European Structured Finance Outlook 2022: Clearer Skies

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S&P Global Ratings

This report does not constitute a rating action

Key Takeaways

Issuance: European securitization issuance could rise to €120 billion in 2022, boosted by a normalization in spending behavior, healthy underlying lending volumes, and a large call pipeline.

Central banks: Central banks' scaling back of cheap term funding schemes for credit institutions may support more bank-originated supply, while ongoing asset purchases and rising rates support demand.

ESG: We expect the importance of sustainable finance features to grow further in 2022, although green and social issuance momentum could be hampered by slow origination of new collateral.

Credit fundamentals: We expect unemployment and corporate default rates to fall across Europe in 2022, easing credit pressures on both consumer and corporate-related collateral backing structured finance transactions. Inflation has spiked, straining household finances, but this effect could soon fade.

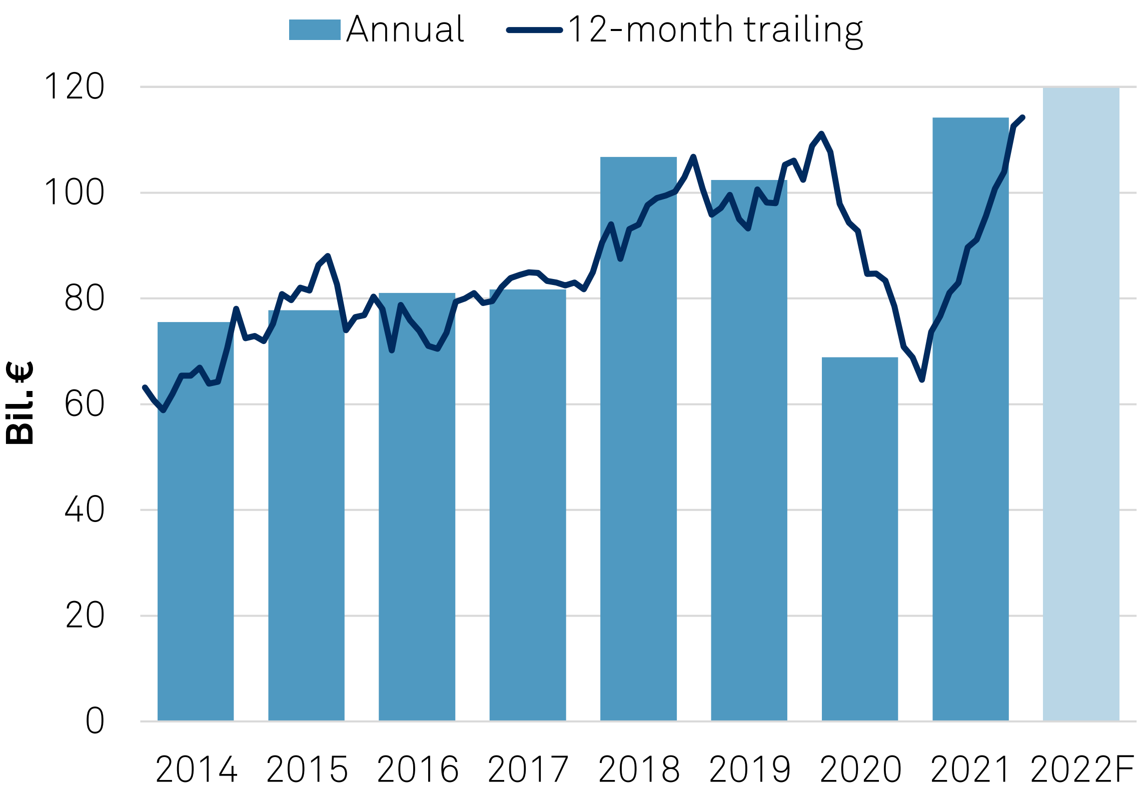
Ratings performance: Our European structured finance ratings have been resilient throughout the COVID-19 pandemic. We lowered only 1% of our ratings in 2021 and the outlook is stable.

Contents

Underlying data for the charts in this report is available by clicking here

Issuance Is Back On Track And Set To Push Higher In 2022

European Investor-Placed Securitization Issuance

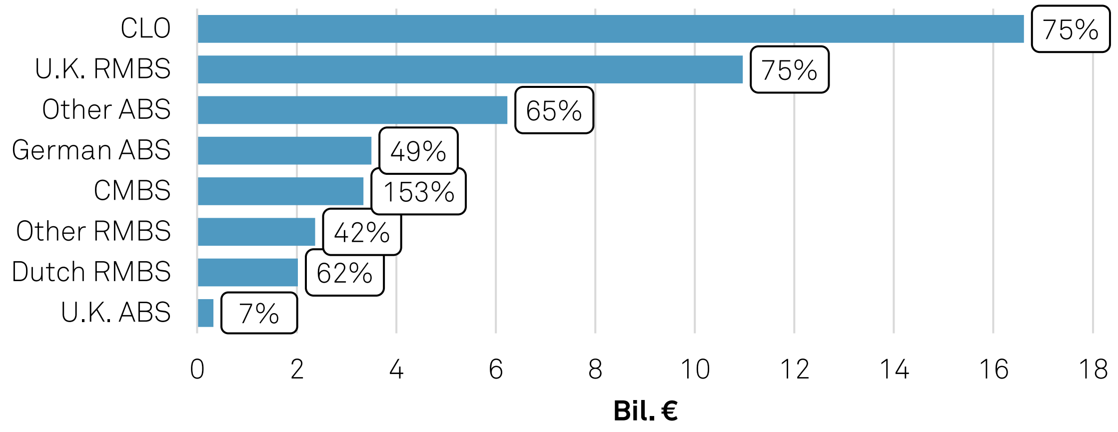


F--Forecast. Excludes CLO refinancings and resets. Source: S&P Global Ratings

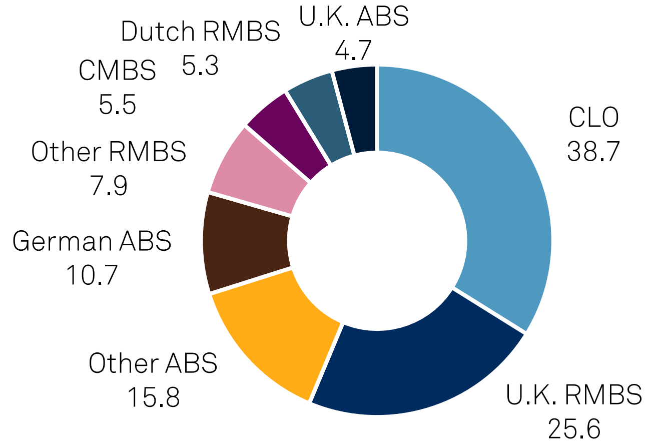
- After stalling at the start of the COVID-19 pandemic, investor-placed European securitization issuance bounced back strongly in 2021, ending the year up by 65% at €114 billion.
- This was the highest annual total since the 2008 financial crisis and back in line with a longer-term upward trend.
- Issuance could rise further to €120 billion in 2022, given a large volume of legacy transactions with upcoming call dates and robust underlying credit origination, especially for the leveraged loans that back CLOs.
- While bank-originated securitization issuance has stagnated over recent years, a normalization in rates of deposit growth and a scaling back of central bank liquidity schemes could gradually bring more bank securitizers back to the market, while non-bank issuance also looks set to continue rising.

Despite Strong Growth In Core Sectors, Issuance Remains Diverse

Increase In Issuance, 2020 To 2021



2021 Issuance By Sector (Bil. €)

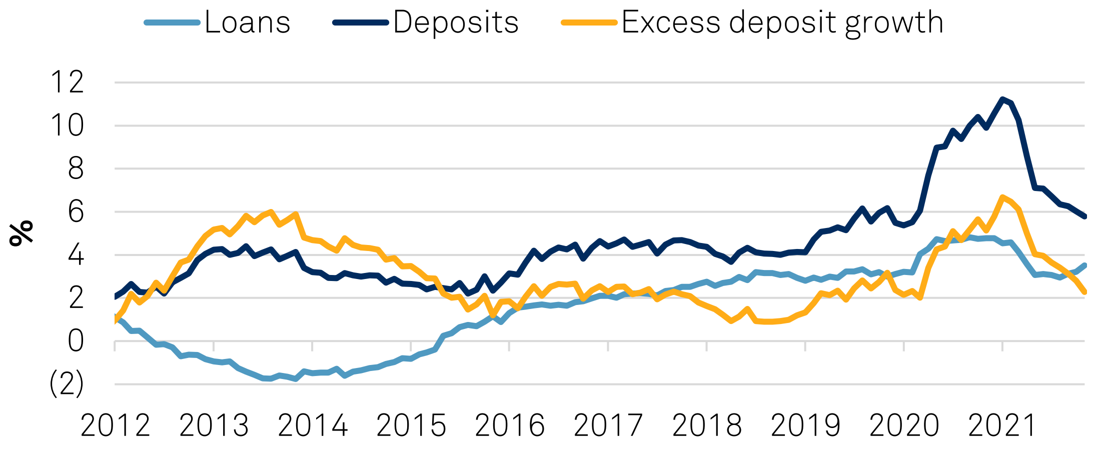


- European securitization volumes rose across most countries and sectors in 2021, so new issuance remained diverse.
- Some smaller sectors bounced back strongly from their pandemic-related dips. For example, CMBS and consumer ABS volumes each more than doubled to hit multi-year highs of over €5 billion and €7 billion, respectively, with new transactions backed by collateral from eight countries.
- However, the large leveraged loan CLO and U.K. RMBS sectors, which together account for more than half of European issuance, also posted above-average growth rates of more than 70% year-over-year. This concentrated their share in the mix, making overall issuance slightly less diverse than in the previous year. Meanwhile, non-U.K. RMBS issuance grew by a more modest 50%, and auto ABS volumes were up only 10%, reducing these sectors' issuance shares.

