September 2021 Update With Justin Ford

Bob Irish
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As one of our privileged members, you get access to real estate expert Justin Ford's monthly DealBook updates.

DealBook covers special situations with our network of experts in the kinds of private deals most people never even hear about.

Each month, I check in with Justin to see how his previous real estate deals are performing. Justin also discusses the latest trends in the market, what to look for when purchasing property as an investment, and much more.

You can listen to my monthly interview with Justin or read the transcript below.

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Transcript

Bob Irish: Welcome to our monthly call with Justin Ford of Pax Properties, our resident real estate expert. Bob Irish here, your *Infinity* liaison.

If you've been with us for a while, you know that Justin has been an extraordinarily successful real estate investor. In fact, throughout real estate booms and busts, Pax Properties has never failed to produce a positive result for investors or missed a mortgage payment.

I said this last month, but just as a reminder, we're going to give updates on all the properties many of you are invested in, but if you want more detail, or if you want to just skip listening to this, you can go log into paxproperties.com.

All the updates that we'll be talking about are listed there, so you'll be able to catch up there in case you don't have the time to listen to our call.

With that said, Justin, it's great to have you back. How are you doing?

Justin Ford: I'm doing well, Bob, thank you. How are you?

Bob: I'm doing just terrific. Justin, before we get into the updates, I wanted to ask you about the view, if you will, from 30,000 feet on the real estate market. I'm currently here in Park City, Utah, and real estate prices are going crazy.

As you know, I live in Delray Beach, Florida, and I've been watching the market just go up like crazy. Is this happening all over the country? Are there any pockets of value anywhere? Give us your perspective on that.

Justin: Well, yes, it is happening all over the country. We've seen similar situations before, leading up to '08. There are significant differences now, but in '08 too, a lot of markets were rising.

But what happens with this process is something like this: You take somewhere like Delray Beach, like you mentioned, which is in South Florida. If you look at Florida on the map, and you consider the very bottom of it where Miami is, imagine a thermometer. It gets hot in the bottom, where Miami is, and then the mercury rises up throughout Florida. And that's kind of how prices move, right?

So they move upwards from Miami, and then they get hotter almost immediately in Fort Lauderdale, then Palm Beach County, then you start to hit your secondary or tertiary markets, like Vero Beach.

We bought a hotel in Vero Beach in 2013, our first large hotel, while it was still affordable relative to the south of Florida, which is very hot, right? Then we bought Melbourne a couple years later, which is further up the coast. It's in what's called the Space Coast, while the rest of Florida is again getting very hot.

Today in Florida, Orlando and the middle is very hot. Tampa, just to the west of Orlando is very hot. So we've bought something recently in Port St. John, which again is up "the thermometer." But on the East Coast, above Melbourne, we got a great value recently, so we bought something tremendously below replacement costs, et cetera. And then, so on.

Now, if you're taking markets like Dallas, Texas, it's a *very* hot market right now. It's probably one of the hottest markets as far as level of activity in the country. And you have people fleeing the COVID conclaves of New York, Chicago, and the high tax, high regulation sort of worlds that are experiencing a bit of a topsy turvy political moment right now.

People are fleeing all that uncertainty and coming to Texas and places like that in the Sun Belt state. In Dallas, prices have risen extremely high, but they're still much more affordable on a fundamental basis than markets like you'll typically find in Boston, New York, and even Miami, LA, et cetera.

But still, they've risen high. They're almost getting to valuations that are similarly high as far as price relative to rents, price relative to earnings, and price relative to construction costs.

But Dallas is now this epicenter in the Southeast, but if you radiate out from that a little north, you're finding markets that are still going up. Even though they started from such a low base, you're still finding tremendous value.

Within four hours of Dallas, we're buying properties, we're putting $20,000 a door into the renovations, and our costs after renovations in good neighborhoods – in up-and-coming neighborhoods near downtown and the major tourist area cities, sometimes secondary cities – is less than $90 a square foot.

If you understand this theory that water seeps to the lowest level, what happens is your cities start to build up in markets like this where money's cheap, and we know that cheap money makes for expensive assets over time. So your cities end up being like volcanoes, and they spew all this high priced real estate activity.

