million a month run rate or are you still a long way away? We're recording this in the middle of September, how has demand been this month?

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Allen: So, things happened slowly coming back, everybody kind of cuts the world into pre-COVID/post-COVID, we're not post-COVID yet and we're still here. I think what's subsided is the panic and the fear over what the market's going to do which is typically what causes these downward spirals. That fear has subsided. I think people have come to terms with what's happening in the world, people's lives have changed, they've adjusted how they do business. We're in a post-COVID era, but still very much a part of our lives.

That being said, because the panic has subsided, capital has been flowing back into the space very quickly, the securitization markets are back, warehouse lenders are back so we're starting to see that demand really ramp-up and ramp-up pretty quickly. From a credit perspective, because all that capital is flowing back into the space and because we actually have a shortage of product, meaning loans, and the space as a result of everybody temporarily pushing pause over the last four/five/six months, it's actually pretty much had a direct opposite effect. It's from where it was pre-COVID even though we're still in COVID.

So, what I mean by that is LTVs are pretty much back where they were, you know, borrower experience requirements, FICO requirements, pretty much anything related to credit underwriting is back to where it was pre-COVID, as far as we are concerned. There are some lenders out there that were higher on loans to cost and things like that that may not be fully back to where they were, but we were ballpark, you know, five to ten points lower than competition anyway. So, as far as our business is concerned, we're pretty much back to where we were, from a credit perspective.

From a pricing perspective, I'd say that loans are still pricing probably 50 to 150 basis points higher than we were pre-COVID, but I think very quickly compressed back down to where we were pre-COVID by like January/February. And then from a volume perspective, we just started taking applications, formally taking applications in July so what we did in April, May and June was focused very much on asset management focusing on funding draws and supporting borrowers that we were already in bed with so that loan activity that we did do was really for existing borrowers that we continue to support.

Going into July, we opened that back to taking applications, not just from existing borrowers, but from new borrowers and of course, there's roughly a 30-day ramp so that led us into August where we closed about $10 Million in volume, September, we're looking at probably doing about $20 to 25 Million in volume. My goal by the end of the year is to be back up to somewhere $60 to 70 Million in volume. I think somewhere towards the end of Q1 or early Q2, we'll be back up to $100 Million in volume, but we have to kind of tippy-toe back into that because, you know, as I mentioned, we're still in COVID era and we don't know what's going to happen and we're also in an election cycle so there's a lot of unknowns.

Peter: Right, right. There is a lot of unknowns and we don't know about stimulus and all that sort of thing. So, I'm curious about, you know, what you did internally staffing-wise because obviously you went down pretty dramatically in originations and maybe just tell us how you managed the staff and like what sort of furloughing you did. I was listening to this interview

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where that said you really.....you shifted a whole bunch of people and you said you didn't have to lay off that many so tell us about that.

Allen: Yeah. So, we had pre-COVID 135 people on staff. We ended up letting go approximately 25 people, it's not an easy decision at all and it's something that we really tried to hold off on doing for several months. We didn't do it as quickly as some other companies did, meaning generally not lending companies, but eventually we had to make that difficult decision. So, as far as the rest of the staff, what we tried to do is we tried to save as many jobs as possible and just transitioned them to different departments.

So, we're going into a cycle where asset management, loan servicing, you know, foreclosure workouts, potentially forbearances, etc. have become part of our day-to-day so we took people from our processing and underwriting departments, we took people from our sales departments, we moved them into more customer service oriented roles making sure that they could properly communicate to our investors, to our borrowers, answer incoming calls, things like that which worked great. Now, we're basically unwinding that and moving people back to their departments that they were initially in as we start to recover our business back.

Peter: Okay, okay, that's good, that's essentially good. So then, interesting about the performance of your loans because, you know, real estate has been interesting because real estate has been booming, in general, there hasn't been much of a downturn, obviously rates have been down particularly in the home mortgage market and prices have either maintained or gone up so I'm really curious about the impact on your loan portfolio. Did you find that there was a significant impact, a small impact or no impact?

