Making hay

In contrast to Europe and the UK, the Australian securitisation market is continuing to see healthy issuance activity, despite the country dealing with the same inflation and rates pressures as the rest of the world. **Vincent Nadeau** investigates why it's always sunny Down Under.

After an extraordinarily busy 2021 – with A$48.79bn publicly placed across 64 individual transactions – the Australian securitisation market reached a post-financial crisis issuance high. Such figures reflect the fact that Australian asset performance surprised significantly to the upside from the early months of the pandemic, helped by the success of the Australian government's support programmes, such as the Structured Finance Support Fund (SFSF) and the Term Funding Facility (TFF). Although market conditions and macro circumstances have changed dramatically this year, Australian securitisation supply held up well at the start of 2022, with issuance levels reaching A$23bn at the end of June – ahead of the year-on-year pace of 2021.

Taking advantage of ideal pricing conditions and ample demand, the Australian securitisation market witnessed a clear issuance skew to the non-bank sector last year. "A key story of the past few years has been the growth, expansion and dominance of non-bank originators. What really worked in favour of the non-bank originators – and the market as a whole – is that banks did not need to fund in capital markets for a good period, thanks to the TFF," notes Martin Jacques, head of covered bond and securitisation strategy at Westpac.

He continues: "Lack of traditional supply into primary markets meant that non-bank originators saw increased demand for their product. Certain investors, who would only focus on specific bank paper, found as spreads kept on inching tighter that non-bank RMBS – as a relative value proposition – was extremely attractive."

As non-bank financial institutions increased their share of the RMBS market, such growth further broadened the pool composition observed within prime portfolios, including new asset types, such as non-resident mortgages and self-managed-super-fund (SMSF) loans. Additionally, it facilitated new programmes from established issuers; for example, Brighten Solaris 2021-1 and ThinkTank Prime RMBS 2021-1.

While there is a market consensus that there would have been a heightened level of non-bank issuer activity, even without the triggers of the pandemic, the sector appears to have jumped on the opportunity presented by such perfect funding conditions. Within this setting of fiscal support, lower rates and government sustenance, Jacques particularly underlines the importance of the Australian Office of Funding Management's SFSF: "The fund was broad, sizeable and nimble enough to address all the issues the market confronted. Initially providing direct support to primary issuance, the SFSF pivoted to secondary market switching into new issuance, which helped underpin secondary spreads while retaining investors in the broader securitisation market. This support extended across asset classes and down the capital structure (except first loss), ensuring individual sectors were not distorted."

Furthermore, the broader scope to provide warehouse financing instilled confidence to maintain business-as-usual for non-bank originators and helped mitigate the risk that funding ▶

Martin Jacques, Westpac

lines would be removed. The ability to fund warehouses also helped reduce the risk that call options would not be met if capital markets were not functioning.

Finally, the establishment of the Forbearance SPV within the SFSF to assist lenders managing payment holidays or hardship arrangements helped allay concerns of many investors. "Long story short, it was a very effective support programme and created an opportunity for new originators to come to market," observes Jacques.

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The market dislocation during the pandemic also generated opportunities for new issuers in the authorised deposit-taking institution (ADI) space. For instance, September 2020 saw HSBC Bank Australia's first RMBS transaction in 13 years, while last year Defence Bank came to market with its inaugural issuance – the A$300m Salute 2021-1 *(SCI 15 March 2021)*.

In this context, ADIs benefited from the supply dynamic, as margins tightened across the capital stack. "An additional outcome of the TFF was the need for ADIs to provide collateral, and the easiest way to do this was by enlarging or establishing internal securitisations. We expect this will translate into a broader pool of ADI issuers in time," notes Jacques.

Meanwhile, the emergence of non-resident RMBS as an asset class has been spurred on over the last year or so by the relative value proposition they presented *(SCI 8 April 2021)*. Jacques explains: "These deals are almost entirely backed by foreign investors, with high exposures to individual jurisdictions, which inevitably creates more risks around recovery and enforcement. Given the pool composition, the structures benefit from huge amounts of credit enhancement – though it is a product that truly tests the market's appetite for more esoteric elements of the Australian mortgage market."

As the Australian securitisation market – in the same way as other jurisdictions – finds a new equilibrium, following the pandemic and the current macroeconomic and political turmoil, it continues to see a large amount of activity. Although the country is dealing with the same pressure from inflation and higher rates as the rest of the world, as at the time of writing, publicly placed securitisation deals continue to print Down Under – in stark contrast to the European and UK markets.

A recent S&P report, entitled 'Monetary tightening to test Australian RMBS', reiterates ongoing trends for the local market, including: the expectation that the strong employment outlook will moderate the transition from arrears to defaults and the risk of property price declines; and the RMBS sector's minimal exposure to fixed rate loans will limit arrears increases after borrowers move to higher rates at the end of their fixed rate period – which, again, is a function of the TFF.

As investor demand for Australian paper remains strong, Jacques points to the structural robustness of Australian RMBS transactions: "Your typical prime bank RMBS will have 8% credit enhancement on day one and 16%-plus before it starts paying pro rata. For your non-bank transactions, that can vary between 10% and 20%, depending on the name or the underlying asset. Also, an excellent selling point and track record to mention is that Australia has not experienced a loss on any rated notes of Australian prime RMBS."

Looking ahead, a significant development for 2022 will be the withdrawal of the committed liquidity facility (CLF), which the Reserve Bank of Australia provided to allow banks to meet their LCR requirements due to the low level of government debt on issue pre-Covid-19. As such, the RBA allowed banks to invest in triple-A rated RMBS as collateral, among other high-quality assets. Bank balance sheet appetite has been significantly impacted by the CLF changes and its withdrawal could mean demand for RMBS may be impacted in the long term.

Jonathan Rochford, Narrow Road Capital

Also likely to impact the market is the quest for foreign currency. Aside from a handful of deals that included US dollar-denominated notes in 2021, the Resimac 2021-3 RMBS featured a Japanese Yen-denominated senior tranche and in 2020 transactions from three issuers (Liberty, Firstmac and Resimac) all contained Japanese Yen tranches.

While the Japanese investor base has always been an important part of the Australian market, local currency denominated tranches help broaden their investor base. Non-bank financial institutions remain highly reliant on RMBS and might have to seek investors offshore to find additional liquidity, if the local market is tapped out by the banks, despite the additional cost.

Foreign investment may also begin to increase as relative value evolves. Jonathan Rochford, portfolio manager at Narrow Road Capital, notes: "At the triple-A level of the capital stack, some issuers have struggled to get away the volume they want with Australian buyers. One obvious way to remedy this is to issue offshore tranches. However, it is not a clear trend in recent deals."

Finally, within an environment of low fixed-rate loans, Rochford warns against the outlook for Australian house prices and a sharper-than-expected rise in interest rates. "We are increasingly seeing economists predict a fall in house prices in the next couple of years. As the cost of borrowing money goes up, we could see a substantial shift in fixed rates. Consequently, this would introduce a level of payment shock," he concludes.

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