Securitized Products Special Topics

Multifamily CRT: Limited Credit Risk on Synthetic Exposures

MSCR/MCAS Deals Offer an Alternative to High Yield Office Exposures

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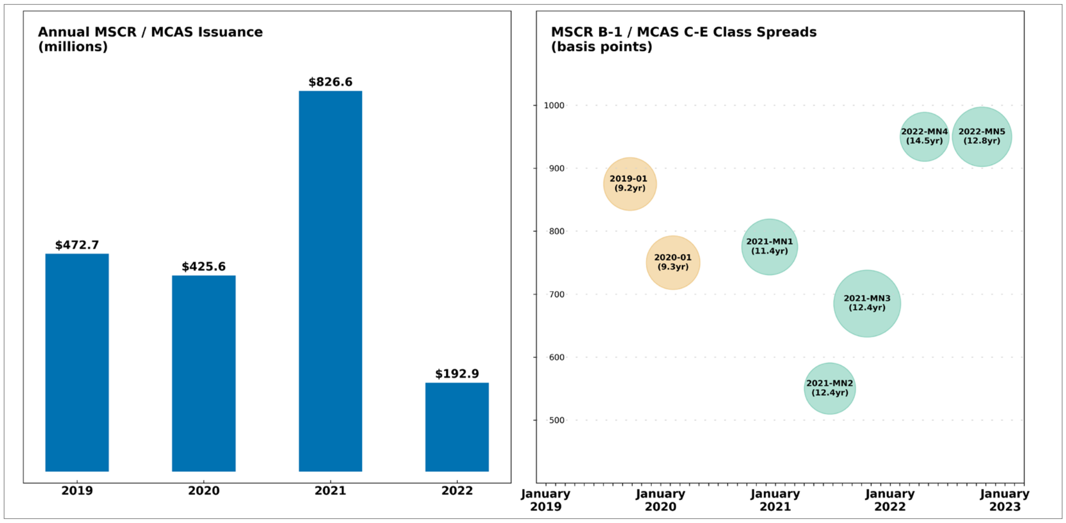
Investors may see more synthetic multifamily credit risk transfer deals popping up in the coming months as the GSEs face elevated execution levels of Agency pools such as Multi PC or DUS. Freddie Mac privately placed three Multifamily Structured Credit (MSCR) deals so far in 2023, and just added a public deal to its multifamily issuance calendar, slated for next month. The agency issued five public MSCR deals in the past two years (Figure 1). The most recent one, MSCR 2022-MN5, priced its $52.3 million B-1 tranche at 950bp over SOFR. In turn, Fannie Mae may resume issuing Multifamily Connecticut Avenue Securities (MCAS) deals after a three-year hiatus. Fannie issued its last MCAS deal in 2020, and has focused on transferring multifamily risk to insurers and reinsurers via Multifamily Credit Insurance Risk Transfer (MCIRT) deals.

Figure 1. MSCR and MCAS Deal Issuance and Spreads



Source: Bloomberg and Academy Securities

The multifamily CRT deals should facilitate diversified, non-guaranteed exposures to agency loans as investors may be shunning high yield positions in other CRE sectors, notably office. The agencies first loss retention, credit enhancement levels, and features such as delinquency test triggers are aimed at reducing an already limited credit risk on the reference pools. The multifamily deals piggyback the structural aspects of the agencies single-family CRT products – Freddie's STACR and Fannie's CAS. For example, MSCR deals may offer M-1 and M-2 mezzanine classes, and B-1 and B-2 subordinate classes, similar to a typical STACR offering. In 2021 Freddie restructured its legacy multifamily SCR deals, shifting to actual loss calculations from fixed-severity formulas, in alignment with a similar shift on STACR deals. The new MSCR deals reference mostly Multi PC pools, while legacy deals transferred Bond Credit Enhancement (BCE) program risk.

Muted Credit Issues, Elevated Prepay Activity

The recent performance of Multi PC pools, which MSCR deals reference, continue to show minimal, though not completely negligible, credit issues. Nearly 100% of the outstanding PC balance (1327 out of 1329 loans) is current, as of March 2023, according to Freddie. No loans have experienced any realized losses. Still, 151 loans ($2.6 billion) are on watchlist, 88.4% of them because of credit issues. New York-area loans, such as Parkchester Condominiums ($205.8 in MSCR 2021-MN2, referenced via WA0203 and WN7001) and Dayton Beach Park ($40.8 million, WA0501, no MSCR reference), continue to dominate the watchlist and delinquent lists.

MSCR reference pool performance reinforces the focus on prepayment analysis for such exposures.[1] The 2022- and 2021-vintage MSCR deals show no delinquent or specially-serviced reference loans (Figure 2). This contrasts with recently issued private-label deals reporting notable multifamily loan delinquencies such as Veritas Multifamily Portfolio Pool ($343.6 million, GSMS 2021-RENT) and Parkhill City ($225 million, PKHL 2021-MF). The overall multifamily delinquency rate across the CMBS universe stood at 1.77% as of March remittance, according to Morningstar.

