CRT Issuance Increases Year-over-Year

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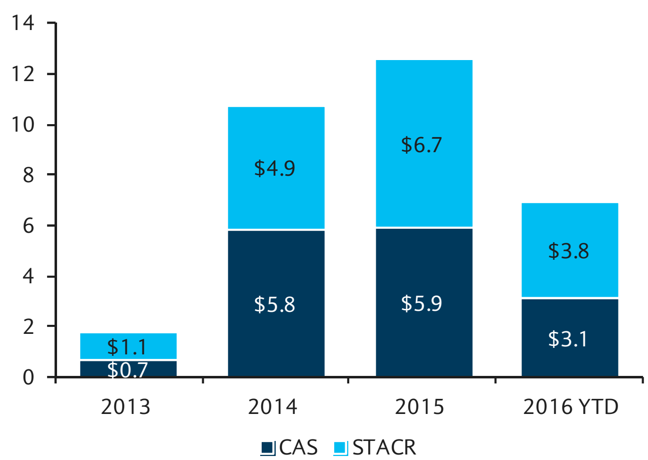
This was another high volume week for ABS, as $6bn in paper priced through Wednesday. The sector composition was varied, consisting of three auto loan ABS, two of which were subprime, a motorcycle deal, one equipment deal, a credit card deal, a FFELP student loan ABS, a wireless tower securitization, and a life sciences and healthcare ABS. Despite the heavy week of issuance, ABS volumes are still 25% below year-ago levels. In CMBS, a Freddie K and a Freddie SB deal increased supply by $1.5bn, although year-to-date levels are still down 14% y/y. Meanwhile, the one area where issuance volumes have grown in 2016 is the GSE CRT space, in which Freddie Mac priced its third low LTV and fifth credit risk transfer deal of the year, bringing 2016 GSE CRT issuance to just under $7bn (+14% y/y). With the continued growth of this emerging sector, we take a closer look at some key trends in the GSE credit risk transfer market and examine the value of the sector relative to other structured credit products.

Issuance and Outstanding

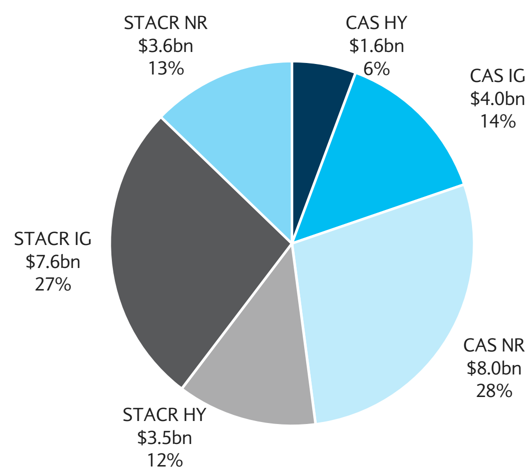
In March 2013, the Federal Housing Finance Agency (FHFA) released its updated Conservatorship Strategic Plan for 2013, calling for the development a credit risk transfer (CRT) program intended to reduce Fannie Mae's and Freddie Mac's overall risk. The transactions that followed were structured debt issuances known as Freddie Mac's Structured Agency Credit Risk (STACR) and Fannie Mae's Connecticut Avenue Securities (CAS). The first of these transactions was issued by Freddie Mac in July 2013 (see *Introduction to GSE risk transfer deals*, July 29, 2013), followed shortly by a Fannie Mae deal in October 2013. To date, the two GSEs have issued a combined $32bn of CRT debt, with 2015 supply topping out at $12.6bn while 2016 year-to-date issuance is just shy of $7bn (Figure 1). Just over $28bn in paper is currently outstanding, with 41% rated investment grade, another 41% unrated, and the remaining 18% rated below investment grade (Figure 2.)

