EPISODE 916

[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]

0:00:24.4 Whitney Sewell: This is your daily Real Estate Syndication Show. I'm your host, Whitney Sewell. Today, our guest is Eric Schleien. Thanks for being on the show Eric.

0:00:32.0 Eric Schleien: It's my pleasure. How are you?

0:00:34.0 WS: I am excellent. Great to have you on the show. I think you have some experience, I think it's gonna help us to better understand a different part of our real estate business or a different kind of real estate out there that a lot of us are not gonna be as familiar with. So looking forward to the conversation, but Eric is a founder and CEO of Granite State Capital Management, and as a host of the intelligent investing podcast, he is a value investor investing in private and public real estate. Eric, welcome to the show, give us a little bit about your focus right now, who you are... And let's talk about this. Publicly traded real estate. What is that?

0:01:08.3 ES: Sure, well, a little bit of background about me. I got into investing when I was a teenager, about 14-15 years old, and I went into a bookstore with my mom, and I wanted to be mature and a big boy and go to the most mature section I can find. So I went to the business section and I found a book by the Motley fool... There was a book on How to, you make more money than your parents. Was the... Something of the title.

I thought that was very intriguing, you talked about very basic financial concepts, the dinners are being in credit card debt, don't spend more than you earn. And then I saw that compound interest graph that blew me away, and they talked about different great investors in the book, and one of them was Warren Buffet. So after researching some of these investors, I started reading about Buffet, and for me, that was a light bulb moment for me, and I went down this investment rabbit hole using those value investing principles, and I realized they could be applied to pretty much any kind of assets including Real Estate.

So I think when people think about value investing, they just think, Oh, you're just buying stocks that low PE ratios or something like that, but really you could be looking at different kinds of public securities, different kinds of bonds, different kinds of private real estate, and there's also publicly traded real estate, so there's a whole host of assets you can get a good value on, but those principles have sort of been a guiding light for me, and I'm 33 now, so for quite a while now, and I started an investment management company.

I also have another real estate company as well, which doesn't have outside investors, but yeah, I'm happy to be here and talk to you about real estate that you can buy that's publicly traded.

0:02:53.2 WS: Tell me... Can you just lay that out a little bit so we can understand what you mean when you say publicly traded real estate, what does that mean for those people that are involved in that?

0:03:01.7 ES: Sure, so there's two ways you can invest in publicly traded real estate, what I mean is if you have a publicly traded asset, it means that it's on a market, you can go into a brokerage firm such as TD Ameritrade. I use Interactive Brokers, and you could buy you type in a stock symbol and what you're buying the assets represent real estate ownership, so when you're buying any kind of stock, it's not just a ticker symbol and move it up and down on a graph, those are representing some kind of assets and liabilities and you have real cash flows and the balance sheet.

So it's legal ownership and equity. When it comes to real estate, they have, there's things like, say, Real Estate Investment Trust, which literally you're buying actual ownership and a piece of real estate. There's also the companies say... Where they own a lot of real estate on the books. So, say a company that's structured as a corporation or structured as a limited partnership, but a lot of their book value is in real estate operations.

Well, if you buy a stake in that company, whether it's 10% of the entire business or one 10th of one, 10th of one-tenth of 1%, you still are taking ownership and a piece of real estate, so that's what I mean by publicly traded real estate is. Going into the public markets to take a fractional ownership stake in real estate assets

0:04:22.9 WS: When doing it through a publicly traded firm like that, are you getting tax benefits, are you getting other benefits just like you would if you were investing through a syndicator operator...

0:04:33.6 ES: Well, so since you are owning a stake in the business, the tax benefits that you're quote and quote getting... And again, it depends on the structure. So if you are investing in a limited partnership and you're getting a K01, there could be some tax benefits to you, but if it's not a limited partnership, the tax benefits are happening at the corporate level, which is reflecting in the value of your shares.

So the tax benefits still exist, it's just that you're not usually gonna see them show up on your personal tax forms, it's gonna show up in the... Increase the value of the share price, if the management is a good steward of your capital.

0:05:08.9 WS: No. That, that makes sense. And that's kind of what I expected. Just wanted to ensure... So why would someone invest in a publicly traded type of rule state versus a syndication or one-off operator?

