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A Housing Bust Comes for Thousands of Small-Time Investors

They were offered the benefits of owning apartment-building rentals without any of the work, in real-estate investments that have already left some people empty-handed

By Will Parker Follow *, Konrad Putzier* Follow *and Shane Shifflett* Follow

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Few investors rode the pandemic-era housing boom as high as Jay Gajavelli. Fewer still have fallen as far.

Before Gajavelli found his real-estate career, the 61-year-old immigrant from India was just another information-technology worker, putting in 60-hour weeks for a middling job in Dallas. Last year, Gajavelli's company owned more than $500 million worth of Sunbelt apartment buildings with more than 7,000 units, and was one of Houston's biggest landlords.

Over the past four years, Gajavelli built his real-estate empire using funds from dozens of small investors who wanted a chance to earn a landlord's riches without any of the work. He pitched double-your-money returns in ebullient, can-do talks at investor conferences and on YouTube videos.

He described buying buildings with plans to upgrade units, raise rents and sell for a profit after as little as three years. The idea that everybody needs a place to live was the bedrock of Gajavelli's pitch. "I never worry about [the] economy now," Gajavelli told investors in a webinar presentation last year for his company, Applesway Investment Group. "Even if [the] economy goes down, still I make money."

Gajavelli's investors were, in fact, highly vulnerable to interest-rate increases over the past year that crushed the business model that they and thousands of others in similar deals across the U.S. had hoped would make them wealthy. For them and a host of small investors — who were expecting a share of rents and a piece of the profit in an eventual sale—it is looking like a looming investment-property disaster.

In April, Gajavelli's company lost more than 3,000 apartments at four rental complexes taken in foreclosure, one of the biggest commercial real estate blowups since the financial crisis.

Investors lost millions. Gajavelli didn't respond to requests for comment.

His company had taken out commercial real-estate loans that carried floating interest rates and were adjusted each month. Those types of loans in 2021 offered initial rates as low as 3.5%. Everything changed when the Federal Reserve began raising rates last year, driving up monthly loan payments. Inflation contributed to higher expenses, and Applesway couldn't raise rents fast enough to keep pace. After bills went unpaid, company properties went into foreclosure.

Jay Gajavelli of Applesway Investment Group in a still from an online video.

Gajavelli is one of thousands of real estate entrepreneurs in the U.S. known as syndicators. Many have come under similar financial pressures and hold properties they can no longer afford. From 2020 through 2022, real estate syndicators reported raising at least $115 billion from investors, according to a Wall Street Journal analysis of Securities and Exchange Commission filings.

So far, defaults have been rare. But real-estate analysts and property investors anticipate a wave of foreclosures ahead.

Congress in 2012 opened the door to the syndicators with a law that made it easier to market real-estate investments online. The law, intended to open financial opportunities to lower-income people, greatly expanded the reach and audience for syndicator deals.

Syndicators largely favored apartment complexes in the South and Southwest, where real-estate prices were lower, rents were rising and housing regulations were generally looser. Many of these locales had fewer renter protections, which made it easier to evict tenants and raise rents.

The rental-market boom made millions for syndicators and their investors through rising rents and escalating property values. Average rent for a one-bedroom apartment in Phoenix has increased 37% since January 2021, driven by pandemic migration and a limited housing supply, according to the rental listing site Zumper. “There was this huge mania where people wouldn’t even look at the unit,” said Colin Ralls, principal of Phoenix-based property manager Acora Asset Management. Prospective tenants would just apply, he said.

Syndicator investors have few legal protections, said Joan MacLeod Heminway, a securities-law professor at the University of Tennessee in Knoxville, Tenn. Unlike public companies, syndicators in many cases aren't required to give regular updates on their buildings' financial performance, she said. As limited partners, investors have no say over spending. Some who lost their investment never knew the properties were in trouble until they were near foreclosure.

Munzer Haque, a former IT professional in Plano, Texas, said he was Applesway's largest individual investor in the company's four foreclosed properties and in two others he described as in trouble. Haque said he and his wife, both in their 60s, lost millions of dollars, the majority of their life savings. Their two adult children also invested in Applesway and lost money, he said.

"When you trust the wrong person, that's the highest risk," Haque said, "because you give them everything."

Many syndicators are racing to either raise funds or sell properties before tipping into foreclosure. Most hold balloon-payment loans that require repayment when they come due this year or next. Those syndicators face large payouts at a time when getting new, more affordable property loans will be difficult. Even firms with multibillion-dollar portfolios have used syndication to buy apartment buildings that no longer make enough money to cover debt payments, bond documents show.