But eventually when people can no longer buy there at any reasonable price, they start seeking the lower priced places. Look at the Midwest for example – places like Dallas, Texas. Right now, we're looking at something in Fort Worth, which is right outside of Dallas. It's got 170 units, and we're looking at something less than $80,000 a door.

So these pockets of affordable real estate do exist, you need to know where to look for them, and you don't want to be seduced by someone talking about a hot market, get in now, and then realize that everyone's buying and prices are going up. That, to me, is a recipe for disaster.

It's better to be anchored by the fundamentals. Can you buy at a good price relative to rent, relative to replacement costs, relative to earnings after you do your work, and are you in a market that exhibits long term signs of growth, of jobs, and population? You will find those, Bob, in select markets in the Southeast and Midwest, especially.

Bob: And that's where you're doing your shopping and investing right now, right?

Justin: Exactly. That's where we're mostly concentrating. Those price pockets.

Bob: Terrific. Thanks for that big picture view. Let's go into our properties and get a quick update on Melbourne to start.

Justin: Melbourne, again, I mentioned we changed our manager a month and a half ago. We'd won a TripAdvisor award five years in a row there this year, every year since we've been there, and now our new manager, a wonderful woman, has officially joined the Melbourne team.

She's a good salesperson for us at Vero, just south of Melbourne, and she was a good GM there, so we brought her here, and we think she's going to be an absolute superstar GM at Melbourne. She's going to take us to the next level. But wouldn't you know it, Bob, as soon as she got into her new GM role, she came down with COVID for the second time.

Bob: Oh no.

Justin: Yeah. She had it rough the first time, and then she got hit this time, and she had it rough again. God bless her, she's doing well, she's fully recovered, and she's back on the job.

Thankfully, Melbourne posted positive earnings throughout COVID, meaning it covered its debt service. And we suspended discretionary investment there for three quarters during COVID, but we resumed that on the fourth quarter, and we've been paying ever since.

I think we're paying over 8%, cash on cash, and now we're finally in a position where we're talking with guys to refinance and file a return investor equity capital for a good portion of it. Because the hotel financing market is finally opening a bit.

I'm hoping that, by our next monthly update, I might be able to report on at least a couple of term sheets from lenders on refinancing Melbourne. So we like what's going on there.

Bob: Great. Let's move up to Tallahassee and talk about Baymont.

Justin: At Baymont, we let go of our long-term GM there. He had been there about 18 months. Good guy, but he wasn't getting the job done.

And what I've been trying to communicate to our folks is look, sometimes nice people aren't the right people for the job. It doesn't matter how good they are – if we all like them, whether they're conscientious, etc. – if they're not getting the job done.

When you're at the management level, it's more than doing what you're told, right? It's also about figuring out what needs to be done. It's about having a sense of urgency.

When you keep people on just because they're nice or good guys, what happens is if they're not the right person for the job, you end up hurting everyone else involved. Everyone who's beneath them, because there's no opportunities for growth, because you're not hitting the numbers you should.

Maybe a lot of people are staying there because you're not generating the numbers that you should to support and take care of the property the way it should be supported. So you're not delivering the experiences you should be delivering, and ultimately, you're not delivering to your investors the way you should.

So long story short, we've gone through a bit of a revolving door there, and employment has been interesting to say the least. Since we fired him, we hired another guy, and that guy lasted a week. This COVID climate situation is tough.

But in any case, we're up there, we're recommitting, and we have a junior person from another hotel who's been stepping in. She's looking quite promising so far, and sometimes these situations help you uncover who your true hidden superstars are.

But we shall see. I will tell you this, though. At Baymont, the real estate value alone gives us equity of a few million dollars more than we have into it. We're probably in it for five and a half, I think our equity in there is maybe two. And I think if we sold today, we'd get two on top of that, at least. I'd say around two on top of that.

Which is nice to know when you have a hotel that just came out of COVID, that's in a market that was especially hard hit, and you know you still have a couple million dollars in equity there.

And fortunately, we were able to return a little over half of investor capital prior to COVID, and we were caught up on our PREF prior to COVID. So all in all, if we decide to exit Baymont, we can exit with a very good return for investors, and redeploy that capital successfully elsewhere.

We're listening to people who are approaching us, but as we always do, even if we were going to sell it next month, we're still going to be working to make it the best hotel we possibly can.

