



Real Estate Finance: Business Purpose Lending Fall 2024



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BUSINESS PURPOSE LENDING

The Business Purpose Lending industry, commonly referred to as fix and flip lending, is a pillar of the \$47.5 trillion¹ U.S. housing market that continues to rebound post-pandemic. The Business Purpose Lending industry represents approximately 8% of U.S. home purchases and serves the aging housing stock and end-user demand for refurbished properties.

Business Purpose Lending institutions provide capital to investors seeking to buy and improve properties to either sell or rent. The investors and their financing sources contribute to the modernization of America’s aging housing stock.

Colonnade is observing significant investor interest in the Business Purpose Lending industry, owing to its short-term, high yield, and low loss profile. Growing access to the capital markets gives lenders with diversification and scale the opportunity to accelerate expansion plans and capitalize on strong market conditions.

Financials buyers, including independent sponsors, large institutional investors, and REITs, continue to be interested in the asset class due to its strong, recurring customer bases with creditworthy profiles and anticipated interest rate decreases, leading to higher expected margins. We expect a significant increase in investment activity in the sector over the next 24 months.

¹Source: Redfin | *as of Feb 2024

THREE MAJOR THEMES RELEVANT TO M&A ACTIVITY IN THE BUSINESS PURPOSE LENDING INDUSTRY

- 1** The industry generates significant lending activity and creates value-add to the overall real estate market
- 2** Industry headwinds in recent years created funding and origination challenges for key market participants
- 3** Improved market conditions are driving a rebound in loan originations, spurring renewed interest in the sector

1 THE INDUSTRY GENERATES SIGNIFICANT LENDING ACTIVITY AND CREATES VALUE-ADD TO THE OVERALL REAL ESTATE MARKET

Business Purpose Lending (“BPL”) comprises a \$120 billion² segment of the U.S. residential mortgage market and provides short-term liquidity primarily to investors looking to renovate and then sell a property quickly. This segment – also known as hard money lending or private lending – has matured considerably in recent years, as several large players have raised significant capital, expanded operations, increased sophistication, consolidated market share, and leveraged a deep and growing securitization market.

Business Purpose Lending includes long-term amortizing loans and short-term non-amortizing loans.

COMMON BORROWER SEGMENTS

Long-term amortizing:

- Single-family rental properties
- Multi-family rental properties

Short-term non-amortizing:

- Residential transition loans for home flipping
- Ground-up construction loans
- Cash-out refinancing loans for investment in and acquisition of additional properties

Borrower, collateral types, and use of funds vary across loan types.

- Simple cosmetic improvements, higher value rehabilitation, and in some cases ground-up construction projects drive borrower needs
- Larger investors often migrate from flipping single-family homes to a more diversified approach that employs both rehabbing and renting, depending on market conditions
- Rental strategies range from single property investors to sophisticated managers with portfolios that include dozens of properties
- Collateral generally consists of residential properties, such as single-family homes and other single-family properties, as well as small multi-family properties (2-4 units)

²Redwood Trust | *as of Mar. 2024

BPL loans are often an attractive option for borrowers in competitive property sales because the turnaround time from application to funding is much quicker for BPL loans than traditional loans.

The key benefits of BPL loans include:



Speed – BPL lenders are more focused on the collateral than the borrower, allowing loans to close more quickly (5-10 days) compared to traditional loans (45-60 days)



Flexibility – BPL lenders, which face less regulatory scrutiny and rely on asset-based valuation underwriting, are more likely to provide unique and customized terms

