The Art of Passive Income Podcast
With Mark Podolsky and Scott Todd

Today's Guest: Lee Kearney

Transcript

Mark: Hey, it's Mark Podolsky, The Land Geek with your favorite nichey real estate website www.TheLandGeek.com and I'm super excited for today's guest. But before we talk to our guest, I'd be remiss if I didn't properly introduce my cohost – Six Sigma, 'the Brain', 'the Professor' – you know him, you love him; Scott Todd from ScottTodd.net, LandModo.com and most importantly if you are not automating your Craigslist and your Facebook postings: PostingDomination.com/TheLandGeek. Scott Todd, how are you?

Scott: Mark, I'm great. How are you?

Mark: I'm good, I'm good. I'm almost intimidated; two Florida guys on the podcast.

Scott: Two Florida men, right?

Mark: Two Florida men.

Scott: The good ones, not the crazy ones.

Lee: It's true.

Mark: Yeah, I don't know. I mean both of you have the [00:01:10] [indiscernible] to own gators.

Scott: We do and there's no proof that we don't own gators.

Mark: So, I'm just going to tread very lightly on today's podcast with you guys but let's talk about our guest because I want to put my anchorman voice Scott he's a big deal. Lee Kearney from FlipYourIncome.com has done over 7500 flips; he has done over a half-billion in sales. If you have gone to a REA meeting, you probably know the name Lee Kearney. He is one of the biggest and best in house flipping in the country. Lee, how are you?

Lee: I'm doing good. Besides hurricane Michael, I'm doing good.

Mark: Besides hurricane Michael, were you affected?

Lee: Oh yeah. We're still doing the asset checks and we can't even access our three worst properties. I got some life satellite imagery today from the NOAA website and it's pretty gnarly.

Mark: Wow, wow. So Lee, let's just kind of rewind the tape and take us back to 2003 your first accidental flip and what were you doing before then and just let's just kind of hear a little bit more about your story.

Lee: Sure. My story like you just said started out by accident. In 2003 I was living in Ireland at the time, I'd gone to college in Florida, went to back to Ireland, I was supposed to run my father's company. I ended up in corporate sales for his company kind of working my way up through the ladder. So, it was low draw high commission job that I was doing really well at that. I bought a condo, bought a penthouse, thought it was going to be awesome. Got broken into within a month, the kids would actually push all the buttons and see who wasn't home and break into people who didn't answer. So, my unit got hit. I said "You know what? I'm out."

So I sold it, made about 35 grand which was a little bit more than my base salary and I'm thinking okay I just made this for doing nothing essentially so I need to look into this. So, that's really when I caught the real estate bug which was back in 2003. Decided to pack up shop, moved to California and one of the first things I did when I moved there was I just asked a lot of people questions, I tried to find a mentor and I didn't really even know what a mentoring was back then I just knew that I needed someone to tell me about real estate.

So, what I would say to everybody out there don’t be afraid to ask a bunch of questions they are not stupid questions. If you don’t know, it's because you haven't done it before and that’s okay. I can definitely relate to that and that's why when people ask me some of the most basic questions, I’m never condescending because I was the guy asking those questions.

So, this mentor, a guy I went to church with at the time showed what area to buy in, what kind of price point to buy in, even some key things like, “Hey, you need to put down sod and a sprinkler system way out in California in the low desert and you've got all these dirt yards and nice green bright yards.” It definitely sold the house and so I picked up some tips from him on curb appeal and price points.

It took me about four months to find my first purposeful flip. So, I bought the house, it was a probate deal, used an agent. I didn't know where to go get the deals myself so I did the more traditional route. Bought it for about 130, sold it right around 185, took about 3 months and that’s when I made my first mistake. Even though I made net about 35,000, I tried to live in the house while flipping it. I was a college kid trying to save money disastrous idea. So, if you’re trying to live in a house that you're flipping and it is a business, don’t do that.

