September 6, 2023

Borrower Profile: StarPoint Properties Zooms in on Risk Mitigation

StarPoint Properties is focusing on risk mitigation, with founder and chief executive Paul Daneshrad believing hedging risk in today's volatile commercial real estate environment must be the number one priority for borrowers.

"We are trying to deliver asymmetrical returns, and what that means is focusing more on the risk component of real estate and make sure we're hedging that," Daneshrad told Real Estate Capital USA. "It has been a great run, prices have been elevated in the sectors where we invest a lot, and whenever you see pricing get elevated like that, we start taking a closer look at risk."

The Beverly Hills, California-based private real estate firm, which targets multifamily and industrial property types, has been looking for assets and markets where positive fundamentals are believed to be long term.

"[We are looking] long term enough [so that] if we do go into a down cycle, we'll be able to work through it," said Daneshrad.

Over the past two years, the firm has been most active in two key areas. The first is opportunity zones, which are typically at the lower end of the risk spectrum, provide higher returns and enhance yields. These make up about 80 percent of its business strategy. The other focus is opportunistic and value-add investments involving a motivated or distressed seller or an asset being poorly managed.

"[We apply] a very singular rifle approach to those type of opportunistic investments," said Daneshrad.

Focusing on cycle theory also sits high on the agenda.

"[Some people say] real estate is no longer cyclical, because there's so much capital in the business and so much stability, so many debt providers – private, public, semi-private, government – and that stability in the lending system now is providing a foundation to real estate. [But] it's just not true. It's always been cyclical and it's always going to be cyclical."

Being in a cyclical industry means business plans must also be cycle-proof, said Daneshrad. To determine this involves looking at the industry with a much broader lens.

“Whenever we feel like we’re at the top of the market, we look at our submarkets and geographies, at job formation. We look at about 30 different metrics to make sure that we’re at the right product in the right submarket with the fundamentals.”

Today is a little different, however, with Daneshrad noting the real estate market is no longer at the top of the current cycle. Real estate prices at the national level have adjusted on average 15 percent across all product types, and in the weaker markets, like office, values are down almost 50 percent.

“We’re starting to see ourselves come into probably the middle of the cycle now, and our expectation is that in the next six to 12 months, we’re probably going to see another 5 to 10 percent reduction in pricing,” said Daneshrad. “So, risk mitigation today really means being very careful with what you’re buying and waiting until you know all the pricing adjustments have worked their way through the industry.”
Hedging interest rates today is another big focus, said Daneshrad, adding that how a business approaches this can vary.

“[It could be] looking at your existing portfolio and figuring out how you’re going to get out hedged your interest rate risk – there are a lot of different ways to do that.”

Maintaining a relatively low profile when it comes to interest rate risk and focusing on strong lender relationships can also help hedge risk.

“We have some variable loans where the interest rates were at 3 percent and today is 6 or 6.5. So, our cost of debt has doubled,” said Daneshrad. “That requires a really strong relationship and communication with the lender to work through those stress points.

“It’s even more important to operate the property really well to not lose your tenants, so having high levels of execution and property management can [help you to] continue to maintain a healthy property that absorb those debt payments.”

Other focus areas

Another area of concern for StarPoint is the short end yield curve volatility, which Daneshrad describes as a definite stress point in today’s commercial real estate lending market.

Lack of lenders is a stress point, too.

“There’s not a lot of lenders for construction loans – most of the regional and money central banks who provided construction loans are out of the market today. The market for construction loans has moved all to debt funds or hedge funds. The cost of capital is also making it harder to get those loans done today.”

The firm continues to focus on multifamily and industrial sectors.

“[The answer to] why we are still in those product types today and why haven’t we pivoted out of them is because of demand,” said Daneshrad. “When you look [forward with] a 10-year horizon, there is no demand and supply imbalance [in these sectors] so from a fundamental basis, supply and demand, and demographics [they make] a great foundation [for investment.]”

The link to the original article can be found here.