Commentary
European RMBS 2023 Outlook

DBRS Morningstar
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Learning to live with high inflation and structurally high rates

After the Coronavirus Disease (COVID-19) crisis and the Brexit aftershocks, 2022 was expected to bring some normalisation to Europe; however, the Russian invasion of Ukraine and record high inflation that proved difficult to contain were not conducive to a quiet year. Through this turmoil, house prices and mortgage performance have so far been resilient thanks to unemployment rates that remain at historical lows. We may be heading for choppy waters, though, as 2023 will likely see a widespread house-price correction across many European countries and mortgage performance will also deteriorate from the historically low levels of arrears.

The initial focus in 2023 will be how successfully central banks will manage to fight inflation, when and at what level the current tightening cycle stops, how economies fare in an environment of higher interest rates, and what further measures governments will be able to offer to households struggling with cost-of-living crises. Later in the year, the impact of such policies on the economy and unemployment rate will start to reflect in mortgage performance. Based on the most recent update to our baseline macroeconomic scenarios, DBRS Morningstar expects the UK and Germany to have negative GDP growth in 2023 with forecasts implying stagnation for most of Europe. Some European countries are also likely to see a rise of 0.2% to 0.4% in unemployment, with the UK and Netherlands expected to see even higher rises of 0.7% and 0.6%, respectively.

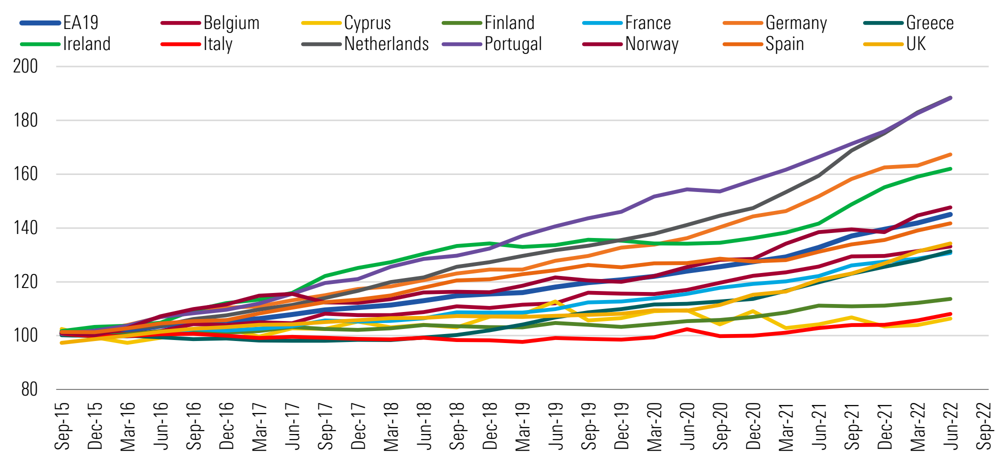
Given a combination of declining house prices, economic stagnation, higher mortgage rates, and modest unemployment increases (albeit from historically low levels), DBRS Morningstar expects mortgage arrears and defaults to increase. This should not pose a significant risk to European residential mortage-backed security (RMBS) ratings but, as a result of an uptick in arrears, we may see fewer upgrades than usual in 2023.

Mortgage borrowers are learning to live with higher mortgage rates, especially new borrowers and borrowers coming to the end of their mortgage rate period, who will find their mortgages much more expensive than before. Most borrowers who refinance will likely have benefitted from house-price growth since purchasing their properties, so their loan-to-value (LTV) ratios would be favourable. Furthermore, since the great financial crisis (GFC) that started in 2008, lenders have become more prudent and usually factor in some rate rises when underwriting mortgages. Unlike during the GFC, wherein many borrowers had weak credit profiles and affordability issues, we now expect borrowers to be better equipped to deal with higher mortgage rates.

Some borrowers who have accumulated savings during the pandemic can also rely on those to help with higher living and mortgage costs. The most affected borrowers will be those in variable or short-term fixed markets (e.g., the UK and Ireland), where a significant number of existing borrowers will face higher rates in the next year. For markets that are predominantly fixed (e.g., the Netherlands, France, Belgium, and Germany) or have caps to the maximum floating rate payable on mortgages (e.g., Italy), existing mortgage holders will be shielded from rate rises for a longer period of time.

Another pocket of risk to monitor during 2023 is the performance of legacy portfolios that were either underwritten before the GFC or include reperforming loans (RPLs), including legacy UK interest-only (IO) portfolios as well as Irish, Spanish, and Italian RPLs. The improved performance of these portfolios in the past five years was due to both the positive economic cycle and the record-low interest rates. With both features abating in 2023, the arrears levels of these loans may rise again.

Exhibit 1 House Prices Across Europe (Base = 2015)



Sources: Haver Analytics, Eurostat, Nationwide Building Society, Bank of Greece.

While we expect house-price corrections across most of Europe, the extent and severity of the correction may vary. Markets with lofty house-price growth since the onset of the coronavirus pandemic and with an already-stretched affordability because house prices have risen faster than income for a prolonged period are more likely to see more significant corrections. In this respect, the UK, the Netherlands, Germany, and Portugal markets appear more vulnerable than markets that experienced less marked growth in the past two years, such as France, Italy, and the Nordic countries (excluding Sweden). However, not all countries that experienced double-digit growth in 2022 are fated to incur a correction in 2023 as we believe that Ireland and Spain are not overheated markets, despite the recent house price index (HPI) boost. More expensive cities within the same country might be affected more than the overall country due to borrowers' affordability constraints.

With UK inflation expected to be higher and more persistent, the UK mortgage market is the most exposed to the cost-of-living crisis. In the same vein, different inflation trajectories within the eurozone will have a varied impact on the different jurisdictions throughout 2023.

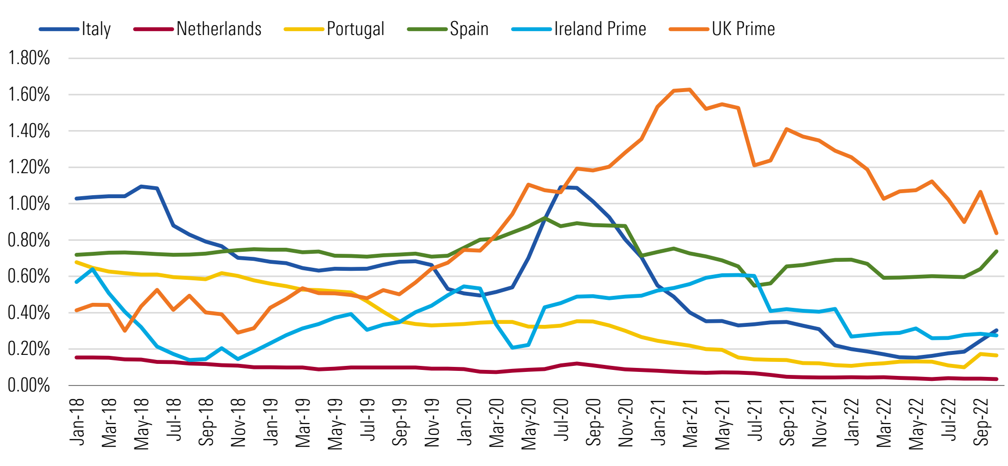
The following table provides further detail on our expectations for the year across the more prominent RMBS markets in Europe.

