STRUCTURED FINANCE ASSOCIATION

Research Corner

July 20, 2020

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Research Corner - Market Signals

Market summary –Over $7.5 billion of new securitizations have been issued so far in July with most of the supply coming from the non-agency RMBS sector and the ABS sectors. With supply constrained, new bond offerings continue to be met with strong investor interest often resulting in stronger pricing levels than original guidance. CMBS has yet to see a new deal in July. Non-agency CMBS supply stands at $36 billion, down 25% from the same period in 2019. As new loan origination levels are expected to be down 60% from 2019, we expect CMBS supply to follow suit.

In the secondary market, the bid-ask spreads for triple-A rated bonds in the most active sectors were unchanged for the week, with the exception of CMBS which widened by 34bp on the week as credit performance showed more signs of deterioration.

What we're watching – CMBS delinquency rates ratcheted higher in June. Kroll Bond Rating Agency reports that the overall delinquency rate for KBRA-rated CMBS jumped 64% from 5% in May to 8.2% in June. While deteriorating performance has been expected, given the effect that the pandemic has had on the economy at large, some commercial real estate segments have been impacted more than others.

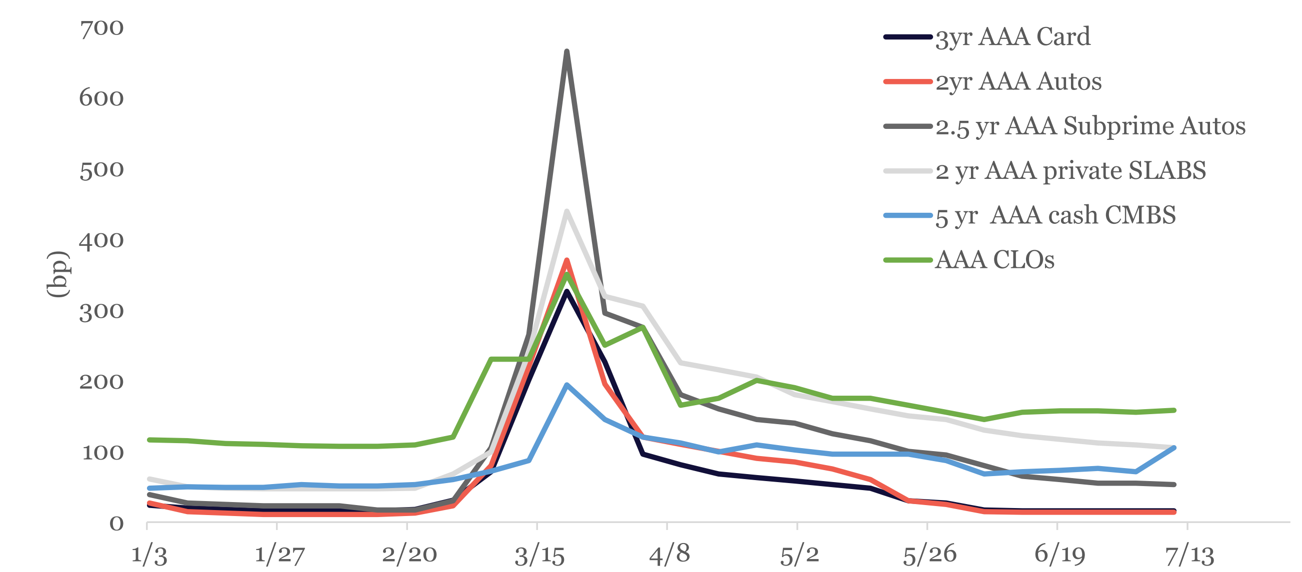
Lodging, which has been strongly affected by containment efforts and travel bans, saw delinquency rates jump from 14% in May to 22% in June. According to KBRA, delinquent retail properties nearly doubled from 6.6% to 12.8%, as nonessential brick and mortar retailers, already under pressure from the prevalence of online shopping, continue to experience declining revenue. Multifamily, office and industrial properties held steady for the month. The National Multifamily Housing Council Rent Payment Tracker found that 96% of apartment households made a full or partial rent payment in June, similar to what was reported in July 2019. Multifamily rent collections have been high despite record levels of unemployment as this sector has found support in the extended unemployment benefits, which is set to expire at month-end. If not extended, we would expect this metric to see meaningful deterioration going forward, particularly in apartments with low-income households. As I discussed previously, this group has been particularly hit hard by pandemic-related layoffs.

