

# Angel Oak Private Strategies: Non-Agency Market Update and Outlook



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## A Record Year for a Scalable Asset Class

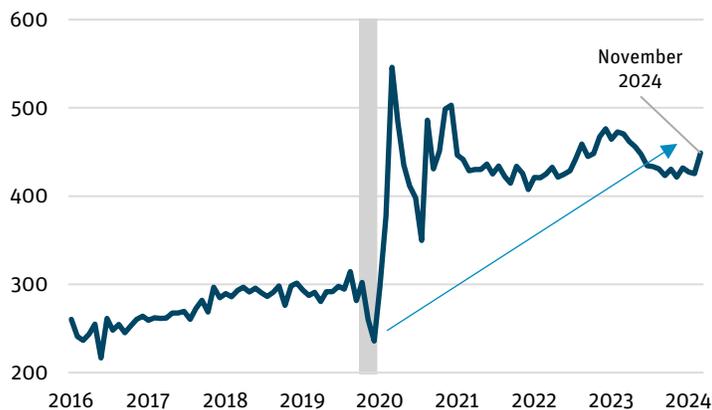
On the heels of the largest year ever for Non-QM securitization issuance, expectations are for robust volume in 2025, with market consensus (BAML, Morgan Stanley, and Nomura Research) forecasting issuance volumes to exceed last year's. As more investors clamor for asset-based finance and strategies that are adjacent to corporate-backed private credit, our argument for residential credit as a scalable alternative seems to be well supported with data.

There are several driving factors behind the increased issuance, in our view. Strong growth in the borrower segments catered to by Non-QM, as shown in the charts below, is a key part of the story. In addition, mortgage originators viewing Non-Agency as a necessary, integral part of their business with sluggish Agency volumes is another reason. A more balanced market between end accounts looking to own whole loans and securitization issuance is yet another positive development for the market. Lastly, the emergence of closed-end second liens and home equity lines of credit (HELOCs) has also triggered another leg of growth outside of more traditional Non-QM collateral. With a changing administration in 2025, there is potential for more volume to emerge in the Non-Agency market with a scaled-back or reduced footprint by the Agencies. Agency-eligible mortgages for investment properties (Agency investor) are a prime example of this. These mortgages are originated within Agency guidelines using standard documentation, but the Non-Agency market potentially offers better pricing for mortgage origination companies as compared to Fannie and Freddie.

In 2024, Bank Statement and Investor (DSCR) mortgages continued to make up the majority of Non-QM. It's no surprise that these two segments make up the primary components of the Non-Agency mortgage market. There are over 33 million small businesses in the U.S., and the number of these firms has continued to grow over the past decade. The number of business applications has surged since 2020, with 2023 the largest year on record at 5.5 million. Through November 2024, there have been 4.8 million new business applications. Bank Statement loans cater to this growing segment of borrowers. Investor loans have also seen significant growth in recent years as mortgage rates have increased. The lock-in effect from homeowners having low mortgage rates has created the incentive to rent out properties, as opposed to selling. Housing turnover is sitting at 40-year lows given the wide gap between current rates and the rate on outstanding mortgages. Affordability for new home purchasers has been challenged and driven demand for rental properties.

## Small Business Growth Increases Need for Bank Statement Mortgages

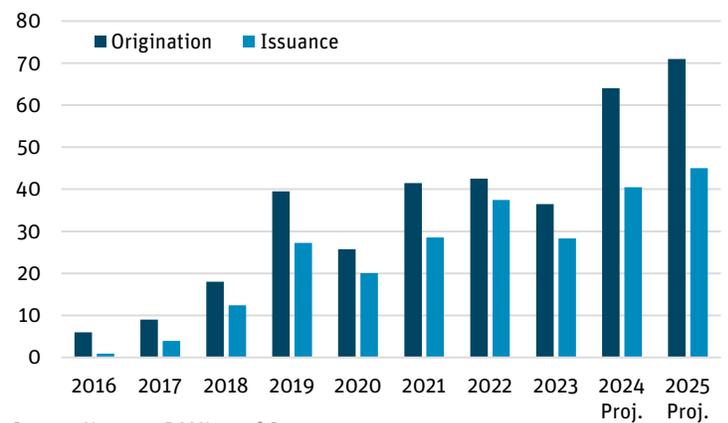
Total Small Business Applications in the U.S. per Month (Thousands)



Source: FRED as of 11/30/24.

