

# Structured Finance – Canada

## 2022 Outlook

Webinar

9 February 2022

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# Summary

As pandemic strains ease, lower unemployment will help uphold new deal credit quality and existing deal performance.

1

## **Canadian credit card & auto ABS**

The growing economy and lower unemployment will aid new collateral quality and existing deal performance.

2

## **RMBS & covered bonds**

Strong borrowers with substantial equity in their properties will uphold new deal collateral quality and existing deal performance.

3

## **ABCP**

Strong sponsor credit quality and oversight, along with a focus on traditional asset types, will support program performance.

# The credit landscape in 2022

## Debt sustainability

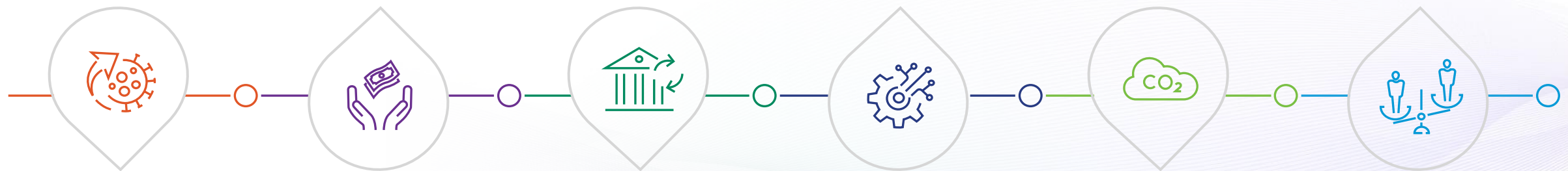
Debt levels have climbed to unprecedented highs, which will create repayment risks where growth and earnings prospects weaken or liquidity wanes

## New technologies

Technological advances, from blockchain to electric vehicles, will offer competitive advantages to some entities and present threats to others; cybersecurity risks will continue to grow

## Inequality & social risk

COVID-19 has exacerbated disparities in employment, incomes and healthcare access, which have the potential to weaken social cohesion and diminish economic progress



## Reshaped economies

The global economic recovery will solidify as pandemic effects lessen and businesses and consumers adapt, but prospects will diverge across regions and sectors

## Policy shifts

Policymakers will scale back fiscal and monetary support to varying degrees; domestic politics, geopolitical risks and regulatory actions will set credit context

## Path to net zero

Policies to meet net-zero carbon emission commitments will heighten credit risk and raise the cost of capital for carbon-intensive sectors; disclosure around climate issues will be in focus

# Credit landscape themes most relevant to Canadian structured finance



## Reshaped economies

- » Canada's recovery will solidify as pandemic effects lessen. Demand for housing and auto supply shortages will support asset values.
- » Canadian gross domestic product (GDP) will grow 4.3% in 2022 after a 5.2% rise in 2021. By contrast, the economy contracted 5.3% in 2020.
- » Unemployment will continue to decline.



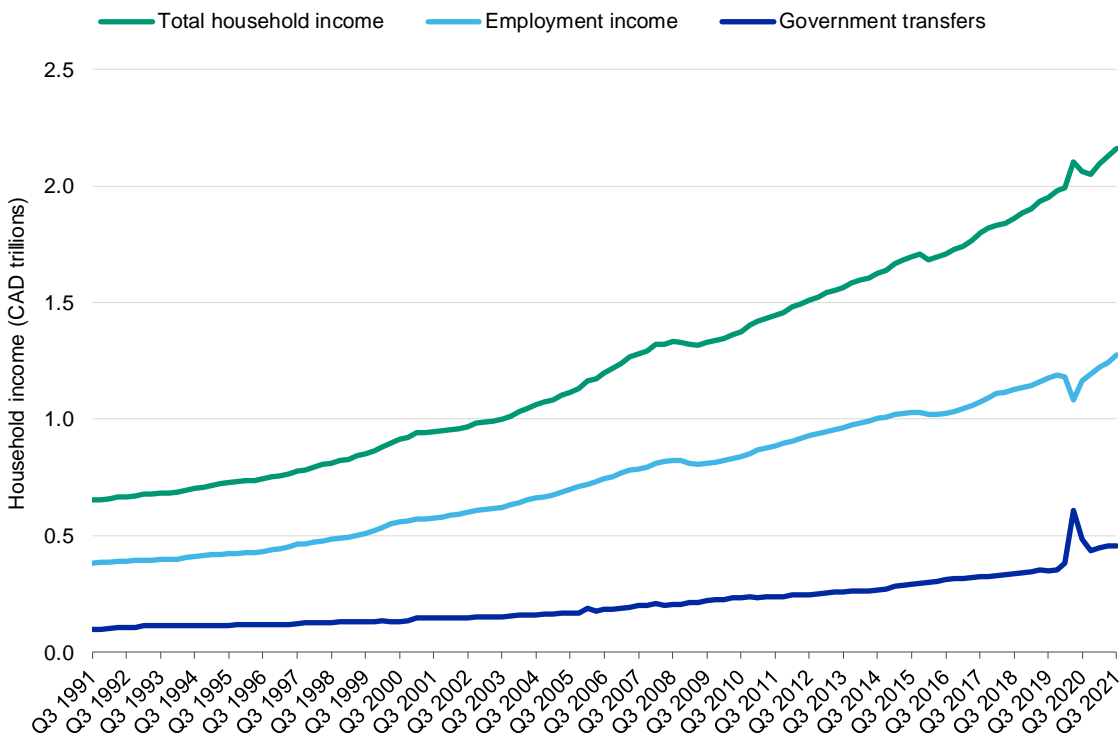
## Debt sustainability

- » Household debt in Canada will continue to grow in 2022, exceeding historical levels, after declining during the peak of the pandemic in 2020.
- » Household debt payments will surpass the pre-pandemic peak.
- » Rising employment and continuing low interest rates will keep household debt service ratios below previous highs.
- » Household savings rates will remain elevated, providing an additional buffer for debt payments.

# Improving economy will support household debt sustainability

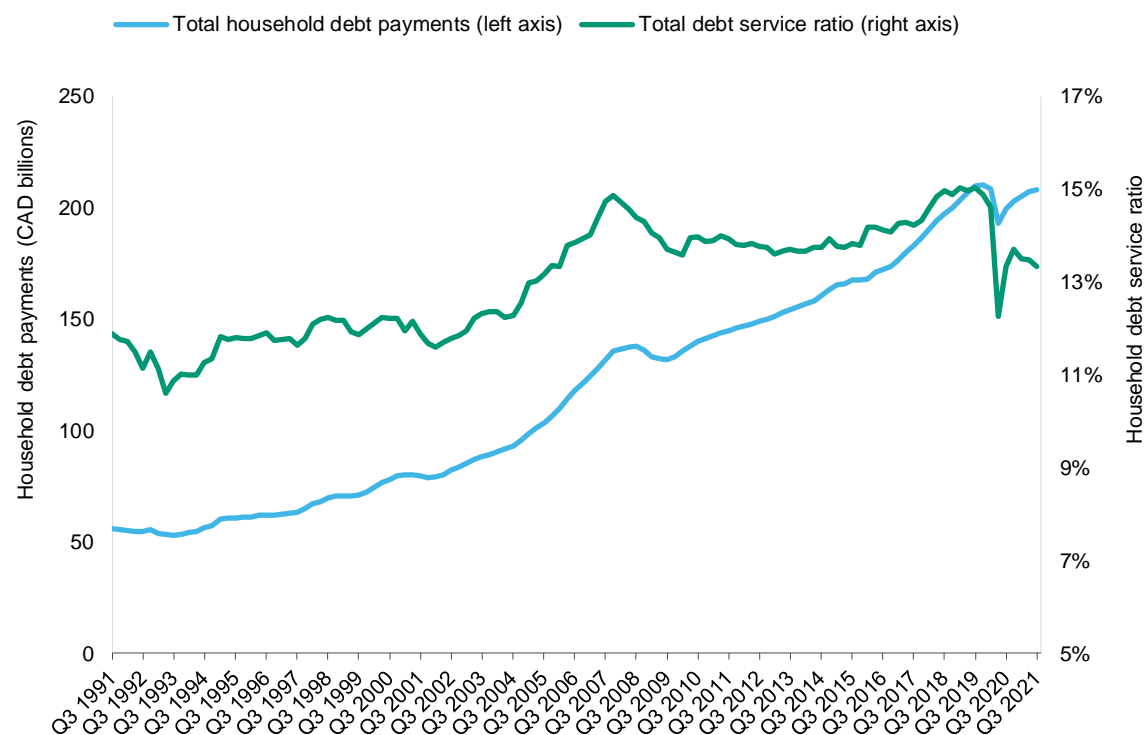
A stronger economy and lower unemployment rates will support household income and keep household debt service ratios below pre-pandemic peaks

