NAIOP
COMMERCIAL REAL ESTATE DEVELOPMENT ASSOCIATION
CHICAGO CHAPTER

"More Than Just a Big Box | How to Achieve Outsized Returns Through Alternative Approaches"

by Matt Baron, NAIOP Chicago Staff Writer

This is a summary of the May 23, 2019, meeting of the Chicago chapter of NAIOP, the Commercial Real Estate Development Association.

Its members gathered at The Estate at Gene & Georgetti in Rosemont for a discussion on how Chicago real estate companies are thriving in non-traditional investment opportunities, including data centers, cold storage, the redevelopment of brownfield sites and marijuana facilities.

The session moderator was Matthew Carolan, *Executive Managing Director*, JLL. Panelists were Wendy Berger, *President & CEO,* WBS Equities; Jeremy Grey, *Director of Development,* Hilco Redevelopment Partners; and Scott McKibben, *Chief Investment Officer/Managing Principal,* Brennan Investment Group, LLC.

For Wendy Berger, the path to the emerging cannabis industry, at least indirectly, was a pizza manufacturing facility in Romeoville that she was asked to help develop 19 years ago.

Her company, WBS Equities, specializes in ground-up construction, renovation, development, sale lease back transactions and acquisition of industrial buildings for food and beverage manufacturers and distributors.

About six years ago, "when it became clear that medical marijuana was going to become legal in Illinois," the company branched into cannabis.

"I started looking to invest in groups that were seeking licenses and I knew that I could be a value-added investor," she continued, "because there are so many similarities between a food-grade facility and a cannabis cultivation facility: air handling, air movement, water, wastewater, lighting."

In the case of Hilco Redevelopment Partners, opportunity has come in the form of massive, complex brownfield redevelopment projects. Their strategy includes being near core markets that are aided by transportation hubs enabling rapid distribution, said Jeremy Grey.

A key early redevelopment was in Baltimore, where Hilco razed 17 million square feet of facilities on a 3,100-acre site to make way for a 5-million-square-foot state-of-the-art industrial park. Tenants include FedEx, Amazon, Under Armour, Grey noted.

Brennan Investment Group's roots date back to 2010, said Scott McKibben, with clientele that initially focused on the multi-tenant sector. At that time, merging from the Great Recession, the niche was attractive for its profit-margin potential.

"As industrial became a hot product, everyone started jumping into that and bidding up the prices on that product and there became less margin there," McKibben recalled. "We transitioned more into other product types."

Those have included the single-tenant net lease business, aggregating portfolios—"because it's very hard to buy existing portfolios," he noted—and developing properties.

“As the markets have evolved, so have we,” McKibben said. “We have kind of changed our thesis, but the underlying thesis has been trying to find margin.”

In short, while each panelist’s company has carved its own place in the market, their common ground is an alert willingness to pivot to other opportunities.

Moderator Matthew Carolan asked panelists about the political climate in Illinois, as well as the importance of interaction with government officials at various levels.

For a frame of reference, McKibben pointed to the challenges that Detroit faced about a decade ago, as institutional investors “ran away from it” amid its economic doldrums. Illinois is “experiencing some of that,” he added.

“Maybe 25 percent of high-net-worth investors have just basically redlined anything in Cook County, for sure, and Illinois in general,” McKibben said. “It has made it a little more difficult.”

His firm, meanwhile, values the “big consumption zone” that is represented by 10 million people in the Chicago metro area and its status as a central distribution point.

“You’re still seeing growth, you’re seeing low vacancy rates in that industrial segment,” added McKibben. “We don’t see that changing and we’re going to continue working on developments here.”

Economic boosts such as the Class 6B incentive and enterprise zone incentives are key in Cook County, noted Grey. Those sweeteners as well as the area’s infrastructure are instrumental in keeping the region competitive.

“It’s absolutely critical to engage different municipalities and government leaders early on in the process,” Grey added. “We really view our investments as a long-term partnership and we also want to make sure we are communicating with community groups and NGOs through the entire process to make sure our interests are fully aligned.”

Berger echoed that point, emphasizing the importance of fostering positive relationships with municipal leaders, economic development organizations, and the like.

In Romeoville, for example, her firm is working on its fifth project. “If you work as a team and you see them as your partners, and not your enemies, great relationships” can develop, said Berger.

On the other side of that coin, there is no sense in wooing a community that is not interested in what you have to offer, she said.

“If they signal they’re going to fight us, we go elsewhere,” said Berger, referring specifically to the cannabis enterprise. “There’s just no time…we will take our jobs elsewhere. And these are high-paying jobs, with full benefits” that typically employ 100 to 150 people.

On the question of identifying ways to try to ensure strong profitability, McKibben referenced the Elk Grove Village Technology Park. That development took two or three years to work through the process with the municipality—a span that he regards as a worthy investment.

“The (potential) returns we’ve modeled a lot of different ways, including having a data center in all or part of the project,” said McKibben. “But we also are receiving a TIF (Tax Increment Financing) there.”

For WBS Equities, said Berger, recurring ingredients in business development are simple math and “telling the story.” There are times when the cost of third-party storage for a company has outgrown its space, so that it can achieve savings by occupying a new building, she noted.

