CRT Credit Focus

Disaster Performance: Pandemic Forbearance Resolutions Bode Well for Future Stresses

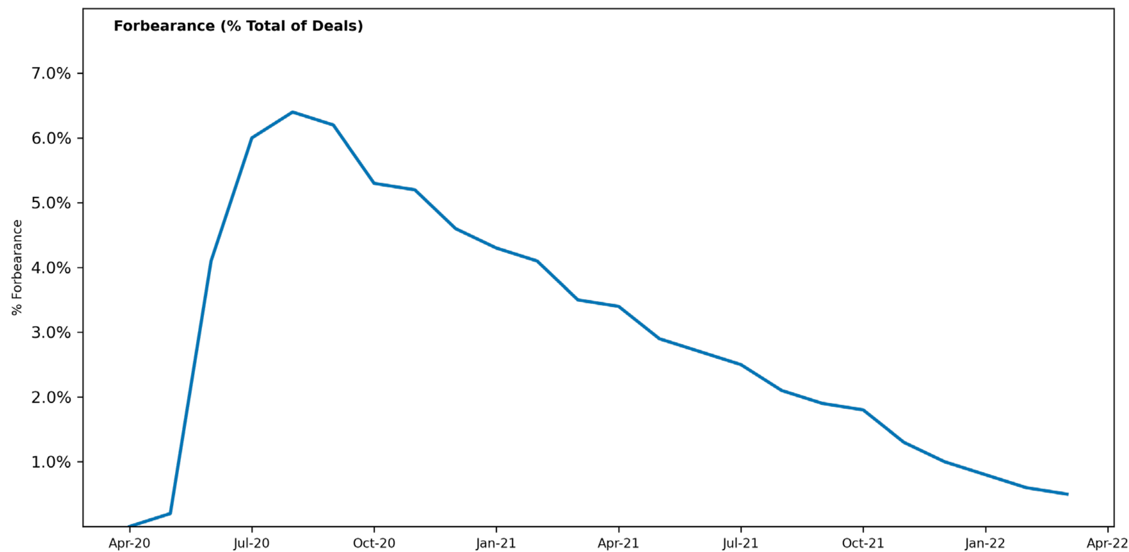
Pandemic Forbearance Resolutions Suggest a Blueprint for Future Stress Events

Stav Gaon
+1 (646) 768-9173
sgaon@academysecurities.com

Headquarters Address:
Academy Securities, Inc.
622 Third Avenue, 12th Fl
New York, NY 10017

Pandemic forbearance resolutions across the CRT sector bode well for future credit performance following disaster-like events. Most loans have now exited their Covid-19 related forbearance. Specifically, 96% of loans in STACR deals exited forbearance, according to Freddie Mac. Active forbearance has declined to ~33K loans as of March 2022 reporting period, compared to a peak of 284K loans in August 2020 (Figure 1).

Figure 1 CRT Forbearance (% Total of Deals)



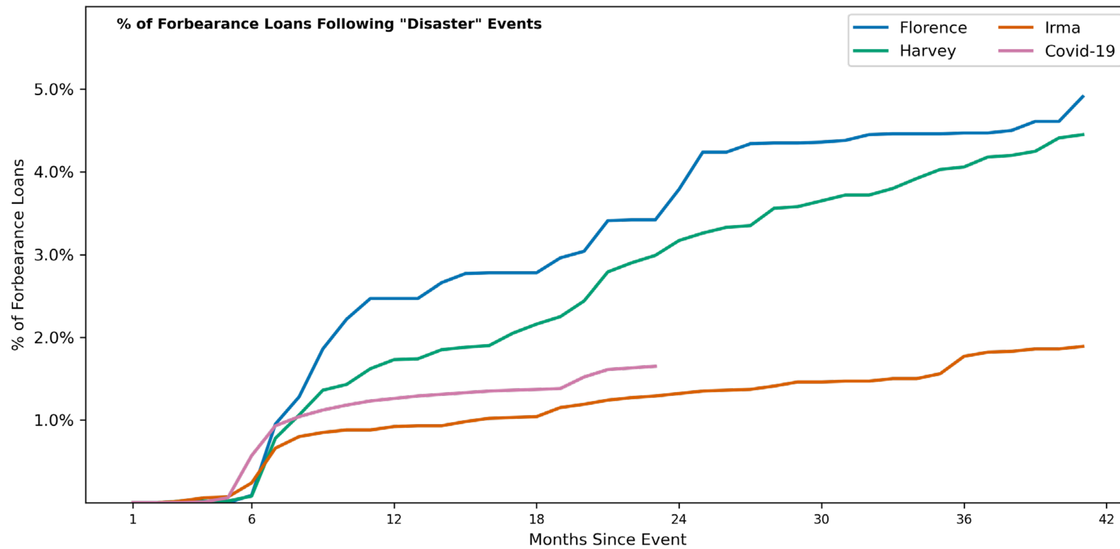
Source: Freddie Mac and Academy Securities

The forbearance resolution of most distressed pandemic loans facilitates performance comparison to earlier "disaster" events. Those events were essentially geographically concentrated hurricanes, such as Hurricane Harvey (August 2018, Texas and Louisiana impact) or Hurricane Florence (September 2018, Carolinas impact). The pandemic performance stands out in providing experience with a widespread stress, that impacted many geographic areas.

