December 2020 Update With Justin Ford

Bob Irish
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As one of our privileged members, you get access to Justin Ford's real estate investment opportunities through our exclusive DealBook service.

DealBook offers special situations to invest side by side 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 what new deals he's been looking into.

You can listen to my monthly interview with Justin by clicking below or read the transcript by scrolling down.

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Transcript

Bob Irish: Welcome to our monthly call with Justin Ford, 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, and he's always on the lookout for profitable real estate investments for the Palm Beach *Infinity* DealBook, which everyone listening has access to.

You need to know that Justin is very conservative, extremely picky when putting together his deals, and as a result, opportunities to invest alongside Justin don't come about frequently, or on any set schedule.

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

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

Bob: I'm doing terrific. This is our last call of 2020.

Justin: Time flies when you're having fun.

Bob: Yeah, it sure does. I thought you could give us a quick overview of what's been going on at Pax Properties in general, and then we'll run through the individual properties and you can give us a short update on each one of those. How does that sound?

Justin: That sounds great. We're at the end of the year right now. So we look back at this COVID-19 year and it was really... Talk about your black swan event.

The year 2008 was a black swan for a lot of folks. We humbly saw it coming, predicted some things, and made provisions. We did okay.

But this pandemic was really out of the blue in certain ways, and we happened to own five hotels. Actually, when it hit, we owned seven hotels, plus an apartment complex. And hotels were among the hardest hit in the industry.

We sold two of those small hotels just before COVID-19 hit. We closed two days before the 14th of March, which is when COVID-19 really broke out. So we sold that at full price. That was good. And it was even through a friend of ours who's, fortunately, a very wealthy guy, and he's going to do fine with them. He bought them in cash, so he's not struggling.

But the long and the short is... I used to tell folks, when asked about our business, "Our modest claim to fame, is that through the boom and the bust, we've never been late on a mortgage payment, never lost an investor a dollar."

And COVID-19's been very rough, so all our equity distributions, cashflow distributions – we certainly had to halt those. We hope and expect to be back, resuming distributions, probably at the end of the second quarter or beginning of the third quarter next year.

But I'm glad to say we still have never lost an investor dollar, and we've made every single debt payment throughout 2020 as well. So it's an 18-year track record for us, and it's been quite a test, and we're quite proud that we've been able to accomplish that.

Bob: Well, Justin, you should be proud. To have come through this year with that kind of track record speaks to extraordinary leadership. So you've done a great job, given a very tough environment.

Let's start south. Let's start at Melbourne. Give us a brief recap of what's going on there.

Justin: Sure. Melbourne is just such a great hotel. The concept there is really what sets us apart.

The two-room suites go for the price of a regular hotel room. And every single month since COVID-19, that property has been making money. Not only making money, but paying its debt. It hasn't generated enough where we're distributing cash to the equity investors, but it pays for itself, which is truly remarkable.

And Melbourne used to be the beat-up hotel, the most visited place by police when we bought it. Then we turned it into an award-winner when we first opened up in 2016. The county gave us an award. For four years in a row, we won the Tripadvisor Award of Excellence. This year it's called the Traveler's Choice Award. And we've been number four in that market for a little while now. Just last week, we moved up to number three.

So Melbourne's doing really good. And we're actually reinvesting in Melbourne too. Like I told you, some of the furniture's getting a little tired, so we're reinvesting there.

Believe it or not, there's a second financing market that does finance furniture and equipment – FF&E lenders they're called – and they have pretty decent terms. We're going to borrow about $150,000 from them to buy replacement sofas. Our mirrors got sort of rusty – we're around 15 miles from the ocean. On an exterior corridor hotel, a lot of stuff that you buy, you realize, "Oh, you've got to buy something else for this environment." We're doing things like that.

In other words, we're reinvesting in the property, which is what I believe in 100%. We're long-term investors. It's not about investing one day and you're done. It's always about *reinvestment*, which is a great thing. You keep the property alive, you keep it fresh for people, you keep it strong, you keep the revenue growing, and you keep opportunity open for people involved.

