

A Guide to Home Equity Investments:

The Untapped Real Estate Asset Class



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Executive Summary



EXECUTIVE SUMMARY

Homeownership remains the primary source of wealth creation among average Americans.¹ Housing wealth is built mainly through price appreciation, which rose to 7.8% over the last decade compared to 5.4% on an annualized basis since 1975.² This growth has translated into solid wealth gains for homeowners. **Tappable home equity — the amount homeowners can access while keeping at least 20% equity in their homes — saw even more growth.** It was approximately \$10.3 trillion at the end of Q3 2022, a gain of more than 13% over the prior 12 months.³ Even as that number fluctuates, this large pool of high-quality investable assets remains available.

The faster a home appreciates, the sooner it will become a homeowner's largest asset and source of wealth. However, home equity is not cash liquidity. So, when homeowners find themselves needing large sums of cash, one of the few options they have is to access their equity through more borrowing and debt.

\$10.3 trillion

of tappable home equity was available to homeowners at the end of Q3 2022, a gain of more than 13% over the prior 12 months.

¹ [Federal Reserve Board Survey of Consumer Finance, 2019](#)

² [Yale Department of Economics/Robert J. Shiller website](#)

³ [Black Knight, Q2 2022](#)

EXECUTIVE SUMMARY

Usually, when homeowners need to access their home equity for cash, those with excellent credit and flexibility may borrow from their equity with loans, lines of credit, or second mortgages. However, these options may not be desirable or possible for a large segment of homeowners with sizable home equity and good credit, and who need (or want) to avoid additional debt. As living expenses rise due to rising inflation, many homeowners may not have the financial flexibility to make additional monthly payments. Higher interest rates further reduce the appeal of debt options.

Home equity investments (HEIs) provide a unique alternative. They go beyond the limitations of equity loans, HELOCs, and second mortgages by allowing private investors to participate alongside homeowners. Homeowners receive the cash they need now in exchange for a percentage of the future value of the home over a set term — this typically ranges from 10 to 30 years. Moreover, HEIs represent a novel opportunity for partnership between investment capital and homeowners.

Despite near-term headwinds, the U.S. housing market remains one of the most resilient asset classes available to private investors. HEIs present an innovative route to residential home equity exposure that is both capital-efficient and scalable while offering the potential for portfolio diversification, downside protection, and enhanced risk-adjusted returns.



This report covers the investment opportunity in untapped home equity and the growth of HEIs in more depth. It also outlines why the current macroeconomic environment presents a unique inflection point for credit-oriented investors to invest in HEIs so they can:

- Gain direct exposure to a multi-trillion-dollar pool of untapped home equity in a scalable manner
- Take advantage of near-term uncertainty in the housing market to create a favorable long-term investment opportunity that offers attractive economics
- Support mission-driven businesses that help average American homeowners strengthen their financial standing and offer additional options for improving their livelihoods without adding to their household debt



Single-Family Home Equity: An Untapped Opportunity



SINGLE-FAMILY HOME EQUITY: AN UNTAPPED OPPORTUNITY

In general, real estate is one of the most established and valuable of the alternative asset classes. A wide variety of strategies and structures — both listed and unlisted (or private) — exist for investors to allocate capital to commercial, industrial, and, increasingly, residential real estate. Single-family homes are a relatively new and fast-growing asset class for institutional investors. Like multi-family properties decades ago, single-family homes are evolving into as viable and profitable an asset as commercial property. **Investing in single-family homes can offer attractive benefits, including portfolio diversification, low correlation to public markets, inflation protection, enhanced risk-adjusted returns, capital preservation, and the potential for a reliable income stream/dividend yield.**

Investors seeking a reliable income stream may pursue direct purchases, single-family rental vehicles (SFRs), or residential mortgage-backed securities (RMBS). RMBS rely on traditional debt, while direct purchases and SFRs require sizable capital outlays to acquire and maintain the properties, which are more difficult to scale. Direct purchases and SFRs also depend on tenants, who come with risk profiles that differ from homeowners in meaningful ways. Both RMBS and SFRs are subject to prevailing interest rates. Rising interest rates and a tightening credit cycle may negatively impact the performance of these vehicles.

