INTRODUCTION: Welcome to the REI Diamond show, with Dan Breslin. Your source for real estate investment Jewels of Wisdom.

Dan Breslin: Welcome to the REI Diamond show. I'm your host, Dan Breslin. And this is Episode 203 on How To Make Triple Net NNN Lease Investments with Drew Wahlgren of MAG Capital Partners. If you're in Building Wealth through real estate investing, you are in the right place. My goal is to identify High Caliber Real Estate Investors, and other industry service providers, invite them on the show, and then draw out the Jewels of Wisdom. Those tactics mindsets and methods are used to create millions of dollars and more in the business of real estate.

Drew Wahlgren began his career as a Risk Analyst at Liberty Mutual Insurance. He then leverages that experience into his current role as director of capital markets with MAG Capital Partners. A commercial real estate firm with a focus on the sale-leaseback strategy of "Net Net Net Lease Investments", "NNN Lease Investments", "Triple Net Lease Investments" made through sale-leaseback agreements with owners who occupy the commercial real estate can be the lowest risk real estate investments available in the market.

In this episode, Drew and I discussed the relative safety of "Triple Net Lease Investments", the latent risks in multi-tenant industrial deals, and MAG Capital's recent direction of simply buying entire operating businesses. Please enjoy this conversation with Drew Wahlgren.

Dan: All right, Drew Wahlgren, welcome to the show.

Drew: Hey, thanks for having me.

Dan: So to location stamp as we do often on our show for the audience. I am in Chicago, where I usually record. Where about are you dialing in from?

Drew: I'm in San Francisco Bay Area on the East Bay Side.

Dan: Nice, nice. I'd have never been. So I don't know the nuance of that, but I'm sure it's nice out there.

Drew: If it's not bad [?], it's good weather, you know, you can't complain about the weather in California, you know, just that's what you pay for out here.

Dan: So, isn't everybody Drew in the Bay Area pretty much working for Tech, but you're not, or maybe you did before. How did you end up in real estate? And in the Bay Area?

Drew: Yeah, it feels like everyone's in Tech out here and it feels like everyone makes, you know, hundreds and hundreds of thousands of dollars doing anything for the Tech these days. It's bizarre. You know, I always used to say that people who Park bicycles at the Google campus, probably make more money than most people. That's, that's kind of the world that's out there in Silicon Valley. But yeah, I found myself in real estate after I bought my first piece of real estate in the very bottom of the market background in 2011. And really got a great deal and fixed up

the property and lived in it for 5 years too. So it wasn't just an investment property but I knew that I had good timing and I fixed it up and I sold it and made a great profit on it. And I decided at that point, which direction I wanted to go as far as real estate investing. Do I want to keep this property? Do I want to sell and put it into something else and flip it? Do some DIY flipping myself, or do I want to go to the passive route? And I had a W2 job that I was getting a lot of opportunities from, which I enjoyed. And so I said, you know what? I think my time is better spent here and I want to the pasta brown [?].

So never looked back, I think there's a lot of great ways to make money in real estate. But for me, that was a great fit and after some time, I looked around at my W2 job and said, "wow, seen a lot of opportunities". And all of a sudden things start to Plateau as you come up through a sort of large corporation, right? You look around and go. "Oh, I'm waiting for someone to retire die." So I said, okay, I think I'm going to, I'm going to make this jump. And my brother who had also worked in the commercial real estate world for some time already. He said, "Hey, let's say, you know, you're tired of where you're at, I'm tired of where I'm at. Let's go, you know, will start raising capital and partner with some of these sponsors." He and I had both invested with already passively.

So, started to do that and quickly realize. Hey, you know what, the guys over at MAG Capital Partners would love the strategy, love the team, and we essentially merged in and sort of kind of just all join together in forces. So just under one umbrella of MAG Capital Partners, we've been rocking and rolling for myself the last couple of years. But as a firm, we've been around since the beginning of 2015, so it's been a good ride, and have kept our focus since 2015.

Dan: Nice. Let's talk about the first passive investment. So I've heard a handful of people come on the show with stories kind of like yours. Most of the audience is probably used to guess who comes on, and we're two swinging hammers, we're flipping a house for changing a toilet. We're buying a rental property. We're repeating that 100 times, and then 100 times per year. And then, we have a handful of people like yourself who had really good careers. And like I always share this story Drew, when I got started, you know, the story about burning the boats and the Vikings and all that. So you have no escape, right? I just didn't because I like pre-burned it all from like the way I was living before. So there was like no other option for me, right? It was like, you know, came from selling cars, got in trouble because I crashed your car that I did not own and like had to your time for that.

So like no one was going to give this kid keys to cars at the dealership ever again, right? So my back was up against a wall. And I remember in the first let's say, I don't know 6 to 8, 6 to 9 months before I think was like 5 or 6 months to try I did the first deal. But I remember thinking like, you know, looking back if I had a job being an architect and I was making 70, 80, 90 thousand dollars a year back in 2006. I don't know that I would have stuck with it. And so, I feel like a lot of people who get started like if there's no other option, we have to make it work because that's life. But if you're in a position where you have something that pays the bills or maybe even more than pays to bills and you're getting a lot of satisfaction out of it. Like it sounds like you were at the time, the challenge going forward and figuring out what direction we want to go. I mean, I guess you have more options maybe than I had at that time when you come into the business.

But I'm curious, if you could elaborate and dive into the decision of active investing versus passive, and then talk about the first passive deal that you actually chose and how you found it.

Drew: Sure. That decision really was, I'm a DIY guy right. So, at my own home that I live in currently, something goes wrong unless it's outside of my capabilities and I'm, you know, all want to my horn here, but I'll say a fairly capable person when I was 19 through 21 or so. I worked as a mechanic and my family has an auto shop, right? So comfortable tools, comfortable doing things like that. So happy to do it. And I was honestly, just at a great stage of my life where I'm starting to understand myself, more and more. And I realized I go, if I own and manage a property, I'm going to be hands-on, too hands-on, more hands-on than the tenant would like to be more hands-on than I would like to be, but it's something that I know I won't be able to help up myself with I'll be going. Okay, what's going on? I'm going to go check it out. I'm going to fix it. I'm going to be in and out of there.

