EPISODE 1428

[INTRODUCTION]

Whitney Sewell (WS): This is your Daily Real Estate Syndication Show and I'm your host, Whitney Sewell. Today we packed a number of shows together to give you some highlights. I know you're gonna enjoy this show. Thank you for being with us today!

[INTERVIEW 1]

WS: Our guest is Mike Zlotnik. Thanks for being on the show.

Mike Zlotnik (MZ:) Whitney, thank you.

WS: Let's just jump in, and maybe can give us an update of anything related to funds and what you've been working on. And then let's dive into this hotel conversion.

MZ: Thank you, Whitney. It's a great introduction. I appreciate the opportunity to be on the show. And we're living in this COVID world. It's a strange experience. It certainly is something that we're concerned for our families and elder and sick folks around the country and around the world for that matter. And this COVID-19 is a terrible thing but it has created opportunities. What's most bizarre is that COVID has differentiated winners and losers. I hate to use the word losers, but you know, if we're just using the economic terms, it has benefited some companies and some businesses tremendously and has heard a lot of businesses and companies as well. If we follow a stock market, in general, two-thirds of the stocks are down and one-third is up substantially. That's what has happened, just on a grand scale of things.

Now, let's talk a little bit about just one specific opportunity that COVID has created. So, it's very simple for this conversion of hotels to affordable housing. So, of all sectors, there's one sector that COVID hurt the most hospitality. And it's pretty obvious. Some hotels are still doing okay if it's a getaway from a big city type of hotel, but otherwise, a lot of the hotels are just dysfunctional, the tourism is down to nothing, and business travel is nonexistent or very, very slow. So, a lot of the hotels are bleeding and they don't have a path forward unless they persevere all the way to the end of COVID and come back to some level of normalcy. So, the opportunity is to convert into affordable housing many cities and towns need that. There's a critical shortage of affordable housing. So, that's the high level.

I have the slide, so I'm going to walk through the slides unless you have a specific question, so please jump in.

WS: Yeah, let's go through some of it.

MZ: We'll skip the wonderful disclaimer. So, again, what's the opportunity? The opportunity is very, very straightforward to acquire a hotel at a distressed price. So, if you're a multifamily investor, I know you have a great show, you have a great audience in the multifamily investing sector. The opportunity is no longer to look for another multifamily asset but to look for distressed hotels. Approach the owner, find out what's happening. Is the hotel in foreclosure? Can you get a special workout deal on it? Can you buy from the bank? Where you can acquire the asset, you can acquire it from the seller through some commercial short sale, or a workout in conjunction with a bank or a bank for closing, perhaps you could buy it from the bank once they foreclose.

Generally speaking, banks want to get the monkey off their books because they have to allocate all kinds of loss reserves and foreclosed assets. So, they're willing to give a good deal to get the asset off their balance sheet. So, you can acquire a distressed hotel, generally speaking, there's no right or wrong hotel, there are what I call "conveyor belt" projects, kind of you can do one after the other, they look very similar. And there are prized assets, like a historic building, and some locations, it was catering to great business travel, the business travel is gone right now. So, you can convert it to multifamily, but it's a unique asset. So, those are different projects. This presentation will focus on the conveyor belt opportunity. In other words, we already did one, and we have two more coming up just like this. And we believe we could do another dozen next year, possibly one a month. This is such a straightforward play.

WS: Nice. You may get into this in a minute, Mike. What about just the location of this opportunity? How should the listener or the investor be thinking about that? Because typically hotels place at higher intersections or busy areas or places, obviously, where a lot of tourism is. Is that still the place where somebody wants to live as their apartment? How should we be thinking about that?

MZ: So that's a great question. That's probably the most important question to think through feasibility, for a feasibility study for a multifamily affordable housing being in that area. Most of the hotels that position too well and not great candidates for conversion because they're too expensive. So, you could convert them to higher-end apartments, which is a valid play. But if you're looking for affordable housing, you're looking more for residential neighborhoods that have sort of one of these, I call them not low flags, but they could be under a high flag like a Marriott. But they are apartments like hotels where people go away for a week from home and maybe near college or University. This particular project that we're going to talk about in Winston-Salem in a neighborhood, just a kind of an average neighborhood, not a downtown type of hotel.

So, what you want to see is that hotel fitting in as an apartment complex in that neighborhood, and if that fits in and you could deliver smaller but more affordable products, then you have a recipe for success. You can convert a downtown hotel for sure. Business hotels are dysfunctional right now, but the reconfiguration of the rooms may be a serious issue on top of that, what is the acquisition cost and redevelopment cost? It comes down to the numbers. We just did a project unrelated to this example, where it was redeveloped as an old hotel in Utah to multifamily. And that project was started two years ago, it just finished. It was unrelated to COVID. And the project is very, very strong and the numbers are coming out about the pro forma. But that's a rare example and one of a kind of deal.

