From the Cincinnati Business Courier:
https://www.bizjournals.com/cincinnati/news/2021/03/19/last-mile-investments-big-bet.html

Cover story

Cincinnati bargain hunters go big on retail

Mar 19, 2021, 5:00am EDT

CORRIE SCHAFFELD | CBC

Todd Pleiman (left), David Birdsall and Ryan Moore started Last Mile with the idea it would become, as Birdsall said, "one of the next great Cincinnati companies."

Pizza parlors. Yogurt shops. Fitness centers. We drive past them all the time. We stop in to grab pizzas for dinner on Friday night. Or pop in for a mid-day frozen yogurt pick-me-up. We squeeze in a morning workout before heading to the office.

Often integral to our daily lives, neighborhood retail centers still manage to be overlooked, and, these days, undervalued.

But David Birdsall and Ryan Moore didn't just see pizza places, yogurt joints and fitness studios. They saw in-person businesses that couldn't shift their presence online. It was an opportunity to zig where others zagged.

"Where the world is going is (toward) smaller spaces, in the neighborhood, with internet and Amazon-resistant tenants," Birdsall said.

Birdsall and Moore, two Phillips Edison & Co. alums, had been trading ideas and found the neighborhood center was an asset class that was somewhat neglected. The result is Last Mile Investment Inc., a real estate investment manager that is completely focused on the retail real estate sector, specifically those in the “last mile” of the retail chain. Their goal is to be the premier owner and operator in the neighborhood center space.

Last Mile Investments was formed in late 2019 and started raising capital right away. Moore, CEO of Last Mile, expects to have $1 billion in assets in five to seven years.

“We’re here to build a company, one of the next great Cincinnati companies,” said Birdsall, chief investment officer.

Last Mile is currently raising money for its first fund. The platform will allow investors, including wealth managers, institutional investors and high net-worth individuals, to participate in the fund. The team is also ramping up its acquisitions, crisscrossing the country looking at potential properties.

Earlier in the pandemic, Last Mile hit the brakes on acquisitions. As a fiduciary, Moore said he takes that role seriously.

“We’re not about high risk, high reward,” Moore said. “We waited, watched and built our brand in markets.”

While the pandemic slowed their plans to begin purchasing properties, it also provided an ideal stress test. In general, retail rental collections have been about 80% to 85%. The portfolio of properties Last Mile is working on had 100% collections.

Birdsall and Moore spent much of 2020 focused on strategic planning, and understanding the current real estate market. Now that Last Mile has the green light, it won’t be any less critical of what it is buying.

“Not all retail is created equal,” Birdsall said.

Moore projects Last Mile will look at about 1,500 deals per year, underwrite about 300 per year, but only purchase 20 to 30.

“It allows you to be highly selective about what you put your investor capital into,” Moore said.

Last Mile is raising money from private investors for its fund and will be in alignment with those investors. But ultimately, Last Mile will be the largest investor in the fund.

Partnering with a giant

During the initial planning phase, Birdsall and Moore started identifying groups they could partner with to accelerate their growth. Enter Cincinnati-based North American Properties. Kevin Riley, chief operating officer and partner at NAP, has known Birdsall and Moore for years. Riley was impressed with the duo's pedigree and what they had accomplished at Phillips Edison.

Founded in 1954, NAP develops multifamily, mixed-use, office, student housing, hotel and retail environments all over the country. The downtown-based real estate company has more than 260 employees, over $7 billion in investments, a portfolio that has more than 22 million square feet of commercial space and more than 19,000 residential units. But the neighborhood retail centers Last Mile is targeting are not part of NAP's repertoire. Last Mile is a North American Properties portfolio company.

The partnership provides more than just capital and back office support. Both Riley and Tom Williams, CEO of NAP, sit on Last Mile's board. Riley and Williams were a part of creating Last Mile.

According to Riley, NAP has a lot of resources that a startup company like Last Mile would need, and it allows its partners to use its horsepower in human resources, marketing and accounting, so the startup can focus on the business of real estate acquisitions. Last Mile itself has six employees, all focused on the growth component of the business. As they were building Last Mile, Birdsall and Moore added Todd Pleiman as partner and chief financial officer. Another Phillips Edison alum, Pleiman brings a wealth of experience in financing and capital markets strategies.

"We have confidence this can be a very large venture for us and we don't have to be the only investor in it," Riley said. "There's no reason why we can't be a billion dollars of assets within a pretty short time frame."

