The Art of Passive Income Podcast
With Mark Podolsky, AKA The Land Geek

Today's Guest: [Brad Smotherman]

Transcript

Mark: Hey, it's Mark Podolsky the Land Geek with your favorite niche-y real estate website www.TheLandGeek.com and I'm really excited for today's guest because he has a model that really I find intriguing and I know Scott finds very intriguing as well. That being said I'd be remiss if I didn't properly introduce my cohost you know him, you love him Scott Todd, ScottTodd.net, LandModo.com and most importantly if you're not automating your Craigslist and your Facebook postings PostingsDomination.com/TheLandGeek. Scott Todd, how are you?

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

Mark: I am great. I'm excited to soak in the wisdom, the knowledge.

Scott: This is always whenever we hear about like this type of investment I kind of get shinny object syndrome and I wonder like, should I be talking to our guest. Should I be talking to our guest and not you, Mark? I don't know, we'll have to see.

Mark: I don't know let's see. I'm excited to just let it all go and maybe you know, be in the Brad Smotherman camp. If you don't know who Brad Smotherman is, Brad Smotherman is our guest from BradSmotherman.com, he is a professional house flipper but the way that he sells houses is very unique and very special and actually kind of cool. So Bradley Smotherman, welcome to the podcast. How are you?

Brad: Doing very well, Mark. I appreciate you guys having me on.

Mark: So Brad, let's rewind the tape a bit and before you became a professional investor what were you doing?

Brad: Well, I got into real estate when I was 17, I decided to get my real estate license and I sold real estate through college. College ended right at in '08 and I thought, oh gosh this is a terrible real estate market, let me use this accounting degree that I had worked on for four years and that lasted for about 30 days.

So I went into tax, decided pretty quickly like, I can’t do this type of work, the desk environment, I'm an entrepreneur at heart and all this and so I went back to selling real estate. Well guys, it was really pretty bad timing. You know 2008; fall of 2008 was not the best time to be jumping back into real estate sales career. But we made ends meet and the beginning of 2010 I started doing the investing side. So I retired my license, started buying houses and selling houses mostly with owner financing and just been rocking and rolling ever since.

Mark: Okay, great. So if you wouldn’t mind, walk us through your model and why it’s unique from the typical house flipper.

Brad: Sure. So, it’s kind of funny the evolution of my business really started as buying with equity and selling with owner financing because I was able to do that in a way that needed very little money. Well, I didn't have any money so I had to find a way that was not traditional and I looked at wholesaling and different things and so I started off creating wrap notes then I built up some cash and I thought well, this is what you do when you get some cash. You start doing these HGTV style rehabs and Joanne Gaines style and these gut reframes, all this and I did that for a couple of years. I realized pretty quickly like there’s really no money in the fixing, the real money is in the financing in my opinion.

So I switched the model back, started doing more and more owner finance , but one of the biggest mistakes I’ve made in the past five years as the market was so great, I retailed out of too much and I should have kept more note. So, right now we are doing probably 70% of our business is we're taking the profit, putting it into note. Instead of taking house retail like a fix and flipper would or instead of wholesaling the house like wholesalers do we're getting the property under contract and then we're selling with owner financing and we're creating all these wrap notes.

Mark: Okay, so that's a lot to unpack. So, let's unpack the first part which is you buying a house with equity. So what does that mean?

Brad: Yeah, so we bought... I guess we bought two yesterday. We bought a house for $50,000 that's a cash offer at 50K and we'll owner finance that one for probably 150 with 20K down. So I'll have net $30,000 cash in a $130,000 note that is financed somewhere around your 7 to 8% on a 30 year note.

The other transaction was actually, we bought it subject to which means that the lien, the mortgage in this case that was in place in our sellers name remains in place after closing. So this lady, really nice lady, she was about six months behind on her mortgage and so we give her $15,000 cash to take over $115,000 loan at 4% and then we'll sell that property at 7.9% at 200'. So, I mean that that's kind of... and I hate to like throw out the numbers because it's confusing for some people but that's kind of like an average deal for us.

