An APS conference call

Outlook 2021: MBS and securitized products

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OVERVIEW

- Markets: Five things to know for 2021
- Economy: Upside surprises in 2021
- Agency MBS: Prepayments peak, servicers consolidate in 2021
- Non-agency MBS: An uneven recovery in mortgage credit
- CMBS: Managing speeds and credit in 2021

Markets: Five things to know for 2021

- The yield curve should steepen faster than forward rates imply
- Lower-rated credits should outperform higher-rated credits
- Private debt should deliver strong returns
- Debt from best-in-class niche platforms should do well
- Returns to informationally intensive assets should run above average

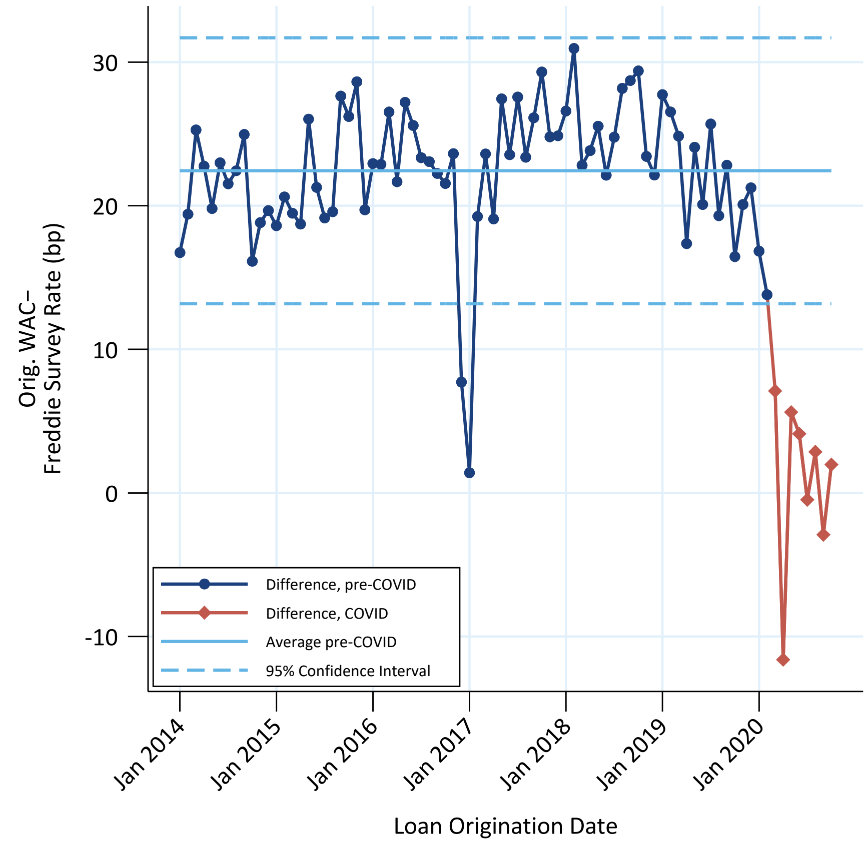
Economy: Upside surprises in 2021

- Consensus 2021 economic forecasts: 3% real GDP growth, unemployment rate falls to around 6% by end of year, and inflation settles at 1¾%.
- Three possible surprises for next year:
- 1. A Near-Complete COVID Recovery
- 2. Labor Market Approaches Full Employment by End-2021
- 3. Inflation Could Be Up or Down in 2021

AGENCY MBS: PREPAYMENTS PEAK, SERVICERS CONSOLIDATE IN 2021

- Primary/secondary spreads don't have much room to tighten
- Higher coupon and jumbo pools should benefit as prepayment speeds are near their peak
- Smaller non-bank servicers' pools may have volatile speeds due to industry consolidation
- COVID-19 appraisal policies permanently increase prepayment risk
- Minimal disruption from FHA MIP changes, GSE LLPA changes, or disruption from the QM patch

The primary mortgage survey rate overstates the rate borrowers receive



Source: Fannie Mae, Freddie Mac, Amherst Pierpont Securities

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Non-agency MBS: An uneven recovery in mortgage credit

- The recovery in mortgage credit is becoming increasingly disparate and may remain so into next year.
  - The non-QM, seasoned RPL and prime 2.0 cohorts have seen the most pronounced recoveries and prepayments are on the rise
  - Most legacy credits are still showing elevated delinquencies, driven in part by elevated roll rates on previously modified loans
- Credit curing in non-QM credit will increase negative convexity both from elevated prepayments and increased incentive for issuers to execute short-dated clean-up calls
  - Within the sector, deals backed by investor loans may outperform given lower delinquency rates, slower speeds and preclusion from potential Ability-to-Repay challenges
- Faster prepayments should be broadly constructive for seasoned RPLs as those speeds will help to deleverage sequential structures
  - Elevated speeds will likely collateral-dependent, cleaner deals backed by lower concentrations of highly modified loans should prepay faster
- The legacy market, particular subprime and option ARM cohorts will likely continue to exhibit elevated delinquency rates and slower prepayments, favoring interest-only profiles

CMBS: Managing speeds and credit in 2021

- A steeper yield curve and higher rates should materially slow voluntary prepayments in agency CMBS for years, and likely for the life of the loans in recent vintage production.
- Slower voluntary prepayments makes high premium principal and interest bonds more attractive, boosts projected performance of select Ginnie Mae project loan IOs, and can add incremental yield to A1 tranches of Freddie K-deals.
- Involuntary prepayments as many multifamily properties transition from forbearance into default will accumulate over the next several years.
- Although overall default and cumulative loss rates are unlikely to reach those experienced during the housing crisis, properties in forbearance are already transitioning to default at an accelerated pace and loss severities may be more severe.
- The risk of involuntary prepayments is more concentrated in Freddie Mac small balance loans, seniors housing, Ginnie Mae construction loans and properties in core urban areas of prime metros.

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