STRUCTURED FINANCE ASSOCIATION

SFA Research Corner

Structured Finance: A View on Market Technicals

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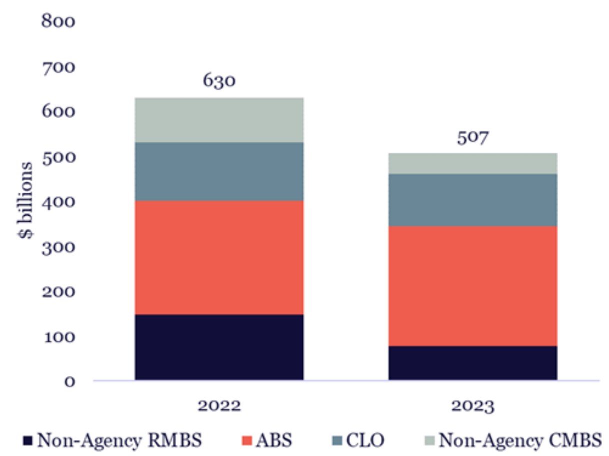
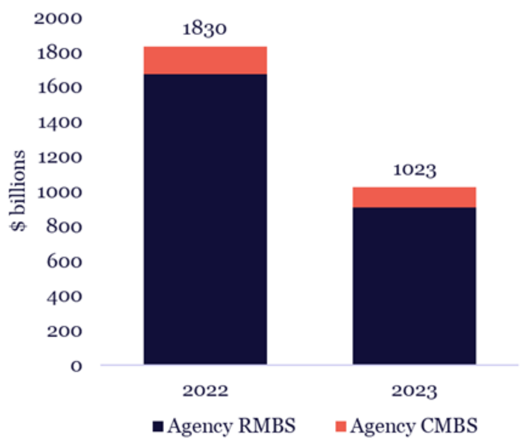
In 2023, issuers accessed the structured finance market, securing over $1.5 trillion in loans to support businesses, households, and communities. While overall issuance across the six major securitization sectors—Agency and Non-Agency RMBS, Agency and Non-Agency CMBS, ABS, and CLOs—declined from 2022 levels, not all sectors witnessed a decrease in activity.

Issuance Volume in the Private Structured Credit Market



Source: SFA Market Compilations.

Agency RMBS and CMBS—2023 Issuance



Source: JPMorgan Securitized Products Weekly, January 5, 2024.

The notable highlight was a 6% year-over-year increase in ABS supply. Particularly, ABS backed by prime retail auto loans and leases, which combined contributed 38% of the ABS category, experienced a 45% year-over-year change. Retail auto loans backed by subprime borrowers climbed a more modest 6% over the same period. Healthy issuance was driven by robust new auto sales, which overcame high loan rates and a UAW strike, reaching 15.5 million units, marking a 12.4% increase for the year. Additionally, ABS linked to digital infrastructure, such as fiber optic broadband and data centers, grew to $12 billion, reflecting a noteworthy 168% increase. While constituting a minor part of the overall ABS market, the growing demand for platforms and services supporting the expanding consumer and commercial digital landscapes is expected to continue driving growth in this sector.

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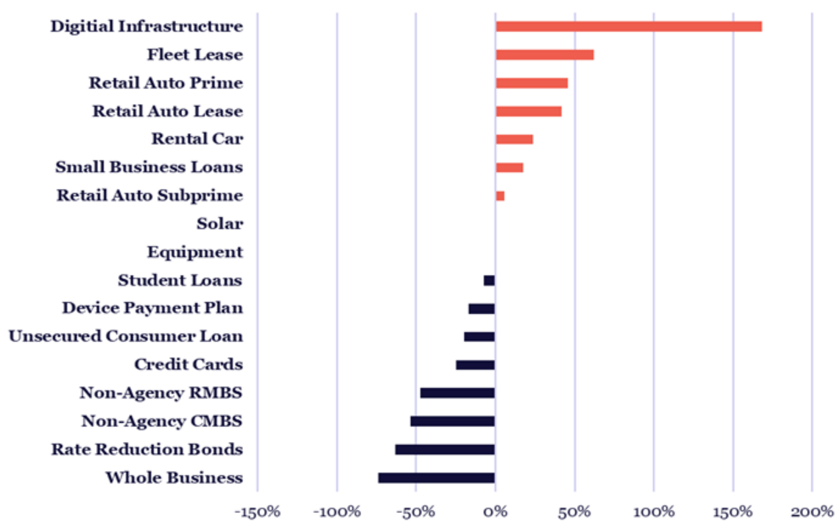
Private Structured Credit Markets YOY Change (2023 versus 2022)



Source: SFA Market Compilation.

Tighter lending conditions and subdued demand, influenced by mortgage rates that peaked near a 20-year high, record-high housing prices, and still low existing home inventory impacted the Agency and non-Agency RMBS markets. With roughly three-quarters of homeowners locked into rates of 4% or lower, the disincentive to sell or refinance has con-tributed to keeping loan origination volumes and RMBS issuance low. Supply of Agency RMBS, which is backed by the federal government, dropped by 46% as non-agency RMBS, which do not carry the government guarantee and bears credit risk, fell by 47%.

Also contending with challenging financing conditions marked by higher rates and wider spreads as well as entrenched property-specific dynamics, the non-Agency CMBS sector concluded the year with a 54% decline compared to 2022. Agency CMBS issuance experienced a 28% reduction, indicative of the relatively better performance of multifamily properties.

The possibility of a soft-landing economy, slowing inflation and rate cuts later in the year has the potential to revive economic activity, which may enhance market liquidity and benefit securitization volumes, particularly in some sectors undergoing a downturn.

Relative Value over Corporate Bonds

Institutional investors, including asset managers, insurance companies, banks, pension funds, and hedge funds, seek fixed income credit products and are attracted to structured credit bonds for various reasons. (This analysis excludes agency-guaranteed mortgage-backed debt due to their implicit government guarantee, eliminating credit risk despite falling within the structured finance category.) Securitized bonds offer a pathway to portfolio diversification, exposing investors to a range of underlying assets, including auto loans, other consumer loans, and unique categories like solar, digital infrastructure financings, whole businesses, franchises, and rate reduction bonds, for example.

Structured credit bonds with investment-grade ratings provide attractive yields compared to other securities of similar ratings. For instance, choosing triple-A rated auto loan asset-backed securities (ABS) instead of a triple-A rated corporate bond in the financial sector could yield an additional spread of approximately 45 to 60 basis points. This spread pick-up becomes more significant in lower-rated investment categories. Anticipated to persist in 2024, these unique characteristics and advantages are expected to continue supporting this market.

ABS Yields Versus Corporate Finance

	Credit Risk Spread Over Benchmark (bp)
2-year triple-A subprime auto loan ABS	120
3-year triple-A rated prime auto loan ABS	95
Triple-A Corporate Financial Bond	50
3-year double-A rated prime auto Loan ABS	145
Double-A Corporate Financial Bond	65
3-year single-A rated prime auto Loan ABS	195
Single-A Corporate Financial Bond	105

Source: Deutsche Bank Research, SFA Market Compilation as of January 16, 2024.