FIGURE 1
CRT Issuance Volumes ($bn)



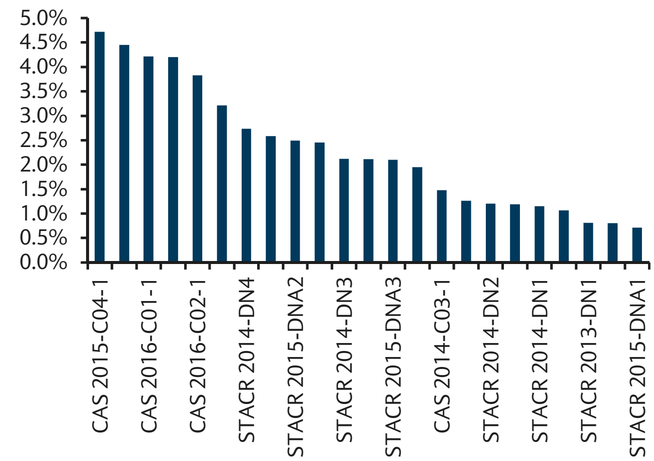
Source: Bloomberg, Barclays Research

FIGURE 2
CRT Outstanding



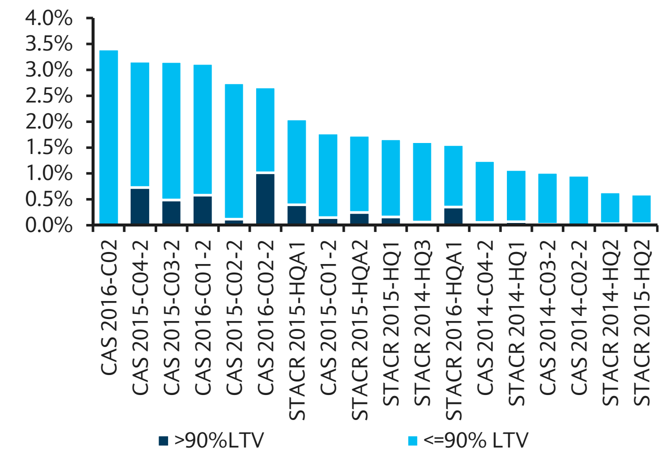
Source: Bloomberg, Barclays Research

FIGURE 3
Low LTV Pools Layered Risks (<680 FICO and >40% DTI)



Source: Deal documentation, 1010data, Barclays Research

FIGURE 4
High LTV Pools Layered Risks (<680 FICO and >40% DTI)



Source: Deal documentation, 1010data, Barclays Research

Layered Risk Remains Low

When evaluating the credit of a reference pool for the junior tranches in STACR/CAS deals, weighted average characteristics are less useful. The tails of the distributions across various characteristics that affect performance, such as FICO, DTI, and CLTV, are much more relevant for investors. Therefore, we looked at the loans most at risk of default, which are those with layered tail risks (loans with more than one of the above three tail risks). Figures 3 and 4 show that in terms of layered risk, the pools are clean.

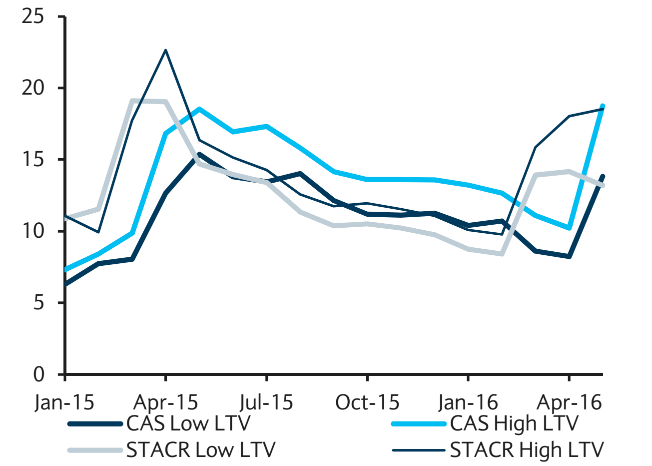
Layered risks remain low across both high- and low-LTV pools, with borrower FICOs below 680 and a DTI over 40% representing less than 5.0% and 3.5% of low- and high-LTV pools at issuance, respectively. This suggests to us that the high-LTV pools have slightly more stringent underwriting, given the inherent higher risk of the smaller down payment. Meanwhile, for high-LTV pools, we naturally get a third tail risk – namely, CLTVs of more than 90%. Layering all three risks reveals that less than 1% of the loans in the high LTV pool exhibit all three.

Prepays Have Picked Up

Looking at speeds, we notice that high-LTV pools continue consistently to pay faster, likely because of the effect of the mortgage insurance premium paid by higher-LTV borrowers, which can be cancelled through a refinance if the home increased in value such that the LTV falls to 80% or below (Figure 5). While mortgage insurance can be cancelled once the LTV based off of the original property value reaches 80%, it can take years for this level to be reached without prepayments. Current property values validated through an appraisal can be used, although for mortgages with less than five years of seasoning, the LTV must be 75% or lower and the mortgage insurance can be cancelled only after the first two years. Therefore, refinancing might be the most cost-efficient way to cancel mortgage insurance, especially given the strong HPA since 2012 (Figure 6) (For more on the MIP as a driver of prepays, please see *CRT high LTV deals prepay faster as LTVs fall*, December 11, 2015).