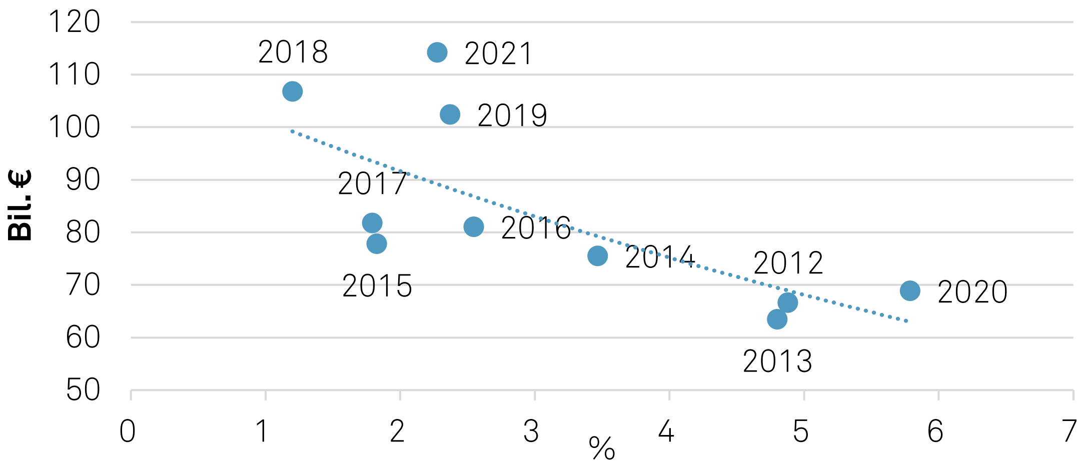
Based on investor-placed issuance. Figures in boxes on left-hand chart show year-on-year growth rate. CLO data excludes refinancings and resets but includes SME CLOs. Source: S&P Global Ratings.

Normalizing Borrowing And Spending Behavior Supports Issuance

12-Month Lending And Deposit Growth



Securitization Issuance Vs. Excess Deposit Growth

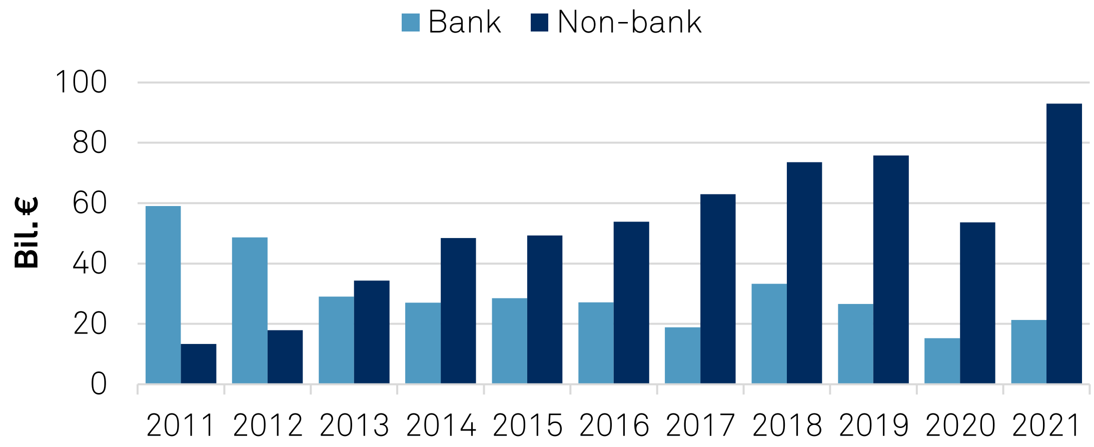


- Underlying lending to households and nonfinancial corporates in the U.K. and the eurozone has been resilient over the past few years, with low single-digit annual growth rates, which even rose at the beginning of the pandemic.
- All else being equal, this would support net issuance of wholesale funding, but banks have seen deposits grow even more strongly than loan books, fueled by a slowdown in household and corporate spending due to social restrictions and economic uncertainty.
- Over the past ten years, such periods of higher deposit growth have typically correlated with lower securitization issuance.
- However, a gradual normalization of borrowing and spending behavior throughout the real economy during 2021 has helped pave the way for further growth in securitization volumes.

Excess deposit growth defined as deposit growth minus loan book growth. Based on data for euro area households and nonfinancial corporates. Source: European Central Bank, S&P Global Ratings.

Bank Originators May Return As Central Banks Scale Down Funding

Bank Vs. Non-Bank Securitization Issuance



Credit Institutions' Term Funding From Central Banks

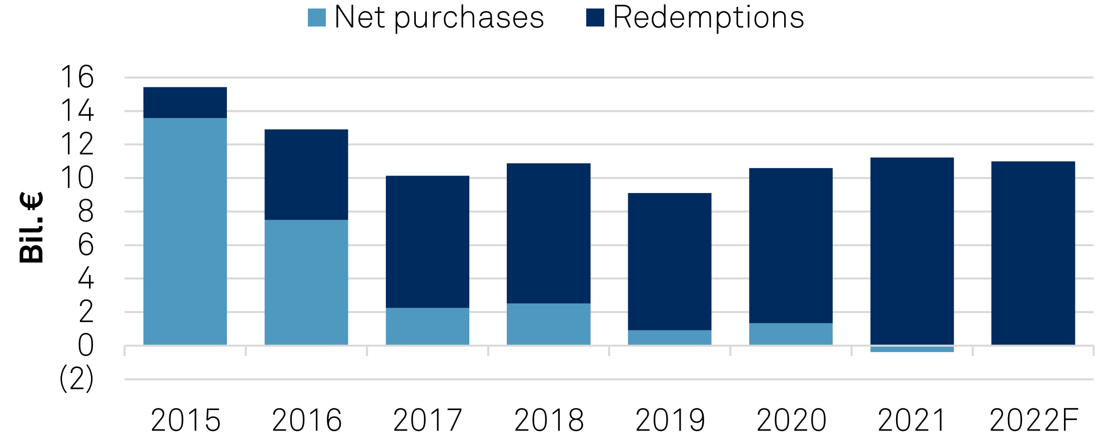
	End-2019	End-2021
European Central Bank	€615 bil.	€2,200 bil.
Bank of England	£110 bil.	£195 bil.

- Over the past decade, non-bank securitization issuance has gained momentum, while bank-originated supply has stagnated, accounting for only 19% of the total in 2021—a new low. However, bank-originated issuance could begin to recover in 2022.
- As part of their policy response to the pandemic, central banks revived liquidity schemes to provide credit institutions with cheap term funding, and borrowings under these facilities were close to all-time highs at the end of 2021.
- However, in the U.K., the Bank of England's TFSME facility closed to new drawdowns in October 2021, and banks may gradually refinance the aggregate £200 billion in four-year funding that they took from the scheme. In the eurozone, the European Central Bank (ECB) has yet to announce details for any extension to its TLTROs, following the last scheduled drawdown under the scheme in mid-December 2021. Tighter terms on future operations could increase the relative appeal of a return to private sector funding markets for eurozone banks.

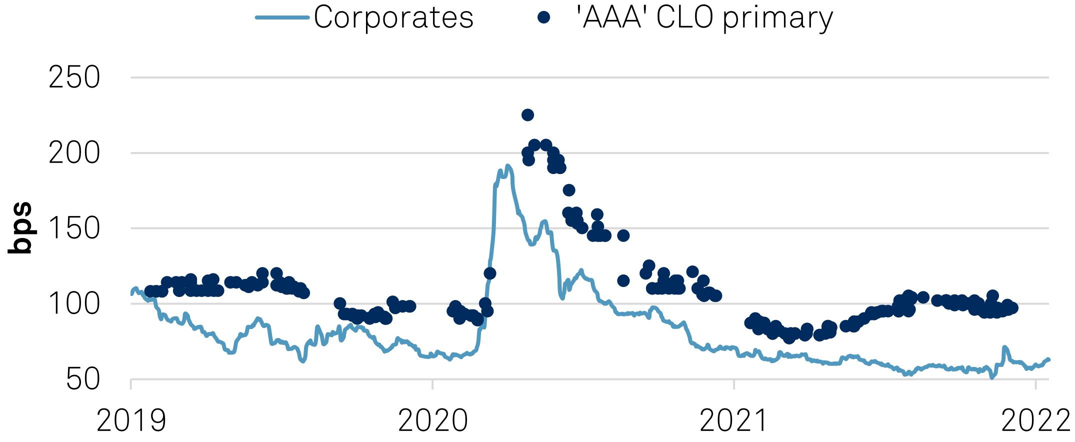
TFSME--Term Funding Scheme with additional incentives for small- and mid-sized enterprises. TLTROs--Targeted longer-term refinancing operations. Source: S&P Global Ratings.

Central Bank Purchases And Rising Rates Should Support Demand

ECB ABS Purchase Program Activity



'AAA' CLO Vs. Investment-Grade Corporate Spreads

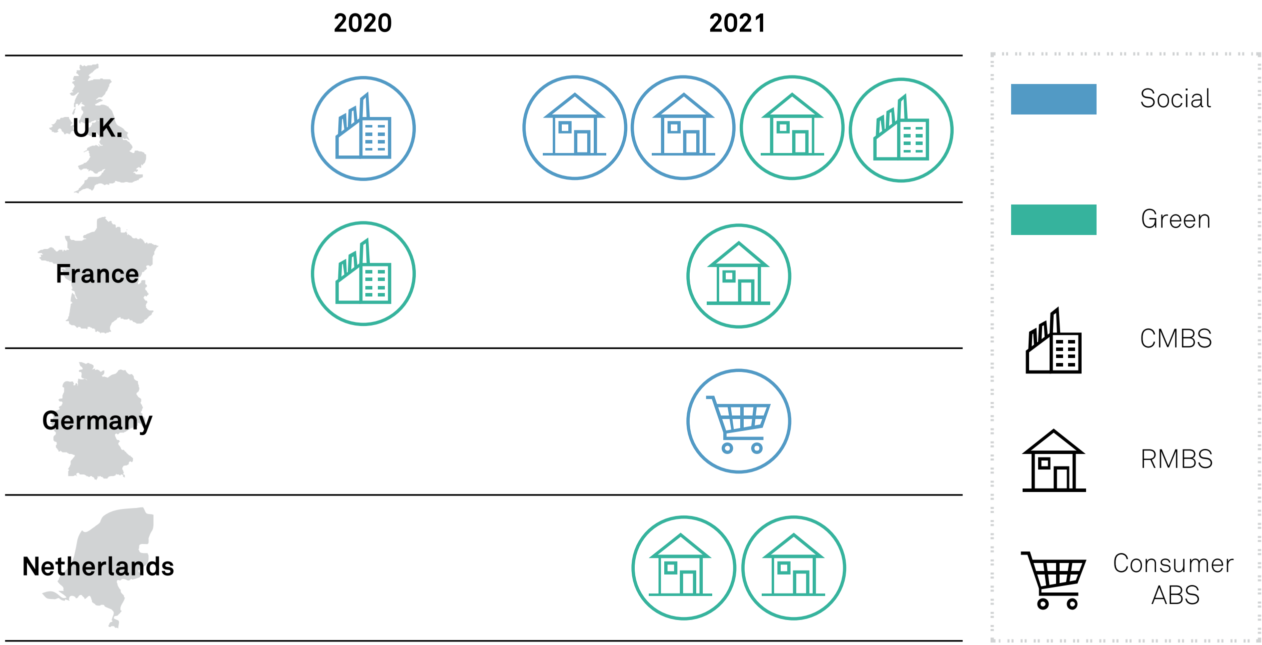


- While the scaling back of funding programs represents a normalization of monetary policy that could increase structured finance supply, ongoing quantitative easing should continue to prop up demand for eligible transactions.
- For example, we don't expect the ECB to taper its main asset purchase program before the end of 2023. Although annual net purchases of securitizations have declined in recent years, gross purchases will likely continue at more than €10 billion in 2022 to cover redemptions.
- At the same time, inflationary pressures and recent interest rate volatility could bolster private-sector demand for European securitized credit.
- In this context, the sector's combination of floating rates and yield pickup, relative to alternative asset classes, could appeal to a broader range of fixed-income investors seeking to lower portfolio duration, subject to mandate constraints.

bps--Basis points. Source: iBoxx € Nonfinancial Corporates index, IHS Markit, ECB, S&P Global Ratings.

