Commentary

Emerging from the COVID-19 Pandemic: Update on European Mortgage Performance

DBRS Morningstar
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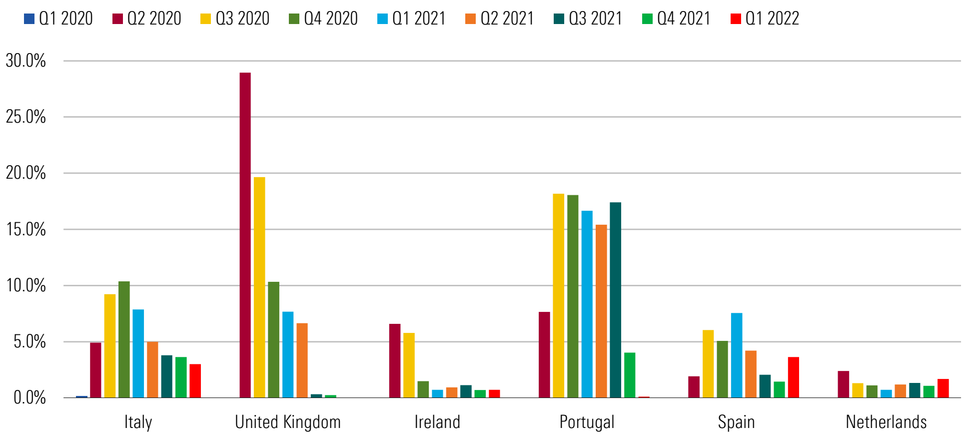
As we draw closer to the end of the current Coronavirus Disease (COVID-19) pandemic, DBRS Morningstar has observed an easing in the uncertainty surrounding all aspects of economic activity for both consumers and businesses in Europe. Government-imposed restrictions on movement throughout the pandemic, which began in Q1 2020, have also relaxed.

In summary, across Europe, DBRS Morningstar:

- Found a resilient performance trend and positive house price movements;
- Removed adjustments to expected performance; and
- Expects no rating actions in residential mortgage-backed security (RMBS) and covered bonds (CB) transactions, but anticipates some potentially positive actions in nonperforming loan (NPL) transactions.

Unprecedented government support in Europe helped to insulate mortgage markets from a downturn that many feared would cause widespread disruption. Payment holidays to help households have largely rolled off, with borrowers returning to a performing status.

Exhibit 1 Average Payment Holiday Rates in European RMBS

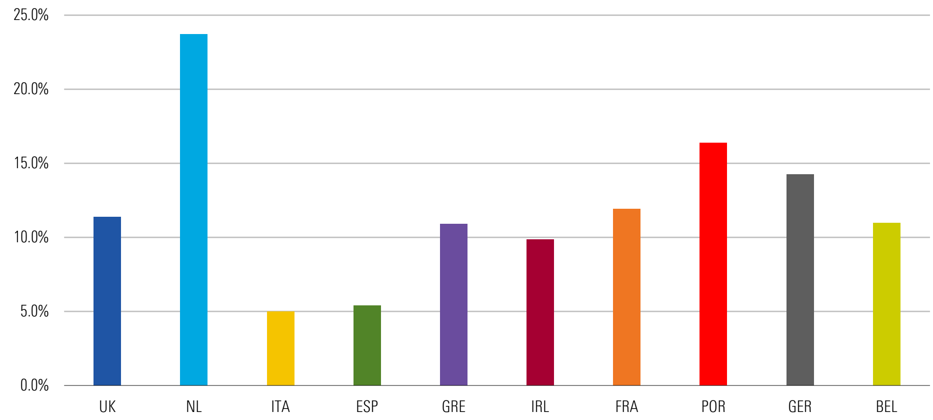


Source: DBRS Morningstar.

House prices have remained resilient with values in most markets continuing to rise or remain stable rather than falling as anticipated two years ago. In the initial phase of the pandemic, we expected that house prices might experience a modest correction relative to the end of 2019 levels and factored this into our analysis in the form of adjustments to expected house price performance. DBRS Morningstar lowered or removed these adjustments for most European markets in June 2021.

The robust performance of housing markets in Europe has since continued. As of Q1 2022, house prices in all European jurisdictions with DBRS Morningstar-rated RMBS transactions have all risen (in the range of 5% to 25%) compared with house prices prior to the onset of the pandemic. As a result, we are now removing all remaining adjustments to expected house price performance in our analysis.

Exhibit 2 House Price Growth Since Onset of COVID-19 Pandemic

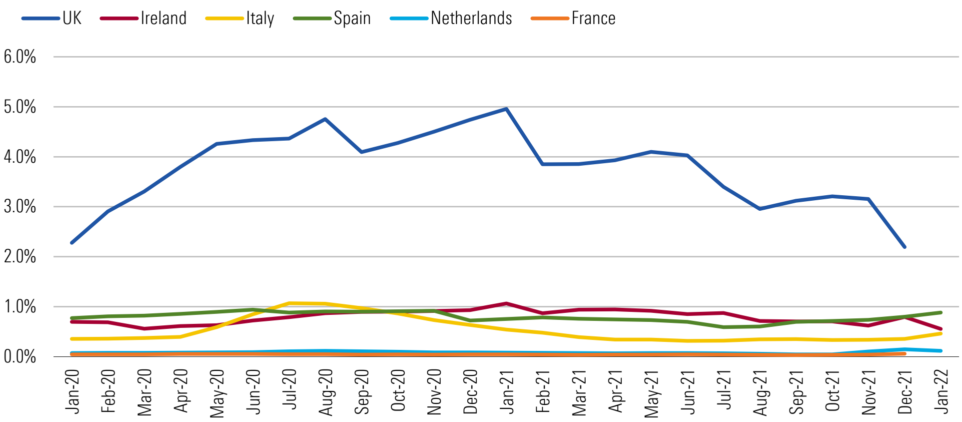


Source: DBRS Morningstar.

