Bob Irish Transcript

Bob Irish: [00:00:06] Bob Irish here with our monthly call with Justin Ford of Pax Properties. Today as we usually do, we're going to update you on all the standalone investments in Florida and keep you abreast of the underlying investments and the Cap Plus Diversified Income Fund. I'm going to say it because I say it every month, 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 good to have you back. How are you doing?

Justin Ford: [00:00:38] I'm doing great, Bob. Thank you. I know you just got back from a trip. I believe after Tahoe, you went to France?

Bob Irish: [00:00:44] Yeah, yeah, I was just in France for about ten days. My wife has some friends who are renovating a chateau. Not the chateau ghetto, but a chateau which is in a big state of disrepair. It did remind me of Melbourne a little bit, a little bit, but yeah, we were there. We spent a couple of days in Paris, saw some great art, visited her friends and it's good to be back in the warmth. It was 40 degrees and raining most of the time we were there, so I don't recommend Paris for Thanksgiving, but we were there. The airfare was cheap and we ate some very good croissants.

Justin Ford: [00:01:28] [Excellent]. Welcome back and could you impress us with your French or do you want to leave that for the PDF version?

Bob Irish: [00:01:34] I had seven years of French in high school, and so you'd think, hey, I can say silver play, and talk with the best of them, but actually I haven't used my French since then, and so I was at a loss for words in many, many situations.

Justin Ford: [00:01:59] Very rare for you. And seven years in high school is a whole story by itself. We got to hear about that one time.

Bob Irish: [00:02:05] Yeah, there's some interesting stuff there, but that's not what we're here to talk.

Justin Ford: [00:02:11] Oh, we're not, we're not. Let's get on to them quickly.

Bob Irish: [00:02:13] Let's switch it up a little bit today. Last time we talked, we were talking about the two pivots. We're talking about the two hotels in Tallahassee that we're going to convert from hotels to apartments. So what's going on there? I know you've got some updates for us.

Justin Ford: [00:02:33] Yeah, well some good and some extremely frustrating. On the good part, our permits are in. We've got our first set of comments back. They were supposed to give us priority, which is above expedited permitting because the city's behind it. They seem to be moving not as quickly as we want, but they're moving more quickly than most. So that's the good side. The bad side is we had that loan, you'll remember a few months ago, I was talking about doing a participation loan and funding the conversion [capital]. And we got a lot of people who responded. They were interested. But then we ended up with a really strong institutional offer, $16.5 million for both the hotels. It would pay off all the debt and fund just about all the construction. The rates were high. It's what's called a bridge loan. And of course, in this market, even normal rates are high for stabilized properties. But we went through all the reports, the appraisals, everything else. The guy came up, I met him. They loved the properties, especially Seven Hills, which is my favorite probably of all our properties, period. It's just so gorgeous. And sure enough last minute again, we get left at the altar. They only want us to finance Seven Hills. They didn't want to finance Casa Bella.

Justin Ford: [00:03:50] They were concerned with our lease up, the ability to lease up that many units in the market. They pointed to a comparable property, Alterra, that converted hotel to apartments. And they took a year to get up to 85%, which is not bad actually. It's actually quite good, but that was really an excuse. The guy I'm working with, he thought they really were just trying to explain away internal problems, because a lot of these banks, they're dealing with their own issues. There were Silicon Valley Bank, there was Republic. And those caused us at least to re trades, people who were committed and then changed. This one, we don't know what the issue was, but so Casa Bella they're not refinancing. And Seven Hills, they cut down the loan from 9.5 to 7 which basically means we have to fund all the construction ourselves. Plus they often have these terms I'm waiting to see that makes you put aside a bunch of cash. So now you have to also add more cash to that mix. It's like a friend of mine said, he goes, in this market, the new definition of secured financing is you give us all your cash and we'll lend it back to you at 12%.

Bob Irish: [00:05:00] Yeah.