The Focus On ESG Factors Looks Set To Gain Further Momentum

Count Of ESG-Labelled European Securitizations, 2020-2021

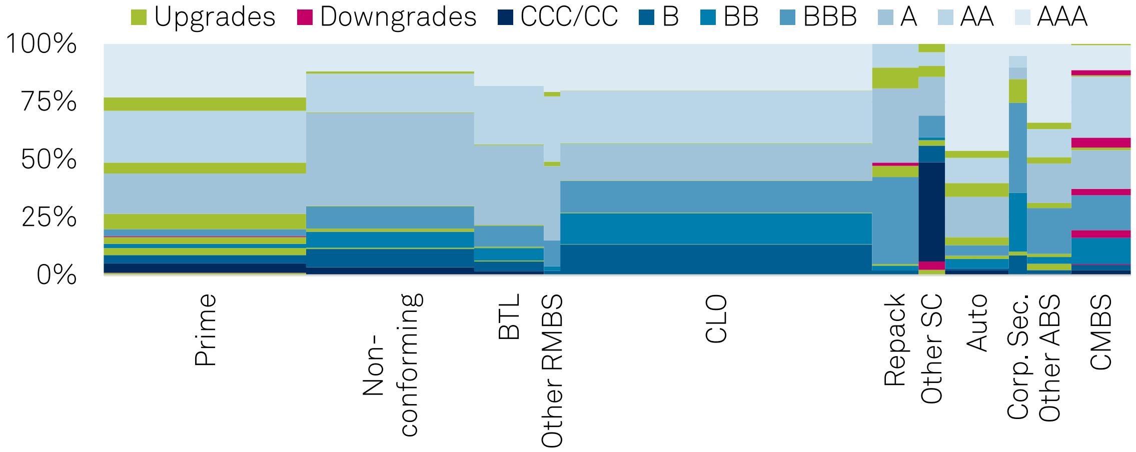


Only includes investor-placed transactions and excludes CLOs. Source: S&P Global Ratings.

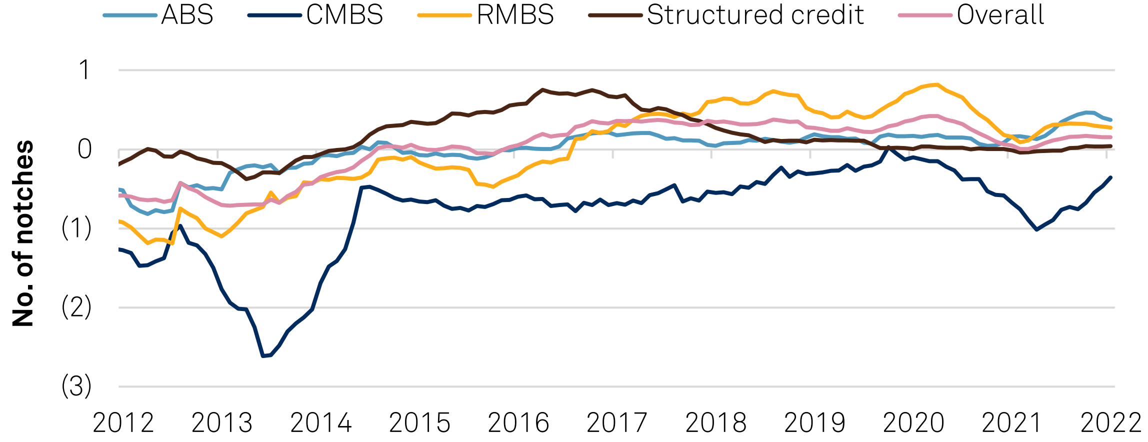
- In 2021, environmental, social, and governance (ESG) considerations became a greater focus for the structured finance market.
- Against a backdrop of wider regulatory developments on disclosure and issuance standards, more originators than ever before came to market with securitizations labelled green or social. Across the ABS, CMBS, and RMBS sectors, we saw eight such transactions during the year, though they still accounted for only about 4% of total issuance.
- We expect the importance of sustainable finance features to grow further in 2022. However, issuance momentum could be hampered by slow origination of new sustainable collateral and the rate at which originators can fulfil use of proceeds commitments already made on previous transactions.
- In the CLO sector, exclusion language for underlying assets, based on ESG factors, is now the norm. In 2022, there will likely be more widespread development and reporting of ESG credential-based scores for underlying borrowers.

Ratings Have Been Resilient And Credit Pressures Are Easing

Distribution Of Ratings And 2021 Transitions



12-Month Average Change In Credit Quality

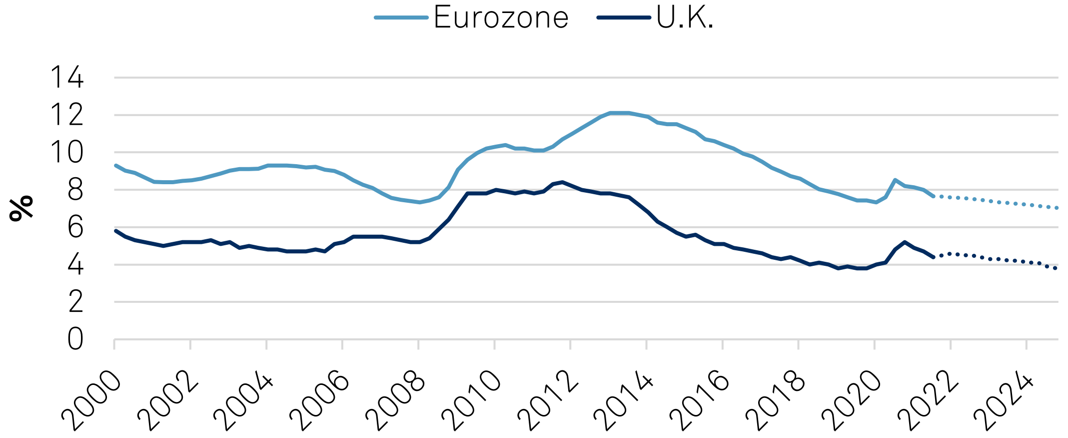


- The prospect of ongoing economic growth and falling unemployment suggests easing pressures on European structured finance credit performance and a fundamentally positive outlook for 2022.
- In 2021, we lowered just over 1% of our ratings on structured finance securities in Europe. CMBS transactions backed by retail assets have been most affected, but this sector constitutes a small portion of our outstanding European securitization ratings.
- For most asset classes, the 12-month trailing average change in credit quality had been positive for several years before the pandemic, indicating aggregate upward ratings movements. Although the trend weakened in 2020, it has since reversed.
- CMBS ratings continued to move lower by an average of 0.7 notches during the 12 months ended September 2021, but other sectors saw net upgrades, and our European structured finance ratings overall moved higher by an average of almost 0.2 notches.

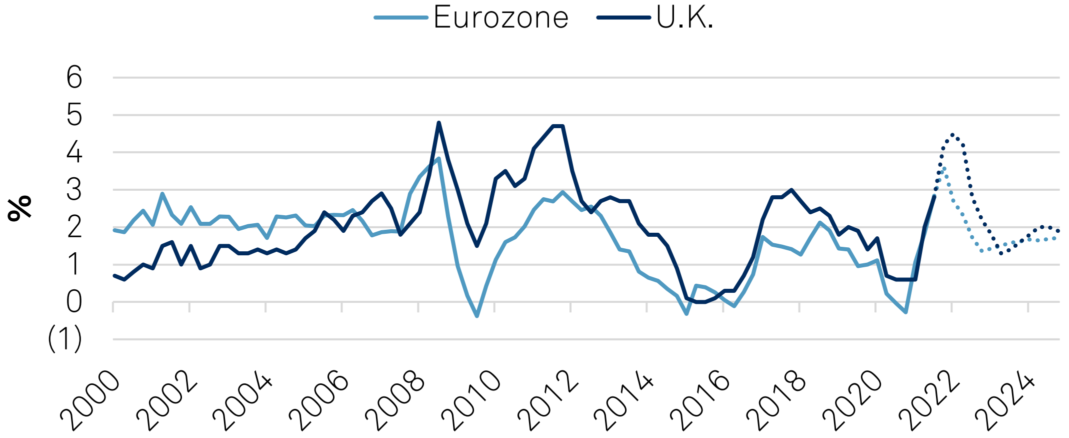
BTL--Buy-to-let. SC--Structured credit. Excludes confidential ratings. Securities whose ratings migrated to 'NR' over the period are classified based on their rating prior to 'NR'. Source: S&P Global Ratings.