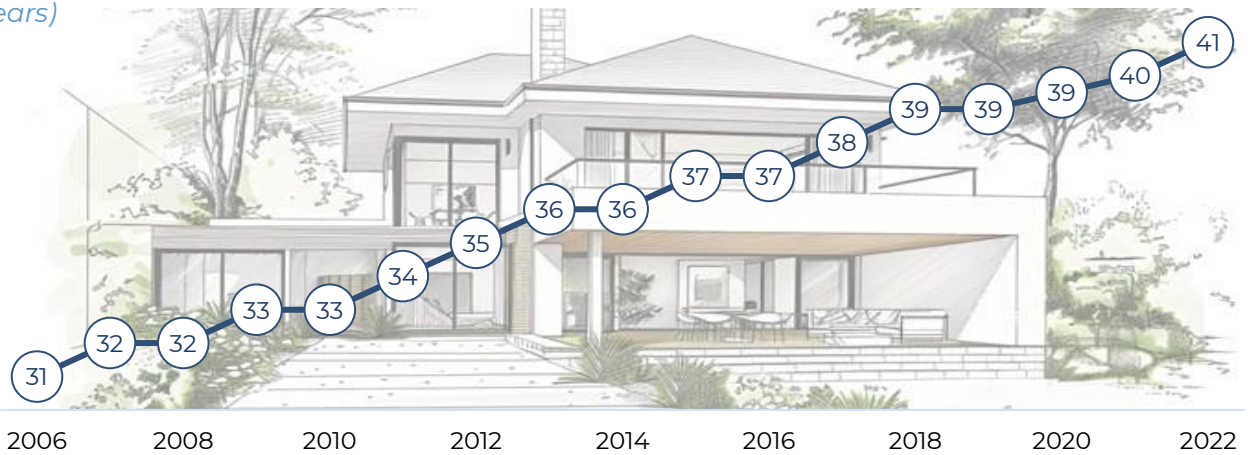


Approval – BPL lenders can underwrite and approve applicants that may have issues with traditional lender approval due to lower credit scores or inconsistent earnings

Home flipping, a significant segment of residential transition loan use, is a highly predictable market that consistently represents 8% of total home sales in the U.S.³ An aging housing stock, attractive borrower returns, and demand for renovated or new properties drive long-term tailwinds. Single-family housing has seen a dramatic increase in the median age, resulting in a significant need for renovations and creating a robust environment for home flipping.

MEDIAN AGE OF OWNER-OCCUPIED HOUSING⁴

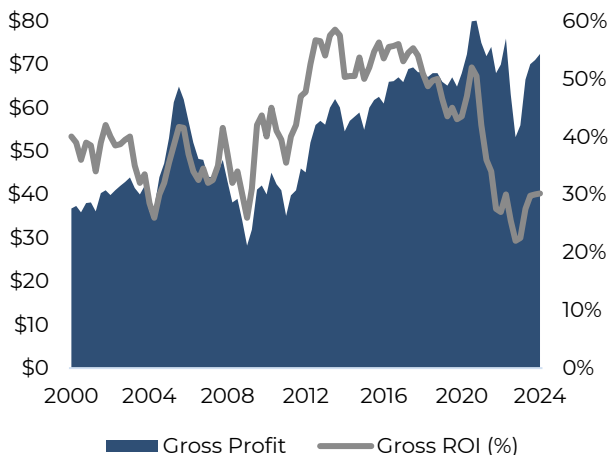
(years)



BPL originations track home flipping activity, as the demand for available homes outpaces supply. Available housing inventory has declined year-over-year since 2019. Tight inventory, aging housing stock and rising prices create a compelling environment for home flipping activity and business purpose loan originations.

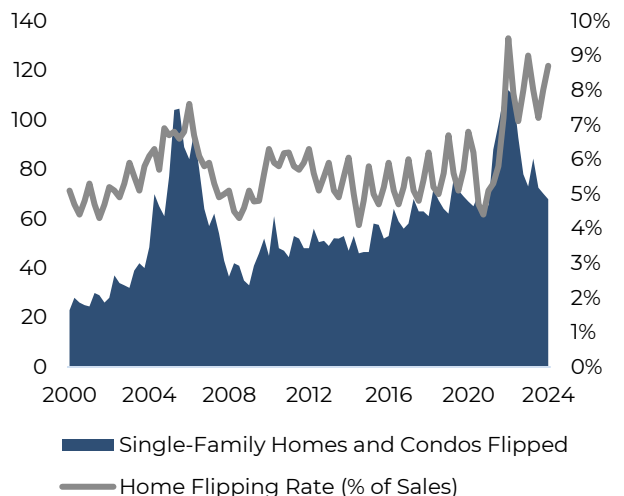
HOME FLIPPING PROFIT⁵

(\$ in thousands; per unit flipped)



