

Beyond the Rate Headlines

A CIO Perspective on Residential Credit

At Angel Oak's 2026 Investment Forum, Manish Valecha, Head of Capital Solutions, sat down with Namit Sinha, Chief Investment Officer, to discuss the Non-Agency mortgage market. Their conversation explores the evolution of the Non-QM sector, trends in borrower behavior and prepayments, and the role of homeowner equity in supporting residential mortgage credit performance.

Q: What are some of the macroeconomic indicators that you monitor most closely when managing mortgage credit portfolios?

A: Beyond the loan-level attributes we can analyze directly, there are three primary macroeconomic variables that drive mortgage credit performance: housing, interest rates, and employment.

Housing matters because home-price performance directly affects the amount of equity supporting a mortgage. One challenge with Non-QM is that the asset class has largely existed during a period of positive home-price appreciation, meaning historical data can only tell us so much about how loans would perform during a prolonged period of broad home-price declines. As a result, we rely heavily on stress testing and downside analysis when evaluating risk.

Interest rates and employment are equally important. Most Non-QM mortgages are fixed-rate loans, so higher rates do not directly affect monthly mortgage payments. They do, however, affect household finances, refinancing behavior, and borrower flexibility. We saw that during 2022 and 2023, when the front end of the yield curve moved roughly 450 basis points. We adjusted our credit box during that period in anticipation of the pressure higher rates would place on consumers. That ultimately showed up in performance, as the 2023 vintage proved to be the weakest for Non-QM from a delinquency standpoint. Our peers experienced delinquency rates of 9% to 10%, while ours were less than half that level. Employment ultimately determines whether borrowers have the income needed to service their obligations, which is why we monitor all three variables together rather than in isolation.

What is particularly notable about this housing cycle is how localized it has become. National averages only tell part of the story because supply-and-demand dynamics vary significantly across markets. In some areas, higher rates have constrained supply enough to support home prices despite affordability challenges. That dispersion reinforces the importance of analyzing housing at the local level and preparing portfolios for a range of economic outcomes.

Q: Considering today's higher interest rate environment, how are you positioning the portfolios you manage?

A: We expect performance dispersion across the Non-QM market to increase again. We saw that in 2023, when some portfolios experienced relatively modest delinquency levels while others came under significantly greater pressure. As rates moved lower, performance became more uniform. If rates remain elevated, differentiation among borrowers, collateral, and issuers is likely to become more pronounced.

Our focus remains on borrower credit quality, leverage, housing fundamentals, and cash-out activity. We are also monitoring how borrowers access the substantial home equity accumulated in recent years, particularly through HELOCs and second liens. Those decisions can provide important signals about borrowers' financial health.

It is also important to distinguish credit risk from market and financing risk. Much of the disruption during the 2022–2023 rate cycle was driven by duration extension, financing pressure, and volatility in securitization markets rather than widespread deterioration in underlying credit. The market can generally adjust to an orderly move in rates. The greater challenge arises when rates move rapidly and unpredictably.

Our approach is to identify emerging pockets of risk early, stress test portfolios, and adjust portfolio construction before any deterioration becomes visible in reported performance.

Q: How is the Non-QM market evolving, and what are you seeing in borrower behavior and prepayment trends?

A: The Non-QM market has matured significantly over the past several years. The borrower base is broader, collateral quality has improved, and the spread between Non-QM and agency mortgage rates has narrowed. In many cases, borrowers can access Non-QM financing at rates only modestly higher than agency alternatives, which has changed refinancing and prepayment behavior.

This narrowing gap is likely the result of several factors, including the strong credit performance of Non-QM loans and softer demand within the agency market. The Federal Reserve, foreign central banks, and other traditional agency buyers may not be as active as they once were, creating a different set of market dynamics. The bottom line is that the propensity for Non-QM borrowers to refinance and prepay has declined.

Even when borrowers have the opportunity to refinance into a lower rate, prepayment speeds have generally been more muted than historical models would suggest. That effect is particularly evident in DSCR loans, where prepayment penalties can further moderate refinancing activity.

Recent seasoned Non-QM transactions have generally prepaid in the mid-to-high teens CPR range, compared with the 25% to 30% levels that were more common in earlier vintages. Prepayments would likely accelerate if rates declined materially, but the increase may be more measured than many investors expect.

For investors, slower and more stable prepayment behavior can improve cash flow visibility and reduce uncertainty around asset performance.

Q: How do you think about hedging mortgage credit risk?

A: We generally do not hedge mortgage credit risk directly. Instead, we focus on originating the right loans and stress testing portfolios across a range of home-price and economic scenarios. Risk management is most effective when it begins with disciplined underwriting and portfolio construction rather than relying primarily on external hedging strategies.

The objective is to understand how a portfolio is likely to perform under different conditions before the loans are originated. If the underlying credit characteristics are strong, a weaker environment may result in higher delinquencies or losses, but those outcomes should remain within the range anticipated during the underwriting process. We place greater emphasis on building resilient portfolios through disciplined loan selection and risk management than on attempting to hedge credit risk after the fact.

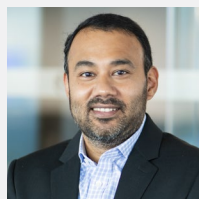
Q: How do you think about the relative value of mortgage credit today compared with other areas of asset-backed finance or corporate credit markets?

A: I have relatively high conviction in mortgage credit because the foundation of the asset class remains exceptionally strong. Today, there is roughly \$50 trillion of single-family housing value in the United States supported by approximately \$15 trillion of mortgage debt, leaving homeowners with an estimated \$35 trillion of equity.

That equity matters. Historically, mortgage credit has outperformed most other segments of consumer credit, and homeowners tend to demonstrate stronger performance across credit cards, auto loans, and other consumer obligations. Although affordability remains challenging and home prices may be declining in real terms in some markets, mortgage investors lend against nominal assets and receive repayment in nominal dollars. As long as borrowers maintain equity and the capacity to service their debt, the credit backdrop remains supportive. We therefore expect mortgage credit to remain a relatively defensive area of the market and offer diversification benefits should other parts of consumer credit come under pressure.

Mortgage credit benefits from being backed by a hard asset, and we believe the variability of that collateral is likely to remain limited given the homeowner equity and mortgage debt dynamics discussed earlier. That is a different dynamic than what investors face in many areas of corporate credit, where company fundamentals can change rapidly due to technological disruption, competitive pressures, regulatory developments, or shifts in market demand.

The principal risk is that interest rates remain elevated for longer than expected. Higher rates place pressure on asset prices and financing conditions across financial markets. We remain constructive on housing and mortgage credit, but investors should continue to be mindful of how a prolonged higher-rate environment could affect valuations, financing conditions, and the broader economy.



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