Allen: It was definitely a significant impact, it was more short lived in nature, but there was definitely a significant impact. There's a lot of misinformation out there over how things are performing. So, the residential market is strong, yes.

Peter: Right.

Allen: What many people don't realize though is that it's not just about selling assets, many of these developers have real estate portfolios with renters that they're collecting rent and that cash flow is what's supporting their debt service on what I call their offline assets or their main construction assets and their cash flow has been impacted. So, if you look this is more of a local issue rather than a national issue because every state, county is handling it slightly differently, but kind of two things really....one thing really caused a problem and that was a ban or a moratorium on evictions.

You'll see many articles that say that rental collections have been fantastic, more than 90% and misinformation....the misconception is that that's really specific so like Class A higher end product. Class B and Class C which is more affordable living or single family home that's renting for a couple of thousand dollars a month, $1,500 a month, that's been impacted very heavily. The collection rate there......I mean, I've read kind of conflicting things, but I've seen anywhere

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from 50 to 70% collections, I mean, landlords are down 30 to 50%. If they have any commercial units, obviously the commercial market was impacted very hard.

I have several friends who are commercial landlords that have office space and retail space that's taken a massive hit which is all cyclical, it's all tied together. So, the short answer is that those rental collections dropping made it difficult for many borrowers to meet their deadlines so we did see a spike in delinquencies between April, May, June and even into July.

We've seen that subsiding since July so borrowers have been able to catch up with payments, other borrowers have been successful in executing some forbearances with which took a few a few months or two months of back payments added it to the payoff while reinstating the loan for go forward payments and workouts, situations like that. Thankfully, we haven't taken a loss on anything and a result of that, we've been able to work through that and the performance has come back, thankfully, in a great way and my expectation is that by the end of October, we'll be back to where we were pre-COVID in terms of collection so we should have.......

Peter: Really?

Allen: .....north of 95% collection rate. Yeah.

Peter: Okay, okay. I imagine there will be some that....you know, I'm just thinking about, the one great thing about what you do is you have an asset and you've got LTVs that are reasonable so are you finding that you're having to foreclose on some of the borrowers that you've had?

Allen: Definitely. So, some borrowers work with you, some borrowers think you're their enemy, less inclined to work with you so we will definitely have a subset of borrowers, probably less than 3% of the delinquencies that we're seeing that will actually end up in foreclosure and stay in foreclosure. There are some borrowers that will start the foreclosure process with, just keep in mind again, locally there are moratoriums on foreclosures in many jurisdictions so we're forced to work out and play nice with which we want to do anyway, but at the same time we have to protect our investors.

So, where we can, we're starting those foreclosure actions to apply pressure to the borrowers that are less inclined to work with us. The expectation is that many of those, as we have seen historically, will come out of foreclosure and roll back to a performing status or some sort of a resolution that's selling the property, doing it even before the foreclosure, whatever shake or form that may take and we're expecting anywhere from a 2 to 3% of the delinquencies to actually really formally stay in foreclosure and go for foreclosure which have varied collection time frames, depending on what state you're in, geographical location areas, etc.

Peter: But, would your expectation be then for no principal loss in those foreclosure proceedings?

Allen: Generally, when we stress test our portfolio that's the expectation, it doesn't always work out that way. So, we've been in business for five and a half years now, we've, of course, had

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losses. I think on a portfolio measure we've had about 50 basis points loss factor while delivering north of 10.5% average return so net effective 10% return on the portfolio. You're going to have losses, it's an inevitable part of our business, but you also have to look out what's driving those losses sometimes.

So, we've had scenarios, for example, where we build leads that we would be fully made whole on the underlying transactions, but we're looking at a 2, 2.5, 3 or 4 foreclosure timeline. There are investors on the other side who says, I'd rather take 90 cents on the dollar today than have to wait two or three years and carry this loan as a default on our book, you know, that balancing act. We’re sometimes forced into situations where we do have to take a worst deal, but that's our job as servicer in that instance to listen to our investors. So, some like 50 basis point loss, for example, actually a lot of it can be attributed to kind of those investor forced sale scenarios.