Moreover, these options do not provide investors with direct exposure to home price appreciation over the long term. The housing market remains tight even as housing prices face near-term uncertainty. As a result of strong price growth, **homeowners have reaped significant gains in equity, with untapped equity valued in the multi-trillions.** Equity may also motivate homeowners to retain or build wealth by refraining from selling. This news is great for homeowners, but home equity does not equate to cash liquidity — hence the “house-rich, cash-poor” problem many homeowners experience.

Combined, these factors make home equity a compelling option for investors. They just need the means to access this asset class, and to be able to do so in a safe and straightforward manner.

Residential On the Rise

Like multi-family property decades ago, single-family homes are evolving into as viable and profitable an asset as commercial property.

2021 Traditional Real Estate Returns

Property Sector	Property Type	2021 Returns ⁴ (%)
 Residential	<ul style="list-style-type: none"> • Multi-family (4 units or less): apartments, duplexes, townhomes • Single-family: most often a detached home where an individual, couple, or family reside 	<ul style="list-style-type: none"> • All Residential: 58.29 • Single-family homes: 52.79
 Commercial	<ul style="list-style-type: none"> • Multi-family (more than four units): apartment building or complex with multiple units • Lodging/resorts • Mobile home parks • Office buildings • Retail spaces • Health care • Self-storage facilities 	<ul style="list-style-type: none"> • Apartments: 63.61 • Lodging/Resorts: 18.22 • Office: 22.00 • Retail: 51.91 • Self-storage: 79.43 • Health care: 16.32
 Industrial	<ul style="list-style-type: none"> • Manufacturing • Storage and distribution • Flex space 	All Industrial: 62.03
 Land	<ul style="list-style-type: none"> • Brownfield: previously developed land that requires rehabilitation for redevelopment • Greenfield: land not previously developed 	* Investments made through direct purchases or unlisted funds. No public benchmark equivalents.

⁴ FTSE Nareit U.S. Real Estate Index



Markets at an Inflection Point



MARKETS AT AN INFLECTION POINT

In 2022, driven by persistently high inflation and monetary tightening, uncertainty has prompted public market selloffs.⁵ As of October 2022, the S&P 500 Index was down more than 20% year-to-date, with the Bloomberg U.S. Aggregate Total Return Index for bonds down about 15% and the MSCI U.S. REIT Index down 19%.⁶

Near-term headwinds in the housing market are also gathering strength. While home inventories remain tight, thus limiting affordable options, rising interest rates are taking a bite out of sales. The contract rate on a 30-year fixed mortgage surpassed 7.0% in October 2022, about a four-percentage point increase from one year ago.⁷ Higher rates tend to dampen home sales, as demonstrated in September 2022, during which home sales fell 19.9% from the previous year.⁸

⁵ [Bloomberg: September 17, 2022](#)

⁶ [S&P 500 Index](#); [Bloomberg U.S. Aggregate Total Return Index](#); [MSCI U.S. REIT Index](#)

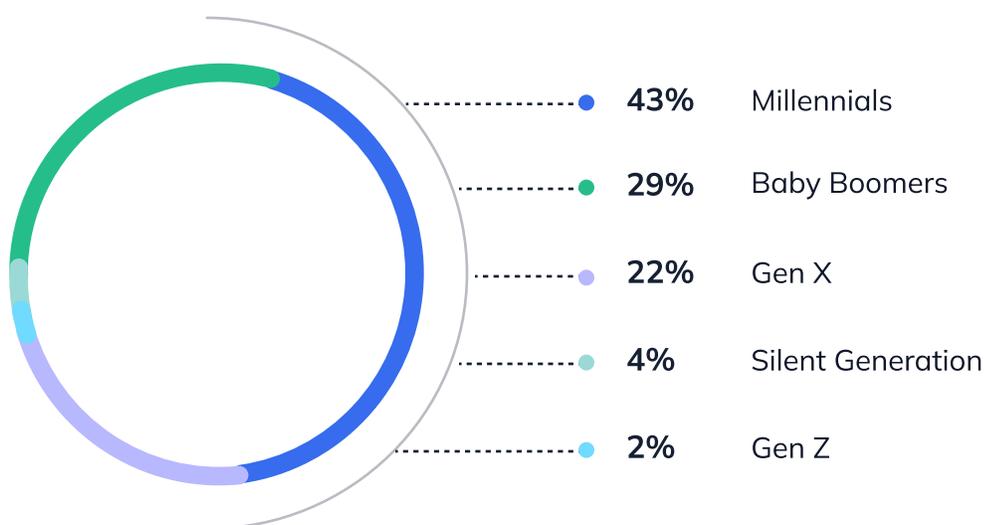
⁷ [Bloomberg: October 27, 2022](#)