Sector	2023 Credit Outlook	Mortgage Arrears/Defaults	2023 Ratings Outlook
UK Prime	**Negative** (Page 7)	Moderate deterioration	Stable
UK Nonconforming	**Negative** (Page 9)	Considerable deterioration	Stable
UK Buy-to-Let	**Negative** (Page 10)	Considerable deterioration	Stable
Ireland Prime	Stable (Page 11)	Limited deterioration	Stable
Ireland Reperforming	**Negative** (Page 13)	Considerable deterioration	Stable
Netherlands	**Negative** (Page 14)	Moderate deterioration	Stable
Italy	Stable (Page 17)	Limited deterioration	Stable
Spain Prime	Stable (Page 20)	Limited deterioration	Stable
Spain Reperforming	**Negative** (Page 22)	Moderate deterioration	Stable
Other European Jurisdictions	**Negative**	Moderate deterioration	Stable

RMBS Delinquencies

While navigating the pandemic without significant upticks in arrears, RMBS performance still deteriorated slightly in Spain and in Italy in 2022, whereas Irish prime mortgage and Dutch mortgage arrears have continued to reach new historical troughs.

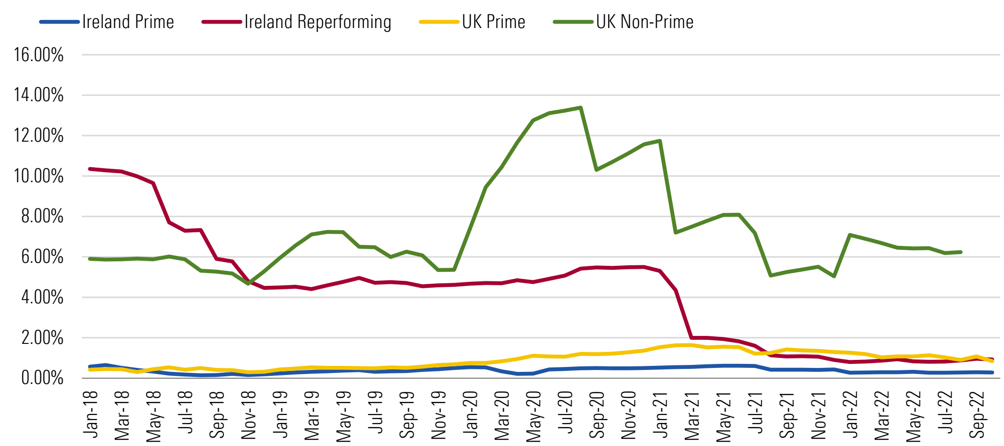
Exhibit 2 RMBS Index for 90-Days+ Arrears Across Europe



Source: DBRS Morningstar.

For the UK and Ireland, we saw improvement in the nonconforming and reperforming sectors, respectively, for the past five years with performance levels of Irish RPLs now converging to prime levels. Because these improvements occurred in a benign economic cycle with record-low rates, this trend will likely reverse in 2023.

Exhibit 3 RMBS Index for 90-Days+ Arrears in Ireland and the UK



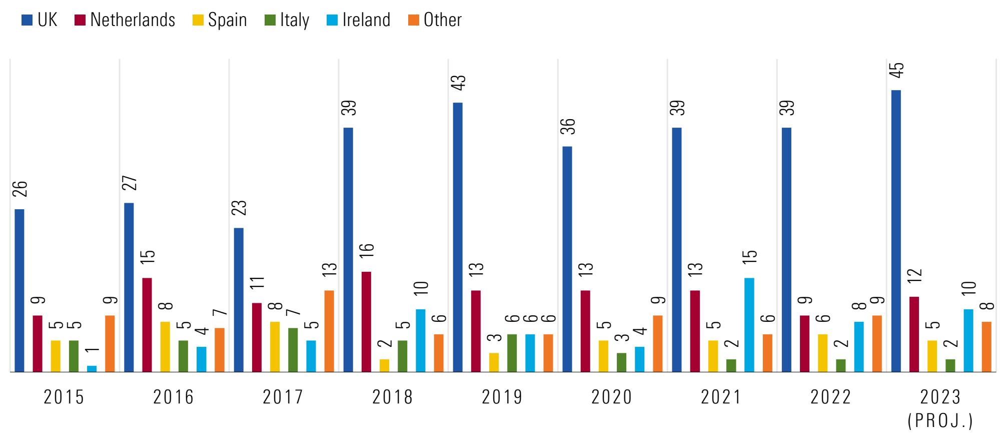
Source: DBRS Morningstar.

RMBS Issuance

Driven by some large retained transactions, European RMBS issuance by volume increased by 30% in 2022 compared with 2021. By number of transactions, 2022 had fewer issuances than expected due to volatile market conditions. With a gradual reopening of the investor-placed market, we expect the number of rated transactions to increase to about 80 in 2023, in line with 2021 levels. However, in terms of overall issuance volumes, we expect a contraction to about EUR 80 billion in 2023 from EUR 109 billion in 2022. Most of the contraction will be due to one-off effects as the issuance amount in 2022 was inflated by jumbo retained transactions in France and Germany, which are unlikely to be repeated in 2023.

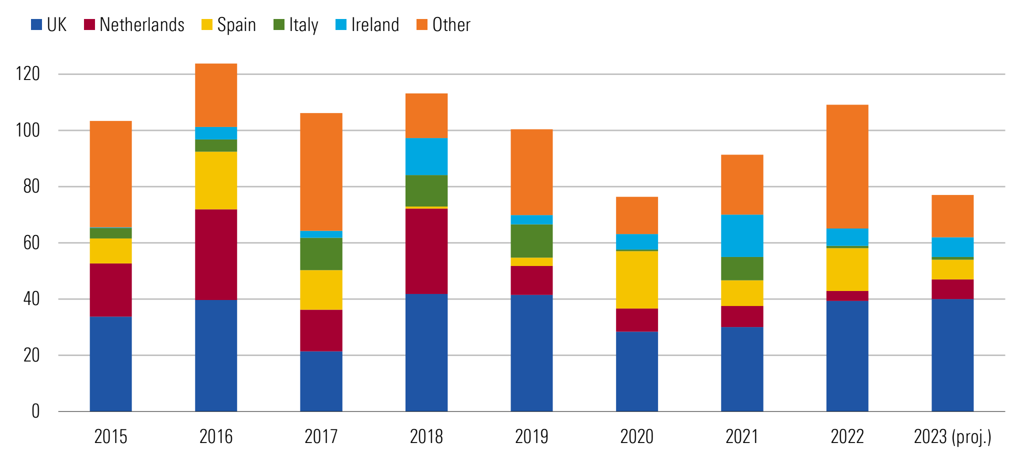
We expect fewer retained transactions and more investor-placed deals as banks will need to fund targeted longer-term refinancing operations repayment by mid-2023. While specialised lender issuances in the UK and the Netherlands have been subdued for most of 2022, we expect a rebound in 2023—even if new originations shrink due to unpalatable margins for lenders, the portfolios originated through 2022 are currently parked in warehouses that necessitate a securitisation exit sooner rather than later.

Exhibit 4 Number of European RMBS Transactions per Closing Year, Split by Jurisdiction



Sources: Concept ABS, DBRS Morningstar.