So then I actually made my second and third mistake on my next flip. Bought my house in California, I decided to move back to Florida and I decided remotely rehab. That’s another big mistake. Don’t try to remotely rehab. We had a three or four week job that took six months. I made my third mistake which is where I hired a friend to do it and so even though I made three mistakes on two houses, I still made money. I'm up to about 50,000 at the time that a lot of money from two properties.

So fast forward to 2005, I'm back in Florida again I asked a bunch of questions trying to find a mentor. It just so happens that one of my friend’s father flipped foreclosures. So, I'm asking questions like what is a foreclosure? So, he tells me what a foreclosure is. Like where do you buy foreclosures? He said the courthouse steps. I'm like what is the courthouse steps? He said go to this room at 2 o’clock every day and they are auctioning houses. So, I go to the auctions and they’re not auctioning houses they are auctioning case numbers. So, I'm like what do these case numbers mean? So, I asked a bunch of questions finally I after a couple of weeks found out that there was a lady selling a book that turned those numbers into addresses. So, now I'm thinking man now I’m off to the races here, I can bid on houses. So, I got the book maybe a week or two in advance, I'd drive all the properties in the morning and then I go to the auction at 2 o’clock.

So, it took me about two to three weeks before I dipped my toe in and bought and that's one thing I did right and I would say to everybody out there – do your due diligence. I mean at some point when you've got ready, aim, fire; you do have to fire and I think a lot of people's problem is they just spend a lot of time getting ready and aiming and they never fire and that's a problem in itself. You know where you've got the paralysis by analysis. They want to build out their business plan, set goals and create action plans and build out a nice office and buy new furniture and they are not even flipping house. So, at some point you do have to fire but I do think that there is a balance there between trying to understand the arena that you're playing in and then jump in and actually doing it.

So, I bought my first house; it was ending up being a homeowner's lien so I paid $7,000. What was great about that is that I didn't have to pay off the mortgage until closing, and so I'm really hungry for this deal. I actually tracked down the person who was in foreclosure, got his Social Security number so I could login to get his bank balance and get his pay off. So, it really worked out great. I paid 7 grand for the house, 140,000 pay off, I think I put about $15,000. I hired my college kid buddies to fix up the house with me at night and I probably made about 40 grand on that deal sold it for 205.

This was back in 2005 when things were really heating up. The California market, by the way, I should note when I was selling that house in 2005 and finally did sell it in 2005; the California market was already starting to shift. I could see cracks in the armor. So I didn't realize there were market cycles or any of this stuff that we will probably talk about on this interview I made a bunch of money. So between 2005 - 2007 I had a good 50 deals under my belt, I'd made over $2 million, had a million and a half in equity. I'm thinking man like this is great. This is never going to end. I am a 25-year-old guy, 27 at the time, I've got a couple of million bucks, and I'm doing great.

Little did I know there was going to be a global collapse not only in real estate but in worldwide markets everything and so I got crushed and the reality is in about 12 months I saw my net worth go from $2 million to negative $1.5 million. So, shaking out all of that debt and really settling everything, not having to file bankruptcy and I would say to everybody out there don't file a bankruptcy unless you really have to because that's going to haunt you for the rest of your career. What's one of the first questions a lender asks you or anybody who is doing business with you when you have to fill out a form? Have you ever filed bankruptcy? So, I thank God that I did not have to file bankruptcy, I was not overleveraged. I was able to liquidate everything and just kind of get everything corralled to the point where essentially end up back at zero. When I say zero, I think maybe I had 20-30 grand to my name something along those lines. I mean I wasn't on food stamps but going from a $2 million to $30,000 was tough.

Mark: So Lee, I know a lot of people that went through that crash, especially here in Phoenix and they... because they spent a couple years figuring out something else to do and shied away just out of fear and just the bad taste of everything that happened on real estate but you stayed in. Why is that?

Lee: Sure. That's actually a good question it's been asked a lot and I think there is tenacity, stupidity; there's probably lots of good answers for that. But I sat down with one of my mentors this was right around the end of 2007 whose name is Frank, his nickname is Bumper. I said, "Bump, what am I going to do? Like I'm broke." He sat down, I'm waiting for some really detailed answer and he looks me dead in the eye and he say son and I said yes. I'm like waiting for this epic answer and he goes, "You've got to sell you way out of it." I'm like that wasn't the answer I was expecting. So, I really sat back and I thought about what he was saying and this is the guy who had made millions of dollars flipping up mobile homes. He was a mobile home king back in the 70s and 80s; he was the largest seller of mobile homes in the entire state.

