White Paper

Why ADU Financing Deserves More Attention From Home Equity Lenders

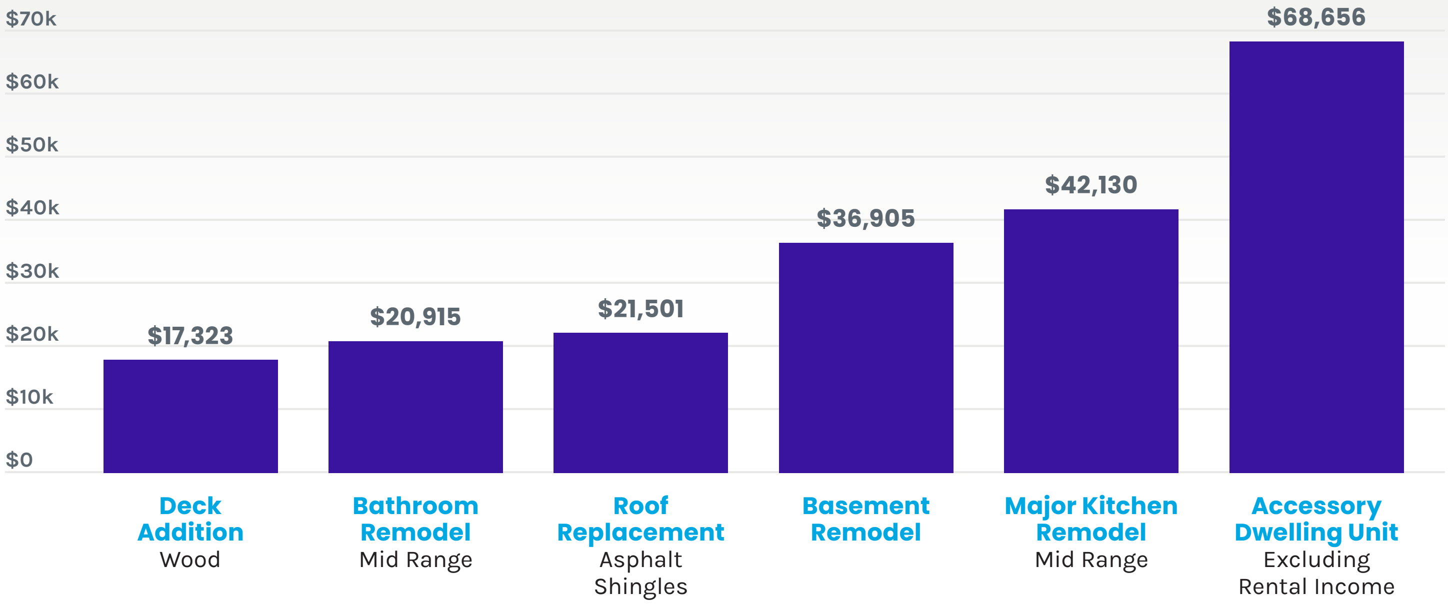
By FirstClose

A Growing Borrower Need

Accessory Dwelling Units (ADUs) have moved from a niche housing solution to a meaningful and growing segment of residential development. ADUs now represent a significant share of new housing permits and are projected to grow at a 9% annual rate through 2035, driven by affordability pressures, the 'lock-in' effect caused by pandemic-era mortgage rates, a growing preference for multi-generational household, and the potential for rental income. [1, 3]

To finance these projects, borrowers are increasingly turning to home equity products. In some markets, as many as 1 in 4 ADUs are partially financed through a Home Equity Line of Credit (HELOC) or Home Equity Loan.[2] This trend is a valuable opportunity for lenders for several reasons.

Average Nominal Home Value Increase by Home Improvement Project



Source: The Journal of Life Construction; jlconline.com/cost-vs-value/2025

The Benefits of ADUs

One inherent benefit of ADUs for lenders is their larger loan sizes. With project costs often reaching six figures, these loans can be significantly larger than typical home improvement loans, creating opportunities for higher balances and increased revenue per loan.