FIGURE 5

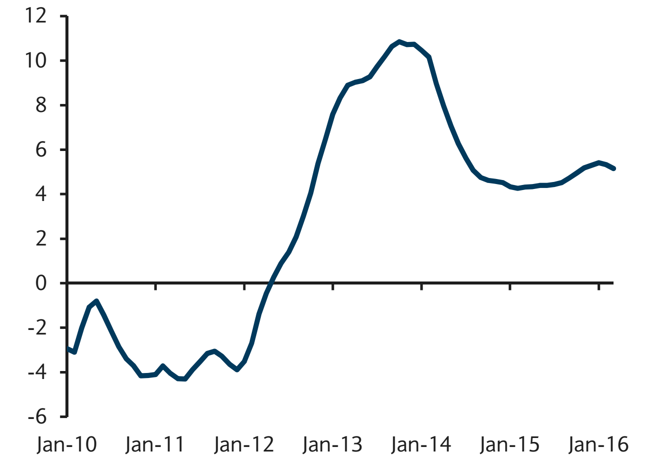
High LTV Pools Prepay Faster than Low LTV Pools



Source: Deal documentation, Barclays Research

FIGURE 6

S&P Case-Shiller US Home Price Y/Y % Change



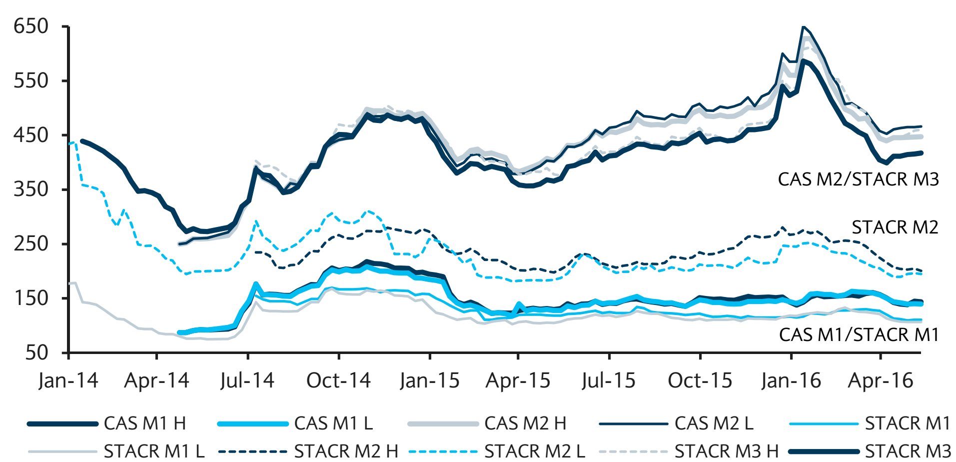
Source: Bloomberg, Barclays Research

Spread Performance

Spreads have moved in tandem with broader credit markets and are now substantially lower than they were at the end of last year and the beginning of this year, especially in the more volatile CAS M2s and STACR M3s. We generally see bonds linked to low -TV pools trade a bit tighter than those linked to high-LTV pools, with the basis having widened more recently. This is most evident in the STACR M3s. CAS M2s are the exception, as the attachment point for the low-LTV 1M2s has been about half of the attachment point for the high-LTV 2M2s. This has changed in 2016, with Fannie sizing the B piece in line with Freddie at 1%, providing the same attachment point for the last cash flow bonds for both and within programs.

FIGURE 7

STACR/CAS Spreads (DM)



Note: High and Low LTV pools are labeled as H and L, respectively. Source: Barclays Research