And I thought, oh, this is not the life, I want to build for myself. So some of it's a personality decision, right? And I think a lot of other people are really good about managing that and separating themselves and saying, "Hey, you know, when I got a handyman, I'm going to stay out of it whatever you know. They separate themselves and they have very little connection with their tenants and you know good for them, right? I don't think and I didn't think at that time that I really would be, that would be a great fit for me. So that was part of the decision, I had at that point had one kid. I have got two now and I thought well, you know, so in the evenings I'm going to be over there, here and there, and you know, hopefully, you scale that too, right. That's the goal is not just to own one and scale that and continue to leverage and acquire more properties. So I'm going to be busy with these things in the evenings after my day job. And now, am I going to spend time with my kids and before you know it they're going to turn, you know, 8, 9, 10, then 20 pages account that come off and you realize that you're busy dealing with stupid fix its issues, right?

So that was part of it for me. I thought I don't want to do that. And that's some again, a little personality, a little bit of a lifestyle thing for me, personally. And that's not the same decision everyone should make, right? Other people have that time and can separate themselves in a way or have a great property manager that can handle a lot of that for them. You know, everyone's in a different place. So that was for me, my decision. And then really the first passive lessees commercial real estate syndication as people call them. As I mentioned, my older brother was working for a commercial real estate sponsor team, and really, they were essentially the capital raising team and they would partner with an operator, right? That you see this a lot in this world where folks will raise capital on one side and they'll partner with another group who actually, you know, acquires a property. They manage it, they stabilize it, they excel at all sorts of on-the-ground operations. So, he'd been working on a couple of deals and showed me and, you know, we would talk about commercial real estate investments over beers all the time.

And so at the time, I sold this property and I'm like, okay, and we have been talking to for a while. He goes, "All right, we got this property. It's in Northwest Houston. It's a large multi-tenant industrial piece of real estate." And it's funny and you know, in hindsight really that's actually the worst investment I made. I never thought, not in the commercial real estate space

possibly, right? And I think I would have recognized some of those things standing back now. So I still give my brother a hard time...[crosstalk]

Dan: Why was that the worst? What specifically made that...

Drew: For as far as I'm concerned, yeah objectively from the numbers and returns and cash flow standpoint so far and it's still active, right? I am still seeing cash flow, but it's minimal. I think I'm averaging about two and a half percent cash flow over the last three and a half four years or so. So that one it's you know, it's lower on the returns and you know, in hindsight, looking back at it, I go, Wow, you know, it's so interesting now after investing in, you know, seven or eight different syndications now and you see and looking at, you know, dozens if not hundreds of other offerings out there, and use your eyes and look back at that I want to go. Yeah, I wouldn't have bid on that one today. But back then I said, I was anxious to get in the game. I was anxious to deploy some capital, see those cash distributions, and it was just a behemoth of a project. Very, very large and with a lot of small businesses, that really, you know, when you have a multi-tenanted industrial property like that, who are your tenants, right? There are a lot of small fabrication shops, small auto-alignment shops, things like that.

And a lot of these companies, these businesses kind of come and goes, you know, come and go with locations and come and go in and out of business, right? People set up their shop and hey, I'm going to make, you know, hand-blown glass art or something like that and you know, sure enough, it goes belly-up in a few years, right? I mean these are the kind of businesses who tended these properties. So there was a lot of that and there were just so many so much more complicated about this that I think in hindsight and looking at deals now, I always try to find something that's a little bit simpler. Frankly, I just look at it and go. I want to find something that makes sense. It's not too many moving parts because frankly, there are just more things to go wrong and I'll make a reference back to when I used to be a mechanic at an auto shop, right? The more bells and whistles the car I had, the more things had to go wrong. Right? That was sort of how I guess the analogy here within a property. And if you have something that's got a lot of different things to manage, there are just more risks that you're taking on. And so that's something to take into account and I'll talk a little bit more about what we do because it is kind of a polar opposite of that.

Dan: Yeah. Before we get into the MAG, and we're going to focus on that here in a moment, but the multi-tenanted industrial property. The first deal will stay on that for just a moment has these transient businesses. Meaning they're coming, they're going, they're small. So we don't have this like five, 10, 15 years, you know, cash flow period where they're staying there and there's no vacancy. I imagine...[crosstalk]

Drew: A lot all things like a [inaudible], you know.

Dan: And then we're filling those that are probably taking longer than an apartment to find just the right fabricator. Get a glassblower to use your example there. What other risks would you have recognized on the front end in the prospectus of that deal? Then knowing everything in you now, is there anything else besides the transient nature of the tenant population there that would have been a red flag for you?

Drew: I think. Now if I looked at it again, I mean, I love the location. I think still Houston's a great market to be in and I'm still very bullish on Texas and Houston. I mean they're rapidly growing. So, I love the market there, but I think one piece of the offering was, you know, some of the value add, right? Hey, there's this is the, you know, for a lot of folks say we're going to add value here. What's wrong here that I can fix up? And there seemed to be a little bit of a trend of tenants who were delinquent, right? And so there was some writing off some bad debts and wasn't just sort of writing off some bad debts and collecting on what you could it was I think more of a trend there. I'm not sure how I would have identified that ahead of time, but it seemed to be that, hey, okay, we collected what we could, we wrote some bad debts and evicted tenants, but now there seems to be some more of that happening. So it was kind of interesting. I don't know how I really could have predicted that, to be honest. You're like, how do you know the next tenants going to start going delinquent?

That's the next sort of what you already have been delinquent. So yeah, it might have been, you know a submarket issue. Really. I have to be honest, I haven't gone back and dissected that piece of it but it's something that seemed to sort of continuing to exist even after the first year or so of kind of eliminating a lot of those bad debts and collecting when you could. So I'm not sure if, if you again if that's a submarket there where that's just more commonplace or I'm not sure, to be honest. I mean see industrial flex property that I've ever invested in personally and, you know, left a little bad taste in my mouth. It doesn't mean that's a bad asset class. And, you know, where MAG Capital Partners is an industrial, but certainly a different type of industrial property. You know, this is a very large, again multi-tenants of property with a lot of very small businesses who you don't have a lot of background, right? And it's very similar for multi-family too. And this is why I like what we do and with MAG, we have these single-tenant properties. I'll get to that again, but you know with a multi-family property, for instance, you know, you lose a tenant.

