

August 2021 Update With Justin Ford



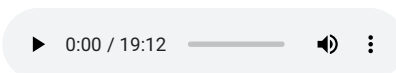
Bob Irish
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14 min read

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.



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 Justin has been an extraordinarily successful real estate investor. Throughout 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, it's great to have you back. How're you doing?

Justin Ford: I'm doing well, Bob. Thank you. It's great to be back.

Bob: How are things going at Pax Properties? I'm looking forward to the updates on the existing portfolio. But I think we mentioned on our last call, the updates on all these properties are available on your website. Isn't that right?

Justin: That's correct, Bob, paxproperties.com. Subscribers will have to log on or they can create their own password and just enter their email. And then they'll be able to see other reports we're putting out on our existing portfolio in more detail.

Bob: That's great. So folks, you can tune out right now and just go to the website and read all about it. Actually, we've got some interesting stuff.

Justin, I know you were just at some sort of a real estate conference in Atlanta. And once we get through our updates, I'd like to get your sense for what is going on in the market. What's the pulse, what's the temperature out there?

But let's go to the updates first. Why don't we start, as we normally do, in Melbourne, Florida.

Justin: Melbourne continues to do well. Last month, I told you that we let our GM go after a while there. She actually had performed fairly well financially, but I saw that it was at the expense of the quality of the upkeep of the property. And the quality of the state of the property.

We did win TripAdvisor's top award a few months ago for the fifth year in a row. But when I went to the property, as I mentioned last time, I didn't like a lot of what I was seeing. So we let her go, and we brought on a superstar new manager. She did remarkable things at another property we have, Vero Beach, which is not part of this call usually.

But anyhow, we're now projecting about \$256,000 of revenue for August. And we expect to bring about \$74,000 to the bottom line. In July, we had another strong month. We had something a little bit less than that, \$200,000 and change. And I think the EBITDA

(Earnings Before Interest, Taxes, Depreciation, and Amortization) was around \$60,000 or so. So we're coming out of it very, very, strong.

We expect Melbourne to have a strong return. Our hotels were really significantly impaired by COVID up until a few months ago. They still are to an extent, but it's dramatically changed. We do expect by the end of this year to have a very, very strong trailing 12 months (TTM) operating profit, and be able to qualify for significant refinance there. So we like what's going on in Melbourne, especially with our new management in place.

Bob: Okay, great. Let's talk about Baymont.

Justin: The Baymont was also struggling for a while. When COVID hit, it was down in the \$60,000-70,000 range in sales. In February this year, it got to the hundred thousand range for the first time during COVID.

And now we're at \$130,000-138,000 that we're projecting for August. That's after \$132,000 from last month. We're on our fourth month in a row of operating profit in Baymont. So we're not where we need to be, but the trend is certainly strong. Sales are growing, and we've got four months of real profitability.

And at the Baymont, we have two new managers starting: the general manager and a sales manager. The general manager is a guy we scooped up from down the street. He was at the Wyndham Garden Inn, and he always had his parking lot full. He was really good at bringing in group business.

We're projecting \$138,000 for August, and this gentleman will have started by the time this call is broadcast. He's projecting that he can bring that to number up to \$200,000. And I believe – given the strategy he's talking about – we'll have a good chance of doing that.

The trend has been very positive at the Baymont for the last four months as far as profits and sales go. And I really like what things are looking like as we move forward.

Besides this gentleman, we're also bringing on a new sales manager, and she comes from Marriott International. She was at a property in Georgia, and her parents moved down to the panhandle of Florida. She didn't want to be too close to them, but she wanted to be close enough, so she moved down to Tallahassee. She's joining us this week, as well.

I think the Baymont could have its best year ever in 2022, alongside a really strong third and fourth quarter this year.

Bob: Excellent news, Justin. Let's talk about Governor's Square. I know that on our last call, you had been receiving some unsolicited offers to buy the property. And I know that, while you would like to hold things forever, if the bid is high enough you've also got to consider that. So where are we on that? And I know there was a refi happening, as well. So bring us up-to-date.

Justin: The refi is scheduled to close this Tuesday. The bank appraisal for that property came in at \$21.3 million, which is about six million more than we had invested in it in total, including all our capital improvements.

And in this market, bank appraisals come in under market transaction value, for sure. We received an unsolicited offer at \$22 million, a few around there. And I'm speaking to some of the top brokers – who I've known for seven or eight years – so I know which guys blow smoke, and which guys tell it like it is.

I'm only talking to people whom I greatly respect, and who I've seen produce, and they're not full of hype. I may give it to one of these guys to market. After we secure our bridge loan and before we close our HUD loan, in that intervening four months.