So Melbourne is doing great. And I think that when we come out of COVID-19… Melbourne is like Rocket City. They've got Tesla, they've got SpaceX, they've got Northrop Grumman. I think the suites in the Melbourne property are going to take off like a rocket.

Bob: Well, we're looking forward to that. Let's talk a little bit about Baymont.

Justin: Baymont is our least stellar member of the group. But to its credit, it's always managed expenses fairly well during this crisis – very well, actually.

What they haven't been able to do is figure out how to generate the revenue. And we worked with them quite a lot on that, and we'll be making some changes soon, and there will be some important personnel changes. And we're working on that.

So Baymont loses a bit… that's manageable. We're not happy with it, but, fortunately, there's no fat in the operations or anything like that. It's just a really nice hotel, and it's the best in its category in that part of town. It should be doing better on revenue.

So we're making some personnel changes, and we're confident the hotel will return to strong profitability, certainly by the second half of 2021.

Bob: Okay. Let's go across the street to Governor's Square. I know we were looking at some occupancy rates that were stellar, and would enable a refi, so how are things going at Governor's Square?

Justin: It's going great. We're currently at 98% occupancy. We have three vacant units. We just had two move-outs. And we had one unit that was vacant for a while, because there was an electrical issue that required city permits. It was just a complicated thing, which we're finally resolving today. So we actually expect to be at about 100% occupancy in around a week.

Bob: Wow. That's great.

Justin: We're really excited. And our collections have been quite good – over 95%. So right now, we have 165 units leased, and we have about 19 of those on a payment plan, which is reasonable. We're more than happy to work with people on a payment plan. A few of those people are applying to the state for help for their rent, which is great. And there's only one, maybe two, who are sort of gaming the system – taking advantage of it.

But overall we're impressed and appreciative of our tenants, and how committed they are to honoring their obligations, as we are to them, and to our investors.

So that's going very well. We're still on track. If we exercise that discipline, we could refi now, but we want to hold off until mid-January. We think we're going to get an extra $1–1.5 million in proceeds if we refi then, because we'll have a stronger annualized financial statement to produce. But we're very happy with what's going on at the Renaissance Apartments.

Bob: Terrific. Let's talk a little bit about Seven Hills, the crown jewel in the Pax Property.

Justin: Out of 59 hotels in Tallahassee, that was one of the lowest-rated. As you know, earlier this year, Seven Hills went all the way to number one [on Tripadvisor]. We won the Traveler's Choice Award, and right now it's still holding a number two spot.

We have three of our four residential buildings still leased out to this charitable organization. It's a triage strategy, we're doing what we can. And thank goodness for them, because we pay all our bills when we pay the debt service. So Seven Hills continues to do well.

I think I mentioned last time, Bob, there was this boutique brand of Wyndham called the Trademark Collection. It's independent hotels, and they're called "soft-branded," where the property maintains its identity, but the tagline is, "Trademarked by Wyndham," and it benefits from the reservation system. They've been really courting us, making this very nice offer, even though we like being independent.

But recently Best Western reached out to us as well. And I really like Best Western. Hilton and Marriott are your number one and two, but Best Western, for the mid-scale, is a very strong brand.

It has 4,700 hotels around the world. It has a very good reservation system. It typically has very high accuracies in the market, and it also has boutique brands. It's got one called Aiden, and one called Eden. It has a Premier Collection, etc.

One of their top guys is going to be in our meeting in Tallahassee next week at the hotel, and we're actually going to take him to Ocala as well, which is about a three-hour drive.

So we're exploring that idea of teaming up. And again, in this environment, I think we could strike a deal that's really quite beneficial, because those brands are hurting as well. Unfortunately, we're all hurting in hospitality. We're all doing what we can to get by.

They'll strike us a deal, and if it's not working out, we can leave after a while without handcuffs, and without a very long timeframe. So that's very exciting because I've always respected Best Western as a brand. In all the markets I looked at, it performed quite well.

Bob: Great. Let's go to Ocala. Let's talk about Equus.

Justin: Again, Best Western's going to go there. By the way, when I say Best Western – these wouldn't be Best Western hotels, they'd be part of its Boutique Collection.

Bob: Right.

