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# Oaktree Propels House Flipping Revival With 20% Gains: Mortgages

John Gittelsohn | March 18, 2014- 9:00 PM PDT

House flipper Greg Hebner expects to rake in about 30 percent profit in eight months, more than twice the return of the Standard and Poor's 500 Index, as he seeks a buyer for his latest makeover.

Hebner, a builder and remodeler, would be able to make that profit thanks to the availability of short-term financing for flippers. He used $360,000 in cash and a loan to purchase the $880,000 home in Los Angeles in August. Ifhe gets his asking price of $1.4 million, his take will have grown to $480,000.

Flippers, who stoked the housing bubble a decade ago, are making a comeback with the help of funding from private-equity firms and other non-bank investment companies. Arixa Capital Advisors LLC, Oaktree Capital Group LLC and Auction.com LLC are offering short-term financing to buy and renovate properties at a time banks are reluctant to extend credit for speculative real estate deals. Hebner financed the purchase of his five-bedroom, four-bath home and a $265,000 renovation with a loan from Los Angeles-based Arixa that covered three-fourths of his costs.

"There are very, very few banks that provide this kind of financing and provide it in a way that would work with our business model," said Hebner, 45, founder of construction company Community Rebuild Partners LLC. Hebner, who became a managing director at Arixa last year, said he recused himself from his own loan review to avoid conflicts of interest.

Flippers are taking advantage of rising prices, limited construction and a shortage of homes on the market. They sold 122,825 single-family U.S. homes within six months of purchase last year, up 20 percent from 2012 and 134 percent from 2011, according to property-data firm RealtyTrac. The properties that were bought and sold had a total value of $38 billion last year, or 4.6 percent of all single-family home sales, RealtyTrac said.

## Speculative Fever

Flippers are not as active today as they were during the last housing boom. In 2006, more than 33 percent of all U.S. home loans went to people who already owned at least one house, according to a 2011 Federal Reserve Bank ofNew York report. "Speculative fever" by flippers who bought homes with little or no down payment and plans to sell quickly fueled the real estate frenzy and compounded the price plunge that followed, according to Robert Shiller, the Yale University professor who won a Nobel Prize last year.

When credit dried up, flippers behaved more responsibly because they relied on their own funds, Daren Blomquist, vice president of RealtyTrac, said. That may change as lenders jump into the market.

"One danger is flippers tend to be less conservative and take more risks when they're using other people's money," Blomquist said.

Oaktree Investment

Oaktree, a Los Angeles-based firm with $84 billion under management, invested $100 million in Genesis Capital LLC in January to make loans to investors who fix and flip foreclosed homes. Since then, Wells Fargo & Co. provided Genesis a $125 million line of credit, increasing its lending capacity by as much as 70 percent.

Genesis, a closely held real estate lender and foreclosure auction house, provides loans for as long as 12 months. They cover as much as 90 percent of purchase costs and 80 percent of renovation expenses, said Robert Wasmund, a senior managing director at the Los Angeles-based firm. The financing has been offered first in California, Florida and Texas, with plans to add more states, he said.

Genesis's borrowers include Thomas James Capital, which has renovated and resold more than 400 homes, mostly on Los Angeles’s westside, since 2017. Genesis charges interest rates starting a 9.99 percent, which is greater than the cost of construction loans from banks. The higher value of the cost of homes and faster closings make the firm's financing del, managing partner at Aliso Viejo, California-based Thomas James.

## Genesis Loans

Thomas James typically invests 20 percent of its own money to buy and remodel a home, with lenders providing the balance, Beadel said. His profit goal is a 20 percent margin on the final price, such as a $600,000 gain on a house that sells for $3 million, he said. The company also strives to sell the home within six months, to minimize interest costs and maximize the amount of equity at work, Beadel said.

"In this business, it all comes down to annualized rate of return on your equity," he said.

Genesis, which started in 2007, made more than 600 loans prior to Oaktree's investment, with only one default, Wasmund said. Most of the financing goes to small investors, including those who purchase bank-owned foreclosures sold at auctions Genesis conducts for Bank of America Corp. and other clients with repossessed properties.