From Q4 2020 to Q3 2021, stronger employment income kept total household moving higher despite a sharp drop in government transfers



Source: Statistics Canada

Rising household income will keep the household debt service ratio below pre-pandemic highs despite higher debt payments

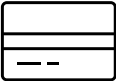
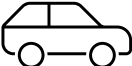


Source: Statistics Canada

# New deals: Growing economy will aid collateral quality

Collateral quality in Canadian ABS, RMBS, covered bonds and ABCP will remain strong as rising employment and economic growth offset the final phaseout of government support programs. Deal structures will remain largely unchanged and continue to support the credit quality of the notes.

## Asset and structure trends

	2022
<div>Credit card ABS</div> <div></div>	<ul style="list-style-type: none"><li>» Receivables' geographic diversification will limit exposure to regional weakness.</li><li>» Accounts will remain highly seasoned.</li><li>» Strong bank sponsors will manage pool composition to support credit quality.</li></ul>
<div>Auto ABS</div> <div></div>	<ul style="list-style-type: none"><li>» Borrowers' credit quality will remain high.</li><li>» Loan contractual terms will stay relatively long.</li><li>» Continuing strong used vehicle prices will aid recoveries.</li></ul>

Source: Moody's Investors Service

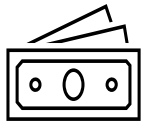
# New deals (continued): Growing economy will aid collateral quality

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## Asset and structure trends

### 2022

#### ABCP

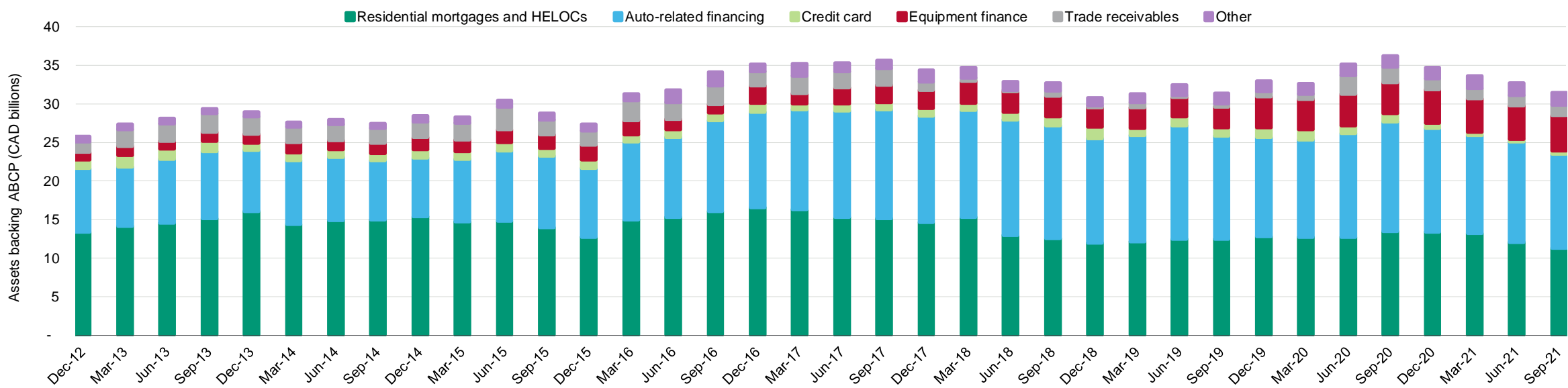


- » Originators and servicers will continue to consist of major Canadian finance companies.
- » New ABCP programs will extend the recent trend of allowing greater flexibility for asset purchases and funding.
- » Auto receivables and prime quality residential mortgages will remain the dominant asset classes, composing more than 75% of assets.

# New deal collateral quality and structures

ABCP - Prime auto receivables and residential mortgages will remain the dominant asset classes

Canadian ABCP is predominantly backed by auto receivables and prime residential mortgages, which have consistently comprised over 75% of assets



Source: Moody's Investors Service

# New deals (continued): Growing economy will aid collateral quality

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## Asset and structure trends

	2022
<b>RMBS and Covered Bonds</b>	<ul style="list-style-type: none"><li>» Borrower credit quality will remain strong, with credit scores improving.</li><li>» Loan-to-value (LTV) ratios for Canadian mortgages will remain conservative.</li><li>» Low mortgage rates and continued job growth will support house prices.</li><li>» Canadian covered bond issuers remain among the highest rated banks in the world.</li></ul>

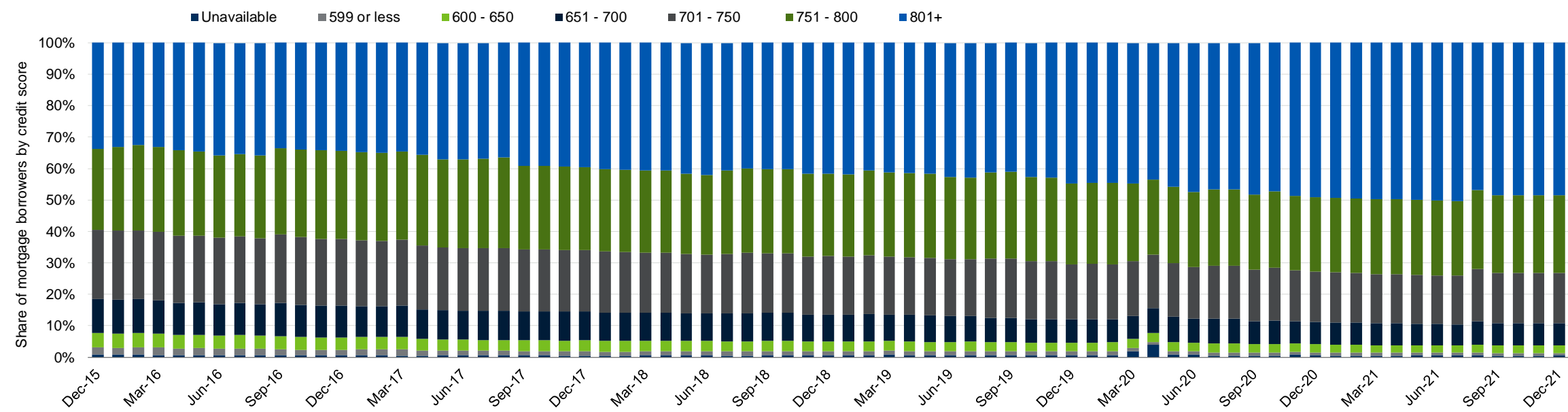


Source: Moody's Investors Service

# New deal collateral quality and structures

RMBS & covered bonds - Robust borrower creditworthiness and low leverage will uphold new deal asset quality

