EPISODE 930

[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 Neil Wahlgren. Thanks for being on the show Neil.

0:00:32.0 Neil Wahlgren: Thanks for having you Whitney.

0:00:33.0 WS: Neil brings nearly two decades of leadership and operations and capital markets. Prior to MAG Capital Partners, he led a Bay Area Real Estate investment firm, raising capital for over 200 million in projects. Before that, Neil piloted the C-130 in both in the Air Force and Navy, logging over 2500 flight hours with combat tours in both Iraq and Afghanistan, and concluding his military career as a lieutenant commander.

Neil... First off, thank you for your service. I've written... And if you see 130s personally, and I appreciate those guys that know how to do that, get us where we need to go safely,right? So very important that task there you had and grateful for your service as always, but now you're not in military anymore, but you are you've got a great business going here and you play a vital role, why don't you give us a little more into MAG Capital Partners, what your all focus is, and maybe let's dive into that asset class and you especially...

0:01:35.1 NW: Yeah, absolutely, so it's a boutique investment firm, we raise equity through syndication, through a network of investors, and our specialty core competency is industrial real estate, and we are buying, ultimately buying industrial estate, typically tenanted by manufacturing firms, and so we play in that manufacturing space and we buy our real estate through sale leaseback. So we are buying the real estate from owner occupants who then turn around and sign long-term single tenant and at least typically 15, 20-year term structures on the back end, so that's the niche we've carved out, we've been doing really successfully for the last eight or 10 years.

0:02:17.8 WS: Okay, tell us a little about the environment or just current environment in the industrial space. Obviously after the last year, everything that's happened, maybe what's happened to that space, has it been good or bad, what have you seen? What do you expect?

0:02:31.7 NW: Yeah, absolutely. So I found a lot of folks don't have a lot of exposure to industrial, even if they have a somewhat sizeable portfolio in multi-family or retail, so on a macro level, really industrial can take several forms, typically you're looking at largely manufacturing, but you also have warehouse distribution, you can think everything from ultimately four walls and a roof that houses production, or you can look at, hey, this is useful space in the logistics and transport of goods.

Say in Amazon delivery, distribution hub or Home Depot, whatever that might look like. And then you also have specialty industrial, and that might be R and D labs, very specialized, high capital, high price per square foot, very custom build for that tenant that's gonna be occupied in the space. So in that space as a whole, our focus is on the manufacturing side, we typically are buying roughly not a-class properties, usually properties that were built maybe 20, 25 years ago.

Often times they've had periodic improvements done to them over the years, but ultimately that space has seen a huge amount of increased demand, especially in the last roughly three years or so, especially with the rise of e-commerce, with more and more deliveries, you're seeing a really a limited amount of supply, new build goes for roughly 100-150 a square foot. So the existing supply that you're able to buy between 50 and 70 a square foot has this irreplaceable component to it from a price perspective.

So as these new uses and as e-commerce come up, that has more and more distribution networks, building out these larger companies and able to service a larger customer base, we're seeing a lot of increased demand pressure on industrial, and that's been really driving the cap rates, squeezing them a little bit, in a way is similar that we've seen on other desirable asset classes like multi-family over the last few years.

0:04:35.6 WS: Nice. Is there a, maybe a recent deal that you can elaborate on and maybe we can highlight some of the things that are different about this asset class that a lot of us aren't exposed to as much on the industrial side.

0:04:46.0 NW: Yeah, absolutely. I'll use a recent one that we closed, I think it was in November or December last year, and it was a company tenanted by a firm called Huntington solutions, and this was really right down the fairway type of tenant, typically what we're buying... Before we jump into the deal itself, really, it helps to understand what is the motivation behind why a company would want to do a sale leaseback...

So this firm had recently been acquired by a private equity group, and that private equity group bought this company, and what the company makes is high density foam and caps, so their customers are appliance manufacturers, electronics manufacturers who require these kinda laser cut and caps that go around their expensive, you know, products, then they ship and are able to ship in a way that doesn't damage them, and you've probably seen them.

Say you buy a Roomba or even a washing machine, and it's gonna have those very dense foam and caps in order to protect them. So that's what these guys make, and they got acquired by a private equity group, and that private equity group likes to really focus and streamline their investment into the operational side of their new portfolio company, if that portfolio company also came with a real estate, PE groups will oftentimes sell us the real estate and turn around and take a tenant position, signing a brand new absolute triple net, typically

20-year term lease.