A second benefit is the potential for higher nominal property value compared to other home improvement projects. ADUs can add functional living space and, in some markets, income-generating potential. This can lower CTLV, creating additional headroom to support larger loan amounts while maintaining policy limits or providing a stronger equity cushion.

Lastly, ADUs can also influence long-term borrower behavior. Rental income generated from an ADU may strengthen a borrower's financial profile over time, potentially enabling future borrowing. Consider the example of Blanca, a homeowner in Sacramento:

> **"Take Blanca Barragan, a 43-year-old electrician who has rented out rooms in her Sacramento home for years.** It's called house hacking, and for Barragan, it's been a path toward what she really wants: to buy even more real estate… Barragan said she had earned $55,780 from renting out the micro-studios in her 583-square-foot home. Over the years, that income has helped her buy her eldest son a $360,000 house—on which she is a co-borrower—and qualify for a loan to add a tiny home in her backyard." [3]

This illustrates how ADUs can contribute to deeper, ongoing borrower relationships.

The Operational Challenge for Lenders

While there are clear benefits for lenders and borrowers, the unique nature of ADUs introduces some subtle but important complexity for a lender's operations. Because ADUs are larger, more capital-intensive projects than standard home improvement projects, they can sometimes introduce appraisal complexity. There are two common approaches to valuation:

- **As-is Valuation (most common).** Many lenders underwrite HELOCs and home equity loans based solely on the property's current value, regardless of the borrower's plans. In these cases, no ADU-specific appraisal is required, no project documentation is needed for valuation, and the ADU is treated purely as a use of proceeds. This aligns with traditional home equity underwriting.
- **Subject-to-Completion Valuation.** Some lenders choose to evaluate the future value of the property after the ADU is completed. In these cases, the process may require preliminary plans or schematic drawings, contractor cost estimates, and/or a rental market analysis if rental income is considered. This approach is typically used when the borrower needs the projected value to qualify or when the ADU significantly impacts collateral value.

This creates a strategic decision for lenders—lenders that rely solely on as-is valuation may limit loan size and borrower eligibility. Those that can support subject-to-completion valuation may be able to qualify more borrowers or extend larger loan amounts.

Supporting ADU Use Cases with Configurable Workflows

Supporting ADU-related lending does not require new loan products, but it does require workflow flexibility. FirstClose XpressEquity supports this through configuration rather than specialization.

Lenders can define internal loan programs within their LOS such as HELOC—ADU (Non-Rental) and HELOC—ADU (Rental). XpressEquity Digital Application can automatically detect and expose these loan programs to help borrowers choose the right program for them. These unique loan programs can in turn allow lenders to leverage differentiated pricing strategies and make risk-based adjustments.

Through configurable order management logic, lenders can also pre-select appropriate the appraisal types and trigger additional services, such as rental market analysis, when needed. Importantly, this logic can be applied only when required, preserving standard workflows for simpler loans.

ADU financing highlights a broader shift in home equity lending: borrowers are using familiar products for increasingly complex projects. Lenders that can adapt their workflows—without introducing operational friction—will be better positioned to accommodate evolving borrower needs and capture higher-value opportunities.

Sources

[1] https://www.businessresearchinsights.com/market-reports/accessory-dwelling-unitmarket-118266

[2] https://www.urban.org/sites/default/files/2024-04/Final_To_Increase_the_Housing_Supply_Focus_on_ADU_Financing.pdf

[3] https://www.businessinsider.com/why-people-build-adus-housing-cost-benefits-cheaper-than-moving-2025-5

[4] https://www.jlconline.com/cost-vs-value/2025/

About FirstClose

Headquartered in Austin, Texas, FirstClose, Inc. is a leading fintech provider of data and workflow solutions for mortgage and home equity lenders nationwide. The company's mission is to increase profitability and reduce costs for mortgage lenders through systems and provider relationships that enable lenders to serve borrowers more effectively, reduce closing costs, and shorten closing times.

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