So, I really thought about that. I said I'm not going to dig my way out of this hole by just sitting and doing nothing and that's really what I took away from that. So, I did take massive action. I said, “Okay, I got my butt kicked rehabbing houses because I'm rehabbing houses into a downward market.” So, I'm like that's the wrong strategy and I will say this I learned two lessons about real estate that day. Number one, there is always money in real estate but the second lesson I learned is you have to be on the right side of the trade. So I said, "There are clearly people making money in real estate I'm not one of those people. What are they doing?” And I looked around and who do you think was making money in the market back then? It’s a question for you.

Mark: The buyers.

Lee: Wholesalers. Wholesalers were making all the money. Why? They took risk off the table. They are just day trading real estate. They didn’t care if the market was in the toilet. They are buying and selling the same day, they are collecting their fee and moving on. Now the buyers were making money too. To your point those buying the foreclosures rather than people getting foreclosed on were snapping up deals. Like $30,000 for a house that I had valued 150,000 mortgage to 100,000 they are now buying my house for

$30,000. So, you’re absolutely correct the people stacking of assets at point in time in the market cycle were making money and the wholesaler’s day trading real estate were racking up cash. So, I think that there are two things going on. There is people getting hood rich and those people creating wealth and that was really what was going on.

I decided back in 2008 I needed to be hood rich because I had no money so I just wanted to focus on stacking up cash. So, what I did as I started wholesaling that's all I did. I'd tie up contracts from the MLS. I realized speed to market was important so I'd make sure my offer was in within five minutes of it being listed. So it would come into my email a house that would fit my criteria, my system would have an offer cranked out in five minutes and basically we're paying full price, zero inspection, close in a week because the deals were that good I would close on as many as I could get and then I would turnaround wholesale them and people were actually coming to me and going, "Hey Lee, you've got that house?" I'm like yep so it's that price in the MLS plus 10K. So I wholesaled almost a hundred deals in 2008 literally within months of losing everything I started back into the right strategy and I probably stacked up close to a million dollars in my first year back into real estate again.

Now and since then the rest is history over 7500 transactions. Our biggest year in 2013 when we were partly operating for hedge fund and helping them buy properties I did in my record month 260 transactions out of my office. I mean we were about to pull our hair out. I mean well, that's... what's that in a day? 26 transactions. No, 13 transactions in a day per business day if we take 20 days in the month. I mean it was just insane. It was just absolutely insane. I remember one Friday we had I think 40 closing packages that day, I mean it was just ridiculous.

Now great money but a lot of stress and actually that stress put me into bad health; my appendix burst and I said you know what, there's got to be a better way. But what I did learn is how to institutionalize my business. When I look back five years ago, I can say that's the point where I turned the corner in terms from being a real estate investor to actually being a real estate business and having institutional processes.

So, by even with our rental portfolio we would be considered a midsize investor, we got up to managing several hundred properties. Personally I owned 320 properties and over 25 million in rentals and so I've learned how to do things in a big way. A lot of that us down to systems, processes, the right software and more importantly giving your team the right tools. You can't see it here from this podcast but I've got six screens around me here, all of my staff have four screens. We've got the right tools to be able to process things correctly and to be able to use all of our tools efficiently and quickly. That's one thing I noticed a lot of people don't invest in. They have a nice desk and a nice chair but they won't have good tool they're working off. They're working of on a laptop and in our business with a lot of moving parts if you want process information quickly having the right set up definitely helps.

Mark: Scott Todd, what are your thoughts?

Scott: I mean where do you start at this point? Lee so let me ask you a question, I've got a couple of questions. One when you talk about institutionalizing your business you're just talking about building processes around it, I mean creating systems so that people can do the work and that you're not having to do it, right?