HOME FLIPPING VOLUME⁵

(units in thousands)



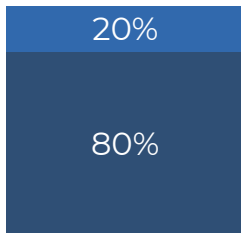
³ATTOM | *as of Mar. 2024

⁴US Census Bureau | *as of Dec. 2022

⁵ATTOM | *as of Jun. 2024

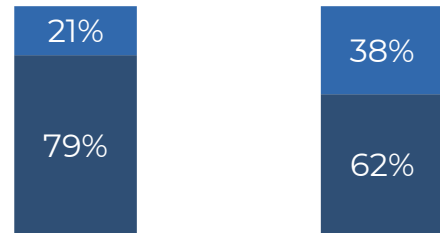
The age of multi-family housing has dramatically increased as well. Over 7.5 million, or 62% of small property units, involve structures built more than 30 years ago, many of which are ripe for renovation.⁶

AGE OF SINGLE-FAMILY HOUSING⁶



■ 25+ years ■ <25 years

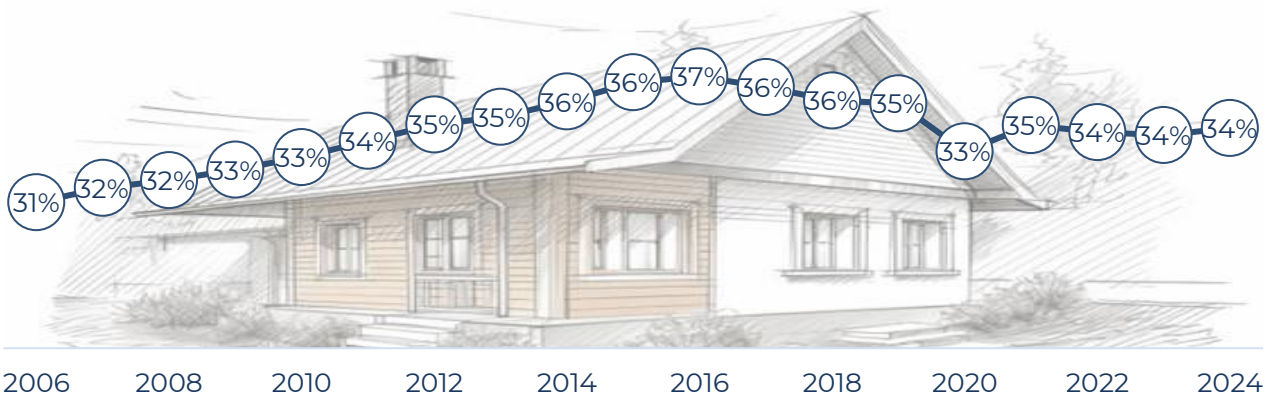
AGE OF MULTI-FAMILY HOUSING⁶



<20 Units >20 Units
 ■ 25+ years ■ <25 years

Single-family rental is another area of opportunity and growth. Since 1965, approximately 35% of the \$27+ trillion U.S. housing stock has been rented consistently.⁷ Shifting demographics and housing affordability make renting a viable option for consumers and attractive for investors. Many investors are rehabbing homes specifically for the rental market.

U.S. RENTERSHIP RATE⁷



Aging housing stock and consumer demand for renovated properties - to buy or rent - drive demand. Business purpose lenders are a much-needed player in the overall real estate market.

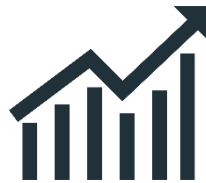
⁶US Census Bureau | *as of Dec. 2022

⁷FRED | *as of Apr. 2024

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INDUSTRY HEADWINDS IN RECENT YEARS CREATED FUNDING AND ORIGINATION CHALLENGES FOR KEY MARKET PARTICIPANTS

