Commentary

Payment Holiday Impact on European Structured Finance Performance

DBRS Morningstar
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After the onset of the Coronavirus Disease (COVID-19) pandemic, many European governments implemented the use of moratoria (payment holidays) and forbearance measures to mitigate the negative economic impact of lockdowns. These measures vary across jurisdictions but have been used mostly to support consumer and small and medium-size enterprises (SMEs). While helpful to curb certain negative pandemic-related economic outcomes, payment holidays can have negative effects on pools of loans and securitisation transactions.

As one year has elapsed since our first *Payment Holiday Impact on European Structured Finance* commentary was published, we are following up two years into the pandemic. In this commentary, we are looking at the performance of the European structured finance market across DBRS Morningstar-rated residential mortgage-backed securities (RMBS), asset-backed securities (ABS) and structured credit transactions.

The performance has continued to remain solid during the pandemic where the payment holidays in most jurisdictions have not rolled into arrears. DBRS Morningstar has been more positive to the expected performance since Q2 2021 and until today, as highlighted in DBRS Morningstar's Quarterly European Structured Finance Rating Action Summaries, the majority of surveillance rating actions were confirmations in 2020, approximately 20% were upgrades in 2021, and 23% have been upgrades so far in 2022.

From our research, we have observed the following:

- The level of prepayments across the DBRS Morningstar-rated universe have remained stable for RMBS, on a slightly increasing trend for ABS, especially auto loans in Germany and the UK, and on a similar increasing trend for SME collateralised loan obligation (CLO) transactions.
- Payment holidays related to COVID-19 are coming towards an end. In some jurisdictions, borrowers have been more affected by the ending of payment holidays, mainly in the UK, where have we seen an increasing trend in 90+-day arrears for DBRS Morningstar-rated transactions.
- There is no clear correlation between payment holidays and prepayments.
- Following the withdrawal of support measures, combined with changed economic environments, DBRS Morningstar has not observed a material negative effect as a result of payment moratoriums coming to an end but we have noticed some volatility in arrears.

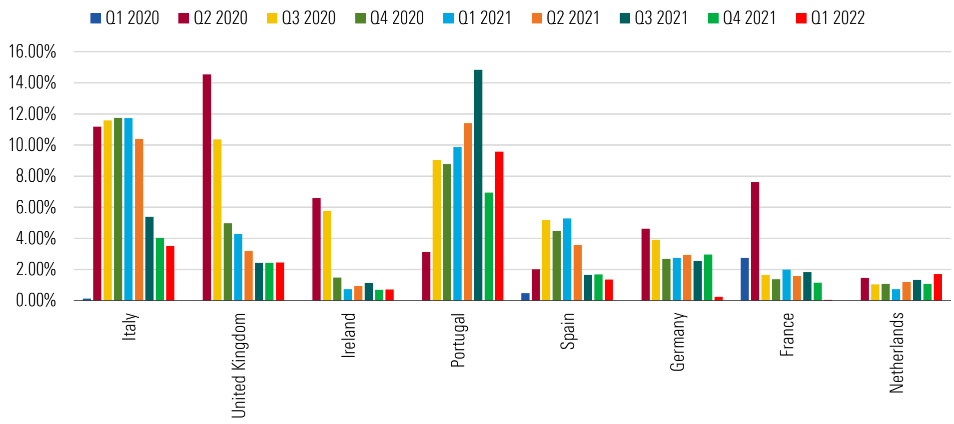
DBRS Morningstar analysed coronavirus-related payment holiday data for 275 RMBS, ABS, and structured credit transactions we rate across eight jurisdictions. The majority of data is from Italy (81 transactions), Spain (77), and the UK (49). The remaining data is from Ireland (20), Germany (11), Netherlands (17), Portugal (11), France (6), and Belgium (2). Overall, only 47 out of the 275 transactions still reported payment holidays in Q1 2022.

Decreasing Support Take-Up Varying Across Countries

The take-up of these measures has been moderate and is currently decreasing in most jurisdictions with an average take-up ranging to 31.7% from just above zero depending on asset type and jurisdiction. The country where the take up has been highest is Italy with a take-up of up to 31.7% in SME CLO transactions. The figures to calculate the average take-up for each jurisdiction considers only transactions rated by DBRS Morningstar which report payment holidays. As such, we are only looking at 61 observations[1] in Q1 2022 compared with the peak in Q2 2020 which is based on 401 observations.