Lee: Yeah, sure. At the end of the day for me, when I say institutionalizing it, what I learned from an institutional hedge fund that I was dealing with is that they track everything so all the data. The reason you track all these data points it's because you can get good reports. You have to track data in order to get good reports so we track all the different characteristics of every home, the size of the home, the size of the lot, the year built, the number of bedrooms, bath square footage, where we bought from, how we sold it. You know we track all of this information and by doing that I can look back at reports and get live reports to tell me how I'm doing.

I've got a death tracker every single day. I know every single dollar of debt that I've got, where it's allocated whether it's available or pending, active, in rehab, on hold, and in trash out so that I can see that pie chart every single day and that's what I mean by institutionalizing your business. It is having everything tracked, having all of your data in a software and having the right people behind it as you said, managing each step of that process. What I did specifically to make sure that my IP was protected is that I got one person specializing in lead acquisition, one-person in acquisition closings side, one person in sales, I've got a construction team, I've got a sales team and so that way everybody specializes doing a lot of their section of the business but no one understands the entire process.

Scott: And so you're collecting a lot of data. Like you said year the house was build and like the lot size. What do you do with that and like how is that helpful to you?

Lee: Okay, that's a great question. So we'll look back to where we made money and where we lost money. We're trying to find correlations. So to answer your questions specifically in a really good way we realized on older assets that we rehab we were losing money. So, now as a result of that data I don’t rehab anything over 1990 that's my cutoff. I don’t want to be replacing pipes underneath the house, I don’t want to be rewiring houses. So our cutoff is 1990 and mobile homes is 2000 and next market cycle as a result of our rental data I’m not going to own a rental more than 20 years old that's my cutoff. So the age of the asset had a direct correlation to profitability.

Mark: That's truly interesting. So Lee, with all your expertise and all of your experience what are some of the worst advice you see or hear given?

Lee: Oh man, you know that's… where do I even start? I would say that building a rental portfolio at the peak of the market is probably some of the worst advice I've heard. That's not being on the right side of the trade. I mean let’s take my properties every landlord in this town is selling their properties. So if I bought them for 30 or 40 and put 20 grand into them and I’m selling for 150,000 I’m on the right side of the trade selling that asset.

The person buying that property even with an 80% conventional loan putting down 20-30 thousand mortgaging 120 at the peak of the market to build a rental portfolio after debt servicing that may or may not throw off $100 or $200 a month and will more than likely have negative equity within 12 to 36 months is probably realistic for that they’re on the wrong side of the trade. So what I’ve realized to answer your question really specifically there’s a time and a place for different strategies in real estate and especially with rentals there is a right time to buy rentals and there is a right time to sell them.

One of my other mentors really described this well, I thought the way he articulated this was good. He said, "It is not important to call the bottom of the market." What he means by that if I bought a 30 or I bought a 40 or I bought it at 20 or I bought it at 50 if I'm doing good buy it's important to call the top. So that message has always haunted me and as I see prices peaking here in Florida I unloaded my rental portfolio. I started that process over year ago. I’m about 90% divested, I've got about 10% about 30 properties or so to go and I'm out.

So that's some of the worst advice I've heard is people talk about cash flow, cash flow, cash flow. What they are ignoring in that equation is their balance sheet and so it doesn’t make sense even if you are cash flowing to have an upside down balance sheet or potentially one. As you scale up the ladder you go from being an investor to being a speculator. Because if you know the market is peaking and you're buying something to hold it, you’re speculating at that point. I don’t think you’re an investor, I think you've crossed over into being a speculator. So, I think for me that's bad advice is to always buy rentals. I think there's a time and a place in the market cycle to buy them and there is a time and a place to sell them.

Mark: Excellent, excellent. Scott Todd?

Scott: All right. So, knowing what you know so you're getting rid of your rentals right now. What are you doing? What is your strategy now?

