November 2022 - Pax Investor Update

Bob Irish: Bob Irish here with our monthly call with Justin Ford of Pax Properties. Today we're going to update you on all the standalone investments in Florida. Keep you abreast of all the underlying investments in the Cap Plus diversified income fund as well. Say it every month but I think it's extremely important given the environment that we're in right now through real estate booms and busts Pax Properties has never failed to produce a positive result for investors or missed a mortgage payment. With that said, Justin, great to have you back. How are you doing?

Justin Ford: I'm doing well, Bob. Thank you. I just got back from Oklahoma the other night and there's a big difference in weather between here in Oklahoma this time of year.

Bob Irish: So you're thinking about moving to Oklahoma, is that it?

Justin Ford: No, I love to visit it, but I'm quite happy here in South Florida with the stormy weather.

Bob Irish: Especially this time of year. Hey, let's get right to it. Let's talk Florida first. Let's start south and talk about the former Chateau ghetto. How's Melbourne doing?

Justin Ford: Well, I want to start with Vero. So Vero, which is our oldest hotel, we've had it nine and a half years, and that's having a record year. It just beat budget both on the top line by $62,000 last month in November. These are the early numbers. And we brought 30 of that to the bottom line. So that's going to come in at, heading for evident this year of about $600,000, which is a record for Vero. And the property is in beautiful, really good shape. We own those two acres right next to them that we recently bought. And we may make that an event center to also bring more traffic to Vero and that kind of thing. So that's a very interesting development.

And then we go to Melbourne, and Melbourne is also on track to have another record year, probably about $150,000. They came in very close to its budget and continues to be on track for about 28 29 in revenue and around 850 or so in operating profit. And we've had that property since 2015. It's been a strong performer ever since we finished our renovations. Ocala is amazing, that one's beating its budget again. It as beat its budget by more than $40,000 in November. And it's stays number two in the market. That's a growth market. We're the leader in our category. We're growing all the important indicators whether it's occupancy, our average daily rate and certainly Rev PAR, which is the revenue you make per available room.

So those three hotels are all doing very well. Then we get to Casa Bella, which is the former Baymont in seven Hills in Tallahassee and then Seven Hills Suite. And I'll talk about those two together because as we discussed, those two we're struggling. We've been in the red on those for a while now after we pivoted Seven Hills and we can lease out to a homeless shelter for a year. That was good for us. It paid our bills. It even enabled us to pay our mortgage and everything else. But the property is beautiful. We've reinvested, it's gorgeous. We have a staff there that's new. We even had a re-grand opening recently but we're not moving the needle the way we need to there. And it may be that legacy reputation of having hosted those folks. We shall see.

And then Casa Bella is in a similar situation that we let the flag go in August and now we're working as independent. Soon we're going to get rid of all the reviews that existed under the flag. That property physically is beautiful as well. But as I said before, the economics of apartments are really much stronger than hotels. Hotels make sense when there's strong demand in the market like there is in Vero, Melbourne and Ocala and there's demand in Tallahassee as well, but we have particular issues with those properties, but a much stronger stabilized demand. Hotels when you can buy them really cheap, like we bought Melbourne for $2 million, 238 rooms. Can you imagine like $10,000/door.

We bought Vero for 2 million. So we put 4, 5 million in each of those properties and they've been profitable ever since. But the apartments, if we convert Seven Hills to apartments, we're going to expect to be making around a little over 2 million a year in Rev apartments. And we'll bring a million dollars to the bottom line roughly as apartments. And instead of 35 employees will have about six. And it's far easier to find a good property manager than is to find a good general manager, especially after Covid or sales managers. So we've already started working with our engineers. These are guys we worked with initially when we renovated the property three and a half years ago. And the architects. So they're working on all those plans. We've already had a pre submittal meeting with the city on it.

We had everyone there. We had the fire, we had the traffic, we had the building, we had the zoning. They were all there. And then we did the same with Casa Bella, Casa Bella should bring in around oh, about a million 3 in revenue, but it should bring to the bottom line steadily around 6, 650. And that was our best year as a hotel. And that was a hurricane year. We didn't get hit by the hurricane, but it was near us. So we got all the hurricane traffic. So we think we can do like best year hospitality results as apartments in a normal year and then grow from there. And the conversion is not that significant. In other words, we put a kitchen at, we have to upgrade the electric so we can actually put out a working stove and some plumbing, and then we're going to have to do some fire and safety stuff, like a sprinkler system perhaps.