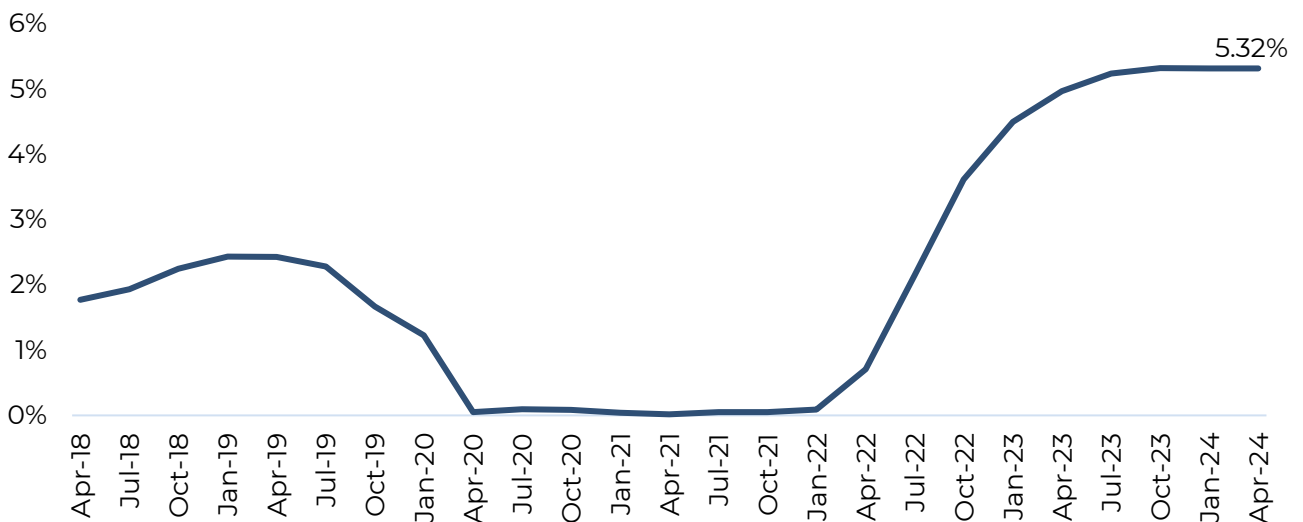
Inflation, supply chain issues, and potential regulatory changes are factors to consider when evaluating the prospects for continued long term growth.



Over the last two years, SOFR reached record highs, creating funding challenges for industry players. Many groups looked for creative capital solutions; but ultimately for the majority, spreads became tighter. Many industry players avoided increasing rates to borrowers despite their own increased borrowing costs to continue originating in a competitive market.

However, for many smaller institutions, the cost of capital exceeded returns available in the market. As a result, originations across the market experienced steep declines.

SECURED OVERNIGHT FUNDING RATE⁸



⁸FRED | *as of Apr. 2022



SUPPLY CHAIN

Home prices have been driven up by post-pandemic robust consumer demand and disruptions to supply chains. The pandemic created labor and material shortages at factories and congestion at ports.

The construction industry, despite the challenges posed by the pandemic, is demonstrating resilience. The time to acquire building materials, which had stretched from weeks to months, is now returning to pre-pandemic levels. The semiconductor shortage, which had affected the availability of appliances, is also showing signs of improvement. However, the prices of materials remain at record highs. Despite these challenges, the industry is adapting and growing, with new construction volume continuing to rise to meet consumer demand.

NEW CONSTRUCTION VOLUME⁹

(units in millions)



REGULATION

States and municipalities continue to seek avenues to solve the housing crisis through means of regulation. With the increasing investment in rental housing, median home prices have increased 28% since 2020⁹. The increased investment interest in rental units, led by new opportunities like Airbnb, has increased demand in the market without proportionally increasing the housing supply, leading to inflated prices. Several proposed solutions include increased capital gains taxes on short-term home flipping (i.e. Bill AB-968 in California), additional regulations on short-term rental properties (i.e. Local Law 18 in New York), and other laws seeking to limit landlord and investor profitability. (i.e. HUD 4000.1 in the US, Bill AB-1771 in California)

⁹FRED | *as of Aug. 2024

3 IMPROVED MARKET CONDITIONS ARE DRIVING A REBOUND IN LOAN ORIGINATIONS, SPURRING RENEWED INTEREST IN THE SECTOR

The Business Purpose Lending industry has seen a dramatic shift in recent years, as several large players have institutionalized the market, increasing liquidity from diversified capital sources. Once a cottage industry of mom-and-pop players, larger firms have standardized originations and underwriting processes and have capitalized on demand from home buyers for improved properties within the aging U.S. housing stock.