⁸ [National Association of Realtors, September 2022 Existing Home Sales Report](#)

MARKETS AT AN INFLECTION POINT

However, today's housing market is decidedly different than the environment leading up to the 2008 housing market crash. Unlike in the years leading up to 2008, with a glut of new home building, today's housing market is characterized by tight inventory — demand outstrips supply. Less new construction, combined with many households leaving cramped apartments in crowded cities for more space in suburbs and smaller cities, and greater demand from millennials, who now make up the **largest cohort of home buyers (43%), led to limited housing inventory.**⁹

2022 Home Buyers by Generation



Furthermore, stringent safety measures and lending standards implemented post-recession are working as intended. Mortgage credit availability is tighter, and adjustable-rate mortgages (ARMs) represent less than 9% of total loans compared to over 35% at the last cycle's peak.¹⁰ Housing government-sponsored enterprise (GSE) mortgage creditworthiness has shown significant improvement. In 2021, the share of housing units with a foreclosure filing was 0.11% compared to 2.23% in 2010 and, as of Q2 2022, the share of mortgage balances that were over 90 days past due remained at a historically low 0.5%.¹¹

⁹ [National Association of Realtors, 2022 Home Buyers and Sellers Generational Report](#)

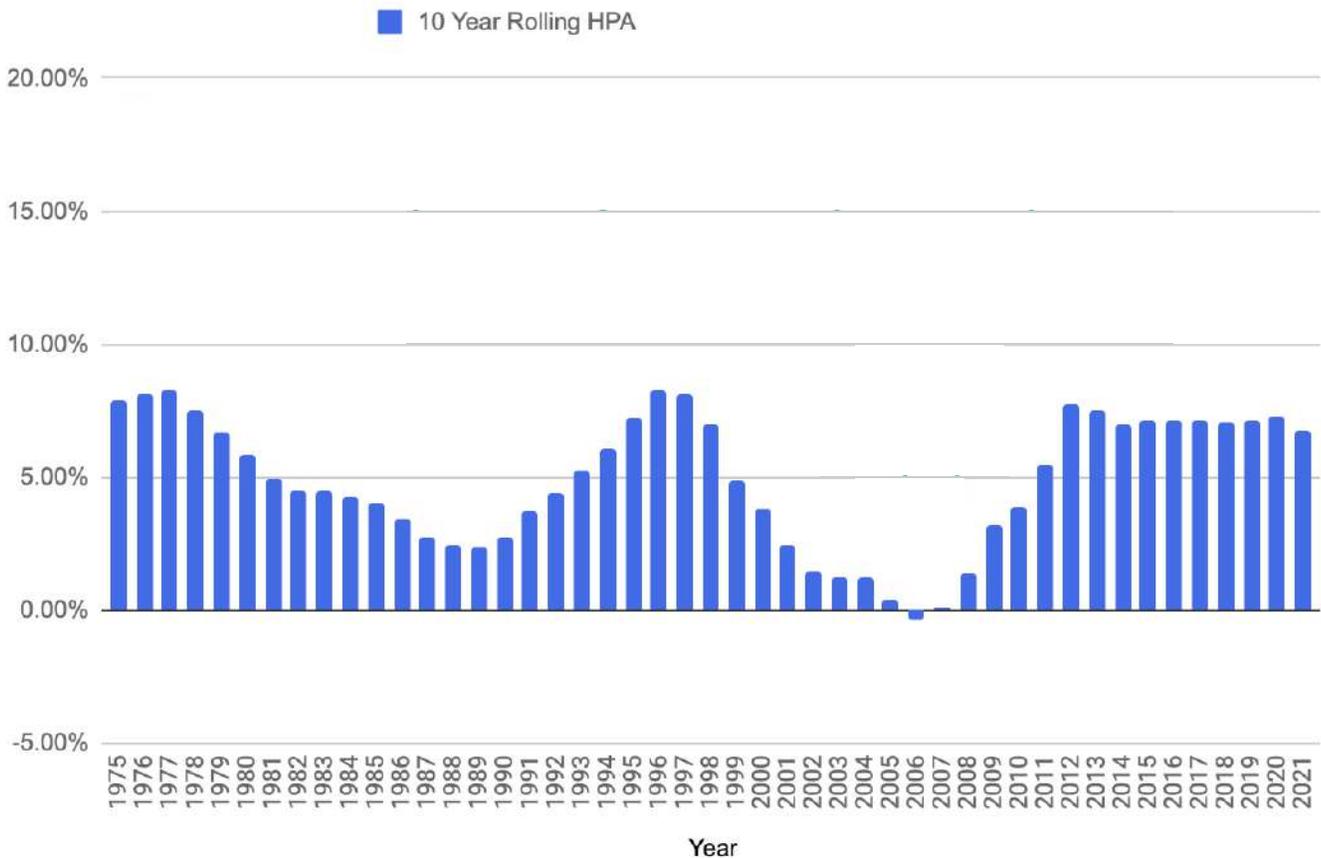
¹⁰ [National Mortgage Professional; Mortgage Bankers Association](#)