Mark: Right, so your passive income then is what on a typical note deal?

Brad: Yeah, so your notes obviously are a promise to pay. So, a lot people kind of get this somewhat confused with like, lease purchasing or land contracts. We don't want to do that we do real owner financing where the buyer gets the deed at closing but an average cash flow for us - I don't know exactly. I used to really keep up with it, I'd say our range would be from $250 to $800 a month and somewhere in the middle there $400 to $500 a month would be an average.

Mark: Right. But essentially, though the way that you have it structured is that, that person living in that house owns that house, they're taking care of that house. So it's not like you're a landlord, correct?

Brad: That's right. So, the reason that we like notes - there are a lot of reasons, but mainly two is, we get out of vacancy and we get out of repair, so there are no tenants and toilets. We have an owner. If their HVAC goes out, then they're calling the HVAC man or woman, they're not calling us as the bank in this kind of position. So, we are able to scale and have a lot more notes and manage notes in house a lot easier than we could rentals all over the place.

Mark: Scott Todd, why doesn’t everyone do this? Why would the HGTV people go into fix and flipping if they could just do notes? This is so much simpler.

Scott: I don't think that they read that line in *Rich Dad Poor Dad* where he says, "Be the bank not the banker." Like, that whole book *Rich Dad Poor Dad* that is like, the one line I remember like, anything be the bank not the banker. I don’t know man, I think that people think the note side is boring, they just don't even think about it, they see what's on HGTV and then they go execute or they try to and the reality is like he’s doing the same thing that we're doing with our notes. Like, we're selling it on owner financing and reaping the yield and that’s where the money is. The money is not in the flipping of anything. I don't know, I want to be the bank.

Mark: I want to be the bank. I mean, Bradley, I love your model, it's very similar to our model. What I’d like to know is what sucks about? Why isn't everyone doing it? If I got to REIA meeting and there is a 100 people in the room 99 of them are flippers, landlords or wholesalers. Why aren't they the bank? Why aren't they note people?

Brad: I think there are a few reasons for that. Number one, I think that the big push for new investors has been wholesaling in the past decade and there’s various people that... I mean it's not a terrible model. I don’t think that there’s a bad way to do a great deal, but I do think that there’s a better way than others to do a great deal and so, I’m not disparaging against wholesalers, but I don’t like the wholesaling model because if you think about it. If someone is willing to sell to you 60 cents on the dollar then they’re probably willing to finance you if you know how to ask for it and you understand deal structure to the context that you need to create financing. And so, I think that’s one thing is that most of the information out there is the wholesaling and fix and flip model.

I think, secondly, that people have the idea that you have to have a lot of cash to get into the note business and that’s not exactly true. If you know how to negotiate deal structure, you can create equity instead of cash and then sell with owner financing. I think that also a part of this is that, people don’t understand that those eight or 10 pieces of paper that's a Deed of Trust or Note Mortgage is real. It doesn’t feel real because you don’t own anything that you really go and look at besides your file cabinet and so, I think for that reason it kind of scares people.

Scott: So, I'm just kind of curious okay so, like can you walk me through this deal. Like the one you did yesterday, you said you bought it for 50, you have somebody that's lined up to $20,000 down or better yet... I don't know if you are doing it or not. But you think theoretically, you're going to get $20,000 on the deal down.

Brad: Correct.

Scott: With 30' in the bank or into the deal. You're going to settle for 150' finance, you know 130' in that case. All right, this house the reason you're getting it with that discount, I mean there's obviously some repairs that need to be done. Like this house is not like turnkey ready to go, is it?

Brad: Well, it's rentable. I wouldn't say that it's like it's not updated, you know it needs updates. So, it has the knotty pine walls and it's a bricks 1960s ranch. So, it needs some updating but I mean it's certainly fine. I mean there's nothing wrong with the house, I didn't see...

Scott: Yeah, it's livable. It's not like [00:10:07] [indiscernible].

Brad: Yeah, it's a good house.

Scott: Ok.