## Lenders Losses

Genesis auctioned 4,500 homes in the last 18 months and has a registry of more than 5,000 qualified bidders. The auctions, which provide Genesis with a steady source of potential borrowers, made the firm attractive to Oaktree, Brian Laibow, a managing director in the investment firm's distressed-debt group, said in a statement in January, when the agreement was announced. Oaktree declined to comment for this story.

Sequoian Investments Inc., whose firm provided flippers $20 million in 2013, lowered its interest rate for high loan-to-value debt from 15 percent to 10 percent this month to compete with other credit providers, said Alexander Favelukis, a partner in the San Diego-based firm. Arixa charged Hebner, the remodeler, 10 percent for his loan.

Sequoian, which offers loans as large as $2 million for as much as 80 percent of the property value, limits its terms to six months to avoid the risks of the housing market taking a downturn, Favelukis said. Lenders lost money during the housing crash when borrowers walked away from projects where plunging prices wiped out all of their equity, he said.

## Auction.com Funding

"When we do a six-month term, we want to make sure the borrower finishes the work," said Favelukis. "Even if they bought the property and did no work, the probability of it falling more than their 20 percent down payment is pretty low."

Auction.com, an Irvine, California-based company that sold $7 billion of real estate online last year, has $170 million in short-term loans for flippers and other home investors. The loans, which average 137 days in duration, are used for as much as 70 percent of the cost buying the properties it sells.

"Obviously, flippers are a lot of the people who use the fund," Rick Sharga, executive vice president at Auction.com, said. The company this month announced a $50 million investment from Google Inc., which said Auction.com has the potential to bring the type of transparency to real estate investments that EBay Inc. brought to other online trading.

## Colony Venture

Colony Capital LLC, which owns about 16,000 rental homes, last month formed a joint venture called Dwell Finance LLC to offer as much as $1 billion this year in short- and long-term funding for investors in single-family homes.

While Dwell originates bridge loans for purchase and improvements, its focus is five- and 10-year debt for landlords because rentals provide a more reliable revenue stream than flipping, said Gregor Watson, co-founder of San Francisco-based Dwell.

"Flipping is an art, because you've got $700,000 homes and $200,000 homes," Watson said. "The rental business is more of a science. I know what flooring I'm going to put in every home. I know what paint I'm going to put on every wall. When it's a science, not an art, it's scalable."

## New York Flippers

The New York metropolitan area had the most flips last year, followed by Detroit, Phoenix, Los Angeles and Atlanta, according to RealtyTrac. Flippers averaged a 31 percent gross price increase per home, based on average purchase price of $189,472, the firm said.

California's Silicon Valley had the largest gain, averaging $162,042 per flipped house, followed by San Francisco, Los Angeles, Boston and San Diego among cities with populations greater than 1 million.

"The difference from the bubble is people were just riding the momentum of home prices back then," said Brzeski, whose firm loaned $45 million last year to home remodelers. "Now you have to transform a house to make money."

Opportunities for transformation abound in Los Angeles, where well-located subdivisions erected after World War II are ripe for renewal, Brzeski said. Renovators often leave only a small portion of the original house standing to allow faster permit approvals than building a totally new structure, he said.

## California Homebuilding

"Homebuilding has changed in California," Brzeski said. "We're not building as many new houses, but we have reached a point where there are thousands and thousands of functionally obsolete houses that were built in the '40s and '50s and '60s and they need to be redone."

Hebner said rising home prices and mortgage rates have cooled demand since last year, when he bought his 1937 bungalow. The 2,944-square-foot (274-square-meter) house went under contract last week, two months after it was listed, for a little under Hebner's asking price.

"It's not a seller's market as much as it was," he said.

Hebner is spending more time these days underwriting loans with Arixa for other builders than renovating houses with his construction company.

"While debt is an important way to get the returns you need, you just have to be really careful," Hebner said. "You've got to buy it right and have a lot of control over what you spend."