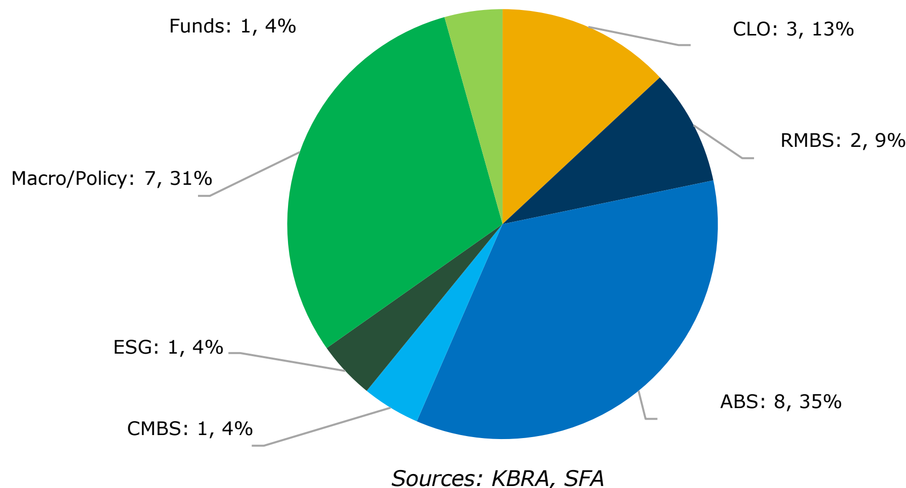
SFVegas 2024 Conference: Monday Recap

Structured finance market professionals assembled at the Aria in Las Vegas for the annual SFVegas 2024 conference held on February 25-28. The event was well attended, and reportedly had a record 8,800 registrants. Following a number of Sunday 101 sessions on a variety of structured finance segments and topics, Monday began with opening remarks from SFA CEO Michael Bright, followed by a discussion focused on the outlook for macroeconomic and geopolitical trends. Later in the morning, Securities and Exchange (SEC) commissioner Hester Peirce and former Director of the National Economic Council Gary Cohn each participated in fireside chats. The afternoon was allocated to several breakout panel sessions focused on the ABS, CLO, CMBS, and RMBS markets.

Figure 1: Breakdown of Monday Conference Panels



Sources: KBRA, SFA

Music Royalty ABS

Panelists provided an overview of the music royalty ABS sector, detailing its growth in recent years and the potential for further expansion. Although the asset class has been around for decades—going back to Bowie bonds issued in 1997—there has been a resurgence over the last few years. One panelist noted that this is one of the most untapped markets in terms of the number of assets available for securitization.

Panelists described how the asset class provides diversification by artist, genre, vintage, as well as different types of music rights, including publishing and recording rights. The panelists noted that recent music royalty transactions have very typical ABS structural features, such as loan-to-value (LTV) and debt service coverage ratio (DSCR) triggers, as well as anticipated repayment dates (ARD).

Finally, panelists noted the evolution of the sector over the past few years and their expectations for growth. One panelist expected three to five public ABS transactions this year, as well as private transactions, and indicated there could be around $3 billion in total issuance. These numbers could trend higher in the coming years as the market gains further comfort in the asset class and the sector matures.

Recurring Revenue ABS

Panelists indicated that recurring revenue ABS continues to perform, and offers strong relative value versus CLOs. So far this year, investors are buying into this story, with 17 new investors taking part in a February transaction. The structures tend to include features and concepts from CLOs, and incorporate eligibility criteria reflecting the manager's origination requirements, such as LTV thresholds, financial covenants, and equity commitments from sponsors.

While the portfolios have performed well to date, investors attending the panel question the ability of the asset class to perform during an economic downturn. Despite a history of limited to no losses, concerns remain surrounding borrowers' ability to perform without sponsor and lender support.

