Securitized Products Special Topics

Device Payment ABS: Expect Stable Performance as Collateral Evolves

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Borrower Prioritization and Decreasing Churn Support DPP ABS

Device payment ABS offer investors exposure to a fairly resilient consumer loan segment, as deal collateral characteristics evolve. We see at least two notable developments in the sector:

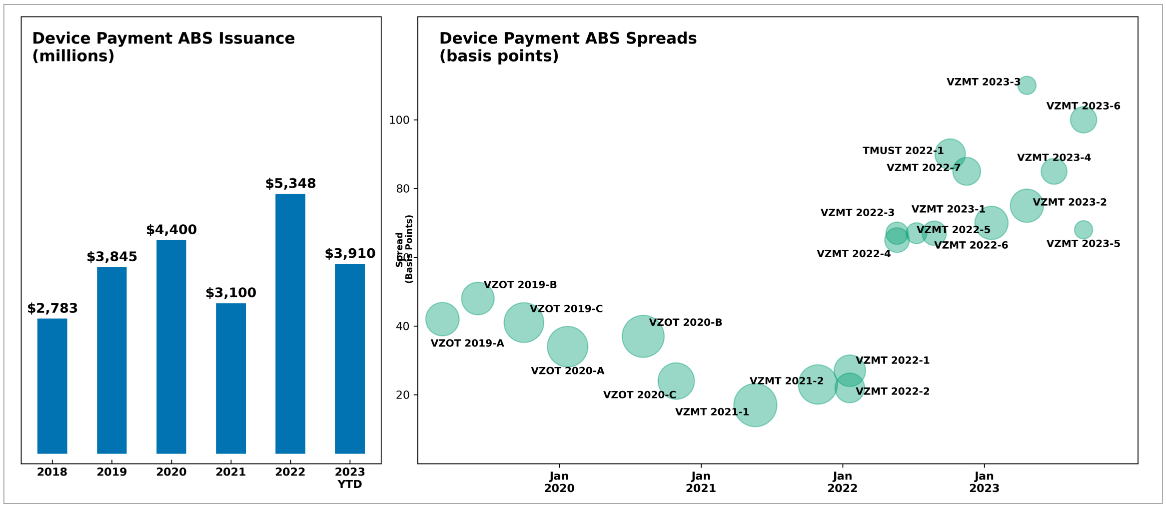
- The shift of Verizon, the most active device payment ABS issuer, to longer device payment plans (DPP). This facilitates the issuance of longer-duration bonds and lower pool churn during revolving periods;
- The entrance of new issuers, such as T-Mobile, diversifies collateral characteristics. This allows investors to gain exposures to pool characteristics they favor, and better manage collateral risks, such as upgrade-driven prepayments or issuer/carrier credit linkages.

Broadly, DPP performance should remain stable even in a more distressed consumer environment, based on recent experience during the pandemic. Delinquencies and defaults stayed low throughout 2020 even as consumers exited payment deferral programs for other loans, according to rating agencies. More recently, the 60+ delinquency rate on Verizon's master trust, VZMT, stood at 0.59% as of July 2023. Generally, the agencies have a favorable view on DPP receivables. Borrowers tend to prioritize mobile device instalment plans, rather than risk losing mobile connectivity. Wireless service providers can disconnect service to delinquent borrowers.

Consistent Issuance

Device payment ABS issuance has been consistent in recent years, ranging between $2.8 billion in 2018 and $5.3 billion in 2022 (Figure 1). Verizon's VZMT remains the dominant shelf in the sector, recording six transactions YTD. VZMT priced its $625 million 2023-6 and $425 million 2023-5 deals last month. T-Mobile's debut transaction, TMUST 2022-1, introduced another issuer last year. This may set the sector for further growth with additional T-Mobile-sponsored deals, or the introduction of other shelves.