Moving away from CMBS and commercial real estate, the newest release of the Federal Reserve's Beige Book reveals that economic activity has increased in almost all districts since the last report, but remains well below where it was pre-pandemic. Atlanta and San Francisco are the exceptions with Atlanta reporting that conditions remain soft and San Francisco reporting that activity has contracted modestly. Although employment increased on net in almost all districts as many businesses reopened or ramped up activity, job turnover rates remained high and new layoffs were reported.

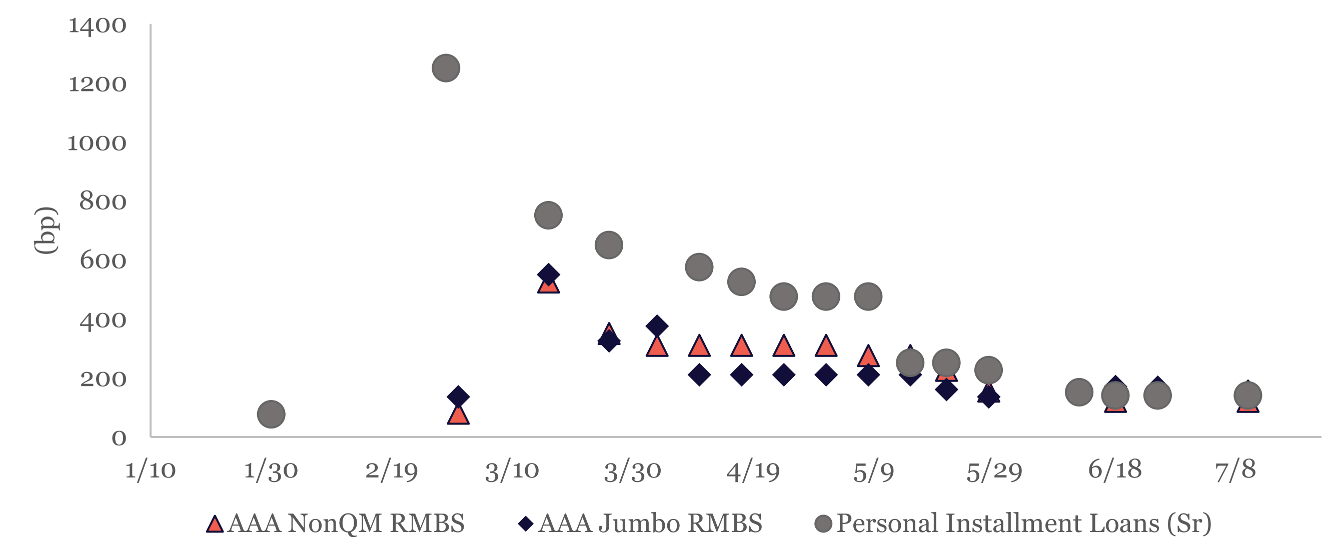
Weekly jobless claims support the anecdotal information collected in the Beige Book. For the week of July 11, 1.3 million Americans newly filed for unemployment. This represents an improvement of only 10,000, the smallest weekly decline since the national emergency was declared and raises new concerns about the speed and sustainability of the recovery. Consumer sentiment pulled back in July as persistently stubborn unemployment rates, the impending end to an additional $600 a week in expanded unemployment benefits, and a resurgence in coronavirus cases and deaths, weighed heavily on consumers' assessment of current conditions. The University of Michigan's Index of Consumer Sentiment dropped to 73.2 in July, reversing most of June's gains. The drop was led by a lower assessment of Current Economic Conditions, which dropped by 17% from June.

Continued economic uncertainty and pandemic-related measures have resulted in lower loan origination volumes across most consumer sectors, according to Equifax. Loan origination volumes for bankcards, retail cards and personal installment loans for the 12-week period between March 1 and June 28 in 2020 are half of what they were for the same period in 2019. Volumes for autos and student loans are down by more than one-third. First mortgage origination volumes have been resilient, dipping a mere 2% year-over-year, as this sector has found strong support in record low mortgage rates, pent-up demand, and the urban exodus.