Borrower credit scores are strong and improving<sup>1</sup>

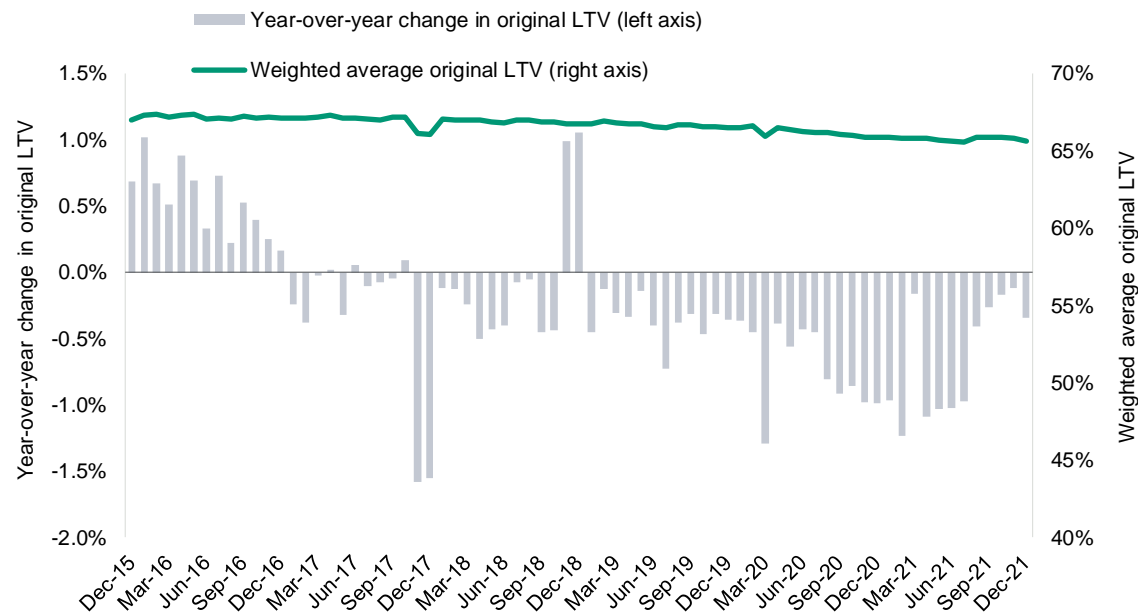


Source: Moody's Investors Service  
<sup>1</sup> Our "Covered Bond Mortgage Tracker – Canada" tracks the weighted average credit performance of the pools of residential mortgages backing the eight largest Canadian registered covered bond programs. The average credit profile is representative of the overall Canadian residential mortgage market.

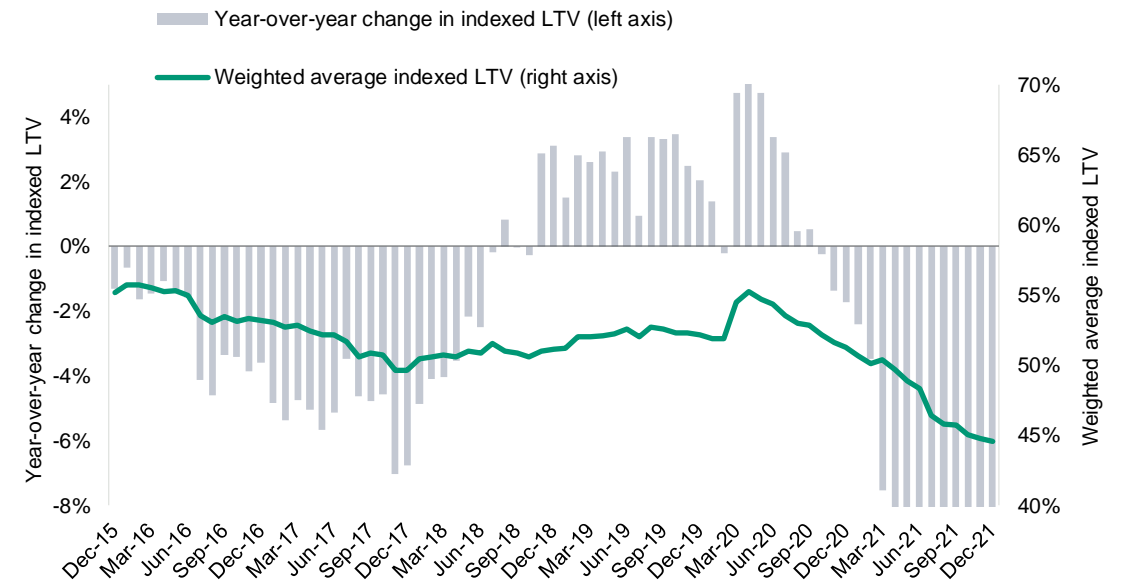
# New deal collateral quality and structures

RMBS and covered bonds - Robust borrower creditworthiness and low leverage will uphold new deal asset quality

LTV ratios at loan inception have been well below the regulatory maximum of 80%, averaging 65.5% at the end of 2021<sup>1</sup>



Canadian borrowers have substantial equity in their residential properties, based on current house prices, averaging 44% at the end of 2021<sup>1</sup>



Source: Moody's Investors Service

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# New deal collateral quality and structures

RMBS & covered bonds - Robust borrower creditworthiness and low leverage will uphold new deal asset quality

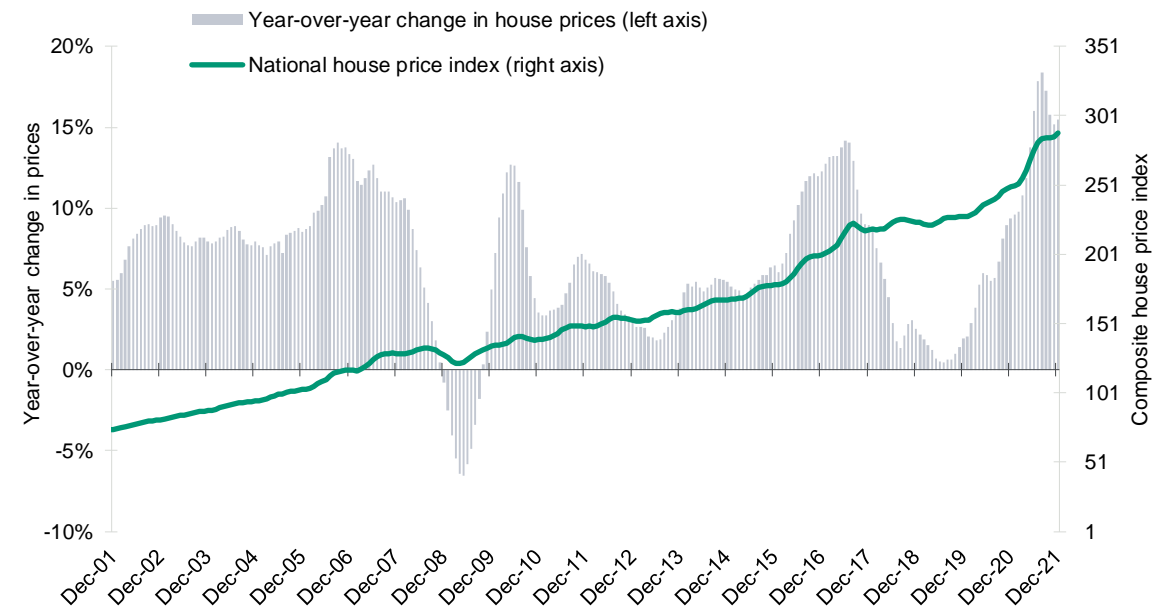
The five-year mortgage rate remained near historic lows through 2021 but will moderately rise through 2022, slowing house price appreciation<sup>1</sup>