Lee: Sure. So we're doing some very, very specific things. Right now my specific action steps in this market we're reducing debt, we're reducing leverage, we're also buying and selling at lower price points. So I'm not rehabbing $500,000 houses I'm rehabbing at median price and below. Even besides that I'm doing easier rehabs. I spoke of that earlier I've made my cutoff 1990 or newer and even then I've made my level of rehab only rehab house that need cosmetics. So, again lower debt, lower leverage, lower price points, lower level of rehab and then the last thing I'm scaling up is wholesaling. So, our ratio of retail/wholesale we're doing less retail and more wholesale. So, that's specifically what I'm doing. I'm not just talking about I've made a big shift in my business over the last 12 months in order to do those things and get the risk off the table. That the primary goal of everything I've just said is I'm trying to reduce risk.

Mark: Yeah, you know what I find interesting... Go ahead, Scott.

Scott: Do you think there's a potential you're like jumping the gun? Like you're getting out, like you're running and I hear what you're saying. Like you have a big portfolio but like at the same time are you trying to haul the top of the market and get out as opposed to kind of just saying I'm a long-term investor here and being that long-term investor... Like if I was long-term investor in stocks I don't care if stocks are... I mean you would care at some point but essentially if you're just like buying it over time the whole portfolio as a whole will be okay. You're buying in down markets; you're buying in up markets. [00:21:22] [indiscernible] coming down.

Lee: Okay, I hear what you're saying, but if I can buy that same property and I can cash flow $500 a month or I can buy it at the top of the market and cash flow $100 a month. Also, if you look at IRR if over that five-year period my portfolio tripled in value, which it did by way the 5 to 7 year period it literally tripled in value my IRR is through the roof. So really it comes down to your willingness to be able to trade at the right time and I guess I can guarantee you my IRR is more but going back to your point.

For simplicity a lot of investors I guess just don't care about that but for me I'm very interested in IRR. I want make most of amount of money, in the least amount of time, with the most amount leverage and so that's my strategy and by buying it low and selling high I'm looking at those market cycles I'm able to do that. And so I could literally I guess going back to my previous point I think it would make sense to take that $30 million in rentals, park the money in cash and buyback twice the amount of houses for that same amount of money rather than ride out the market cycle.

So, that's where yes you can do that and so to your point specifically we're moving into some safer asset classes for long-term hauls as we ride through this next market cycle specifically student housing that's one area where we're delving into. I'm actually flying to Oklahoma on Thursday looking to take over it's about 150 unit building and so that's going to be an asset that will hopefully I will tie up that deal this week.

We're also looking into multifamily. Now I'm not as hot on multifamily as everybody else I know it's a buzzword out there. The problem with that is all of the things being equal, if the demand goes up what happens to the price? Prices are going through the roof. So I am seeing multifamily traded at crazy CAP rates because people just want to say I own 500 units, I own a thousand doors but they're paying prices that just don't make sense.

Also, you've got rates rising. So, if you are buying something that's 7 CAP and your cost of capital 6% I think you're a pretty scary place. If you ask me, I don't want to work off those kinds of margins. I don't want to have a bunch assets on my balance sheet where my liabilities are real close to what the asset is worth it just doesn't make sense. For me a healthy balance sheet for me gives me a good sleep at night as much as cash flow does. I looked at both things and I think a lot... going back to your point about just riding it out I think a lot of people ignore their balance sheet and I don't think that that's the smartest approach in real estate. Yes you can make money but I think a seasoned investor looks at all of these things. They're looking at the full picture of both their balance sheet and their cash flow and their P&L. So you really got to look at all three things.

Scott: Got you.

Mark: I love it. So Lee, you kind of glossed over I think one of the most interesting things which was scaling to the next level. So, I used to do investment banking. One of the biggest challenges that we would see is a company with let's say a 5 million in revenue get to 500 million in revenue and you get new problems every time you go up...

Lee: Oh, for sure.

Mark: ...let's say 10 million in revenue or whatever it is depending on your industry. What did you learn from scaling and what mistakes did you make and why do you think you were so successful where other people...? You go to a REIA meeting 99 of the people in there they've done a couple of flips but you can do a hundred...

Lee: Or no flips.

Mark: Or no flips.

Lee: They've gone to REIA meetings for years and just liked the idea of being around investors and never actually done a deal. I see that in a lot of REIAs they're dreamers.