Justin Ford: [00:05:04] The terms are insane, but being as don't like to be have only one choice, we shop this deal to quite a few people, and when we chose the lender who left us at the altar, whose name I feel like mentioning, but I won't. When we chose them, there was another second best offer, and there were a few other people were interested, so we've already gone out the second best offer guy. They decided they're coming back. I might have the LOI in my email. I checked this morning. I didn't see it so we do think we're going to get maybe two separate offers instead of one. Maybe we'll get one. We're not sure. Again, we already have the appraisals. Then we have the new appraisals. We have the survey, all that stuff. With any luck, we could still close on the loans before the end of the year. But luck like hope, is not a good strategy. And so we're going to work very diligently a few angles at once. And there is a slight possibility that we may have a participation mortgage again for investors. And I don't know if you remember the details of roughly what a participation mortgage is, Bob.

Bob Irish: [00:06:17] Well, I remember the rate was eight plus a point, and there was, I think, an 18, 12. If it wasn't done in 18 months, it was another point or something like that. Well, why don't you?

Justin Ford: [00:06:34] Actually basically that's exactly right. Plus they would participate in the upside. The upside would be after the current equity investors and after the current equity investors pref. So they would get some ownership and that ownership would only come out on my end. So no investors would be diluted, but those details will share again if and when we do decide that that is really the way to go. We're hoping some of these guys who are on deck will step up, because we'll be able to close more quickly and start getting to work. But we shall keep you posted.

Bob Irish: [00:07:05] Okay. So we'll find out more next month on how it's gone down with these other lenders. Hey, let's shift gears. Let's go down the coast. Let's talk about Vero Beach. How's Vero Beach doing?

Justin Ford: [00:07:20] Vero is doing extremely well. And it's been beating its index again. It was crushing it first half of the year then it sank for a while. It was doing okay. It was always profitable. But it was underperformance index a little bit. Now we're back up on top. It's got zero deferred maintenance. And we have to refinance that because we've had a mortgage on that for about eight or. We've owned a little more than ten years. Current mortgage was something like eight years we've had on it. And the bank that had it, we had a great relationship with. We had something like nine different loans on them. They would invite me to one of their board lunches. They invited me to become a shareholder. I did all that. And then they were bought by another bank. That other bank doesn't want independent hotels, so they don't want to give us a new loan which is fine. We're profitable. It's profitable. There's low leverage and all that and that kind of thing so today I'm at a conference. Right now I'm at the Rusty Pelican. I'm at a real estate conference on Biscayne Bay. It's a beautiful restaurant. If you haven't been here, Bob, you gotta come down. It's great. I've been here a few times. So I'm taking a break from the panels right now. And while I'm there sitting at the panel, I meet a couple of bankers, and they do this kind of financing. And they're exactly the right bank for this type of asset.

Justin Ford: [00:08:33] Every asset is the right type of lender. For independent hotels, it's local banks. That's perfect. And small local banks, even better because they're not as competitive going after the big guys don't have as much money, they have to syndicate it, etcetera, etcetera. But this fits right in their wheelhouse. And I tell you, this guy gave me his card from this bank, and then he kept asking me for my card and I said, better yet, the package is in your email already. I had like ten docs in his email and unbeknownst to him, I shot went to the woman on the other table right next to us. So I expect a refi in Melbourne. We've already returned 80% of your capital quite a while ago. We've returned. We've averaged like over 50% cash on cash returns for years and years on that. We have unrealized capital gains significantly in there. But we're going to refi that soon, which is good. And we'll try to negotiate a thing where there's low prepayment penalties. So if two years from now rates are significantly lower, we can go into another loan without a heavy cost. So we're doing well overall.

Bob Irish: [00:09:40] Wow that's great to hear. Listen we usually go to Melbourne from Vero, but I want to save Melbourne for last because I think there's some pretty good news or potentially good news on that. Let's go back to Tallahassee or why don't we go to Ocala. Let's go to Ocala.