The hardest part for North American is the management of smaller assets. Where NAP has focused on $50 million to $100 million properties, the neighborhood centers are closer to $5 million to $10 million. But knowing Birdsall, Moore and Pleiman's background gives Riley the confidence it can be done.

For Moore and his team, NAP is truly a partner. “They’re not just capital providers. They have board seats. They are talking about what is going on in the country,” Moore said. “When we debate, the ideas only get better.”

Stocks, bonds and real estate?

Last Mile is building a strategy for investors that offers a better return than other options, such as high-yield corporate bonds or U.S. Treasuries. Moore said Last Mile’s potential investors realize they need to be more diversified than just equities and fixed income. Real estate can be one of those alternatives.

The difference between Last Mile’s strategy and the development (or redevelopment) of existing centers is those projects come with more risk, though they typically offer a higher return.

“You’re taking a lot of risk, you could lose money,” Moore said.

In general, real estate always has a place in clients’ well-diversified portfolios, according to Jim Russell, partner and portfolio manager at Bahl & Gaynor Investment Counsel.

“It’s very important given how the economy has reacted to Covid,” Russell said.

But he stresses being selective with investments, especially with real estate, as different segments of the market will rebound at varying rates and degrees. Real estate provides the advantage of a higher dividend yield.

Riley said North American Properties prefers to deploy capital toward investments it can see and touch, such as its recent purchase of a stake in Skyline Chili.

“There are plenty of like-minded investors who want the same thing,” Riley said.

The investor herd has moved away from retail real estate. When capital pulls out, valuations plummet. In fact, Moody’s, the credit rating firm, projects commercial real estate values will decline by 7% nationally from their pre-pandemic levels, bottoming out by the end of this year. The hardest hit will be the office and retail sectors, with values declining by 13% and 17%, respectively.

“Because of our background, we have the ability to execute in a space with less competition going forward,” Moore said.

Retail is a diverse category of commercial real estate, encompassing everything from shopping malls and power centers to stand-alone quick service restaurants. While malls and big-box centers are struggling, others have held steady, even during the Covid-19 pandemic.

Trendsetters

Neighborhood retail is benefiting from consumer trends. Retailers want to be as convenient as possible for their customers. That means either delivering it to your doorstep or having a physical presence right down the street. Retail tenants that used to pine for 10,000 square feet of space in power centers are now looking to downsize. And the tenant mix for neighborhood centers continues to diversify. Dentists, physical therapists, urgent care and professional services firms happily rub shoulders with retail clients.

“We have leasing options. If we lose a yogurt guy, we can replace him with a physical therapist, or State Farm insurance,” Birdsall said.

Last Mile will handle all asset strategy in-house, but it will partner with local leasing and management for the neighborhood centers. Last Mile has spent a year developing that network of brokers and other experts.

Last Mile plans to take advantage of multiple themes in today’s retail environment, including:

Retailers focusing on smaller, more convenient spaces that are close to their customers
Non-retail tenants, such as medical and dental, who also want a neighborhood presence
Tenants that provide daily needs, services and other e-commerce resistant products, such as fitness centers, coffee shops and hair salons.

The investment criteria for Last Mile includes centers ranging from 10,000 to 50,000 square feet, with dense neighborhood or daytime population, high traffic counts, a mix of strong tenants, and a purchase price ranging from $2 million to $25 million.

“We’re not looking to buy anything that is broken,” Moore said. “We’re not going to spend $1 million to turn it into something and hopefully lease it. We’re going for great cash-flow assets out of the gate.”

Last Mile sees its value-add as having stronger relationships, and the ability to attract top tenants to backfill spaces at better rents.

Last Mile is also pairing its asset strategy with a market strategy. It believes neighborhood retail is a misunderstood, mispriced and undermanaged asset class that has untapped opportunity. It is pairing that with geographic markets that have their own tailwinds, such as strong population and job growth.

Last Mile will heavily target the Southeast, Texas, Arizona and Colorado. These areas are seeing heavy positive net migration of individuals and businesses. Last Mile is looking for acquisitions in Orlando, Tampa, Dallas, Austin, Nashville, Phoenix and Denver. The company also views Cincinnati as an investable market.

“We follow jobs and we follow people,” Moore said.

When Last Mile’s Fund 1 is complete, Moore expects it will have between $100 million and $125 million in assets.

The plan is to have Fund 1 invested by early 2022. The firm would then begin

raising capital for a second fund later in that year.

Eventually, Last Mile may pare back its focus on neighborhood centers, as other investors catch on.

“We want to own as much of this as possible to the benefit of our investors,” Moore said.

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