And it makes sense for them 'cause they're able to extract the money out of the real estate, reinvest it into manufacturing, sometimes pay down some of the debt that they took on to acquire that portfolio company, basically de-leverage that acquisition or even additional head counts. Really, what they do best is just invest in that new operating company in order to grow in the way that they feel they can through that acquisition.

0:06:39.8 WS: I Guess it allows them to focus on what they're good at, right? Focus on their business model and what they're... their specially is, not real estate.

0:06:47.2 NW: Absolutely, yeah, and really, I find the approach, you can expand that so many different fields, to just focus on your core competency and realize for those guys, they say, hey, if we invest in the business, this is what we are experts at, and they really... They're like, maybe we can make some money owning real estate, but we are not real estate investors by trade, we are private equity by trade, so by removing that investment piece out of real estate and doubling down on their really their operational company investment, they're able to put all their money in their core competency, and that provides opportunity for a group like us that specializes in owning real estate, and really it's a win-win on both sides.

0:07:29.4 WS: It is interesting 'cause yeah, that would be my first thought or question is, why would they do that, why would they sell their property but stay there, and I could say it made me think, well, are they planning to leave... What's the problem, right? You probably get that from investors a lot, I would imagine, is that right?

0:07:44.4 NW: Absolutely, the whole nature of it seems a little, I would say four in to a lot of investors who maybe haven't seen that in other types of investments before, but really it makes sense, and from our side as a real estate investment group, we are effectively buying real estate, and we are buying a very predictable known set of cash flow streams that come from rents that are pre-determined and structured by the lease, and we have completely removed the operational risk component.

So there is no roof replacements that affect our cash flow, there's no... The tax assessor can double the taxes on the property, all that goes on the tenant. The insurance premiums could double all that goes on the tenant, so as an ownership group, as an investment group, we really have a high degree of certainty what that cash flow will look like even three, four or five years down the road. I mean, almost to the cent, so I can structure an incredibly predictable set of cash flow to my investors, and ultimately all, all that cash flow is tied to the risk of the credit of the tenant, and it's important to understand the risk of any deal and how that may be different from other asset classes.

0:08:54.2 WS: I mean, is it accurate that you're mostly just removing that debt piece for them?

0:08:58.0 NW: Can you elaborate on that little?

0:08:59.0 WS: I mean like, they're still covering the roof if it needs repairing or they're paying the taxes, which they were doing all that before you purchased a property, right. And so now the big piece is that they don't own the real estate, they don't have the debt there, so they have that capital back if there was equity in the property that either way. Is that the biggest thing that's changed?

0:09:18.8 NW: Yeah, absolutely, and also from a balance sheet treatment, there's a lot of advantages of being a renter versus an owner, the main two, you're able to write off 100% of your rent payments, whereas if you're an owner and you have that mortgage, your amount that you're able to write off is much smaller, a smaller component of the mortgage interest only, and then the second piece is from a balance sheet standpoint, if a company is an owner and they have a mortgage on that piece of real estate, then they have a huge long-term liability on their balance sheet.

Whereas if they convert that over to a renter position, now there's typically a sub-note on the bottom of the balance sheet that mentions that least liability, but it's not put on the assets and liabilities in the same way that having a form of mortgage is...

0:10:06.8 WS: Tell me a little about the typical, say, business plan or whole period, things like that on a project like this.

0:10:12.6 NW: Yeah. So we come in as an ownership group, we negotiate both the price of the real estate and the terms of the lease that we're turning around and leasing back to the selling company for it, so those two pieces, there's a lot more work that happens up front because of that kind of two-pronged approach, and there's a little bit of an art form as well, for example, if I have a seller who says, hey, I wanna maximize proceeds from the sale. I might say, okay, we will give you on the higher end of market price for the building, but you're gonna turn around and rent it back at the higher end of the rent rate.

Or they might say, hey, we want a low price per square foot rent, so okay, we'll buy on the low end of market, the range there, and lease it back to you on the lower end, so you're really able to kind of finance and find a win-win with your seller, and either way, you're still able to more or less create the same non-a yield for your investors. So we've come in, we take ownership, really once you take ownership, there's not a lot of operational churn, most of that work is done up front.

