

Doug Smith of Hawthorne Funds.

Hall T Martin: [00:00:04] This is the Investor Connect Podcast Program, I'm Hall T Martin. I'm the host of the show in which we interview angel investors, venture capital, family offices, private equity, and many other investors for early-stage and growth companies. I hope you enjoy this episode.

Hall T Martin: [00:00:23] Well hello, this is Hall Martin with Investor Connect. Joining us today is Doug Smith, CEO and Lead Investor Leadership Team at Hawthorne Funds, a Houston-based private equity firm that couples Doug Smith's funds with those of other investors to purchase, subdivide, and sell large rural tracts of land in Texas. So, Doug, thank you for joining us.

Doug Smith: [00:00:43] Great to be here Hall.

Hall T Martin: [00:00:44] So tell us a little about your background. What did you do before you started this work?

Doug Smith: [00:00:49] Well, I moved to Houston, Texas, to be a software developer for Exxon Mobil, quit that after a year or two, bought and sold about 100 houses over the next few years. Then I started an internet company that provides listings of properties, ran that for about 10 years, and then switched over to rural land development where I am now.

Hall T Martin: [00:01:09] Well, great. And so, what excites you right now?

Doug Smith: [00:01:11] Well, luckily, what excites me is the business that I'm currently in, and my business partner and I really lucked out being in the land business going into this pandemic. There was already a strong demand for our product, which is small "ranchettes" - we call them ranchettes, small ranches outside of town - and the demand has mostly increased since the pandemic because there was already kind of a desire to leave the hustle and bustle of the city and be out in wide, open spaces and have a place for the family to get together. But that was certainly accelerated with the pandemic as people started to look more negatively upon crowded places like cities.

Hall T Martin: [00:01:50] Well, great. And so, what's your advice for those investing in the real-estate sector? What do you tell them to do before they write that check?

Doug Smith: [00:01:57] Well, if you're just looking to invest in say, someone's private equity fund as a founder too, you definitely want to check out the sponsor, make sure you get to know them as well as possible. If you're running in some of those same circles as the sponsor, ask around about them. And, of course, you'll look at a pitch deck and then ask any questions you have, but you certainly these days, you want to make sure that they're doing well enough through this pandemic so that they can still generate those strong returns for you.

Hall T Martin: [00:02:29] Well, great. And so, how do you see the real-estate sector changing during the COVID times? You've talked about people moving out into the rural areas and forming ranchettes and so forth, but what are the changes you think it's going to have on the real-estate sector?

Doug Smith: [00:02:46] Well, that really kind of depends on which niche you're in. And so, it would be hard to say that real estate has been either positively or negatively impacted, you just really have to look at the niche. So, for example, if you have single-family rentals, well, I just got off the phone with a large property management company, they say they're doing fairly well collecting those rents, it's off a little bit. There are some slow pays and no-pays with the tenants, so that's doing OK. Single-family sales of houses, those are doing fairly well, surprisingly, with _____ market down and values up, that's definitely happening here in Houston, I would imagine that's happening in many parts of the country. I'm not sure about San Francisco with kind of like a flight away from there to a decent degree. Warehouses, a lot of people are looking to store the equipment, maybe they downsized their business, they're looking to store the equipment, or office furniture, or things of that sort. So, I think that area is doing fairly well. Self-storage, same category. So, if you owned strip centers with a lot of retail, that's not doing well. So, it just depends which niche you're in as to kind of how it's looking during the pandemic and how it will look afterward. Definitely, we'll almost certainly be seeing for many years to come in the office-space area, that's going to be suffering because even businesses that are doing well are still downsizing their office space because they're having so many of their employees work from home. But other

areas I think would rebound more quickly than that. So, yeah, that's kind of what I'm seeing in the different areas in real estate.

Hall T Martin: [00:04:28] Well, great. And so, what's the biggest change you think we're going to see in the long term?