Consumer-Backed Transactions Should See Limited Deterioration

Unemployment Rate



Consumer Price Inflation

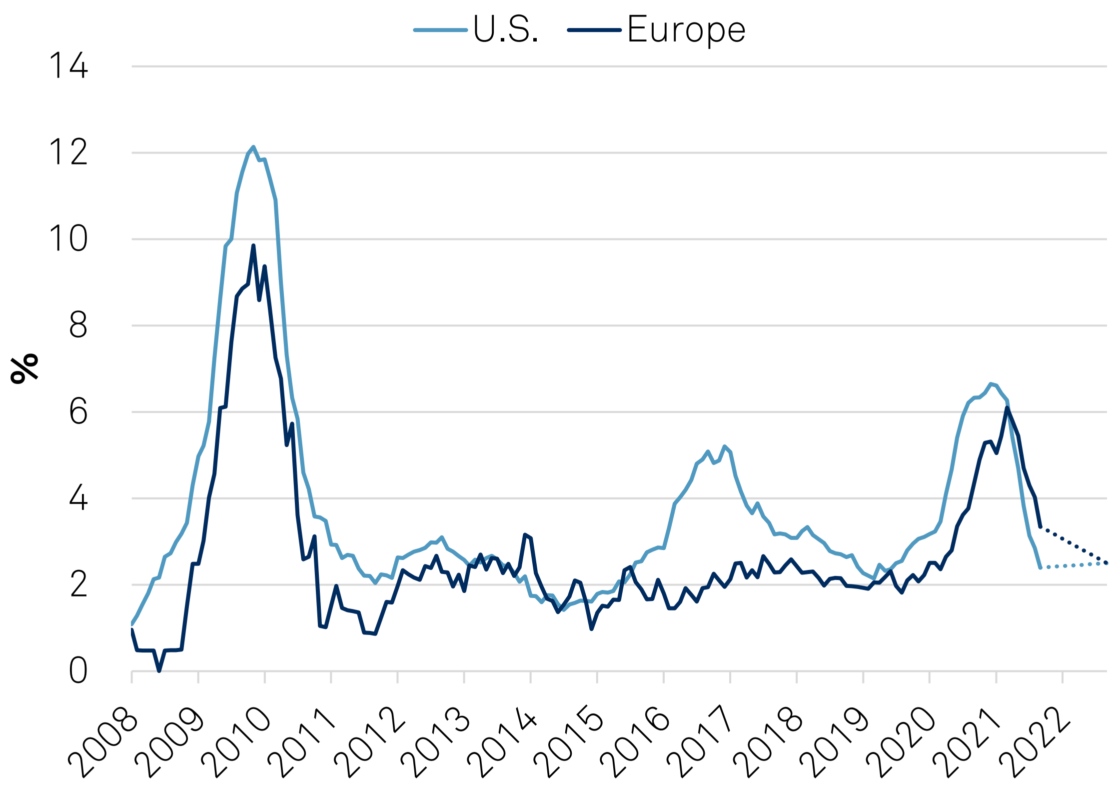


- We expect both eurozone and U.K. unemployment rates to moderate in 2022, falling back to 7.5% and 4.5%, respectively, which would be credit positive for consumer-related assets backing securitizations. Underlying obligors have benefited from both furlough schemes and payment holidays during the pandemic. The negative effect of these support programs ending for marginal borrowers could gradually feed through to securitization collateral performance. That said, the schemes' wind-down appears well-synchronized with counteracting improvements in labor markets, we have seen little deterioration so far, and servicers appear well-equipped to manage these cases.
- Headline inflation figures reached decade highs in late 2021, spelling renewed pressure on household finances. However, this effect was due to likely transient mismatches between supply and demand as economies reopened and one-off distortions from pandemic-related tax cuts. We therefore expect inflation to slow through 2022 as these temporary effects begin to fade.

Dotted lines indicate forecast. Source: Eurostat, S&P Global Ratings forecasts.

Fundamentals Are Also Improving For Corporate-Backed Sectors

Speculative-Grade Corporate Default Rate



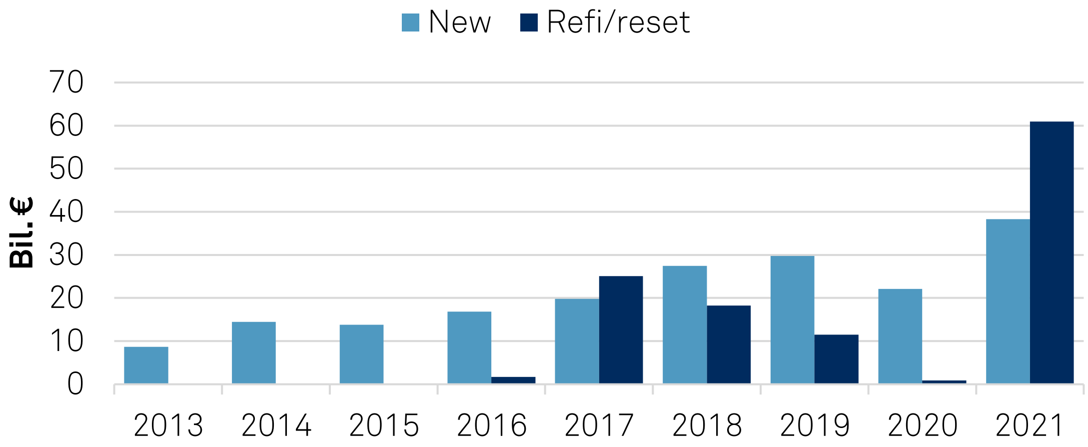
Trailing 12-month basis. Dotted lines indicate forecast. Source: S&P Global Ratings.

- For corporate-backed transactions, there remains some downside risk to ratings if credit distress among underlying borrowers rises, although this seems increasingly likely to be sector-specific. For example, parts of the tourism industry will likely take more time to recover to pre-pandemic activity levels than some other sectors, given ongoing precautions over international travel and potentially longer-term changes in consumer behavior.
- However, the overall picture is more positive than it was a year ago. For example, we forecast the annualized default rate for European speculative-grade corporates could fall to 2.5% by September 2022, from a recent peak of more than 6%.
- The impact for European CLO ratings will partly depend on how well collateral managers continue to mitigate credit deterioration through trading activity.
- Some areas of commercial real estate, and therefore CMBS, remain under pressure.

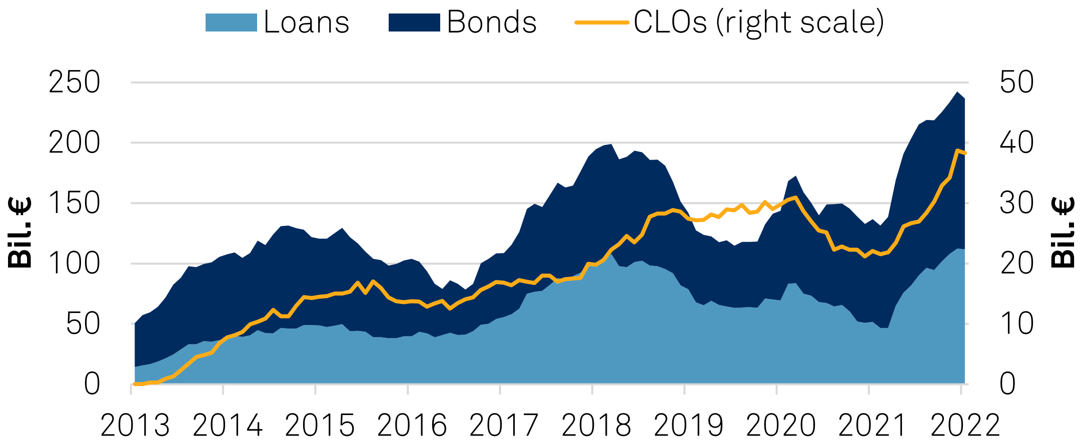
CLO

CLO New Issues, Refinancings, And Resets All Posting New Highs

European CLO Issuance



European Leveraged Finance Vs. CLO Origination Volumes

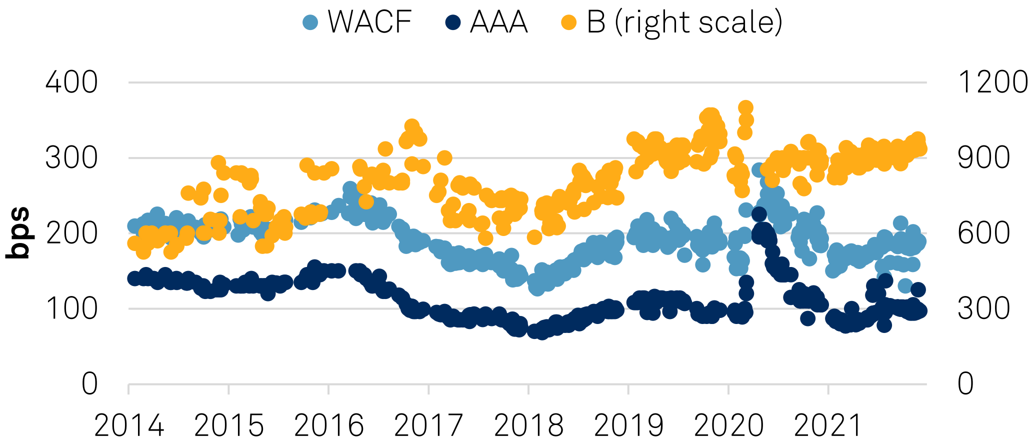


- New European CLO issuance rose by more than 70% to €38 billion in 2021, returning to the multi-year growth trend that had preceded the pandemic and setting a new high.
- We believe CLO volumes could continue at an elevated level of about €35 billion in 2022, given the growing number of managers active in the European market and continued strength in leveraged loan and high-yield bond originations, partly fueled by M&A activity.
- In 2021, refinancings and resets accounted for a record €61 billion of additional activity.
- CLO liability spreads generally remained tighter than in 2019 and 2020, so managers had strong incentives to refinance or reset transactions that exited their non-call periods.

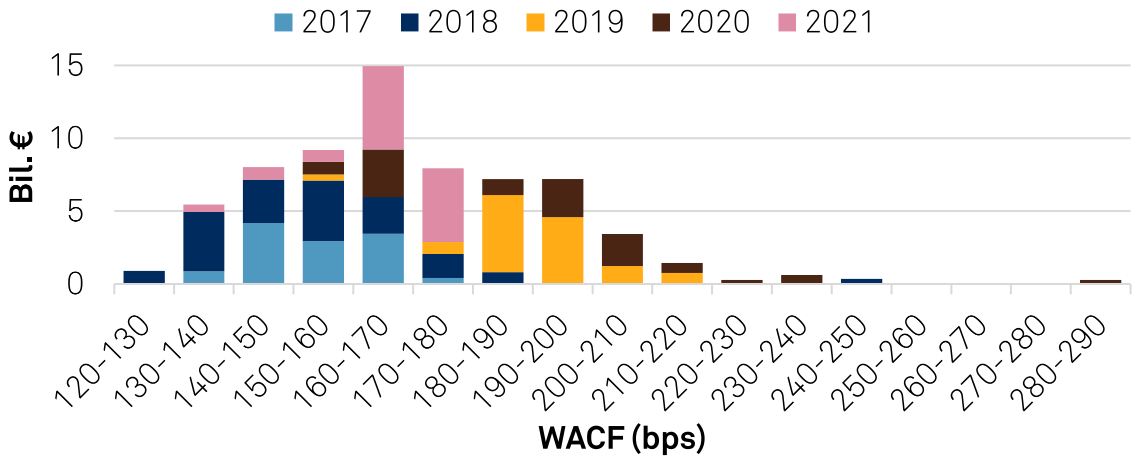
Right chart shows volumes on a 12-month rolling basis. Loan figures are institutional only. Source: S&P Global Ratings, S&P LCD.