So we'll typically hold about five years, and that's intentional, we're building equity in the project or paying down principal, oftentimes, if the private equity backers are successful, that tenant company is actually able to expand and now I'm sitting on a more valuable piece of real estate because that tenant credit has improved over the years, and so ultimately after about five years, we go to sell and it's a, I would say, attractive sale to the next party, 'cause there's still roughly 15 years left on that at least.

So the next buyer is able to buy it to hold it, still get a decent amount of term and they could even turn and sell it to another group before a release, an event where reap actually has to happen.

0:11:54.0 WS: So is your goal to be the first buyer from the entity that's operating there...

0:11:59.0 NW: Absolutely, and by doing that, we've more or less removed the releasing risk from these investments, which is fine, and other groups tend to like that additional risk that comes, will they or will and not release and you might be able to buy at a premium or... Excuse me, at a discount in that scenario, but for our risk tolerance and business model that we built, we like being on a front end of a brand new lease.

0:12:23.6 WS: Okay, no, that's interesting. What about markets that you're located in, or is this something you're doing nationwide, do you have some specific places you're looking?

0:12:31.7 NW: Typically… And really it's two-fold, so one, we're buying on the Midwest first for cap rates, and we'll just see really a better, more rent dollars per dollar of a real estate through those higher cap rates that we find in the Midwest compared to the coastal markets, and then the second piece is for manufacturing, really most of our tenant companies, they produce and distribute nationwide, so being quiescent ally located there in the middle of the US makes sense from a geographic standpoint for buying a lot of Texas, Oklahoma, Nebraska, Iowa, Indiana and Michigan.

Really ride up in that central corridor there in Midwest in Texas. I used to just say the Midwest, and I'd had some Texans... Let me know at... These are two very separate markets, but yeah, that's our bread and butter spot.

0:13:19.1 WS: Would it be accurate to say that the location in your asset class is not as important as it is in almost every other aspect of real estate, it's important, but I just mean like the importance of your tenant is so much more important, I guess, and if they're like you said, if they're distributing all over the country, you know, the immediate location of their building may not be as important, I mean, I guess unless you wanted to sell it or when you need to say, oh, if the tenant had issues and had to leave or something like that.

0:13:46.3 NW: Yeah, no, you hit the nail on the head there, Witney, especially compared to multi-family and, you know... have that 30% of my personal portfolio is multi-family, I love it, don't get me wrong, but going from a multi-family project where it's location, location, demographics, sub-market demographics, I really need to know that like the back of my hand in order to be successful, especially if I plan on increasing rents and occupancy and really making an investment and hoping to see the return from that.

On the single-tenant side, really the location and sub-market is way less important than the credit of your tenant. I mean really, you're making a gamble that you're going in and you're saying, hey, I have 100% occupancy, I am making a really an educated that my tenant will stay financially solvent, will not default on the lease for the roughly four to five years that I plan on own invest real estate. So from that side, rather than doing heavy market reports and demographic studies, what we actually do is produce what's called a credit memo.

And we have a supplementary seven, eight-page document that supplements our investment summaries, and that credit memo really deep dives into financial summaries, balance sheets, debt loads, customer diversification, and we have a really top-notch credit analyst on our team who creates his reports, and that is the fundamental background on the due diligence side for these kind of investments.

0:15:16.0 WS: What about... What's the biggest risk in an asset like that?

0:15:19.0 NW: Yeah, I mean really, there's several things that would happen before, probably the place you don't wanna be is sitting on an empty building, right? Especially if it's somewhat tertiary, so we do... We have several safeguards. One of them brings instances, we work in our leases, our tenants are required to submit quarterly and audited annual financial statements to us, so we are keeping a very close, you know kind of, pulse on that economic health of our tenant, and in general, you can have a down quarter... That's fine.

We'll just kinda keep an eye on it. But if you started seeing some trends where profitability is starting to squeeze or revenues or dropping, we could start that conversation early and say, Hey, you know what's going on, do we need to... How do we work with you on this? What are your plans and really get ahead of the ball, do we need to start trying to find a new tenant early before these guys are out...

