EPISODE 821

[INTRODUCTION]

[0:00:00.0] 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.

[INTERVIEW]

[0:00:24.0] WS: This is your daily Real Estate Syndication Show. I'm your host, Whitney Sewell. Today, our guest is Kevin McGrath. Thanks for being on the show, Kevin.

[0:00:32.4] KM: Yeah, thanks for having me, Whitney. Glad to be here.

[0:00:34.6] WS: Yeah. Kevin began his commercial real estate career in 2007. And in that time, he's been involved in leasing, acquisition and disposition of more than $1 billion in industrial real estate throughout the United States. Kevin had a successful 12-year career as a Senior Vice President with CBRE specializing in industrial brokerage. And in 2019, switched to investing full-time as he became a Principal with Cardinal Industrial and owner and operator of 12 million square feet of industrial property. He is deeply passionate about investing in real estate as he sees it as a vehicle to produce passive income, thus creating time freedom.

Kevin, welcome to the show and you have a great background and I know you're going to be a great guest. Looking forward to this conversation. I just want to hear a little bit about your background, how you transitioned from CBRE to getting in as even passive and also active. But then just your specialized niche to an industrial, and how it's been working right now through COVID, pre versus post-COVID. Get us started a little bit with your background and your movement into the active space.

[0:01:48.9] KM: Yeah. Well, thanks for having me on again, Whitney. I got started in real estate, commercial real estate in 2007, like what you said. In brokerage in Columbus, Ohio where I'm from originally. My niche at the time was — still is — was industrial real estate. When I got into it, Whitney, I didn't know anything about industrial. It just so happened that the team I interviewed with, I got along with them well. Our personalities meshed and they had a spot on their team for a junior broker. So, in a way, I just kind of fell into industrial.

I'm sitting here where I am today, I'm glad I did. There were certainly some bumpy times getting started because I started 2007. Had a one year of salary then came off salary in the fall of 2008, which if you remember, that was when the market collapsed and the start of the great recession. It was not a great time to get started in real estate, especially coming off a salary going to 100% commission. But was able to fight through it, to persist. And it was really helpful to have two senior-level partners who helped me a lot, were great mentors for me. And continued with a successful brokerage career.

Fast forward to about 2018, I got the bug to start investing passively in real estate. I was tired of my money not doing much in the stock market. I was investing conservatively in index funds and it really wasn't going anywhere. I wanted some passive income that I could really provide kind of a safety net or a cushion because of the grind of brokerage. Where you're starting every year at zero. I got started, like I said in 2018. Had some friends who are syndicators full-time. Started learning more about what they're doing, all the tax advantages that were involved. I knew that this was something I wanted to get into full-time. I made the leap about, really, the spring of 2019 when I left CBRE and joined Cardinal Industrial, which owns about 12 million square feet of industrial across the country. Mainly in the Midwest and the southeast. It's been a great ride since.

[0:04:10.0] WS: Nice. Well, grateful just to hear some of your story. I find that most of us didn't have a direct path to becoming an operator or buying large commercial real estate. There are something else we were doing or something that led us there. It wasn't like you're five years old, typically thinking, "You know what, I'm going to be a syndicator." So it's interesting just to hear your story. Definitely a great background to become an operator and get into the space. No doubt about it.

Let's dive into just the industrial world a little bit. I know you said you fell into it as a junior broker. But even at that point, obviously, that's post-COVID and all that stuff. Why industrial versus multifamily or senior living, or anything else, all the other asset classes that you could have gotten into.

[0:05:01.7] KM: Well, I think what industrial has done, and I'll talk about it post-COVID kind of where we are today. Not to pit one against the other because I still invest passively in multifamily. There are several great vehicles to invest in throughout the different sectors in commercial real estate. But I think what industrial has proved over the last really six, eight months since COVID how resilient it is. Supposedly right now we're in recession, but in my world, it's anything but. I mean, it's probably as active or competitive today that it's ever been anytime over the last 20 years. A lot of that is because of e-commerce. You've probably read a lot about it or heard a lot about e-commerce and I'm sure you had a lot of hands-on experience buying goods and services over the internet. That's been the absolute game changer for industrial.

We can talk more about that in some of the stats and research that have come out since COVID. At the end of 2019, e-commerce accounted for roughly about 15% of all retail sales and was growing at about a 15% clip year over year over the last 10 years, so it was really steady growth. What COVID has done is really accelerated that. This year, in the 12 months since, e-commerce now is going to count for about 25% of all retail sales. There's a huge job because of COVID because people couldn't get out to shop. And they were forced to buy products online.