Still A Stock Of Refi Candidates, Although Spreads Have Widened

European CLO WACF And Tranche Discount Margins



2022 Refinancing/Reset Candidates, By WACF And Vintage

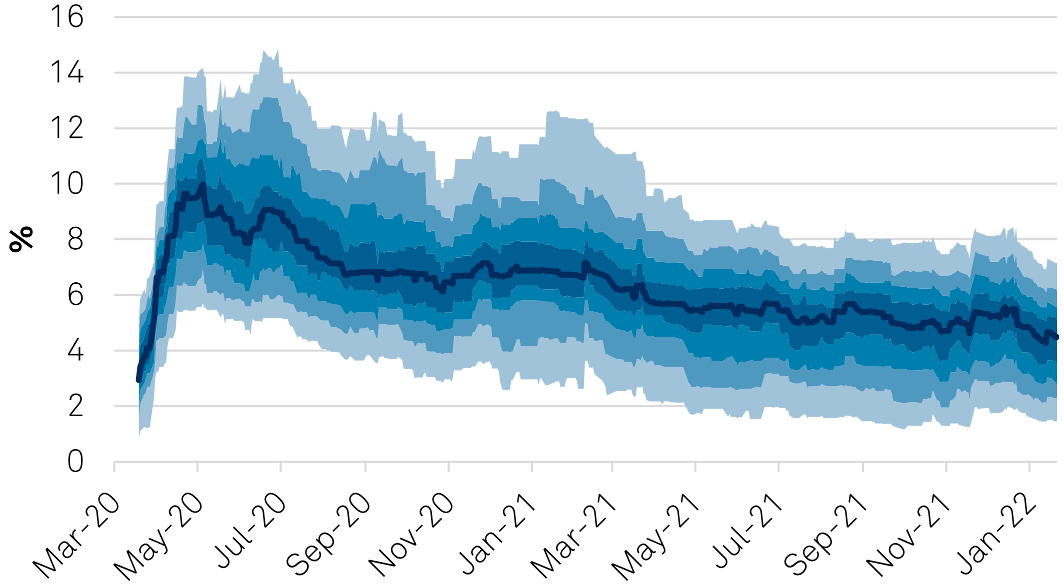


- Refinancing and reset volumes were inflated in 2021, because many 2020 vintage CLOs were structured with short non-call periods in anticipation of a trend toward lower financing costs, which later materialized.
- More than €65 billion of 2017-2021 vintage new issue CLOs will be out of their non-call periods by end-2022. As many of these already have funding costs lower than the most recent transactions in late 2021, potentially fewer are viable for refinancing or reset. We therefore expect CLO refinancing and reset activity to continue at a slower pace in 2022.
- That said, some CLOs may become reset candidates even if their original liability costs are somewhat lower than current market rates. For example, managers may prefer to reset a transaction in order to continue reinvesting on an existing platform, rather than allowing the transaction to amortize.

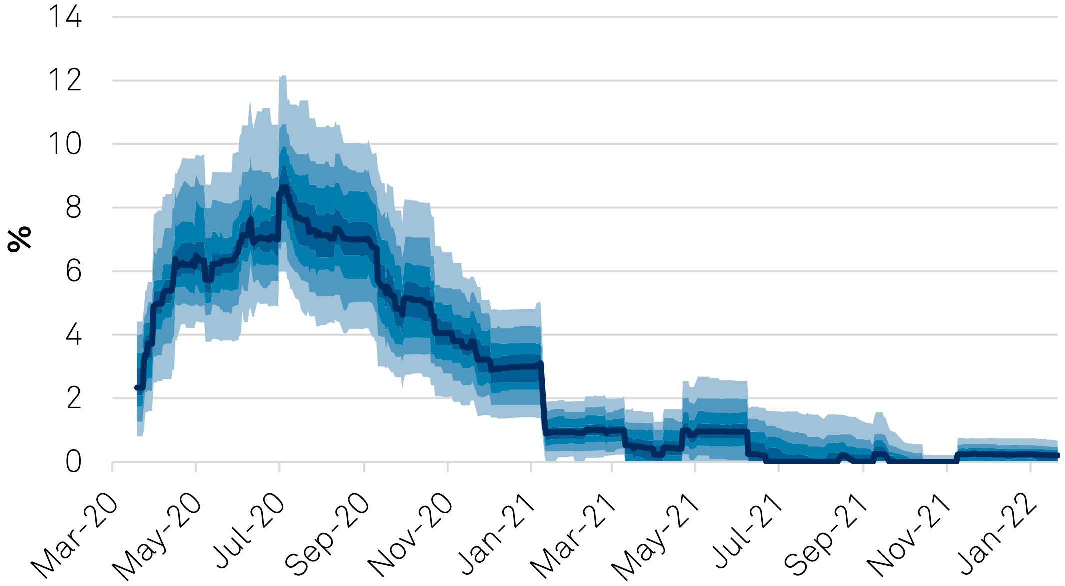
WACF--Weighted-average cost of funding as coupon margin over three-month EURIBOR. bps--Basis points. Based on new issue transactions only. Source: S&P Global Ratings, S&P LCD.

Key Credit Metrics For CLO Portfolios Continue To Stabilize

European CLO Exposure To 'CCC' Category Obligors



European CLO Exposure To Obligors On CreditWatch Negative

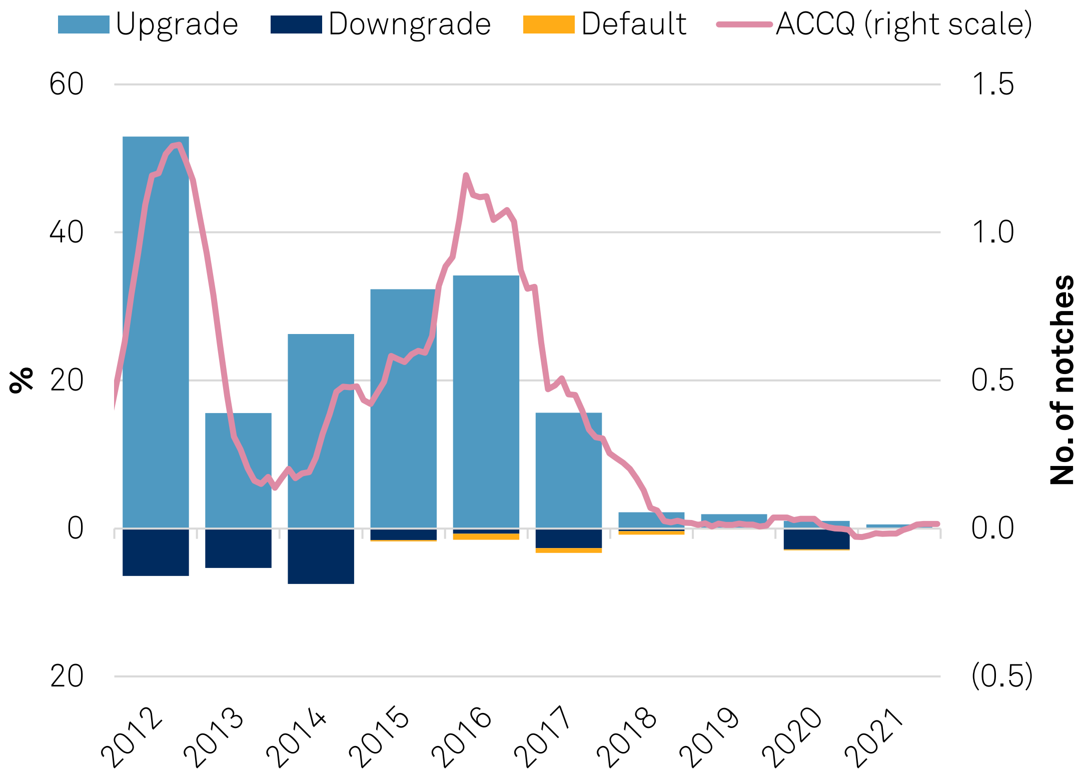


- Across the European CLOs that we rate, the median exposure to obligors rated in the 'CCC' category has gradually declined to about 4.5%.
- In very few transactions is this statistic still higher than the 7.5% threshold above which some assets are carried at market value in overcollateralization test ratios.
- Few underlying obligors now have ratings that are on CreditWatch negative, partly driven by CLO managers actively trading out of weaker credits and sectors.

Solid line is the median, with each band representing a decile, from 10th to 90th percentiles. Estimates based on portfolios from latest available trustee reports, with ratings updated. Source: S&P Global Ratings.