Peter: Right, right, okay, that makes sense. So then, when you're sourcing new deals today, are you......you said you're back working with new borrowers, I mean, is the way you're trying to source deals....has that changed since from what you were doing pre-COVID?

Allen: No, not really. We've never really done a whole lot of online marketing and advertising, most of our origination volume was coming the old-fashioned way (garbled) stuff which obviously you can't do right now.

Peter: I’m aware. (laughs)

Allen: Yeah. So, we are...I think it's a lot of phase where there is more limited capital than there is for our demand because still a lot of lenders still haven't come back to the space so we're actually seeing borrowers naturally find us or same brokers come to us with deals as well. So, we probably have more deals than we know at this point so we're not really doing a lot of outbound marketing for borrowers.

Peter: Right, right, okay, that makes sense. So then, I'm curious about your take on this little niche of the industry that we're in where you've got a marketplace, you're doing the commercial fix & flip type loans, what do you think the impact of the pandemic is going to have on this sort of niche in the industry?

Allen: Long term, not much. I think in the short term, it's what we've been describing. There’s going to be shortage of capital for a period of time, they're going to see wider pricing as a result of that, but my expectation is that assuming we don't end up in another massive shutdown of the economy that we’ll eventually rollback to where we were pre-COVID, I don't think that change is going to take more than six months, eight months.

Peter: Right, right, okay. So, we're almost out of time so last question then. You know, as you look to 2021, I'm sure most of us are looking forward to a new year, to have 2020 behind us, what are you excited about, what are your goals for the business towards the next year.

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Allen: Yeah. So, we have a couple of exciting initiatives. So, aside from continuing to grow our core business, we have plans to launch an NPL, non-performing loan marketplace, recognizing that, you know, that there will be defaults that will happen as a result of the COVID pandemic, there will be a need for certain lenders and aggregators to have to offer those. So, we're actually targeting, I think, November or December for the launch of our NPL marketplace, it's really built as a full end-to-end automated service for buyers and sellers to interact through an organized platform, streamline the process for selling the non-performing loan and hopefully get better execution for the seller and then separately from that, we're also starting a business purpose loan servicing platform.

One of the things that we've learned in being in this business and really in the investor non-QM business for the 30-year mortgage product is that many of the loan servicers that are out there are servicing consumer mortgage purpose loans as well so they're kind of shackled and limited in how they service business purpose loans because their policies and procedures are set up in light of CFPB regulations, consumer regulations, etc. and that does not make for a great servicing platform per se for business purpose loans. So, we have that as an offshoot as well which we're excited about launching. Those are two kind of new sister platforms to Sharestates that hopefully will make a big splash.

Peter: Very interesting. Well, good luck with that, Allen, it's been great to chat with you again and best of luck as we all navigate the pandemic.

Allen: Thank you so much, appreciate it, Peter.

Peter: Okay, my pleasure. See you.

You know, it's not surprising to me that companies like Sharestates really were impacted by the pandemic, I mean, everyone has been across the lending space, in one way or another. But, you know, with real estate that I think is different when you're investing in consumer loans or investing in small business loans is certainly.....I find this personally is that it's definitely more of a sense of security investing as an individual because you know you have that asset that's really backing the loan that can be foreclosed on.

And as I said, that really is a huge protection that's why I continue to like the real estate asset class, in particular, this fix & flip asset class because I think you're getting, Allen said you are getting 10% net returns there which is hard to get anywhere these days. Certainly, I don't expect that that would maybe maintain that level all the way through here, but given the fact that they can foreclose these properties it may be a multi-year process, but your principal is obviously more protected than it would be in other kinds of investing.

Anyway on that note, I will sign off. I very much appreciate your listening and I'll catch you next time. Bye.

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