Covid-19 CRT credit events on forbearance loans now hover around 1.65%, about two years following the disaster start date (Figure 2). This compares to 3.0-3.4% levels two years after Hurricanes Harvey and Florence, back in August 2017 and September 2018, respectively. Credit events following these two hurricanes later increased to the 4.9-5.5% range.

Disaster Performance: Pandemic Forbearance Resolutions Bode Well for Future Stresses

Figure 2 CRT Credit Events Performance Following "Disaster" Events

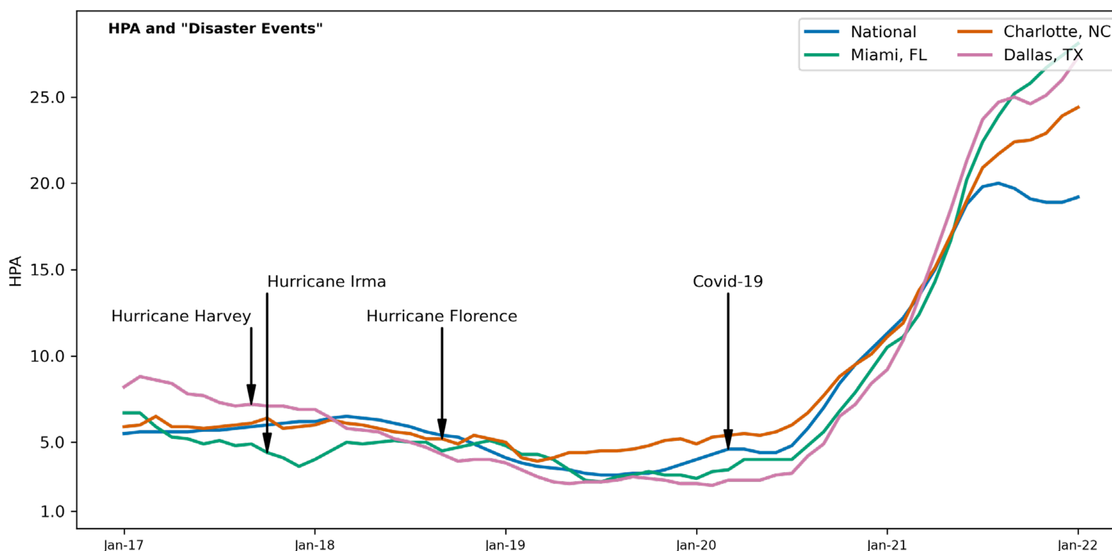


Source: Freddie Mac and Academy Securities

Projecting Performance in Different HPA and Rate Environments

Using Covid-19 forbearance resolution experience to project future disaster performance may have some limitations. Strong HPA growth and low interest rates were likely key drivers of the successful exit of many forbearance loans in the past couple of years. In a softer HPA and elevated rate environment, home borrowers may not be as incentivized to keep ownership of their homes or prepay their mortgages. To be sure, HPA can remain robust in the coming months even amid rising rates – on the heels of housing shortage and remote work-driven geographic preferences. But as HPA decelerates to pre-pandemic levels, disaster events can again lead to the higher credit event levels previous incidents showed. The hurricanes in 2017 and 2018 hit areas just experiencing decelerating or flattening HPA growth levels, using nearby metro-level Case-Shiller indices as (imperfect) price appreciation proxies (Figure 3).