## Non-QM Origination and Issuance Volumes

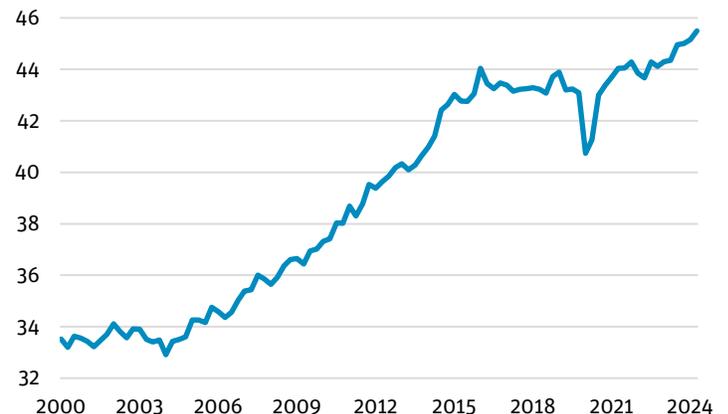
Volume (\$bn)



Source: Nomura, BAML as of Q4 2024.

## Renter Household Growth in the U.S. Has Been Increasing

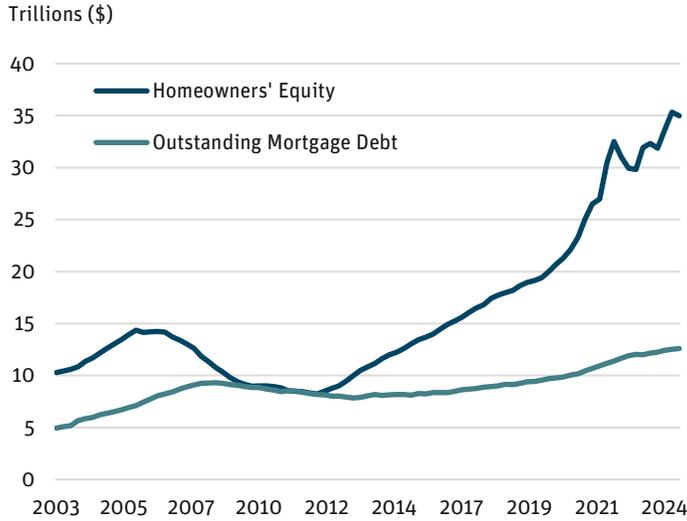
Renter Households (Millions)



Source: U.S. Census Bureau, FRED as of 11/30/24.

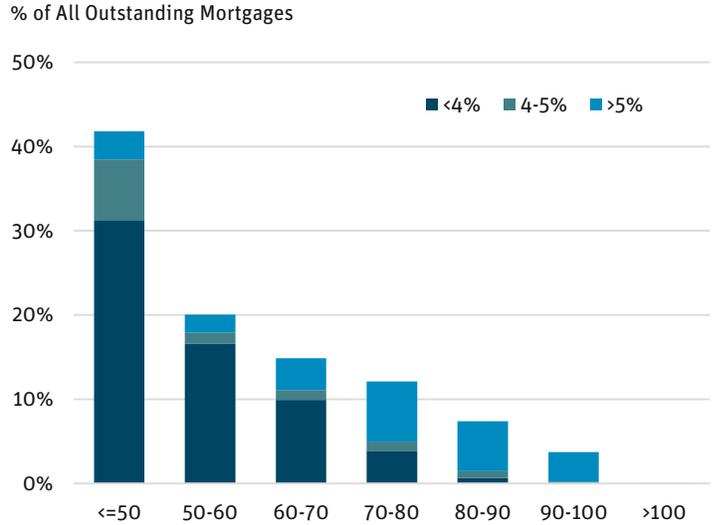
Home equity extraction products such as HELOCs and second liens are forecast to continue to grow in 2025. In a rate environment that can be described as “higher for longer,” we believe both products could see issuance roughly double to \$20 billion in 2025, with Angel Oak set to come to market with its first stand-alone HELOC securitization in early 2025. Approximately 90% of Agency borrowers have a loan-to-value (LTV) below 80%, with home equity in the U.S. estimated to be over \$35 trillion.