Exhibit 5 RMBS Transaction Volumes (EUR Billions) per Year, Split by Jurisdiction



Source: Concept ABS, DBRS Morningstar

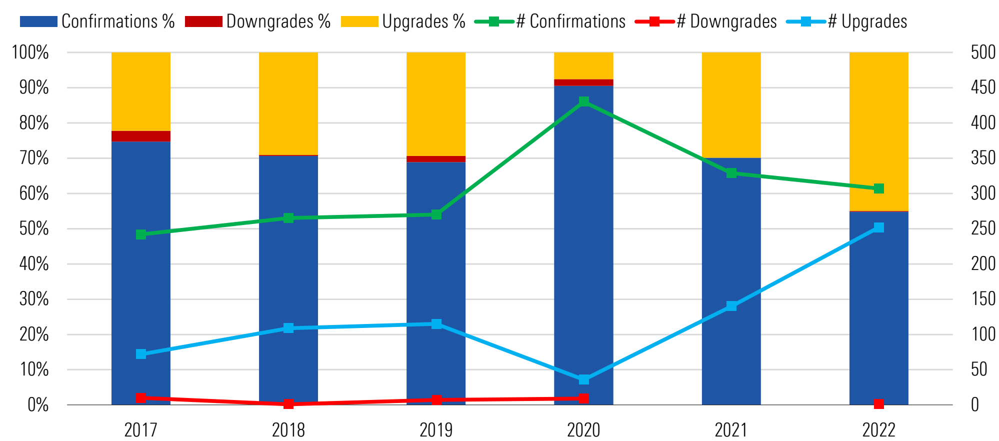
After peaking at EUR 3.0 billion in 2021, green bonds issuance in the RMBS space contracted in 2022 to about EUR 0.5 billion, which is in line with the issuance levels recorded before 2021. In 2023, we expect green bond issuance increase as the energy crisis has put the question of energy efficiency in houses at the forefront of government agendas across Europe. The increased incentives are likely to attract an increasing number of lenders to approach this new segment of the market.

Social bonds issuance was also down in 2022, contracting to just above EUR 100 million compared with EUR 3.0 billion in 2021. Minimal issuance is also likely for 2023 as lenders are less likely to target lower-income borrowers while the cost-of-living crisis continues to run its course.

RMBS Rating Activity

While the number of rating upgrades in 2020 was limited by the pandemic, on a percentage basis in 2021, rating upgrades have been in line with those in 2019 and 2018. In 2022, the number of upgrades was higher than usual because of a methodology update for UK RMBS, which led to significant upgrade activity for the mezzanine notes in UK RMBS transactions. The past two years have seen only one rating downgrade due to the long, positive credit cycle benefitting performance across Europe.

Exhibit 6 European RMBS Surveillance Rating Actions



Source: DBRS Morningstar

United Kingdom

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2023 UK RMBS Credit Outlook

Negative

As the UK economy enters a recession and navigates the cost-of-living crisis, borrowers are facing increased living costs, shrinking real salaries, and rising mortgage/rent payments. The negative outlook is further underpinned by the expectation of house-price declines, which could reverse some of the price rises during and since the pandemic. As a mitigant, due to improved underwriting standards and more cautious lending after the GFC, UK borrowers are expected to weather this negative cycle better than in the aftermath of 2008. Moreover, UK house prices still benefit from structural undersupply and government support. We do not believe the expected arrears deterioration to affect the stability of ratings in 2023.

Macroenomic Scenario

Negative

- The economy is already in recession with a further 1% GDP contraction expected in 2023.
- Inflation is higher than in the euro area, expected to peak at 11% in Q4 2022 and to remain elevated but lower than 10% in 2023.
- Unemployment is expected to increase by 0.7% in 2023.

Positive

- The government has more fiscal headroom than other European peers to support households through the cost-of-living crisis.

House Prices

Negative

- The Office for Budget Responsibility forecasts a 9% decline between Q4 2022 and Q3 2024.
- While a supply shortage will remain, higher mortgage rates will dampen demand from both owner-occupiers and investors.

Positive

- The UK government has a track record of supporting housing market (e.g., the stamp duty holiday introduced at the start of the pandemic).

Credit Risk

Negative

- OBR expects a 4.3% reduction in household disposable income (HDI). It will take more than five years for the real HDI to climb back to pre-pandemic levels.
- There will be higher mortgage rates and payment shocks for borrowers looking to refinance.
- Buy-to-let borrowers face a greater challenge because the increase in mortgage payments may not be fully recouped by higher rents, especially in a prolonged recession.

Positive

- Borrowers in the UK have more refinancing options than peers, even in a downturn market (e.g., affordability can be stretched through term extension).

Issuance

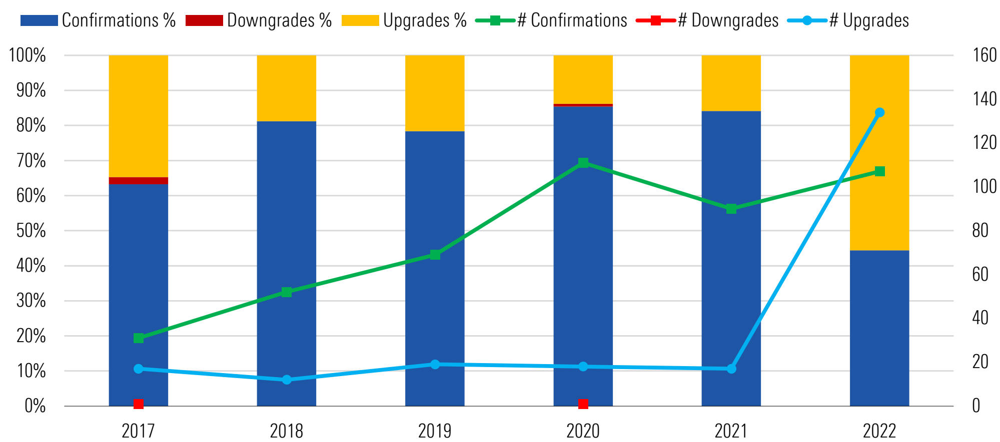
Negative

- Market turbulence for UK bond yields could make publicly placed securitisation difficult to achieve.
- Low yields locked in by the borrowers in the short term compared with the rising cost of funding will make deal economics unpalatable.

Positive

- Even if mortgage issuance falls, there is a 'backlog' of new originations sitting in warehouses that could be tapped for public securitisations.
- Nonbank lenders need a securitisation exit even if the economic terms are not as favourable as in the past decade.

Exhibit 7 UK RMBS Surveillance Rating Actions



Source: DBRS Morningstar

Most of the upgrades in 2022 were driven by an update to DBRS Morningstar's European RMBS Insight: UK Addendum methodology. Please see https://www.dbrsmorningstar.com/research/407499/dbrs-morningstar-upgrades-and-confirms-ratings-on-22-uk-rmbs-transactions-following-update-to-european-rmbs-insight-uk-addendum for further details.

United Kingdom

Cost-of-living crisis and government support

Household income growth is not keeping pace with the nearly 11% inflation experienced in 2022. With energy costs sharply rising, the government implemented a temporary price cap at a much higher level than previous energy prices and provided a GBP 400 discount on electricity bills to every household for October 2022 to March 2023. From April 2023 onward, energy prices will however likely rise further. On top of the general increase in the cost of living, UK residents are facing steep increases in their mortgage or rental bills, leading to pressure on the government to provide further support to households and increase wages for public-sector workers. To avoid a wage inflation spiral, the government is resisting such pressure as the UK faces a prolonged period of strikes by various public-sector workers. Overall, while wages are likely to rise nominally in 2023, they will likely still decline in real terms given high inflation.