Secondary Market Spreads

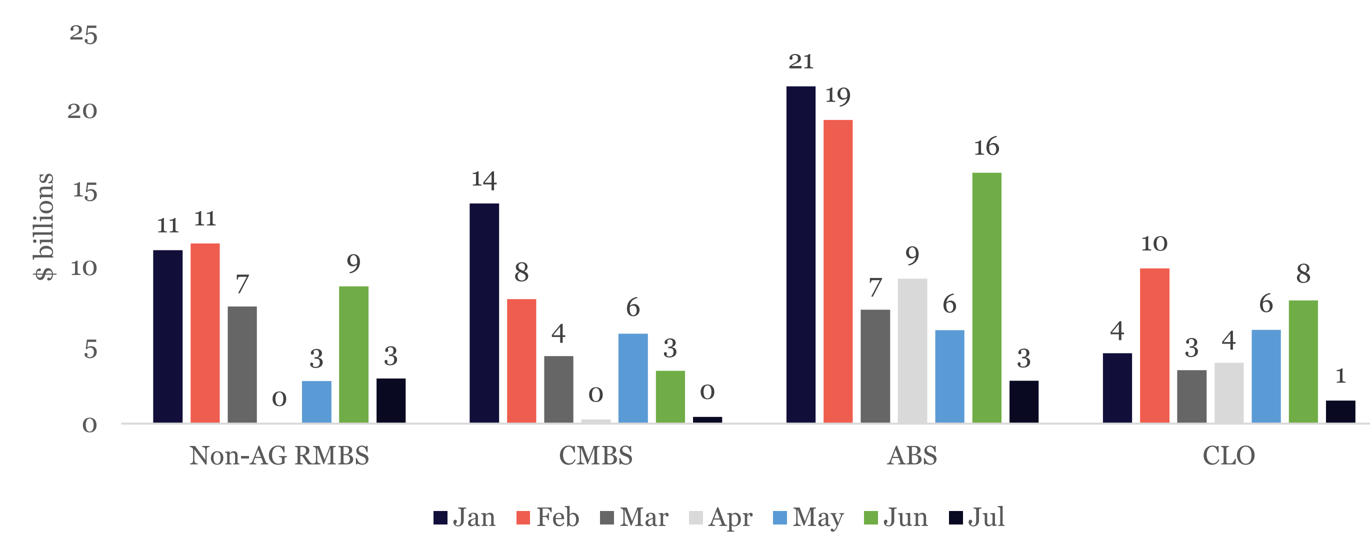


Source: Deutsche Bank Research



Source: Market Compilation

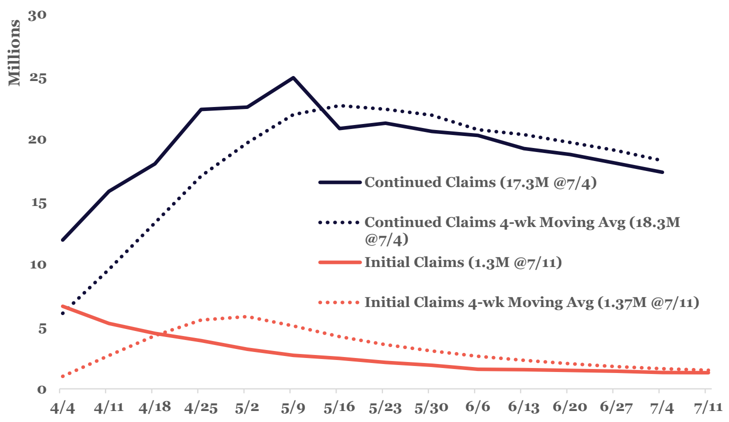
New Issue Activity



Source: Deutsche Bank Research

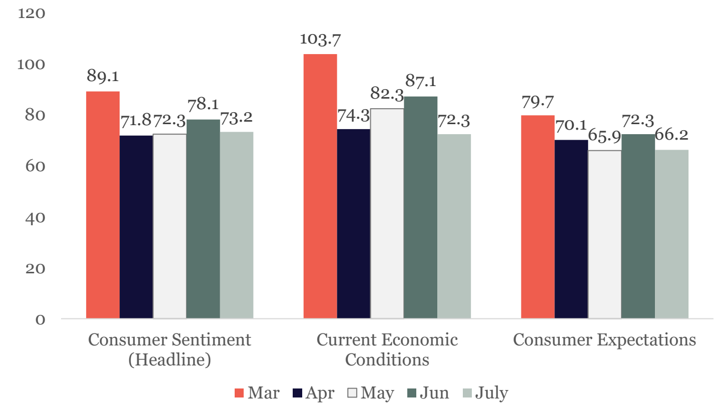
What We're Watching

Initial jobless dip 10k to 1.3M (as of 7/11); Continued Claims at 18.3M (as of 7/4)



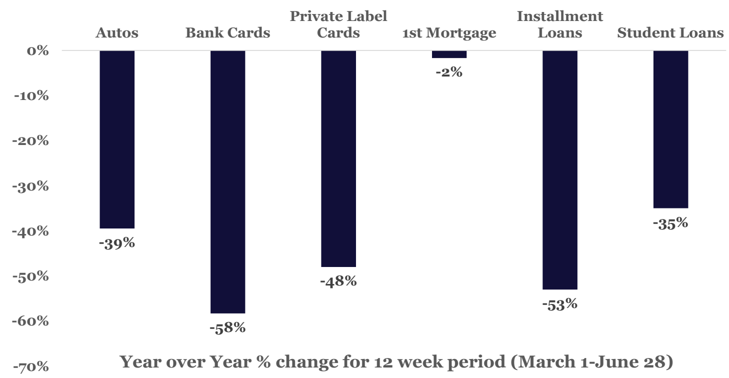
Source: Department of Labor

As coronavirus cases rise in July, Index of Consumer Sentiment retreats giving back most of June's gains.