I think what we're going to see through the holidays, this holiday season is even more of a jump. It's going to be absolutely going gangbusters for these retailers and the amount of —

they call it adoption. How many new users are coming and buying things online? There's a stat that recently came out that e-commerce sales are projected to hit about $700 billion this year. By 2025, that number is going to go up to $1.5 trillion. What that means, Whitney, is that $800 million delta is going to create a demand of one billion square feet of industrial space that's going to be needed. It's such a huge significant number because it doesn't matter if it's industrial, multifamily or office. What drives investors in what we do is tenant demand. You need tenant demand. That's what e-commerce is giving industrial real estate, is just significant tenant demand that the developers really can't keep up building enough warehouse space before it gets absorbed.

[0:07:47.1] WS: Can you talk about that tenant just a little bit? Maybe just how that's changed over the last year or two, and then through COVID or maybe how you see that changing over the next years as there is such a demand? Is it more just warehouse space now or are there other types of tenants that you're looking for?

[0:08:07.7] KM: The biggest driver again is e-commerce and e-commerce users. Again, this could be the Amazon, Walmarts, any retailer that has an online presence could be considered an e-commerce user or occupier. That they account for about 25% of the overall industrial base or industrial users. It's only about a fourth of all industrial users. What we're seeing is, it's really the rising tide lifts all boats theory — that these e-commerce users are growing at such a clip. It's creating such demand that these other industrial tenants such as manufacturers. It could be retailers but retailers that are distributing to stores. It could be third-party logistics companies, which are if you're not familiar, they are basically when a company outsources the warehousing or their logistics. They are having to go out and find spacing, compete with these e-commerce companies. What it's doing, it's raising rental rates and it's causing these other users to go out and lease space that the e-commerce companies are not. They're being driven down to the class B product and e-commerce users, a lot of them are occupying only class A products.

[0:09:29.8] WS: What's the biggest risk right now. Let's say for a passive investor, when investing with an operator that's purchasing industrial property?

[0:09:39.6] KM: I would say, the biggest risk is, a lot of the industrial buildings — I shouldn't say a lot. It just depends which type of product, but what we acquire mainly, Whitney is single-tenant assets. Leased long-term to creditworthy tenants. And sometimes when the lease expires, tenants don't renew. I would say that's probably the biggest downside is, if you're investing in a single-tenant asset and the tenant does not renew and moves out. Having said that, we go into a deal when we acquire it, knowing that this could happen. We set aside a significant amount of reserves. And then also the tenant must give us notice, typically six to nine months before the lease expires if they're going to renew or not. That six or nine months is kind of a buffer where it kind of allows us to go out and try to lease the property out to another tenant.

[0:10:37.5] WS: What is the typical time it would take to release some — I know there's so many factors there; type of property and location and all these things. But when you're just looking at a property or you are underwriting something like that, and you're trying to calculate that amount of reserves that you need for that time. How do we do that? Or if I'm a passive investor looking to say, "I want to invest with you, Kevin." I may ask you, "How do you know how long we need to account for that vacancy and how much reserves do you have?"

[0:11:09.2] KM: Like you said before, it depends on the market. It also depends on the vacancy size. If it is 100,000 square feet, in an A location, in a first or second-tier market, you're looking at maybe four to six months right now. Versus if it's a 800,000 square foot huge distribution center in a tertiary market, it could be 12 to 18 months. We know that going in. Typically, we hold about six months of reserves. And then working with our lenders as well. I would say, six to nine months reserves. And that's in addition to the six to nine months that we typically have to go out and market the property if the tenant doesn't exercise the renewal options.

Having said that, all of this, this happens pretty infrequently. We'll have maybe one vacancy like this every couple of years. It's not very frequent that it happens.

[0:12:06.2] WS: Nice. I think, typically, it's pretty long-term leases, right?

[0:12:11.2] KM: They are, yeah. And it just depends what operator and kind of their appetite and their investor's appetite for risk. We're looking for five years of lease term or longer. And depending on the situation, maybe we'll go a little bit shorter. But on average, Whitney, it's five years of lease term or longer.

[0:12:31.5] WS: In just the current state of the market, just with COVID, everything that's happening right now. Are you all buyers, sellers? Are you sitting on the sideline? What's y'all's take?

[0:12:41.0] KM: We are buyers and sellers. Like I said before, it's super, super competitive right now. But there's so much capital pouring into industrial real estate. A lot of it at the highest level, institutional money, whatever. Their cost of capital is so inexpensive compared to ours. That it's hard to compete, so we have to differentiate ourselves a little bit. We'll go into maybe markets where they won't, so second. And in tertiary markets, we'll buy product that they won't. Maybe a little bit older class B, a metal building that maybe isn't aesthetically as pleasing to the eye. But we just have to do things a little bit differently right now to find deals. We have to look harder and we have to look a little bit longer, and we have to rely on our broker relationships to do so. But it's a really competitive environment, so that's why it's a good selling environment.