This opportunity, I believe, exists in the more residential neighborhoods where the hotels are just not placed great. They don't work at hotels there. Does that make sense?

WS: It does. Yes.

MZ: So, we will continue the process again, this is a straightforward acquisition, conversion, obviously feasibility study, and then all the math has to make sense, leased up stabilized and then refi. And then you can cash flow the asset or you could sell, whatever you prefer to do. So, a very simple redevelopment type of project. Again, the opportunity of the high-level, hotel demand is weak. There's substantial oversupply. There's a shortage of affordable housing. Hotels operating at a loss, they're bleeding. And it's a way to relieve the distress and people can't take this bleeding anymore. And affordable housing isn't in huge demand anywhere you go. I don't know if you can find a city where there's an oversupply. Everywhere in the states is a great need for lease types of affordable hotels.

The key component if you invest, either you have to be a competent operator or you have to invest with a competent operator because it's a conversion. It's a redevelopment. There's work related to potentially zoning potential entitlements, making sure the hotels are approved there. Of them naturally, the zoning will allow for multifamily housing in some cases may need to be zoning request approval. Most cities will welcome it, but still, working well. And then this redevelopment work, this construction, so make sure that if you invest you invest with a competent operator and if you do it yourself, you know how to do the work, you know how to manage construction because it is a project even though it's not heavy lifting, it is still work required.

Here's an example. So, in Winston-Salem, North Carolina, we just invested in this project. We really liked the basic thesis. It's an 88-unit Residence Inn by Marriott constructed in '86, renovated 2012/2013. So, it's not a very old renovation. It looks reasonable. You don't have a very modern kitchen. They look a little bit more classic kitchens but they're still kitchens. And some people like that retro view or the classic view. So, if you can redevelop without redoing the kitchens because the kitchen is a substantial expense, that saves on cost. And then you have to look at the rents in a given market. If you can deliver a product with rents well below the market, then it's an affordable product. It doesn't have to be what is an affordable product. It varies by neighborhood. In a little bit nicer neighborhood the affordability will be just as good as in a little bit lower-income neighborhood because it's affordable for that neighborhood. That's the whole thesis here.

Again, has to be limited supply, this particular example, the property is located one mile from Wake Forest University and approximately six miles from Wake Forest Baptist Medical Center. And this particular zoning allows for conversion to multifamily used by right and apartment-like amenities pool, fitness center lounge, and tennis courts. All those things make the apartment complex desirable. It's 49, half a thousand square feet spread across 11 buildings, so you don't have any high rises. The hotel looks like an apartment. I mean, that's what it looks like. It fits in the neighborhood right off the get-go.

MSA again, Winston-Salem, is the fifth most popular MSA in North Carolina. It's a great area, a very Steady Eddie market. So, I'm not going to read the whole thing here, but it's kind of a market we actually like. The next project we have is in South Bend, Indiana. And then the next one we have in Texas is in New Braunfels, Texas, San Antonio suburb.

WS: What about just the renovation time and leasing time or until a property like this could be considered stabilized?

MZ: Yeah, it's a great question. So, I'm going to cover the economics first, and then I'll answer. So, the short answer to the question is 18 months. From the time the project starts until the time is fully stabilized, it's 18 months. Compared to ground-up construction, we typically need two years from the ground up, this is a faster project and 18 months is pretty conservative. You can actually get there in 12 months. So, from zero to full cash flow in 18 months is not a bad setup. This particular acquisition price is 4.6 million. Construction is light. As you can see, it's not a massive construction budget. We've invested in projects where construction is greater than the acquisition price, but not here. This one is fairly light. You have 88 units, 750,000. This includes all our renovations internal/external, so it's not a terribly expensive budget. That's less than 10,000 a unit, it can really bring units a fresh feel, make them look appealing, and improve the curb appeal, without spending the family jewels. And then it's got a $550,000 legal other operating budgets, operating capital.

So, the total capitalization is 5.9 million. That includes all the debt service, all the reserves to keep the property afloat all the way to full stabilization. This project was structured with a senior debt of $3 million. There's also mezzanine debt at one and a half million. And then the mezz debt is 1.4 million, senior that is 3 million, just want clarification and common equity is

1.5 million. So, the total capitalization is 4.4 million. And the target sales price obligation is just under 8 million on completion of the project.

