KBRA KROLL BOND RATING AGENCY

Outstanding Questions on SFA / KBRA Consumer ABS Webinar

Structured Finance: ABS | Research

On June 25, 2020, Structured Finance Association and Kroll Bond Rating Agency (KBRA) held a webinar entitled Deep Dive: How the Consumer is Holding Up? An Update on Consumer ABS. During the webinar, we received several questions from participants but due to time constraints we were unable to get to all of them. Below, please find answers to the remaining questions.

1. **During the Financial Crisis, payments from obligors were prioritized. During this pandemic, is that priority of payment on debt also occurring? Do you have an opinion as to what that priority is? Are obligors prioritizing mortgage payments compared to auto loan/lease or credit card payments?**

   To date, we have not seen a clear prioritization of debt payments. This is likely a function of significant consumer deleveraging since the financial crisis (DTI ratios have fallen from ~1.25x in 2007 to ~0.90x in 1Q20), as well as the unprecedented level of fiscal stimulus and widespread payment assistance programs provided by servicers.

   Without these mitigating factors, we would have expected utility (solar loan/lease, PACE, etc.) and handset device payment plans to be prioritized first, followed by auto loan and mortgage payments (unlike 2007 most borrowers now have significant equity in their homes), and finally unsecured loan types such as credit cards, student loans and unsecured consumer loans. Payment forbearance for some asset classes such as mortgage payments are considerably longer than others (up to 6 months versus 1-3 months) which may enable borrowers to stay current on seemingly lower priority payments but that may be temporary.

   Depending on whether additional stimulus is forthcoming, the ability and desire of servicers to grant further payment relief, as well as the overall duration and shape of the economic recovery, prioritization may become more evident later this year and into 2021.

2. **What are your thoughts on esoterics, i.e. tax liens?**

   We have a few tax lien ratings currently outstanding and as a general matter, we haven't seen a corresponding impact due to COVID-19 in the tax lien space that may be observed in other asset classes such as RMBS. This may be in part due to the ability of mortgage lenders / servicers to step in and extinguish the delinquency (considering the delinquent tax lien amount is typically a small percentage of the property value). Whether or not there is some material impact that hasn't manifested itself remains to be seen, but the data doesn't currently point to it.

   Since tax lien transactions are structured as full turbo paydown to the notes and excess spread is typically around 10%, a slowdown in redemption rates doesn't necessarily translate to an equivalent slowdown in the amortization rate of the notes. In fact an immaterial slowdown of the redemption rate allows more penalty interest to accrue. With the turbo structure this provides more excess spread to the deal. Stated another way, a slowdown would need to be significant to materially change the repayment profile of the notes.

3. **What was the increase in credit quality for borrowers of newly originated non-QM loans during the last couple months as many originators slowed or ceased lending? Assume slightly higher avg. FICOs/lower LTVs?**

   As far as we are aware, newly originated non-QM since March has been exceedingly low as of the date of our webinar. Many lenders have still not come back to the market with new offerings, so it's difficult to say what the effects are or will be on borrower quality. All of the recent non-QM securitizations issued during COVID-19 through the date of our webinar (end of June) have been collateral originated prior to COVID-19.

4. **It appears that subprime borrowers are being harder hit than prime borrowers (blue vs. white collar) on a relative basis compared to the Great Recession. Do you foresee any possible changes to minimum coverage multiples for deals collateralized by subprime loans given the possibly higher volatility of losses?**

   We have not seen a large increase in delinquencies and defaults in subprime transactions compared to prime deals. This is due in part to the stimulus payments by the government and borrower assistance programs which have assisted borrowers. The government assistance plans have provided greater income replacement for lower income borrowers than higher earners.

   As these programs rolls off, the impact going forward is dependent on employment levels and reopening of states across the country. Additional stimulus programs provided by the government may further assist borrowers. Due to the higher level of absolute losses in subprime portfolios and the higher income coverage by government stimulus programs, we do not expect higher volatility in subprime deals.

5. **Given the historically high unemployment rate environment we are in, do you expect a spike in delinquencies in the consumer and small business asset classes post July 31st when the increased US government unemployment benefits end?**

   In the small business sector, delinquencies have already spiked up even with the implementation of Paycheck Protection Program. We don't believe that will change in the near term unless the U.S. economy starts to recover.

   In the consumer sector, it will depend on employment levels and whether or not a second stimulus package, either in the form of another one-time deposit to relieve consumers' financial stress or an incentive for consumers to go back to work, can be passed by Congress in a timely manner to mitigate the loss of the extra $600 unemployment benefit.

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