0:05:19.2 ES: Yeah, that's a good question. So one of the things that I learned from studying in buff, partner try to … over the years. You know, neither of them have any kind of psychological attachment to the kind of asset they invest in, right, so you go look at Bircher Hathaway, they're a conglomerate. They've bought a 100% stake and Dairy Queen, and they had bought a piece of the Washington Post and Coca-Cola, and they want a stake in Apple now.

So they aren't just tied to the insurance business, and you can even say, going back to the 1960s, if they had just re-invest in the textile industry, they won't be a company today, so a lot of people have sort of the psychological anchoring that if they run a business, they must… You know, if I run a shoe company, I must just grow by making more acquisitions and to businesses.

And I think you see the same thing in real estate, you have people to... Well, I only invest in single family, I only invest in multi-family, I just focus on mobile home parks, and I'm not saying there's anything wrong in doing that, certainly, if you feel you have an edge or you know a certain kind of market very well, you should certainly stick to where you feel you have some kind of edge, whether it's informational or just that you know the market really well, however, if you aren't attached to the kind of asset that you're buying, there's a whole world that opens up.

So the reason to look at public real estate is to make money, and we happen to live in a time right now where interest rich are very low, cap rates on lots of private real estate deals are... Depending on the market, but generally pretty low, there are some exceptions in some cities, but for the most part, pretty low, and in the stock market, I would say actually generally, stocks are on the expensive side that most of the stuff that I look at, however, if you can own something that isn't GameStop or isn't some kind of high flyer...

AKA a business that owns a lot of real estate, some of of these companies are kind of hard to categorize, and the thing on Wall Street is that if something isn't clear-cut, black and white, t his is the industry it's in, and we can package it, and this mutual fund, often, it gets left behind, and that creates an opportunity for investors like you and I who aren't running gigantic mutual funds, for full disclosure, I'm running an investment management firm, and I do have clients, but even the firm that I run is pretty small.

And being a small investor, there's opportunities to buy publicly traded real estate that would be 50, 75 cents on the dollar of or less sometimes of what you would get in a private transaction. It hasn't always been this way. So if you go back to 20-30 years, you could say that publicly traded real estate was actually tended to be more expensive, but you have the inverse situation today where there's, I think, more opportunity in these publicly traded real estate assets that some of them are significantly trading at significant discounts to the actual private market value of that real estate.

0:08:31.0 WS: Tell me about who is that investor that's like the prime candidate for investing in publicly traded real estate, is that just anyone, is that... Who is that investor?

0:08:39.0 ES: So I would say it's someone who has... They're not looking to get rich quick. They have a long-term time frame. And they're in it for the long run, so we talked about tax benefits, if you can own an asset and not sell the stock for 30 years, you're essentially deferring capital gains for decades, so if you're looking to do short-term trading or you're someone who's flipping homes and this is probably not for you, but for someone who has a long runway ahead of them or they wanna pass that com to their kids at some point, investing in some public, publicly traded real estate with good management. There could be an opportunity there.

0:09:19.0 WS: For sure. I mean, I was just thinking through investing through a publicly traded real estate in that individual, what about just how do they know to think about somebody that's never thought about investing in real estate to publicly trade methods. What are a few things that are very important that they know, how do they know they're making the wise decision as far as how they invest this way?

0:09:39.0 ES: So first to start off, I'm not gonna be giving investment advice, so you know anything I say, do your own due diligence.

0:09:45.8 WS: Sure.

0:09:46.0 ES: But look, it's the same thing with real estate, if you're getting into real estate, I would hope that you have some understanding of the asset that you're buying, you're not just... Or that's a nice looking house, I guess I'll just spend whatever on it, you wouldn't do that. So it's the same thing with the stock, just 'cause you think the business is interesting, are good, it doesn't mean that the price is good, so you wanna be able to learn how to figure out what those assets are worth.

So I would say if you're already someone who's a real estate investor, you can use the same principles that you're gonna analyze a piece of real estate in a private transaction, if I'm looking at a privately held self-storage unit, there's a certain value I'm gonna put towards those cash flows. Well, I could do the same thing with a publicly traded self-storage company. The principles aren't gonna be any different.

I would say if you don't really know how to value a business or how to value real estate, then I won't recommend that you go ahead and start investing in real estate or find someone who has a good track record and has a rational and intelligent way of looking at things and go put your money with them.