Her firm draws the line on what it will pay on a per-square-foot basis, with tenants bearing the balance of the cost. “Your assumptions on the residual value matter and we assume really low residual value,” said Berger.

Attractive features of potential investment properties include infrastructure that is already in place, she said, such as water and sewer, fiber optics, and finished roads.

“It’s a cliché, but I would say location, location, location,” Grey responded. “As everyone in the room knows, industrial users being in close proximity to a population is absolutely critical, both from a labor perspective…as well as an end consumer base. Everyone is expecting next-day delivery, so you have to be close to the customer.”

Proximity to transportation infrastructure is also a key component to keep down supply-chain costs, Grey said. He cited, as one example, his firm’s purchase last year of 350 acres in New Jersey next to the second-largest port in the United States.

McKibben’s company has nearly 200 single-tenant net lease facilities across 30 states—“that’s a ripe environment for us to talk to those tenants…we’re trying to mine opportunities with that portfolio.”

Since embarking on the marijuana business six years ago, Berger has joined the board of directors of a publicly traded marijuana company that is operating in 11 states. Her firm has purchased five buildings that are leased to marijuana cultivators or dispensaries.

For this capital-intensive niche, she said, “the due diligence is a little different…you don’t have strong financials to look at. You’re obviously looking at people. We used to joke when we first got into the business that the only people who were real experts—who were doing this at a large scale for a very long time—were drug dealers.”

Her company just bought 11 properties on nearly 30 acres in Ocala, Fla., and will demolish all but one and build from the ground up.

“We’re still debating on whose side of the ledger all of the costs (will go on),” Berger said. “We’re really looking to strengthen the balance sheet. The marijuana business is like a rollercoaster. We say, `Strap in and be ready for some great times and some tough times and hiccups along the way as the states make their way through it and we are still dealing with a business that’s federally illegal.”

On the topic of equity sources and lenders, Grey said that his company looks for “patient capital”—investors who are willing to “deal with long lead times related to remediation, as well as checking each other’s homework in terms of extensive due diligence.”

At Brennan Investment Group, there are about 20 institutional partners the firm works with, including insurance companies, foreign investors, and high net-worth investors. For any given project, the company tries to find a deal and match it with an investor.

“Some firms work with one monolithic partner,” McKibben said. “We’ve maintained entrepreneurial prerogative in how we do deals…sometimes six of our existing partners will say ‘no’ to a deal, and the seventh partner will say they want to do it.”

In the realm of marijuana investing, “access to capital throughout the entire business is the number one problem,” said Berger. “…there is almost no access to traditional debt, and access to traditional capital sources is non-existent. The world is changing very quickly on this, and a year and a half from now I am guessing we will be bankable.”

Meantime, it is “truly friends and family to raise money,” though whereas it used to be in increments of about $50,000, it has now risen as high as $1 million per investor, said Berger.

Signs of the niche’s emergence: there are two publicly traded REITs that are cannabis properties only, with three more coming. In addition, there are two or three companies with properties “all over” that are looking to have headquarters in Chicago.

“Access to capital is changing really quickly, but it’s still really hard,” she summed up.

Looking to the future, she said that “cannabis cultivation will quickly become (a) commodity. Those who produce at scale will be the winners. That’s the challenge is picking the right locations today. Today there is no interstate commerce, so if we grow in Florida, we can only sell in Florida…when that changes, there will be large pockets of over-capacity and small pockets of under-capacity and figuring out those investment opportunities is the number one challenge."

Hilco's primary focus is complex industrial facilities that have grown obsolete and ready to be transformed for another business purpose, said Grey. Beyond the 85 percent of the business that is industrial, the company works with some value-add mixed use and office buildings.

Many of Hilco's sites have underground challenges that need to be addressed and fully mitigated before development can occur. One example is the company's work on a 1-million-square-foot spec warehouse in Little Village, near I-55 and Pulaski Road. Formerly the Crawford Power Plant on the city's Southwest Side, it is undergoing a site remediation process.

Once Hilco obtains a No Further Remediation (NFR) letter from the Illinois Environmental Protection Agency, then the tenant will be able to move in.

There is a state-by-state and market-by-market competition for data centers that panelists also discussed. In some cases, developers are being asked to build a shell while in other instances more infrastructure needs are being sought, said Grey.

Though the upward market cycle has been lengthy, Grey still likes the industrial market's fundamentals. At the same time, as Hilco takes on larger developments, they are "stress-testing a lot of our deals" by running less optimistic scenarios to ensure they can withstand lesser returns, he added.

Among the markets where the firm is looking to grow are core industrial markets with robust demographic growth trends, such as the northeast corridor, inland empire, Dallas, as well as Midwestern markets with solid fundamentals, such as Chicago and Indianapolis.

For WBS Equities, the focus with the cannabis side of the business is on limited-license markets with very tight state controls, said Berger.

She cited Florida (14 licenses, population: 21 million) and New York (10 licenses, population: 20 million) as attractive markets in that regard.

"Under the medical model…being one of the (select few licensees) is important," Berger said. "Then when we believe adult-use recreational is inevitable in these states, we will have had the runway and knowledge and have built the depth of experience to have some edge on our competition."

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