EPISODE 1135

[INTRODUCTION]

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ANNOUNCER: Welcome to the Real Estate Syndication Show. Whether you are a seasoned investor or building a new real estate business, this is the show for you. Whitney Sewell talks to top experts in the business. Our goal is to help you master real estate syndication.

And now your host, Whitney Sewell.

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Whitney Sewell (WS): This is your daily Real Estate Syndication Show. I'm your host, Whitney Sewell. Today our guest is Mike Zlotnik. Mike has been on the show a couple other times. I encourage you to listen to show 130, I can't already believe it is a 1,000 shows ago, and also show 539. We've talked about numerous things. But he is a very experienced fund manager, and we talk about different aspects of managing funds.

Today we're talking about something a little differentut. But a little bit about him in case you have not heard of him before or didn't listen to those shows, he has been a debt and equity investor in real estate since 2000. He started his career and had spent nearly 15 years in the information technology field managing Risk, Business Intelligence, and Quality of complex systems, software, and processes. In 2009, Mike joined Tempo Funding, LLC (Mortgage Pool Fund) as a managing partner, and Vice President of funding operations. Starting from January 2014, Mike has assumed the responsibility of a CEO and has since founded TF Management Group, LLC, launching 3 new real estate investment funds.

So, I encourage you to reach out to Mike especially if you are interested in funds and even listening to those other shows to learn about how he is operating funds. But today we talked about a project he's doing in New York City. But then we spend majority of time talking about hotel conversions. And he is creating some great opportunities in that niche. It's kind of a niche that's getting a lot bigger now, more active, more people getting into that since the pandemic. So, I think he's gonna mention many things about hotel conversions that whether you're a passive investor or whether you're an active operator, you're gonna learn a lot and that you're gonna need to know.

[INTERVIEW]

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WS: Mike, welcome back to the show. I've enjoyed us catching up a few times and I was on your show and you've been on twice in the past, I think, which isn't very common on our show. But you are doing some big stuff in this business and there's some specific things you're working on I want us to be able to highlight today. I know you came in first on show 130. That seems like forever ago. It was actually 1000 shows ago, nearly and so, Mike, welcome back. Why don't you give us a little update on some things you're working on right now and let's jump in?

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Mike Zlotnik (MZ): Thank you, Whitney, very much. I appreciate the opportunity to be on the show. And I bow to you for your ability to run the show. I think you do it every day which is very hard. I only do one episode a week, you're doing five, and it's yeoman's work, it's hard. So, anyway, I appreciate being on the show. Just a couple of quick updates what's going on right now working on really exciting deal here in New York City, partnering up with basically, the gentleman who we've invested with. He does distressed that in New York and through distressed debt he got a unique opportunity to get basically 20 apartment complex in Manhattan, on the 73rd Street. But this used to be a single-family townhouse and we kind of went to the conversation, we realized this is a phenomenal opportunity. And to make long story short, now we're working to redevelop it back as a townhouse it's 35 feet wide, townhouse that is about 70,000 square feet. If you can imagine New York City, 35 feet wide, it’s got substantial depth.

So, what's unique about it and what's so exciting about it? It's going to be one of the top ten townhouses on the east side, and it's only going to cost that's it, not a big number, you know, New York City townhouse, what do you think is going to cost? Do you have an idea what are fully developed, down to the beam, top, by the way we're partnering up with top name architect, their requirements. So, what do you think a product like this could cost in New York?

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WS: I really have no idea but if I was gonna guess, maybe $600,000.

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MZ: $600,000 in New York City, Manhattan, you can't get a closet for the money.

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WS: I have no idea. I don't know anything about New York City. Educate me Mike.

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MZ: The funny thing is you said $675,000, of course, in New York City, it's impossible. It's going to be between $65 to $70 million.

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WS: Oh, I was thinking per unit, I didn't think about the whole complex.

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MZ: Yeah, it's gonna be no more 20 apartments. It's going to be one single-family residential townhouse, essentially your massive wow factor will be designed by famous architect, will be executed by by a strong developer in New York. And it's an exciting project because it does have history. This building has some famous actors famous. Even a prince live in this house. Prince of Monaco, or something like that years ago. And it is very limited supply of them, especially 35 feet away. You can imagine, 20 feet, 18 feet, it's very hard to have great living but a 35-feet wide townhouse, you can have a phenomenal living room, dining room.

