IFR International Financing Review

THOMSON REUTERS

EIKON™

Risk transfer bonds get performance index - IFR News

26-Apr-2018 04:27:29 PM

To view this story on Eikon, click here

By Natalie Harrison

NEW YORK, April 26 (IFR) - A new index that tracks the total returns on credit risk transfer bonds was launched this week - some five years since the first such security was sold to investors.

CRT issuance, aimed at reducing taxpayer exposure to home loans with a government backstop, have been sold since 2013 by mortgage giants Fannie Mae and Freddie Mac.

Since then, volumes have soared to about US$66bn, according to Fannie and Freddie data. But investors have lacked a benchmark to gauge returns, similar to the way corporate bond performance is tracked.

The Credit Risk Transfer Return Tracking Index (CRTx), created by advisory firm Mark Fontanilla & Co, aims to fill that gap.

"The CRT market is one of the younger sectors in the mortgage credit space, but until now it has not been possible to look at the relative value across the asset class," founder Mark Fontanilla told IFR.

The index will help users monitor CRT returns on an aggregate basis, and across upper mezzanine, lower mezzanine and subordinated tranches which carry varying degrees of risk.

The new index, that tracks performance back to 2013, references over US$1trn in mortgage loans and will be updated and rebalanced monthly.

Mark Fontanilla, who set up the firm about a year and a half ago, previously worked at Fannie Mae as a senior fixed income marketing strategist and as a residential mortgage securities strategist at Wells Fargo Securities.

GOOD COMPARISON

In an age where investors dabble in different asset classes in a hunt for yield, the index will help them compare returns against other fixed income products.

According to the index, aggregate total returns on CRT bonds were 8.1% over the past year. That's better than those on US investment-grade corporate bonds at 3.4% over the same period, according to ICE BAML data.

A performance gauge is also expected to help boost demand and supply of CRT bonds, which is growing in volume but remains a shadow of the private label mortgage issuance in pre-crisis years.

"Some investors have expressed an interest in an index as a tool for benchmarking or marketing agency CRT to customers," one mortgage specialist said. "Any well constructed index is a positive should it benefit investors."

Fannie and Freddie sold roughly US$14.3bn of CRT bonds in 2017, second only to the US$35.4bn raised from securities pooling re-performing and non-performing mortgages, JP Morgan data shows.

And quality - so far - has not been an issue with the uptick in supply.

Fitch Ratings said in a recent report that its loss projections on mortgages pooled in CRT deals were lower on every transaction relative to its prior review in July 2017.

Projected losses were revised downward by an average of 23bp for Triple B rated bonds. At the Triple A level, those projected losses were revised downward by an average of 79bp.

"The declining projected losses reflect strong collateral performance, increased home price appreciation and a shorter remaining period until transaction maturity," Fitch said.

Investors want more of these bonds. But some said the rating agencies have been overly cautious when rating them.

Subordinated tranches on new deals are typically unrated, which means some investors are restricted from buying them.

"The bonds are rated incorrectly, and you can tell by the market price," Philip Mendonca, a portfolio manager at Ryan Labs Asset Management, told IFR.

"Unrated tranches trade at about 300bp, but we think those spreads will tighten tremendously. It's very frustrating for money managers who cannot participate in residual/unrated tranches."

(Reporting by Natalie Harrison
Editing by Shankar Ramkarishnan and Joy Wiltermuth)

((natalie.harrison@thomsonreuters.com ; 646 223 4070; Reuters Messaging: natalie.harrison.thomsonreuters.com@reuters.net))

nL1N1S21HO