And even that sprinkler system, maybe what's called an exterior egress sprinkler system, where it doesn't have to run into the rooms so it's quicker to install. It's less expensive than the other kind. So we have that in work. So we have crews lined up ready to go. We have our materials kind of priced out already and already agreed. So we're ready to move on those two. And we just have our drawings going. The architects and engineers are working on that now. And so it's going to be a race. By January we'll know if our hotels are showing that they're going to pop back to where they should be, we'll be there. But if we get our permits by then, we're just going to start putting in kitchen X, we won't even change the use yet to apartments we'll have kitchen X so that we can have extended stay and apartments at the same time. And if we need to do the full conversion, we'll do that as well. So that's what we're doing there.

So when you look at our portfolio, it's interesting. When I thought about these apartments, I've said, why aren't I doing more apartments with my other hotels? I mean, you can go back to Melbourne. So Melbourne Bob, you've been invested in Melbourne and that's been a big producer for you. I mean, I think we've been paying you 12 and a half percent yields for quite a few years now.

Bob Irish: Yeah. I look forward to those checks every quarter.

Justin Ford: Yeah. And that's a significant cash yield. And we haven't returned capital via refi that's done your original investment. We may do a Refi soon that will start to return capital too. Again, that market has to come back, that financing market for independent hotels. It's coming back, we've had some conversation. But I'm looking at Vero and I'm thinking 238 units. Vero, which like I said, is going to do about 28, 29 million this year, bringing around 850 has 35 employees. We change it to apartments. We're going to do 3 million and we'll bring one and a half million to the bottom line with about eight employees. And that's just converting the existing and making the micro pharmacies 300 square foot studios with little work installations.

Now, when we did the pre-submittal meeting in Tallahassee, the zoning guy, he told us the Seven Hills suite is on 9 acres. I mean, we knew that of course. But he said, yeah, your density is 45 units per acre. I said, well, two of those acres are what's called water retention acres for rain overflow, storm water overflow. And he goes, yeah, but those count for density as well, even if you can't build on them. And there's a possibility that we could even build on them if we had to as well. And there's a way you can build on certain types of that stuff. It can be a little more expensive, but it would also be worth it. But the interesting thing is that land itself, you can build 405 units on it, on that land.

And I'll be working with a civil engineer soon to make sure that is indeed possible at one point, should we want to go that route, either partially or wholly. But that's a real interesting possibility there. And right now we can convert those 160 hotels to 160 apartments without any split at all, without change, without rebuilding just doing those interior plumbing and electric and fire suppression modifications. And they also have something that's bonus density, where, if you're pricing your stuff so it's affordable to people who make 80% of the average median income, it's called AMI, they give you 25% bonus on your density. So you could theoretically build 506 units there.

Now this is subject to how high can you go. There you can do like four stories. Your setback is required, but this piece of land, I'm pretty sure accommodates all of that. We're not going to that. But it's really interesting to see that because what I'm starting to do, I'm looking at all this tremendous demand that's flowing into Florida, especially into the southern and central part of Florida, like Ocala, Vero, Melbourne. And I'm looking even at our successful hotel, what I'm saying, is this our highest and best use? Could we have something that requires less work and produces more income and is more recession resistant? Apartments are more recession resistant than hotels.

Bob Irish: Exactly.

Justin Ford: So this is a very interesting, I had lunch today with a land planner I worked with down in Pompano. You remember those properties we had down there? So that same guy, we've kept touch over the years and we've stayed in touch with him and he's going to do a preliminary feasibility study. We're going to play with some of our properties and understand if we wanted to repurpose them, not all of them, but a few of them, the hotels, we're going to do that for Vero, we're going to do that for Melbourne. We don't need to do it for Ocala. Again, Melbourne and Vero are also very successful. But since we're looking at them in the terms of future growth, which we're talking about in a moment.