Bob: Right.

Justin: I may have them market it for two months. I have a high level of confidence that we're going to receive a number of offers above \$22 million. And there could be a number of offers significantly above \$22 million.

Again, I don't want to be too specific on the price to raise hopes to any great level. We will see. We love owning that property forever. If we put that HUD on it, we'll return 75% of investor capital. The cash-on-cash yield of holding that property should be 15–20% a year.

Bob: Wow.

Justin: Because our cost of money that we wanted to invest can be around 3%, our revenue's growing. Governor's Square has 100% physical occupancy right now.

We do have issues with collections because of COVID, but a lot of those issues are covered by the CARES Act and others. About a third of our tenants were in arrears because of COVID. But of that third that's in arrears, a few of them are only minimally in arrears, and probably half are well-covered by CARE payments.

And then the others, we're working on. But Governor's Square looks very, very promising. Either we're going to have a great asset that's going to be refinanced at very low cost, owned forever (or a very long time) with great cash-on-cash, or we're going to have a surprisingly early exit because the offer, to borrow Don Corleone's phrase, is just going to be, "Too good to refuse."

Bob: Let's move to Seven Hills.

Justin: We pivoted strongly on Seven Hills. We rented to the homeless organization throughout lockdown, so we were able to remain profitable throughout COVID. We covered our debt service throughout COVID, and that was great because our particular section of the market was hit very hard.

All the competitors went down, from an average RevPAR (revenue per available room) of like \$55-60 in our composite down to like \$15. It was decimated. But we stayed profitable by making our pivot.

We let those folks go at the end of March, and for the last few months we've taken a hit back and we've been renovating. We know that the guys that were in there didn't take the best care of the place, so we've gone and spent another \$300,000 on fixing it up.

Of that, we expect the homeless shelter to come up with about a \$100,000. So we'll be \$200,000 out of pocket, which in the grand scheme of things works, because they kept us afloat for a year during the worst market in history.

And now we've done about \$50,000 in sales per month over the last three months. And this month we're at \$75,000. Initially, we needed to average about \$250,000. That's where we're originally budgeting at. And in September, it looks like with graduations and so forth, we may be back at \$250,000.

We have some bookings coming on. The key issue is all the supply chain shortages. Replacement mattresses for three buildings were promised to us a month ago, and then it was moved to three weeks ago, and then to today. Everything keeps being pushed back on everything; the windows, the mirrors, we're dealing with a lot of pushbacks.

We may go borrow some mattresses from Baymont because they have 134 rooms. And if they sell 100, they're doing great right now. We still think we're going to get a delivery on the 13th of this month, which will put three of our buildings fully back in commission –possibly all four – by the end of this month.

In which case, I believe September will be a \$200,000 month, which will be a great month, and it will bring a significant, \$75,000-80,000 to the bottom line. And if we hit the full 250, which I think we will, we'll be back having a six-figure profit month, which is extraordinary.

Bob: Oh, okay. That's great. Let's finish things off and talk about Equus over in Ocala.

Justin: At Equus we had our grand opening in July, and Equus is growing its profits every single month as well. It is projected to do \$150,000 this month. Usually we project conservatively in the beginning of the month, and then it grows.

For instance, last month we did \$160,000 in sales, and the profits are just starting to grow. At Equus, I believe we have had four months of rolling profit since we finished our renovations in May. Equus is still number four in the market.

Again, I think we'll get to number one soon. I believe that Equus should be posting over \$200,000 average in sales, starting in the fourth quarter, from September onwards. And then the trend is positive. Both the top and the bottom lines are growing, and our reviews are excellent.

Bob: That's just a great update.

Now I know that upfront, we promised folks a little bit of your very general insight into the real estate market. You were just at a conference in Atlanta, right?

Justin: Yes. I was invited to speak at the IMN (Information Management Network) Conference. You can look them up, I can't remember what it stands for, but I've spoken at nine of their conferences. And next month in September, I'm speaking in Rhode Island at a private equity conference as well.

It was on commercial real estate. And so in Atlanta, I hosted a panel and we talked about cashflow versus appreciation, how COVID affects things, et cetera.

Well, there are guys, like one guy in my panel who had like 15,000 units, and they're buying C+ class properties in the Carolinas, and the cap rates they're paying are in the threes. So the lower the cap rate, the higher the multiple. It's kind of the opposite of the price-to-earnings (P/E) multiple.