¹¹ [Bankrate.com, May 2022](#)

MARKETS AT AN INFLECTION POINT

Overall, the housing market is on stable footing to weather any short-term uncertainty. As of Q2, including first and second liens, total market leverage was just 42% of mortgaged homes' values, the lowest on record.¹² Home price growth is broadly expected to continue, albeit at a more moderate rate.¹³ As illustrated in Case-Shiller Index historical data, the U.S. housing market has proven resilient in the long term. **Despite any near-term headwinds, single-family homes are well-positioned to continue increasing in value.**

Case-Shiller Annual Home Price Appreciation



Source: Case-Shiller (see footnote 2)

¹² [Black Knight Mortgage Monitor, September 7, 2022](#)

¹³ [Freddie Mac Quarterly Forecast, July 2022](#)



A Smart Alternative for Homeowners



A SMART ALTERNATIVE FOR HOMEOWNERS

Home equity remains the primary source of wealth for many homeowners. Yet, its historical illiquidity has made it difficult to use this wealth towards life expenses or new financial opportunities that homeowners have today. Homeowners' need for cash may run the gamut from unexpected repairs or medical expenses to fulfilling a dream, such as paying for college, starting a business, or buying a second property. Still others may seek to pay off debt from credit cards, auto loans, or other borrowing.

Traditional options for home equity include equity loans, mortgage refinancing, second mortgages, or HELOCs. These options come with stringent criteria for credit scores and income minimums that preclude many responsible homeowners in good financial standing and with quality homes from borrowing. In addition, the current rising interest rate environment is making financing more expensive. Plus, an annual inflation rate of around 8.2% is shrinking consumer spending power.¹⁴ **Tighter household budgets may limit how much additional debt homeowners could take on — especially when it means putting their home on the line. Moreover, traditional financing typically restricts how cash may be used. Homeowners need more options that allow them to avoid more debt and help them achieve their goals.**

¹⁴ [Ycharts.com](https://ycharts.com): [Historical U.S. inflation rates](https://ycharts.com)

A SMART ALTERNATIVE FOR HOMEOWNERS

HEIs offer an alternative to taking on debt or selling a home outright. HEIs enable homeowners to share the gains in their home values with investors in exchange for upfront cash. Rather than keeping them dependent on lenders and debt, HEIs empower homeowners to put a portion of their home equity to work without taking out a loan or worrying about monthly payments plus interest. HEIs are still a relatively new concept, and companies that offer them are working hard to educate homeowners about this alternative.

Many websites dedicated to personal finance, such as Bankrate, LendEDU, and Consumers Advocate, have begun covering HEI providers and reviewing their HEI products to help educate consumers on this financing option and the various pricing models and product structures that exist. Many HEI providers also receive ratings on independent consumer review platforms such as Trustpilot. Between these various personal finance sites and review platforms, there is now an abundance of informational articles and customer reviews to help guide homeowners researching their options.

Search volume for 'home equity investments' has **grown 400%** in the United States in the last two years.