### Homeowners' Equity



Source: HAVER, Nomura as of 11/30/24.

### Outstanding U.S. Residential Mortgage Market by Rate & LTV



Source: Bloomberg, Fannie Mae, Freddie Mac as of 11/30/24.

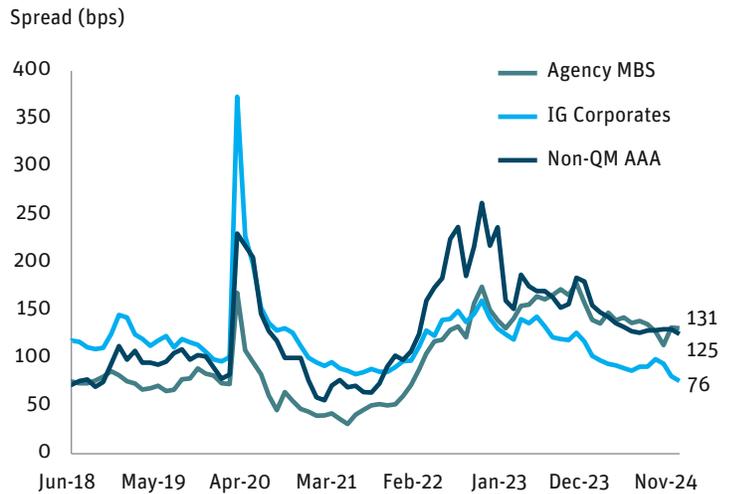
### Securitization Trends

The securitization rate for Non-QM was approximately 50% in 2024, down from over 80% in 2022. According to BAML research, the insurance industry has raised \$1 trillion in annuity products over the past four years, primarily targeting the U.S. population that is 65 and over. These products have filled insurance coffers with capital that needs to be put to work in public and private credit sectors such as residential mortgages. We believe insurance company participation in the space provides diversification and support to a market with additional outlets away from capital markets and securitization.

Non-QM Triple A spreads were at roughly 115-120 basis points (bps) as 2024 ended. This compares to the wides of 250-300 bps in Q4 2022 and approximately 50-60 bps for the tightens in 2021. So, where do spreads go from here? We expect spreads to have a tightening bias in 2025, with Non-QM Triple A's an attractive relative value play in our view. Further potential tightening in the investment grade corporate credit market also provides support for relative value in Non-QM.

A few additional factors that have the potential to lead to tighter spreads include flows into fixed income money managers and a pickup in prepaids and deal calls leading to further reinvestment needs. Looking at the key participants at the top of the capital structure in Non-Agency, we are optimistic heading into 2025.

### Spreads Across Sectors



Source: Bloomberg, Yield Book, Nomura as of 11/30/24.

### Supply Outlook for Key Non-QM Investor Groups

Investor Type	Expectation for 2025	Estimated Inflows		Upside/Downside Risks
		2023	2024	
Money Manager	Elevated	\$3bn/week (fixed income funds)	\$9bn/week (fixed income funds)	Equity/fixed income rebalancing, level of rates, macro volatility
Annuity (Insurance)	Elevated	\$41bn/quarter sales of fixed rate deferred annuities	\$42bn/quarter sales of fixed rate deferred annuities	Higher penetration vs. lower rates