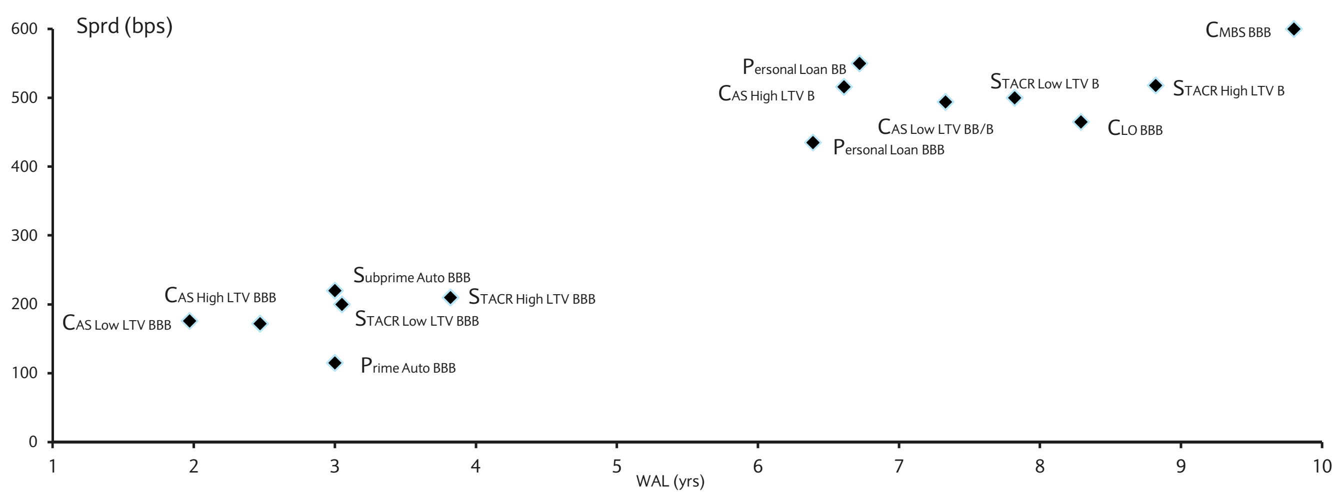
Relative Value

As discussed in *Cross Asset Outlook 2016: Relative value across securitized credit*, November 18, 2015, further down the capital structure, the relative risks at each rating level, across asset classes, becomes very subjective, making it difficult to determine comparable bonds. For instance, we would argue that CMBS BBB-s and CLO BBB bonds have differing risk profiles due to worsening underwriting in the CMBS sector, as well as concentrations in certain CRE sectors such as retail hotel and multifamily that could be volatile in a downturn.

Meanwhile, the CRT BBB-rated bonds (CAS FCF M1 and STACR MCF M2s) are likely much better protected than any of the CMBS/CLO BBBs and, understandably, trade at much tighter spreads. As such, coming up with comparable bonds at this level is much more of a judgment call. We believe that the CRT bonds that are comparable with the CMBS/CLO BBBs from a risk-reward standpoint are the BB/B rated STACR LCF M3s bonds and 2016 vintage CAS LCF M2s, which have higher enhancement levels than earlier vintage CAS M2s. While investors with more bullish outlooks may prefer the widest bonds (CMBS BBB-s), we think that the CRT LCF bonds, especially the STACR M3s and newer vintage CAS M2s, offer value.

FIGURE 8

Relative Value at the Low Investment Grade and Non-Investment Grade Rating Levels

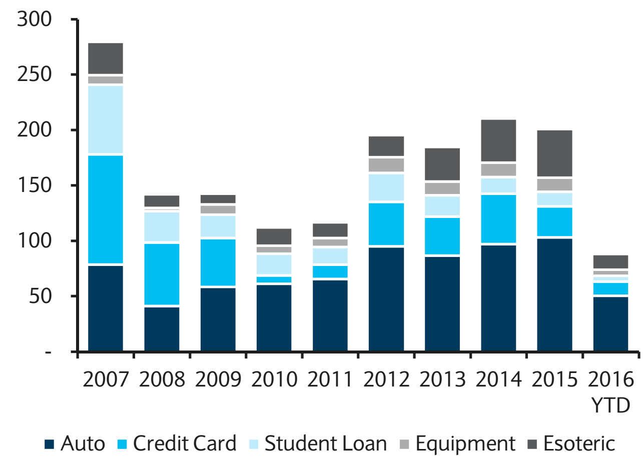


Note; Spreads represent the most on-the-run securities from benchmark issuers in each asset class or sub-asset class. Source: Barclays Research