Right now, we have a recovery program in place, as far as we have this sort of interim acting junior GM, and we're growing the top and the bottom-line numbers, we've been positive in EBITDA (earnings before interest, taxes, depreciation, and amortization) with this property for four months now.

So the trend is good, and if we don't get it to exactly where we want to very soon, there's a serious possibility of selling it and getting equity to redeploy elsewhere. That way we can return it to investors, and they can readjust however they want it handled.

We still have challenges there, but the trend is positive, and we like where we're headed.

Bob: Okay. Well, let's move across the street to Governor's Square. I understand the bridge loan has been completed, talk to us a little bit about what's going on there.

Justin: Governor's Square was appraised at 21.3 million in a bank ordered appraisal, so it's an arm's length appraisal. We have a little over 15 in there. But I know the market value's much higher than that. We've received offers much higher than that.

In any case, we finally pulled off our bridge loan we've been talking about for a long time, and yesterday we closed on a $13.65 million loan. We started paying off all the private lenders, who had around $4 million on our balance sheet when we increased our scope of work and made it the best-in-class property in the city for a B+ property.

We paid all of them off and brought our cost of capital way down, from about 10% to around 3.75%. And then all our investors, they're getting caught up on the preferred return, so any investor who got in on the second mortgage for about $200,000 in is getting around a $60,000 check either today or tomorrow.

And then the HUD, which should close around November or December, should return, and that same $200,000 investor may get $120,000 back of his initial capital then. And if we can get them to push the appraisal up, which we think is a possibility, they might get more than that. They might get close to the full $200,000 back.

So basically, you're pulling a lot of your chips off the table, you've made good returns on your initial equity, and now the cost of your capital has dramatically gone down. So people should receive very significant cash-on-cash returns from the end of this year onwards.

Plus, if they get all the capital back, they're basically still receiving distributions; their ownership stake is never diluted in any of those cases. So they just can see consistent, multiple streams of income, because the money they get back they can deploy elsewhere – either with Pax or someone else.

And there are multiple situations where they have equity stakes and the potential to continue to grow. In fact, in our case, they should continually grow, regardless of market appreciation because we use amortizing loans.

So every payment goes to reducing our balance, and therefore increases our equity. Our tenants consistently pay down our loans.

All of this is to say we're so happy we have tremendous investors everywhere. And we're finally delivering on this long process, and paying off all those loans, and delivering good checks to equity investors, and three months from now will be even better still when we close the HUD loan.

Bob: Well, that's great news from Governor's Square. I understand you have some good news as far as Seven Hills goes too.

Justin: Yep, well, we have good and bad like everyone else. Let me start with the bad. The bad is we had a nice new manager there, this European lady who was trained and qualified and so forth, but she came in, and then she left after six weeks. Something about having to be in South Florida.

Then we bring in another guy, really nice, but at the end of the day, a bit problematic. So we let that guy go, which means Seven Hills has been a revolving door.

In this market, that's been *really* tough. But now again, Sam, our director of operations, is up there. And I don't mind going and living on our properties if I need to, to be there while we're going through transition.

And yet, Bob, through all that, we just won TripAdvisor's top award again. We won the Traveler's Choice Award for 2021. So even despite all that, our reviews are outstanding, and we'd let the homeless folks move out recently. We've been renovating those spaces, but our challenge there has been materials. As you know, there's bottlenecks in supplies everywhere at the moment.

But we have three quarters of our hotel now available to regular folks, and we're selling record numbers of rooms since the onset of COVID. And Bob, I can now say that for our last three independent hotels, all of them have won TripAdvisor's top award every year they've been in existence.

Bob: Well, congratulations. That just speaks to a job well done.

Justin: Thank you, I appreciate that. But the numbers are coming up at Seven Hills as well, and we should have that fourth building finished up in about two weeks, maybe a bit sooner.

Our head of construction is up there right now on the job, as a matter of fact. So Seven Hills is going to be the beautiful hotel it was meant to be. Unfortunately, we opened that just before COVID hit, so that had sort of a special introduction to the world. But now that we're coming out, it's starting to do beautifully, and again, we're being recognized by the public as an exceptional hotel.

We're still rated second out of 60 hotels in the market, so we like the way things are going at Seven Hills.

Bob: Wonderful, let's go to Ocala. What's going on with Equus?