Payment holidays are coming to an end in most jurisdictions, the goal for these measurements was to mitigate some of the negative impacts caused by the pandemic. As seen in the table below, across most European jurisdictions, we observe a decrease in the take-up levels of such schemes. The largest decreases in absolute terms have been observed in the UK and Italy where the average take-up went to 2.4% and 6.7% from a peak of 14.5% and 11.7%, respectively. Italy's still high exposure to payment holidays is driven by SMEs. Countries such as Germany, France, and Netherlands also show declines in the exposure to payment moratoria but the take-up has been low throughout the year 2020 and 2021 in comparison. For most jurisdictions[2] such as Ireland, Spain, Germany, France, and Netherlands, the take-up levels have all had a stable downward trend ranging around 1.7% to 0.11% for all jurisdictions.

Exhibit 1 AVG Take-Up



Source: DBRS Morningstar and Issuer Reports.

1 61 investor report observations across 47 transactions.

2 Portugal's spike in Q1 2022 is driven by one transaction.

RMBS: Take-Up Declines, Arrears Increasing

UK, Italy, Portugal, and Spain are currently experiencing declines in their average take-up for residential mortgages with multiple transactions stopping the additional information on reporting payment holidays that many transactions had been temporarily reporting during the pandemic, following related government support measures coming to an end.

Country	Currently Outstanding Coronavirus Measures
UK	None, measures expired on 31 December 2021
Italy	None, measures expired on 31 December 2021
Spain	None, measures expired on 31 March 2022
Netherlands	None, measures expired on 13 April 2022
Ireland	Employment Wage Subsidy Scheme valid until 30 April 2022 (not directly impacted by public health restrictions) 31 May 2022 (directly impacted by public health sector); for new employers ended 1 January 2022
Germany	Überbrückungshilfe IV and Neustarthilfe für Soloselbstständige until June 2022

As expected, across all jurisdictions, the highest levels of moratoria were in 2020, as many moratoria came to an end in the UK, Spain and Ireland, we noticed an increasing trend in the 90+-day delinquency buckets. There are several factors that could cause this increase such as the end of the payment holidays together with increased inflation. Italy's 90+ delinquencies peaked in Q2 of 2020 and quickly recovered to levels prior to the pandemic.

Exhibit 2 RMBS AVG Take-up

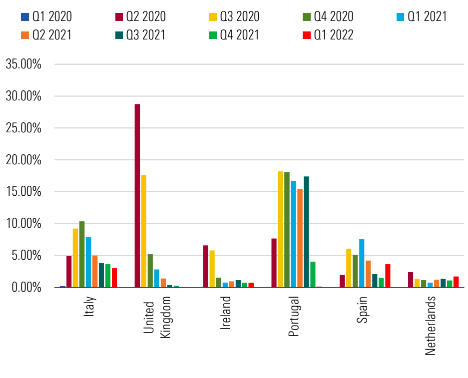
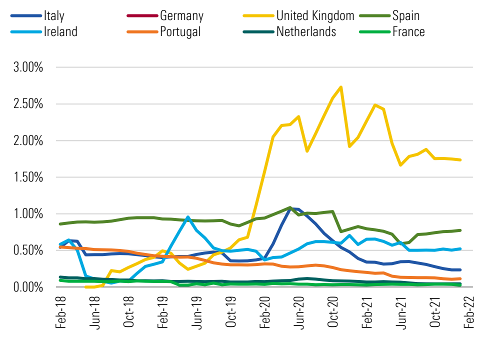


Exhibit 3 RMBS 90+ days delinquencies



Source: DBRS Morningstar.

ABS: Take-Up Increases in Spain and Portugal

Similarly, for the ABS portion of our portfolio, we see a steady decline in the average take-up across all jurisdictions after the peak in Q3 2020. The average take-up in Portugal has been removed due to a lack of data causing an unnatural increase after Q2 2021 due to fewer transactions reporting the moratoria. The observed average take-up for ABS is lower compared with what we see for residential mortgage borrowers, and most schemes have already come to an end, the observed arrears continue to be low and stable with one peak for Spain in Q2 2020 which quickly recovered back to normal levels again.

Exhibit 4 ABS AVG Take-up

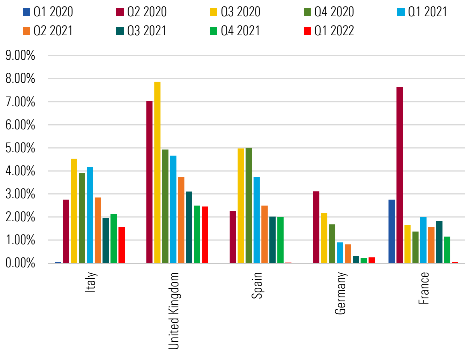
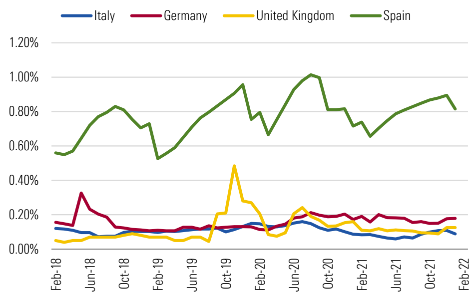


Exhibit 5 ABS 90+ days delinquencies



Source: DBRS Morningstar.