Justin Ford: [00:09:58] Equus. Yeah. So Equus, we also just signed an LOI for refi there. So Equus has been performing well since we, I think we finished renovations there about almost two and a half years ago. And since then, we've been paying a good prep. I think our prep is like 10%. We're paying on that cash and cash. Of course during COVID, we didn't pay anything so we have a few quarters to catch up there, but this refi will get prep all caught up on all investors. It may return a little bit of equity too, but not much. Usually we return 50 to 75% when we do a major refi. But again, given the current market, you're not at 5% interest rate. You're at 8% interest rates, you're not 75% LTV, you're at 60% LTV. Everyone's expensive and cautious. I don't necessarily blame them, but the top line and the bottom line at Equus keeps growing. We're finally doing a refi. Get us all caught up in profit, return a little bit of equity. That market's still booming. So Equus is galloping, if I may use a metaphor.

Bob Irish: [00:11:13] Of course you may. Let's talk about Renaissance. What's your occupancy rate there now?

Justin Ford: [00:11:21] I'm sorry [didn't] check for this call, but we should be around 97, 98. We have a new manager. That was just wonderful so that's performing well. And she's pushing rents. I love that. I love when a person just steps in even when you don't ask them. All of a sudden they turn around, they tell you you're getting 7 or 8% more in your units than you were before. And that's huge. Because if you look, our rent roll is like $2.2 million. No. Yeah. Let's say 2.2 after budgeting 7.5% for vacancy collection losses and so forth. So you're around 2.2 million. So if you push that 7%, that's 150,000 roughly let's say. That whole 150 goes to your bottom line.

Bob Irish: [00:12:05] Right.

Justin Ford: [00:12:05] Yeah. And if you're let's say 6, let's call it five cap to make the math easy. That's $3 million in value you basically added. It wouldn't be that, but let's say it's at least 2 million. So the caps nowadays are probably closer to six on that one so Renaissance is going well. And I really love my apartments and I love my shopping center. Many fewer employers, a lot less employees rather, a lot less stuff to manage. And fortunately, Renaissance is going well.

Bob Irish: [00:12:38] Wow, that's great to hear. What do you say we leave the state for the time being and head to Oklahoma, specifically Tulsa, one of your favorite towns?

Justin Ford: [00:12:50] I love Tulsa, it's such a great town. And I love our little property there, 91 units. I think we're 95 to 96% vacancy. We're giving a fresh makeover to two units that we never got the full renovation on. We have some lingering things. We've lingering for a while. It's really a question of manpower, but it doesn't prevent us from operating. There's a couple small things. There's some railings. We have to kind of shore up, but they're safe. But we have to change the code. There's a balustrade that has to be shored up, and there's that final electric hookup we have to do on the new meters. But all that stuff doesn't prevent us from operating. So that's really just a question of we have just finished two major construction projects and getting the manpower out and allocating it, but it's performing beautifully. We were up for an award. We didn't win it, but was at least glad that had a chance to have our team out at a night at a round table with open bar or something at a industry association.

Bob Irish: [00:13:50] We're talking about Apex now, aren't we?

Justin Ford: [00:13:53] Talking about Apex Apartments in Tulsa. That's right.

Bob Irish: [00:13:56] Yeah, yeah.

Justin Ford: [00:13:57] Elevate, we're up for another award. That's Oklahoma. So we might as well switch over there. I think that dinner happens in like two weeks or something. So hopefully we'll get the recognition there where we've gotten the hotels. We've won 13 of Tripadvisor's highest awards. 13 times we won community beautification awards. We won Booking.com, Expedia awards, but we never put our hat in the ring for apartments. And we really also turned ugly ducklings into swans in the apartment side and money losers into profitable places. We provide secure employment, great housing and that kind of thing. So I'm hoping our team out there will get recognition with the Elevate because renovations are done, done, done. I mean the courtyards in, the parking lots paved, that last unit we were waiting for the tenant to move out has moved out. It's now completely renovated. We're at just about 80% occupancy now, and we've pushed rents a little bit there, not as dramatically as at Renaissance, but still we pushed it above our original pro forma. The location just keeps getting better and better. There's new construction here and there and it's a very, very pivotal, very busy corner so I just love what's going on at Elevate. It elevates my spirits. Okay. That's my last pun for this conversation.