0:10:50.0 WS: Is this kind of investment liquid, do you know? And are there minimums?

0:10:53.0 ES: Depends on the stock. There's one stock in particular that I'm thinking about, that I have a pretty large position in my company that's pretty liquid, but at the same time, it's gonna be more liquid than buying a single family home somewhere, which as you know, that could be on the market for a while before it sells depending on the market, so there's one stock and pick it up, thinking of where it might take me a few weeks to sell my position, but that's a liquid for a bubble could traded stock.

If you buy in South Coca-Cola, you could put a million dollars in, sell a million dollars within a matter of seconds, but again, if you're a long-term investor, having this instant liquidity shouldn't really be an issue for you.

0:11:36.8 WS: Yeah, that's a good point. Do you have an example, maybe you could just kinda walk through an example of investor that actually did this and the types of maybe returns or their expectations and things like that.

0:11:47.5 ES: I'll use myself as an example, since I've done this a few times in my life. So there's one of the stocks that I own at my company, and I also own this for most of my investors, it's a business called LACO for the Los Angeles Athletic Club, The ticker is LA A-CZ. And right now, I think it's a publicly traded limited partnership, it's run by the Hathaway family, and they've been at... That family has been a staple in Los Angeles for about 100 years.

The companies from the 1880s, they started with the Los Angeles Athletic Club, and for your listeners that live in LA, they certainly know what the LA athletic club is, and to grow the business, they had sold some shares to investors, it became traded over the counter for about 100 years now, and then a few decades ago, the company started reinvesting those cash flows into self-storage units. So today, while they still own the Athletic Club building, which is certainly worth something, most of the business is in self-storage units today.

Now, if you look at the brand, the self-storage company that they own is called Store West, that's the name of the self-storage business, and most of the business is in either California or Arizona or Texas, it's all in the West Coast. Very high quality self-storage business in very, very good locations, and generally, you could say that those self-storage units would probably get somewhere between maybe 4 or 5% cap.

Well, today, you can buy the entire business of LACO, you would buy stock in it or units, 'cause it's a partnership for probably in the 8- 9% cap rate today, so you can go on the stock market right now and trades for about 24, 2,500 dollars a unit, where if they decided tomorrow they wanted to sell us self-storage business, they probably get at least 4,000 a unit for those sales charge operations.

So here you have a situation where you're getting slightly under a 4% distribution every year and dividends, and you have this tremendous asset value that at some point they might sell the self-storage, but business and you would get an extra boost, so if you take in distribution yield plus growth, you're looking at maybe 8 to 10, 8 to 11% growth in a very conservative scenario, and then say they sell the self-storage business in 10 years from now, and you take into account rent increases, you might be getting a 15% annualized return over the next decade.

So I don't know exactly what the returns are, no one can ever promise an annualized return, especially with a publicly traded stock, but to be able to have something with probably pretty low downside, again, probably do your own due diligence, but my opinion is that there's a pretty low downside, and you're getting the stability of a bond-like asset with significant optionality to the upside if they ended up selling out of those self-storage units in the next decade.

So that would be an example of a publicly real estate where if I was to go out right now with a broker and try to buy those exact same self-storage units from Storage West directly, I'd be paying a price significantly higher than if I just bought LACO units outright on the stock market.

0:15:15.8 WS: Okay, no, that's helpful. And I wonder when you're making that decision to invest in, how much of that business plan do you know upfront, like you talked about, if they say, Oh, this many years from now, this might happen, do you know any of that going on?

0:15:30.3 ES: No, I actually take him to the assumption that it doesn't happen. Right so one of as Buffet said, would say, rule number one, don't lose money. Rule number two, don't forget rule number one. And there's another guy in the investment business who very much respected ..., he wrote a book called The Dhandho Investor, what she talks about, this concept of low risk, high uncertainty, so is it certain they're gonna sell the self-storage unit the next 10 years, not at all.

There's a high uncertainty, however, I would say you're buying, it's such a discount to the real estate that there's a bunch of different situations that can happen, but there's very few ways to lose in many, many ways to win. So I'm actually always looking for in a bad scenario, Am I still gonna do okay, and I think in a bad scenario, you're still doing high single digits to low double digits and sort of... If things just keep going the way they are and the family has been managing this thing for decades, I can tell you what they're not gonna do, I can tell you they're not gonna start taking out more leverage and leverage the self-storage business, super high.