If we're leaving in effect a few hundred thousand dollars on the table here, half a million dollars on the table there in property and so forth, and they're more intense to manage, we're going to evaluate, should we make those conversions there as well? Make them easier to manage, make them more profitable, and give us also the space to grow with our attention being more available. So that's the story on the hotels right now. And now because apartments, I made the argument that apartments are really a much more stable business and a much more predictable business. The reason that you might go into hotels when they're cheap, like when we bought them. And the reason you might shy away from apartments is because they sell at super crazy premiums in the market we had like a year ago, right?

They were selling an enormous premium. They skyrocket. But they perform well. Like our Renaissance apartments at Tallahassee. That's at 90, I think it's 7% occupancy. We have a few pre-lease, so we're staying pretty close to a hundred percent there. We brought in, I believe, I think it was $90,000 in EBITDA last month. So that property is going to produce, it should be producing about a million and 2 in 2023. And this year it'll produce about a little over a million, maybe a million 50. And that's with five and a half employees. It's our most successful property. And one of the relatively easier to run than hotels especially. So that's what we're doing there. That covers the Florida non-portfolio market. So we're going to look at some of that stuff that should be very, very, actually all that is in the non-fund market. That's all the non fund market.

Bob Irish: Well, I gotta tell you, just from an energy standpoint, converting these things to apartments is going to enable you to not have to put so much effort into these things. That's the other part of it. The numbers are better. But your intellectual resources can be deployed on a bigger pallet.

Justin Ford: Yeah, exactly. Give us some more bandwidth, correct. Yeah, exactly. That's what we're looking for. And the ones that are, like Ocala, just that thing is on fire is doing just amazing. Again, Melbourne and Vero is doing well too, but I think that those conversions, at least we'll think about those. We don't need to do those. We'll think about those.

Bob Irish: Let's go to the underlying investments in the fund.

Justin Ford: Okay, very good. So I guess we'll start in Florida with the shopping center. Remains 100% occupied. We're still trying to get our roofing materials to fix that roof. I mean, it's been nine months that we've been, after that. They end up with, you have TPO sheets, you have what's called taper insulation. You have termination bars. The termination bars are little thin metal bars that they use at the very end of the roof. So they get all the big pieces, but you're held up because they don't have enough screws. We don't have the little termination bonus. It's a crazy, crazy market. So that's the one thing that's really frustrating there. But it continues to perform very well.

We have all our tenants perform well. I think one of our tenants, we have this weird tenant in there that's like a gambling den or something, it's like we inherit them. I mean, I guess they're called an arcade, but you never see anyone go in and out. If you ask me, it's an arcade that's kind of a bit dicey. But they're a tenant and they were closed down for a little while, I believe. And then they opened back up, but they paid their rent and then they stopped and they paid. So this is one of our story tenants. It's real estate, Bob. You're always going to get a story. I wish everything was nondramatic, but there's always an interesting twist here and there.

But overall, 78,000 square feet producing over $600,000, maybe close to $700,000 in EBITDA next year. And we have people making us offers on our out parcel. So we have two or three chains making us offers on that. We got a coffee chain, we had a hot dog chain, we had a car wash chain. I think we talked about that a little bit last month. So that continues to be just really satisfying investment. We want to do better. We want to finish putting the roof on. We want to do some other improvements, but we're dealing with these materials issues. We'll get that taken care of soon. But again, I like that investment so much. Now we've had it almost a year and a half. I am looking at other opportunities there.

And in this high interest rate market, grocery anchored retail and the right corridor, like that one has a great deal of traffic. It's got a lot of communities being built around it. It's a perfect recipe because these communities are going to be shopping nearby. And those things in the environment where the interest rates are going up today, they're presenting opportunities. The pricing is getting better and better. And brokers are calling me left and right. They're sending stuff. Before it was hard to get a broker on the phone. So we think there may be opportunities to pick up one or two of these significant grocery anchored centers and at a good price, like we did.