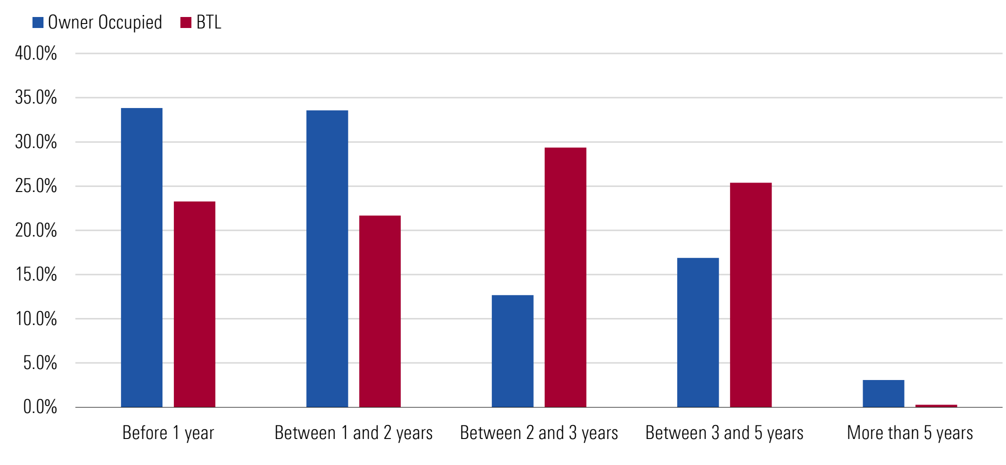
Mortgage rate hikes affecting lenders and borrowers alike

To tackle the persistently high inflation in the UK, the Bank of England (BoE) increased the Bank Base Rate (BBR) to 3.5% in December 2022 from 0.1% in December 2021. In 2023, the BBR is expected to increase to over 4.0% by mid-year. Lenders have priced the rate increase into mortgage rates, making mortgages significantly more expensive in the UK; this is likely to continue in 2023 and UK mortgage borrowers will gradually have to adjust to living with structurally higher mortgage rates than what they have been used to in the past decade. Higher rates make mortgages less affordable and, hence, borrowers are finding that they can borrow less now with the same income than they could before, effectively credit-rationing some borrowers. Early indications point to a larger proportion of mortgages originated with lower LTVs (below 80%) as borrowers adjust to their reduced ability to borrow. The UK mortgage market will remain fairly competitive so, for good-quality borrowers with low LTVs, there will still be mortgage availability.

Refinancing risk increasing, but borrowers more resilient than in the past

Even though, as of Q1 2022, 80% of outstanding UK mortgages were fixed rate, data that DBRS Morningstar collected for a selected list of UK transactions (see Exhibit 8) show that more than two-thirds of mortgages that currently pay a fixed rate will need to refinance or undergo a rate reset in the next two years as their initial teaser periods expire. Most of these borrowers have benefitted from rising house prices, reducing their LTV and allowing them to access cheaper mortgage products, but will still see a significant increase in their instalments.

Exhibit 8 Time to Reset Distribution in UK RMBS Rated by DBRS Morningstar



Source: DBRS Morningstar.

Overall, mortgage holders are in better shape now than during the GFC, thanks to better underwriting standards and a low unemployment rate. BoE data show that the percentage of households above the "enhanced" danger threshold of 70% for the high cost of living-adjusted debt service-to-income ratio was still relatively low in Q4 2022 at just over 1.5%, in line with the long-term average and well below the peak of 2.8% just before the GFC.

Buy-to-let (BTL) under pressure

Unlike the GFC when BTL borrowers benefitted from lower mortgage rates, BTL borrowers now face significantly higher mortgage costs at refinancing or at rate reset. In many cases, mortgage payments will likely increase by between 50% and 100%. While rents will likely increase as well, landlords may struggle to pass on the entire increase to tenants. In addition, some BTL borrowers face higher investment needs, considering existing and upcoming letting restrictions linked to the energy performance of their properties. All in all, BTL loans, especially those with higher LTVs and lower rental yields (more common in areas with expensive real estate), will struggle in 2023 as we expect BTL to underperform prime UK owner-occupier mortgages.

Ireland

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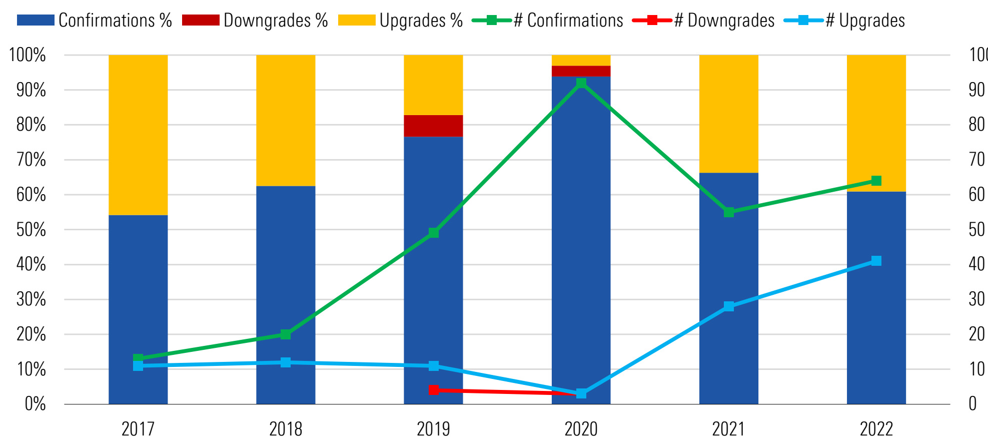
2023 Irish RMBS Credit Outlook

Stable for prime / Negative for reperforming

The Irish economy performed relatively well in 2022 with GDP growth of 8.8% compared with the rest of Europe and is expected to grow in 2023 as well, albeit at a slower pace of 1.3%. Unemployment will likely increase by 0.2% but, in absolute terms, will remain quite low. House prices have been growing, but the macroprudential rules introduced since 2015 seem to have prevented a bubble. Prime Irish mortgage loans should see only a modest deterioration in arrears and default levels; however, greater credit concerns remain about Irish mortgage portfolios that are composed of RPLs. We expect the impact of rising mortgage rates and the cost-of-living crisis to affect these portfolios more significantly, potentially resulting in higher default levels. Even for this more exposed sector, we believe ratings will remain stable in 2023, considering transaction deleveraging and a positive house-price trajectory.

Macroeconomic Scenario	House Prices	Credit Risk	Issuance
Negative • GDP growth will slow in 2023 (1.3% vs. 8.8%) with downside risks linked to reliance on global economic partners and the UK in particular. • The unemployment rate is expected to modestly increase. • High inflation will persist in the eurozone.	**Negative** • Rising mortgage rates and unemployment will likely put some downward pressure on house-price growth.	**Negative** • Reperforming portfolios are heavily exposed to rising mortgage rates. • Loosened macroprudential mortgage policies will be introduced in January 2023.	**Negative** • Mortgage lending volumes may decline in 2023. • Nonbank specialist lenders relying on wholesale market for funding may reduce lending.
Positive • Ireland is coming off a very strong 2022 in terms of GDP growth (8.8%). • The economy is also expected to perform better than most other eurozone countries (GDP growth of 1.3%). • The government fiscal balance is in good order, allowing for strong measures in fighting the high cost of living through 2023.	**Positive** • While prices have recently increased rapidly, they remain just slightly above 2007 levels. • While house-price growth might see a modest correction in 2023, there remains a structural undersupply of housing.	**Positive** • Ireland has a high saving rate (among the highest in Europe). • Around 50% of outstanding mortgages are originated under macroprudential rules, which restricts LTV and loan-to-income (LTI) ratios.	**Positive** • In the medium term, there will be healthy demand for mortgage lending.