And like you said, you can return those properties somewhat quickly. If you're, you know, if you have a nice property or something at least set as a good value for the rent that you're asking for, you're going to be able to retain it up to the property in like 30 to 60 days usually. A lot of folks I didn't see in there like every tenant on the property in a week, right? They have someone at lease signing the lease and the move-in date is set. With these like you said, it might take a little longer, it might take two, three months. And might take longer than that, right? So but you still have that lack of credit and the background of these businesses. We all have a light touch on credit. I mean with multi-family tenants, you don't know much. You can do a credit check. That doesn't tell you much, but that's okay. You have multi-tenants of property. So that's a trade-off. And again, we'll get into what we do, but with single-tenant properties, where you have a lot more due diligence and credit. And a lot more, there to sink your teeth into, of the credit of the tenant. You have a lot more of an understanding of who that is, even though it's a concentrated tenancy that is 100% tenant in a single-tenant property. So I hope that makes sense and we'll jump into that later. Got in ahead of my...

Dan: Yeah. It sounds like it's just simple as evaluating the old based on the risk of the tenants and obviously, there's more or less of that available depending on the asset class and depending on who the tenant is. So I think it's solid and we all who are progressing in our real estate career, learn to get a little bit more instinctual about our gauging of those tenants as time goes on, you

know, from the single-family section 8 or otherwise landlord who gets a gut feel or checks the car for trash as an example. When the tenant comes for the showing is making their decision on these other alternative pieces of information. I'm sure you're going to get into some of that nuance about selecting industrial tenants who are actually capable of paying the bills and they're going to continue to do so over a period of time. And why that might be exciting to people investing passively in a deal. So what's your role at MAG Capital Drew?

Drew: I'm the Capital Markets Director of Capital Markets officially. So I'm working on the debt side and equity lining up, you know, lending from Banks as well as bringing in and raising capital from our investors to raise the equity for acquisitions.

Dan: Perfect. What are the primary deal types that MAG capital is and has done so far?

Drew: I'd say our first love and probably about 80% of what we do, our single tenant net leased industrial real estate, and kind of get more specific on that. It's usually we're making acquisitions to be a sale-leaseback transaction. So we're purchasing a property from Commercial Business that operates and owns the property and they're essentially selling the property and leasing it back simultaneously. So for them, it's a Financing transaction, they're looking to access the capital that they're sitting on. So, that's the main thing we do. And I'd say outside of that, we do some blend and extend deals as people call them, or we'll get into contract on a property and work to with the tenants and blend their lease rates and kind of smooth it out and get an extension on that lease. It's something we like to do and then outside of that in the last year, we've made a pushover into the Private Equity space, and I'll kind of explain the reasoning for that, but we have a lot of similar core competencies as a Private Equity Group does because we work so closely with a single-tenant property that we've begun to understand how to evaluate businesses really well. So we've made some acquisitions now in the Private Equity space where we're buying not only the real estate but the operating company as well.

Dan: Can you tell me about that?

Drew: Yeah, absolutely. So we, you know, we have a credit team here on our staff and we evaluate the credit of these businesses from a real estate perspective, right? So we've done this for years since 2015. We have, you know, that skillset. And I always used to say, we kind of waddle and quack, like, a Private Equity Group, you know, we focus so much on that because that's where the risk is when you have a single-tenant property with the long-term lease and a triple net lease. You know, where is the risk? It's all in the solvency of this tenant. So for us, we've had, you know, a lot of repetition, a lot of experience, looking at tenants and understanding the risk around them and what they look like. And we've been rubbing shoulders with Private Equity groups the whole time. As Private Equity Groups purchase an operating company, oftentimes that acquisition comes with real estate. So we'll partner with them. And they say, okay, I bought Joe's manufacturing here for 20 million dollars, but you know what, 10 million of that is tied up in the real estate. That's not what I want to do as a Private Equity Group. I want to spin off the real estate so I can use that 10 million of capital and go buy another business, right?

Continue to acquire and find synergies in my operating company. So we partnered with them.

We've really understood how they evaluate investment opportunities, how they stack their capital, and structure Gantt as they make an acquisition. So learn for, I mean, the last couple of years, we've just been thinking to looking around, going. Okay, this is a natural diversification for us, you know, it makes perfect sense to kind of get in this world because it's so similar to what we do now. And so we just made an acquisition of a company an Auto Transport Company in Texas. You know this is not sexy stuff. These are businesses that are already profitable. You know, this particular company is about 20 million dollars in revenue about 10% EBITDA margins. And so they're profitable. So you go. All right. This is a much stable, more stable investment than a start-up, right? I'm not investing in the next looper technologies or something like that. This is not a swing for the fences. This is a company that's cash flowing now and we see an opportunity to grow that. So we just closed on this operating company and came with all the trucks and trailers and real estate. So you can use that depreciation just like you would in a real estate only deal front load that depreciation offset gains.

And in the meantime, this company has contractual relationships that go back over 20 years with Mercedes, Volkswagen, Hyundai, and Kia to bring their vehicles from ports and the railheads out to their dealership. So really nice and stable kind of business with great long-term relationships. You know, what we want to do is just diversify their customer base more grow the business more, get more contracts, you know, possibly hire more drivers and buy more trucks and grow that EBITDA by a certain amount. So, I mean I could talk about this for a while, it's a little bit of a departure from Real Estate, but the way these businesses are valued in the way you add value is a little bit different, and it's pretty interesting. And something that we've got a lot of experience again with.

But in this case, we actually JV with them. A guy who used to be the CEO of one of our tenant companies, if you can believe so, here's the manufacturing company with own the asset for 5-6 years, really, get to know the management staff including the CEO. And so we have this relationship with them and we JV with them over here, to place him as CEO of this operating company so he could manage it. I want to focus on real estate, not managing the day-to-day operations of an operating company. So that's important to kind of make sure we can keep our focus on real estate and maybe new Private Equity Acquisitions as well. But I can't do that if I'm tied up with day-to-day operations with the Auto Transport Company, right?

Dan: Yeah. It makes sense. I'm curious. Did you guys see volumes drop off with the chip shortage and the vehicle shortage that we see now? Is that like a real...