So very excited working on this project. We're going to be all in about $40 million, it's an acquisition of about $23 million bucks. $14 million development on a single house. And then, of course, $40 million all in and then 65 to 70 hopefully sale in three to four years.

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WS: Wow. Have you done other projects in this market or is this a market you know or have known for a while?

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MZ: That's a great question and normally we don't do that, like New York City, we don't do these type of projects. I call them very speculative projects. There's a lot of risk, but the reward is pretty strong. So we did a institutional waterfall and the deal the target returns between 25 to 30% annually IRR. What we're doing is we're partnering with people who have done a lot, right. This famous architect, famous developer, and then, Eric is the other partner and me, essentially an arrow podcast style that's coming out on this with Eric. But I don't have experienced personally being a developer in New York City. I live here. I invest but I'm not a developer per se. So all I do is raise capital, we deploy the projects. This particular project is not our typical wheelhouse.

The typical wheelhouse, just to give you an update, what else we're doing, we continuously investing more and more into the hotels to multifamily conversions. We're probably up to, you know, close to a dozen in the portfolio. We have three exits this quarter in Temple Grow Fund basically fascinating exits. So talking about opportunities, things have worked out. So, you can't compare. There's a very different projects but what's in need today? Affordable housing right? Workforce housing. And we've been investing very heavily in that sector. You are a multifamily guru, you know how these projects are. If you can have a affordable housing project, they fly off the shelves.

So we did our first exit this quarter, which basically was an investment in September of last year. So we put a million bucks from a Temple Grow Fund into total equity of a million and a half, we took about two thirds of the equity. All in hotel redevelop into multifamily was about $6 million in Winston Salem, North Carolina. This thing was supposed to sell in five years for about

$8 million bucks, right ? So you get $2 million in equity upside on a million and a half investment in five years, whatever target return is like 20%.

Well, it looked all good on paper about a year ago. Now we just exited. Well, I'll fall off the chair, because it exit instead of eight for 10 and a quarter, talking about the market and a good execution, 13 months. It exited for 10 and a quarter, and the IRR, we got back essentially when a million invested 2.6 in 13 months. Whatever they are comes up to be about 140%. Right, so that is a hot sector. So we do from the projects perspective, these developers especially extended stay hotels the multifamily is flying off the shelf.

We have another one exiting probably in December, our Ramada Inn. So it's a little different. This was a residence inn that I mentioned first and then Ramada Inn. They look like studios, I mean you can imagine what their models look like. Right? This Ramada Inn is exiting in Mesa, Arizona. It's exiting in about 18 months, with about 2x multiple. So we're going to double the money in 18 months. I think it's like 60% IRR. It's massive lagging the 140%, it is still a home run. Still a massive home run.

So, these are some of the exits Temple Grow Fund early access that we are observing and I'm almost shocked when planning for anything to exit for at least two years, we've got three exits this quarter in essentially between 13 months, 18 months, and 21 months. It’s too fast.

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WS: Mike, speak to hotel conversions a little bit. I mean what does that process look like a little bit and for the passive investor listening, maybe some things they need to know when they're considering investing with an operator that's doing hotel conversions?

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MZ: Sure. So, hotell conversions, as easy as it sounds, does take work. So we invest, only with the institutional quality operator. They do many of them, it takes tons of experience. Obviously, number one, zoning, and entitlements. So if you're looking at potential property under ideal circumstances, you want to find that the property is located on land that is naturally permitted, or allowed for multifamily. If you can't do that, then you have to go to the zoning board and see what's the appetite and the interest for conversion of a hotel to multifamily. If local zoning board is excited about it, if they would love to have more workforce housing, then you have potentially a good project. Obviously economics have to work. So you have to be all in. Typically, cost versus the future value and the future value is determined based on your traditional multifamily cap rate approach.