"The bubble is going to start popping if these guys can't get out of these deals in time," said Ralls, of Acora Asset. Lenders also risk heavy losses.

This account of Gajavelli and Applesway is based on interviews with his investors, tenant organizers and others who did business with him and his company, as well as securities filings, investor documents, social-media posts and property records.

Get on board

Gajavelli grew up in a lower-middle-class family in rural India before immigrating to the U.S., he said in one of his promotional videos. After finishing one exhausting workweek, he said, he was struck by a thought that changed his life: "I'm sick and tired of working for my money."

That was when he decided to become a landlord, he said. In time, "I was able to replace my IT income," he told prospective investors last year in a webinar. "I live on my own terms."

Last February, he passed on that message to Shri Sinha, another IT professional, saying he had acquired more than $400 million worth of rentals and was looking to buy more. “That’s what got me attracted to him,” Sinha recalled.

They were on a bus tour of Dallas apartment buildings, hosted by real-estate investing coach Brad Sumrok, who drives a Ferrari with the vanity license plate “APT KING,” according to his social-media posts. He, too, assembles investors as a syndicator to buy apartment buildings. Mr. Sumrok also charges for membership in his real-estate investment clubs—as much as $35,000 a year—where he teaches the ropes to prospects.

“Just love collecting rent from 9,716 miles away,” Sumrok said in one post. “Invest in apartments and make money while you travel.” His online testimonials feature middle-age people who had quit 9-to-5 jobs and, with Sumrok’s help, became millionaires purchasing “doors,” investor lingo for apartment units.

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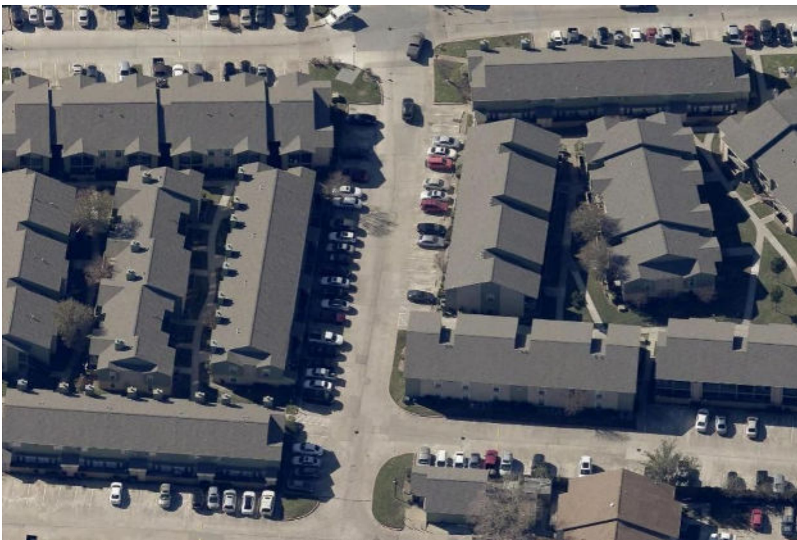
Today is Sept 1...ya know what that means...?

That's right....Rent is due!

> The apartment sector has proven to be extremely resilient during covid...even in August with no extended stimulus package...
>
> Lets see how we do in Sept! We are encouraged and optimistic that renters will continue prioritizing their rent payments.
>
> As our politicians duke it out and play partisan politics...92.% of renters paid their rent in Aug 27, 2020 compared to 94.0% in 2019....even with talks of rent strikes and extended / modified eviction moratoriums in some locations.



Timber Ridge and Reserve at Westwood were among the properties Applesway lost to foreclosure.