Figure 3 Pandemic and Hurricane HPA Proxies



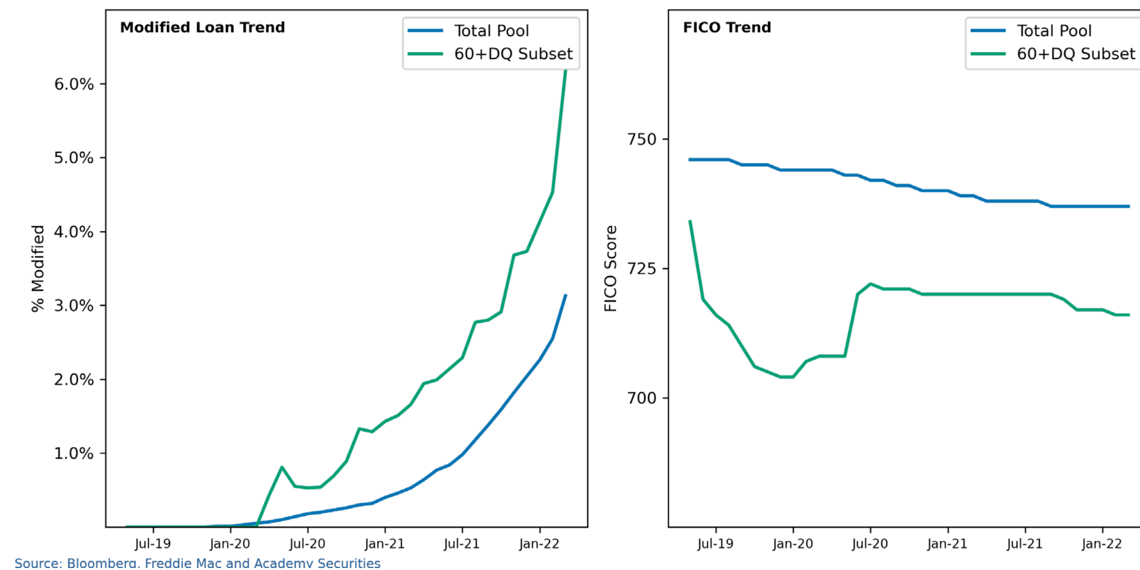
Source: Bloomberg, S&P CoreLogic Case-Shiller and Academy Securities

Adverse Selection in Remaining Forbearance Loans

While the Covid-19 active forbearance population has significantly decreased, there is a lingering concern about "adverse selection" in the remaining distressed loans. The loans that have not been reinstated by now may represent deeply struggling borrowers. A reasonable stress scenario may treat all seriously delinquent loans as future credit events. Still, even if all active forbearance loans become credit events, they should represent only a fraction of first loss credit enhancement in STACR fixed-severity deals, according to Freddie Mac.

Borrower and loan parameters in STACR 2019-HQA2 – the deal with the highest current delinquency levels ¬– support the idea that remaining delinquencies are facing resolution challenges. The deal's 5.66% D60+ cohort features 716 FICO, 68.5 HPI-adjusted CLTV, and 40.5 DTI. This compares to 737, 66.2 and 38.0 levels on the overall loan population in the deal. The delinquent population also contains an elevated level of modified loans (Figure 4, left). Modified loans pose future performance risk to the deal – the percentage of stressed borrowers is increasing rather than leaving the deal. In turn, prepays and borrower issues are creating a downward trend in the deal's FICO levels (Figure 4, right).

Figure 4 STACR 2019-HQA2 Modification and FICO Levels – Delinquent vs. Total Population



Source: Bloomberg, Freddie Mac and Academy Securities

Disclaimer

Although certain information has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness or fairness. We have relied upon and assumed without independent verification, the accuracy and completeness of all information available from public sources.

Views and opinions expressed are for informational purposes only and do not constitute a recommendation by Academy Securities for any purpose including buying, selling, or holding any security. Views and opinions are current as of the date of this presentation and may be subject to change, they should not be construed as investment advice.

This information discusses general market activity, industry or sector trends, or other broad-based business, economic, market or political conditions and should not be construed as operational, research or investment advice. This material has been prepared by Academy Securities and is not financial research nor a product of Academy Securities. It was not prepared in compliance with applicable provisions of law designed to promote the independence of financial analysis and is not subject to a prohibition on trading following the distribution of financial research. The views and opinions expressed may differ from those of Academy Securities. Investors are urged to consult with their financial advisors before buying or selling any securities. This information may not be current and Academy Securities has no obligation to provide any updates or changes.

Economic and market forecasts presented herein reflect a series of assumptions and judgments as of the date of this presentation and are subject to change without notice. These forecasts do not take into account the specific investment objectives, restrictions, tax and financial situation or other needs of any specific client. Actual data will vary and may not be reflected here. These forecasts are subject to high levels of uncertainty that may affect actual performance. Accordingly, these forecasts should be viewed as merely representative of a broad range of possible outcomes. These forecasts are estimated, based on assumptions, and are subject to significant revision and may change materially as economic and market conditions change. Academy Securities has no obligation to provide updates or changes to these forecasts. Case studies and examples are for illustrative purposes only.

Index Benchmarks

Indices are unmanaged. The figures for the index reflect the reinvestment of all income or dividends, as applicable, but do not reflect the deduction of any fees or expenses which would reduce returns. Investors cannot invest directly in indices.

The indices referenced herein have been selected because they are well known, easily recognized by investors, and reflect those indices that the Investment Manager believes, in part based on industry practice, provide a suitable benchmark against which to evaluate the investment or broader market described herein. The exclusion of “failed” or closed hedge funds may mean that each index overstates the performance of hedge funds generally.

THIS MATERIAL DOES NOT CONSTITUTE AN OFFER OR SOLICITATION IN ANY JURISDICTION WHERE OR TO ANY PERSON TO WHOM IT WOULD BE UNAUTHORIZED OR UNLAWFUL TO DO SO.

©Academy Securities, Inc.