Brad: Not at all. I mean I have done deals with those before. We had one house where the roof leaked so bad that we had put on our marketing, if it's raining today then take your umbrella inside the house and we actually sold that one with owner financing.

Scott: Yeah, and I think that's the key. That's the key is that you're selling it with owner financing. So like, how are you getting your deal flow? Where are the deals coming from? Are they coming from bandit signs and that type of thing or like how do you find these things?

Brad: Yeah, well when I started off in 2010 all I did was bandit signs and I found that in my markets at least, that the signs work less effectively as they used which I would say that's probably for all marketing mediums because the market was so bad in 2010. But now all of our lead flow... I can't say all 90% is from Google Ad Words and we just started a cold calling campaign across multiple states to contact pre-foreclosures. So, I'm really testing the cold calling to see how that's going to work. I don't know exactly yet but it looks promising and I think it's going to be something that we're going to want to do long-term. But yes, to answer the question we have to do real marketing to create the lead flow that's necessary to buy this high equity deals.

Scott: All right. And then, are you sending somebody out to look at because you’re doing multistate? You know like if you're doing multistate, I don't think you're going out looking at them. Do you have teams or people going out to look at them?

Brad: Yeah. So my business hub is still metro Nashville, so most of what we do still within driving distance but yeah, we’ve done deals and I think 16 states at this point. It looks like we're buying a house, a guy called me yesterday and it’s just south of Sacramento, California and it looks like a promising deal that we would do, so we're kind of all over the place. So to answer the question, yes we have to have a real idea of value and a real idea of condition and so, we're going to lean on local professionals to give us that information.

Scott: Got you, okay. All right, and so then you're not selling with a realtor then. Like, you're just doing your ads to find your buyer.

Brad: Correct. So when we're selling with owner financing, which again is roughly 70% of my business and we're going to handle the seller ourselves. We don't list with a realtor; we don’t find that it’s necessary. Although I do think would be easier sometimes because we've got like, we can still buy more houses than we can really effectively manage the sale of which is kind of funny because we've been in a sellers’ market for a long time but we can still buy more equity than we can get rid of which is a great position to be in.

Scott: Got you.

Brad: But you know, most of the time we're selling the property ourselves.

Scott: Yeah. Mark, that sounds like exactly kind of what we're doing. You know, obviously it's a different approach because we're doing direct mail but I mean like, that's the same problem we have. Like I can buy more, I can buy like unlimited land and the sellers are there but like, it's so easy to accumulate this stuff that you're going to sell and you have to have like a full court of press to sell them and you can do it. The problem is you can find the land easier or in Brad’s case, the houses easier than you can sometimes find the sellers. That's amazing.

Brad: Yeah. I mean the buyer's pool for owner financing is vast and I don't remember the exact statistics but I think it was January of somewhere around 31% of mortgage applications were denied. When you think about that, that’s roughly a third of the mortgage applications. So, if we think about today’s market, for every two houses that are selling another house could have been sold had they been able to get the money and that’s a big market and there’s not many of us playing in it.

Scott: Yeah, that's huge.

Mark: Yeah, I love it.

Scott: [00:13:47] [indiscernible].

Mark: I know I’m getting shiny object syndrome, but there are the legal issues that land is exempt because we're not dealing with a tenant. So, do you have to deal with Dodd Frank, RESPA and the Safe Act?

Brad: Yeah. I mean Dodd Frank is something that we have to consider. So, the short answer on that for those that don't know Dodd Frank, is a banking regulatory act and part of which was putting the clampdown on owner financing. So, we have limited amount transactions that we can do per individual without a residential mortgage loan officer approving the transaction, but the short answer is, if the Dodd Frank act is a concern is to not originate. So, what we do in majority of our transactions is, we're having our seller, before we close we're going to put our buyer in place and our seller is originating the loan. So, the only place that we show up is in an assignment of note or deed of trust or mortgage.

Scott: That's slick.

Mark: That's slick.

Scott: Like that's skirting of it, isn't it?

Brad: Yeah, so it's like we don’t originate and so that it's like, there’s no issue. The second reason that we want to do it that way is we're starting to put a lot of our notes into a Roth and so self-directed Roth, well the seller originates the...