Figure 2. Freddie Mac MSCR Deal Pool and Performance Parameters

Deal	MSCR 2022-MN5	MSCR 2022-MN4	MSCR 2021-MN3	MSCR 2021-MN2	MSCR 2021-MN1
Issuance Date	11/18/2022	5/20/2022	11/18/2021	7/21/2021	1/12/2021
Offered Classes	B-1	M-1, M-2, B-1	M-1, M-2, B-1	M-1, M-2, B-1	M-1, M-2, B-1
Balance ($MM)	52.3	140.6	317.2	232.7	276.6
Reference Pool					
# of Loans	231	257	270	40	302
Reference Pool Balance	$5.5 Billion	$6.0 Billion	$5.6 Billion	$4.1 Billion	$4.9 Billion
Average Loan Balance	$24 Million	$23 Million	$21 Million	$102 Million	$16 Million
DSCR/LTV (WA)	1.54x / 59.7%	1.49x / 65.8%	1.78x / 67.2%	2.21x / 60.4%	1.77x / 67.2%
Subordinate C/E (%)	1.00	0.75	0.75	1.50	1.50
Collateral Type	PC	PC	PC	PC and BCE	PC
Current Reference Pool Performance					
Watchlist (%)	0.00	11.32	8.41	20.51	5.90
Specially Serviced (%)	0.00	0.00	0.00	0.00	0.00
Prepaid (%)	0.00	0.00	5.76	0.00	10.32

Source: Freddie Mac, Bloomberg and Academy Securities

1 See "Multifamily Prepays: Property Sales Trigger Paydowns," Securitized Products Special Topics, Academy Securities, August 10, 2022

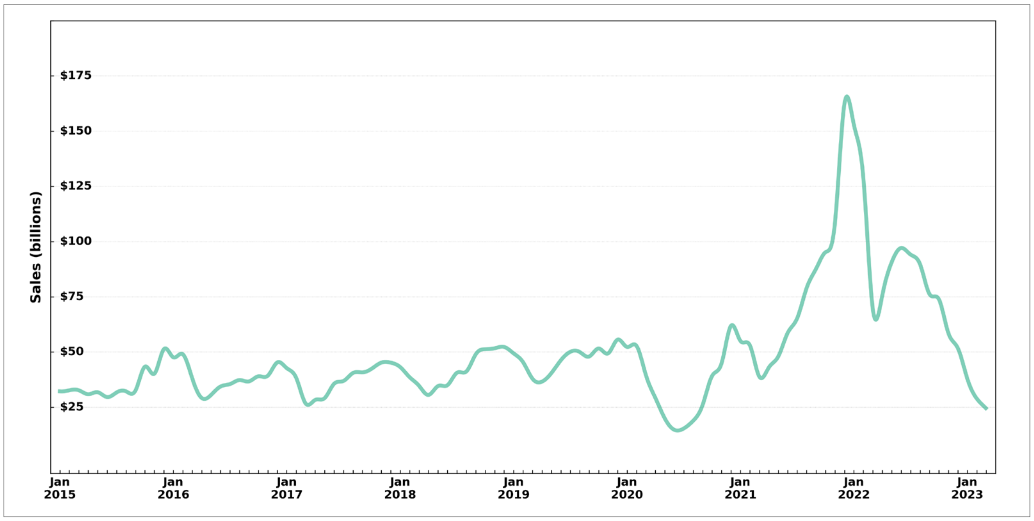
While seeing no loan delinquencies, the MSCR deals did experience significant prepayments shortly after issuance, amid largely flexible prepayment provisions on PC pools. For example, MSCR 2021-MN1 saw 10.32% of its reference pool paying off, including large loans such as Palomar Station ($77.4 million original balance) and Lofts At the Ballpark ($44.3 million). MSCR 2021-MN3 reference balance decreased by 5.76% since the deal's issuance in November 2021.

Fewer Property Transactions Could Mean Less Prepayments

Multi PC prepayments suggest property change-of-ownership plays a key role in the prepay activity, as we discussed in a previous report. Borrowers may prepay even shortly after mortgage origination and bond issuance, and amid prepayment premium penalties. The vast majority of pools do not have lockout periods. The pools do feature prepayment penalty provisions designed to protect investors from prepayment risks, similar to Fannie Mae DUS pools.[2] The typical prepayment penalty payment ("PPP") in PC pools is via yield maintenance or penalty points. With a yield maintenance provision, the PPP investors receive as borrowers prepay will be a function of (1) the difference between the PC coupon and the prevailing reinvestment rate (typically Treasury) and (2) the pool's time to the end of the YM period.

Subdued transaction activity should decrease prepays across PC pools, and by extension on MSCR deals. Multifamily buyers may stay on the sidelines amid higher interest rates and a period of price discovery. Despite a reported jump in multifamily transaction volume last month, national sales volume dropped to $24.4 billion in March 2023 on a three-month rolling basis, down nearly 65% YoY, RCA data shows (Figure 3).

Figure 3. Multifamily Transaction Volume



Note: Sales figures represent 3-month rolling sum levels
Source: Bloomberg, RCA, and Academy Securities

2 See "Manufactured Housing: Resilient Segment Amid Potential Multifamily Softness," Securitized Products Special Topics, Academy Securities, July 27, 2022

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