Source: Conductor insights

A SMART ALTERNATIVE FOR HOMEOWNERS

HEIs likely appeal to the large number of homeowners with good credit and quality homes who may not meet the requirements for other financing options. With more flexible qualification criteria, HEIs enable more homeowners to tap into their equity. While homeowners do need significant home equity for an HEI — around 25% is typical — credit requirements are less stringent for HEIs, with an average minimum FICO score of 500. Although HEI providers may vary, a typical investment amount is 30% or less of the total home value. Homeowners are responsible for appraisal costs, an origination fee, and various third-party expenses, which can typically be deducted from the investment total to avoid out-of-pocket costs.

The Life of a Home Equity Investment



Data above is an example scenario.

Year 1:

Homeowner receives 10% investment
(\$100,000) on home valued at \$1,000,000.

Year 10:

Home is valued at \$1,628,895
Home equity investment share: \$271,482
Homeowner share: \$1,357,412

A SMART ALTERNATIVE FOR HOMEOWNERS

The term length of the HEI varies by provider, but is usually between 10-30 years. To settle the investment, the homeowner pays the HEI company the agreed-upon percentage of the home's current market value following a third-party appraisal. And, unlike an equity loan or HELOC, home equity investments allow homeowners to use the funds for any reason, making it a flexible option. Some use the cash like they might a loan or line of credit, but the possibilities do not stop there. For example, HEIs provide homeowners with the option to pay down or eliminate debt without paying interest or monthly payments. With improved credit scores and stronger financial standing, some homeowners may qualify for and select a traditional financing solution for their long-term needs, thereby settling their HEI well before the term ends with proceeds from their new arrangement. With the optionality that HEIs provide, homeowners may achieve newfound financial flexibility.

A softer home sales environment suggests that current mortgage holders who locked in 30-year fixed-rate mortgages when interest rates were low are well positioned to weather near-term uncertainty — a benefit from buying at low rates and from their accrued home equity. In the event of a job loss or recession, HEIs position homeowners well, increasing their liquidity without taking on additional monthly payments. They also have less incentive to sell if they have concerns about the housing market or economy.

Achieving Financial Milestones

Homeowners use the funds from HEIs most often to pay off high interest debt, fund home renovations, purchase a second property, pay for higher education, and to create a cash cushion for whatever lies ahead.



Why Allocate Capital to HEI Funds?

WHY ALLOCATE CAPITAL TO HEI FUNDS?

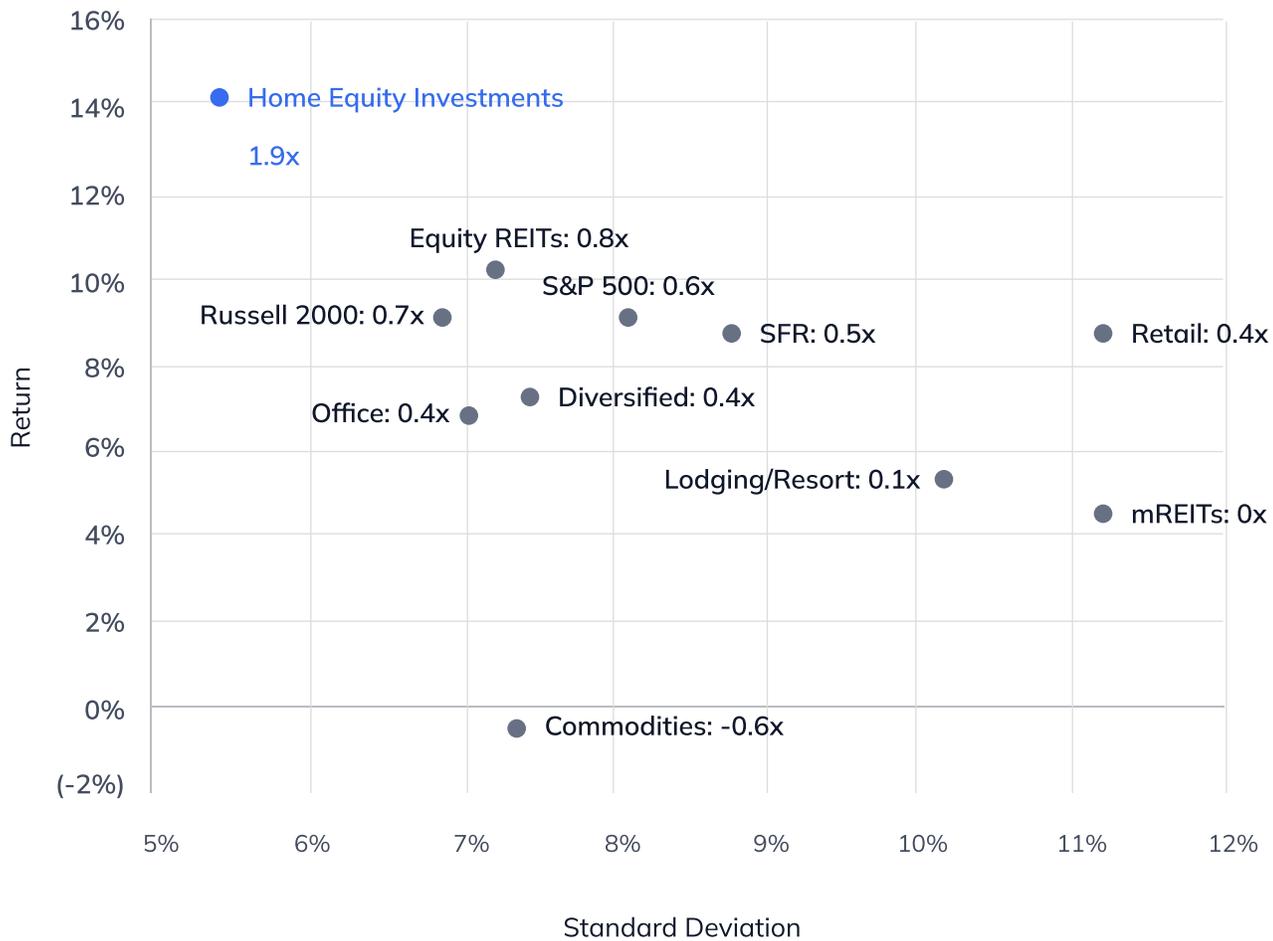
The benefits of home equity investments aren't exclusive to homeowners. HEIs also offer an efficient and scalable way for credit-oriented investors to gain exposure to growth in home values and stable returns over time without incurring the cost and management of ownership or risks associated with credit market cycles. They also result in aligned incentives and shared benefits by providing a mechanism for homeowners to preserve their property value.