Drew: A hundred percent. Yeah, 2020 and 2021 little drop in their revenues. And what's great about this particular business that we acquired was, they have a really variable cost structure. So as revenues dropped, so to their costs and expenses and so their EBITDA margins remain the exact same, even though they had a 15, 20 percent drop in revenue. So companies are well managed and they have that structure which really helps them. You don't have to worry about the amount of overhead killing you in a short-term temporary drop-in. You know, we obviously see an upswing coming up in the future with production kinks in Logistics and all that. Hopefully being worked out. I know right now, we're like in the throes of it out there. I know they're talking about the ports that Long Beach on the East Coast are everyone's backed up and you know. So hopefully, we get through this, and as that happens these guys only stand to see an upswing.

Dan: Nice. Interesting. So let's circle back to the Triple Net Leaseback Sale-Leaseback, right? You know in the example you threw out a 20 million dollar business and 10 million dollars in real estate immediately being peeled off. I guess a lease is put in place and I feel like at first blush me as a Real Estate Investors like why didn't I just go get cash-out refinance from the bank, you know if that's possible on the difficult one. And or you know, what's the plan with the Private Equity then, they're just going to buy another business and sell off this business with the lease and kind of the assets stripped out of it a little bit. I guess I'm looking for a little more, you know, of the story of how that shakes out, right?

Drew: Well, good questions. Absolutely. So the seller's motivation, like can vary from deal to deal. And so I find this stuff interesting, each business where they're at, in their journey, you know, a lot of these businesses have been around for you know, 60 70, 100 plus years. And so at some of these have owned the real estate operates out of since like we did a deal recently and the company had been there since 1950 actually develops the property of the buildings and everything there. And at this point, we're just looking to "hey, we're going to do this transaction and basically, they leverage a little bit, strengthen our balance sheet". Again, it's nothing really exciting sometimes about it. And at other times, it can be, right? Hey, we're going to use the proceeds. Were going to invest in new equipment, new product lines, you know, we're going to see, you know, 20% growth in revenues over the next 12 months from this investment, whatever it might be. It just depends on case to case. But you're right. They have other options, right?

So if I'm the CFO of Joe's manufacturing and I'd go, I want to access some Capital because if they want to buy new equipment, whatever it might be. I could go get a loan from a bank, right? And the disadvantage there is it's going to come with some covenants. That bank is going to say, okay, you have to maintain certain Financial benchmarks. You have to, you know, you really have to watch certain things. Just like, if you have ever seen a CMBS loan for instance, or all kinds of loans, that will have these little tripwires, basically, where they can default on you. And maybe possess an asset. So you want to make sure that you have something that's a loan that's not coming with too many of those tripwires, too many of those default scenarios where, "Hey, if I'm not careful, I might be defaulting on my loan with this bank." And now that 10 dollars go on the liability side of my balance sheet. So keep that in mind because when you look at the other side of the real estate piece, you're right. I can't get a line of credit, right?

Cash-out refinances line of credit either one, but I can't access 100% of the equity in here. By the 10 million dollar property, I can access maybe 7 million dollars with a line of credit. And again, that's going to go on the liability side of my balance sheet. So maybe I already have a senior, some senior debt with a bank and they say, you can only have so much, you know, debt to EBITDA ratio, you know, there's a cap here. So, if I take on more debt through this line of credit, okay. Well, now I just violated a covenant with my existing debt over here. So it's always important to kind of make sure these different debt instruments. These are in capital instruments, play nicely with each other. So now we look at the sale-leaseback, right? Hey, I could just sell this property. I can set up a nice long-term lease of 15-20 years. Sure, it's triple net. I take on the responsibility, maintaining the property, but I've owned it for a long time. I'm used to that. I already have, you know, generally, is people have taken very good care of their property because they've owned it for a while and they operate their whole business oftentimes out of this

property.

So for them had doesn't go on that their liability side of the balance sheet. So that's really nice. They're not leveraging up on their balance sheet and that rent that they pay is tax-deductible. So there are a couple of other pieces there, but it's really, those are the top two things is unable to access, you know. All that equity you tied up in here and make tax-deductible rent payments, and protect myself from volatility and the rental market out there, right? I'm going to have maybe two, two and a half, three percent annual increases over 20 years. Oh, friends kind of go crazy. Then I feel a little bit protected. I'm not subject to that. If I have to sign a new lease in 5 years for instance. So, you know, if your company doesn't plan on going anywhere, that's kind of nice long-term protection for you.

Dan: So, a Triple Net Lease is what Drew typically going to be a 15-year term of the 20-year term. Who's pushing for the longer term?

Drew: We are. Typically, you know, a tenant I want to last, of course, you know, but it depends. Yes. Someone may say, "Hey, I would like to protect myself from many volatilities in rent prices". So I would like a long-term lease, you know, it's interesting. Everyone sort of has their own motivation and wants and needs. But Triple Net Lease just run your listeners who don't know? That means the tenant is responsible for the property taxes, insurance, utilities, and really what we call, what we call the lease that we set up as an absolute net lease, meaning, it's everything. They're also responsible for maintenance, capital expenditure items, like, roof and structure, paving the parking lot, mechanical HVAC, and all of them. So, it's a very passive lease for the landlord. We don't have to manage a property and we keep tabs on it of course. You still need to make sure that their tenants not letting it fall apart but generally, you don't see that because you have someone who's operating their company. They can't make money, you know, manufacturing gears and sprockets or food or whatever it is well, the roofs leaking, right? They need to make sure it's clean and up to date. So that Triple Net Lease is a lot more common when you get to single-tenant properties.

We'll see this where a tenant is essentially trading off the management of the property and you know, the maintenance and repairs of the property for a low overhead in the rent, right? You're you know, you're a gross lease which is the opposite of a triple net, right? A gross lease for the landlords responsible for all that. They're going to pay more. You're responsible for more as a landlord so. There's a trade-off there and for us, we would rather go the triple net lease space because it's much more predictable. We have a really consistent cash flow that we can depend on, right. We're not going to get cash flow doubled that by some expenses from one cord to the next.

