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Newer issue CRT claw back value with fundamentals, not liquidity in driver's seat

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Late-vintage credit risk transfer bonds are posting the strongest rebounds within the sector in the past two weeks as fire sales ebb and investors recalibrate expectations of losses on the bonds, said two investors and two analysts.

None of the 2019 or 2020 CRT from Fannie Mae and Freddie Mac would take losses in even harsh scenarios, although dozens of them are "at risk," according to a report from Andrew Davidson & Co. this week.

"Most of the spread widening was liquidity dislocation in the business to business credit markets, not expectations of gigantic credit losses in GSE bonds," said Richard Cooperstein, the Andrew Davidson analyst who co-authored one of two studies at the mortgage analytics firm.

Subordinate CRT issued in 2019 and 2020 rebounded 13.76% and 9.11% in the week through Thursday, trouncing the returns of 4.78% and less for earlier vintages, MF&Co.'s CRTx indexes show. The gains helped reduce monthly losses for 2019 and 2020 subs to 45.38% and 48.48%, from 58.20% and 60.62%, respectively, from two weeks earlier, the CRTx data show.

Funds capitalizing on distressed pricing may be looking to newer vintage CRT, in part because those bonds are more available than more seasoned deals locked away, said Mark Fontanilla, founder of the CRTx.

A larger than USD 5m CAS 2019-R02 1B1 traded on Thursday at 62.52, up from a trade at 45 at the end of March, according to Finra's TRACE. Similarly, two CAS 2019-R03 1B1 trades of at least USD 5m traded as high as 61.88 on Thursday, up from its record low of 37.50 on 3 April, Trace data show.
A second Andrew Davidson report by Alex Levin found that price drops of as much as 65 points in March works out to a doubling or tripling of "real world" loss expectations of 2019 GSE loans. That prices dropped even for M1 tranches -- which have strong credit support and short projected lives -- suggests that the widening there was mostly technical, Levin concluded.

It's important to note that those expectations are up from very low levels, Cooperstein said. Cooperstein's report, led by William (Mickey) Storms, shows the bonds at risk of loss are concentrated in subordinate and lower mezzanine classes from 2017 through 2019, or 121 securities out of a total 160. By contrast, most of the 69 bonds that would be safe from loss in a severe scenario are in the earlier, 2014 through 2016 vintages, and include even some of the deepest mezzanine tranches, the report shows.

Bonds that would almost certainly take losses are first loss bonds from 2016, according to the Storms-Cooperstein report. But price action shows investors saw those bonds overshoot on the downside, too. A USD 1.2m CAS 2016-C05 2M2B traded on Monday at 94.31, up from 75.63 on 27 March, according to Trace. The bonds were 106.72 in early February.

Others struggled to rebound. At least USD 5m CAS 2016-C04 1Bs traded on Tuesday at 83.19, up only slightly from its recent low of 79.75 last week and still an eye-popping decline from the 135.10 level on 20 February, Trace shows.

While the liquidity impact can be understood, predicting performance of CRT reference pool loans will be difficult, said the investors and Cooperstein. As of Thursday, 6.4% of all mortgages have entered into COVID-19 mortgage forbearance plans, up from 5.5% the week before, according to Black Knight.
The data is bothersome on its own, but the main question is how many of those forbearances turn into modifications, and how many will ultimately default, Cooperstein said.

Investors will likely have to wait for May for clarity in the CRT performance picture. April remittance reports for STACR deals show the overall 30-day plus delinquency rate increased only 19bps, while loans in forbearance actually declined a bit, according to a Nomura Securities report today.
“We expect delinquencies and forbearance rates to increase meaningfully starting in May remits, when borrowers missing their April mortgage payment will be reported as 30 days delinquent,” the Nomura analysts wrote.
by Al Yoon