HEI investment vehicles fundamentally differ from debt products, which pay a contractual interest payment or dividends (like SFRs or RMBS). With HEI investments, investors gain structured exposure to untapped home equity valued in the trillions and ongoing cash flows as homeowners sell, refinance, or settle with cash. In addition, many of the same benefits associated with investing in real estate assets apply to HEI investments:

- Portfolio diversification/low correlation to public markets
- Inflation protection
- Favorable long-term capital gains tax treatment
- Geographic diversification with a portfolio of investments across the U.S.
- Attractive risk-adjusted returns. Depending on the provider, historical returns may be in the double-digits on average, with a Sharpe Ratio of approximately 1.9x, a significant premium to other asset classes.

WHY ALLOCATE CAPITAL TO HEI FUNDS?

HEI Relative to Other Asset Classes (Sharpe Ratio)



Sources:

FactSet index returns (5-year rating averages between 2000-2020).

SFR data sourced from academic research between 1986-2014.

HEI data based on Monte Carlo simulations for each vintage year (2000 to current) using a random sample of homes.



WHY ALLOCATE CAPITAL TO HEI FUNDS?

HEI companies deploy the capital from investors to make minority investments into select homes by providing cash sums to homeowners in exchange for a percentage of the future value of the homes. Capital raised from institutional investors can be pooled into asset investment funds comprised of HEIs. The HEI company manages fund portfolios in most cases. When investing in a fund, institutional investors do not directly own the HEI; rather, investors earn a return on HEIs as homeowners settle. Under an alternative structure, an investor can purchase HEIs from the HEI company. The HEI company also manages each homeowner's account and customer service.

Investor capital may be deployed in one of three investment vehicles:

1. **Asset fund**

An HEI company is the general partner, and investors are limited partners who pay a management fee to the HEI company and receive distributions as investments settle.

2. **Separately Managed Account (SMA)**

Investors act as limited partners and are assigned their own accounts with additional rights and controls.

3. **Forward flow agreement or purchase flow agreement**

Investors own the HEIs originated by the HEI company and receive certain rights. Investors pay a management fee to the HEI company, and the HEI company services and manages the portfolio on their behalf.

WHY ALLOCATE CAPITAL TO HEI FUNDS?