Mark: I'm sorry, I lost you. You put your notes in a self-directed Roth?

Brad: Correct. Putting it into a self-directed Roth and so with that, if the seller originates this loan then my Roth can come in and buy that loan at closing. So, you think about what's the value of second behind a first that we just pulled from foreclosure with the COD paper borrower? Well, on the open markets it's worth very little so we're able to go in and buy for pennies on the dollar these notes and throw it into a Roth which is kind of my a long-term strategy.

Scott: Wow.

Mark: I love it. Scott the shiny object.

Scott: Yeah. I'm just thinking.

Brad: Well, you guys could do that with the land. You know, you guys are creating notes on land, so I mean just throw it in the Roth.

Scott: Yeah and like, I'll buy land in my qualified retirement plan, I'll do that and then sell it. So, I'm doing kind of the same thing. For us I don't have to worry about the origination piece. So you know, it's a little bit easier I think.

Brad: Right.

[00:16:14] [indiscernible]

Scott: But essentially, it's just one last step.

Brad: Sure.

Mark: Right. Now, what about our foreclosure? I mean, I imagine that hopefully it's a rare event. Like, I know for us we have because we use land contracts, it's not a big deal if someone defaults but with a Deed of Trust, you would have to pay you know an attorney, the foreclosure fees and the time. What percent of that occurs would you say?

Brad: And that's a great question and it's probably one thing that I missed on why people don't get involved in notes is, they are scared of the foreclosure process. Well, depending on the state you know if you're in a mortgage state then certainly the foreclosure process is a longer process than an eviction. But in Deed of Trust states, which is most of where I play it's really not that big of a deal, it's not that much difference but all of your paper... All is a big word let me back up.

90% of your paper is either going to default or pay off in five or six years, okay, and I would say roughly 10% of your papers are going to default. I've yet to have a default happen where it wasn't to my financial benefit to take the house because we get real down payments and we service the loan pretty closely. But also you know, we've been in a very appreciating market and so, we would basically recapture three or more five years of appreciation at that point, plus we got a 20K or 25K down payment on the front end. So, it's just double dipping you know those kinds of transactions.

I don't mind it from a financial perspective. I do mind it from an ethical perspective. I don't want to foreclose on anyone. Certainly not a family, but at the same time we have agreements and if they don't pay, then I can't give them the house and they understand that and I've never had a super difficult situation with a seller. You know, if someone is getting... I said a seller, a borrower. If someone is getting behind on a payment we'll do an in-house refinance, we'll put back payments on the backend of the loan to get people current if we think that they can at that point afford the loan. So, if somebody loses a job or they get sick then we're going to take those circumstances into consideration, but at the same time we're running a business. So, there's kind of a gray area there and a fine line between being fair and being a push over, I would say.

Mark: Yeah, absolutely and I'm wondering because a lot of times people ask me what is the best places to go to buy raw land and I'm always like, well it's the Southwest, Northwest, California and Florida because nobody wakes up and thinks to themselves by, I'd like to buy some raw land today in Minnesota, unless you live in Minnesota. So, are there certain states or counties or cities that you would say are ideal for this type of investing over others or is it are you agnostic as far as the areas are you opportunistic?

Brad: Yeah, and I guess it's a really good question, and I think it's a really deep answer that I could really go into but the high points, it depends. So of course, I would think a little bit differently on a transaction in Flint, Michigan because they still to my understanding haven't dealt with the water problem. But if a property is in a market of you know, 15 or 20+ thousand people so we have to have population. I really don't want a transaction in the middle of Littleton, Kansas, if there is such a thing where there's a population of 150 people. So like, that's something that would kind of turn me off.

As far as states I mean, there are certain states that are a little bit more pro-business than others. I know that Washington State has some kind of weird laws about investors marketing to pre-foreclosure people. I mean, my personal stance is that has to drive the foreclosure rate up because we buy a lot of houses and save a lot of people foreclosure, but I guess the short answer is, it depends. There's not a deal that I cannot look at probably outside of Alaska because we had one come in that was in Alaska and I was just like, I don't know anything about there. Like, I've heard it stays dark there, three months a year or something. It's like, I didn't want to take the time to learn about that market to kind of figure that one out.