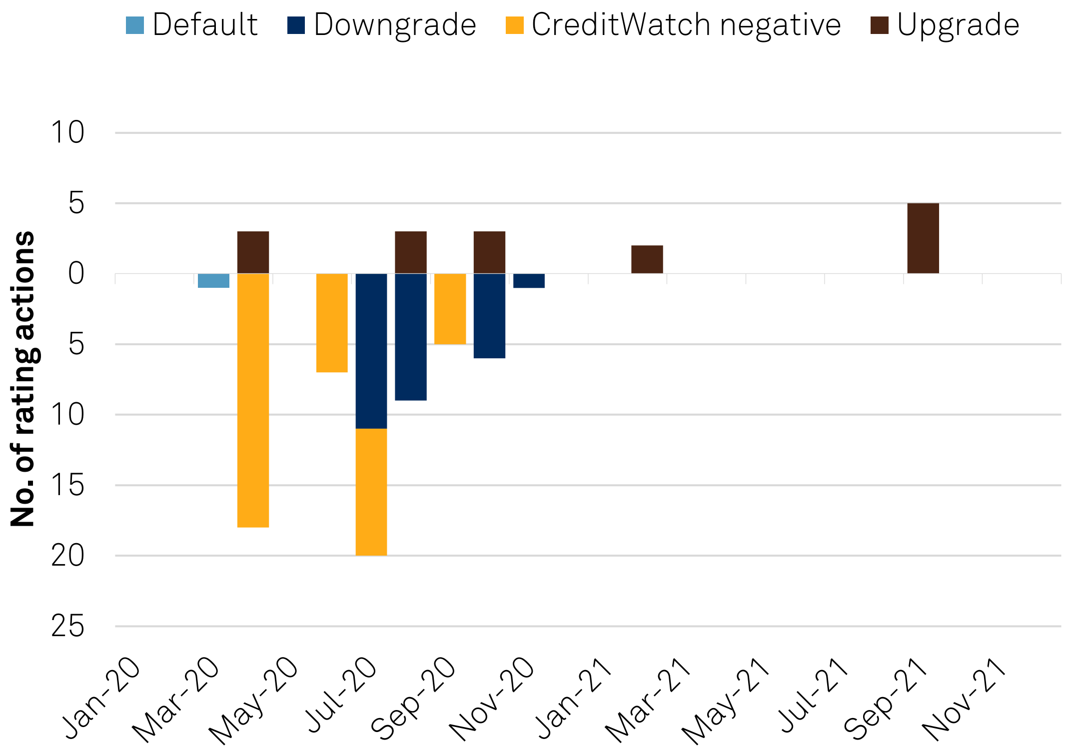
CLOs Saw Very Few Rating Actions Through The Pandemic

CLO Transition Rates And Change In Credit Quality



ACCQ--Average change in credit quality, i.e., the average number of notches by which ratings changed over a trailing 12-month period. Downgrades exclude defaults. Source: S&P Global Ratings.

CLO Monthly Rating Action Count, 2020-2021

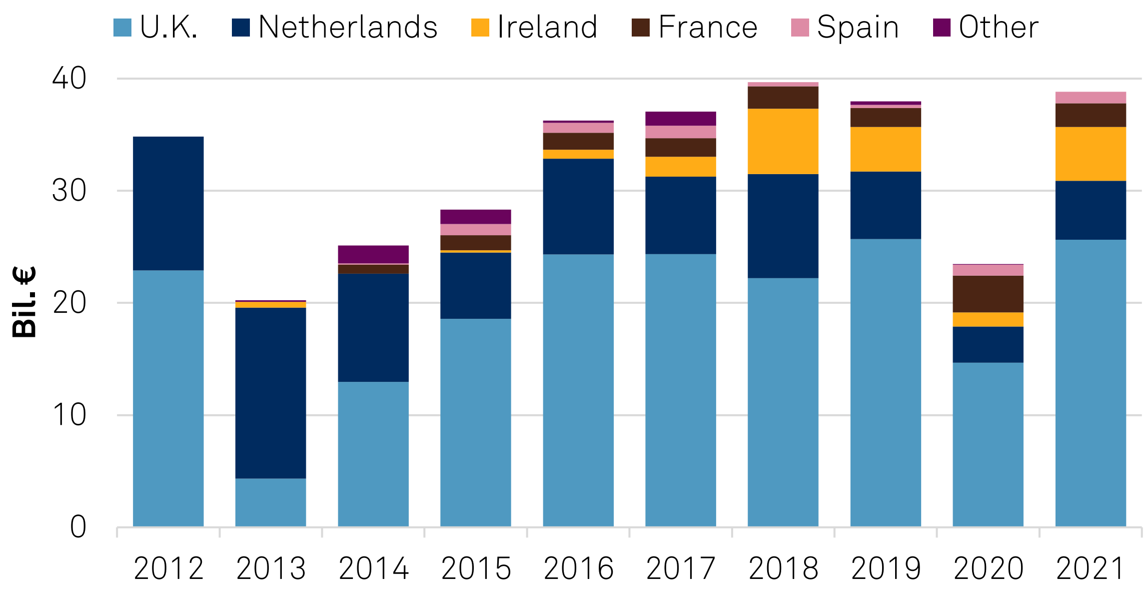


Excludes confidential ratings. Source: S&P Global Ratings.

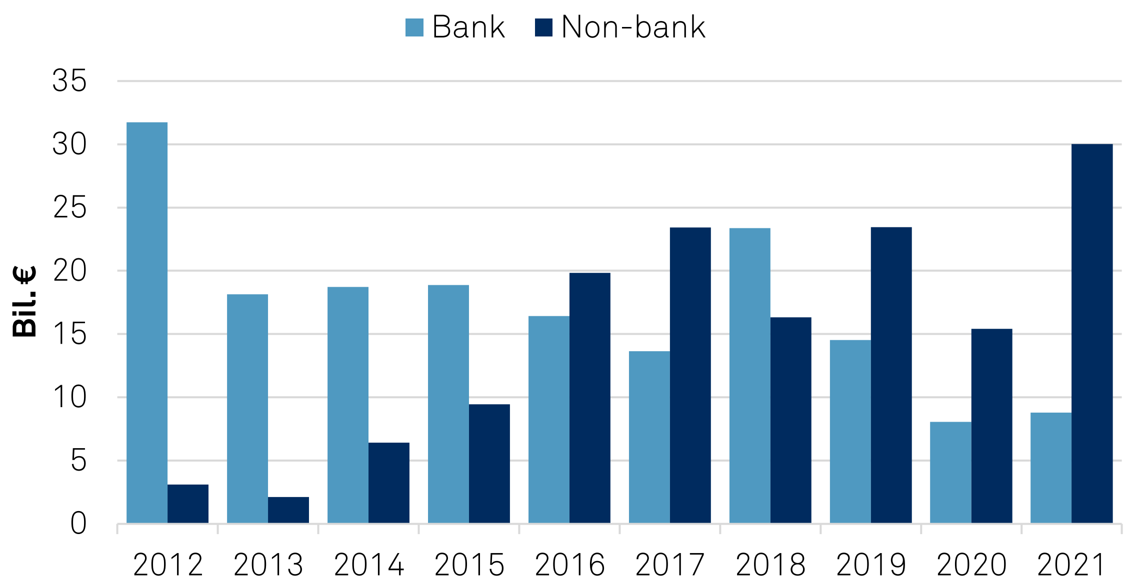
RMBS

RMBS Issuance Bounced Back Close To Decade Highs In 2021

European RMBS Issuance, By Country



European RMBS Issuance, By Originator Type

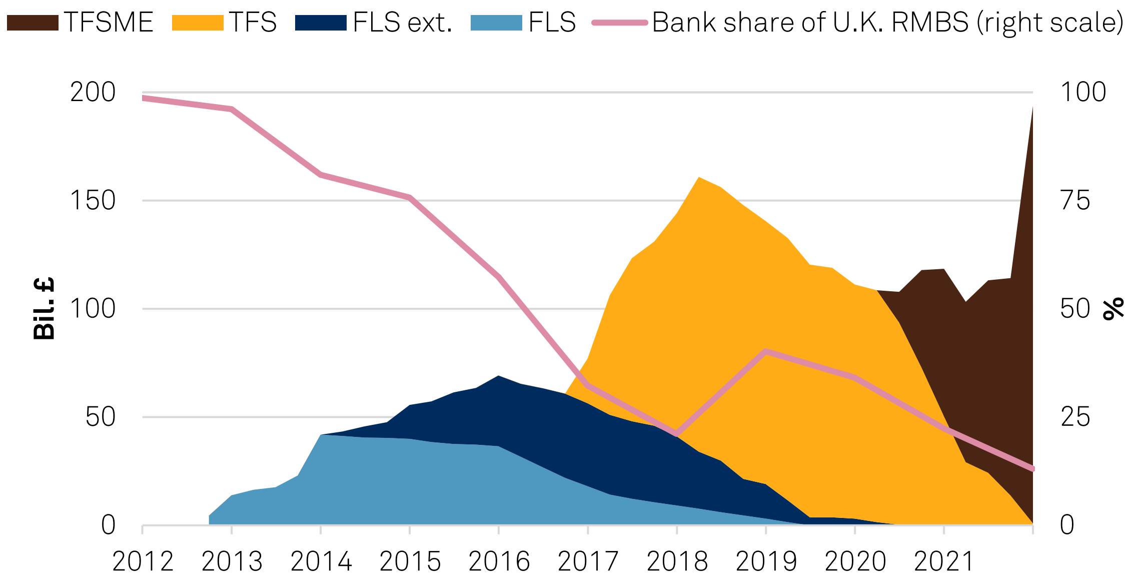


- RMBS volumes were up 65% to €39 billion in 2021, with strong growth in each of the top three markets: U.K., the Netherlands, and Ireland.
- Transactions brought by non-bank originators dominated more than ever, accounting for 77% of the total volume compared with 9% in 2012, and there was very little issuance from traditional U.K. prime RMBS master trusts.
- Issuance could grow further in 2022, given the lower availability of central bank funding, a large call pipeline, and buoyant housing markets.

