Fix-and-Flip Real Estate Is Back Big. Credit Funds Are an Excellent Way to Take Advantage.

Real estate credit funds offer the advantages of liquidity, convenience, priority of returns, diversification, and reduced risk.

By Jeffrey Sweeney, Chairman and CEO at US Capital Global

As *Forbes* recently reported, residential housing remains a strong sector of the economy, the result of increased housing demand in a growing economy. This momentum combined with the fact that much of the housing stock in the US is worn out and obsolete, and that new tracts for development are limited, has led to a steady rise in the home renovation and flipping market.

Fix-and-flip, as it is called—in which a home is bought, renovated, and resold quickly—is potentially a highly lucrative investment opportunity. Last year, flippers reported up to 129.5% ROI in the top fix-and-flip cities, and flipping accounted for up to 6.1% of total home sales.

Investors can take advantage of fix-and-flip strategies without the hassle, illiquidity, inherent risk, and other disadvantages that stem from real estate equity investing by investing in well-managed real estate credit funds.

Real estate equity funds: potential drawbacks

Real estate equity funds can have some drawbacks that stem from the nature of real estate as an asset class. Real estate can be highly illiquid. Selling real estate assets can be difficult when the market turns for the worse. Furthermore, it is expensive to buy and sell real estate on account of interest-carrying costs, taxes, legal fees, and agents' fees. Any returns

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are therefore eroded by these very high transaction costs, which can amount to 6–7% of the returns of the fund.

These issues are, of course, compounded in an open-ended equity fund, which must return money to its investors if they decide to exit the fund. Selling real estate is usually a slow process, and an open-ended fund will therefore need a good cash buffer to handle redemptions. As a result, a lot of money is usually not invested but kept in reserve, which dilutes investor returns.

Real estate credit funds that provide fix-and-flip loans: relatively high rates of return

House flipping requires fast access to money and provides relatively high rates of return when executed properly. Developers are willing to pay higher interest rates to exploit this opportunity. This has been creating a rise in real estate funds and pooled investment vehicles that provide short-term loans to residential real estate builders and developers. Recently, for example, Goldman Sachs bought Genesis Capital, a leading lender to house flippers.

As *The New York Times* reported, the funds that finance house flippers "offer reliable returns of about 8%," for those who can meet minimum investments, usually $100,000. The loans are backed by the property and typically run for a year or less.

Fix-and-flip loans can be more secured than a bank mortgage because they are secured by properties at a lower loan-to-value (LTV) ratio, a risk assessment used by lenders. The average LTV ratio in the industry is about 55%, compared with 75–80% for a typical mortgage. This provides a substantial cushion to protect against a property's dropping in value.

Additional advantages of a fix-and-flip credit fund

Investing in a fix-and-flip credit fund is a passive, hassle-free experience. The market intelligence and experience of a fund will also invariably exceed the average investor's fix-and-flip know-how. A well-managed fix-and-flip credit fund can offer eligible investors greater security, diversification, steadiness, and liquidity:

- Asset-backed secure investment: Generally, the relatively low LTV parameters of such a fund make investments secure from an asset-backed perspective. The fund's secured loan agreements will ensure that the fund is repaid before its borrowers make any money.

- Diversification: Credit fund investments are diversified across hundreds, maybe even thousands of homes, and across different geographical areas, rather than one or a handful of properties, thereby ensuring a superior risk play.

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- Steady investment valuation: The value of such a credit fund remains steady, as its investments consist of performing loans with real estate collateral backing and are relatively short term. Real estate equity funds, by contrast, make investments that are held for a longer term and their overall asset values can fluctuate considerably over time due to market conditions or interest rate increases.

- Consistent income: The steady flow of income from numerous short-term, asset-backed loans can be used to meet redemptions and generate a steady quarterly income for investors. Such a credit fund does not require a large cash buffer to handle redemptions. This means more money is actually invested, thereby maximizing returns for the fund's investors.

US Capital Global and its real estate investment funds

Headquartered in San Francisco, US Capital Global is a private financial group that leverages a track-record of successful fund management and asset-based finance. Working with its registered investment banking affiliate, US Capital Global Securities, LLC, the group offers both independent investors and institutional investors an opportunity to invest in a variety of private investment funds designed for different risk tolerances and investment objectives.

To learn more, email Patrick Steele at psteele@uscgs.com or call +1 415-889-1010

Jeffrey Sweeney is an investment professional and fund manager with decades of experience in direct lending and corporate finance for small to lower-middle-market businesses. He is Chairman and CEO at US Capital Global (www.uscapglobal.com) and founder of US Capital Investment Management, LLC, an innovative fund manager headquartered in San Francisco, CA.