Unsecured Consumer ABS Market

The panel opened with a recap of the deterioration in the unsecured consumer sector in 2023, stating that consumers faced rising interest rates, elevated inflation, lower discretionary income, and a higher cost of living. It was also noted that 2021 and 2022 vintage transactions have shown increased deterioration relative to more recent vintage securitizations, but that prime-based collateral did not see as much of a deterioration relative to non-prime based collateral.

However, panelists agree that there was more stabilization in the sector by year-end 2023, as originators began tightening lending standards generally in 2H 2022. One panelist expects loss metrics to improve in 1H of this year, based on lender credit tightening.

While potential risks exist such as an uptick in unemployment, the resumption of student loan payments, and sticky inflation, panelists have an optimistic view on the sector's performance over the next 12 months. Pointing to a soft-landing scenario, a strong labor market, and positive real wage growth, credit performance is expected to improve gradually in 2024.

Litigation Settlement ABS

Litigation finance can be broken down into three general categories: consumer litigation financing, commercial litigation financing, and mass tort litigation financing to law firms. In 2023, total litigation financing totaled approximately $4.5 billion, with one panelist forecasting that this could reach $10 billion by 2025. However, only a small portion of the total litigation financings have been securitized to date. This may be about to change, as panelists indicated that the sector is gaining wider ABS investor acceptance.

To date, only consumer litigation financings have been securitized, as they provide greater diversification (by case type, law firm, plaintiff, and payor) and more predictable cash flows relative to commercial litigation and mass tort, which are highly concentrated in single, large-dollar cases that may not cash flow for extended and unpredictable periods of time. However, the lack of rated litigation settlement ABS backed by commercial litigation and mass tort does not mean that investors have not found avenues to gain exposure to this attractive asset type.

The majority of the financing volume for commercial litigation and mass tort is in the form of loans. The loans may be structured in many different forms depending on investor appetite, with different tranches and exposure to different types of cases. There may be senior tranches, which in some cases benefit from insurance policies, as well as subordinate tranches. Given the large existing base of structured loans and investor appetite, the sector may see new structures in the coming years that offer the pooling of such loans into securitizations.

CMBS Credit Crunch and Relative Value

Several trends were noted in the new issue market. Leverage has declined to its lowest levels since CMBS 2.0 began, conduit pools are less diversified, coupons have risen, and property type distributions have shifted. Notably, pool composition has shifted away from office while retail has risen. One panelist noted that conduit volume may remain depressed as local and regional banks remain active, originating smaller commercial mortgages despite the well-publicized troubles at several institutions, as banks have few alternative options to put their funds to work. In contrast, volume in the single-asset single borrower space may increase as regulators pressure the larger banks—that have the capacity to originate large commercial real estate (CRE) loans—to decrease their exposure to CRE.

Among seasoned deals, participants noted the rapid rise in delinquencies, especially among loans backed by office buildings. However, although overall delinquencies are approaching 5%, that figure is still well below the peak reached during the GFC. It was noted that servicer behavior with regard to advancing, particularly on seasoned deals with a handful of loans outstanding, presented some uncertainty surrounding transaction cash flows, as did modifications and extensions.

Opportunities in Esoteric ABS

The panel began by addressing the size of the esoteric ABS market, noting $76 billion issued in 2023 and nearly $16 billion issued so far in 2024. Panelists then discussed investor concerns as well as some favorable aspects of the sector. The concerns included a lack of liquidity, as well as some transactions and even sectors that lacked meaningful historical data, which makes it harder to analyze transactions. Panelists also noted that a lack of familiarity with certain transaction types reduces the overall investor base.

On the other hand, panelists agree that the broad appeal of esoteric transactions is the relative value or yield pick-up, as esoteric pools typically offer higher yields than similarly rated corporate bonds and other structured products. Another attribute in the sector is diversification, which allows investors to add other risks that do not necessarily correlate with the performance of an overall asset-backed portfolio.

Consumers Turn to Credit Unions, Credit Unions Turn to Securitization

The National Credit Union Administration paved the way for credit unions to securitize their assets in 2017. The first transaction was completed in 2019—a prime auto deal. However, issuance did not gain momentum until 2022, and issuance volumes for auto deals surged to over $2 billion by 2023.