Dan: Yeah, and you don't have these vacancies within that 15 or 20 year period, either like single-family residential multi-family. The vacancies and repairs are to really kill us in that space, whereas you know, the allure of you describing the Triple Net Lease situation is that there's not going to be any vacancies as long as my credit team made the correct call and then, of course, a little bit of luck in the marketplace for the business who's in that space isn't going to hurt the situation. So let's run through an example deal. Maybe, if you have one that's real. I'm curious. You know, what's the purchase price to the seller? Maybe what the rent is to the seller?

How that purchase price is determined by your end? I assume there's some kind of negotiation there and then how that would shake out with the investors who put the money up? But maybe even the capital structure in their these like a 50-50 kind of capital? Or they leveraged up to 75 percent of the value from MAG Capitals perspective.

Because how much of that Leverage is in each deal is going to equate to a higher or lower risk for the passive investor who might be listening? But yeah, my mind's wandering how these deals shake out, right. Because one of the things I'm assuming and maybe I'm wrong is well, it's a Triple Net Lease. And so when I do all the math, it's a very, very safe type of investment to have my money because of the long-term nature of the tenant. I mean, am I only looking at 7 or 8 percent as a passive investor? Is this going to be more of a 10% plus a kind of a deal for someone putting their cash into a deal like this?

Drew: All good questions. I can try to unpack this is like a number of all that I was pulling up a deal and, you know, I won't go into the name of the tenant, this one that was in contract for right now, right? And I'll use this as an example, had some materials ready but a single-tenant property company that manufactures basically highly engineered components for the battery industry. I'll leave it at that since they're you know, it's a little sensitive still until the transaction gets done. But the properties in Tennessee, and we're doing a set of leasebacks. A 20-year triple net lease will be signed at close to the property or purchasing it for 13 and a half million dollars. Year-one rent is nine hundred and twenty-four thousand. So that comes out to I think about a six-point eight-five percent cap rate. And again, you know, I'm taking the rents and I'm going and you're going wait, hold on.

What about your expenses? Remember, there are no expenses here so that your one rent is my net operating income, right? So, that's about a five-dollar per foot, annual per square foot, rent rate. It's, you know, very right down the middle as far as what we're seeing for a lot of these types of properties and especially in an area that's not a primary market. It's a little bit more of a secondary market just outside of Knoxville, Tennessee. And this case, yeah, it's about 183 thousand square feet. Trying to think of what else I can give you here. But you know this as far as a return structure, you know, for our investors, I mean we're oftentimes pretty close to the same as far as cash flow goes. And you know the attraction to what we do is that we don't have a value-add strategy here, right? I have a tenant in place. They're paying rent from day one. Let me some cash flowing from day one. There's nothing I need to do. I don't need to start renovating units and get this place stabilized. It is stabilized. So generally we'll see anywhere from 8 to 10 percent in cash flow starting from day one, which is great.

And then, on the backside, if we hold the property for, you know, five years, let's just say on average. At the end of that, you know, you pay down debt, you've increased the net operating income, and usually takes work to do that. We have this built into that lease, right? There are two, two, and a half percent rent increases annually. So over time, you've increased the rent and there is some front-end value that's created too. And this part is that I know it's a little bit less tangible, but I've always kind of tell people to look you have these properties shorts for sale, but we're creating a lot of contractual value through this institutional great lease. So, 20-year triple net lease, we build in institutional features like quarterly financial reporting from the tenant. So why, we mitigate risk, right? We follow how they're performing and doing strong Force Majeure

Clauses. And we've really steadied the publicly-traded reaps and we see how they structure their leases. We realize what they look for in an institutional-grade lease so, we've learned how to mimic that learn from the great strength and create a lease that has that kind of strength to it. Because that's also what publicly-traded REITs is going to look for when we sell as they may be the buyer.

So if I sell five years from now, I have 15 years left on this lease. It's a pretty damn stable property still. So you have a very nice run rate as a buyer if you're a publicly-traded going, hey, I have this triple-net portfolio. I'd love to roll this into make sense for us. And here we have a property with an Institutional grade lease. This is exactly what we want, you know, as REITs. And for MAG Capital as a seller, it's a nice easy transaction. So, that's really some value creation. I'm not going to say it's 50, 100 basis points, and cap right there. But a little bit of value is created in, just pulling all these pieces together, executing that lease. And now you have the stabilized property.

Dan: Yeah. I think it's pretty cool. All the pieces were there. When you have the lead and then you guys are just negotiating all of them and assembling them. What's the debt structure on this one, 13.5 mil is the purchase price, and you guys borrow?

Drew: Seventy-five percent. So in that case, that's about 10 million is financed. And so, you know, it could be anywhere from 70 to 75 percent. That's typical. Sometimes we get as low as 65 sometimes a CMBS product out there has a little bit lower leverage, but longer amortization, you know, 30-year amortization there. But oftentimes we're finding that 70 to 75 percent 25-year amortization. Usually a fixed rate over 10 years. And this is a nice stable investment for banks too, right? That's why you're going to get that, long-term. They're going. "Hey, I'll give you a 10, 15-year term sometimes because I haven't a 20-year lease here. I really believe in this tenant. You shook me all their financials. You know, this particular one I mentioned in Tennessee company does about 105 million in revenue, which is okay. Right? I mean if you look at the Public Equities Market, I mean this would be considered, you know, small-cap rate, as far as how large they are. However, they do a 20% EBITDA margin. That's a really high margin.

Dan: Nice.

Drew: And you can find people in manufacturing in the low tenants, and even in the sort of mid to high single digits depending on the industry that they're in, right. Food production, for instance, is a low-margin industry, really steady demand, but they ride on a thinner margin. So you find these different sort of characteristics of different tenants and it's important for us to know and that's why we have a really great credit team here. What sort of normal? What's strong? What's weak? And so we kind of determined, "Hey, is this a good tenant?" "Do we want these people backing this long-term lease?"

Dan: So, when I do the, let's just call it a two percent per year increase in rent. Is that what you said roughly that's conservative?

Drew: Correct?

Dan: So, is that going to compound each year Drew, is it like it's 102 percent in year two? And then it's like a hundred and two-point two, or?

Drew: That's really compound. So, two percent increase from the year before. So...