Source: Statistics Canada

<sup>1</sup> [Canada Housing Market: Slower Price Growth, Moody's Analytics, October 2021](#)

Annual house price growth was 15.5% in December 2021, according to the Teranet-National Bank Composite House Price Index



Source: Teranet-National Bank Composite House Price Index

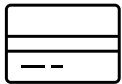
# Outstanding deals: Recovering incomes and asset prices will help maintain existing deal performance

As pandemic fallout wanes and household finances firm, the performance of Canadian ABS, RMBS, covered bonds and ABCP will remain robust. Strong prices for used vehicles and houses will maintain collateral values for auto ABS, RMBS and covered bonds.

## Performance trends

### 2022

#### Credit card ABS



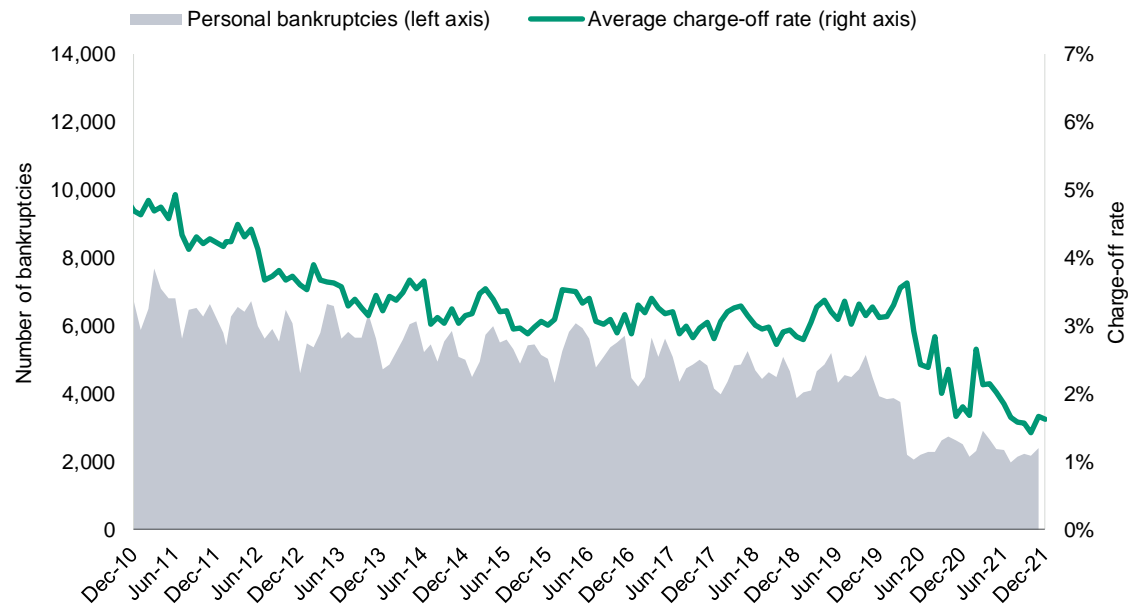
- » Rising employment will support household disposable income and borrowers' ability to service debt.
- » Charge-offs and delinquencies will stabilize in 2022 after falling to historic lows in 2021 as remaining government support programs are withdrawn.

Source: Moody's Investors Service

# Outstanding credit card ABS: Job growth will aid debt payments

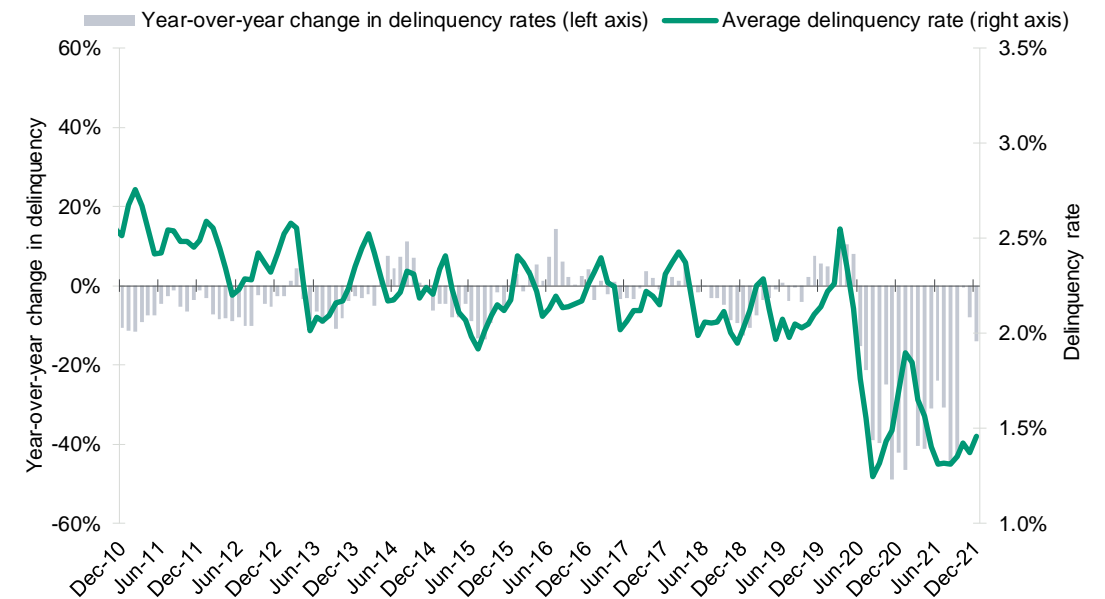
Rising employment will support household disposable income and borrowers' ability to service debt

Consumer bankruptcies and credit card default rates continued to fall in 2021



Source: Moody's Investor Service

30+ day delinquency rate for Canadian credit cards remained low in 2021



Source: Moody's Investors Service

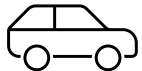
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## Performance trends