So if you are multifamily investor and you're comfortable with those type of assets, what is the end product will look like? What kind of apartments? What can they rent for? And if you establish the value, how cheaply can you get in? If you can get in under 75% of the future value that's a decent setup.

At the end of the day, the underwriting has to be conservative, and you have to be very comfortable and execution given what's going on with the current heavy inflation environment on the labor and materials, and the supply chain broken, right? So your ability to execute is going to make a big difference. The heavier the project, the greater the risk. Extended stay hotels into multifamily where there's it, they look like apartments already. Those are the easy lifts, the harder list is the ones that you have to be comfortable with.

So, key piece of the due diligence is what can you execute the construction? What cost? And what time and what are the risks you can get stuck without some critical supply supply chain item?

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WS: Everybody says, you know, conservative underwriting, but when looking at hotel conversions, what are a couple things that maybe the passive investors should ask about, so they know that it actually is conservative underwriting when we're talking about hotel conversions?

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MZ: Sure. So I would say in the underwriting process I always think about three things. Number one is who is the operator. You can't even talk about the numbers if the operator has a ton, how many projects like this have you done? If you got dozens of them, and you've got a strong team that knows this stuff, that's a no guarantee of success but a strong starting point. Obviously, referrals, right? You could have somebody claiming that they are specialists and then they blow their own horn. Do the due diligence, make sure you somehow, establish their credibility and get referrals and feel confident that that that operator knows what they're doing, which is critical piece. And then too obviously, go into financial underwriting.

So the financial, at the asset level underwriting, you have to look at what's the most important metric in multifamily on these value add projects, development, redevelopment what's the number one metric? In my view, it's post-renovation rent. What rent can you achieve, right? Can you be realistic of these rents? We are in a heavy inflationary environment, obviously. So, you can't assume this is going to continue. You have to go back, revert to the mean, what has been the average historic rate of appreciation or what were the rent increases in that area, right?

So as long as you can get comfortable with the future and then you can get comfortable with the whole model. If there and that's a very optimistic for this type of product, that's a risk, if the rents are very realistic. So, typically they develop, you know, into a studio, one bedroom, a small one bedroom, compared to the similar product after the redevelopment. What does it rent for? Can you give the right number? if you can, that's one of the key underwriting. If you can't get there, nothing else matters. Then you look at the area, you look at basically kind of trans, is this a good area? Is this an improving area? The rents going up because something else is happening in the area.

You can actually justify rents that are substantially higher than the current rents if you can see, you know, till your eyes moving in and they're going to open a big plan nearby and you feel, you know, the other factors that can drive the decision. But I would say that's a creek key metric, and obviously cost. You look at the pro forma, what are they going to spend on the construction, can you get comfortable with this numbers? Maybe talk to the sponsor and say “how are you going to deal with, you know, inflation of the materials?”

By the way, just one really important comment, as I've been thinking from these projects, I compare three type of multifamily projects, right? One called hotell to multifamily conversion. Two, value-add multifamily to value-ddd multifamily classic. If you buy something underperforming, rents below the market, then you valu- add internal, external innovations and then increase rents. And the third is ground up, right? The three different projects. And people ask me, "well, you know, what do you think about all three?" This is really important because you're comparing to something that's got two other kind of methodology, it is how you get into multifamily and they're very different.

One of the major strength of hotel redevelopment versus the others, ground up takes up substantially longer. Right? Whoever is going to tell you they're going to do a ground up, all in, within two years, that's wonderful. It's possible but the delays could drag you easily into three years. So delayed time and the cost overruns risk on the ground up is a lot higher.

Then you have the value-adds. The value-adds, they're wonderful. The cash flow from day one, hopefully, right. The problem is, you can only renovate on term, unless you're going to start kicking people out. So your time for renovation is just going to take longer. You can get to your civilization point after innovation but it takes two, two and a half, three years. Normally when evaluating on a value-add multifamily.

Now you look at the hotel to multifamily conversion, it's empty. You just execute, you just do it, you can actually get there within a year, 18 months the longest. So one of the major benefits, is if you execute it right, you can have a finished product a lot faster. So, I've looked at number of, again we find the funds, we invest in a bunch of deals and I deal with sponsors all day long. And I've compared a lot of value-add multifamilies versus the hotel to multifamily conversions. And you can actually get a little bit more aggressive in the underwriting with hotel to multifamily because you get there faster. So your refi event happens faster, your settlement happens faster.