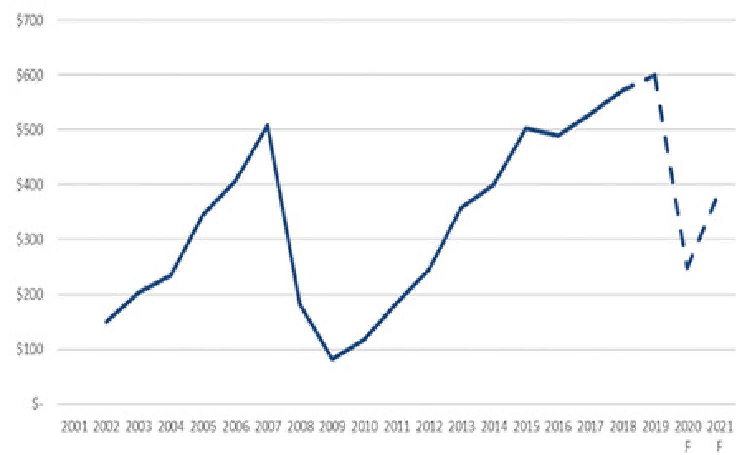
Source: Surveys of Consumers, University of Michigan

For March-June, bankcard and personal installment loan origination levels down over 50% year-over-year; 1st mortgage origination level down only 2%



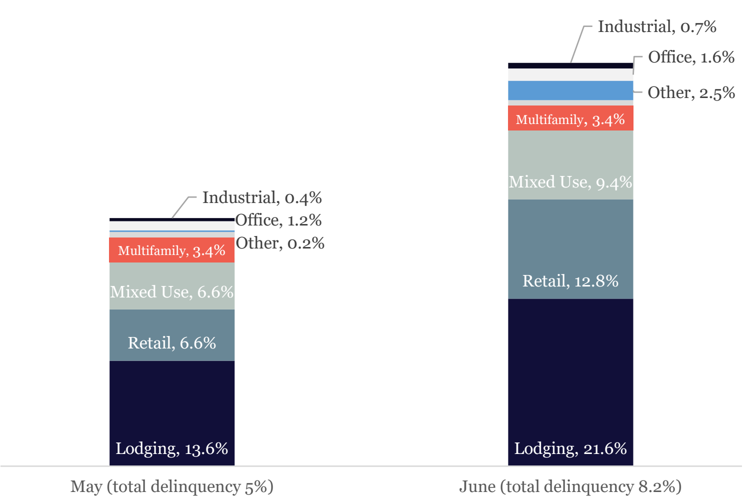
Source: Equifax

MBA: Commercial and multifamily mortgage originations forecasted to be down 60% in 2020



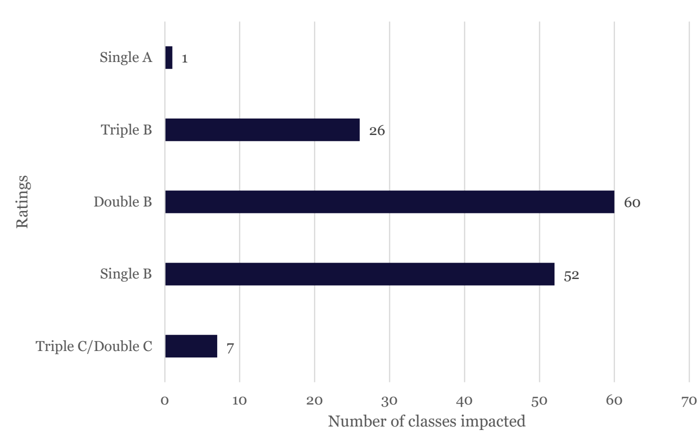
Source: Mortgage Bankers Association

CMBS delinquencies jump 64% in June led by delinquencies in lodging and retail properties



Source: Kroll Bond Rating Agency

KBRA places 146 classes across 41 CMBS transactions on watch for downgrade – AA and AAA classes not impacted



Source: Kroll Bond Rating Agency