### 2022

#### Auto ABS



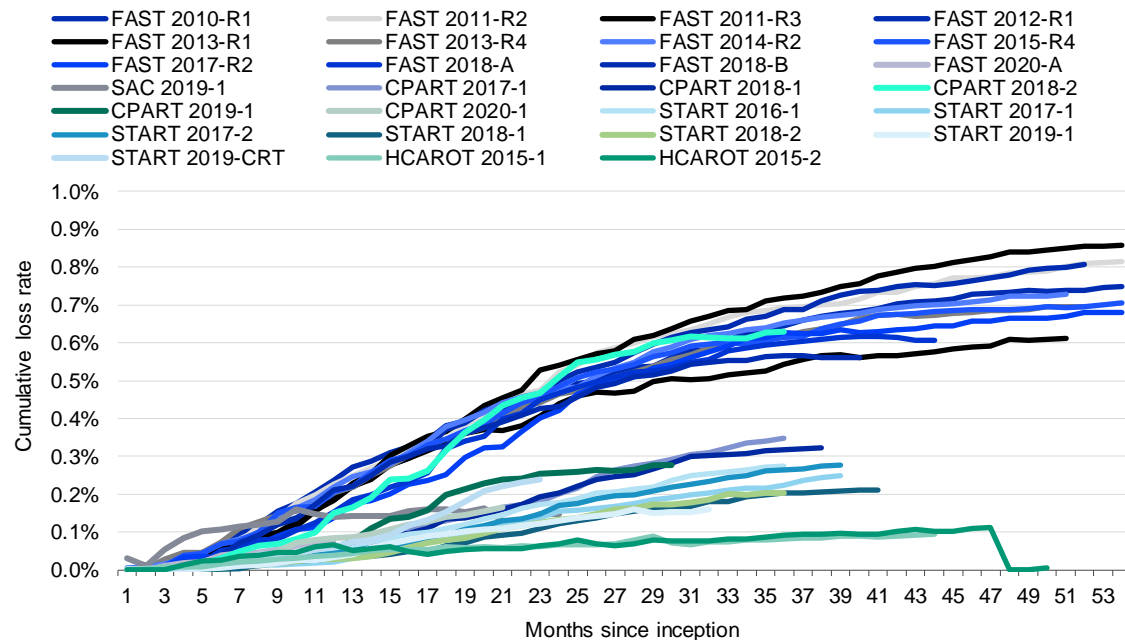
- » Asset performance for new and existing deals will remain stable in 2022.
- » Low interest rates and increased demand for used vehicles will support used vehicle prices.
- » Cumulative losses on Canadian auto loan ABS will remain in a tight band, while Canadian auto lease ABS will continue to report cumulative residual value gains.

Source: Moody's Investors Service

# Outstanding auto ABS: Job growth will aid debt payments, supply shortages will support collateral values

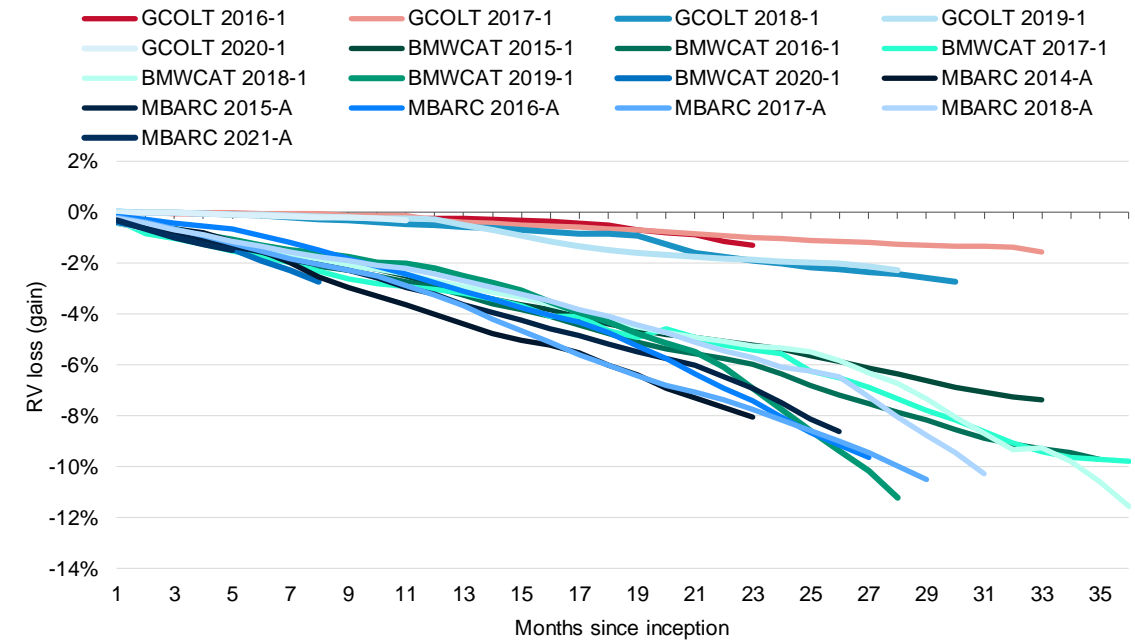
Rising employment will aid disposable income as strong used vehicle prices elevate recovery values

Over the past 10 years, Canadian auto loan ABS performance has been relatively stable, with cumulative net loss rates remaining within a tight band



Source: Moody's Investor Service

High used vehicle prices have resulted in increasingly strong residual value realization performance for all recent auto lease transactions



Source: Moody's Investors Service

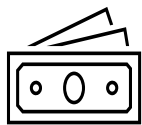
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## Performance trends

### 2022

#### ABCP



- » Asset performance in the ABCP pools will remain stable due to the positive influence of declining unemployment and low interest rates on consumer credit, and the continued strength in the housing and used vehicle markets..

#### RMBS & Covered Bonds



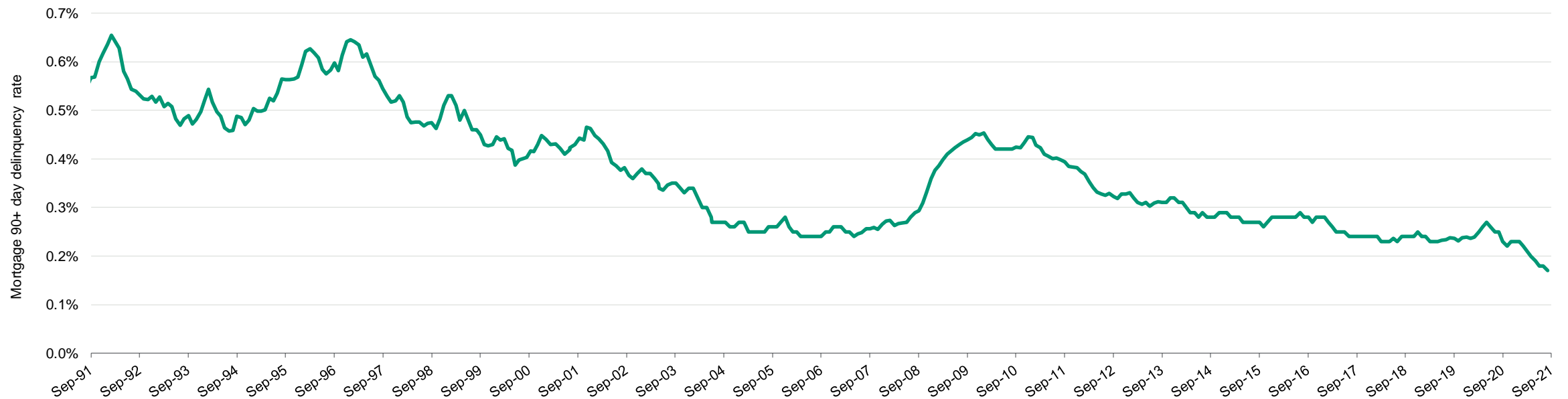
- » Asset performance for new and existing deals will remain stable as rising employment offsets the phaseout of government support programs.
- » House prices will be supported by lower unemployment, continued low interest rates and a tight resale supply.
- » Mortgage delinquency rates will remain near the cyclical lows reached in 2021.