The industry is made up of several key players: independent originators, institutional loan buyers, and securitization lenders. Originators market to and underwrite loans for real estate development professionals to be held on balance sheet or sold to third parties. Institutional loan buyers develop relationships with a handful of originators to purchase loans in bulk to achieve the critical mass needed for securitizations.

We estimate the top ten originators control roughly 20% of the market, after which the industry appears highly fragmented.

LEADING MARKET PARTICIPANTS

COMPANY	MARKET SHARE	ESTIMATED ANNUAL ORIGINATIONS (\$MM)
Roc360	6.3%	\$7,600
Kiavi (fka LendingHome)	3.3%	4,000
MFA / Lima One	1.8%	2,100
Genesis Capital	1.7%	2,000
Anchor Loans	1.5%	1,800
RCN Capital	1.4%	1,700
Redwood / Corevest	1.3%	1,531
Velocity Financial	0.9%	1,118
LendingOne	0.8%	1,000
Easy Street Capital	0.8%	1,000
Other Firms	80.2%	\$96,151
TOTAL MARKET	100%	\$120,000

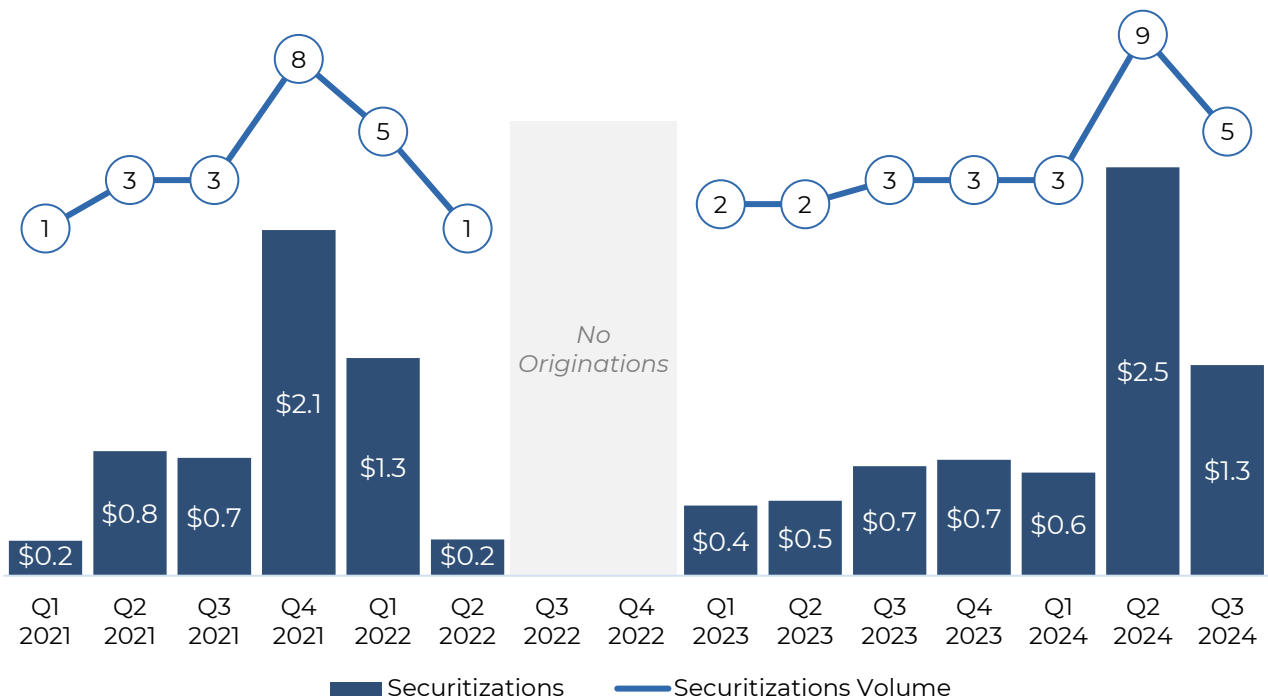
The Business Purpose Lending addressable market size declined 16% from 2021 to 2022 due to the rapid increase in interest rates, but Redwood's recent Q2/2024 earnings release illustrates the highest level of originations since mid-2023 and overall market growth of 20% since late 2022, further signaling a market rebound.