Justin: Equus, again, won the TripAdvisor top award a couple months ago when we first opened up. Equus continues to post rising sales and rising earnings. I believe we're on track for about $160,000–170,000 this month with an EBITDA which will cover its debt.

We've resumed vested distributions to investors, so the trend is very positive there. And again, like with Equus, we'll be a candidate for a refi and return of investor capital, we hope, by the end of this year.

And we may have something to report on that, if not this coming monthly update, the one after that. So growing top line, growing bottom line, excellent reputation, number four in the market out of about 40 hotels, and I think we'll get to number one soon, and a good candidate for refi by the end of the year that will return a good portion of investor capital.

Bob: All right, Justin. Well, thanks for the updates. And I want to kind of go back to your view from 30,000 feet, where we opened our call, and I guess to recap that, you're finding good value in specific undervalued markets around the country, primarily in the Midwest?

Justin: And the Southeast, yeah. Even in pockets of the Southeast, that's correct, Bob. And so, the CAP strategy's about focusing on cash flow, organization, and positive leverage.

Cash flows pay your expenses. You pay your debt service, you put aside reserves, you look for some money you can put in your pocket – that's cash flow getting paid now.

Amortization is a loan that you're paying a portion of the loan down as you go, so that your tenants eventually pay off your mortgage, and then you don't have any payments to make, and so all the cash that used to go to the bank now goes to you.

Amortization is about getting paid later. And amortization increases your equity with every payment as well. So you're earning cash flow and you're growing your equity regardless of market prices rising. Even if they stay the same, you're growing your equity.

So really, it's about focusing on the things you can control, and then that positive leverage combines your amortizing loan and your cash flow in property in a way that produces greater returns without dramatically increasing risk.

This is what we do, and we add that to the element, we add buying close to or below replacement costs. That's a nice little extra margin of safety. And we're finding this in the Midwest, in Texas, and in other parts.

Again, we just invested $8 million in a property in Florida. It's in the Space Coast, away from the most heated activity. Bob, you know where Elon Musk has SpaceX.

You can find out what's going on out there, Bob, but for me, it's really about focusing on what you can control.

It's amazing. I've spoken at maybe a dozen commercial conferences, but large groups, equity groups, we talked about this last time. And what I tell people is that we have our ideas about appreciation, but we don't focus on it.

I'm surprised that even at the commercial level, people look at me and they have a light bulb moment. They're like, "Oh, wow, that's so interesting." I'm like, "Wait a second, you're part of a group that does billions of dollars."

These groups are good, I'm not putting them down, but to me, that's the core realization. The core realization is always focus on what you can control. It's a very stoic approach to investing. You may still benefit, of course, if the market appreciates and we have an asset there, we're going to benefit as well. But if you focus on what you can control, through turmoil, through good markets, through bad markets, you're likely to do well, regardless, because you're focusing on those factors.

And what happens also, Bob, is that because we're disciplined by that, it's got to meet our CAP criteria, and our replacement costs criteria, and if it doesn't, then it takes us out of that market. We're not chasing that market. We're not chasing the core Atlanta market. I love Atlanta, great market, but I'm only going to buy an asset that is close to replacement value that meets my CAP criteria.

Which explains why I can't find anything in Miami. It's a great market, and there's some guys that are going to get rich there, it's just not going to be us. We're going to do it in more of our bread-and-butter markets, where we can buy at prices that make fundamental sense.

We're finding that in the Midwest, and in parts of North Florida, believe it or not – even in the Panhandle. Parts of the Carolinas and Georgia, too. And even in the Snow Belt where people said, "Boy, that's not sexy."

You'd be surprised.

You're delivering valuable living quarters and quality accommodations to good people at a fair price and making a very strong return. To me, that's appealing. So we're finding those deals, but we combine all of this with our discipline.

We let our criteria discipline us, and we execute in the markets that present opportunities according to those criteria. The Midwest, the Southeast primarily.

Bob: Well, Justin, it's obviously been a winning formula, as evidenced by your track record.

Again, for those of you who want to dive in a little bit deeper on this, log into paxproperties.com. We've got in depth updates, and I would encourage you to go there to check it out.

Justin, anything else before we sign off?

Justin: No, Bob, it's always a slice of heaven.

Bob: Yes, it is. I'll look forward to speaking to you next month, Justin, thanks.

Justin: Thank you, Bob. Take care.