When evaluating HEI companies for capital allocation, it is important to consider the three S's: structure, selection, and security.

Structure

In structuring investment vehicles, HEI companies aim to balance several investor considerations, including returns on investment, downside and inflation protection, potential for long-term capital gain treatment, and attractive risk-adjusted returns. Specific investments vary by HEI company, but typical structures provide meaningful downside protection should home prices decline. This structure allows investors to sustain an approximately 30% decline in real estate prices before losses occur. This feature is not typical of other real estate investments in which lower property values typically result in losses for the investor.

Homeowners settle the investment upon home sale, refinancing, investment rollover, or buyout — whichever comes first — within an agreed-upon term, typically 10-30 years but may vary by HEI provider. However, many HEIs are settled in less time. Portfolio cash flow is generated when HEIs settle and is returned to investors annually.

During periods of housing market uncertainty, homeowners with significant home equity are expected to delay selling or refinancing until the sales market rebounds or interest rates decline. While this factor may extend the duration of some HEIs, homeowners are well-positioned to avoid selling in distress — their equity gains will help them weather a potential recession.

Selection

A rigorous selection process is another critical factor to consider. HEI companies typically screen investments against strict underwriting rules to generate a portfolio of high-quality homeowners with good FICO credit and risk characteristics and high-quality homes with low loan-to-value (LTV). Equity exposure is limited by ensuring an adequate cushion in each property investment to minimize potential losses. As part of the terms and conditions, homeowners must agree that they will not accrue additional debt in a manner that could jeopardize the value of the HEI company's interest. This stipulation also helps to limit potential losses.

Security

HEIs are secured in a similar manner to loans. The HEI in a residential owner-occupied (or non-owner-occupied) home is secured by a lien on the title and recorded in the homeowner's local jurisdiction. Although the documentation is slightly different, this process follows that of the lending industry, with rigorous recordkeeping to ensure that investments are settled within the specified term of the agreement.



HEIs: A “Win-Win” for Investors & Homeowners

HEIs: A “WIN-WIN” FOR INVESTORS & HOMEOWNERS

HEIs represent an innovative solution for both investors and homeowners.

For credit-oriented investors, HEIs present a capital-efficient, scalable route to residential home value growth without the cost and management of ownership or the inherent risks of credit cycles. In addition to meaningful downside protection, HEIs offer many of the same benefits as the broad real estate market, including portfolio diversification/low correlation to public markets, inflation protection, geographic diversification, and attractive risk-adjusted returns.

For homeowners, HEIs provide a means to tap into their home equity for necessary cash without the stress of increased debt or restrictions on how they can use the funds. In exchange for cash up front, homeowners allow investors to earn a share of their home’s future value, paid to the investor after a fixed period, or when the homeowner secures other financing or sells their home.

HEIs Benefit Investors and Homeowners

Investors

Homeowners



Problem

No efficient or scalable way to invest in a multi-trillion-dollar pool of untapped home equity.

Dependent on lenders and debt to access cash from home equity.



Solution

Structured HEI vehicles provide a capital-efficient, scalable route to untapped home equity and have a proven track record of strong risk-adjusted returns, among other benefits.

HEIs help homeowners tap into their home equity for necessary cash without going further into debt in exchange for a share of their home’s future value. Homeowners use investment proceeds to cover significant expenses or to reinforce their financial position.

About Hometap

When considering an investment with an HEI provider, partnership with companies that homeowners trust is essential. Hometap, a leading provider of home equity investments, is on a mission to make homeownership less stressful and more accessible. Hometap's HEI product provides homeowners with a fast, simple, and straightforward way to access the equity in their home without taking out a loan or having to sell. With the total cost of homeownership rising, along with increasing interest rates and record-breaking total household debt, there is a growing need for alternative financing solutions that allow Americans to tap into their most important asset without going further into debt.

As of 2022, Hometap has made thousands of investments in US homes across 18 states, helping homeowners nationwide tap into their home equity without monthly payments or interest. Hometap is not only revolutionizing the home financing industry for homeowners, but it's also giving investors the chance to participate in a brand new asset class. Since 2018, Hometap has provided institutional investors with diversified exposure to the multi-trillion dollar real estate market by enabling them to invest in home equity through its asset investment funds.

Learn more about Hometap at <https://www.hometap.com/investors/>.

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