SME CLOs: Take-Up Remains High in Italy

In the SME CLO DBRS Morningstar-rated universe, Italy and Spain are the only jurisdictions with sufficient data points. Considering the high average take-up observed in Italy, which has been significantly lower in 2021 from around 33% throughout 2020 to around 15%, the potential deterioration in the 90+ delinquency bucket is likely influenced by the end of such supportive schemes. Delinquencies in Italy increased during the beginning of the pandemic up to Q2 2020, since then we have noticed a clear downward trend and quick recovery to delinquency levels below the average we saw prior to the pandemic. The delinquencies in Spain have remained stable throughout the pandemic in DBRS Morningstar-rated transactions.

Exhibit 6 SME CLO AVG Take-up

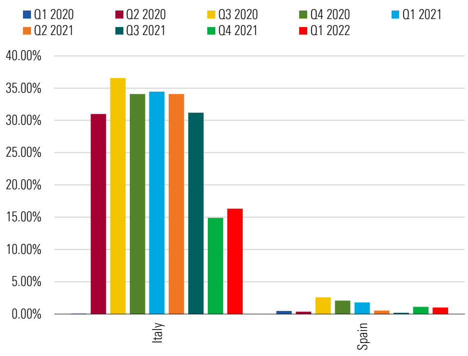
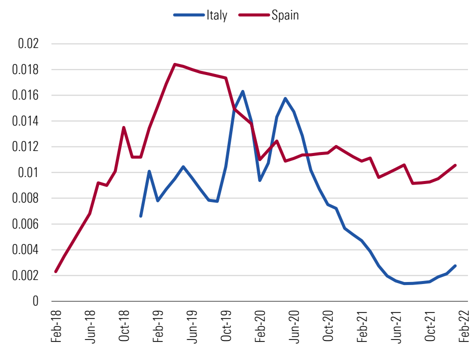


Exhibit 7 SME CLO 90+ days delinquencies



Source: DBRS Morningstar.

Credit Performance

Payment holiday initiatives (temporarily) gave relief to the borrowers during the length of the scheme. The economic and financial consequences could extend far beyond the expected end of the moratoria periods, which might result in deterioration in asset quality. As most schemes have already ended, we continue to monitor the performance of each asset class across all DBRS Morningstar-rated jurisdictions.

ABS

As highlighted in our European Auto ABS: Recovery Performance Update commentary, the consequences of, among others, the availability of remarketing channels to realise vehicle sales proceeds caused DBRS Morningstar to apply a moderate adjustment to its recovery rates for auto ABS transactions during 2020 and most of 2021. This risk is now considered largely offset by pricing increases associated with factors that have affected used vehicle supply/demand, as such DBRS Morningstar is no longer applying coronavirus-specific recovery adjustments.

RMBS

During the beginning of the pandemic, general market consensus at the time was that house prices would drop relative to end-2019 levels. As such, we applied adjustments on the expected house price performance in our analysis. However, DBRS Morningstar has noticed a robust performance of the housing markets in Europe, with house prices across all jurisdictions for DBRS Morningstar-rated RMBS transactions increasing between 5% to 25% as highlighted in the Emerging from the COVID-19 Pandemic: Update on European Mortgage Performance commentary. Hence, DBRS Morningstar has removed all adjustments to the expected house price performance in March 2022.

SME CLO

SMEs have largely benefited from payment holidays, the expected default increase was avoided mainly driven by support measures, even driving the default levels down for certain industries. Tourism, leisure, and hospitality have suffered from the pandemic driven by uncertainties related to international travel restrictions and requirements, with some increase in national tourism, but not enough to offset international travellers and their spending. As highlighted in our Two Years into COVID-19: Risks to European Structured Credit Transactions commentary, tourism arrivals dropped by 73% and 72% in 2020 and 2021, respectively, compared with levels in 2019. The Omicron variant was a reminder of how quickly the pandemic can disrupt the tourism sector. DBRS Morningstar continues to apply industry-specific coronavirus adjustments to the expected default assumptions in its analysis, with a slightly more positive look into 2022 where adjustments are now ranging from 3% to 37% compared with 17% and 45% during 2020 and 2021. DBRS Morningstar will continue to monitor the transactions as the support measures are mostly concluded and we expect all industries to operate at full capacity again, with additional debt to repay and increased inflation.

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