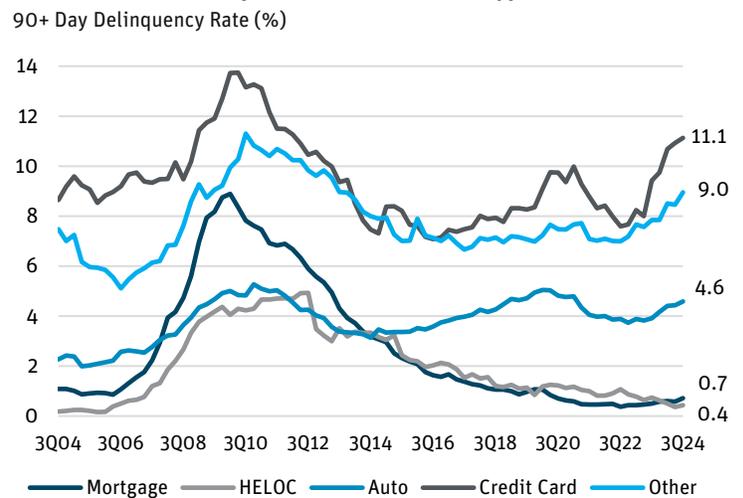
Source: Nomura as of 11/30/24.

### Credit and Prepayment Fundamentals

The fundamentals can be summarized as being supportive overall for the U.S. housing sector, with specific pockets of weakness from a geographical perspective. Delinquencies in residential credit have been minimal, with less than 1% of borrower delinquencies at 90 days or greater. This compares to 4.6% in auto loans and 11.1% in credit cards according to the NY Fed, as shown in the chart below. Loss rates have been very low across the residential credit sector.

That being said, we believe there are areas of concern on a local level, with specific geographic areas facing rising inventories coupled with higher insurance premiums. We believe these issues are region specific and not representative of the overall housing market, taking into account areas such as the Northeast and Midwest, where conditions are stable in our view. Overall delinquency rates for Non-QM have seen a slight pickup since mid-2022 to approximately 3%-4%. However, cumulative losses for the sector have remained low at 2 bps across \$160 billion of origination since 2018. As we wrote in our recent whitepaper, [A Deep Dive into Non-Agency Credit Performance](#), FICO credit scores and LTV ratios are two of the main drivers of higher delinquencies among Non-QM collateral. The mortgages that have transitioned from delinquent to default and liquidation largely have FICO scores below 700 and LTVs above 80%. While loans with FICO scores below 700 make up 18% of the outstanding Non-QM universe, they are responsible for approximately 40% of the mortgages in foreclosure and REO. Mortgages above 80% LTV make up 11% of the outstanding unpaid principal balance of Non-QM loans but are responsible for approximately 22% of the FC/REO balance.

#### Share of Serious Delinquent Loans Across Debt Type



Source: New York Fed Consumer Credit Panel/Equifax as of 11/30/24.

Along with delinquencies and credit losses, the additional return driver for investors is prepayment speeds. We believe prepayment speeds will remain muted in 2025. Once again, a higher-for-longer rate environment as a base case should lead to a reduced refinancing incentive for borrowers with rates in the 4%-7% area, with faster prepayment speeds likely for the higher-coupon mortgages originated during the 2023 vintage of 8% or above. Our proprietary modeling suggests the following prepayment speeds for Non-QM given changes to the prevailing Agency rate.

#### Bank Statement: Forward Projected CPR in Two Years

WAC	WALA	Base Agency Rate	Agency Rate After Shock From Base Rate			
			-50 bps	-100 bps	-150 bps	-200 bps
8%	3	6.9%	6.4%	5.9%	5.4%	4.9%
7%	3	6.9%	6.4%	5.9%	5.4%	4.9%
7%	3	14%	19%	25%	33%	42%
6%	30	7%	8%	12%	16%	22%
5%	36	6%	6%	6%	8%	11%

#### Investor Cash Flow: Forward Projected CPR in Two Years

WAC	WALA	Base Agency Rate	Agency Rate After Shock From Base Rate			
			-50 bps	-100 bps	-150 bps	-200 bps
8%	3	6.9%	6.4%	5.9%	5.4%	4.9%
8%	3	18%	25%	32%	32%	33%
7%	3	10%	14%	18%	25%	32%
6%	30	5%	6%	9%	12%	16%
5%	36	4%	4%	4%	6%	8%

Source: AOCA as of January 2025.