The nice thing about being with a kind of smaller boutique firm is that we can be agile. And if we get an unsolicited offer for a property and it makes sense, we'll sell it. So yeah, we're actively selling and buying right now.

[0:13:49.1] WS: For an industrial property, how should I — if I'm fixing to possibly invest, what should I be asking to make sure that that operator is prepared for a potential downturn?

[0:14:00.0] KM: Yeah. I think, I guess we're on a downturn right now, some would say. But I think it's important to have, again, reserves going into a building. And a market that has enough users in the adjacent area that if the tenant didn't move out, that there's going to be enough demand nearby that it can be backfilled quickly and relatively easily. I think those are really two important things.

Industrial in a sense is a lot more hands-off from a management point of view than it would be for a multifamily syndicator such as yourself. Way less issues as far as trying to go out and turnover and dealing with the tenants, it's a little less management intensive. It makes it a little bit easier to scale on the industrial side, without having a huge management presence.

[0:14:55.5] WS: No doubt about it. Very different type of operation for sure. Going back just a little bit and talking, and thinking about your path to becoming an operator and coming active versus the hopping W-2 to being a passive investor. What's really been the hardest part of that process for you?

[0:15:16.9] KM: A couple of things. First having enough gumption to actually do it. It's something I was kicking around for a year. I remember, I would leave quite a bit, my W-2 job. Looking back on it, I was making a lot of money, I was comfortable. I was established but I would leave almost every single day with this kind of pit in my stomach, knowing that there was something else that I wanted to do. So actually, having enough courage to go out and actually do what was the tough part.

Then actually, once I got started, what was most daunting for me was raising the capital or at least trying to. Now, what made it a little bit easier for me was, I had the relationships from the brokerage side to actually dig up the deals. That made it easier. It made sense for me and it was more synergistic to join a firm that needed deals and had the investor bench, where they could fund the deals but they just needed more of them. Again, it made sense from that standpoint where I could bring the relationships and bring more deals, and then there was the equity that was waiting to fund them.

[0:16:27.7] WS: It's neat to hear. I mean, you talk about having the courage to step out there and you think, so many may have — may or may not have that high-paying W-2, but it's very difficult to step out and say, "You know what", you felt that pit in your stomach that you talked about. And just stepping out to make that happen. Any pushback, family, anybody saying, “Wait a minute, Kevin. You’re crazy.” How did you handle that?

[0:16:55.5] KM: No. I would say, yeah, my family was surprised, probably. No one said anything to my face. I’m sure behind my back, they were probably thinking I was crazy. But it’s been almost two years now and I still get uncomfortable to this day. There were so many moments, especially that first year where I was so uncomfortable. I just know looking back that it’s kind of going to shape who I am, not only as a business person but as a person that’s going to make me better.

One of the things I did, Whitney was to really help me quantify my decision-making, there was an exercise by Tim Ferriss called — I think it was fear-setting. If your listeners Google fear-setting*,* Tim Ferriss, it’s just a really good exercise to again, quantify whatever risk you want to take, whether it’s switching to a high-paying or leaving a high-paying job or whatever it what you want to do that involves some sort of risk and makes you uncomfortable. It just helps lay it out and that really helped me again to quantify it.

Really, what it did was, at the end of the day, if it didn’t work out, I can always go back to where I was before. In doing so, I would become a better broker, picking up the knowledge that I did along the way. So there was really not as much downside as I probably thought.

[0:18:22.1] WS: Kevin, do you have a couple of daily habits that have helped you achieve success?

[0:18:27.6] KM: Yeah, a few. I exercise. Four to five times a week, I do CrossFit, try to do it either 5:00 or 6:00 in the morning to have a routine. Meditation has been really important for me, doing meditation once or twice a day. I recently got into journaling. That’s been really, really helpful for me to get my thoughts and my feelings out. Where I was repressing and actually getting them on paper. Those three things have been really, really important to alleviate some stress and really fulfill my growth and potential.

[0:19:08.1] WS: Is journaling something you do electronically or like handwriting?

[0:19:12.8] KM: No, I hand write. So I have a book, and some days it's easier to get things out, some days I'll have a page or two. Other days I'll just have a paragraph. Really, whatever is top of mind, you put it on paper. Again, it's something that I had tried in the past and I couldn't be very consistent at it. But the last six months or so, I've really made an effort. Once I got in the routine and got consistent doing it, it became easier and easier. I think it's really helped me again get things out because probably like most guys, I keep things inward. It's been again really helpful to just be — it's freeing and deliberating, really just to get things out.

