LEFT LANE

Bringing the past into the future

David "Mac" McWhorter, executive director of the Institute for Real Estate Operating Companies (iREOC), recently spoke with Andy Bernard, partner and chief investment officer of LEFT LANE. An excerpt of their conversation follows.

For those that might not know a lot about LEFT LANE, can you tell me a little bit about your history and what you do today?

LEFT LANE is a vertically integrated investor, fund manager, hotel brand creator and owner, delivering market-leading hotel and residential assets in high-growth markets. We have three disciplines in-house: a development team, which has eight licensed architects on staff; an investment, special situations and capital markets team that I head up; and an operations team that focuses on hotel and restaurant/bar operations, as well as marketing, branding and IT. We also have an operational joint venture with Highgate Hotels, called LEFT LANE Hospitality, which is the operator of our hotel assets. This JV allows LEFT LANE to focus on its strengths (the customer facing, high-margin elements of running independent luxury hotels, think revenue strategy and management, etc.) and at the same time leverage the scale of a large company like Highgate, vis a vis buying power, systems and access to labor. My partners and I have known each other and have been close friends for 30 years, as we went to Colgate University together.

Do you have a regional focus?

We are focused on high-growth markets in the U.S. that don't have enough independent luxury hotels and best-in-class residential, to serve their demand. When we raised our GP vehicle in 2021, we wanted to do a couple of things: 1) take advantage of the distress that COVID had caused in real estate and 2) do it in markets that were growing rapidly and were benefiting from the movement out of gateway cities into secondary markets.

We identified our markets by conducting a three month-long research project. We analyzed the success of markets like Austin, Nashville, Denver and Tampa pre-COVID and identified the key demographic, economic and cultural variables that led to their outperformance in our two asset types. We also used the CMBS loan universe as a proxy for broader distress by building our own asset valuation model to identify markets with large pockets of underwater CMBS loans. We then looked for those signals In markets across the U.S.

Twenty markets scored high enough on our proprietary model to take to the next phase of analysis, which was asset identification. We inventoried the historic buildings in those markets which were the right size and shape for a conversion at an economically viable basis, and were well-located enough to support a luxury asset. That work yielded 600 buildings across 20 markets.

The final step was to feed those 600 historic buildings into our CMBS loans model to see which, if any had upcoming loan maturities their owners were not going to be able to refinance or sell without coming out of pocket. That last screen yielded 200 buildings across 20 markets that we wanted to go after and see if we could strike deals with the owners off-market.

What was your pitch to those owners?

The pitch was simple. We would call owners and say "Hello Mr. McWhorter, my name Is Andy Bernard. I am so sorry, but I know you have a $40 million loan coming due in March, and I also know that you're not going to be able to refinance it because your office building is 40 percent occupied, versus 90 percent when you put this loan on. Further, you've owned this building for 30 years, which means you have a negative tax basis because you have taken advantage of depreciation."

"So, what if I were to buy this building from you for something close to your debt level so you don't have to come out of pocket, much and, if you would like, I will allow you to stay in the new development in a sliver equity capacity so you can continue to avoid your tax problem, while providing upside to boot?"

How was that offer received typically?

That offer is what has allowed us to acquire a five-asset, 1.2 million square-foot portfolio of iconic, historic buildings for $80 PSF and four of the five previous owners have not only stayed in the new transactions with us, have proven to be incredible local partners, as well.

Why are you focused on historic buildings?

There are a few reasons why historic buildings make sense for our strategy: 1) Historic buildings are often at Main and Main locations and were constructed with wonderful architectural detail and quality that could not be replicated today due to cost and the lack of skilled labor required. These locations and quality make for incredible boutique luxury assets.

2) We get the benefit of federal and state historic tax credits to offset the cost of the renovation, in some cases up to 45 percent of our renovation expenses. At the federal level you get 20 percent and each state has their own program with Georgia at the high end with an additional 25 percent. That means that if I am spending $100, I am getting $45 of it back from the federal and state governments, which not only mitigates construction costs and cost increases if they exist, it also engenders outsized cash on cash yields due to the cash flowing back to our investors from the tax credit buyer upon project completion.

3) Historic office buildings are, by definition, Class B and C. They are not where today's office users want to be. They want to be in a bright, shiny new structures. That means that our buildings were underperforming before COVID, which meant they were the most distressed when COVID happened, which contributed to our ability to acquire them so cheaply. Further, the local and state governments are providing additional financial

Hotel Bardo Savannah

incentives via tax abatements and grants to help facilitate the redevelopment of iconic buildings like ours.

4) Historic buildings, for the most part, are the right size and shape to be converted in an economically viable manner.

What do you mean by "the right size and shape"?

I mean that you do not have to change the structure of the building to convert it to another use. Structural modification adds too much cost to an adaptive re-use project, particularly in secondary cities. Historic buildings were built before the advent of central air conditioning, which meant that their interior spaces had to have great natural light and air quality. From a design perspective, this means the floor plates are not too wide or too deep. So, we can build an efficient double-loaded corridor without removing the center of the building and rebuilding the core elsewhere, which is what would be required of most modern office buildings with 40,000 square feet rectangular floor plates.

Are you finding investors happy with this strategy?

Yes. Investors recognize that we have an edge via our off-market, special-sites sourcing, combined with our historic, adaptive re-use experience, design chops and operational control. We do have to spend time walking through how we have mitigated construction delay and cost risk, but that is fairly straightforward to understand for most investors.

You've mentioned that you've created two brands. What are they?

Our luxury brand is called Bardo. The first hotel under that brand was opened 11 months ago in Savannah. Check it out at www.staybardo.com. It Is already the rate leading asset in the market, with a robust private club membership, and we have received a tremendous amount of positive press as well. We have created an urban resort In the historic district of Savannah — there is nothing like it in market. Our second brand is called Recess. Recess is a lifestyle brand, which complements Bardo nicely in that it also has incredible design and vibrant public spaces but is priced a tier below the top-end of the market.

Are these hotels located near amenities, or do they have their own amenities?

They all have their own amenities, typically intended to be the most robust in market. At Bardo Savannah, which has 149 rooms, we have an amazing pool complex, spa, gym, restaurants, bars and the best meeting space in the market. As I mentioned previously, we also have a members' club; the membership gets to access certain areas of the property, member programming etc. We will have these member clubs at most, if not all, of our properties.

Are you marketing to conference event planners or are you working with the individuals?

Absolutely. The hotel business is interesting In that because the conference business looks so far out in the future, a sales manager is often booking 6, 9, 12 months out in the future. That advance base of business allows us to drive incremental rate from the transient guest the closer and closer it gets to the actual day of stay.

What are your future plans?

Our primary focus currently is to finish the six assets we have under development and then transition to begin raising our next fund. Our intention is to grow our portfolio meaningfully over the next five years, expand the Bardo and Recess brands and eventually branch out to gateway cities like Los Angeles, New York, Montreal and London.

Do you expect to eventually expand into greenfield development?

Yes, absolutely. In fact, our project in Bozeman, Mont., is a ground-up development. It was one of two markets in the United States that we believe ground-up construction actually makes economic sense for our product focus, given the supply, demand, barriers to entry and construction cost dynamics.

As a final question, what gives LEFT LANE its competitive advantage?

The combination of our special situations, off-market sourcing, high-design, independent luxury hotel and residential track record, our experience with historic buildings and the operational JV that we have is very unusual. I don't know another firm that has combined these skill sets and is taking advantage of the distressed office market in this way. We are proud of what we do and are excited about the future.

For more information about LEFT LANE:

646.992.0206 | andy@leftlane.dev | www.leftlanedevelopment.com