Source: Moody's Investors Service

# Outstanding RMBS & covered bonds: Performance will remain stable

Collateral performance will remain stable due to the growing economy and strong house prices

Mortgage delinquency rates will remain near the historic lows reached in 2021

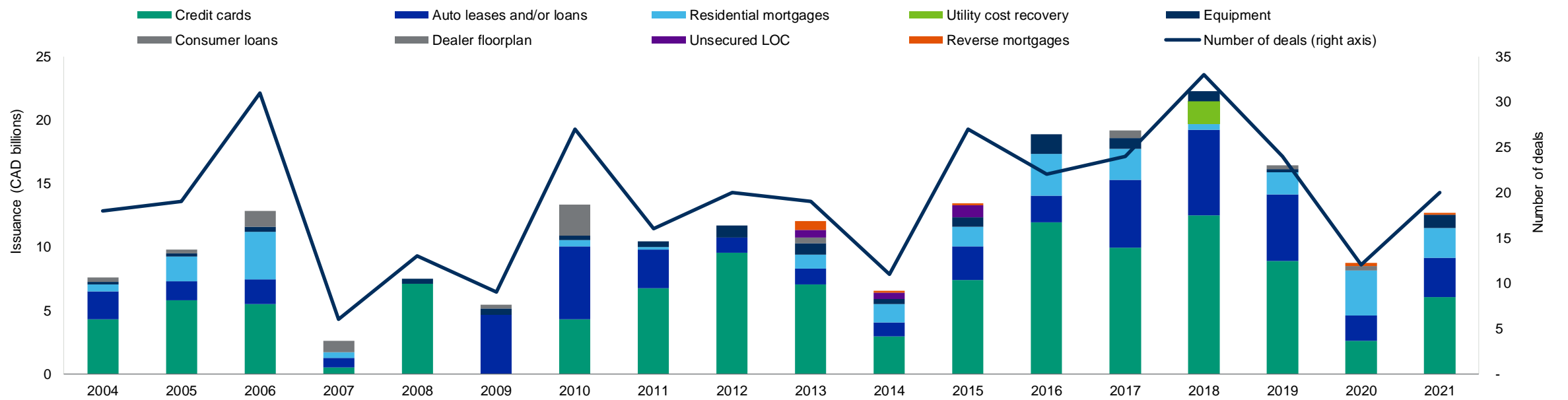


Source: Canadian Bankers Association

# Issuance: ABS and RMBS

Issuance levels will grow in 2022 as pandemic effects lessen, sponsor liquidity normalizes, and new car supply improves

ABS and RMBS recovered in 2021, but remained below pre-pandemic levels with credit cards, auto and residential mortgages remaining the largest asset classes

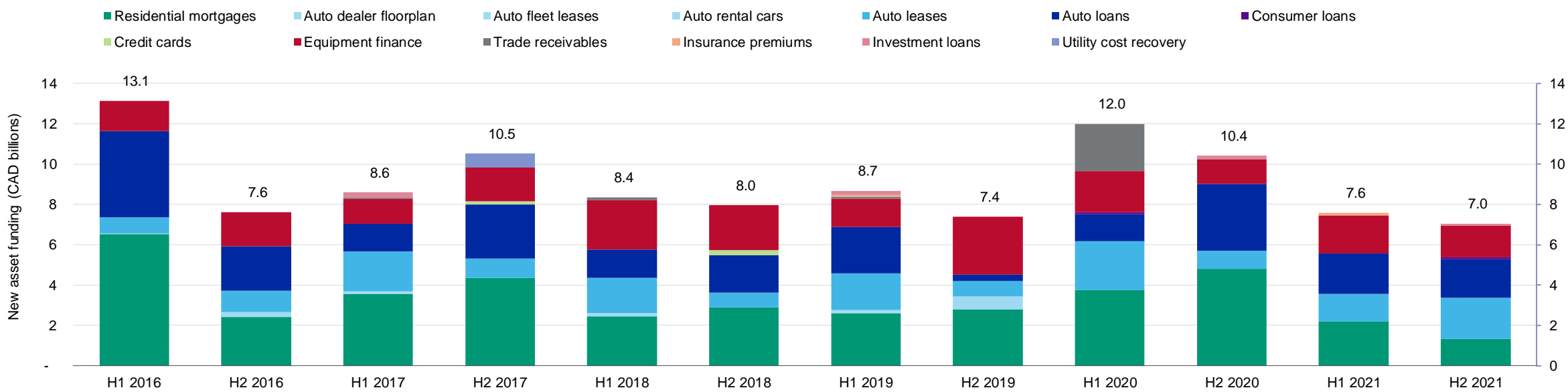


Source: Moody's Investors Service

# Issuance: ABCP

New seller volumes will lighten as sellers return to the term ABS and RMBS markets

Canadian ABCP new asset funding peaked in 2020 as originators sought the liquidity of that market during the peak of the pandemic

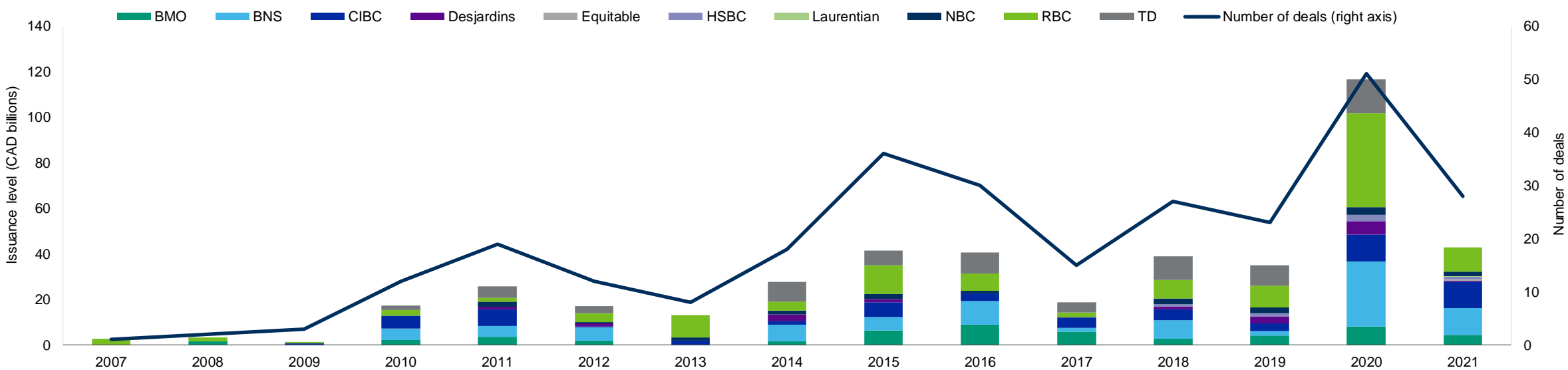


Source: Moody's Investors Service

# Issuance: Covered bonds

Issuance in 2022 will remain near normal historical levels for covered bonds

Covered bond issuance returned to normal levels in 2021 following a spike in 2020 as banks raised liquidity at the start of the pandemic



Source: Moody's Investors Service

# A world in transition



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# CMBS – US and Canadian Trends

