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Q&A: New Capital Sources Creating Opportunities for Developers, Investors

13th Floor Investments' Daryl Shevin Addresses Changes in Equity Markets

Daryl Shevin, chief financial officer of 13th Floor Investments, sees big changes in the equity markets - all unrelated to falling stock prices in recent days.

Shevin said new players are bullish on real estate investments. What's more, he predicts that less reliance on traditional equity will lead to a more vibrant market and reach all commercial real estate asset classes.

Miami-based 13th Floor is an alternative investment management firm that invests in residential and commercial properties across Florida. Shevin, who joined the firm eight years ago, has closed $340 million of debt and $285 million in equity transactions. A chartered financial analyst, Shevin graduated from the University of Florida in 1998.

CoStar News: How would you describe the state of real estate equity markets today?

Daryl Shevin » While recent activity within the stock market has created concerns about inflation that may lead to volatility in the equity markets, there remains reason to be bullish on real estate because the sector has proven to be the big winner in tax reform. The equity markets have always run deep. The difference in this market, however, is that the addition of new types of capital providers has created both a deep and wide equity market. We have always had private equity firms and traditional capital, such as insurance companies, that operate within this market. But now we are seeing more distinct and diverse groups, such as family offices, creative Wall Street groups and high-net-worth individuals looking to make commercial real estate a core part of their portfolios.

The massive amount of wealth accumulation in recent years has resulted in substantial growth among these various types of equity vehicles, resulting in deeper check sizes and larger equity portions. As widening equity markets continue to create new capital sources, they will invariably lead to new opportunities for developers and investors, resulting in a more resilient market overall.

What investments are these new players targeting?

» Today's equity markets have given rise to countless paths to capital. While the higher returns of development still appeal to many, we are now seeing many investors gravitate toward "value-add" properties. Value-add assets can be appealing as owners are able to generate immediate cash flow while making improvements or repositioning the property to further increase returns.

In the development spectrum, the transit-oriented development trend continues to gain momentum as investors seek out projects built around existing transit. In this way, they are not only building for demand, but can be strategic by eliminating or reducing the need for structured parking garages. In addition to the massive costs of these structures, it is likely that they will require repositioning in the future as parking needs reduce and eventually are eliminated with the acceptance of the car-free lifestyle many are beginning to adopt.

In addition to transit-oriented developments, we also are seeing a lot of competition for properties that can offer surface-level parking, particularly in the multifamily sector. Looking ahead, the market is proving that capital will remain available for the right projects with strong sponsors that can offer solid returns on investment.

How are lending requirements changing?

»There is no doubt that traditional lenders have become more stringent in the years following the Great Recession, especially in the development sector. I like to say that "60 is the new 65," meaning that lenders used to require that commercial real estate projects max out at 65% leveraged (loan to cost). Today, we are seeing banks lean closer to 60% leverage in their desired structures. This additional equity protects the bank by requiring developers to have a significant amount of skin in the game. This may seem like bad news for developers, but at 13th Floor Investments, we welcome the conservative lending approach because it's another buffer to prevent the next downturn from being like the last one.

Will these changes in lending practices force developers to explore more alternative financing?

» While traditional lending is tightening, there is a robust world of third-party lenders available to developers seeking higher leverage and more aggressive financing structures. Whether it be via senior positions or mezzanine structures, these more creative lenders offer higher cost debt with looser requirements in exchange for high interest rates. Depending on the project and the developer's risk appetite, these structures can certainly be appealing to some.

All that said, our company prefers to operate within the confines of the traditional banking world, and fortunately has strong relationships within this arena. Our firm has largely chosen the more conservative routes for both debt (lower cost / lower leverage) and equity (more of it) in order to best manage risk.