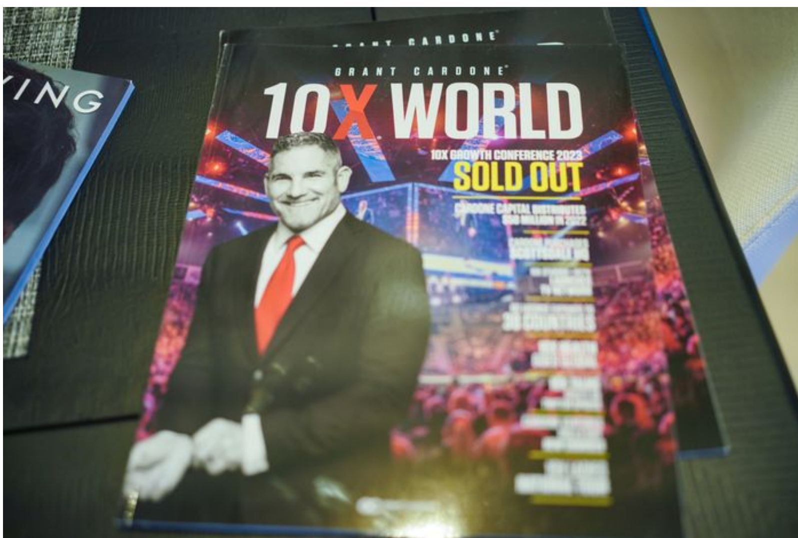
EAGLEVIEW

Syndicators generally invest little of their own money. They collect acquisition fees from investors that typically go from about 2% to as high as 5% of an apartment building's purchase price. They also take management fees of 2% to 3% from the building's gross income. Syndicators often profit even if the investment is a failure, which real-estate analysts say encourages excessive risk-taking at the expense of inexperienced investors.

During the pandemic, syndicators found it easier than ever to raise money. Sean Tate, a Dallas-based real estate attorney who has worked with syndicators, said he was inundated with calls from people seeking help to syndicate rental-apartment deals.

Many of the callers learned about the chance to become a landlord from social-media ads, Tate said, and had little idea of what they were getting into. “You couldn’t get on Facebook without the algorithm saying ‘Deal! Deal! Buy multifamily!’” he said.

One of Sumrok’s mentors, Grant Cardone, a former car salesman from Louisiana turned syndicator, has amassed 4.3 million Instagram followers, and his company bought $618 million worth of apartments in 2019, according to CoStar. In one December 2020 presentation, Cardone tells the audience that making only $400,000 a year is embarrassing. “My plane eats $2.7 million a year,” he said. Cardone didn’t respond to a request for comment.



Grant Cardone on the cover of a promotional magazine at an event last month in his Malibu, Calif., home. PHOTO: GONZALO MARROQUIN/GETTY IMAGES FOR HAUTE LIVING

Broom clean

A video for prospective Applesway investors that was posted in December of 2021 featured the 704-unit Houston apartment complex called Timber Ridge. Applesway, Gajavelli’s company, bought the complex that month for $56.7 million with plans to more than double investor returns by raising rents and adding tenant fees for washing machines and covered carports.

The investor video showed a tidy complex of apartments arranged around a shimmering swimming pool. By summer 2022, the pool water had turned a sickly green. High piles of trash

littered the parking lot. Tenants complained to city officials about rats, mold, illegal evictions and the failure of management to properly maintain the buildings.

Kim Alexander, the former asset manager of Applesway, said Gajavelli refused to buy new air conditioning units when old ones broke down. Alexander said she ferried working AC units from vacant apartments to ones where families with children were living without air conditioning.

Last July, Houston Mayor Sylvester Turner, visited the Timber Ridge Apartments and threatened legal action. “The situation that the people are living in right now is deplorable,” Turner said at a news conference in the property’s parking lot. “And none of us would want to live in it.”

“The tenants were desperate,” said Mitzi Ordoñez, a former staff member of the nonprofit Texas Organizing Project. The group had worked with the complex’s mostly low-income, Spanish-speaking tenants to get help from the city.

A boarded-up unit last summer at the Timber Ridge Apartments in Houston. PHOTO: MITZI ORDONEZ/TEXAS ORGANIZING PROJECT

For most of 2022, Applesway sent brief updates to investors about the company’s various properties, as well as monthly cash disbursements based on the amount of their investment.

Sinha said the first big sign of trouble came this year in a late February email. Gajavelli asked investors for additional funds to shore up property finances at Reserve at Westwood, the Houston apartment complex he had invested in. “I want to let you know that things are not going well,” Gajavelli wrote.

Applesway was losing money because of higher mortgage costs, the result of much higher interest rates, the email said. Property taxes and insurance costs were up. And, as the company moved to raise rents, more tenants fell behind on their payments.

In March, Gajavelli told investors no money was needed after all. In early April, he sent investors letters telling them the buildings had gone into foreclosure. “Few things are more painful than having to notify investors of a failed business,” he wrote in one letter.

Gajavelli offered a silver lining. “We suggest that you contact your tax advisor to discuss how your investment loss can be recognized on your tax filings,” he wrote.

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