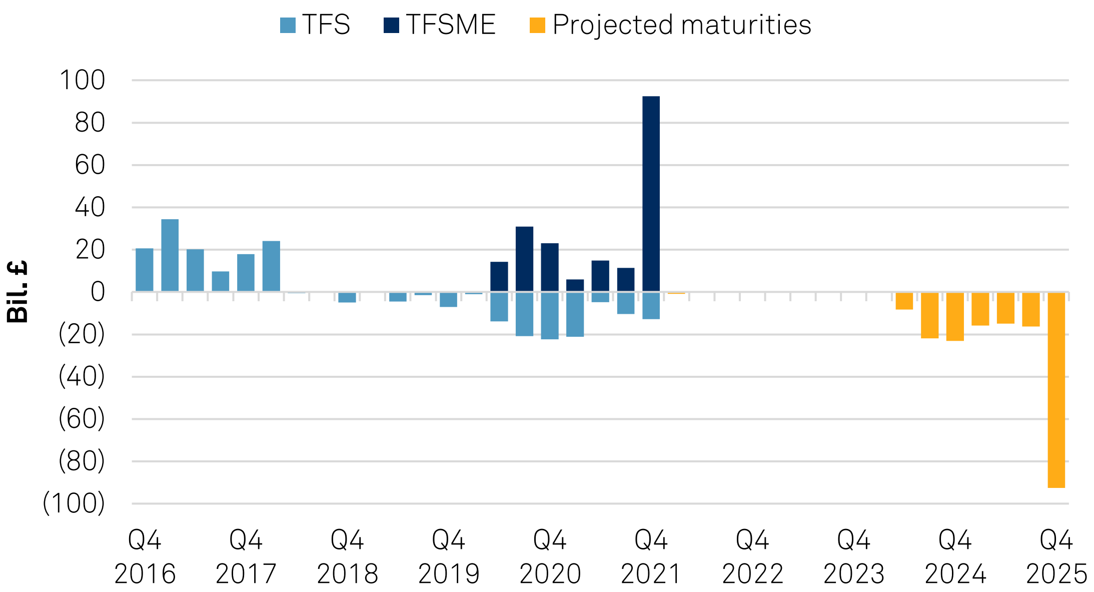
Investor-placed issuance only. Source: S&P Global Ratings

In The U.K., Lenders Can No Longer Draw On Central Bank Funding

Central Bank Borrowing Versus Bank % Of U.K. RMBS Issuance



Bank of England Scheme Net Drawdowns/(Redemptions)

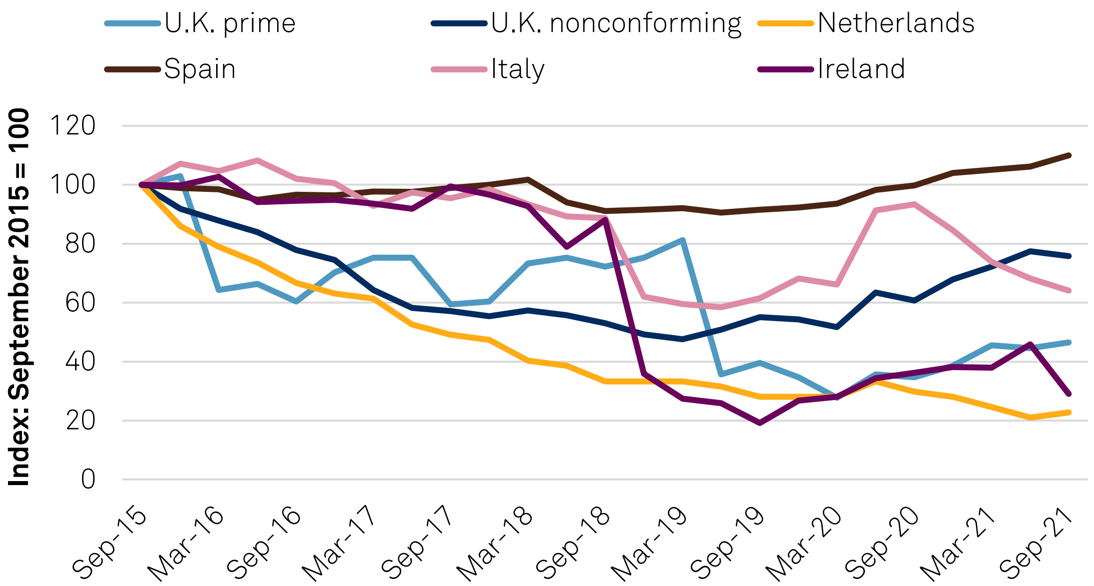


- The bank-originated share of new U.K. RMBS supply has dwindled over the past decade, to only 13% in 2021, as financial institutions' borrowing from cheap Bank of England funding schemes has risen to nearly £200 billion.
- However, the central bank's TFSME facility closed to new drawdowns in October 2021. While these borrowings will not start maturing until 2024, banks will likely have to stagger their refinancing over time, potentially involving a gradual return to wholesale debt markets, including RMBS issuance.

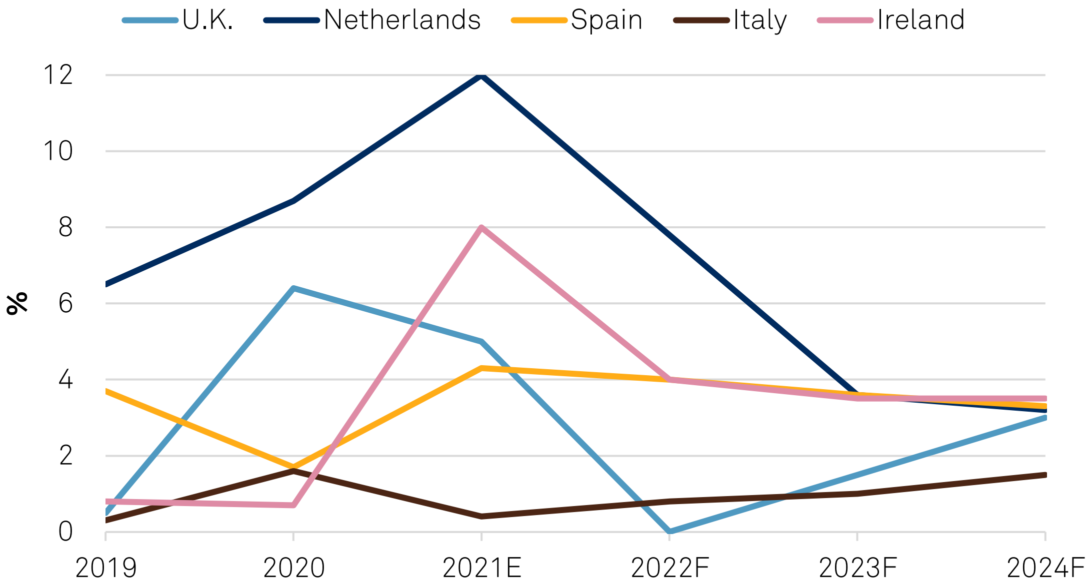
FLS (ext.)--Funding for Lending Scheme (and extension). TFS(ME)--Term Funding Scheme (with additional incentives for small- and mid-sized enterprises). Source: Bank of England, S&P Global Ratings estimates.

Arrears Are Stable And House Price Strength Is Also Credit Positive

European RMBS 90+ Day Delinquency Indices



House Price Growth Forecasts For RMBS Markets

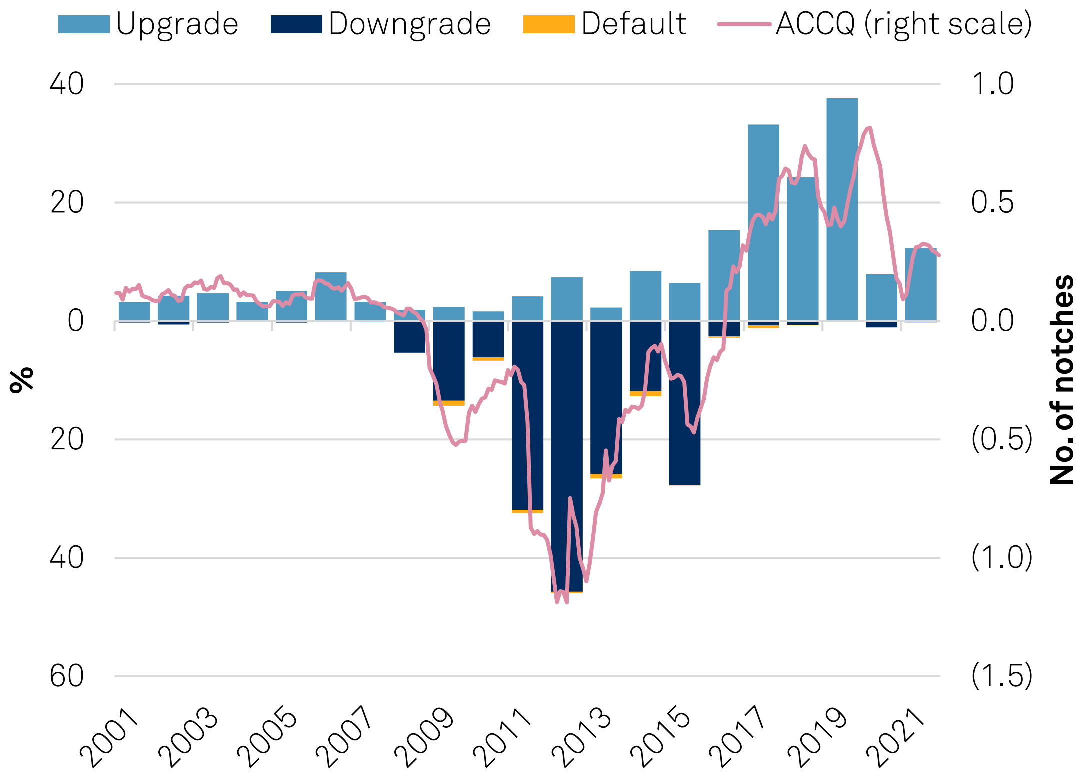


- On average, severe delinquencies reported for the mortgage pools backing RMBS that we rate are only modestly higher than before the pandemic. Some volatility is likely due to differing reporting practices in light of borrower support measures.
- House price inflation looks set to continue in most European countries, as new housing supply is not able to keep pace with structurally high demand. That said, as savings are absorbed and central banks start tightening their policy stance, the rate of house price growth will likely start to decline to varying degrees, depending on country-specific factors.

