STRUCTURED FINANCE ASSOCIATION

SFA Research Corner

Home Equity Revival: Trends in Non-Agency RMBS

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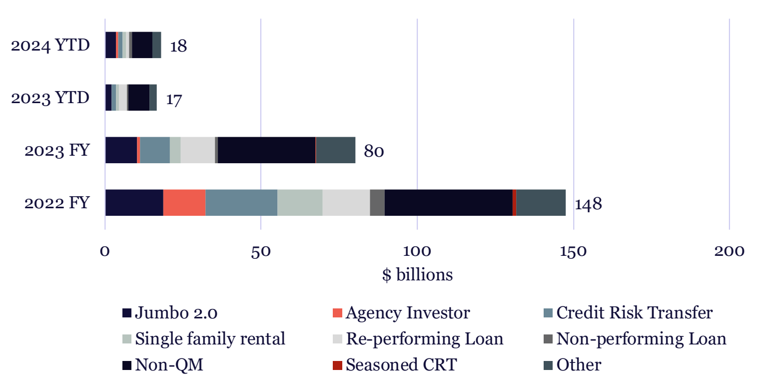
Non-Agency RMBS issuance, which exhibited robust performance in January compared to the previous year, experienced a slowdown in February as market attention shifted to SFVegas, the industry's premier conference. Currently, new supply stands at $18 billion, in line with the volume at this time in 2023, according to J.P. Morgan. As in previous years, the primary drivers of issuance this year, accounting for 72% of total issuance, have been Non-QM-backed deals (36%), Jumbo mortgages (20%), Other (16%), and Credit Risk Transfer securities (8%).

In the Other category, RMBS backed by Home Equity Lines of Credits (HELOCs) and Closed-End Second (CES) loans, also known as Home Equity Loans (HELs), have emerged as the leaders, boasting $1.4 billion in issuance to date.

HELOCs and CES loans allow borrowers access to their accumulated home equity (which has reached a record high of $31 trillion, according to the Federal Reserve) while typically holding a subordinate position to a first-lien mortgage. As reported by Deutsche Bank Research, a CES loan today typically features an average balance ranging from $85,000 to $95,000. It is a fixed-rate loan that disburses funds in a single lump sum and has a repayment period of about 10 years, commencing immediately.

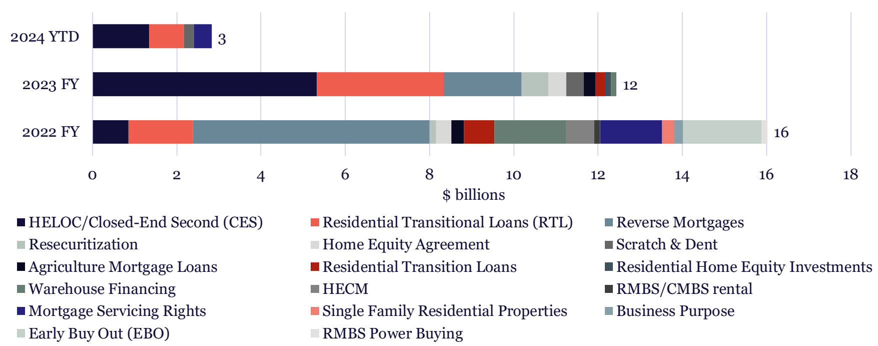
In contrast, a HELOC is typically smaller, with an average balance of approximately $65,000. It features a variable interest rate and has a draw period of 5 to 10 years, during which borrowers have the flexibility to access funds up to their pre-set borrowing limit. Following the draw period, a repayment period of 5 to 10 years begin, during which additional draws are no longer permitted.

Non-Agency RMBS Issuance by $ amount



Source: J.P. Morgan Non-Agency RMBS Research

"Other" Category Issuance Led by HELOC/CES Collateral



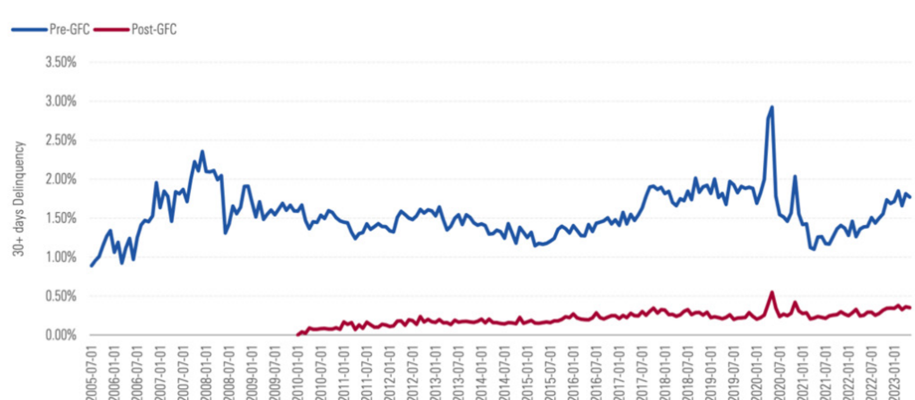
Source: J.P. Morgan Non-Agency RMBS Research

Before the 2008 financial crisis, HELOC and CES securitizations were widespread, with issuance reaching peaks of $52 billion and $59 billion, respectively, in 2006, according to Deutsche Bank Research. However, after 2008, there was a significant decrease in the issuance of HELOC and CES-backed RMBS. This decline was driven by various factors, including depreciating home values between 2008 and 2012. As the housing market gradually recovered, supply remained limited due to tighter lending standards, regulatory reforms, and a shift away from home equity products. Banks, in particular, pulled back on lending as higher capital requirements made these loans less attractive, further constraining supply.

It was not until nearly a decade later that HELOC and CES-backed RMBS reemerged, fueled by small nonbank financial entities increasing production. Factors such as low inventory levels, strong demand from buyers, and favorable mortgage rates led to significant appreciation in home values, providing an opportune environment for the resurgence of HELOC/CES products, funded through RMBS.

Present-day HELOC loans differ significantly from those issued pre-2008, reflecting more stringent underwriting criteria and adjustments aimed at mitigating risk and ensuring greater market stability. Notably, these changes have led to lower delinquency rates compared to loans originated before the 2008 financial crisis, as observed in a recent commentary by Morningstar DBRS. Moreover, concerns about the "using-the home-as-an-ATM" mindset, which contributed to the 2008 housing crisis, are now less prevalent due to higher interest rates. KBRA's 2023 sector outlook noted, "the potential for equity release products such as CES and HELOCs is evident. Borrower demand is fueled by several factors, including rising living costs, relatively stagnant wages, and a decline in personal savings rates." The rating agency continues, "[in] a less volatile market, this demand would more typically be met with cash-out refinance products… would-be borrowers are not interested in refinancing their full mortgage balance (and then some) at unfavorable rates." Encouraged by this demand, market participants anticipate that the issuance of HELOC/CES-backed RMBS in 2024 will either match or slightly surpass the $5 billion recorded in 2023.

Delinquency History of HELOC Loans Originated Pre-2008 and Post-2008



Source: Black Knight Inc and Morningstar DBRS