Another driver of potential slower speeds in Non-QM is the shrinking difference between Non-QM and Agency rates. As the Non-QM sector continues to mature, the spread between Non-QM and Agency rates has tightened from 200-300 bps back in 2020 to as low as sub-100 bps in H2 2024, which has contributed to the reduced rate incentive in Non-QM, specifically.

### Angel Oak Perspective

Angel Oak continues to be well positioned as a consistent issuer and leader in the Non-Agency space. We continue to stay conservative relative to our peers and have focused our efforts on being selective as opposed to looking to capture volume in an uncertain economic environment. Even as animal spirits seem to have returned across sectors, we remain focused on delivering good-quality credit performance as shown in our outperformance relative to peers since 2022. Our 2023 and 2024 purchases exhibit a noticeably cleaner profile than previous vintages, with higher average FICO, lower LTV, and significantly smaller tails in those metrics.

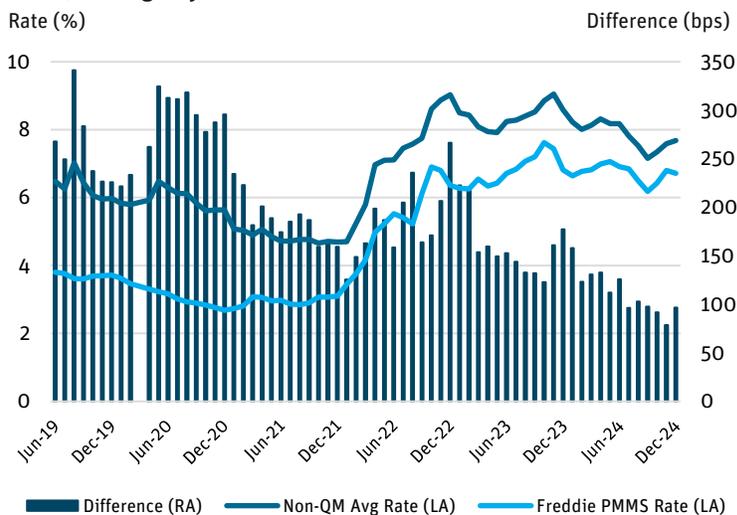
### Angel Oak Loan Purchase Summary by Purchase Year

Purchase Year	Average Loan Size	WA FICO	WA LTV	WA DTI	% FICO <680	% LTV >80%	% DSCR	% Investor
2021	\$510,729	743.7	71.6%	31.5%	7%	21%	17%	27%
2022	\$484,761	738.9	72.0%	32.0%	9%	19%	29%	37%
2023	\$404,279	751.2	70.5%	31.5%	2%	5%	39%	49%
2024	\$492,008	754.9	70.4%	32.2%	2%	6%	34%	44%

Source: AOCA.

In another example, our concentration of CPA/P&L only loans continues to be well below that of our competition. These mortgages are available in the market for borrowers who prefer to provide a profit and loss statement for their small business as opposed to sharing bank statements. Delinquency rates have been higher for these mortgages as compared to other programs, particularly in 2022 and 2023 as shown to the left.

### Non-QM vs. Agency Rate



Source: AOCA, Bloomberg, Freddie Mac as of December 2024.