Doug Smith: [00:04:32] Well, from the pandemic, it's going to be the same thing that a lot of people are seeing is more people working from home, more video calls, things of that sort. Definitely more online shopping, that was already a major trend that's going to probably continue, so retail, I would imagine, would continue to suffer for quite some time. So, things of that sort.

Hall T Martin: [00:04:52] Cool. And so, what's your investment thesis for what you do, your fund? What do you look for and how do you make decisions as far as funding projects?

Doug Smith: [00:05:01] Well, what we used to do is we would pre-fund, we were buying and selling - my business partner and I buying and selling - all these houses, buying them for cash and selling them on owner financing, then we switched over to land, and just as an experiment and that went well. And so, what we've kind of learned to look for over the last several years of investing in land, is a property usually that is about an hour, maybe an hour and a half at most away from the city, and that has a decent amount of road frontage so that we can carve out little 10-acre ranchettes and have each ranchette have access to a road, and then we'll be able to go in and put in water wells, and bring in power and so forth, and prepare that ranchette for sale to an in-buyer. At some point, we may start building more roads, we're already building one right now, and we won't need the road frontage as much. But it does need to be a property that's about an hour outside of town for it to work for our model.

Hall T Martin: [00:05:59] Well, great. You're currently doing this around Houston, are you planning to do this in other metros in Texas and even outside of Texas?

Doug Smith: [00:06:06] Yes, well, we have our hands full with Houston right now, there's just so much land available and such a strong demand for it. We run Facebook ads, for example, advertising these ranchettes for sale, and we just can crank our

budget up or down and get as many leads as we want. So, we don't necessarily have to leave this area, but we are going to experiment more outside of this area, we'll go to maybe San Antonio and Dallas, for example. And we recently bought a property near Corpus Christi, so, we do try to branch out a little bit, we don't necessarily have to.

Hall T Martin: [00:06:39] Do you find COVID had an impact on your business with respect to building the houses, or setting it up, or selling it? Certainly, it's driving people out of the cities, but, has there been any negative impact on your business from it?

Doug Smith: [00:06:53] The negative - a lot of people in the single-family-home industry, that's where a lot of my friends and colleagues are, they're having a hard time getting materials and getting contractors. We're doing OK. We're out away from the city and we already have regular crews of contractors we're working with and we have, we're not fighting over necessarily the same materials that those other single-family guys are fighting over, because all we're really doing is putting in water wells, we're bringing in power, we'll put in a driveway, gates, culverts, fences, and so, we're doing OK in that regard. The way it kind of negatively impacted us a little bit is that for two, or three, or four months near the beginning of the pandemic, several of the people that we had sold these ranchettes to on owner financing, they thought they didn't have to pay their mortgage anymore because there were a few articles going around the internet and people talking that maybe mortgage payments were going to be waived, and I think that was the case for certain loans that were backed by the government, but definitely not in our case. Because when we do sell a ranchette, we normally sell it on owner financing, we collect on the note for a few months, and then we sell the note. So, that was a negative. And then also it became harder to work with banks because for most of 2020, banks just kind of froze their desire, frozen new lending activity, and so, even if they like what we're doing and they would like to lend on it, someone high up in the bank has decided no new lending or no new clients. We have been able to continue to work with a couple of our existing bankers, but not a lot of headway working with new bankers. There's been a couple of ways, but I would say it's minimal. So, what we've done just to kind of head off a couple of those problems, we stay on the phone on a regular basis with our current bankers to keep that relationship warm, and then I'm on the phone and via email, in touch with our investors in the private equity firm, just reassuring them that everything's going well, which it is. So, doing that. Oh, and another negative impact at the beginning was some of our buyers seemed to have cold feet.