I mean, the one we have in Port Saint John in Florida, we own that thing for a hundred dollars, less than a hundred dollars a square foot and 10 acres. By the intracoastal even though there's a power plant there. But those types of deals we can still find. And so the silver lining of the interest rate pitch that's going on right now is that we think there's going to be some opportunities for acquisitions soon. Also apartments, we can talk about that in a moment, but speaking of apartments, let's go to Oklahoma. I was just there Tuesday through Thursday and it was like 30 degrees one day and then it was 60 degrees the other day. It was just bouncing all around. But that Oklahoma for you.

But Apex is completely done. And we finally got our electric meters in too. There was 40 units that were common metered and we wanted to put individual stuff there. And we've been waiting six or eight months or 10 months for those. And they weren't expecting them now until the first quarter of the year. We just found that they got them in. So we think we're going to get those in maybe this month or next month. So by that point, everyone now pays their own electric. And they also, of course they got bill back for some water sewer and trash and there's also small buildings for apartment insurance.

But one of the benefits of that is it's less to manage. People don't waste money when it's their meter. They don't leave the lights on and so forth. And you tend to get better tenants because they have to qualify for an electric utility account. What happens is when you're in some of these apartments or where you first buy them, they're what's called all bills paid. And you have tenants who are not highly responsible financially and that's why they do the all bills paid thing. Because if they went themselves the electric utility and so, given your credit history, you gotta give us a thousand dollars deposit and they don't have it. So it's just better for the community overall.

So Apex is doing well and we're working on that HUD refinance. So we expect to have some good news about the HUD refinance I would say by February. We expect to close that maybe in April. So the Apex R91 units in Tulsa, that deal we did renovated a little over a year. And that's going well. Right now we recently dropped down to 90% occupancy, but we're moving back up. We should be at a hundred percent again by the end of the year. We did that because there was a VA organization that asked us for some apartments that we held for them. And then they dropped through on that request. So we had a refill on that.

But overall, Apex is doing well. Then you go to Elevate. Elevate, that has been a bear of a construction project. It's been one of those boxing cracker jacks. You never know what you're going to get when you open it. And we have so many of those apartments. We had so many plumbing issues. We've had more plumbing issues there than we anticipated. We had to open floors and walls and replace cast iron pipe and chip away a couple feet of concrete in the floor sometimes to get down a few more feet in dirt.

So that has been a big one. And because of that, when you have more of those problems than expected, you're also replacing more drywall. You have more plumbing, more drywall. But having said all that you know, we get offers on that property all the time as well. That property is going to be a home run. It's going to be an absolutely home run. It looks absolutely stunning right now, the outside the ifis, the way we've changed it from that old manson that run all the way down the building. We took it off and we put in the ifis and the whole process of the ifis, you have to do the framing and you have to do the insulation and then you have to put a sheet between the insulation and the next sheet that goes on. And there's mesh.

It's really intense. And we're kind of doing it a bit in house, in that we have a contract with the crews that do it. And we've been learning and do it ourselves. And the properties look absolutely beautiful. We're just transforming entirely. So we finished, we've turned over 44 units to the manager for rent. By the end of this year, we'll probably have about 65 of them turned over to the manager for rent more than half. And the last 60 units are there are going to go much quicker because most of the units that we're working on now, and the ones we're going to be working on in the future, the second floor units. And the second floor tend to have less of the plumbing issues than the first floor did. So we expect to go much, much faster.

And the ifis thing, we're on our last few buildings, the ifis should be done this month, which is impeded also to an extent our interior renovations. We've gone up there on ourselves and we've redone some of the routes that had issues. So that has been like a renovation in the

Renaissance. Remember the Renaissance ended up being a bigger can of worms than we expected. But it ended up being an extremely beautiful poverty. When we finished for 17, 18 million, and the thing was we could have gotten 30 million at the peak for that thing, or close to a 20 or so. Even today we get over 25 million for that. But that thing is producing very strong returns. I think we're paying over 10% to investors cash on cash on that.

When we returned over half their equity. I think elevate's going to be a very similar story. So we're at a good point in elevate. I think we're going to be able to finish that in February, probably March. And then our next big renovation is Ascend which is in Moore Oklahoma 146 units. And that one, that has its can of worms aspect, but it's not in the unit so much. So it's all outside. So you have this utility room where you have your water heater and you have your chiller. So your water heater of course sends your hot water to your units and your chiller sends your hot water to your baseboard pipes, that radiate in the unit.