We do at least modification, a huge amount of steps in between the day they start out in trouble, in the day that we got a notice, the defaults on the lease there, but fast forward, if they did run into real trouble, what would probably happen is they would likely sell the tenant company to a private equity group that specializes in distressed asset purchases, and with that they would ultimately buy the obligations of that lease with it, so they would probably restructure the tenant company.

Keep at least obligation, so as an investment group, it really wouldn't affect us much. And then ultimately, at the very end, if we were to have a full... If they declared Chapter 11, defaulted and exited the lease, then ultimately the due diligence we did upfront on making sure we're buying good real estate with a dependable basis, ultimately, now we have that building and we go through the releasing process in order to get it refilled

0:17:04.2 WS: Nice... Okay, no, that's just interesting to hear about a different asset classes and risks that you see there, so we're aware of that also. How do you prepare for a downturn in a property like this?

0:17:14.0 NW: It’s really into your homework you do upfront with these... That due diligence period upfront is huge, and what's nice is these tenant companies have history, and what I mean by that, I would say are our average tenant tenure, if you will, most of them have been business... 50, 60, 70. We just had a tenant company has been around 90 years now a while, so these guys have seen so many downturns.

They have substantial operations, most of them pull in close to 100 million a year in revenue, so they have cash reserves, they know how to responsibly run our business, they know how to change with, changes in consumer behavior, and the last piece is we focus on real estate tenanted by what I call B2B, one level of companies, and so they are not selling to end users, most of them are creating intermediate parts, for example, that phone company is not selling to you and I, they're selling to an appliance manufacturer, we had another company recently made aerospace parts.

These guys create custom parts for about seven or eight major aerospace manufacturers. So they have a huge amount of B2B relationships, so really ups and downs of events to say like covid affect these type of B2B type of industries a lot less, or at least not as quickly, and so they're able to, I would say smooth out, flatten the curve, if you will, of supply and demand on what's affected their businesses.

0:18:42.2 WS: It seems like there's a whole another layer of due diligence here, just on the tenants business, may need to know a lot about business to be able to assess if this is a great investment or not... 'cause the life of that tenant's business is so important, crucially important. Any tips on assessing that tenant's business like that before we have to move to a few final questions.

0:19:04.0 NW: Yeah, I would say if you're looking at investing in this as a passive investor for that you can educate yourself a little bit on really credit analysis and everything from how a private equity group looks at companies, and there's some basic research out there, what are good debt loads, etcetera. But I would say more so, you're really... You are coming in on the coattails of an experienced sponsor who does this full-time, and the biggest things you can look for are heavy sponsor co-invest.

And then that sponsor has a lot of skin in the game, then as long as that sponsor has more to lose, if this thing goes south, then you as an investor, you're sitting in a good position, ultimately that sponsor is motivated financially and by reputation to do what it takes and to do that to a diligence in a way that is likely more than you as an individual investor would ever be able to do, and that's okay. You don't need to be an expert in everything, but to make sure that you're investing with a group that has motivations aligned, in my opinion is the most important part about looking at this asset class.

0:20:10.0 WS: Do you have any predictions, Neil, just for the real estate market, or you can be specific to your asset class, but just for the next 6 to 12 months.

0:20:18.3 NW: So we've seen continued increasing attention and demand in the industrial space, and I'm not gonna lie. We have seen a little bit of cap compression with larger investment groups just getting higher and higher for what you could get cheaper maybe a year or two ago, the offsetting factor of that is the whole idea of sale leaseback at one point, 10 years ago was somewhat of a rare financial instrument that companies would use in order to free up capital, now it's becoming more and more, I would say, common and accepted.

So we're seeing more supply because of the increased adoption of sale leaseback, but more limited supply because of more dollars chasing real estate. So from my assessment and what we've seen, those two roughly cancel each other out in a way that we're probably gonna continue to see a decent deal flow and availability of, I would say competitive deals in this space, but really, it'll be interesting to see what happens with rates 'cause as long as capital is cheap, people are having to put money somewhere.

And this asset class is becoming more exposed, so we may start to see a little bit of overpaying, and at that point you have to get more choosy on what we actually invest in.

0:21:33.9 WS: I love talking to other people that's been in the military as well, and asking this question about any daily habits that you're disciplined about that have helped you achieve success...

