



# Attractive Investment Opportunities in Prime Jumbo 2.0

4Q 2021

As most dislocations in structured credit caused by the COVID-19 pandemic have run their course, Angel Oak is now positioning for a longer-term expansion at the zero bound. The firm's investment team remains focused on areas with relatively wide spreads that are well positioned for its outlook for sustained high growth, accommodative monetary policy, persistent inflation, a robust consumer and a solid housing market. The Prime Jumbo, or "Jumbo 2.0," subsector of new-issue non-agency residential mortgage-backed securities (NA RMBS) is one of those areas. Extraordinarily high-quality collateral, increasing gross issuance, a dislocated investor base, and strong historical credit performance make Jumbo 2.0 one of Angel Oak's highest conviction opportunities over the medium term.

Angel Oak's structured credit investment process focuses on the quality of the underlying collateral first and the structure of the security second. The underlying collateral of loans within Jumbo 2.0 is of an extraordinarily high quality. The weighted average profile of the outstanding Jumbo 2.0 investment universe has a FICO score of 771, a home price index loan-to-value of 66%, a debt-to-income ratio of 32%, and an average loan size of more than \$715,000 (Figure 1).

**FIGURE 1: POST-CRISIS JUMBO 2.0 LOANS VS. PRE-CRISIS PRIME ORIGINATIONS**

LEGACY PRIME	BAL (\$BN)	FICO	ORIG LTV	% IO	% WAC	% FIXED RATE
<b>2002</b>	167.3	735	65	21%	6.0%	58%
<b>2003</b>	219.5	736	65	27%	5.1%	47%
<b>2004</b>	181.2	736	69	52%	4.9%	27%
<b>2005</b>	166.0	741	70	60%	5.6%	36%
<b>2006</b>	124.6	742	71	58%	6.4%	50%
<b>2007</b>	104.8	744	72	57%	6.4%	64%
<b>JUMBO 2.0</b>						
<b>2011</b>	2.5	769	64	20%	4.4%	75%
<b>2012</b>	7.7	770	65	16%	3.9%	80%
<b>2013</b>	13.2	769	66	8%	3.8%	88%
<b>2014</b>	12.3	768	71	2%	4.1%	92%
<b>2015</b>	10.4	768	72	1%	4.0%	98%
<b>2016</b>	7.1	768	68	2%	3.8%	95%
<b>2017</b>	13.8	768	70	1%	4.1%	98%
<b>2018</b>	13.7	767	72	0%	4.5%	100%
<b>2019</b>	17.2	767	71	2%	4.1%	98%
<b>2020</b>	18.7	775	69	0%	3.2%	100%
<b>2021 YTD</b>	25.8	773	68	0%	3.0%	100%

Note: Averages are balanced weighted averages; risk retention was enforced in 2014 corresponding to the sharp drop in IO%.  
Source: J.P. Morgan, CoreLogic as of 11/15/21.

The large average loan size is why use of the word “jumbo” was initiated. Jumbo loans typically exceed Fannie Mae’s and Freddie Mac’s government-sponsored enterprise loan limits, and private market participants such as banks and insurance companies, and NA RMBS provide the necessary capital to fund these loans. Prime jumbo mortgage loans are first lien, primarily fixed rate, and adhere to strict post-global financial crisis (GFC) underwriting standards that emerged because of the Dodd-Frank Act, the Consumer Financial Protection Bureau, and the subsequent creation of the Qualified Mortgage guidelines. These sweeping regulatory reforms improved the integrity of the mortgage underwriting process by emphasizing the ability to repay, income documentation, asset verification, employment verification, fraud prevention, and independent third-party appraisals. Not only are collateral characteristics better than pre-global financial crisis, but more important, the underwriting standards are also far superior.

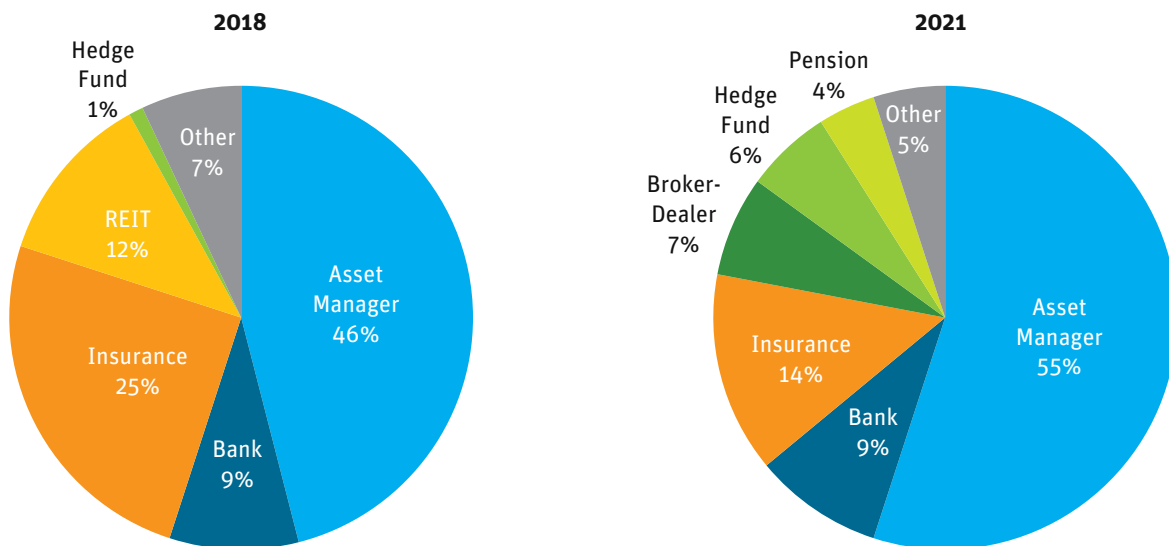
Jumbo 2.0 was the first subsector of newly originated mortgages to be securitized following the GFC, and it has grown to be the second-largest subsector within NA RMBS with just over \$200 billion of gross issuance. 2021 is the busiest post-GFC year on record for the market, with just over \$50 billion coming to market to date and likely growing to \$60 billion by year-end (Figure 2). Moving forward, as more banks establish loan conduit and issuance platforms, Angel Oak expects forward issuance to trend closer to 2021 volumes than to prior years’ volume.

