October 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 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.

I say it every month, and I'll say it again. Justin's super conservative, very 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: I'm doing great Bob. Welcome home to South Florida. I know you just got back from Utah, a day or two ago.

Bob: Yeah. Utah was delightful this summer – low humidity, a much nicer climate than Florida during the summer. But it's great to be back in Florida, that's for sure.

Justin: Oh cool. You don't want to miss any hurricanes in the last few months of the year here.

Bob: Well, actually that has everything to do with when we like to get back. We try to avoid the month of September, because having lived down here for 30 years, we've found that September typically is the worst for hurricanes.

Justin: Oh, that's interesting. Well, it's great to be back with you. How would you like to go over our portfolio this month?

Bob: Usually what we do, Justin, is we work the map from south to north. I'd like to mix it up a little bit today. I wonder if you might just give us a total portfolio overview, and if we need to get into some specifics on specific properties, we will do that. But why don't you give us an overall picture of what's going on.

Justin: Sure, that sounds like a good idea. So right now, we have six commercial properties – five of those six, a lot of people who listen to this call are invested in. Until recently during COVID-19, three of those were profitable, and they were profitable with paying their debt. And the other three were posting losses, mostly manageable, but still losses.

And now we're at four properties that are not only profitable, but paying their debt, and two that are posting losses. So there's been that improvement, plus two of those were starting to decrease the losses a little bit. So that's *very* encouraging.

We also have some news on the financing front: We just received from the SBA (Small Business Administration) two more loans. You'll recall previously, Bob, that we got PPP (Paycheck Protection Program) loans for all six of our properties. We did go over that quite a few times in previous months.

Bob: Yeah.

Justin: Yep. So the SBA or EIDL (Economy Injury Disaster Loan) loans – these are different.

On those PPP loans by the way, Bob, we got 100% forgiveness on every single one of them. In fact, I think there's eight in total. Six for the properties, one for our management company, and one for the parent company.

Bob: That's fantastic.

Justin: Yep. We qualified in every account as far as every measure, and we've done all that work. My son Chris has been spearheading that, so that's been a help to us during these very tough times. We didn't ask the economy to be shut down, so that was a boon that we took.

Now, the SBA loans are loans you pay back, but they're highly favorable. They're about 3%, and the amortization period is a very long period. We received two previously, and just in the past month we got one for Ocala and one for Baymont, each for $150,000.

And I think we're expecting one more soon for about the same amount for Seven Hills. Again, anything that adds to our cash coffers in these difficult times, we're happy about. So our cash flow picture right now is looking pretty good, I'm very glad to say.

In addition to that, I just sold the little duplex – the last small property I had. So that packs in more cash to support things as well.

Now, jumping from north to south, I'll go through some of the properties really quickly. Let's start in the North. Let's start with the apartments, which is Renaissance. So Renaissance, at the end of September, completed its first 90/90. Have I told you what 90/90 means via Fannie Mae, Bob?

Bob: I believe you have, but there may be some folks on the call that aren't familiar with it. So go ahead and reiterate that.

Justin: Okay. So to qualify for a Fannie Mae commercial property loan, multifamily loan, or an FHA supplemental (which is an additional loan to your existing first mortgage Fannie Mae loan) – that's what we're going for – on a property that you've recently stabilized, you need 90 days of 90% occupancy in order to apply. We achieved that in September because we had 90% in July, August, and September. So we theoretically could apply today for that loan.

That loan would dramatically lower our cost of capital by hundreds of thousands of dollars a year. It would catch us up on all our preferred return, and perhaps return a little bit of investor capital.

But when we look at where we are over the past, and what our trailing 12 months will look like going forward, we've decided that, strategically, it makes sense to wait until about January or February to go for this new loan, because the amount of loan you can get is based on the valuation of your property. And that's based on the amount of net operating income (NOI) that you produce.

Right now, an annualized NOI based on our last 90 days would be about $1.06 million, or $1,060,000. And long story short, that'd probably get us a loan around $13 million, maybe $14 million, depending on what multiple they're giving to the earnings as far as when they put a valuation on us – or what cap rate they use is another way of saying that in the industry.