Exhibit 9 Irish RMBS Surveillance Rating Actions



Source: DBRS Morningstar

Ireland

Market resilient to inflationary pressures

Like in most countries, Irish borrowers will face a higher cost of living due to inflation and rising mortgage/rents. Based on the most updated household survey data, mortgage borrowers' current savings can cover 13 months of mortgage instalments; however, this buffer is a slimmer seven months for lower-income mortgagors, which means that borrowers from lower-income households remain more vulnerable. The Central Bank of Ireland (CBOI) estimates that the median borrower could experience a 12% increase in monthly mortgage payments if the European Central Bank rose its rate by 4.0% relative to June 2022. In this scenario, about 5% of borrowers would struggle to stay current on their mortgage payments.

Fixed-rate shift is credit positive, but not enough to hedge against inflation

In recent years, the Irish market has shifted towards fixed-rate mortgages with almost 90% of mortgages originated after 2020 being fixed rate and about 50% of the outstanding loans now paying a fixed rate. Nearly 40% of these fixed loans will revert to floating within three years. The remaining loans pay a variable rate, either tracking the ECB rate or paying a discretionary rate set by the lender. Borrowers facing payment shocks are more likely to default in the short term than those on fixed rates. The most exposed, however, are the reperforming borrowers on variable rates as they may have limited capacity to deal with higher payments along with higher living costs.

Nonbank lending emergence threatened by rate hikes, but not a credit concern

Nonbank lenders are a growing part of the Irish mortgage market, reaching 14% of total new mortgage lending in 2021 and about 20% of new originations in H1 2022. The main driver of growth for nonbank lenders is the first-time buyer (FTB) and remortgage market. Many of these lenders rely on wholesale markets for their funding; 2023 could be challenging for these lenders if property transactions decline as FTBs struggle with rising rates and funding costs remain elevated in the wholesale market. Nonbank lenders have also benefitted from a growing BTL market, which could also suffer as rate rises may still exceed the relatively healthy rent increases compared with other BTL markets in Europe (namely, the UK and the Netherlands).

From a credit perspective, macroprudential rules have ensured that the expansion of nonbank lending has not eroded credit standards. We expect the performance of RMBS transactions backed by specialist lender originations to remain strong.

Tighter credit conditions may mute looser macroprudential rules

The CBOI introduced macroprudential mortgage measures back in 2015. Since then, those rules coupled with a more prudent credit appetite informed by the mistakes made prior to the GFC, have kept credit standards under control. As of June 2022, about half of outstanding mortgages were originated under the macroprudential framework. Because house-price increases outpaced wage growth in the past seven years, the rules became particularly restrictive and caused credit-rationing for younger people buying their first properties. For this reason, starting in January 2023, the CBOI has relaxed the rules (see Exhibit 10) by raising the LTI limit for FTBs to 4.0 times (x) from 3.5x. The lower percentage of exceptions available to lenders, which moved to 15% from 20%, partially offset this change. These loosened rules are rather timely, considering that interest rate hikes introduced further shock to affordability. Indeed, should mortgage rates increase from their current levels (2.7% as of September 2022) in 2023, overall affordability after accounting for the new limit might still be worse than in 2022.

Exhibit 10 Irish Macroprudential Rules Before and After 1 January 2023

Borrower type	FTBs		Non-FTBs		BTL	
	Until 1 Jan 2023	From 1 Jan. 2023	Until 1 Jan 2023	From 1 Jan. 2023	Until 1 Jan 2023	From 1 Jan. 2023
Limits under the mortgage measures	LTI: 3.5x LTV: 90%	LTI: 4.0x LTV: 90%	LTI: 3.5x LTV: 80%	LTI: 3.5x LTV: 90%	LTV: 70%	LTV: 70%
Allowance share above the limits	LTI: 20% LTV: 5%	LTI: 15%	LTI: 10% LTV: 20%	LTI: 15%	10%	10%
Exemptions	Switcher loans are exempt from the mortgage measures. The LTI limit does not apply to lifetime mortgages. The LTV limit does not apply to negative equity mortgages.					

After taking more caution during the pandemic, Irish lenders showed increased risk appetite in H1 2022 when the share of loans to FTBs above the LTI policy limits increased to 18% compared with 13% in H1 2021. This credit expansion is likely to reverse in 2023 as lenders are expected to take a more conservative stance amid the heightened credit risks.

Netherlands

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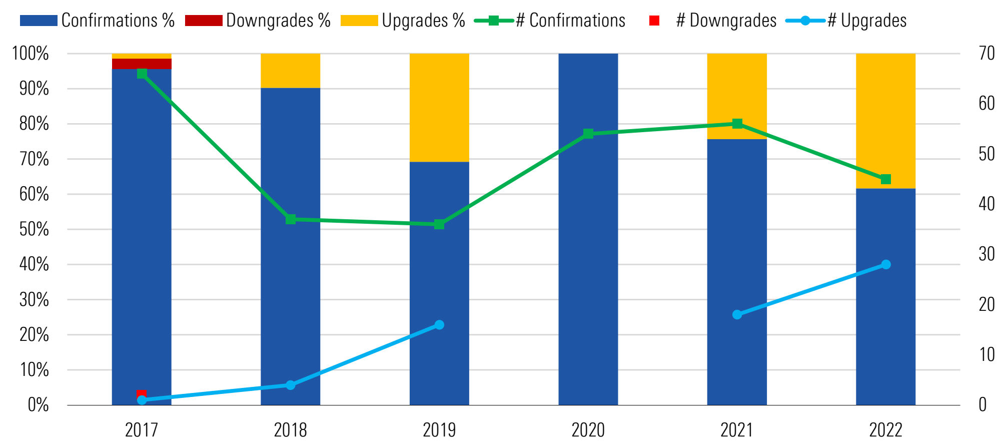
2023 Dutch RMBS Credit Outlook

Negative

The Netherlands has experienced one of the largest house-price increases in Europe since the onset of the coronavirus pandemic. A strong economy and record low mortgage rates have fuelled this growth, stretching mortgage affordability. We expect Dutch house prices to correct in 2023 due to a combination of factors, including inflation, rising mortgage rates, and the general economic situation. We also expect GDP growth to reduce significantly to 0.4% in 2023 from 4.4% in 2022. However, we anticipate that mortgage performance will not worsen significantly as existing borrowers are protected from immediate rate rises due to the long-term fixed-rate nature of Dutch mortgages. Dutch mortgage borrowers will benefit from rising nominal wages, built-in property equity, and savings buffers accumulated during the pandemic. We believe that the expected house-price correction and moderate arrears deterioration will not affect the stability of Dutch RMBS ratings in 2023.