Justin: It's Best Western's high-end collection, and it's also soft branded. And the Ocala property is interested in that as well.

So we're shooting to finish the interiors at the end of this month. It'll probably be early January now, and then we'll finish everything in February.

Ocala, I think I told you, was number 13 when we bought it… in July it was 12, and it recently started to move up. It went to eight, then went to six last we spoke. It just shot up to number four in the market. It's the number-four-rated hotel by Tripadvisor in the market, while we're still under construction.

That's extraordinary and it's going through the roof. It's showing up in the business as well, in the sense that… I told you we tried to revamp our sales system a few months ago, and we basically took something that wasn't broken and kind of broke it. And now we've gone back to where it was before, and everything's going great at most of the hotels.

And at Ocala, the group sales aspect, specifically, is going great – that aspect is selling local negotiated rates to local businesses, and group sales to SMERFs. SMERFs are sports, medical, entertainment, religious, and family. That's the acronym for those types of sales.

So these group sales are doing really well. The quota for a sales manager of a typical property is five times their salary. So if they're making $50,000 or $60,000, they've got to pull in at least five times that. Above that, they start to make an incentive, or a bonus. Our sales manager at Ocala just came short of 10x last month.

Bob: Whoa, that's awesome.

Justin: This is during COVID-19, no less. Remember, these aren't normal times. And she'd bring in all these groups. We even have the U.S. Army staying with us. They book 20 to 25 rooms, around two nights, twice a month. So it's really incredibly gratifying.

Also, early in 2021, we're scheduled to finish the World Equestrian Center in Ocala, which is purportedly the largest equestrian center in the U.S. Ocala calls itself, "The Horse Capital of the World."

So we're really excited about that. We think we're perfectly positioned for all that's going on, and it's quite a growth market.

I went to Ocala around seven or eight years ago. I had a chance to buy a hotel for $6,000 per door by the highway. I was thinking, "I don't even want to come to Ocala. What's going on in this place?" It looked like nothing but cow pasture. Now I go to Ocala, and I can't make a left turn for 30 minutes because of the traffic. It's just growing like weeds. Again, the rating at Ocala is up there.

To finish those renovations, we're going to be raising about $450,000–500,000 in capital. They'll pay 8% interest, plus one point to a minimum 9%. It will be for 18 months, and then renewable for another 18 months at 9% interest, plus another point.

So when you do the math, it's between 8.33–10% yield, comes with a guarantee of the borrower, which is of Equus, Pax Properties, and myself personally, like all our private notes.

And that's what we're doing there. We think it's going to come out of the gate roaring, just the way Seven Hills did before COVID-19 hit.

Bob: So Justin, if our DealBook members want to participate in this loan, and want a piece of this loan, what should they do?

Justin: Just send me an email to justin@paxproperties.com, and they can put in the subject count line, "Ocala Note Offering."

That would be fine. I'll see it, and I'll respond. We'll send them the docs. They can review it. There's no pressure. We just send out the docs, people review, whatever they want to do, they do.

Bob: Well, that sounds great. That's a very attractive yield in this environment.

Justin: It's a very high yield, but we think we'll probably pay it off in about a year. But it's structured, if it's needed longer, that the interest rate goes up.

And we're incentivized to return it sooner to get another point for the following 18 months. But the London Inter-Bank Offered Rate (LIBOR) – a lot of the stuff we borrow based on LIBOR plus on spread, margin – LIBOR is at around 0.33%. So this type of interest rate is competitive.

Bob: It certainly is.

Last month you talked about the dealmakers and how your intelligence around the country, in terms of finding deals, has gotten much better. And also how your due diligence on these potential deals has gotten a lot faster. You've subscribed to a service which really helps you there. Is there anything interesting on the horizon?

Justin: Yeah, there truly is. I now finally have one of my guys working full-time with me on acquisitions. So he's basically now 100% acquisitions, and I'm probably right now, 30 or 40% on acquisitions. I hope to be 80% by January, because we have our operations really doing quite well at our properties.