So we knew there were plumbing issues when we bought that, when take it and that's one of the reasons got a great deal. And we've solved a lot of those issues both right outside the buildings themselves at the pipes that feed the buildings, and then from the main building itself. But it's like, with plumbing, when you fix something in a line, if other parts are older, they can break when you fix this one because the other one is getting more pressure than it did before. And so they're breaking. So we recently placed a hundred straight run of cast iron pipe from there to the building for the chillers.

Now we're not going to need the chiller when we're done with our AC. Because when we install our ACs, now every unit will have their own heat. We've gone through with the AC back and forth. We're going to do central, but we're doing what's called mini split. It just, we don't have to upgrade the electric so much. And we found it's really quite a nice solution. We've already installed a few of them. So those will have their own heat. But recently those pipes, some of those pipes that we hadn't replaced, leaned to the buildings were breaking, the chiller pipes, the heating pipes, again, we're not going to need those after this.

And of course, yeah, I've been in real estate 20 years with Bob. The breaks always happen Friday at 6:00 PM. It's when the plumbing rates double, it's when you can't get them on the phone, it's when the tenants are going to be and of course the temperature's dropping at 30, below 30. That's when it always happens. And so we've been working very diligently to be responsible with our tenants but we played a bit of whack-a-mole there. But we've solved most of the problems and we've solved them spending far less than if we contracted other guys. There were guys who wanted to charge like $90,000 to come in and do something that. We did it in house. We took care of it legitimately for probably less than $15,000, because we understand the problem, but you can't see everything underground.

But the units themselves, Bob. The units are mostly just cosmetic. We don't have to go behind the walls. We're just doing basically countertops. We're keeping most of the cabinets. All the cabinets are good. We're refinishing them. We're putting tile instead of installing a whole new carpet. But it's big tile, kind of a whole new [38:26 quartz], I mean to say, but it's large pieces, like 32 by 32 inch pieces so it kind of looks that way, but it's just a much faster renovation. And still, the unit transforms because we take the popcorn, we put smooth over it in the common area. So you have that nice clean look. You have the crown molding, you have the new appliances, you have the new countertop.

You have your new hardware on your cabinets. We pop the old sliders. We have new French doors. So it really does look elegant. We have our floors going down. We used to do tile floors, but we're just doing the vinyl and people like it. And the vinyl, it's like a wood plank floor it looks like. And then there's carpet in the bedrooms. So that's moving fairly quickly. We've turned over I think including today or tomorrow 17 units. We have another 8 coming, we expect next week. So that'll be 25. So we once we get all those ACs in. Our main issues as far as the plumbing and the heating stuff goes, are pretty much we think solve. So that's moving fairly well. And it continues to, previously it was paying for itself even under renovations. Now it's about break even or maybe we're a little bit in the red because we're taking work units under construction, but we're going to keep it at a small minimum.

But I recently met with someone we're going to keep it by small minimum. I mean, we're going to keep it around 20 units vacant, 20 to 22 vacant. Right now we have a little bit more than that because we just took out a new batch. So we can keep it sort of cash flow positive while we renovate. But I just met this big construction group out of California that's part of a group that I'm in this business organization called the Entrepreneurs Organization or EO. There are similar organizations people heard of, like YPO, like young professional organizations, that kind of thing. It's a really great group. I've been in it maybe seven years and I think I've learned a great deal from it. And I've met amazing people, a lot of good friends there as well.

So someone from EO Chicago connected with someone that I know in Florida and this construction company came and visited me. And these guys do thousands of turns and they do thousands of renovations. And we're talking in a price budget that's not too far from what we do ourselves. This guy's coming back in a few days as well, he's going to value a few things. These guys may be able to turn this stuff for us much, much quicker. We'll take a portion and they'll do a portion. Instead of doing, as we're planning about 15 units a month w may be able to triple that. We shall see or at least double that. So we're taking a hard look at that. But that as well, the demand for it is very strong. So we think that's going to be another very, very successful apartment similar to Apex and Elevate

Bob Irish: Well, that's a great report Justin, I want to ask you, you mentioned earlier this high interest rate environment is not necessarily a bad thing for Pax properties. Are you seeing some really good opportunities out there? And if so, do you have enough capital to pursue them?