# Floating-Rate Preference To Continue In 2022

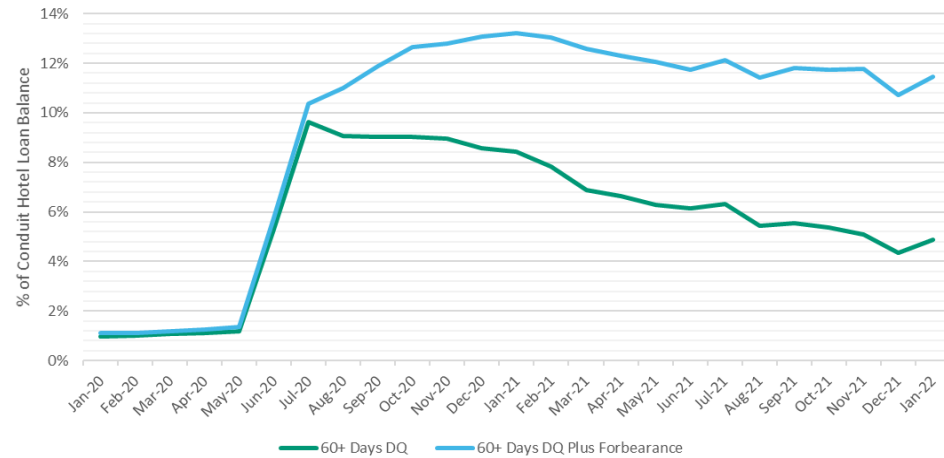
	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021E</u>	<u>2022F</u>
CMBS Conduit	42.15	50.83	32.01	31.43	40.00
SASB	33.57	44.87	24.83	78.31	60.00
Freddie	69.75	87.73	78.10	77.82	77.50
Fannie	64.33	69.86	75.73	64.98	73.00
Ginnie	16.07	15.02	33.51	43.66	40.00
CRE CLO	13.88	19.53	8.71	45.44	50.00
<b>Total</b>	<b>239.74</b>	<b>287.84</b>	<b>252.90</b>	<b>341.64</b>	<b>340.50</b>

Source: Moody's Analytics CMBS Data Feed

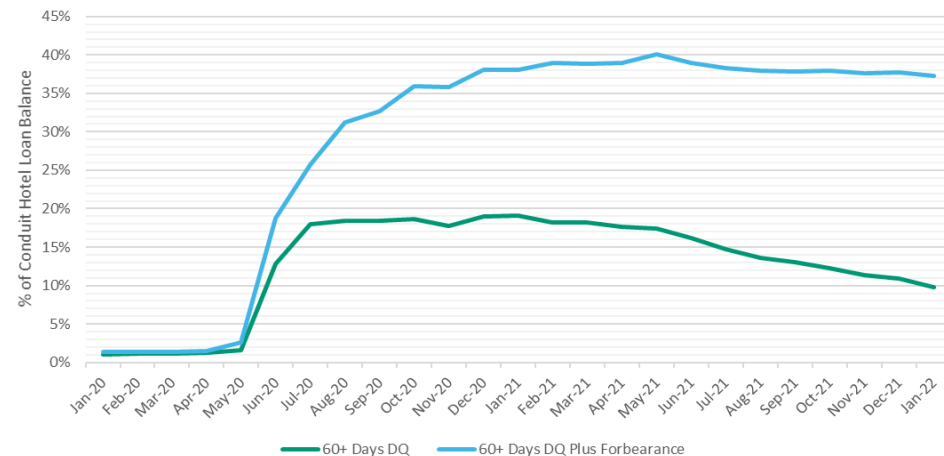
- » COVID-19 continued to hinder 2021 financials, leaving borrowers inclined to reach for floating-rate bridge loans that depend upon value rather than historical CF underwriting that CMBS and Agency CMBS fixed-rate loans rely upon.
- » Multifamily CRE CLOs have been taking market share from conduits and ACMBS. This issuance is growing, but CMBS investors are cautious and looking for better electronic reporting (a finalized CRE CLO IRP would help).
- » CMBS conduit will see potential 2022 supply, but issuers continue to cautiously underwrite financials, so volumes will likely only be \$35 to \$40 billion.
- » SASB volume will continue to be supported by transaction volume as it offer 70%+ LTV and initial low cost coupons.

# Servicers Have Responded To COVID-19 With Forbearance

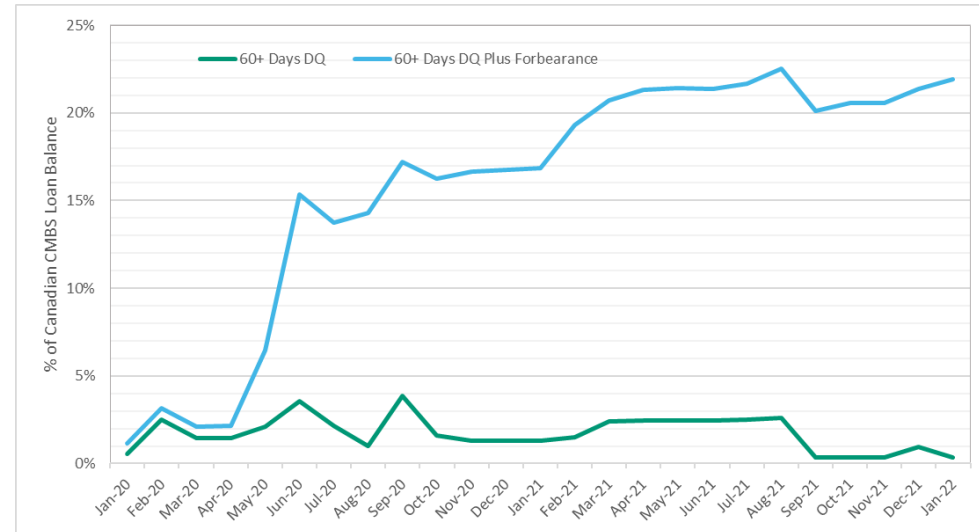
## US Troubled CMBS Conduit Retail Loans



## US Troubled CMBS Conduit Hotel Loans



## Canadian Troubled CMBS



Source: Moody's Analytics CMBS Data Feed

- » Canadian delinquency never exceeded 5%.
- » Servicers responded with forbearance in both markets.
- » Currently only see one delinquent Canadian loan.

# CMBS Loan Characteristics, Q4 2021

## Conduit

Property Type	Issued Loan Balance	Term (Mnths)	% Fixed	WA Coupon	UW DSCR	UW LTV	UW Debt Yield	Lowest Debt Yield
Office	2,256,824,141	111.2	100	3.18	3.29	53.36	9.93	7.01
Multifamily	893,038,179	120.0	100	3.62	2.18	61.32	8.62	6.46
Co-Op Housing	340,505,238	120.0	100	2.86	8.60	13.21	33.83	13.13
Industrial	686,469,456	113.1	100	3.42	2.84	58.71	10.56	7.86
Retail	1,932,159,127	114.1	100	3.46	2.92	56.41	11.86	7.64
Hotel	163,617,933	120.0	100	4.14	2.96	60.84	16.31	12.47
Mixed Use	712,440,111	115.2	100	3.19	3.11	51.13	8.62	6.59
<b>All</b>	<b>\$ 7,914,376,019</b>	<b>113.3</b>	<b>100</b>	<b>3.38</b>	<b>3.16</b>	<b>54.24</b>	<b>11.33</b>	<b>6.46</b>

## SASB

Property Type	Issued Loan Balance	Term (Mnths)	% Floating	WA Coupon	WA Spread	UW DSCR	UW LTV	UW Debt Yield	Lowest Debt Yield
Office	405,365,000	120.0	0.0	2.80	N/A	3.24	58.80	9.20	N/A
Multifamily	3,347,800,000	24.0	100	1.72	1.62	3.84	59.89	6.61	5.35
Industrial	8,700,101,000	24.0	100	2.07	1.97	1.99	69.83	5.91	5.24
Retail	-	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Hotel	340,000,000	36.0	100	2.38	2.28	3.92	65.30	9.73	9.73
Mixed Use	-	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
<b>All</b>	<b>\$ 12,793,266,000</b>	<b>24.3</b>	<b>96.8</b>	<b>2.01</b>	<b>1.91</b>	<b>2.54</b>	<b>67.09</b>	<b>6.23</b>	<b>5.24</b>