Dan: So our rent, our rent will be what? A hundred and eleven percent of what they are they want? And then when you apply the cap rate if we assume the cap rate is still what it is today, the 13.5 million purchase turns into what sale price on that conservative basis and if you just had to guess, that's fine, too. We don't need an exact calculation.

Drew: Yeah, now, I'm doing the math. I can't help myself back [inaudible] because I have the Pro Forma on the front of me but 924 thousand dollars in year one. Year five, it's a million dollars in 160 million $167. So you figure you got about 76 thousand dollars in increase a little bit more than that. I'll see. You know, that's about eight and a half percent or so increase in rents over that time. So, yeah, it's not a value-add deal but you are creating some value over the course of that time. So it's certainly, you know, we're not getting, I mean, I've seen multifamily deals where people are projecting. "Hey, we're going to have four or five percent rent increases annually" which is pretty wild considering where some markets are I would say, Hey if you're an investor take a step back, think about how realistic you might think that is and maybe it is, you know. But really step back and just look at that and think about where that means rents are going and why they're going to justify that. So in our case, you know, we have very nice steady increases, but we're not going to double rents over the course of 5 years. That's not the goal.

The goal here is to have a very steady yielding cash flow and it's been really attractive for people recently because they are looking around at housing prices and how wild it is. And a guy saying, "Hey, I used to really believe in and buying this house and holding it and renting it for a few years", and seeing that appreciation. And now it's getting a little bit harder for me to wrap my head around that. It feels riskier because I see pricing, and housing going up 25% over the last 12 months, or whatever it is. It's something like that. But I don't feel as comfortable buying a house and planning on the same appreciation, because I feel like things could flatten out a little bit or even go down, right? It's always possible. So, people are starting to look around for yield and I'm finding a lot of our investors saying, "hey they're doubling down with us because they're going, I'm looking for more yield for cash flow because what I'm seeing in the housing market is scaring me a little bit." And I don't want to tell people, you know, your listeners that I believe it's a bad investment. Absolutely not. It's just, there are a little bit more risks in certain markets. You know at market prices, it is a little difficult to imagine pricing going up at the same rate that it has over the last five years.

Dan: It makes sense. So if we apply that new cash flow at the 6.85 caps. What do you think to resell or even resell that used in the Pro Forma of you guys? So I'm making the assumption to just based on what you said Drew that, you guys are probably building on a 5 or 7-year timeline and then actually planning to exit these and then return capitals to investors. Correct me if I'm wrong. If I'm right, what would be the Pro Forma?

Drew: Absolutely.

Dan: Sale price?

Drew: Yeah, we have a preferred return that hurdle that we meet with our investors. We actually increase that over time since the rents are going up and then when we sell, we have an 80/20 split with our investors in favor of the investors of course. And, you know, a lot of our deals were somewhere between 16 and 20 percent average annual return is where we're targeting and we've gone full cycle and about 20 deals. So it's always helpful, you know if you're talking to a sponsor, have you done this before? Do you know in projecting this? But I do hate your targets before and you know, we missed on a couple of targets, not by a lot, but we've missed on a couple and we've acquired lease exceeded some, and a lot of just nailed right on target. So you have that spread of course in real estate deals. You just you know, it's I don't know anyone who's just nailed exactly what they thought they would hit on every single deal. It just really depends...

Dan: Yeah, right. Bernie Madoff. [laughs]

Drew: Right. Exactly. So far we've done pretty well just by being conservative on that exit cap rate. And I mean all again, I kind of talking about this Tennessee example. And some of these, we get an opportunity because that seller needs to execute, right? They're not widely marketing it going. We're going to go to the highest bidder. They wanted to know that someone can, it's a financing transaction. Remember that. So they're going I needed the funds in 4, 5 months from now. Maybe they don't need it, but they're going. I have initiatives that I'm trying to execute, right? I have, you know new things I need to invest in and you have capital or needs for this Capital so I can't dilly-dally with the highest bidder and have someone go or financing fell through.

Okay, back to the drawing board, try to find a new buyer. So they want to find someone who has experience doing this and so we get a little bit of a price break there. I mean, honestly, this property that we're getting at about a six-point eight-five percent cap rate, I really think this would trade for kind of six and a quarter percent cap rate if we're just widely marketed. Especially after executing on a lease like this. So there is some value that we're able to, I don't want to say create but kind of inherent just through this transaction from a seller who really wants to get the transaction done at a fair price, but not doesn't necessarily have to have a top dollar.

Dan: Got it. So the sale price on the Pro forma for this deal is?

Drew: I don't have that in front of me. But I think we were, again, we're being a little conservative and a six and a half percent cap rate. I mean really is conserve, especially I think, again, this thing could be close to a six percent cap rate today, but you don't know where you're going to be in five years. So for us, you know, we'll always look at the interest rates. I think that's the biggest risk to a lot of the commercial real estate investment world is, hey, it work things going to be in 5 years, right? But if I plan to exit then, you know, if there's a spike though, that's a great place for us to be in though. As if there is a spike in interest rates, may go up, but sometimes you see over time, they will have a sudden spike. And we usually, settle back down. If that happens, we're not going to sell at that time. So, horrible time to sell, right? All the buyers are going to pull back, sales prices are going to go down. But usually, you see that even out and

so we're in a great place because, in year five, I'll have 15 years left on that lease. We're not going to sell them, we're going to continue to hold in cash flow.

I have a lot of security around that lease term that's in front of me, being 15 years. And we don't see the value of that asset start to erode until they get below about 8 to 10 years left on that lease. That's when you see the value come down because a buyer is going to say, "Hey, I'm taking on a little more risk, right? In eight years, I might have a vacant building for all I know." So it starts slowly to sort of a road away. And so, for us, we're always looking to sell, you know, before that eight to ten-year lease term left, you know, that's your inner pretty good place. As long as you're above that when you exit and someone else feels good about taking on, you know, 10 plus years of lease term left and they go, "Hey, this is great. I need to cash flow for 15 years." So it's a nice place for them. And I hope that makes sense.

Dan: It seems like you don't want to answer the question directly. Is it like a legal thing? It's a disclosure thing? Don't want to know in a recording?

Drew: The exits cap rate or what were the...

Dan: The exits sale price? Yeah, it was a third to...

Drew: I don't have it in front of me. I think it's a six-and-a-half percent cap rate. We got this 6.85 and...