So if you're paying P/E of 20 on a stock, and then a month from now, it's the same stock, but people are paying a P/E of 30, they're paying a much higher multiple of earnings. And it's the same thing with the cap rate.

A P/E of four basically means they're paying 25 times the earnings for C+ property. That's generally unheard of. But now, they're paying like 28 times earnings for a C+ property in the Carolinas. With multifamily homes especially, the valuations are going through the roof.

And that's why I want to look at our best-in-class Tallahassee Renaissance Apartments. I think for certain that we'll get quite a few bids in the low four cap rate range. And with a net operating income of almost 1.2 million trailing, that creates a *very* significant money. The kind of offer that might be hard to walk away from.

There's also just tons of cash in this market. There's debt, there's equity, everything. And everyone's looking for a home because everything's gotten so expensive. So people are buying these things at three caps.

At PAX Properties, we always guide against that. We try not to be seduced by greed, or mania, or desperation to buy another deal before the market goes too high. We try to stay tethered by our fundamentals, the cap strategy by cashflow with an amortizing loan, and combine them so that they produce a positive leverage, which increases your return without dramatically increasing your risk.

The way we're doing this is what we've always done. When we look at things, we looked at tertiary markets, secondary markets, some of them that are stealth growth markets, and the ones that have consistently grown in jobs and in income over the short and long term.

But they're not the ones you hear about all the time. And you buy these properties, and we have properties where we're looking at where we might have to put in \$20,000 per door in improvements.

And yet even after improvements, you could be looking at \$85 a square foot. So you're way under replacement value. You have that margin of safety. You're not bidding at these crazy numbers, where if everything comes down, you paid way over the fundamentals. We're always tethered by the fundamentals.

I also had this one gentleman from Teaneck speak to me. He was a really funny, interesting guy. And in 2011, he talked to his uncle, who's in the banking business. And he said, "Hey, I want to lend money." So he lent \$150,000 on a house.

He was very nervous he wouldn't get paid back, but the guy sold the house and he got paid back.

He said to me, "Well, Justin, since 2011, we've lent a billion dollars, right?" So that guy had that real trajectory of growth, and it was exciting to hear. And we have a more modest scale projected growth like that. But he also said, "Justin, today I'm sitting on \$200 million worth of equity. And we're fine. We're looking for homes to put into place."

There were so many other people like that who came and sat down with me, talking about investing with PAX on an institutional level. Family offices where they write \$5 million checks, institutions where they're at minimum, and the smallest check is \$10 million.

And the thing is, Bob, that there's money out there. As you know, interest rates are *very* low.

Bob: Right.

Justin: It's a little different than 2008. In 2008, all you needed was a pulse.

Let me take that back. You probably didn't even need a pulse in 2008. All you needed was someone to sign your name on a piece of paper, and you got a loan, right?

Bob: Yeah.

Justin: Now, the banks are a little bit more diligent, but the money is flowing and it's cheap. And cheap money over a long time creates expensive assets. So we're always looking to be really focused on being disciplined by the cap strategy, cashflow, amortization, and positive leverage by keeping at or below replacement value.

The last few properties we bought in the last few months, all of them are anywhere from 15 to 30% below replacement value. And they were all at 85-95% accuracy, when we bought them.

But you have to go into the second third of the tertiary markets to find those kinds of deals. And you can still combine them with this ultra-low long-term leverage and create really strong returns. So I think it's a very interesting market. And I think investors should be aware that, even in this market prices are just shooting up very rapidly – everything from homes to apartment buildings, to warehouses, storage, all these things.

But if you are truly careful and selective, you can still make decisions that are tethered to the fundamentals. And you're much, much more likely to have a positive outcome.

Bob: That's exactly what you're doing at PAX Properties. That's what you've done in the past, and that's what you're doing right now. And that's the big difference between what you do and where this hot money is going, right?

Justin: I believe so. We like to focus on the things we can control, so we never bet on appreciation. We have our suspicions of what may happen and what may not, with all the money out there, with inflation, etc. But we focus on what we can control.

Once we own a property, our price point is set. Once we fix our debt, the price of money is set. Now it's up to us to execute according to plan. And that's where we like to be.

Bob: All right, Justin. Well, that's a really interesting perspective on the real estate market right now.

I just want to remind all of our subscribers: I know we kind of went through them relatively quickly, but they can get more detail on every one of those properties by going to Justin’s website, paxproperties.com, and logging in. Justin, anything else to add before we sign off?

Justin: Nothing else, Bob, always a pleasure and I greatly enjoyed it.

Bob: Okay. Nice talking to you, Justin. We’ll see you next month.

Justin: Thank you, Bob.

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