Macroeconomic Scenario	House Prices	Credit Risk	Issuance
Negative	**Negative**	**Negative**	**Negative**
• GDP growth is expected to significantly slow down (0.4% vs. 4.4%). • A 0.6% rise in unemployment is expected. • Inflation remains higher than in the rest of the eurozone. • There has been a significant loss of households' purchasing power because wages lag inflation. • Consumer confidence is at its lowest level on record.	• Correction is expected in 2023, which partially reverses gains made since the onset of the pandemic. • The number of property sales should decline due to stretched affordability.	• Higher rates and increasing unemployment will lead to a modest rise in arrears and defaults. • There is a trend toward variable and cheaper short-term fixed mortgages to avoid locking into currently high rates for longer periods.	• Mortgage lending volumes could decline, reflecting fewer housing transactions.
Positive	**Positive**	**Positive**	**Positive**
• Support measures protect households from higher public spending. • The Netherlands have relatively stable public debts compared with the eurozone. • The Dutch financial sector's strong starting position offset high inflation and interest rate rises. • The unemployment rate is low, even accounting for the expected increase in 2023.	• Even after correction, house prices are expected to be higher than at the start of the pandemic. • Positive demand-supply balance for houses underpins long-term house prices.	• There is a long-term fixed-rate market in the Netherlands with an average fixed-rate period for new mortgage loans of more than 15 years in Q1 2022. • The refinancing/rate reset risk is low compared with the eurozone; currently ~75% of outstanding mortgage debt is fixed for more than five years. • The Dutch mortgage market has historically performed very strongly, even during recessions.	• More green mortgage originations from Dutch banks may lead to more "green" issuances. • More BTL issuances are expected as the number of lenders in this space is growing.

Exhibit 11 Dutch RMBS Surveillance Rating Actions



Source: DBRS Morningstar

Netherlands

Housing market super performer in Europe

Overall, Dutch house prices have consistently increased since 2012 as large cities like Amsterdam, Rotterdam, and Hague have grown significantly. The main reason for this continuous growth is the chronic housing supply shortage, strong economy, and low interest rates over the past few years (currently below 2%y). The Netherlands experienced one of the highest house-price growth levels since the coronavirus pandemic across Europe.

The current inflation rate in the Netherlands exceeds that of the eurozone, peaking at 15.4% in Q4 2022 mostly due to continued pressure on energy prices. With increased interest rates, new borrowers have reduced capacity to borrow. DBRS Morningstar expects Dutch house prices to correct, but still remain higher than pre-pandemic levels.

New business trending toward variable and short-term fixed mortgages

Typically, most of the Dutch mortgage market carries a fixed rate of interest that remains unchanged for a term between five and 30 years. Very low interest rates in recent years have made it attractive for homebuyers to fix mortgage rates for longer periods; however, some borrowers might opt for cheaper short-term fixed or variable rates, hoping to find lower rates in the future and avoid locking into current rates for a long period. On one hand, lending for variable-rate loans and one-year fixed-rate loans increased by 7% in the last quarter and 47% since the beginning of 2022. On the other hand, lending volumes for fixed-rate loans with a fixed period of more than 10 years reduced by 41% since the beginning of 2022.

Housing shortage remains

A key driver for the increase in house prices over the last few years has been the imbalance of supply and demand for residential properties in the Dutch market. According to government estimates, there is still a shortage of more than 300,000 homes. To address this shortage, the Dutch Ministry of Infrastructure and the Environment is trying to raise the construction rate to 100,000 new homes per year 70,000 new homes.

This structural housing shortage in the medium term is likely to provide support to house prices and ensure any house-price correction remains relatively contained.

BTL mortgages and affordable housing

BTL mortgages have been a rapidly growing part of the Dutch mortgage market as many more lenders now offer this product compared with only a few years ago. The growth in investors who might sometimes compete with prospective owner-occupiers has also raised some political concerns, leading to the introduction of certain measures that favour FTBs over investors. We expect this political bias in favour of FTBs to continue in 2023. The recent regulatory developments that affect the housing rental market include:

- Further increase to the Real Estate Transfer Tax (RETT) to 10.4% for investors in 2023 following a previous increase in RETT to 8% in 2021 for investors from 2%.
- Opkoopbescherming (2022): In several major cities (including Amsterdam, Rotterdam, Hague, and Utrecht), governments have implemented a ban on BTL purchases for homes with a property value up to a certain value.
    - For a period of three years (from 1 May 2021 to 1 May 2024), the law has limited the annual rent increase. The maximum rent increase is 1% over inflation in the previous year. For 2022, the maximum rent increase was 3.3%.
    - Role of property value (WOZ) on rental price limited (May 2022): The maximum rental price of regulated rental homes is determined by a points system. Points are provided based on various quality characteristics, including WOZ. The share of points that can be assigned based on WOZ is now capped at 33% for homes in the regulated segment.

So far, with all the new regulations, the Dutch BTL market has continued to grow. However, it remains to be seen if these regulations along with other pending national and local government measures, along with rising mortgage rates and a correction in property prices, will significantly cool off the BTL market and get more FTBs on the property ladder.

Italy

2023 Italian RMBS Credit Outlook

Stable

The typically low private household indebtedness coupled with traditionally sticky house prices should keep Italian mortgage performance under control in 2023. While the potential economic stagnation could increase arrears, we do not believe that high inflation will affect residential borrowers in Italy more than in peer countries. The stock of floating-rate loans and the unsavoury trend of new borrowers opting for a variable rate in 2022 are concerning in the current rising interest environment, but low mortgage leverage and conservative lending criteria should help borrowers and lenders alike to weather the cost-of-living crisis without much hassle. Thanks to a high level of credit enhancement, we expect Italian ratings to remain stable even in a more adverse scenario wherein delinquencies pick up considerably.

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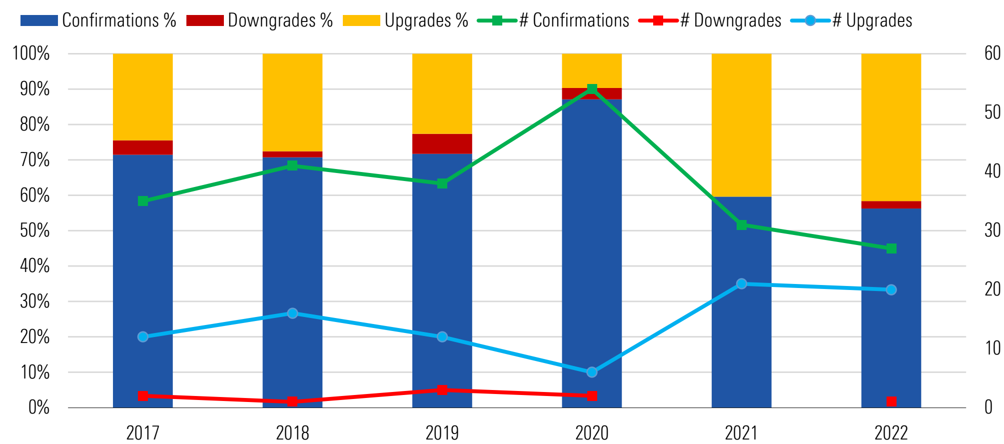
Macroeconomic Scenario	House Prices	Credit Risk	Issuance
Negative	**Negative**	**Negative**	**Negative**
• After recovering from the pandemic and seeing 3.7% growth in 2022, GDP is expected to stagnate in 2023 (-0.1%) with the unemployment rate climbing to 8.5% from 8.1%. • Sustained high inflation of almost 9% in 2022 should persist in 2023 and at higher levels than the eurozone average of 7% to 8%). • Due to high public debt, the government may not sustain households through a prolonged period of high inflation.	• Despite a post-pandemic rebound, Italian residential property prices remain among the most structurally depressed in Europe, with the national HPI still at a lower level than before 2013.	• About 40% of the outstanding mortgage stock is linked to a variable rate such as Euribor, which may cause a pickup in arrears in 2023. • As offered rates increased through 2022, most Italian new borrowers preferred floating-rate loans as the initial instalments are currently lower than with fixed-rate loans, thus creating a pocket of vulnerable borrowers that have not deleveraged their loans yet.	• As market rates rise, Italian issuers (mainly consisting of large retail banks) may prefer covered bond issuances to RMBS.
Positive	**Positive**	**Positive**	**Positive**
• Internal demand and investment have been bolstered by the European Union (EU)-funded National Recovery & Resilience Plan. While creating inflationary pressures, the plan will keep positively affecting the overall economy through 2023.	• Outside Milan and Rome, house prices in Italy are historically sticky in expansionary and recessionary cycles. • Even in a downside scenario, we expect house-price corrections to be marginal compared with the rest of Europe.	• Most lenders that offer variable rates have an explicit cap to the interest rate payable by the mortgagor. • The overall household indebtedness in Italy (stable at 64% of the disposable income) is among the lowest in Europe so that households are less vulnerable to inflationary pressures on their income and typically do not have further debt to repay in addition to mortgage payments.	• The balance sheet reduction tied out by legacy nonperforming loan (NPL) portfolios means that lenders are better positioned than in the past to support households through tougher times and may avoid restricting originations to levels seen in recent past crises.