They would fill out an online form saying they were interested in a ranchette, but we had a hard time converting most of those buyers into actual buyers, get them to the closing table. So, that happened for a couple of months, and we were a little bit concerned just because when there's economic uncertainty, people are generally not as willing to move forward with a large purchase, because each of these ranchettes can cost maybe \$140,000-\$180,000, so that was just a little bit too much for some of these people to swallow. And, what we really learned over the next few weeks after that is that it was not necessarily a problem with our buyers, it was a problem with our sales team, that our sales team was scared. And, so that fear was being conveyed either consciously or subconsciously to the ranchette buyers. And so, what we ended up doing was a couple of pep talks with the sales team to get them back on track, but more importantly, bringing in a top-notch salesperson from another organization to come in and show that, yes, we can continue to sell during a pandemic and then kind of motivated the rest of the team, and everything has been basically back to normal since then.

Hall T Martin: [00:10:04] So, besides the different changes that went with the banks and so forth, did you change your investment thesis for the ranchette portion of the business? I know you're not involved in the strip malls and those things, but for the ranchettes, did you have to change the criteria or anything in that direction, or is it just continuing forward as before?

Doug Smith: [00:10:23] We kind of did and it's something we might have already done, regardless of the pandemic. We started, instead of requiring, say, 10% or 15% down on each ranchette sale, we started requiring closer to 5% down and we started qualifying the buyers more on their debt-to-income ratio, and that has proven to be a very successful strategy. These people are paying just as well as the prior group were paying because the idea previously was that the larger their down payment, the more likely they are to continue paying on their loan. But what we found with this new approach, it works just as well, and we're able to sell, qualify and sell to a lot larger pool of buyers. And I just think that would have probably happened anyway. Another thing we started doing too is we started using a software called MapRight to be able to send information and a link to the property, a map actually, so that they can actually go out to the property on their own and give themselves a self-guided tour of the property without ever having to interact in-person with an agent. And, so they're doing that now, so people are taking self-guided tours of our properties all the time. And so, I think the

pandemic sped that up, us implementing that system, and it's something we'll definitely keep going forward.

Hall T Martin: [00:11:38] Do you find you lose anything not being there in person, or how far does the virtual tour take care of it? Because we hear the same thing about Zoom, it's not face to face, but it's online. A lot of benefits of being online because meetings are shorter, less travel, but, some people say we haven't quite got the same experience checking body language and nuances and so forth. What's your experience with the virtual tour software?

Doug Smith: [00:12:03] Yes, you do lose something, but if a salesperson or the sales team's overwhelmed with people wanting to go out and take tours or are having a hard time coordinating a time to meet the person or their family out there, this is a great way, this is a great strategy. So, they can even go give themselves a self-guided tour at first, and if they're super interested, then the sales agent will go meet them out there in person with the map and all the other precautions.

Hall T Martin: [00:12:28] Ok, great. Well, in the last few minutes that we have here, what else should we cover that we haven't?

Doug Smith: [00:12:33] Well, I could give some general advice. So, it seems fairly clear to me at this point that the pandemic has not impacted my business to a large degree and that's nice. My heart does go out to all those who are seeing a significant impact. I was in their shoes maybe 12 years ago during the financial crisis, housing crisis. I almost lost my internet business at the time, barely salvaged it, and it was just such a bleak period and I would just encourage anyone who's going through a time like that just to hang in there, because it's always darkest before the dawn and there is a light at the end of the tunnel and you will get through this.

Hall T Martin: [00:13:12] Well, that's good advice and great words to live by. Appreciate that. Thank you so much for taking time to join us today. How best for listeners to get back in touch with you?

Doug Smith: [00:13:21] Well, you can shoot me an email, doug@hawthornefunds.com, and I would be more than happy to include and copy you on the regular updates that I

send to our current fund investors so that if you did want to possibly invest someday, you at least know what's been going on and be in a position to do so.

Hall T Martin: [00:13:39] Great. I'll put that in the show notes. I want to thank you for joining us today and hope to have you back for a follow-up soon.

Doug Smith: [00:13:45] I'd love to come back. Thank you so much Hall.

Hall T Martin: [00:13:47] Investor Connect helps investors interested in startup funding. In this podcast series, experienced investors share their experience and advice. You can learn more at Investorconnect.org.

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