Dan: So, you got, we would have to do some math on that and it would be like...

Drew: Yes. I don't know. Sorry. I'm not that good at math. [crosstalk] I didn't...

Dan: Got you. I thought it was on the Pro forma there not to be difficult. It's just that.

Drew: I'm looking at the debt Pro Forma that I was just working with on a bank. So I'm still adding up and getting on this thing and we don't put on...

Dan: I'm not trying to be, not trying to be a dick. I'm just penciling on...

Drew: No, no, no.

Dan: I came up with 15.384 million at a 6.5 cap, roughly.

Drew: It sounds about [inaudible]...

Dan: It's probably a little higher because I think I used a million flat for the cash flow when we did the compounding by 2%. So I think you actually have a little higher cash flow there. I didn't know if it was like, you know, a filing thing and we weren't allowed to pin a number on there. That's all.

Drew: Right. No, I mean you can take that rents, for instance, that about a million bucks and

divide it by 6 and a half cap. Is that what you just did?

Dan: That's what I did. Yeah.

Drew: Right. Exactly. So I found, I pulled up our full Pro forma. And yeah, we're assuming at a six and a half percent exit cap rate. And again, we're not looking at, you know, we're buying at a 6.85. We're not assuming that the market is going to compress. We're looking at it as we got a better deal than what you would see openly and widely marketed today. Certainly much better, you know, and I think it would go for less than a six and a half percent in cap rate, you know a higher price if it were widely marketed today, but we're being a little conservative. And so, important to kind of note that because sometimes people go all you're assuming that the markets just going to keep getting higher and higher and pricing on the cap rate and the answer is no, right? Actually looking at it being a little bit softened up from where it is today. We just got a great price on this by coming in and executing on a sale-leaseback.

Dan: Yeah, and I guess there's not this wild competition out there maybe for the sale-leaseback kind of deals. Right? It's the first time I've ever had this conversation on my show in the last six or seven years, I think that I've been doing it. So you kind of has this unique niche that you're able to get in there and negotiate at what is potentially a stronger deal. And then I mean with the inspirational buyer in mind already when you're doing the paperwork on the front end. It feels like a logical step and to me, I'm buying multi-family and I see what's out there in the marketplace and what is closing. And the 6.85 cap rate sounds like kind of a little high actually. You know, I might think if, I might have thought it would have been in the fives and I'm sure if we were in, you know, one of the major cities, we probably are in the fives for a product like this versus a secondary market. So yeah, I think the cap rates sound reasonable, but you and I would be both looking into a very foggy crystal ball if we thought we were going to be able to pin that for sure 100% five years from now.

Drew: So that cap really depends around, again, where's the risk in this type of Investments. It's around the tenant and their credit profile. So, if I have this exact same building in Tennessee that I'm talking about now, with exact same lease except signing at the bottom of that lessee's Amazon instead of this company, right? Again, this company is very profitable. They do, you know, twenty million dollars in profit every year. If you, you know, there's still a chance that they can go out and solve it, right. There's absolutely more credit risk around them than Amazon, which is not going anywhere, right? So if Amazon signs at the lease, what cap rate does this trade at today, it's going to be more like a four and a half four, maybe even closer to three and a half. Higher than [?] 3% cap rate.

It's going to be a very low-yielding investment that's going to attract institutional dollars who basically want to place and park their dollars, right? They're going to say hey, we're getting, you know, three and a half four percent yield here, we're able to keep up with inflation with the real state benefits that we have here, and I have a sure thing for the next 20 years of the Amazon, right? Amazon is never going to break that lease. So, and if they do this recourse, obviously, they're always [inaudible] going to be solvents. At least, that's what I would say over the next 10 years minimum. So that's really where these cap rates are the hinge on, is the credit risk around the tenants. So, for instance, if it was a startup company. Hey, you know what, we've been in

business for a year or two. We want to, you know, sign a new lease on this thing. They don't have a credit background so it doesn't mean that we're actually going to be scared away. We'll look for things like a personal guarantee from the founder. You know, you oftentimes find a serial entrepreneur who they go. This is my 10th company. I've started, I have a wild successful track record behind me. Well, that's where something except this entity has no assets. No balance sheet. I don't feel really great about them signing this lease because if they go under, I've just, you know, stockholding this property here that's baking and really have to work to get a new tenant in, and if I've done my job right, then I can do that, but it's still can take 3 to 6 months, right?

So in that case, we might say, okay, this personal guarantee from the founder who's worth fifty hundred hundred fifty million dollars maybe, this individual is going to give us a personal guarantee. Okay, I can work around this. And now I may also have an opportunity to get a property at something like a 10, 11, 12 percent cap rate. I mean, that's what you will see in that world with this sort of start-up 10 because they're going to know that it's going to, they're going to have to pay a premium rent or they're going to have to give a hell of a discount on the purchase price with that type of tenant in there. So, there are opportunities to be had there. But that's not where we like to play. Again, unless they have a weird example where someone's going to sign on the dotted line with a lot of personal net worth. Otherwise, you know, no, thanks. We want a really nice solid credit tenant.

But a private credit tenant, so I want that Middle Market because I can't find the yield with an Amazon or a Walmart or Home Depot. You can again, find an investment there. You're not going to see the yield that most investors are looking for. A couple are. But getting back to what you said though on there must not be a lot of competition there. It's not coming from individuals. Right? We're in a sort of an Institutional sandbox that we play in. This is a really sophisticated transaction. Again, we've hired, we have three guys on our crediting that all came from publicly-traded REITs. Why do you think that is? That's because we compete with publicly treasury day in and day out for these properties. You know, I just talked to a broker yesterday and he goes, "Yeah, we got two, three offers already", and I'm like, let me guess and I named off for five big reads, you know, store Capital Angelo Gordon, Veritas, STAG Industrial. And he goes, "yep, you just named off all of them." Yes, and I'm I like we see these guys day in and day out because this is the world that they operate in and what's cool for us and our investors are were able to take these institutional Investments and bring them directly to private investors because your only way to get exposure to a lot of these types of transactions and that type of investment, I should say is through a Publicly-Traded REIT. And if I go by publicly traded shares of store Capital, I'm going to yield like four and a half percent. That's pretty standard for, and that's actually pretty good for REITs. Right? So four and a half percent and okay, fine, you know, it's going to be really diversified. They're going to manage it really long. They're actually a great company but being in that sort of structure and all of the inefficiencies around the REITs, you're not going to get the kind of yield that you can with the direct investment.