[0:20:01.8] WS: I meant to ask you. I know we've talked about parts of this, but just from your standpoint, your experience, what do you see just the real estate market in general, say 6 to 12 months from now?

[0:20:13.0] KM: I think industrial, again, continuous at its current pace, if not, get even more frantic. I think when the first quarter rolls around and some of the stats come out about how well e-commerce has performed over the holiday season, I think it's going to be even more competitive. It's hard for me to kind of fathom that, but I think so. As far as the other sectors, it's kind of tough to say, Whitney. I'm certainly not an expert in multifamily. I know enough to be dangerous. But all of the government stimulus and everything, when all of it goes away and we go through the winter, maybe the COVID cases keep increasing. It might be a tough first half of the year for some multifamily, at least on the occupancy and probably, definitely not any rent growth. I think in the long run, multifamily is a great play. But the next 12 months might be a little bumpy, but I think for people to just have some patience and I think this storm will pass over for sure.

[0:21:22.6] WS: Now, I think that's pretty accurate. If you're expecting much rent growth over the next year and don't have any reserves or enough reserves, you're maybe hurting unfortunately, but hopefully not. No one knows for sure. What's your best source for meeting new investors right now?

[0:21:41.3] KM: Podcasts, yeah. Content and word-of-mouth. Just asking people who they know. I think those are the three best sources. Yeah, podcasts, getting on podcast are pretty remarkable source of letting people know who you are and what you're doing.

[0:22:03.4] WS: I agree. What's been the number one thing that's contributed to your success?

[0:22:09.1] KM: Two things, I think. Persistence, never giving, because so often in what we do in really business and life in general, you hear so many objections, you hear so many now. Just being able to push through that, having some thick skin. Then also, always be open to learning and thirsting for the knowledge as cheesy as it might sound. But I'm really into personal development. The more I've gotten into it over the years, I mean, there's a direct relation to what success I've had. There's no doubt about it.

[0:22:44.1] WS: Is there a specific resource that has helped you just for personal development, also just think it's directly related to your business success and things like that? But what about you, have just improved as far as personal development?

[0:22:58.6] KM: Yeah. I think for people, I guess some things easy people can do is whenever they're driving, always be listening to a podcast or CDs in your car. I mean, that's something easy that they can do. I think having a morning routine is really really important. I recommend Hal Elrod's book, I think *The Morning Miracle*.

[0:23:22.9] WS: *The Miracle Morning*, yeah.

[0:23:23.7] KM: *The Miracle Morning*, there you go. Yeah, that's a great resource and not too difficult to implement. It might take someone who doesn't have a morning routine a month or so to get used to it, but once they do, it would be tough for them to go back to their old morning habits. I mean, it really is that much of a game changer to have success during the day. That's what I would recommend something someone could do and pick up right away.

[0:23:52.6] WS: How do you like to give back?

[0:23:54.9] KM: I like volunteering, being hands-on. I would say the organization I'm most active in, Special Olympics. I've been a coach there in multiple sports over the years. It's a great organization.

[0:24:07.7] WS: Nice. Well, Kevin, I'm grateful for your time. Pleasure to have met you and just really hear your story going from a junior broker, especially when you became a junior broker in 2007 until time relying on a commission at the worst time probably to rely on a commission in the real estate business that we can remember. Then moving into passive and active and just industrial space. I don't have too many guests that focus on industrial, so it's great to hear your take. And just what's happening in that space right now. Tell the listeners how they can get in touch with you and learn more about you.

[0:24:44.5] KM: Sure. The best way to get in touch with me is my personal website, it's mcgrathindustrial.com and I have eBook there on industrial real estate and a little bit into passive investing that could be a good free resource for that, and as well some other content. My email address is on the website as well. If anyone has any questions or wants to get on our distribution list to see our deals, all that information is on the website.

[0:25:15.8] WS: Awesome, Kevin. That's a wrap. Thank you very much.

[0:25:18.9] KM: Yeah, absolutely, Whitney. It was a pleasure.

[END OF INTERVIEW]

[0:25:21.1] WS: Don't go yet, thank you for listening to today's episode. I would love it if you would go to iTunes right now and leave a rating and written review. I want to hear your feedback. It makes a big difference in getting the podcast out there. You can also go to the Real Estate Syndication Show on Facebook so you can connect with me and we can also receive feedback and your questions there that you want me to answer on the show.

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[OUTRO]

[0:26:01.9] ANNOUNCER: Thank you for listening to The Real Estate Syndication Show, brought to you by Life Bridge Capital. Life Bridge Capital works with investors nationwide to invest in real estate while also donating 50% of its profits to assist parents who are committing to adoption. Life Bridge Capital, making a difference one investor and one child at a time. Connect online at www.LifeBridgeCapital.com for free material and videos to further your success.

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