So, if you look at it, that you're all under six, the exit price is at eight or refi value. And from the return on equity, it's $1.5 million equity that's projected to generate $2 million of equity creation. So, it's not a bad return, it works well on a five-year hold, that sells sooner that'll generate a return even higher than the projected IRR. That's the basic economics of the deal. And as you can see, the apartments look like they already have kitchenettes, they have the stuff set up. So, the lifting is not that heavy. Just a couple of comments on the financial structure.

We invested in this deal from two different funds, because we have a growth fund, we have a growth and income fund. We try to match the investment objective with the type of equity or debt on a given deal. So, that deal, as I mentioned, had 1.4 million mezz debt and we took a position in the mezz debt of 700,000 from our camp opportunity fund. It generates a 12% yield and a point and then the temple growth fund took a million-dollar position in million-and-a-half total equity. And it does have a waterfall. We're not the sponsor, the sponsor has to get compensated for doing the work, very competent sponsor, but it has an institutional level waterfall, it pays 9% pref. Then there is a 75/25 split until an 18% IRR is achieved and after that, there's a 65/35%, split 65 to investors, 35 to the sponsor, and IRR on a five-year hold is about 21.5%.

[INTERVIEW 2]

WS: Mike, welcome to the show. A pleasure to meet you. Personally, I can't believe we've not met before now, actually, but a pleasure to meet you. Now it's interesting just a few moments that we've had before we started recording, to learn a little bit about what you're up to and looking forward to this but, share a little bit of that, with the listeners share a little bit about your focus right now, your real estate business, maybe some things you're working on, and we'll dive in.

Michael Stohler (MS): Sure. Thank you, Whitney. I transitioned from multifamily to hotels 'bout four or five years ago just because of the cap rates. I didn't like the cap rates in multifamily and, hotels are still there 9, 10, 10+ cap rates so we're focusing on those. And wow, you know, I bought my last hotel on November 19 right before what hit, so it's been a lesson. Many, many lessons that I've learned on running hotels and keeping them open during COCID. But I still strongly believe in hotels, and we're still going to invest in hotels, we're getting ready to open up a fund. And the reason why we're doing a fund instead of syndication is those hotels are not going to make it because of COVID, and most of those, it's because they had maybe the CMBS loans, which is a market-based loan and they could not get any of the help so the owners, they could be very, very good hotels, but because the lenders not wanting to work with them they're not able to survive, and those are going on auctions, are going to be turned over to the company so, you need an open fund, you need that money to be able to pounce on those opportunities. And that's why we're doing it open fund instead of regular syndication.

WS: Yeah, now I can relate to that. We launched a fund as well, definitely gives you a lot of buying power, right? When that seller or whoever knows that you got that balance sheet there, you're a different player at that point in the race But I want you to speak to, and I'm sure you get this question often and you said it, not many people have many hotel experts right on their show that are syndicating hotels and so, I want you to speak to that some to the listeners, just the current market of hotels and maybe speak to some differences that may be misunderstood between multifamily and hotels, and then just the current market around hotels

MS: Sure. The first question is one that I get a lot, is the transition from multifamily to hotels. You have people that are very strong multifamily lovers and then you have your hotel group, and not a lot of people did both so the differences that I've learned, and the reason why I like hotels is, hotels I get to set my, I'm going to use rent, I'm going to use some multifamily lingo. I get to choose my rent every day, I get to change it, I get to position my rent depending on the market.

You know, a concert comes into town, bam! You know, I'm $60 higher for that night. The NFL comes into town, bam! I'm $100. Super Bowl is going to be and I'm going to be a lot higher. But then, I'm in Arizona so, during the summer I get to bring it down a little bit lower, to keep people coming in. So, I get to change it every day, but I also get my renters to change every day. So, if you have a 100 room multifamily, it's 100% full, you have six months to 12-month leases, and it doesn't change, unless you have turnover. With a 100 room hotel, I get, and let's just say for conversation it's full every day, I get new renters every day at different rates. So, the compounding of the numbers on a monthly and yearly basis is a lot, lot larger in hotels to we're grossing a lot, lot more than multifamily.

Another thing that is really, really good about when you get in hotels is, hotels are real estate and a business. Okay, so I own a small business, I own a flag hotel which means it has a franchise attached to it, I own a Marriott Hotel, that sits on real estate, so I have an appreciating landmass, and I have a business that appreciates, and I can then move and work on the expenses and the revenue. The other thing is because it's a business, I'm eligible for, during COVID this last time, it's an SBA – small business type of loan so I was able to get the PPP in order to pay for my employees, in order to keep them employed and I was also able to get the EIDL which is the disaster loan recovery in order to keep the hotels float and keep them going. So that's another thing that is really good because it is a business. So, the government sees me as a business, but I also have that real estate on top. That's a big difference.