Exhibit 12 Italian RMBS Surveillance Rating Actions



Source: DBRS Morningstar

Italy

Sticky house prices resilient to inflation and moderate recession

Contrary to most housing markets across Europe, the Italian market is not afflicted with undersupply, which is one of the factors that have kept house-price growth at low levels in recent decades. While the market did not heat up during expansionary cycles, price corrections during recent economic crises have also been limited. We expect that, even if the downside scenario of a mild recession materialises in 2023, the impact on house prices will be minor. A prolonged period of high inflation is also not overly concerning since borrower affordability is far from stretched and the knock-on effects on house prices will be less prominent than in other European countries. High inflation may actually be positive if the high cost of living does not excessively smother internal demand and investment. With nominal wages for younger people set for a rare increase and the healthy construction sector expected to pass through increased construction costs to buyers of new dwellings, house prices may actually increase in 2023 more than in recent years.

Floaters back in vogue and problematic

The record low interest rates in the past decade have transformed what has traditionally been a floating-rate market into a fixed-rate market, with only 40% of outstanding residential mortgages currently on a tracker rate. The shift was made possible by the convergence between fixed-rate and tracker spreads offered on mortgages underwritten since 2019, which highly incentivised borrowers to pick a fixed-rate product. While this is positive in the current scenario of rising rates, as soon as fixed-rate loans became more expensive at the start of 2022, borrowers immediately flocked back to floaters. The Bank of Italy data show that, in Q2 and Q3 2022, less than 50% of new borrowers opted for a fixed rate compared with 90% in 2021. Opting for a lower initial instalment at the high risk of successive payments spiralling to unsustainable amounts could be problematic if high rates linger while these new origination vintages are still not deleveraged. Lenders themselves offer one mitigant to rising instalments in the form of rate caps that set a maximum rate payable on a loan. According to the Bank of Italy, caps were a product feature for about 40% of new originations in Q3 2022 as lenders needed a quick fix for their stressed affordability tests in the rising interest rate environment.

Healthier lenders and sturdy borrowers

NPL stocks on banks' balance sheets are finally receding, now accounting for 3.5% of total loans compared with 17.1% in September 2015. While residential mortgages performed relatively well during the GFC and the sovereign crisis in the early 2010s, the bad small and medium-size enterprise and corporate credit saturating banks' balance sheets meant that lenders had to be overly cautious about extending new credit in the past decade, thus effectively credit-rationing a sizeable portion of prospective FTBs. These credit standards—among the tightest in Europe—should reap some benefits in a downside economic scenario. Moreover, the declining NPL stock also means that lenders now have more capacity to dedicate to new residential arrears management in case high inflation prompts performance deterioration. This could translate into better forbearance measures and a more timely workout process, leading to better cure rates. In terms of legacy portfolios, so-called RPLs represent a smaller portion of the market compared with Ireland or Spain. While borrowers that have benefitted from low rates on their renegotiated loans are at risk in the current rate environment, these exposures are typically not securitised and are therefore not a concern for Italian RMBS performance.

Spain

2023 Spanish RMBS Credit Outlook

Stable for prime / Negative for reperforming

Spain has historically been a floating-rate mortgage market. Until 2016, more than 90% of the mortgage originations were floating-rate loans mainly referenced to 12-month Euribor. Since then, and due to the low interest rate environment, banks started to promote fixed-rate mortgage loans. As of mid-2022, the Spanish outstanding mortgage loan book consisted of approximately 30% fixed-rate mortgages. Prime Spanish mortgage loans will likely see only a modest deterioration in arrears and default levels, partly due to a higher share of fixed-rate loans and lower indebtedness levels. However, greater credit concerns remain about many Spanish mortgage portfolios composed of RPLs as we expect rising mortgage rates to affect these portfolios more significantly because of their floating-rate nature and these borrowers' vulnerability to the rising cost of living. We believe that a potential increase in delinquency levels will not affect the stability of Spanish RMBS ratings in 2023.

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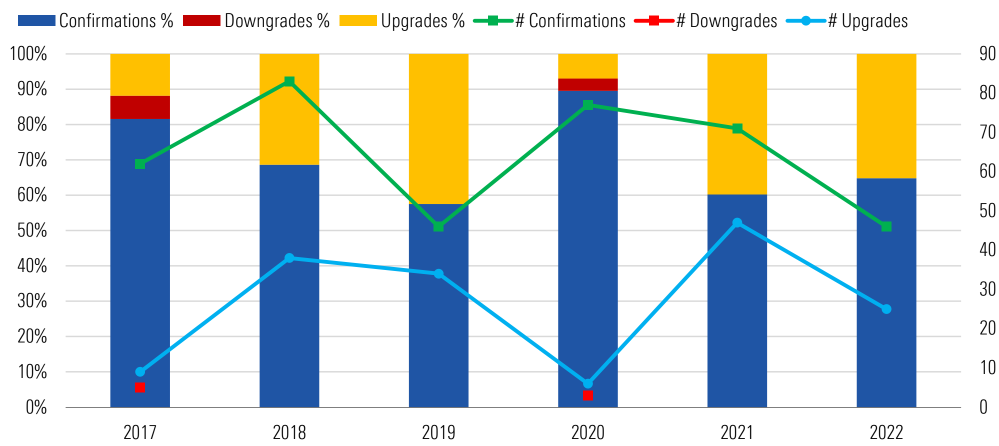
Macroeconomic Scenario	House Prices	Credit Risk	Issuance
Negative	**Negative**	**Negative**	**Negative**
• GDP growth will decelerate in 2023 (0.9% vs. 4.6%), similar to most European countries. • A modest increase of 0.3% in unemployment is likely. • High inflation and interest rates will continue to put pressure on households' disposable income.	• Rising interest rates, along with the general economic slowdown, pose a risk to house prices.	• Rising mortgage and unemployment rates will lead to some increase in arrears and defaults. • Spanish RPLs are most at risk due to their weaker borrower profile.	• Reduced mortgage origination volumes could result in lower collateral available for securitisation. • Interest rate volatility and market conditions could affect securitisation issuances. Large retail banks may prefer covered bond issuances to RMBS.
Positive	**Positive**	**Positive**	**Positive**
• Supportive government measures like those that the Spanish government approved on 24 November 2022 will help the most vulnerable borrowers.	• Since 2005, house prices in Spain have only increased by 14.6% compared with an average of 68.3% in the EU. • Demand from foreign investors could sustain residential property prices, especially in some main cities.	• Most vulnerable borrowers will have some protection from forbearance measures. • The gradual transition of the Spanish mortgage market toward fixed rates reduces systemic risk. • A high savings rate during the coronavirus pandemic leaves borrowers in better shape compared with 2008.	• Reduced overcollateralisation requirements for Spanish covered bonds could result in more collateral being available for securitisations.

