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Angel Oak Stresses Viability of Nonprime Lending, Demand for Higher-Priced Loans

Originating nonprime mortgages can be done without repeating the mistakes that contributed to the financial crisis, according to officials at Angel Oak Mortgage Solutions. The firm, one of the most prominent lenders in a severely constrained market, launched in early 2014 and offers nonprime mortgages via wholesale and correspondent channels.

Tom Hutchens, a senior vice president of sales and marketing at Angel Oak, said the lender is comfortable extending nonprime mortgages due to downpayment requirements and ability-to-repay standards. "Those two things really change the dynamics, and the performance, ultimately, of these types of loans," he said during a recent webinar hosted by the lender.

Eric Morgenson, a sales manager at Angel Oak, said the lender has originated close to 1,300 mortgages, only two of which have gone more than 90 days delinquent. The Atlanta-based lender focuses on nonprime and non-qualified mortgages. The average credit score is 680.

Hutchens said Angel Oak often works with borrowers who experienced a credit event such as a foreclosure or short sale that hasn't seasoned enough for the borrower to qualify for an agency mortgage. He noted that there was plenty of demand for nonprime mortgages before the financial crisis.

"We believe quite strongly that those borrowers haven't gone away," Hutchens said. "Unfortunately, the loan programs available to those borrowers have gone away."

Hutchens stressed a number of differences between today's nonprime mortgages and those originated before the financial crisis. In the past, subprime borrowers could get loans with 100 percent combined loan-to-value ratios, he said, but now they have to make a downpayment with funds that are sourced and seasoned, and meet reserves requirements.

Still, downpayment requirements on nonprime mortgages have loosened somewhat. Angel Oak recently started allowing combined LTV ratios as high as 90 percent for borrowers with credit scores above 680.

Morgenson noted that gift funds can cover all of a borrower's downpayment. And Angel Oak considers money in a borrower's bank account to be "seasoned" as long as the funds have been there for at least 30 days.

Hutchens noted that appraisal independence is much improved since the financial crisis, giving industry participants more confidence regarding LTV ratios.

He added that Angel Oak puts an emphasis on borrowers' front-end debt-to-income ratios, which track the burden of a borrower's monthly mortgage payment. Hutchens said the firm works for borrowers to have front-end DTI ratios of about 35.0 percent.

He said a borrower with a 45.0 percent front-end DTI ratio doesn't have much "wiggle room" to make their mortgage payment should financial issues arise. "For a borrower with a 25.0 percent front-end DTI ratio, there's a lot of room in their debt load," Hutchens said.

Morgenson said Angel Oak allows front-end DTI ratios as high as 40.0 percent and back-end DTI ratios as high as 50.0 percent, with compensating factors. "The borrower [would need] a boatload of reserves in the bank, have job stability or there's something in their history that's explainable," he said.

He said the nonbank also works with borrowers who predominantly derive income from investment properties as opposed to wages reported on W-2 documents.

Hutchens noted that Angel Oak has a bank statement program aimed at self-employed borrowers. “Their tax returns may not necessarily reflect their true income due to business write-offs,” he said.

Morgenson said the company’s bank statement program is particularly popular. While some nonprime lenders will only qualify borrowers based on 50 percent of the funds in a borrower’s account, he said Angel Oak underwrites based on 100 percent of the funds.

Strong Margins

Morgenson said the lender doesn’t offer agency mortgages, noting that there’s strong competition and low margins. Interest rates on Angel Oak loans range from 5.00 percent to close to 10.00 percent.

“The only way to get purchasers into this market is for them to be compensated with a higher rate of return to take on the risk,” Hutchens said. “The 4.00 percent conforming interest rates do not apply in a nonprime environment.”

Morgenson said Angel Oak borrowers don’t expect to get a low interest rate on a nonprime mortgage. “These borrowers are delighted they can even get a loan,” he said.

Hutchens said many nonprime mortgages are defined as high-priced mortgage loans under regulations administered by the Consumer Financial Protection Bureau. He said the loans have points and fees ranging from 3.00 percent to 5.00 percent of the loan amount and interest rates from 1.50 percent to 6.50 percent above the average prime offer rate.

He noted that high-priced mortgages are very different from high-cost mortgages, which have points and fees ranging from 5.00 percent to 8.00 percent of the loan amount and interest rates at least 6.50 percent above APOR. “[High-priced mortgages] are much safer than high-cost loans and always meet the ability-to-repay requirements.”

High-cost loans are subject to onerous regulatory requirements, while high-priced mortgages also must meet stiffer requirements than qualified mortgages.

To this point, Angel Oak has delivered its originations to investors, including to a fund managed by an affiliate. A non-agency mortgage-backed security from Angel Oak Mortgage Solutions and Nomura Securities has been in the works, but has met with repeated delays this fall.

All of Angel Oak’s originations are manually underwritten, which can be slower than automated underwriting. Officials at the lender repeatedly stressed that manual underwriting has some benefits. “We don’t have a computer saying ‘no’ to loans that might make sense,” Hutchens said. “We are making underwriting credit decisions loan-by-loan.”

Hutchens added that the majority of Angel Oak’s originations have been purchase mortgages, which are particularly sensitive to processing times. “We know how to meet closing dates,” he said.

Morgenson said the mortgages include representations-and-warranties protection regarding fraud for the life of the loan. He said if the originator knew about fraud, they are forced to buy back the loan. Otherwise, he said, Angel Oak doesn’t pursue buybacks from brokers and correspondents.

Outlook

Hutchens said public perception regarding nonprime lending continues to evolve. “We expect the market for non-agency mortgages to see significant growth as availability, awareness and demand for these products continues to develop,” he said.

Morgenson added that when interest rates increase, more lenders will consider offering nonprime mortgages and non-QMs. “Everybody is going to scramble to alternative loan programs to make up for lost refinance business,” he said.

Morgenson predicted it will be at least five years before major banks are comfortable offering nonprime products again. “They can’t handle the headline risk,” he said.

In the meantime, one of Angel Oak’s top brokers has been sourcing borrowers directly from bank retail originators who turn down nonprime borrowers.