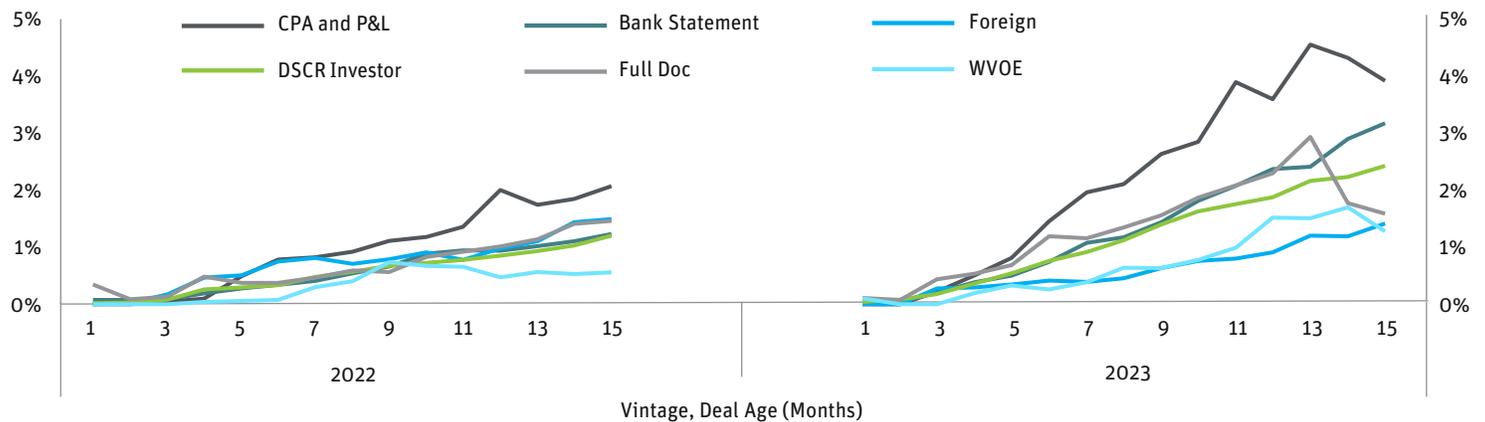
### Product Distribution Across Shelves for 2023 and 2024 Origination

Non-QM Product Type	Angel Oak	Issuer 1	Issuer 2	Issuer 3
Full Doc	5%	5%	5%	5%
Bank Statement	52%	21%	31%	42%
Investor	36%	46%	38%	42%
CPA and P&L	2%	14%	13%	5%
WVOE	0%	6%	8%	0%
Asset Depletion	2%	1%	1%	2%
Foreign	3%	6%	3%	3%

Source: CoreLogic, Nomura as of Q4 2024.

### 90+ Day Delinquency Rates by Vintage and Product Type

90+ Day Delinquency Rate (%)



Source: CoreLogic, Nomura as of Q4 2024.

In 2024, we securitized \$4.8 billion across 14 Non-QM deals, the highest annual volume we have securitized since inception. We plan to continue securitizing loans in a timely manner, reducing the need and potential risks of holding loans on warehouse lines for extended periods. We have grown our infrastructure with the addition of a 25+ person support team to manage the increased securitization activity and whole loan purchase activity.

To reiterate the positive factors for Non-Agency mortgage investing, the potential for stable to tightening Triple A spreads, strong credit performance, and muted prepayment speeds lead us to believe that we are in a very favorable environment. Additional areas of growth include home equity extraction products (HELOCs, etc.) and potential market expansion related to a reduction in Agency activity within the U.S. housing market. Risks to consider include a potential dramatic rate rally leading to faster-than-anticipated prepayment speeds on recent securitizations and collateral or a potential worsening housing market that is broad based as opposed to region specific. In addition to strong demand and household formation, a decline in rates has generally been associated with a favorable environment for housing. So, faster prepaes may lead to a decline in return potential, but they support capital preservation by improving affordability for potential homeowners. The median age of first-time homebuyers increased to a record high (38) in 2024, and a decline in rates associated with an economic contraction has the potential to increase housing demand particularly for first-time homebuyers.

We continue to focus on taking a conservative approach to credit, growing our securitization and insurance solutions platforms and continuing to provide creative solutions for clients to access the asset class. We look forward to meeting you all in person in 2025.

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