0:21:42.3 NW: I Am a... Excuse my French, but a checklist Nazis… you know as a pilot in the C-130, everything, we had pages of checklists and everything from opening the plane out to get into your seat, your pre-flights, you're starting engines checklist before take off. Checklist, departure, checklist, everything. And that checklist is designed over years and years and years, a really accumulation of knowledge and expertise on how to do the skill repeatably, and in a way that is probably the safest and most efficient way that a huge community of folks have created.

And for me personally, I do the same thing, I have every deal that we put together from due diligence to building materials or how we communicate on going after close support with our investors, quarterly reports, monthly distributions, having a very repeatable system through the use of checklist for me, creates consistency, not only for me, but for my investors as well, and it gives them repeatability, and what I've found is it helps accelerate the process of building trust with us in a two-way street.

0:22:51.8 WS: No. That is awesome. Yeah, those checklists are important, especially when you're a pilot... Right? I mean, it is for anybody but me. Anybody else writing on their hope, you're using that checklist.

0:23:00.8 NW: I wish I could say I had it all up, you... But you forget, right?

0:23:04.4 WS: Right. What's your best source for meeting new investors right now?

0:23:08.2 NW: Oh wow. We do, I mean, really we've started a, kind of, internal practice of active referrals, and when I finish conversations with folks, I'll leave it open and say, hey, is there anyone who might benefit that I might be able to bring value either to their portfolio or really just have a conversation with them about just investing passively in real estate in general, and I found just a simple ask without...

Not a cell, but is simply, Hey, I'm available, if there's someone that you think would find value in this conversation, and it's been a huge... Just open the flood gates in terms of people coming to us, it helps... We've had a really strong track record, we've protected capital, we hit her projections, and they've seen that consistency, and so they're happy to bring folks to the table, so I would say that's probably our number one.

And the second we do a lot of just... My brother and I run a capital side, and we do just a lot of interactions through podcasts, through REIs, through meetup groups, just staying engaged in trying to add value first before you're ever trying to sell an investment, so try to answer questions, provide… Just to know how... And just see what other people are looking for. And then once you kind of bring value to the table and you can ask and say, hey, is there an opportunity to bring you into this network?

0:24:29.3 WS: What's the number one thing that's contributed to your success?

0:24:31.9 NW: Number one thing for my success, I would say absolutely, and I know it sounds cliche, but relationships, but I'll take it one step further. And relationships with people, I genuinely like... I know it's a catch all of the say relationships, but I've found to find people that you genuinely enjoy spending time with, you just... It becomes, it takes the work out of it, and it becomes your spitball and with your really your colleagues, but they're your friends too.

And you're able to share new ideas with... Send a link to an articles, ask their opinion on whether it's a technical question or just a new investment type or a deal specific by blending, friendship and peers, I found that has really motivated me and I found... It's made me a better person to work with and a better team member with our internal group here as well.

0:25:25.8 S2: How do you like to give back?

0:25:27.0 NW: I mean, mostly just spend time answering and asking people, how can I help... At the end of every investor conversation, I'll ask them, hey, outside of this, how can I help, and they'll have questions about other asset classes they're looking at, but I love being able to make introductions. I think that's one of my favorite ways, when you know exactly the piece that fits their missing piece in their puzzle, and it is usually not you on it, I'm certainly not the smartest guy in the room.

But if I know someone who's smarter than I am, and I can introduce them and they can really piece together that burning question that they had, I get a huge amount of just satisfaction from that, so I would say that's in a perfect world, that is how I would give back every time...

0:26:11.9 WS: Awesome. Neil, it’s been a pleasure to get to meet you. Thank you again for your service. Always honored to have servicemen and women on and who are now in real estate and doing well, but it's just been a great conversation about the industrial asset class, we don't have many guests on that are focused in that niche, and so it's great to learn more about that and just learning about that company and that business and doing due diligence properly on them and what the biggest risk are, and different thought processes that you all have when you're looking for and buying those properties, and is the location important or not. But tell listeners how they can get in touch with you and learn more about you.

0:26:46.3 NW: Absolutely, some general information about our company and business model and go to our website, it's MAD Capital Partners is our company... A website's www.MAGCP.com for easy to remember. And then I love to hear comments, questions. If you're interested in joining our Investor Network, just shoot me a note or an email... My name's Neil, N-E-I-L like the astronaut @magcp.com. Neil@magcp.com.

[END OF INTERVIEW]

[OUTRO]

0:27:14.0 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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