**FIGURE 2: NON-AGENCY RMBS ISSUANCE**

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2021E
<b>Prime Jumbo/Seasoned</b>	\$1,559	\$3,584	\$13,523	\$12,587	\$14,631	\$6,088	\$17,352	\$25,766	\$22,235	\$21,538	\$54,677	\$60,000
<b>Prime Jumbo/Seasoned as % of Total NA RMBS Issuance</b>	7.1%	13.9%	33.8%	18.7%	16.0%	9.2%	15.2%	17.2%	14.8%	15.9%	34.8%	34.3%

Prior to the COVID crisis, the Jumbo 2.0 market investor base was dominated by banks, insurance companies, and asset managers at the top of the capital structure, while levered players, such as real estate investment trusts and hedge funds, were at the bottom of the capital structure. The post-COVID dislocation of asset prices created an opportunity for investment down the capital structure, as many levered players were forced to exit Jumbo 2.0, which created an opportunity at wider spreads for unlevered investors (Figure 3).

**FIGURE 3: INVESTOR BREAKDOWN IN 2018 VS. 2021 ISSUED PRIME JUMBO 2.0**



Note: Based on J.P. Morgan syndicate estimates. Source: J.P. Morgan as of 12/31/18.

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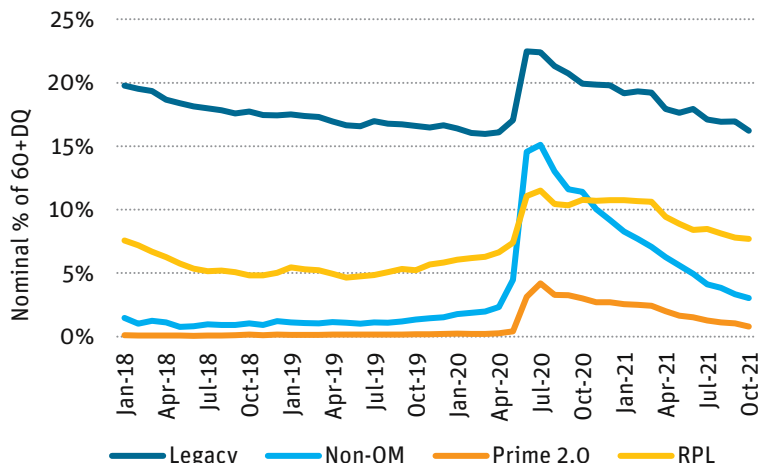
Given the high quality of the underlying collateral, it comes as no surprise that the credit performance since 2011 is exemplary. Throughout 2020, Jumbo 2.0 exhibited the lowest rise in delinquencies of any collateral type, and that market has seen a strong recovery since last year (Figure 4).

Additionally, by loan count, approximately 0.17% of securitized loans have experienced a default and only 0.02% of loans have defaulted with any severity.<sup>1</sup>

Since the GFC, residential mortgage credit conditions tightened as a result of intense regulation. Even the strongest borrowers go through a very rigorous underwriting process. Stronger underwriting and pristine credit quality of the underlying collateral coupled with increased issuance amid continued strength in the housing market make Jumbo 2.0 one of the investment team's highest-conviction ideas over the medium term. Angel Oak's position as one of the leaders in U.S. structured credit investing, with several unique fund mandates, enables the firm to strategically participate across the entire jumbo prime capital structure, a strategic advantage.

<sup>1</sup>J.P. Morgan.

**FIGURE 4: 60+ DAY % DELINQUENT (BY BALANCE)**



Source: Citi Research, Corelogic, Bloomberg, Intex as of 10/31/21.

## DEFINITIONS

**FICO:** Fair Isaac Corporation.

**IO:** Interest-only.

**Legacy:** RMBS issued in 2009 or earlier.

**Loan-to-value (LTV):** A calculation to determine the ratio of a loan to the value of an asset purchased.

**Non-QM:** Non-qualified mortgage.

**RPL:** Reperforming loan.

**Weighted Average Coupon (WAC):** The weighted average of the underlying coupon interest rates of mortgage loans using the balance of each mortgage as the weighting factor.

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