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WS: You know, you spoke about like the inflation on materials and maybe the fear of lack of materials at times as well. I get that question often from investors. I just wonder, how do you all, what's the backup plan, I guess for you all if we can't get materials or just planning for inflation on materials?

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MZ: That's a great question. You got some really interesting kind of flavors of this what I've seen happening. One is, in some of these projects again, hotels to multifamily conversions, they keep running the thing as a hotel for as long as they can. So if you have a backup plan where you don't have to, you know, turn off the whole thing overnight, you can do it in sections. I've seen hotels that they have separate buildings, especially garden style hotels. Then you can start converting and upgrading the hotel at the same time. At that point, if you have delays in the conversion, you can still keep the lights on for all the execution of a hotel operation. So, it's a risk mitigation.

We don't move materials or stuck delayed and you're working one of the four buildings, garden style hotel for example, one is stuck you don't start the other one. It's one of the mitigation strategies. The other stuff is obviously competent operator with a strong supply chain. Again, everybody is now competing for the materials and for the labor. Typically, the more competent operator wins because they can secure the materials and the product, and they can pay people a little more. So it's a risk and your level of comfort with whoever you're investing with can the source the materials. It's for sure risk something to be very well aware, and you can ask the operator. “How do you, how do you get materials? How do you know you will get the materials when you need them?” And I've seen different answers. Some people we invest with, they have massive warehouses and they do multiple projects in the same city, they buy a whole lot of stuff in advance, at today's prices and then they store it in their warehouse because that's the cheapest way to do it.

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WS: I've seen people do the same thing. We've worked with some builders who do that as well. We're like, “well, how are you going to get these things?” He's like, “we're ready.” Okay I mean that's such a relief right there.You know, what's something else maybe they should know or consider when they're investing in a hotel conversion?

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MZ: At end of the day, it's execution risk on the construction right? I don't know how else to put it. Depending on your comfort level, I want to see more reserves. If it's one of the risk mitigating strategies. So the longest the budget can sustain that service, typically these projects have leverage.

So if you capitalize the project with enough reserves, or the sponsor says, “Listen, you know, the results are light, but we are communicating upfront that there may be a capital call to investors in this thing may take longer.” So just the financial ability to sustain the project for longer risk is an important risk.

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WS: I agree. Reserves are so important to us as well. Do you have a certain amount or way to calculate an amount that you like to see, Mike, before partnering on a project?

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MZ: It’s a great question, by the way, Whitney. We were looking at the ground up construction project, and in Phoenix, and to make long story short developer was so excited motivated, confident, comfortable with the 24 months cycle on a basically mini subdivision development. And we were looked at the project, we basically said you got to have a minimum six to 12 months of additional reserves. So it's crazy as it sounds, but I'd like to see the project being able to survive without going back to investors for six to 12 months because of the delays today. It may be longer, it really depends on the complexity, right?

For the project we're doing in New York, we think we can bank it out to three years, but we are really aiming conservatively for four years, why? Because it may take an extra year. There's no right or wrong number, but a year worth of interest reserves, a year worth of reserves. To me, it feels good today but, you know, otherwise you get really conservatively, you get over conservative and then your return starts getting diluted. So, six to 12 months of reserves is a pretty decent number.

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WS: I love that, and often we sometimes hear one to two months, you know, of operating expenses and that makes me a little nervous. I'm not okay with that. They may show those big returns but you know I'm not gonna be able to sleep very well. Right.

So anyway, I love that number though. We love at least six to nine months or 12 months would be just amazing. Mike, you know, a few final questions. You know, what's your best source right now for meeting and finding new investors?

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MZ: So investors is folks with capital, people who invest in the deals?

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WS: Right.