One of the fundamental differences in credit union securitization relative to banks is the higher geographic concentration in collateral pools. Credit union transactions typically have more than 90% of their pool contained in either one state or spread across only two states. Although higher state concentration poses a risk to transactions, as they are more exposed to local economic downturns or natural disasters, there is a positive side to this. With credit unions restricted to lending to certain counties within a state, they have higher expertise within their respective markets regarding consumer behavior and credit performance.

New Developments in the CLO Market and Private Credit

Panelists expect 2024 to look a lot like 2023 for the CLO market, which was not all the doom and gloom it was portrayed to be, as total returns remained healthy despite elevated defaults across portfolios (trending around 3%). Refis and resets are expected to drive near-term market issuance, as asset origination has yet to rebound in light of a broader economic rebalancing brought about by the current interest rate environment.

It was noted that the private credit sector had taken market share from CLOs in 2023. Although some of that may have been clawed back with recent initial public offerings (IPO), the take-private trend continues to expand, which has started encroaching on obligors traditionally thought of as fit for broad syndication.

RMBS Market

This panel discussed different aspects of the Agency and non-Agency markets that included origination volume, pricing trends, performance, and expectations. Panelists expected Agency loans and securitization volumes to be flat in 2024 relative to 2023 levels. The drag on volume is being impacted by constraints on the supply of Agency loan originations and demand for Agency bonds. Panelists noted that key factors influencing the supply and demand are the decrease in the number of expected Federal Reserve rate cuts in 2024 to three from seven and the lack of bank investors in the space. Further, one panelist sees Agency spreads continuing to widen this year due to uncertainties in the market including Fed action, the outcome of U.S. elections, and several global geopolitical issues.

Panelists expect non-Agency loan origination volume to increase slightly year-over-year in 2024. Origination growth is expected to be led by products that allow homeowners to unlock built-up home equity (closed-end seconds, home equity line of credits (HELOC), and home equity investments). In addition, growth may also come from both prime and non-qualified mortgage (NQM) sectors if meaningful rate cuts occur in 2024. Panelists also noted increasing liquidity for seasoned scratch-and-dent and reperforming loans. Non-Agency securitization expectations are for “decent growth” in 2024 with one panelist mentioning a roughly 30% increase in volume, primarily driven by new originations over 2023. The panelists see strong investor demand for RMBS relative to a lack of supply in bonds. Some panelists expect non-Agency bond spreads to show reduced volatility relative to recent years but to continue to be range-bound in 2024. While there was some optimism in issuance volume expectations, some panelists noted cracks in loan performance for some sectors, pointing to rises in NQM delinquencies. While other panelists acknowledged these performance trends, they believed these observations should be weighed alongside the current positive unemployment level and the strength of the housing market and overall economy.

Student Loan ABS: Are Servicers Ready for Student Loan Repayments?

The panel discussed student loan performance and the impact of the resumption of federal student loan payments. For private student loans, the panel noted that after record-low loss and delinquency levels in 2020 due to COVID-19 economic stimulus, performance began to normalize in 2021 and 2022. Performance weakened in 2023, in some cases beyond pre-pandemic levels, as the consumer faced headwinds with rising interest rates, inflationary pressures, and the end of federally mandated student loan forbearance options. Inflation and the labor market are expected to be key drivers of performance in 2024.

Federal student loan payments resumed in October 2023 after being on pause since March 2020. Of the borrowers that entered into repayment, approximately 40% did not make their first payment, as there was confusion regarding additional government proposals to provide forbearance; this has since normalized. The panel also commented on prepayments on Federal Family Education Loan Program (FFELP) loans. Borrowers need to consolidate their FFELP loans with their direct loans to qualify for government assistance; this drove high prepayments in the last two years. The implementation of the income-based repayment plan Saving on a Valuable Education (SAVE) could lead to increased prepayment in this space in 2024.

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