So what we have today might give us a $13–$14 million loan, that would achieve a lot of what we're talking about: Reduce the cost of money, catch up on all the profit, et cetera.

But by January, February, we expect that NOI to be closer to $1.2 million, maybe a little over 1.2. And that could increase our loan proceeds by $3–$4 million. And that means that in addition to achieving all of that, we might be able to return a significant chunk of original investor equity as well.

So we decided that we're going to go all the way out to January to do that. And we're pushing like heck to lease this thing from 95%, where it is now, to 100%, and to maintain as close to 100% as we can. As older rents renew, we have to bring them fully up to market value.

Now there's a risk in that Bob, as you can imagine. The risk would be that the economy goes into the dumps, and so rent collection really falls, so we don't achieve that objective. But we think that we have so much momentum that if that does happen, one of the negative case scenarios would be that in January, we're where we are now. So we think that it's worth the risk to wait to January, to work really hard, and to go for that.

Bob: Yeah. It sounds like a risk worth taking for sure, for that big of raising your loan amount. Wow yeah.

Justin: Yeah, exactly. But $3–$4 million, no small amounts. That's what's happening in the apartments.

When we move over to Seven Hills: Still performing beautifully, thanks to the Kearney Center – the center that helps out homeless folks. Plus, our fourth building that's rented individually – we're working to dramatically increase our occupancy there. And we just got the SBA loan there, so that continues to work well.

Moving over to the Baymont: Some of the Kearney Center that we got at the Seven Hills – they're putting up different types of Kearney folks... These are called "at-risk" folks, so they're less in distress. Some of them are going to our Baymont, which is really helping our Baymont move up as well.

So we expect that the losses we've been seeing at the Baymont – that, and with other sales efforts we're working on – our goal is to get that to a break-even by the end of this month. We're working hard at that, but that would be a nice change after about five or six rough months with COVID-19.

That covers Tallahassee. If we're moving south to Ocala, we got our ACs in the other day. Supply chain disruption during COVID-19 has been really, really hard. I don't know if you've heard any about the supply chain disruption in any other dealings with the other financial parts of Legacy, but in real estate it's been a real issue with us.

So we finally got them the other day, and now we're working on installing them. We expect to have half of our property fully renovated – right now being about a quarter of it – but we'll be at half renovated within the next 10 days to two weeks. We'll have about 80 of the 154 rooms fully renovated, leased out, along with a lot of it being fully renovated. That's very good.

The other two inspections are tough. Ocala, those guys are pretty good, and they work with us. But we found out Bob, that between start and finish with the ACs, would you guess how many inspections we have to go through? Take a wild guess.

Bob: Start to finish, I'd say three.

Justin: 29 inspections.

Bob: Come on, that's insane.

Justin: I know. 29 inspections. Then when you count your ACs and finals, we're in the 30s – I mean the framing, the installation, rough plumbing, rough electric, finished plumbing, finished electric. It just goes on and on and on. We're used to managing that, but I didn't realize it was that much, and it's insane.

So we're working on all that, and we expect our goal now – given the supply chain disruption – our optimistic goal is at end of the year to be done with construction inside and out. It could run until as late as early February, but we're shooting for January.

Right now, we're moving on, and getting all the outside done within the next month and a half, by early December. So Ocala's looking up. It also advanced the one point on TripAdvisor. So, we liked the long-term outlook for capital.

And then the last one going south would be Melbourne. Melbourne continues to outperform its peers by 15–25% regularly, and continues selling rooms, again because of our superior product offering, and we put in pretty good management.

But Melbourne now has its first full month of rent receipts for our restaurant. It is so exciting. We run two restaurants ourselves, one in Vero, which we ran breakeven for a long time. It was treated as a neglected stepchild. And then we thought we'd give it our full effort in Melbourne, and that really made a difference.

When we went and gave it our full effort, we weren't breakeven – we lost $100,000. And we found out that we're not up to the job of being part-time restaurateurs. Being a part-time restaurateur is like being a part-time demolition explosives guy, someone who dabbles in demos and explosives. You don't want to do that, and it's not an easy business to treat casually. So we've done a smart thing. We closed that down quite a while ago, as you know.