Reference Tables

FIGURE 9

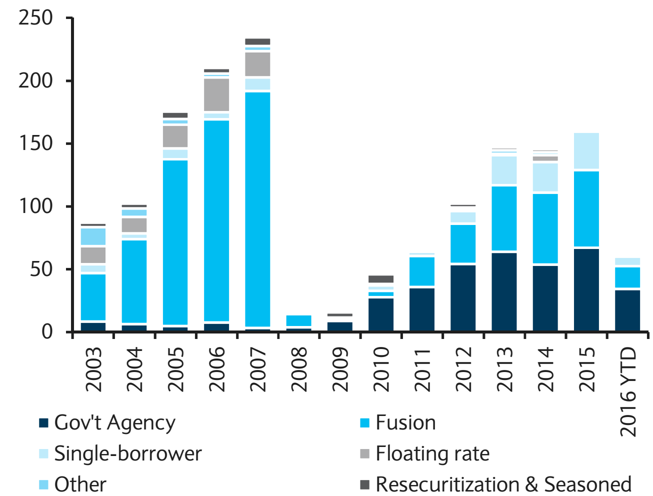
ABS Yearly Issuance ($bn)



Source: Barclays Research

FIGURE 10

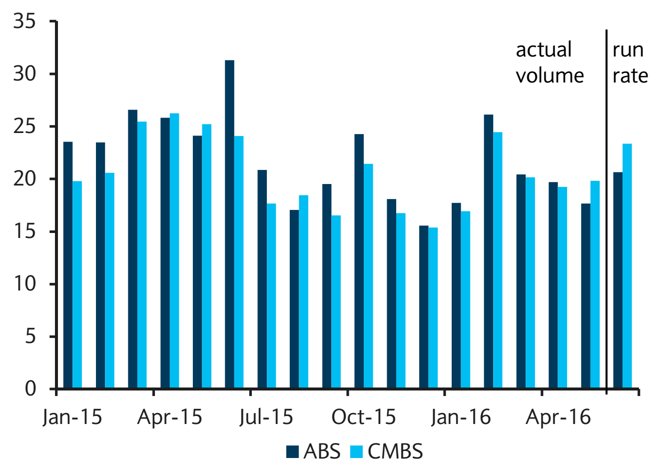
CMBS Yearly Issuance ($bn)



Source: CMA, Barclays Research

FIGURE 11

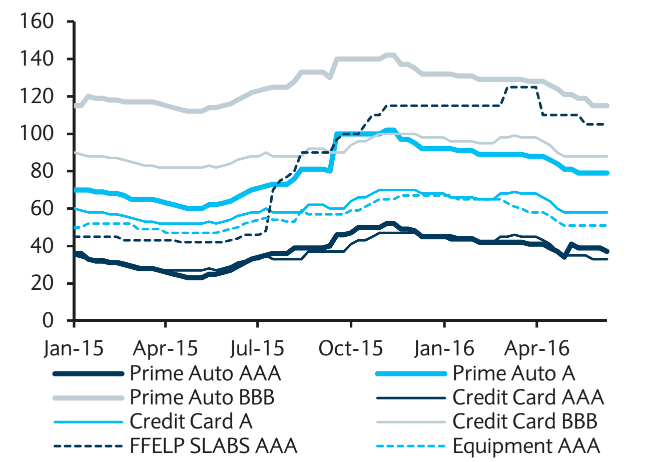
Monthly Total Trading Volumes ($bn)



Source: FINRA, Barclays Research

FIGURE 12

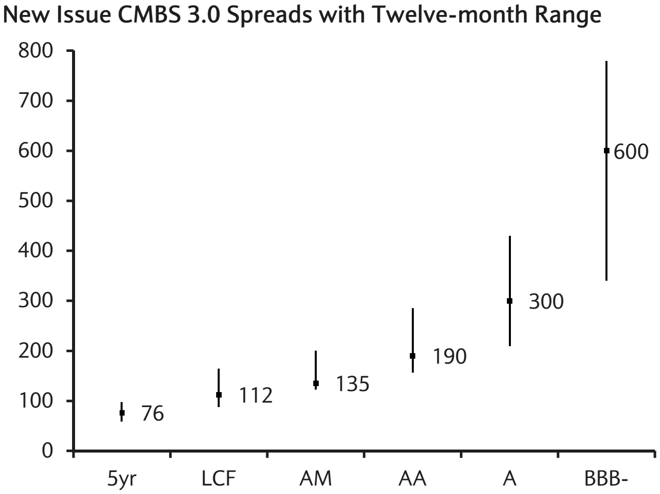
Investment Grade 3y WAL ABS Spreads (bp)