Justin Ford: So yes and no. Yes, we're seeing things and I mean we have the capital, we could go after it, but the higher interest rates, you look at the shopping centers I was talking about a moment ago. We're now seeing some really good grocery anchor centers where the WALT, that's a triple net term that means weighted average lease term. So if you're buying a shopping center, the first thing you want to do when you're looking at a shopping center is you want to look at your anchors. Who are they? How strong are they? And how long is the lease remaining? So when we bought Port Saint. John's, that lease was coming to an end, but it renewed, you know while we were supposed to run, it was contingent on it and they did.

So our anchor, Win Dixie is going to be there for another 10 years. Guaranteed. And also Win Dixie was the second one also, planet Fitness. Those guys were there for, they had another five years and everything else was full. They were local mom and pops. So that was a very strong lease profile on a property that we bought at a very good price. So typically when you find a shopping center like that, that's inexpensive, the anchor may have only three years left or two years left. And if you look at the market, you may see them, oh, they might pull up stakes and leave and now you have to get a new anchor tenant there and that kind of thing.

But now I'm seeing like strong locations, where the anchor's been there for 25 years and he's still got six or seven years left on this lease right here. And you get a piece of data, which is called basically same store sales. And so if you're looking at, like the grocery we have, they're doing 20 million a year and then they grew to 22. And you can see their history. So you see them growing, growing, growing. And you know what they're paying, as an actor, they get a very low price per square foot. It was negotiated a long time ago. So the economics for them are so favorable that they are almost certainly going to stay because you see them growing.

And even if you had a re-tenant, you knew they put a new tenant there. And that wouldn't happen at Port Saint. John, of course because we have 10 years left. But the demand is so strong because you can see the growth in the houses around you. You can see the growth in that same-store sales, you can see all those types of indicators. Usually when you see those strong indicators, you see very high prices. But right now we're seeing those types of profiles and really priced well, where we can get those types of things with a seven cap, seven and a half cap, we can put in financing that's maybe probably five and a half, maybe 6%. But there's financing out there that we can put in that we can lock it in for four or five years.

But we can structure it in a way where we can refine two years without paying a dramatic prepayment penalty. So that we can, two years from now, if we buy something like that, we got a good cap rate, everything's going. You have influx in population and so forth supporting the area. Now all of a sudden your interest rates come down. We can refine a few years. If they don't, if they keep going up, we're still fixed for a while, 5 years and then it can even adjust. But even there, we know what our max is because it'll be a five and five year loan, a five that resets for five, often not always depends on the lease. But we're seeing opportunities that you just didn't see six months ago and certainly not a year ago.

And it's the same with apartments. We're now seeing apartments that are fully occupied, 90% plus or something like that, that are in decent shape, that the mostly cosmetic renovations that you can pick up at a six cap. And you couldn't touch those. You couldn't get those in a four and a half cap a year ago. Those are the far and few between deals. So over the next month or two, we may be sending an offer to our investors if they want to put more equity in the fund. I will tell you this, the way the docs are written, we raise the price two quarters ago I think it was. But new existing investors can always get in at the original price. So any existing investor wants to recapitalize, we'll still get the same equity for the same per dollar equity that they originally got.

But we're watching and we're looking, we're also taking care of these new conversions. We're making sure we're taking care of what we have, but we do think that those opportunities might arise soon. So folks might want to be aware that they could be getting an email that if they want to put some more money in the fund that opportunity may arise.

Bob Irish: So the word is keep your eye on your inbox because this could be coming down the pike. I'm sure you'll have more details on this when we wrap things up at the end of the year. Anything else you want to cover before we sign off?

Justin Ford: No, I can't think of anything. I just wish everyone a really peaceful and enjoyable holiday season.

Bob Irish: Well, that's great Justin. I just want to say one thing before we sign off. I am so grateful to have money invested in something that's producing a positive result that has nothing to do with this fricking stock market. So thank you for that. Catch you next month, Justin. Thank you.

Justin Ford: Thanks Bob.