Another thing with multifamily, if someone moves out, your expense to clean and get that rent ready again is a lot higher for you and me. You know, you're having probably repaint, clean the carpet, you're just doing a lot of things. I have experts that work eight hours a day and all they do is clean rooms, and within 15 minutes, someone moves out and boom, we can have someone else at a new rate go right in, so it's a lot more efficient with the costs. And those are the things. The biggest difference is you have to learn how to run a business instead of just multifamily which is real estate, landlord-tenant laws, and things like that. So the biggest thing that I tell people "Don't jump into hotels because now you're running an actual business with 15 to 20 plus employees, so it is a lot more different," but those are some of the things.

On your second point with the market right now, what I found out during COVID, everyone's like "Oh my god," you know, COVID. Well, depending on where you live, the hotels were hit a little bit differently. In real estate, you need to be in a statement – I'm not going to get into politics, you know, this just state, local government, things like that – you need to be in a landlord-friendly state, or with me and hotels, you need to be in a small business-friendly state.

And here in Arizona, and some of the other places, hotels were a necessity. We did not have to shut down, it was an essential business. You get into a lot of states where everything shut down, you know, there was no essential. So we got lucky and it taught me that "Okay, you know when I get into new hotels, I need to actually pay attention to this other type of segment: How friendly is that state going to be to me? You know, I'm going to be paying all these taxes to them but do they actually care about me?" So that is a big thing that I've learned during COVID. And, COVID did affect hotels. I mean, it was a lot worse than 2007-2008, but none of my hotels closed down and, I did learn what hotels really, really performed, and which ones did not.

WS: Would you elaborate on that? Like some things, you learn there. You were talking about it before we started recording and it was such a great point, it's like when bad things happen you can stress out, or it can be an opportunity to learn, right, and become better. I just appreciate that.

You mentioned like military experience, and there's a reason to stress out about it, let's figure out a way to make it happen, right, and get through this, and sounds like that's what you did, Mike. But speak to that a little bit. What happened? Things that you learned just through COVID, maybe what you would do differently now in buying hotels versus what you would have done two years ago.

MS: Yeah, great question. What I learned during COVID is, the hotels that I thought were pretty cool that would have done really, really well are the ones in business parks, you know, I have a fancy Radisson right into a business park where, you know, the Tech Park. Well, which one did the worst during COVID? It was that one because there was no business travel and it relied on business people. The ones that did fantastic are my limited service, which means free breakfast, free Wi-Fi, you know, you know, it's basically the limited-service right off the highway outside of a major metro area, because during COVID no one wanted to stay in the big city, and because nobody was air traveling, they're still traveling but they were going via the highway system, you know, via RVs, via the cars.

So I learned that the ones right often exit and major highway but outside of a major metro, you know in a small town outside. And the ones that had truck driver parking, you know, this is the Blue Color, the Blue Color Limited Service Hotels, the ones that I wasn't even thinking of. I'm thinking "Man, I'm with these big fancy duh, duh," bars and restaurants and all this stuff, no. Free breakfast, free Wi-Fi, Class B hotel that is just a simple one because you know, and also what I learned is, what did not stop during COVID? What was the most essential was the truck drivers, the emergency crews, and they were always traveling and if I could sit there and say Okay, I need to move to where… before I didn't really go after that type of commercial business, man I went head-on and make sure that every single one of those truck drivers stayed at that hotel, and that hotel is actually going to probably exceed 2019 numbers this year.

WS: Wow.

MS: And it's fantastic. So that's what I'd learned, and going on is it's like going after. Do you eventually want to get that A-Class multifamily? Yeah if you want half percent cap rate, you know, things like that but man, those Bs, B-minuses, you know, the C-pluses all day long, we call those the lunch, pail Joe-type of living quarters, and they don't ask for much, just clean and it's at a price point that they love. Those are the ones that we're going to focus on. Extended stated also very, very well so we'll look at extended say because when people are caring for people, a loved one was in the hospital and family needed extended stay or for the nurses and the doctors that couldn't go home because they're on the front line, they stated extended stay in hotels.

[END OF INTERVIEW]

[OUTRO]

Whitney Sewell: Thank you for being a loyal listener of The Real Estate Syndication Show. Please subscribe and like the show. Share with your friends so we can help them as well. Don't forget to go to LifeBridgeCapital.com where you can sign up and start investing in real estate today. Have a blessed day!

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