As the Business Purpose Lending industry has become more institutionalized, it has paved the way for institutional investors to deploy additional capital, typically through the securitization market.

While residential mortgage-backed security issuances have been declining over the last year due to fewer mortgages being originated in the current interest rate environment, the securitization market for BPLs remains robust. YTD 2024 posted \$4.4 billion in BPL securitization transactions, a 175% increase over the same period in 2023, demonstrating strong momentum and confidence going forward.

BUSINESS PURPOSE LOAN SECURITIZATION ACTIVITY¹⁰

(\$ in billions, units in actuals)



A growing securitization market indicates confidence in the underlying asset class and provides additional capital for strong originators. Despite the recent but fading industry headwinds we described, the depth of the securitization market indicates long-term confidence in the sector.

¹⁰Finsight | *as of Sep. 2024

Recent M&A Transactions

More than a dozen significant M&A transactions have been completed in recent years, with Redwood Trust and ROC360 being the most acquisitive. We expect ongoing consolidation in the next 24 months, as originations increase and market conditions continue to improve.

	TARGET	BUYER	COMMENTS
July 2024	ARCHWEST CAPITAL	BAIN CAPITAL	Originated \$700 million since 2022
May 2023	CIVIC FINANCIAL	ROC360	Distressed sale. Originated \$1.8 billion in 2022
February 2023	FINANCE OF AMERICA COMPANIES INC	ROC360	Acquired assets of the FAcO division specializing in residential investment loans
July 2022	HOUSEMAX FUNDING	HUNT COMPANIES	Minority equity sale
April 2022	RIVERBEND LENDING	REDWOOD TRUST (NYSE-RWT)	Originated \$798 million in 2021
January 2022	MERCHANT'S MORTGAGE & TRUST	KKR	Originated \$500 million in 2021
November 2021	ANCHOR LOANS	PRETIUM	Originated \$1.0 billion in 2020
October 2021	GENESIS CAPITAL LLC	NEW RESIDENTIAL INVESTMENT CORP (NYSE: NRZ)	Originated \$1.5 billion in 2020
May 2021	LIMA ONE CAPITAL	MFA FINANCIAL (NYSE: MFA)	MFA previously acquired a strategic interest in 2018
April 2021	FINANCE OF AMERICA MORTGAGE (NYSE: FOA)	REPLAY ACQUISITION CORP	Public offering at a \$1.9 billion valuation
February 2021	CIVIC FINANCIAL	PACWEST BANCORP (NASDAQ: PACW)	\$300 million loan portfolio
December 2020	KIAVI	BENEFIT STREET PARTNERS	\$75 million Series E funding round
January 2020	VELOCITY FINANCIAL	IPO – NYSE: VEL	Originated \$1 billion in 2019

CONCLUSION

With market headwinds subsiding and originations rising, Colonnade believes that the Business Purpose Lending industry is poised for a strong upcoming year and an attractive long-term investment opportunity.

The industry serves an essential need in the real estate value chain, and demand for its services will continue to increase. Consumer demand for housing and elevated housing prices continue, further driving demand for updating older homes. For institutions, larger and more established players will continue to command a competitive advantage, promoting increased industry consolidation among the smaller lenders.

Following a period of industry headwinds, the institutions that survived are those that successfully developed reliable and consistent origination networks and consistent funding sources. These groups win on levels of service, experience, leverage, rate, speed/execution, and capital availability.

In summary, subsiding headwinds, long-term industry tailwinds, increasing originations, more access to capital, and continued market demand are paving the way toward significant investment activity and consolidation in the sector over the next 24 months.

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The undersigned acted as exclusive financial advisor to Independent Bank

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"Beyond Great Rates & Superb Service"

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Sources: SEC filings, regulatory filings, company presentations, Redwood, ATTOM, US Census Bureau, FRED, Colonnade Research, Finsight

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