Bob Irish: [00:15:18] Come on. You can work one in for Ascend, can't you?

Justin Ford: [00:15:22] I probably can look for one that's maybe a little higher than that. Let's see if I can do that. All right. So Ascend, that has been that has been a real hard renovation again, because the city required us to redo those 72 balconies entirely, demolish and rebuild, and they wouldn't give us certificates of occupancy until the until those things were done. And they added some other requirements on electrical in the hallways and stuff like this. So this just pushed us back. Now the tenants that we inherited. And you're never this surprised by that. When you buy a property with 85% oxygen, 90% oxygen, that was a horrible condition which that property was. Those tenants, a lot of them are not very reliable, probably because they're living in this terrible place because they can't probably qualify for a good place. Right?

Bob Irish: [00:16:17] Right.

Justin Ford: [00:16:18] That 85, 90%, actually, we had kept falling because either people would eventually go bad on their rent or they wouldn't renew. And then that would be okay. If we were moving more quickly on our renovations, we weren't stopped getting our COs. But as a result, our accuracy has fallen to about 35% and the bank with the draws has been very difficult on the draws with us. But we're pushing through all of it. There's just problems that we got to work on. The funny thing is that the one of the really powerful positive countervailing points is that the rents we're getting there are much higher than we had pro forma. We have one bedrooms pro form. My pro forma was 770 as a base rent. We're getting 890. I mean that's huge. I mean it's more than 10%. And we had our two bedrooms and our threes or twos, I think we're getting an extra 100 bucks as well and when you compare it to the market, we're still not aggressive. We're right in line or maybe even a few bucks under the market. So when we get this done and we get it up, it's going to be a really strong, strong investment result and it's going to be a great community. Those balconies are pretty much all done. We're fine. We got five CEOs the other day that had TCOs, temporary CEOs. But again the inspectors are being, they're being precious like they like to be. Only inspect one unit at a time. I mean one building at a time or two units or something like that. And so you try to work in the whims of the inspectors. But long story short, one more challenge is that right now in Oklahoma, it's the slowest leasing time of the year. Not only the holidays, but between now and February.

Justin Ford: [00:18:11] Oklahoma has the craziest weather I've ever seen. It's an ice storm with like ten car pile ups. And then the next day it's 62 degrees, it's insane. And I'm not exaggerating. That actually just happened the other day. And the husband, our regional manager was in a serious accident. Fortunately, he's fine, but it was a terrible, terrible accident so because of that, people are not running out to lease and because of the holidays, those kind of stuff. But March becomes strong again. And again people like our apartments as they should, and we're getting really strong rents. The whole market rents have stayed up there, so it's taking a little longer to get to the finish line. But when we get to the finish line, we're going to end up with a stronger property than we originally underwrote. I think we'll be going for a permanent loan application there. I would say probably April, and then we'll move out of the expensive bridge loan and then we'll we should be 90% occupied midyear, June, July. That's the plan. I think we can really hit it now that we're just about two months away from finishing construction. I actually think it might, I'm pushing my guys for the end of the year. But realistically, before the end of January, we should be 100% done there.

Bob Irish: [00:19:32] Fantastic. That's great. Hey, let's finish up the properties inside of the CAP Plus Diversified Income Fund. Let's go to Port Saint John. What's going on there?

Justin Ford: [00:19:44] So Port Saint John, again it's the closest thing I've ever had to mailbox money. It's 97% occupied. There's no toilets to fix. You don't get a lot of tenant drama and that kind of thing. It's amazing. And it's just a great piece of property. And we picked up 10.1 acres on US-1 and a coastal city and growing Florida less than 800 grand an acre. I mean with an anchor tenant that just renewed for ten years, he's been there for 35 years. So, I mean, the story is just so great there. So we're investing a little bit. I wanted to beautify it a little bit. Not going overboard, but they have this 300 foot long, five foot high partition wall at the end and everything's kind of drab. It's like a c-plus type property, but we're painting a beautiful mural.