Dan: Got you. So if anyone's listening right now Drew, there's probably I'm guessing two ways. They might want to reach out and do business. Number one, probably Passive Capital Investing, you know, the way you described that early in the episode. And would someone want to reach out if they stumbled upon a deal like this and somebody was looking for a triple net leaseback

situation?

Drew: A hundred percent. Yeah, we're always looking at new opportunities. So, you know someone goes, "Hey, you know, I know a guy I'll make a connection with you and may we could work out some kind of brokerage situation." We're always looking at new opportunities say all these facts. That's what I'm constantly looking at and our whole team is. But yeah, if someone wants to reach out and say, Hey, I want to participate or get some exposure here and just kind of see how we can partner up in a passive sort of way. They can reach out to me. My email is drew@magcp.com. That's magcp.com. Or they can go to the website @magcp.com.

Dan: Cool. I have two final questions here as we wrap up. Do you have a book recommendation or two? Could be commercial real estate or otherwise, that was impactful for you and your career Drew?

Drew: I'll just give you what I'm currently reading. I'm a big podcast and audiobook guy. I'm going through an audiobook right now. Sam Zell is a kind of notable, billionaire, real estate investor and he has a book called, Am I Being Too Subtle? And it's all about him sort of zigging when other people sag. And really finding being kind of a contrarian and looking into areas whereas people seem to be running away from. And kind of asking questions and finding opportunities as people tend to kind of run like a crowd towards certain things and away from other things. He's I mean, it's a great, you know, just a personality and a trait to kind of pick up some on and think, Hey don't just follow the crowd, look over here doesn't mean and say, you know, a good place to be, but ask some questions dig around because there might be some gems there and that's a little bit of what we do sometimes as a firm. You know, we kind of go, okay, why is this seller having a hard time here? What's going on? Okay, there's some hair around, the environmental issues. Okay, can we work around that and you find these great opportunities. I mean, as all your listeners, who are Real Estate Investors, you know, keep that in mind and or read that book and just kind of think about that when something looks like, too hairy, just see, ask some more questions, and try to get creative because that's ultimately where the best investments come from.

Dan: Yeah, we make money solving problems. So, the last is the gem, the crown jewel of wisdom, if you will. If you could go back and tell yourself right there where you were deciding whether or not to be active or passive, right? So early in your career, you know, everything, you know, now is there anything that you would go back and share with your younger self?

Drew: I just want to buy Bitcoins instead, you know, that's...

Dan: Not the first time that's has been the answer.

Drew: Yeah, I know. I know. Yeah, whatever might be, Google stock and anything hindsight's 20/20 or I would have known who to bet on the 2015 Super Bowl, you know, all that. So no, if I'm going back then, I think I would have told myself to really you've made your decision. Drew you've gone passive. That's fine. And really in hindsight, I believe that was the right decision for me wouldn't change anything about that but I would have said, hold on, review more deals. Look at you know, look at least a dozen deals and ask questions that in every single one of those

before you write a check. And I was just so excited to jump in that I jumped in on pretty much the first one that I looked into deeply.

And you know, so be it. I hope I'm learning a lesson. Again, I happened lost money from it, but I certainly could have done better by just slowing down for a minute and I really believe in leaning into every kind of situation in life and biting but you can live in a little too hard sometimes. And you got to find that balance. So, you know, it never feels like maybe the right time to write a check for any type of investment, and you can tie yourself up and just worry, but you should just like anything. Look at a few different things and not jump on the first opportunity that's placed in front of you.

Dan: Nice, good stuff. Drew. I had a blast great conversation here. Thank you for giving us this hour here. Appreciate you coming on the show.

Drew: That's great Dan. Thanks for having me.

Low-cost capital is the fuel of any volume real estate investment business. As a real estate investor, I am sure you're well aware of these two facts. First, your business is driven by access to Capital or starved from a lack thereof. And two, you make more money when you reduce the cost of said Capital. Whether you're looking for hard money loans to fix and flip houses, rental, portfolio, loans, or even a line of credit. Lending home offers the most competitive rates in the market. Currently, as low as six-point four nine percent, which is good for fixing flip single-family loans. I pay 10% myself @fundrehabdeals.com to my private investors. So, at six-point four nine percent if you like that interest rate, go to reilineofcredit.com. Even if you're not currently in the market for a loan at this very minute, I encourage you to still go through that one-minute sign-up process right now. So you can get on the email list, that way once you're ready and you have a deal or a few, their name is Top of Mind. Plus as a bonus for signing up through reilineofcredit.com, you'll receive a free iPad when you close your first loan. That's reilineofcredit.com.

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In 2020, my house flipping business Diamond Equity Investments, bought and sold 283 houses. And we have done 320 so far in 2021. Mostly houses, if you are apartment buildings, and we currently have another 147 more in our inventory, either under construction or under contract, the waiting close. We are a busy, blessed, and growing. If you are interested in a career in real estate, go to careers.diamondequity.com to see what we have available right now.

And here are three more ways that you and I can do business. Number one, if you are interested

in having access to real estate deals that you can buy Fix and Flip for profit, go to accessrealestatedeals.com. That's accessrealestatedeals.com. Number two, if you are an accredited investor who is seeking double-digit returns, you can sign up to receive my private mortgage investment opportunity emails @fundrehabdeals.com. That is how you join my network of private lenders to potentially fund my projects. And number three, last but not least, I am always buying houses that I can flip and occupied apartment buildings that have below-market rents. I will buy all over the country, but I do ask for specifically when it comes to the houses, I like the deals that are in Atlanta, Chicago, in the Philadelphia region where we have our main office is located. So, please send me an email with the details.

We are at the conclusion, my friend. Next up, we have Mike Stoler, joining us to discuss investing in value-add hotel deals. I'll catch you in the hotel investing with Mike next time. Signing off.

Thank you for listening to this episode of the REI diamonds, show with Dan Breslin. To receive email notifications of new weekly episodes, sign up at www.reidiamonds.com.

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