Source: Moody's Analytics CMBS Data Feed

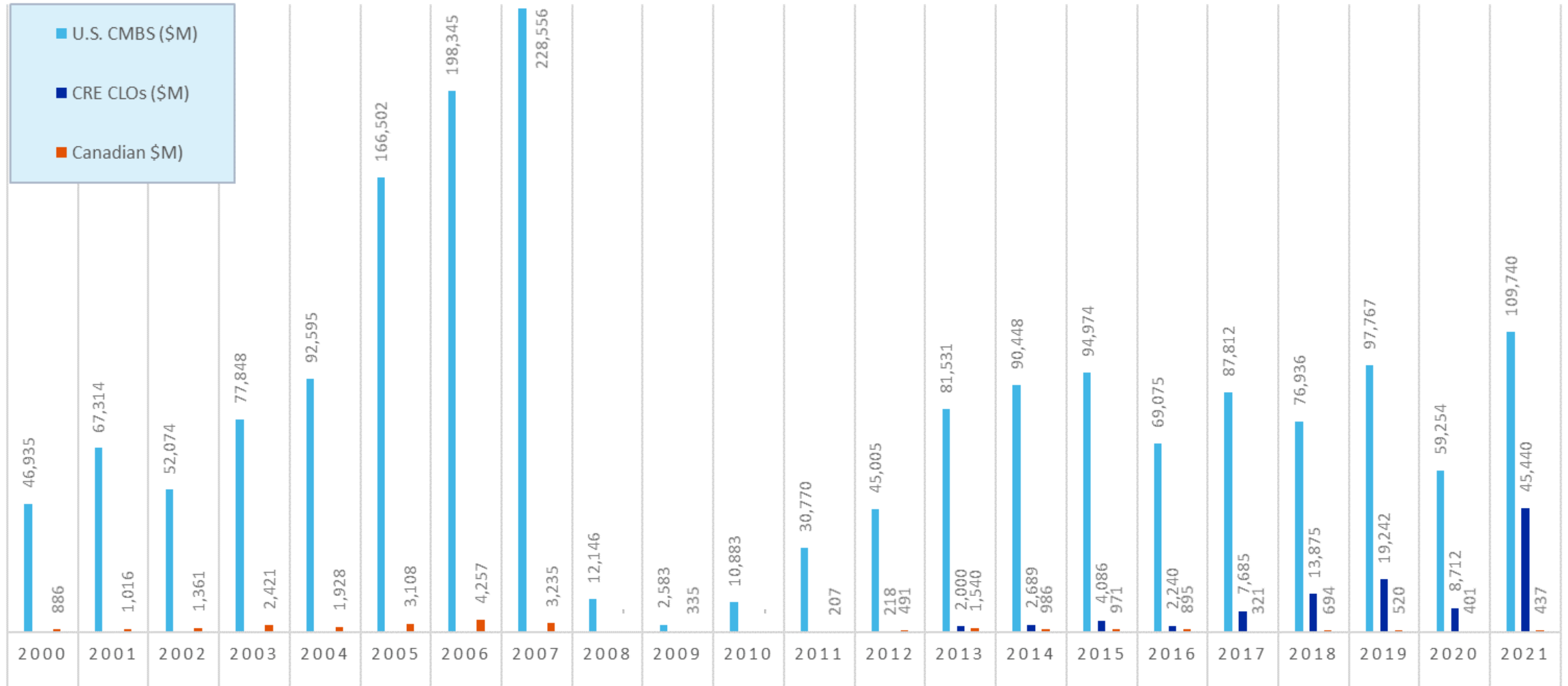
» **CMBS conduits have retail and hotel loans at lower leverage levels.** The retail loans had a DSCR of 2.92 x and debt yields of 11.86%. Hotels had underwritten DSCR of 2.96x and a debt yield of 16.31% (no conduit hotel loan had a debt yield < 12.47%).

» **The conduit had some higher leverage loans.** The lowest debt yield for each category ranges from 6.46% to 7.86% for every property type except for hospitality and cooperative housing.

» **The average conduit coupon of 3.38% is 58bp wider than the office fixed-rate SASB coupon which had similar terms.** Fixed-rate SASB loan will create triple-A A-notes that are placed into conduit transactions at very tight spreads, which likely kept the SASB pricing down.

» Multifamily SASB debt yield was 6.61% with one loan having a 5.35% debt yield. Conduit multifamily loans are separated from Co-op loans to reveal leverage still does not approach SASB leverage.

# CMBS Issuance (\$Millions)



Source: Commercial Mortgage Alert's CMBS Database

# Tracking The Loans That Cured After August 2020:

## Performance as of October 26, 2021

Property Type	DSCR < 1			1 -1.49			1.5 -1.99			> 2.0			Not Reported			Average Debt Yield		
	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021
Retail	3	21	12	39	49	34	44	18	36	22	15	13	68	73	81	15.8	15.9	9.8
Hotel	4	158	90	25	17	30	66	2	13	92	4	11	53	59	96	16.5	10.1	5.5
Multifamily	10	13	11	10	8	6	5	5	4	0	1	2	65	63	67	20.7	21.5	5.9
Office	0	0	0	2	4	1	2	2	2	1	1	0	25	23	27	19.9	22.1	8.4
Industrial	0	1	0	0	0	1	2	1	0	0	0	0	32	32	33	32.6	34.2	8.9
Overall (Balance \$M)	\$140	\$4,746	\$4,425	\$3,379	\$4,559	\$2,000	\$3,645	\$572	\$1,279	\$3,385	\$433	\$384	\$2,496	\$2,735	\$4,956			
Overall	18	204	116	85	103	87	143	31	59	123	22	30	293	302	370	17.8	15.5	7.2

## Performance as of February 2, 2022

Source for both tables: Moody's Analytics CMBS Data Feed

Property Type	DSCR < 1x			1 -1.49x			1.5 -1.99x			> 2.0x			Not Reported			Average Debt Yield		
	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021
Retail	7	30	23	54	57	34	54	19	48	25	17	19	77	94	93	15.4	14.8	10.0
Hotel	7	176	93	32	22	35	89	6	34	108	4	38	72	100	108	16.3	9.6	8.3
Multifamily	14	19	15	10	8	10	6	5	6	0	1	1	63	60	61	21.0	21.6	5.9
Office	0	1	3	6	4	4	2	1	2	1	0	0	24	27	24	19.4	20.9	7.1
Industrial	0	1	0	0	0	1	2	1	1	0	0	0	33	33	33	32.6	33.6	11.4
Overall (Balance \$M)	\$427	\$4,935	\$3,141	\$3,385	\$3,684	\$1,953	\$3,475	\$653	\$2,215	\$3,533	\$471	\$2,059	\$4,440	\$5,516	\$5,890			
Overall	31	240	142	114	110	96	170	35	103	143	23	63	331	381	385	17.5	14.7	8.6

- » **The number of retail, hotel, and multifamily loans with DSCR < 1x improved from a high of 232 in 2020 to be only 145 in our most recent 2021 figures.**
- » **Hotel loans mostly shifted from having DSCR < 1x to 1-1.49x DSCR..**
- » **For Retail, the < 1x and 1 - 1.49x category loan counts decreased.** These loans mostly moved to the 1.5 - 1.99x category, which has increased by 48 loans in 2021.
- » **The 1.5 – 1.99 coverage category continues to expand.** There are now 103 loans with a \$2.2 billion balance within the 1.5 - 1.99 times category.

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