Exhibit 13 Spanish RMBS Surveillance Rating Actions



Source: DBRS Morningstar.

Spain

Housing market appears not to be overheated

We expect there will be pressure on house prices mainly due to lower demand because of high inflation and interest rates, which will continue to pressure households' disposable income. However, we do not consider the housing market to be overheated compared with other European countries. Since 2005, house prices in Spain have increased by 14.6% compared with an average of 68.3% in the EU while inflation during the same period has been in line with that of the EU.

Spanish households savings rate to keep their downward trajectory

Historically, the savings rate for Spanish households has been significantly lower than other EU countries. During 2020 and 2021, mainly because of pandemic-related restrictions and government support measures, Spanish households' savings rate significantly increased to be in line with the average in the EU. Higher savings will cushion mortgage performance against higher inflation and mortgage rates; however, we expect Spanish households' savings ability to diminish in the near future because of the higher cost of living and higher debt servicing costs.

Transactions with restructured loans are vulnerable

There is a clear differentiation in terms of performance within the Spanish RMBS market. Transactions with underlying prime mortgages originated by high street banks show lower levels of arrears and defaults compared with nonprime transactions with a high level of restructured loans in their portfolios. This difference in performance was more pronounced during periods of stress in the Spanish economy like that experienced during the 2008–12 period.
Although we expect a modest deterioration on prime mortgages, we could see a more pronounced deterioration for nonprime mortgages as the increase in their instalments caused by the floating-rate nature of the underlying loans, on top of a higher cost of living, could further damage the economic situation of already-weak borrowers.

Spanish government support measures

On 24 November 2022, the Spanish government approved a new package of measures to provide relief from the impact of higher interest rates on households with mortgages. The measures include an option to extend mortgage maturity for seven additional years and to maintain mortgage instalments fixed for 12 months as well as to facilitate a change of the loan's interest rate type to fixed rate from floating rate.

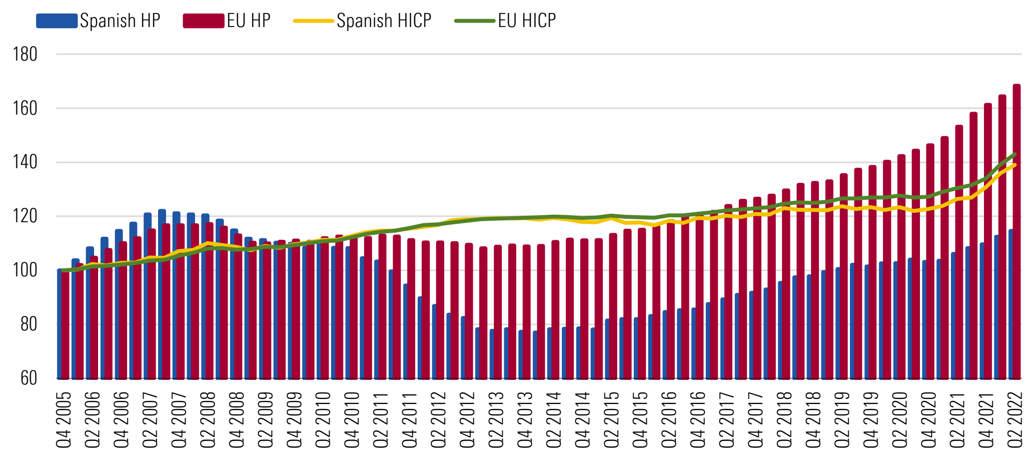
Although we consider that the potential perimeter affected by these measures would be minimal for prime mortgages and greater for nonprime mortgage loans, we expect the measures to have a limited impact on the asset performance of Spanish RMBS portfolios. Providing access to temporary payment holidays and maturity extensions to low-income borrowers in distress can reduce collections in the short term; however, this flexibility should help to reduce delinquency levels and prevent defaults. Additionally, the possibility of moving to a fixed-rate loan from a floating-rate loan can also help borrowers avoid unexpected changes in their mortgage costs. Spanish RMBS transactions commonly feature structural elements that can reduce the risk of excess spread volatility, such as combined waterfalls, cash reserves, and total-return swaps.

Will the increase of fixed-rate mortgage loans continue?

Since 2016, the Spanish mortgage market has experienced a shift, with fixed-rate loans reaching a peak of 75% of mortgage origination during 2022. Although the share of fixed interest rate origination remains high, mainly due to the hawkish interest rate environment, we are starting to see a decrease in fixed-rate loan originations that could indicate the beginning of the end of the interest rate hike period.

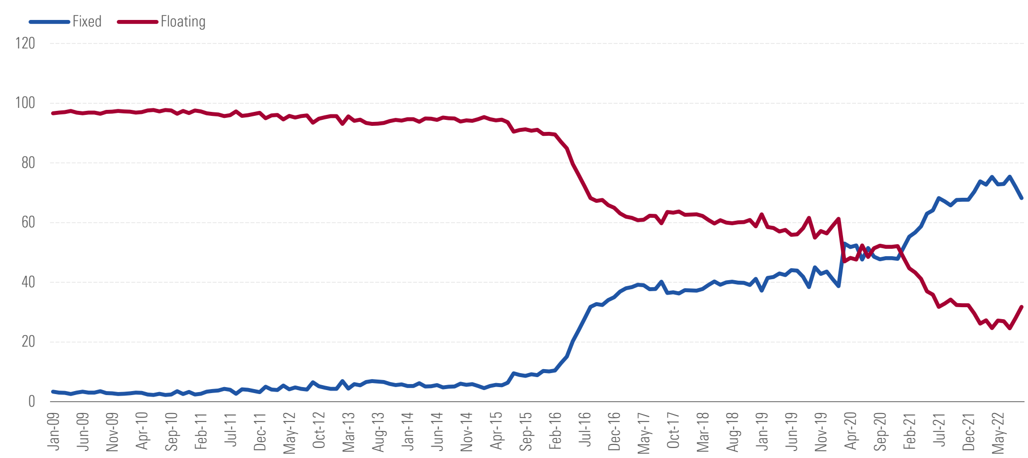
Although we expect fixed-rate mortgage origination to be less relevant in the near future versus recent years, we believe that fixed-rate loans will continue to represent a higher share of the Spanish mortgage market due to: (1) government relief measures that facilitate the shift to fixed rates from variable rates, (2) the uncertain economic environment, and (3) the natural amortisation of seasoned floating-rate loans in the total outstanding Spanish mortgage loan amount.

Exhibit 14 Comparison Between Spanish and EU House Prices and Harmonised Index of Consumer Prices



Source: EUROSTAT.

Exhibit 15 Fixed versus Floating Interest Rates



Sources: Instituto Nacional de Estadística, DBRS Morningstar.

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