Mark: So, what allowed you to scale so quickly?

Lee: Sure, I think some of the biggest mistakes I learned along the way is on my reporting to not just look at averages but to look at outliers. What I mean by that is to look at problems and so as you scale up you have a rehab that sits around for six months, you can have a house doesn't sell for six months. So what we've done as we scale up to make sure that no houses left behind, no assets left behind I have report: any rehab over 60 days that gets pushed to me every week, any house that's been available for over 60 days get pushed to me. So I've created reports that create limits and basically outlier reports for every aspect of my business. So here's the norm and if it's within the norm the manager can handle it. If it falls outside of the norm I get that report; if we've gone over budget X percentage. So that way then everything operates within normal range but when it's outside the normal range that's when it lands on my desk.

So, that's the biggest thing I've learned from scaling up is that you have to allow for normal course of business but then you also need to identify what those lower and upper limits are and when something crosses outside of the normal range. If you look at a bell curve, you've got to know this basically where most of your data is but then as you got out then you've got outliers that's what you need to see as a business owner. Because otherwise you could be busy saying well my average days on market is 43 days. You could have one house sitting on there for 300 days, I mean that's crazy. We're not in the business of buying and rehabbing, we're not in the business of buying. We're in the business of buying either buying and selling or buying, rehab and ultimately selling an asset and because most times we have leverage, time is your enemy because the market typically is not going out appreciate your cost of capital and your holding costs. So therefore, our equation is to move assets as quickly as possible from buying them to disposing of them.

Mark: All right, fantastic. So Lee, we're at that point now in the podcast where we are going to ask you for your tip of the week: a website, a resource, a book – something actionable for the art of passive income listeners can go right now – improve their businesses, improve their lives. What have you got?

Lee: Sure. I actually have a board I'm going to read it right now. I write what I'm focusing on for the week so that's what I was going to use for my tip of the day. I found myself task saturated the last couple of weeks so what I did was I set my goal become more efficient with my time and so even though I focus on the past my goal for this specific week is to figure out where can I find efficiencies in my time. Because if I've got tasks that are all creating revenue which by the way I've got a to do list like the length of my arm it's all opportunity, it's all money. I've got to figure out how to filter through the best of those opportunities as quick as possible, not waste time on things that don't create revenue. So that's my specific goal for this week is really making it a focus on finding those efficiencies with my time.

Mark: All right, fantastic. Scott Todd, what's your tip of the week?

Scott: Mark, my tip of the week is a website called RealTimeBoard.com and at RealTimeBoard.com, you can kind of think of it like a white board but online. So, as you know our team is in different places and they're spread out so you can essentially create kind of a virtual whiteboard if you will where you can contribute to it, but also you can interject some cool things like spreadsheets and other stuff through there to work with your team. So, the pricing is pretty cool and they also have like a mind mapping feature, they've got some other things so pretty cool place if you're looking for something that you can coordinate with your team better this is the place to do it.

Mark: This is geeky I love it, I love it. Well, no one is going to trump my tip of the week which is going to be to learn about how Lee Kearney makes millions, go to FlipYourIncome.com. FlipYourIncome.com and he will walk you through his seven step process on how to find and then ultimately flip a house and...

Lee: Flip lots of houses.

Mark: Flip lots of houses. So, we'll have a link to FlipYourIncome.com. I do want to remind the listeners that the only way, the only way we're going to get the quality guests like Lee Kearney from FlipYourIncome.com is if you do us three little favors: you've got to subscribe, you've got to rate and you've got to review the podcast. Send us a screenshot of that review to support@TheLandGeek.com we're going to send you for free the $97 *Passive Income Launch Kit* please do that it really, really helps. So Lee Kearney, are we good?

Lee: We're good.

Mark: Scott, are we good?

Scott: We're good, Mark.

Mark: All right. I want to thank all the listeners and just remind you let…

Scott: Freedom.

Mark: Ring.

Scott: Ring.

Mark: Thanks everybody.

Lee: Thanks guys.

[End of Transcript]