They're overly conservative. If you or I were managing that business, we can actually juice up returns, the family is already wealthy, they’re not… they're looking to stay wealthy, not the … looking at wealthier, but they could take more risk if they wanted to, so they're probably actually hurting the value a little bit by being too conservative and not having enough debt, especially in a low interest rate environment.

So if they ever sold to a larger public public storage or they sold to a read or something like that, certainly that business would take on more debt. The things that I do know though, is that the Hathaway family control 70% of that stock, and that they're using it for... They're using their dividends, a lot of the family members are using the dividends for their mortgage payments and to feed their families, so that's the reason for that conservatism is they wanna stay around for very unknowable Black Swan kind of event, so very well-capitalized business. They're not going away, but I see it as a very high yielding bond that has significant upside... A few things happen.

0:17:38.6 WS: Yes, and I ask every operator this, and I'll ask you as well, but thinking about it towards publicly traded real estate, and you've talked about it a lot, but I’m always asking how you prepare for a downturn... Right, and is there, with your experience in this industry, what have you seen in companies like this versus others, and how they were prepared or how they performed through this pandemic over the last year, and just what you like to see that says, You know what that we haven't already mentioned, I know you've talked about it a lot, which is great, but anything that's specific to say, You know what, they're ready for that black Sanomat.

0:18:12.2 ES: LACO in particular is especially ready, even though they're public, they're still run like a family business. They are traded over the counter, very thinly traded, so for all intents of purposes, they look at themselves as pretty much as a private business, there's only about 100 and something shareholders of record. I want to visit the property, the athletic club a few weeks ago, I asked the assistant manager, I said, You know, how often do investors come by and she said you're the first person in five years.

So they're looking to manage for the family, but they're over the top conservative, but in general, what I'm looking for in a management team is a very well-capitalized business. One that isn't spending money on pet projects, so you do have some... Say, Real Estate Investment Trust. I'm not gonna bash any management teams publicly, but what I will say is, You wanna avoid companies that have a history of just selling lots of stock and investing in these pet projects or investing just to expand their empire.

So anyone can just... As you know from investing real estate, you could buy 200 single-family homes, doesn't mean you're getting good price for it, however, if you are a public business, let's say if you were running a real estate investment trust and your salary was being tied to say FFO or some kind of real estate cash flows, your incentive to how good returns on capital may be outweighed by your incentive just to grow the business in any costs.

So if you can go from a small real estate investment trust, a multi-billion dollar real estate investment trust, well, you can bump up your own personal salary good for you, not necessarily very good for your shareholders, so you wanna look to avoid businesses where they don't know how to allocate capital very well or they're gonna take excessive risk. I'm gonna be highly, highly leveraged, so in a downturn that you can get wiped out, you wanna typically avoid those kinds of situations

0:20:09.0 WS: Eric, what your predictions, just in the real estate market over the next six to 12 months.

0:20:13.8 S2: I don't know, I try not to spend any brain power on things that I can't control or have an understanding, so I'm taking the position that I'm buying assets that I like today, that I think I... Look, if there's a few companies I'm thinking about where in a downturn, if you're well capitalized, you can do those cash flows and by cheaper real estate. You know, are those businesses with good management teams, they can allocate capital and even a higher rate of return.

So in a downturn, any of the businesses that are my portfolio, the portfolio of my investors, they'll end up being better off because of it, and if there isn't a downturn, they'll stay prudent and may have been slightly underperformed, say some of the highly levered names that are taking excessive risk and reaching for yield, which I see a lot of that activity, especially with low interest rates.

0:21:03.3 WS: Do you have any daily habits that you are disciplined about that have helped you achieve success?

0:21:07.7 ES : Yeah, so I'm extremely focused on reading, so everyday, religiously, I will read every news article that I can find about the different businesses that I own, I read things about competitors, so I'm always safe for self-storage stuff, I'm always reading about the different... Self-storage company is... There's another real estate asset management company that I own, stock is...

I'm always reading about that company in that industry, listening to conference calls, I also talk to a lot of my colleagues, so there's a few websites that I go on every day on is called The Corner brick, Hare and Fairfax. And we talk a lot about these kinds of businesses, so if you're someone who wants to be part of a community where we can talk about things like LACO and St. Joe Corporation and Bradfield Asset Management, a few other of these kinds of businesses, JG Boswell, and kind of a cult stock amongst us.