Mark: All right, great. And then, as far as managing your notes, I assume you're using note servicing company.

Brad: No, we manage in-house.

Mark: You do manage in-house.

Brad: We manage in-house. Do you collect automatically via ACH?

Brad: We don't and I really should and so basically, I'm kind of old-school on that and it's just by laziness. When I started, I had a program that amortizes everything out, build statements and 1098s and all that and so, our payments are due on the 10th and the underlying payments are due on the 15th. So, we have kind of a five-day grace period there, they don't get the cash in, they get it deposited see who's going to pay or not, put some pressure on them and then the underlying payments are due on the 15th. I mean we're pretty, I don't know, 19th century when it comes to our collection processes I guess.

Scott: Man, if there was just some platform that would manage note payments, Mark.

Mark: It would be amazing, wouldn't it? If there was just some way to automate that.

Scott: Completely.

Mark: You get ACH; you do the amortization and have no note setup fees. I wish there was something out there, but wait. Today's podcast is sponsored by GeekPay.io. It is the way to automate and a one-time set it and forget it, way to automate collecting your notes. If the ACH fails, you can have a credit card on file as a backup. You're definitely going to get paid with certainty, your borrower can login, they can make a prepayment at any time, it automates notifications, it is going to save you so much time and actually with a note servicing fee, the way that we have it priced because there's no note setup fees, it's actually a profit center and doesn't cost you anything. Check it out, do the demo at GeekPay.io.

Also if you want to learn how to get to the next level in our business, you want to schedule a call with the 'Zen master' Mike Zaino or Scott Bossman at TheLandGeek.com/Training. So Brad, how did you like that little setup?

Brad: Sold.

Mark: Are you sold? Check it out you'll love it and I'm sure you have tons of notes. I think the way that we do it is it's like a buck a note after 99 notes.

Brad: Yeah, that's certainly agreeable.

Mark: It's super affordable. Anyways, back to you right? Okay, I want to do your model, what's the best way to get started?

Brad: You know, real estate is a super wide and a super deep knowledge base. So, you have to know a lot about a lot of different things and so, what I would say is this model begins the same way that almost every other model begins which is, through the marketing machine. So, we have to have effective marketing to go out and capture motivated seller leads to where we can buy equity.

The second thing that we have to understand is, how to negotiate from the front door to the contract in a way that's going allow us to buy on terms. So, I'm not a big fan of like, hey let's pay all cash for houses in most circumstances and without some form of financing. So, you know we buy subject to, we buy with true owner financing usually 0% rates because of our negotiation that we have kind of set up that structure.

Then third, you have to have the deal structure in mind while you're going through that negotiation so that you can pave the road for that seller, the direction that you want them to go. So, a lot of it is really starts with the marketing. So, if someone starts a marketing machine, they have a negotiation structure from front-door to contract and then they learn a lot about deal structure and how to negotiate it then they can be successful in this.

Mark: Scott Todd, you're ready to partner on this?

Scott: Mark, I'm ready to roll man. I'm like ready to like start cruising. Now, could I buy this through a realtor or not? Like the realtors that [00:24:45] [indiscernible].

Brad: It's tough to negotiate good deals with a third-party. You know, I am a firm believer that negotiation is best done in person and it's really bad to have a framework and a script whenever you do your negotiation. So, we have all that, I've kind of come up with across the years, but going through realtors is really, really tough.

Scott: Got you. Okay, all right.

Mark: You know what? Scott and I are kind of spoiled now, we're each working about two hours a week in our land business because it's automated. How many hours a week are you working in your note here, your house note business?

Brad: Yeah, and that's a great question. It's so funny because whenever you're in real estate, if you have your iPad or iPhone you're technically on call. So I mean, I'm on call like all the time but as far as the amount of work I don't know it. It becomes a gray area on what is work, because I'll go to the Mexican restaurant for lunch and you know, work a little bit when I'm more just having a good time. If I had to guess I'd say, somewhere around 25 hours.