And now we have this beautiful restaurant, we started to market it, and we got this great guy – The Sushi Factory. Melbourne is his third restaurant.

And we have this very lenient lease because we don't want to hold the restaurant guy to harsh terms during COVID-19, if he keeps getting restricted. So we had a fluid lease. It gave him reductions during restrictions.

But last month, the State of Florida eliminated capacity restrictions. So for October, he paid a full month of rent, which is $5,000. Plus, he pays around $1,800 towards utilities.

So all in all, we're going to post around, if we continue this relationship – well the lease is written to review it in January, and I think we will – we'll be pulling $80,000 a year, and I'm going to guess at least $60,000 of that goes straight to the bottom line, so that's good news.

Bob: Well, that's terrific, and I'm assuming that when you visit there, you can get all the free sushi you can eat, right?

Justin: No, he doesn't give me free sushi. That's okay. But I did arrange for my employees, and when it comes to discounts, I'm an employee too – I get an employee discount. I think we get a 10% discount, which is good. Because the worst thing you can do for anyone you're in a business relationship with is take a free meal. You take a free meal, and all of a sudden, they want $10,000 in free stuff from you. I prefer to pay for my sushi.

Bob: Okay, I had to throw it out there. Anything else on Melbourne before we switch gears?

Justin: One thing that's nice is that restaurant-owner might go to another property of ours. We have a hotel in Vero Beach, as you know. But he might also go there and could become a tenant of our space in Vero, which is nice. So all in all we like the way things are going, and we're fairly optimistic that we can continue to make it through this period.

Bob: Well, Justin, last month we talked about triple net leases – triple net lease investments. And I know that as of last month you were continuing your due diligence in that area. Any new opportunities present themselves to you, or what can you tell us in terms of an overview of that whole idea?

Justin: Sure. I'm seeing more opportunities arise. It's interesting. So our key acquisitions guy has now become me. I had a few folks working with me. One of my sons – actually two of my sons, but one of them has gone on to another business, which is fine. We're trying out individually for a while, testing it.

And then Chris has been with me for over three years. He's doing a great job for us. He's really busy with a lot of other things, including financing and helping out with operations. So it's me and this other guy who's also still busy, so I've been looking at more deals myself personally than I have in a long time, and I love doing it.

And fortunately I can do it because we have a great operations team in place, and we have reporting processes and so forth, where I have my eye on all this stuff, and we have regular meeting accountability.

So I'm able to look at these deals, and I'm seeing the market present more and more deals on the triple net side which is quite interesting. It looks like a slow opening-up of value, so that's curious.

Then on the apartment side, there are some deals that are starting to pop up. Bob, as I said, and I'll give you the thumbnail of it: I've had strong convictions a few times in my life about the bubble when it was happening, after the crash about the extreme value that existed, and those things worked out very well both times.

And one of the extreme convictions I have right now is that we're probably never going to see these low interest rates ever again in our lifetime – it's quite possible. And, there's still a positive spread on many apartments, and on many apartments that actually sell at prices that are not far from replacement value. So that gives you a protection against possible future competition – some cushion.

It's an extraordinary time where you might be able to buy an asset with producing a 5.5–6% unleveraged deal. It's called a cap rate.

So $10 million, it produces in an NOI, let's say $600,000. But your cost of debt is only $300,000 or 3%. That's your interest cost. And when you include amortization, maybe it's $400,000. There's a big, big spread on that. And you can amortize it over 30, sometimes 35 years.

The long, and the short of is that I'm building that team. We're about to make an investment probably soon in CoStar, which is the 800-pound gorilla in multifamily data as far as properties that are on the market, and that are off the market, and that's a significant investment.

And we're bringing to that – I just talked about a guy who was going to work for me maybe part-time, because he wants to learn this. He's an established business guy. I mean, he's 40 years old, so he's established that way – and we're going to develop some interns, some assistants, and we're going to be hammering that market more and more.