Source: Barclays Research

FIGURE 13

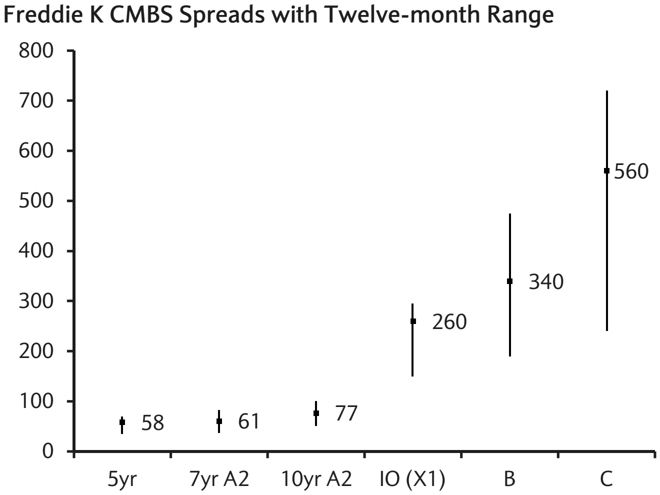
New Issue CMBS 3.0 Spreads with Twelve-month Range



Source: Barclays Research

FIGURE 14

Freddie K CMBS Spreads with Twelve-month Range



Source: Barclays Research

FIGURE 15

ABS Spreads

				12-month		
Rat.,WAL	**Benchmark**	**6/9**	**1-wk Chg**	**Avg**	**High**	**Low**
Prime Auto ABS						
AAA, 1y	EDSF	19	0	31	39	19
AAA, 2y	Swaps	29	-2	38	49	27
AAA, 3y	Swaps	37	-2	42	52	31
A, 3y	Swaps	79	0	87	102	68
BBB, 3y	Swaps	115	0	130	142	115
Subprime Auto ABS						
AAA, 1y	EDSF	53	-2	67	80	53
AAA, 2y	Swaps	58	-2	74	90	58
A, 3y	Swaps	145	-5	188	225	145
BBB, 3y	Swaps	215	-5	261	300	215
Equipment ABS						
AAA, 1y	EDSF	33	0	41	49	32
AAA, 2y	Swaps	43	0	51	59	42
AAA, 3y	Swaps	51	0	59	67	51

				12-month		
Rat., WAL	**Benchmark**	**6/9**	**1-wk Chg**	**Avg**	**High**	**Low**
Credit Card ABS						
AAA, 3y	1m Libor	33	0	40	47	32
AAA, 5y	1m Libor	46	0	50	58	42
AAA, 7y	1m Libor	57	0	61	69	50
A, 3y	1m Libor	58	0	64	70	57
A, 5y	1m Libor	83	0	85	93	75
A, 7y	1m Libor	99	0	101	109	90
BBB, 3y	1m Libor	88	0	94	100	87
BBB, 5y	1m Libor	113	0	115	123	105
BBB, 7y	1m Libor	129	0	131	139	121
Student Loan ABS						
AAA, 1y	1m Libor	80	0	80	100	37
AAA, 3y	1m Libor	105	0	102	125	46
AAA, 5y	1m Libor	130	0	119	135	58
AAA, 7y	1m Libor	145	0	137	150	71

Source: Barclays Research

FIGURE 16

CMBS Spreads

			12-month		
Rating	**6/9**	**1-wk Chg.**	**Avg.**	**High**	**Low**
CMBS 3.0 2015					
5y	76	0	81	97	66
LCF	112	0	128	165	94
AM	135	0	159	200	130
AA	190	0	215	285	171
A	300	0	319	430	230
BBB-	600	0	548	780	370
CMBS 3.0 2014					
5y	78	0	81	96	66
LCF	115	0	123	158	94
AM	135	0	154	190	126
AA	175	0	206	260	166
A	260	0	294	380	218
BBB-	560	0	513	705	361

			12-month		
Rating	**6/9**	**1-wk Chg.**	**Avg.**	**High**	**Low**
CMBS 3.0 2013					
5y	76	0	79	95	62
LCF	94	0	117	154	86
AM	125	0	146	185	118
AA	160	0	180	210	144
A	235	0	261	330	204
BBB-	485	0	464	630	336
Freddie K					
5y	58	3	56	70	35
7y A2	61	6	63	82	37
10y A2	77	7	77	100	51
IO (X1)	260	0	235	295	150
B	340	25	319	475	190
C	560	-15	464	720	240

Source: Barclays Research

Analyst Certification

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