Bob Irish: [00:20:41] Are you hiring the local graffiti artists to do this or?

Justin Ford: [00:20:46] Maybe I just should have bought a bunch of beer for a bunch of hoodlums and have tags or whatever. But no, I actually hired a professional artist, interesting young woman I met down in the Miami business thing down here. She's actually painting it now as we talk. Actually, we'll pop on the screen the image that's being put up there if you guys like it? And other than that, the outparcel, we've had people inquire about it. So the outparcels people know. Imagine you're shopping center. It's set back from the road, a few hundred yards or whatever. You got all your parking. And then near the road you usually have like your quick food or your casual dining whatever, like your KFC or your Outback, whatever else is right near the road, really. Those are called outparcels. You may own them or other people may own them. So we have an outparcel there, but it serves as part of water retention that's required for that land. Now, we could create water retention elsewhere in the property and then make that available or a tenant could come in and could use whatever engineering is required to build over that so it's still serves.

[00:21:56] We've had like three chains inquire, never really went anywhere. I don't think, because we really gave it the right resources to tell the truth. But now we have a couple of strong brokers who are telling us they may be able to get us what's called a ground lease or triple net lease. So we're back in the hunt to do that. I mean, that was never in our underwriting. But when it came up, this is this is whipped cream. And it's whipped cream that if we're able to pull it off, you could add a million bucks to a million bucks in value, and it could add at least $100,000 a year to our NOI, which would bump our NOI from around 700 to around 850 so it's good, just very happy with that property.

Bob Irish: [00:22:43] Hey. That's great. Well, we'll get some more updates on that outparcel next month maybe or keep us abreast as it progresses. Why don't we finish off our call with Melbourne, the former Chateau ghetto?

Justin Ford: [00:22:58] Absolutely. So Melbourne, which we bought eight and a half years ago, always perform well to very well. I think it paid for itself even through the pandemic, believe it or not. That's continued to perform well and that's been beating its index like ten weeks in a row. But of course, we got this offer to buy it and we went to contract 3 or 4 months ago. And at a premium price, probably 35% more than it's really worth in the market today, maybe $3 million more than it's worth in the market today and 3 to 4, actually. But this property, the buyers are going to convert it to apartments.

Bob Irish: [00:23:44] Yeah.

Justin Ford: [00:23:44] So there's a long due diligence period. And Melbourne is a real strong growth market. It's got tech, Northrop Grumman. It's got Tesla, not Tesla. Space X is out there stuff like that. So it's a really booming coastal market. And so our due diligence is supposed to end next week. And the guys want an extension because there's some small encroachments on the land that my survey missed nine years ago, but it existed in the original survey of 50 years ago or 45 years ago, something like that. But tiny, tiny encroachments, they're like five feet. They're like five feet on a pond, basically so the sellers try to make a deal. But we're saying, look it's really not material. So he wanted what's called an easement. And we said, we're not going to be negotiating an easement for you back and forth. And we get you an easement and you tell you it's not good enough. You need this language. We said, you can get it if you want, but we're not going to get it for you. So he's now pursuing that. So we're going to give him an extension to mid-January on the due diligence. That would change closing. Should they go hard? Should they go after due diligence? Would instead of closing late January. We're going to close now April or May. And that is actually a good thing, a really good thing because that's initially what I wanted.

They wanted to close sooner because the thing is that season for us. Season is late January, but especially February and especially March. And so February, March, those months, let's say February, March, half of April, whatever. In that period, we make probably 40% of our revenue and probably 60% of our profits because your fixed costs don't go up when your rates and your occupancies skyrocket, your fixed costs are fixed and even most of your labor only goes up a little bit, most of the housekeeping. So these guys before we talked about extension, I got on the phone with the seller and said, okay, my lawyer gave me great guidance and asked him some questions I said, do you have any more due diligence? He said no, more due diligence.

