Q&A: The Growing Opportunity Surrounding Second Liens and HELOCs

In this Q&A, Adam Beeler, Head of Institutional Sales at Angel Oak Capital Advisors, and Tom Hutchens, Executive Vice President of Production at Angel Oak Mortgage Solutions LLC, NMLS ID #1160240, a sister company to Angel Oak Capital Advisors, discuss the emergence of and opportunity surrounding second lien mortgages and home equity lines of credit (HELOCs).

Q: Tell us about Angel Oak Mortgage Solutions. What is the firm's history in the mortgage origination space?

A: Angel Oak Mortgage Solutions has been around for over ten years. We introduced non-agency mortgages after the great financial crisis. Due to regulations, these mortgages have since been labeled "non-qualified," and many people know them now as "non-QM." We have been originating non-QM loans almost exclusively for over ten years with historically proven processes, procedures, and guidelines. Angel Oak Mortgage Solutions has a long track record and an experienced team across sales, operations, and probably most importantly, credit risk.

Q: Can you explain how underwriting for second liens and HELOCs is different than it is for a traditional first mortgage?

A: The underwriting is essentially the same, though there are different regulations around second liens, such as disclosures and what needs to be provided to the borrower. People ask if ability to repay (ATR) is considered. Although it's not a guideline or a regulation that we have to follow, it's one that we absolutely do. We have a documented ATR on every single transaction we fund, and we believe that's how we make good loans.

Ultimately, second liens and HELOCs have presented themselves as opportunities in the current market because in the post-COVID era, so many people are locked into low mortgages and find themselves with tons of equity. According to recent marketplace statistics, the average homeowner has $308,000 in equity in their home—it wasn't long ago that the average price of a house was less than that. With rising levels of credit card debt, second liens and HELOCs give borrowers an opportunity to tap into their equity and put themselves in a much better financial position.

Q: What are the basic differences between a second mortgage and a HELOC?

A: A closed-end second lien is funded at the closing table, and then you pay that back over a 15-, 20-, or 30-year period, just like a first lien mortgage.

Comparatively, a HELOC is a line of credit. If a borrower comes to us for a $300,000 HELOC, they don't have to draw the entire amount at the closing table. (Not to get into the weeds, but they do have to draw 80% of the line up front.) Then, going forward over a five- or ten-year period, it's a cash flow management product. They can pay it down or tap into it every single month, and they're only paying interest on their outstanding balance for that month.

Business owners and self-employed borrowers—the base Angel Oak Mortgage Solutions has been serving for the past decade—understand cash flow management. A large part of the reason we have seen such a rush to HELOCs is that they give these self-employed borrowers flexibility for both personal use and perhaps cash management in their businesses. That's where the market is currently. We've tapped into this new product over the past few months, but it's growing rapidly.

Q: How does Angel Oak Mortgage Solutions originate second liens and HELOCs?

A: We originate them through the same broker network through which we originate first liens. It's been exciting for our brokers because they know the number of borrowers for whom they originated 4% to 4.5% bank statement loans over the past several years. Those borrowers are not going anywhere—they're not selling, they're not buying, and they're not interested in cash-out given current interest rates. Our brokers are going back to these borrowers who they know have a lot of equity and asking, "What's your financial situation?" They essentially become consultants—if a broker learns, for example, that a borrower is running $50,000 of credit card debt at 25% to 30% interest rates, they can say, "I have a solution for you." Our brokers are out there having these conversations with borrowers and homeowners every single day.

Q: It would make sense for HELOCs to be a bank product. Do you believe the increased rules, regulations, and capital ratios for banks, especially small to midsize banks, have made it more difficult for banks to be competitive?

A: Absolutely. Our broker base is not accustomed to originating HELOCs, because in the past, a borrower could simply walk into their bank and say, "I need a $50,000 HELOC." They'd sign a piece of paper and then could tap into it and pay it down, just like we do today. Now, because of increased regulations, HELOCs must be originated in a manner similar to a first lien mortgage. That has been both a big change and a big opportunity, because we can scale this much more effectively than the community banks, who were waiting for their customers to walk in and say, "I need this."

Q: What are the CLTVs for loans that Angel Oak Mortgage Solutions is running the underwriting processes and procedures for?

A: We allow a CLTV of up to 85%, but we aren't seeing anything close to that being requested right now. We're mostly seeing 60% to 65% CLTV.

Q: What is the typical loan size that Angel Oak Mortgage Solutions originates?

A: We'll go up to a $750,000 closed-end second lien, capping it at a 70% to 75% CLTV at that amount. For HELOCs, we'll go up to $500,000, but we're seeing loan amounts that are lower than that. However, we're seeing pretty good sizes—$200,000 to $250,000 second liens, whether they're closed-end or HELOCs.

Tom Hutchens
Executive Vice President of Production
Angel Oak Mortgage Solutions

Adam Beeler
Head of Institutional Sales
Angel Oak Capital Advisors

For more information about Angel Oak Mortgage Solutions, including resources, product highlights, and a coverage map, visit www.angeloakms.com.

This document does not constitute advice or a recommendation or offer to sell or a solicitation to deal in any security or financial product. It is provided for informational purposes only and on the understanding that the recipient has sufficient knowledge and experience to be able to understand and make their own evaluation of the proposals and services described herein, any risks associated therewith and any related legal, tax, accounting or other material considerations. To the extent that the reader has any questions regarding the applicability of any specific issue discussed above to their situation, please contact Angel Oak Mortgage Solutions or consult with the professional advisor of their choosing.

There is no guarantee that the investment objectives will be achieved. Moreover, the past performance is not a guarantee or indicator of future results.

Angel Oak Mortgage Solutions – NMLS ID #1160240 (NMLS Consumer Access).