And we have another guy coming on soon. He was overseas and joined us in acquisition. So we're able to look at a lot more deals than we were before, and we've set up processes and templates, where there are around 20 factors we need to look at, from square footage, to acreage, to market rents, to deferred maintenance issues, to CapEx (capital expenditure) budget. But there's a way to gather all the key information quickly. And also the gross rents versus the price we're likely to buy at.

We plug these in, and can quickly separate the wheat from the shaft, and focus on potential deals. So we're now seeing more deals, more quickly. We're able to quickly rule out the large majority of them, and find those few that are possible deals, and work on them intelligently.

Right now, we're looking at a 100-plus-unit apartment deal. Again, in Georgia. We talked about one last week. It's not that one – that one we had a certain bid, we didn't get it. We got the consolation prize, which is a cigar. I don't know… I'm waiting for them to send me a cigar. That's fine. We'd rather miss a deal than bid too high on a deal.

In Augusta, Georgia, we're looking at another one that's very interesting. Augusta's an interesting market. There's a military presence there. It's a growth tertiary market, which is a really interesting market. The tertiary markets are growing because you still get really good dollar-per-square-foot cost. You get good prices relative to rents. It's very different than Atlanta, or the primary or the secondary markets, that are really moving *very* quickly, as far as price going above the rents, because debts so cheap. So Augusta's one.

In Tallahassee, we're looking at another one across town from us, that's also fairly turnkey, but it's not well-managed. So most of the capital improvement there would be in the form of improving the management. We'd be improving units as people moved out and moved in, so it would be a light thing.

But we'd be buying it at 91–92% occupancy, if we get the deal. And we'd be improving it over the course of two to three years, as you have normal turnover in the tenants. But a lot of the exterior's already done. In fact, just about all of it. It really just needs good management.

It's what you call a "light-value" add. So you don't have to wait awhile until you start paying income. This property would pay distributions from the beginning, and we'd expect those to be modest initially.

If we get the deal, probably 4–6% in the first two years, and then after that, it'd probably go to 6–8% in the following two years, and then right around there, above 8% cash on cash – plus principal reduction, which is unrealized equity you're gaining.

So total returns would be in the double digits, not counting appreciation. That's how these deals are underwriting. It depends, of course, if we can buy it at the price we think we can buy at. But the really nice thing is, we're getting a chance to look at a lot of these deals, and we're being patient.

And I think, Bob, I've told you about my Jimi Hendrix philosophy on buying deals. Do you know that one? It's called *Red House*.

Bob: I know the song *Red House* by Jimi Hendrix, but I'm not sure I'm following you here. Why don't you explain?

Justin: All right, let me explain it to you. The song goes, "There's a red house over yonder way, on beyond the hill. If you don't love me, your sister will."

So every time you look at a deal, you've got to remember that. You've got your number. You stay at your number. And if that property won't do a deal, well then, we just go to the red house down the hill. That's how we do it. You always have to keep your best alternative in mind. It's part of a discipline that hopefully lets you buy at reasonable prices, and not get carried away, as if the deal you're looking at is the only deal in town.

Bob: Who knew Jimi Hendrix would be an inspiration for Pax Properties?

Justin: Here's something true, by the way. We got the Fannie Mae loan on the apartments in Renaissance. A guy came out from Fannie Mae to inspect our properties. We were renovating. He was very nice and was really impressed by what we did. His name was Jimi Hendrix.

Bob: Come on.

Justin: I'm not kidding. He didn't play guitar and didn't have an afro, but his name was Jimi Hendrix. It's true.

Bob: Oh, for crying out loud.

Well, Justin, thanks so much for the update. I guess we'll hear more about these two potential deals on our call in January, and hopefully there'll be an opportunity for some of our *Infinity* members to participate.

Justin: Fantastic. Well, I appreciate it, Bob. Always great to speak with you.

Bob: Great talking to you, Justin. Have a great holiday season, and I'll talk to you next year.

Justin: Same to you, Bob. Thank you.

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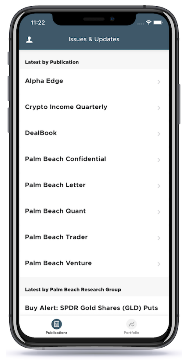

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