[00:25:53] Are you really looking for financing? Is that the problem? No, we can even buy a cache, blah blah blah. I said, are you going to try to come back to me and ask for a big cut in price a month from now? He goes, nope, nope, nope. And I said, did you get your approvals? And he said, yeah, he got his approvals. So that's big. Now part of our contract Bob is that if they don't close, all these reports, this is something I put in the contract. They come to me. Every single one of them are mine, right. So every single one. So in worst case scenario and this is a boom market, this is a much stronger market for rentals in Tallahassee. So if they didn't close we still got a profitable hotel. We're doing good. We're paying for ourselves, all that kind of stuff. We can refine now that the market's getting a little better, because rates recently seemed to have eased off and banks are a little less skittish. But we could convert them to apartments.

Bob Irish: [00:26:44] Right.

Justin Ford: [00:26:45] And I've done the underwriting on this. The underwriting that's roughly, those little hotel rooms as like what I call boutique studios, they're going to be worth $1,100 a piece, which is like $13,000 a year, and you got 238 of them so your revenue is going to be close to after chargebacks for water, around $3 million. And if you're selling it, it's not unusual to say. And that's a big piece of land. It's like 8.5 Acres on a really busy street that you get at least eight times sales, which would make it 24 million bucks now. And to do that conversion probably costs around, we would probably do it for around 4 million, maybe call it five. So we're in it for like I think eight now. So eight or now maybe ten. So ten plus, yeah maybe ten. So ten plus five is 15. And then you have a valuation of 24. You really expanded your return. We didn't do it because we have a lot of things going on. And this guy went to contracts where he went to contract at his time, which just made sense.

So we like our prospects. Worst case scenario, we have a successful hotel that we're still operating that's paying 12.5% cash on cash, hasn't been paying for a long time. And second worst case scenario is we decide to convert it ourselves but the best scenario is indeed that we do close this sale without much to do after season. We squeeze a lot more profits out of it and then return that capital. And typically what happens when we return capital investors, they often ask what are the other opportunities we may have? So we like what's going on there.

Bob Irish: [00:28:28] Wow. It sounds like a classic. Heads I win, tails I win scenario.

Justin Ford: [00:28:34] I wouldn't couch it so [] but thank you. Just because I've been in this business for a long time, and this is a challenging market. I mean, high interest rates, inflation, labor shortages, etcetera. This is like, I might have said before, in many ways I think this is tougher than 2008, but we've been making it through. We only have really those two Tallahassee conversions that are the big challenges and finishing the construction and more. But once we finish we tend to do very, very well. In fact, that's been our track record, but I do like what's happening in Melbourne. I don't want to track the wrath of the gods by being too optimistic. I've got to be prepared to work.

Bob Irish: [00:29:19] Let the record show I never made that comment, but I set it up top Justin. You said this is a tough market, but as I said and I say it every time throughout real estate booms and busts, Pax has never failed to produce a positive result. So I'm expecting a very, very positive result out of this one way or another.

Justin Ford: [00:29:41] I appreciate.

Bob Irish: [00:29:41] Hey Justin, anything else to add before we sign off?

Justin Ford: [00:29:45] No. That participation mortgage we mentioned, it's tentative again. Again, a quite a few investors that did shoot me an email. If you didn't previously, you might be interested. Just shoot me an email. Justin@paxproperties in the subject line. Just put participation mortgage please. And I'll put you on that list in case we do it. But it is tentative. I'm not sure yet.

Bob Irish: [00:30:08] Okay, great. Well, we'll hear more about that next year. Justin, great to see you again and look forward to chatting with you in 2024.

Justin Ford: [00:30:19] Bob, the plaisir silmia.

Bob Irish: [00:30:21] Ohhh.

Justin Ford: [00:30:23] I think that [] the pleasure was mine.

Bob Irish: [00:30:26] I should have had you with me in France. My wife had brought her French phrasebook with her. But pretty much everybody that we were dealing with heard a little bit of our French, and they immediately went to their English. Justin, good talking to you. We'll talk to you soon.

Justin Ford: [00:30:50] Great to talk with you, Bob. Thank you.

Bob Irish: [00:30:52] Thanks.