But the long and the short, Bob, is I'm very excited about the possibilities. I'm seeing a lot more deals out there. We just have to keep digging and digging and digging a while more.

I'll give you one example and then I'm ready to wrap it up. One example is the other day I was driving down to Ft. Lauderdale for a meeting. A guy calls me out of the blue on the phone – a guy from one of the major brokerages. And he tells me about a 100-unit apartment building trading in Georgia in some out-of-the-way town. But it's only 55 miles from Tallahassee, where we have three properties. And this thing's supposed to sell around $60,000 a door. And the apartments, on average just by the rough numbers, I think they're going to make $7,500 as far as rents. So you're talking about around an eight times GRM (gross rent multiplier), about eight times the gross rents.

And typically we improve things. We can move rents up a bit. But those numbers – buying at eight times rent on an asset which you already stabilized – in today's interest rate environment typically leads to exceptional returns.

Now, granted it's only a 102-unit property, so it's maybe a $6 million deal, give or take. So with leverage, it'll only be $1.5 million of equity, or maybe $2 million, if there's some CapEx (capital expenditure).

So it's not a giant deal as far as the listeners are concerned, but it's indicative of some of the deals that you can find out there. We're looking at deals ranging up to 1,000 units as well.

But yeah, I'm very optimistic. I think within the next one to two months, we may have some specific deals coming across that we'll be ready to share with people.

Bob: Well, you heard him folks, state tuned for these updates. In the next couple of months, we may see something. Justin, I share your excitement about the low interest rates. And yeah, I just wonder whether we will look back at this time and say, "Why didn't I step up to the plate?" And so, good. I'm excited about this as well.

Justin: Bob, if I can mention too, just to give you an idea what these interest rates mean. They also become a value proposition in different ways.

I'll give you an example about that:

Say, we buy that $10 million property I talked about, and that's $600,000 in EBITDA. And we put on an $8 million loan because you go up to 80%, right? So $8 million times 3% is actually $240,000 in interest that you're paying.

Say it's $350,000 with the amortization – you get $110,000 amortization, $240,000 you're paying in interest. I mean, it's over 30 years, and I'm just pulling these numbers out of my head.

But now you're getting $600,000. So you're getting $250,000 in free cash flow on $2 million invested. Please don't expect this as a normal deal. I'm giving you some extreme example.

But the point I'm trying to make is about the future. So let's talk about the future 10 years from now. I think there's a reasonable case for inflation. Everything going up – with all the money being printed, your cost of coffee, your cost of labor, your cost of petroleum – everything goes up and therefore, eventually your rents have to go up because your cost of construction goes up.

So if your rents go up to a million bucks, now you're at... let's say $1.2 million over 20 years. Your rents double over 20 years – modest proposition – about a 3% change per year. Now, all of a sudden, you're at $1.2 million. Now your property's maybe worth keeping the same cap rate or evaluation of multiple. Now your property's worth maybe $20 million. Now that $8 million mortgage we had is worth only $4 million, but it's at 3%.

Now, anyone who comes in, they don't want to put in $16 million in equity on that. But you can add to that $4 million, another $10 or $15 million, and that supplemental loan like we're doing, and we'll add it at the market rate. That $4 million at that super low 3% rate will bring down the overall cost of your debt. So your new buyer can assume that new combined loan, and it increases the value of your property.

I apologize in advance for spewing off a million numbers off the top of my head. I'm sure I had some people getting dizzy there. But the long and the short is, to summarize, that low interest rate we lock in now can help us with cashflow, and can even help us a little bit on the exit if, and when, we sell 10 or 20 years down the road.

Bob: Well, Justin you've said it all. This has been a great call. Anything else to add before we sign off?

Justin: No, just it's a pleasure as always. Great to talk with you and appreciate everyone tuning in.

Bob: Look forward to talking to you next month, Justin, you take care now.

Justin: Thanks Bob. You too.

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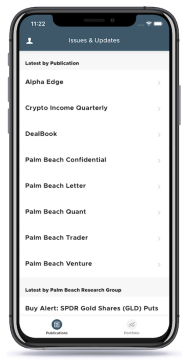

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