Mark: Okay, all right. Well Brad, this has been really enlightening. I'm so glad that you came on to share your wisdom on this incredible model but as you know we're going to ask you for one last piece of wisdom: a website, a resource, a book something actionable where the Art of Passive Income listeners can go right now improve their businesses, improve their lives. What have you got?

Brad: This is not exactly real estate related but I've been reading *12 Rules for Life* by Jordan Peterson, and I think it's just an amazing book. So, if you're a business person or not, there's so much wisdom and insight in that book, that's where I'm sending people right now.

Mark: I love that book. That book is like a hard slap in the face, every page. There's a lot of depth to that book. It is not the lightest read.

Brad: No. It's not, but I think it will withstand the test of time and there are so much media right now that doesn't.

Mark: Yeah absolutely that's a great tip. Scott Todd, are you ready for your tip of the week?

Scott: Man, how do I stand up against that one? That is a good book by the way. All right Mark, check out this Chrome plug-in that I have like adopted and love, it's called ColorZilla, and you can Google like, ColorZilla.com and what it does...

Mark: ColorZilla.

Scott: ColorZilla.com and basically, what it is, it's like it's a Chrome plug-in, it goes up there in your Chrome browser and then whenever you want to know like, what color something is on a website. Like maybe, you're trying to do some design or maybe you're trying to match colors or something you just go and you take the eye drop, you drop it on the color thing and then what it does is it takes eye color and saves it to your clipboard. You just copy it to your clipboard and then boom, you're off to the races and you have all the hex colors that you want. So, all of our designers will like that. I like it.

Mark: Erik Peterson right now is smiling.

Scott: Maybe. He probably already knows about it though.

Mark: I know. Maybe he's rolling his eyes right now, like really? ColorZilla, that's so 2012.

Scott: I like it. I just found it and I like it.

Mark: Yeah, I think it's cool though. I've never heard of it so, very good tip. My tip of the week is learn more about Brad and his incredible model at BradSmotherman.com and if you can't spell Smotherman, don't worry about it because we're going to have a link to the page. So, learn more BradSmotherman.com and Brad, are we good?

Brad: Yeah. I mean that was fantastic. You guys can also find me on *Investor Creator Podcast with Brad,* I go through notes and financing and all kinds of fun stuff that my wife doesn't want to hear about anymore. So, you're doing her a favor by not shutting me down, you know, you guys keep listening, I'll keep talking and she will not have to hear it.

Mark: Fantastic.

Scott: That's how my wife feels I think and Mark's wife too. Like, we just might need to like get on this call more often and just talk.

Brad: It's such a fun business and it's a great thing to enjoy what you do. So I mean, I love it.

Scott: Yeah.

Mark: Yeah, I love it. It's not work, is it?

Scott: No.

Brad: No, that's why I have a tough time answering that question, it's like, I don't really know.

Mark: Right. It's like, define work.

Brad: Yeah.

Mark: Scott Todd, are we good?

Scott: We're good, Mark.

Mark: Well, I want to than all of the listeners and if you're getting value out of this podcasts, do me a favor put it on social media, send it to a friend, but the most important thing you can do to really help us out is three little things. 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 for free. So please, do that. All right Scott, are you ready?

Scott: We're ready, Mark. Ready 1, 2, 3. Let...

Mark: ...freedom...

Scott: ...ring.

Mark: Ring. Brad is like rolling his eyes he's like, "Really guys?"

Scott: We did it really, really good at the last Bootcamp though. That's all I've got to say.

Mark: It's way better live.

Scott: It's way better live.

Mark: I like it when we're not live that we do it every other word.

Scott: Yeah, I think so too. We'll change it up next time.

Mark: Right, because Brad will not come back again, he's be like this is just too geeky.

Scott: We'll get him back.

Brad: No, I'm happy to come back absolutely.

Mark: All right, awesome. Well, thanks everyone and we'll see everyone next time.

[End of Transcript]