Figure 1. Device Payment ABS Issuance and Spread Levels



Source: Bloomberg and Academy Securities

Shifting DPP Terms Impact Pool Dynamics

We find the following aspects relevant in looking at device payment ABS collateral:

- **Longer term loans and varying revolving periods.** DPP pools are poised to see an increasing share of longer, 36-month loans, following Verizon's shift to such tenor in early 2022. For example, 91.3% of the DPPs in VZMT 2023-6 and 2023-5 pool have a 36-month original term. Only 1.8% of the pool are the historical 24-month loans. The remainder of the pool is 30-month loans. The longer loans should reduce the churn in pools. Lower churn somewhat alleviates the focus on eligibility criteria during revolving periods. Such criteria are designed to prevent collateral quality degradation. We also observe variation on the duration of revolving periods across different transactions, which used to be dominated by two-year revolving periods. For example, in VZMT 2023-6 and 2023-3 the revolving periods are five years (Figure 2). In VZMT 2023-5 and TMUST 2022-1 the revolving periods are still two years.

Figure 2. Device Payment ABS Pool Characteristics

	VZMT 2023-6	VZMT 2023-5	VZMT 2023-4	VZMT 2023-3	VZMT 2023-2	VZMT 2023-1	TMUST 2022-1
Pricing Date	9/12/2023	9/12/2023	6/30/2023	4/25/2023	4/25/2023	1/26/2023	10/4/2022
Deal Size ($MM)	625.0	425.0	800.0	300.0	1,000.0	1,000.0	842.0
Revolving Period (years)	5	2	3	5	2	3	2
36-Month Contracts (%)	91.3	91.3	87.2	82.3	82.3	72.4	NA
30-Month Contracts (%)	6.9	6.9	9.5	12.5	12.5	18.3	NA
24-Month Contracts (%)	1.8	1.8	3.3	5.2	5.2	9.3	NA

Source: Ratings Agencies and Academy Securities

- **Potentially Lower Upgrade-driven Risks.** The longer DPP contracts that Verizon (and AT&T) adopted may also impact pool dynamics around upgrades, which pose some reinvestment and issuer risks. DPP borrowers can typically upgrade to a new device once they pay via their payment plan a minimum percentage of the retail price on their existing device. The current threshold on Verizon's DPPs is 50%, according to deal documents. As part of the upgrade the borrower pays off the remainder DPP balance, which flows as a prepayment to the pool. The deal's sponsor is required to remit the upgrade payment to the pool, thereby creating some sponsor risk. With longer term contracts, it may take longer for borrowers to become eligible for upgrades, all else equal, thereby reducing upgrade program risks. Deals report the upgrade eligibility percentage, which hovered around 60% in recent transactions.

- **Issuer/Sponsor Linkage.** DPP ABS have strong linkage to their sponsors, unlike other ABS sectors. This has implications on how investors can approach the sector. Several drivers create such linkage to the issuer's credit, including the issuer's role in funneling DPP funds to the pools, and how a potential issuer bankruptcy can adversely impact such function. Relatedly, deterioration in the business profile of the issuer or the quality of the mobile network it maintains may impact borrowers' willingness to continue paying their DPP debt. Interestingly, the shift to longer-term DPP contracts, with the implicit goal of tethering borrowers to a specific mobile network for a longer period, could exacerbate any potential issuer credit risks. Still, the issuer credit linkage may also entice investors already familiar with the issuer business and credit risk to gain exposure to the sponsor's DPP pools. This should enhance liquidity in the sector, and facilitate crossover investing. In a similar vein, ABS investors that developed expertise and became comfortable with cell tower ABS, can leverage the analysis for DPP ABS investment. Several salient features of cell tower leases and tower ABS real estate security underscore the potential resiliency of the segment's collateral in a more challenging economic environment, as we discussed in a previous report.[1]

1 "Cell Towers: Lender-Friendly Features Dovetail with Secular Tailwinds," Securitized Products Special Topics, Academy Securities, March 14, 2023

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