In May 2020, DBRS Morningstar expected the weakest transactions to be those secured by asset pools with high numbers of restructured loans, reperforming loans, or past delinquencies, along with concentrations to self-employed borrowers. As a result, for borrowers with restructured loans, borrowers in arrears in the past five years, or borrowers who are self-employed, we made additional adjustments to expected performance.

During the pandemic, we did note a weakening in performance in terms of increased delinquencies. However, we now see three-month+ delinquencies in most jurisdictions returning to pre-pandemic levels. In other jurisdictions they did not increase to the levels we initially anticipated.

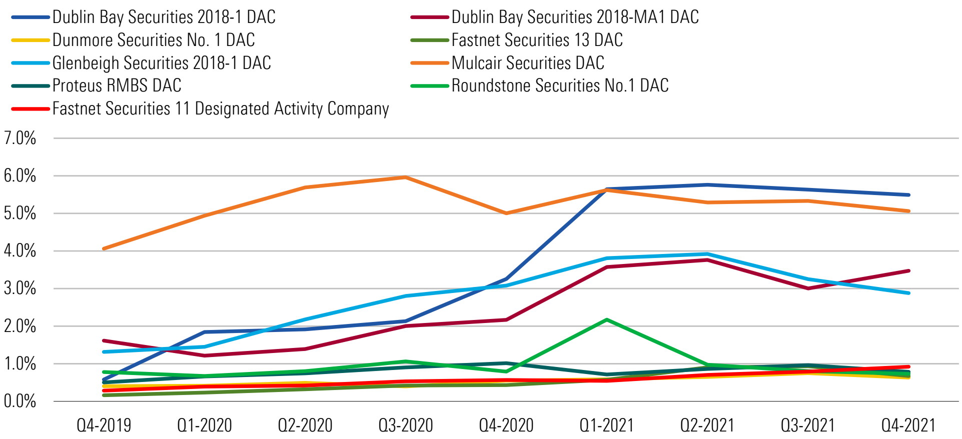
Exhibit 3 Weighted-Average Delinquencies by Jurisdiction (>3 Months)



Source: DBRS Morningstar-rated transactions.

While restructured portfolios have deteriorated, overall they were not materially worse compared with pre-pandemic expectations, displaying a more stabilised and expected delinquency trend.

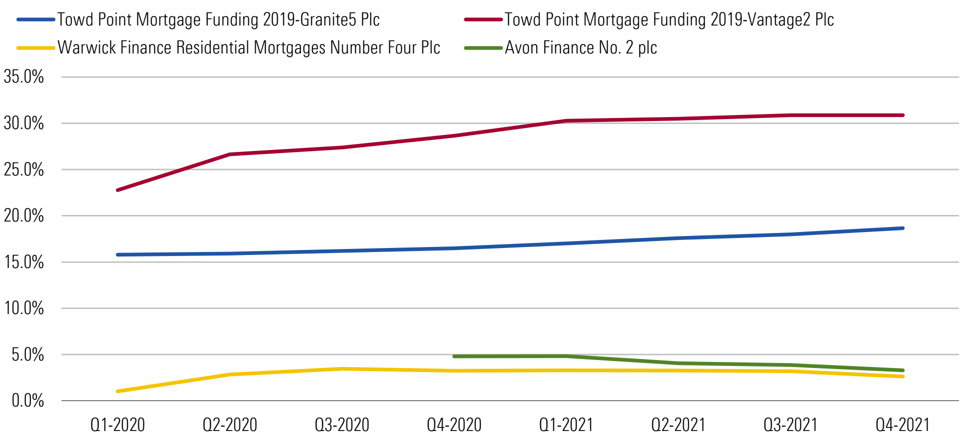
Exhibit 4 Restructured Portfolios Irish Delinquencies (>3 Months)



Source: DBRS Morningstar.

Notable transactions that showed increased delinquencies included Dublin Bay Securities 2018-1 DAC and Dublin Bay Securities 2018-MA1 DAC. In each transaction, the increasing delinquency trend cannot be directly attributed to an unexpected deterioration in restructured loans. In the case of the Dublin Bay transactions, for example, we have seen an increasing trend in interest-only loans that have matured but on which the loan principal has not been repaid. These loans tend to continue to pay interest. We account for such transaction-specific nuances in our analysis.

Exhibit 5 Restructured Portfolios UK Delinquencies (>3 Months)



Source: DBRS Morningstar.

Not included in the exhibits is the Glenbeigh 2 Issuer 2021-2 Designated Activity Company transaction (which closed in September 2021) as well as two Spanish Miravet transactions: Miravet 2019-1 and Miravet 2020-1.

We will continue to evaluate the credit risk of restructured portfolios on a case-by-case basis and, in accordance with our methodologies, view restructured or reperforming loans as having a higher probability of default (PD) relative to loans that have always been performing.

However, we will no longer make additional and specific adjustments to the expected performance related to the impact of the coronavirus.

Implications of Changes to COVID-19-Related Adjustments

The reduction in the coronavirus-related house price adjustment and the rollback of adjustments to expected performance for loans to self-employed borrowers or loans with previous credit issues would lead to lower PD and loss given default for some portfolios backed by residential mortgages and/or properties.. We do not expect immediate rating actions on RMBS and CB transactions, but we do expect some rating actions for certain Italian and Spanish NPL transactions. DBRS Morningstar will continue to monitor all transactions and may review outstanding ratings if we deem necessary and in accordance with our surveillance activities.

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