If you join that message board corner behind Fairfax, you'll be able to participate in a conversation with a lot of very highly intelligent and very open and welcoming people to participate in those conversations. I also read, so I don't usually participate, but I'm always reading that message board, I also, every single day, I open up a value investors club, and there's always a few new write-ups every day, you do have to be a member to read those instantly, but for non-members, you can register for, I believe it's either a 60 or a 90-day delayed account, which is free, and then most of these names don't move all the time, so typically a 90-day old idea, often they're still just as valid.

I read that every day, and then that usually leads to rabbit hole, so I would spend most of my morning afternoon just reading.

0:22:52.7 WS: What's your best source for meeting new investors right now?

0:22:55.6 ES: For meeting new investors. That's a good question. You know what, when people always ask is sometimes, but what's your process for finding new investors, and it's just spending time with really smart and interesting people, I know this sounds like a cheesy thing, but I don't... I don't have a pitch book, I don't go out and start aggressively marketing what I do.

I'm looking to attract a certain kind of investor, and this is for me personally, so I like to have people that are gonna be with me for the long term. They're not going to give me money 'cause they just are on some emotional high, 'cause those people will leave when they're on emotional low, so spending time with people who are smart, rational, have a high ethical bar in business. And people will ask me, What are you up to? And how you...

People know that I do this, so they'll ask me on occasion what I'm doing when a mom too, and I'll share and just through the natural conversation where you've been doing on this podcast, there'll be a certain percentage of people in this... A small percentage, it's a certain percentage, I was like, Oh, that actually might be something I'm interested in, you know, maybe I can give you some money at some point, so that's why I've structured my firm.

I have a very boutique firm, I have about 20 or so investors, but all of the people at our investors, we either my partners, and there are people that I respect them, I admire, and that they're not calling me every week asking me how their portfolio is done and I don't have to suck up to them and play golf for them, so that's how I do it, but how I do it may not always be appropriate for how someone else wants to do it, where they wanna have a sales book and...

So the 100 calls a day, so very... I would say if I could give any advice, think about the kind of person that you want for investment capital, if you're any kind of investor, because if you don't have good and good clients or good investors are good partners. I could invest in LACO if I had a partner or as an investor demand name and I show good quarterly numbers every quarter. Laco would not be the one to buy.

0:24:50.6 WS: That makes complete sense. I… , elaborating on maybe your philosophy on finding investors and just thinking about who that person is, it's important that we do think about our avatar, you know what some people call it, but who this investor is that works with you, but how do you like to give back?

0:25:07.0 ES: How do... I love teaching. So I have my own podcast, which I know you shared about it on the show, and I just go into the weeds and I share... And I share my knowledge, I get messages all the time on Twitter and Instagram, especially Instagram now that's like... For whatever is... And I'm trying to get messages on Instagram all of a sudden, and I respond to every single message, and it doesn't matter if you're a seasoned investor or you're just learning...

I will answer questions, I'll share book recommendations, I send books to people all the time, so I just love to share my knowledge, and it's been such a life-long journey, an incredible journey for me that if I can share my passion with someone else and make a difference for someone else, that makes me really happy, and I do that for people, whether they invest with me or not.

0:25:51.8 WS: Eric, I'm grateful for your time today and just really talking to a publicly traded real estate, and it's just interesting thought that... I don't know if you're ever talked about it on the show, maybe once or twice, but out of 900 plus shows, it's not too often, it's just grateful to raise awareness to our investors that are listening and operators, you know that this option is out there and at least to go educate yourself or meet some by like here, so you can ask more questions about this opportunity, but again, grateful for laying many things out that we need to know about this type of investing in real estate. Tell the listeners how they get in touch with you and learn more about you.

0:26:27.3 ES: Yeah, so you can go on to my website, it's GSCM.CO, I also have a personal website, EricSchleien.com, but then if they just wanna not contact me through the websites, I'm very, very active on Twitter. It was… my handles are Eric Schleien. And the spelling, I would imagine that you can just put in the show now so they can click on it, and then I'm also very active on Instagram, that's also Eric Schleien on Instagram. So I do respond to every message and I love participating in conversations with people.

[END OF INTERVIEW]

[OUTRO]

0:26:55.5 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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