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MZ: It's a relational capital. It is really no better way to put it, you have to, we raise more capital from referrals and membership tribes that are basically kind of private invitations, and it's not a solicited, you know, we're not marketing out there. So we raise a lot of capitals from the, some of the folks, you know, freedom founders, were these number of investments from other similar organizations, their relational tribes. We would try out of Australia that's been investing with us, that's all doing a membership also for folks that your financial freedom, different. These work a whole lot better than cold sell being a real market.

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WS: So, you get inside of a tribe and build some relationships and adds and value ultimately, right?

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MZ: That's right. You serve the community and then they get to know I can trust you. I don't know how people can invest Whitney if they don't know they can trust you. So somehow you've gotta be open, you gotta make the people feel like you're accessible and you're serving the community. Over time you'll get that.

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WS: Mike, what are some daily habits that you're disciplined about that have helped you achieve success?

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MZ: I try to exercise, although it's not a perfect habit. But for me, during Covid, we've all kind of suffered quite a bit from not being able to get back and work out. At least now, I'm trying to exercise regularly. I doTaekwando, for years doing it. And so one of the, if I can go to the class, I'm trying to stretch at least just one healthy exercise.

Another really important habit is working with a coach. No matter who you are, you could always use a coach. So I have a fitness coach that we track the eating habits, the food, the abs, my fitness. So a little bit of that to what you do, whatever is your business. Also make sure you balance it out with trying to better care of yourself.

And then the other thing is if you have kids, I have kids, I have four kids. I try to talk to my kids just to make sure that they don't get too disengaged. We're very busy, so have a conversation, I drive kids to school, I pick them up, I try to talk to them. No matter how busy you are, just try to find a little bit of time to get close to with the kids.

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WS: I love that answer too. I don't hear that often enough, just spending that time, quality time with your kids. I think you have to be so intentional with that. My wife and I were working on that all the time. I was reading a John Maxwell book just recently. I think it's, good leaders ask great questions. And I love that because it's so true. And one of those, one of the parts of the book he talks about was asking your kids questions right. And she said one of our favorite parts of the things that we do, we're sitting at the dinner table where they can ask questions and get answers. Right? So I love that opportunity. You bring up there is being intentional, about spending that time.

Mike, how do you like to give back?

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MZ: So I wanted to broaden, one comment on that subject before…

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WS: Please.

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MZ: So my second kid, she's 16, I'm really actually excited. She's been reading Rich Dad, Poor Dad and getting involved with learning a little bit about what I do. And she literally just hit and explained to me, she said, “What do you do? I really wanna understand, I really wanna invest.” And I started explaining to her what real estate, the benefits. We spent the time talking about depreciation. And she was fascinated. So if you get a chance, if you're kids somehow, you're in real estate, just talk to them and explain, as boring as it sound, depreciation. You can actually explain to them, “Listen, you can make great investments, you can get a good cash flow. Depreciation helps you defer taxes.” So little things like that can make a difference.

How do I give back? I serve. I serve my friends, I serve family, I serve people. If you have a great question, schedule time with me. Go to bigmikecall.com. It's not a very difficult thing to remember, bigmikecall.com and just book 15 minutes with me. And I can't promise I'll be able to answer your question, but I will try to at least put you the right path. I do have some coaching students. I have bigmikecoaching.com, I’m not not selling that 'cause I'm very selective, quite, coach. But the way I give back is a little bit of thoughts that people have approached asking me about some of the interesting problem, and I may be able to give you a 15 minutes of enough or feedback based on my life and business experience. I might put you on the right path.

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WS: Mike, always a pleasure to catch up with you. You are definitely a very experienced fund operator, doing an amazing job and always a pleasure to learn from you and the listeners learn from you as well. I appreciate you sharing about the New York City project and really going in-depth about hotel conversions, and it's not something again, we've talked about on the show too many times. So I'd love that you can break some of those things down for the investors that are listening and also other active operators that are trying to get into that space.

I think there's many things that you mentioned that they're gonna, they need to be thinking about it and learning from you or people like yourself. And so, Mike, mentioned again, how can people get in touch with you or learn more about you?

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MZ: Sure. If you want a chat, bigmikecall.com. And then if you wanna reach out to learn a little bit about our family of funds, so we have some great educational content on our website. The easy way to remember, it is bigmikefund.com.

[OUTRO]

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