E--Estimate. F--Forecast. House price growth based on year on year change in the fourth quarter. Source: OECD, S&P Global Ratings

RMBS Actions Over The Past Two Years Have Mostly Been Upgrades

RMBS Transition Rates And Change In Credit Quality



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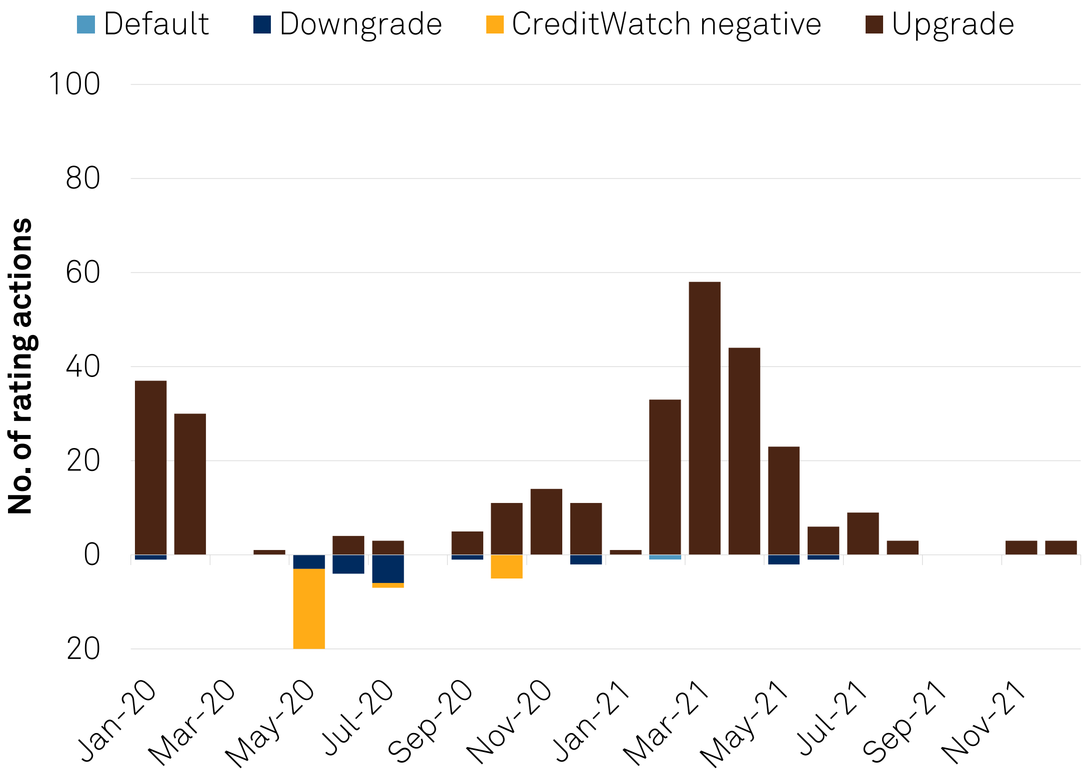
RMBS Monthly Rating Action Count, 2020-2021



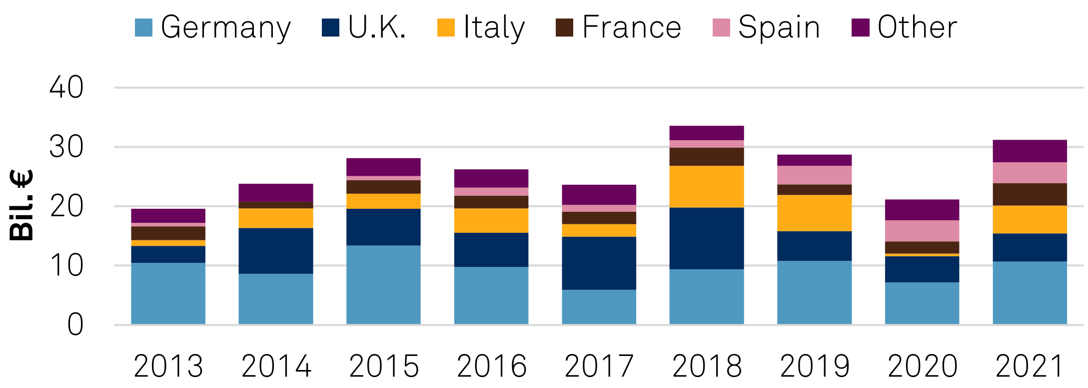
Excludes confidential ratings. Source: S&P Global Ratings.

ABS

S&P Global
Ratings

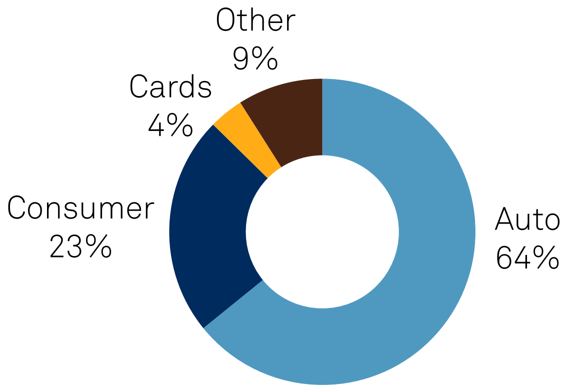
ABS Issuance Has Been Buoyant, With Good Country Diversity

European ABS Issuance, By Country

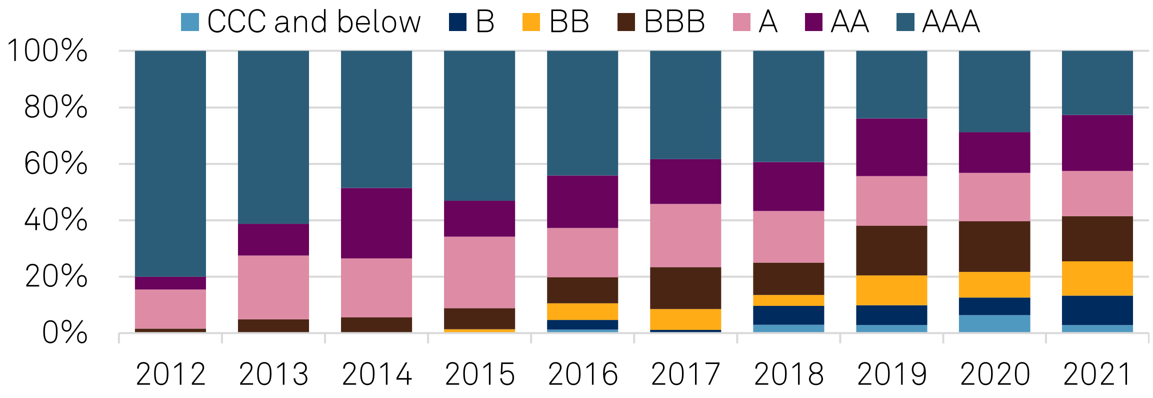


- In 2021, investor-placed ABS issuance bounced back from the lows of 2020. Transactions backed by auto loan and lease collateral dominated, with issuance from 11 countries. Originators are also exploring the securitization of new collateral types, such as solar and buy now pay later finance.
- More than a quarter of tranches (by count) placed with investors were rated in the 'BB' category or lower. Some originators have continued the trend toward selling the full capital structure of their ABS transactions, rather than retaining the higher-risk portions. This could signal increasing use of securitization for capital relief—rather than solely as a funding too—spurring further issuance growth.

2021 Issuance Mix, By Sub-Sector



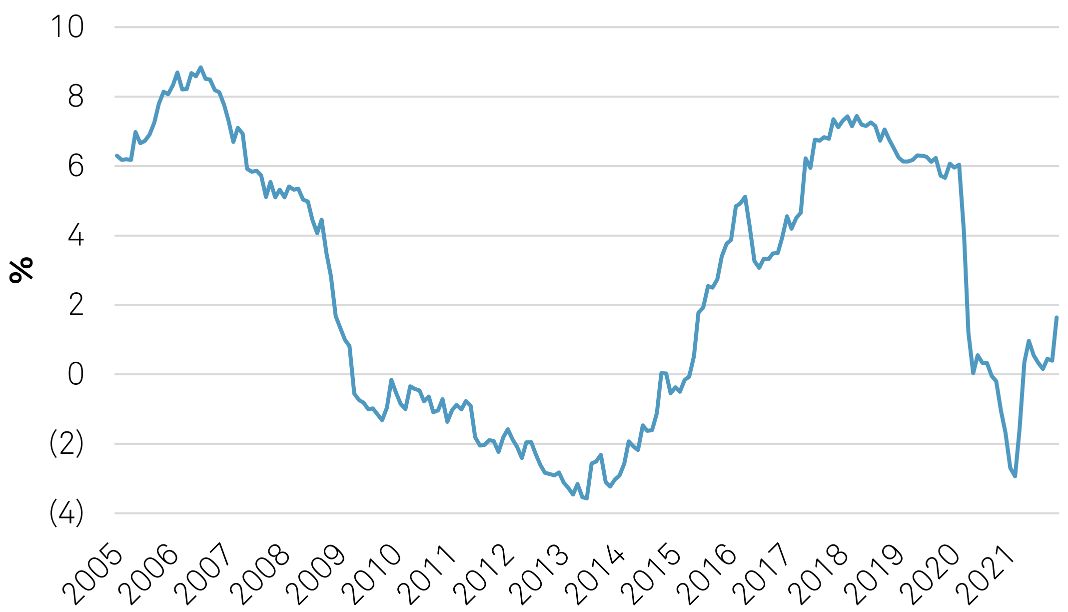
Issuance Mix, By Number Of Tranches And Rating Category



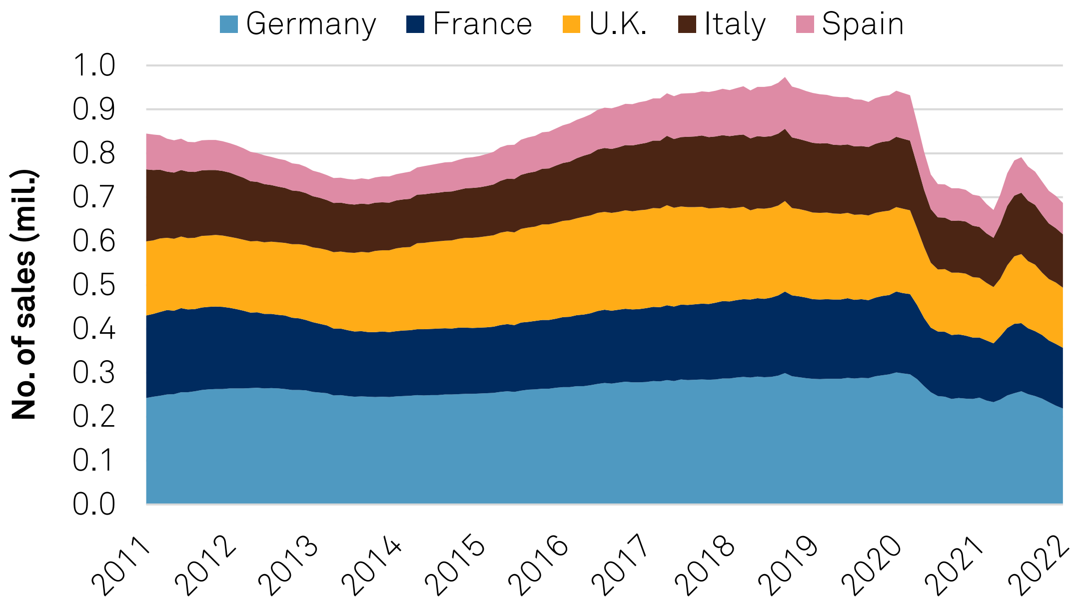
Investor-placed issuance only. Source: S&P Global Ratings.

Consumer Loan Books Are Recovering, Supporting ABS Issuance

Growth In Lending To Households For Consumption



New Auto Sales Volumes

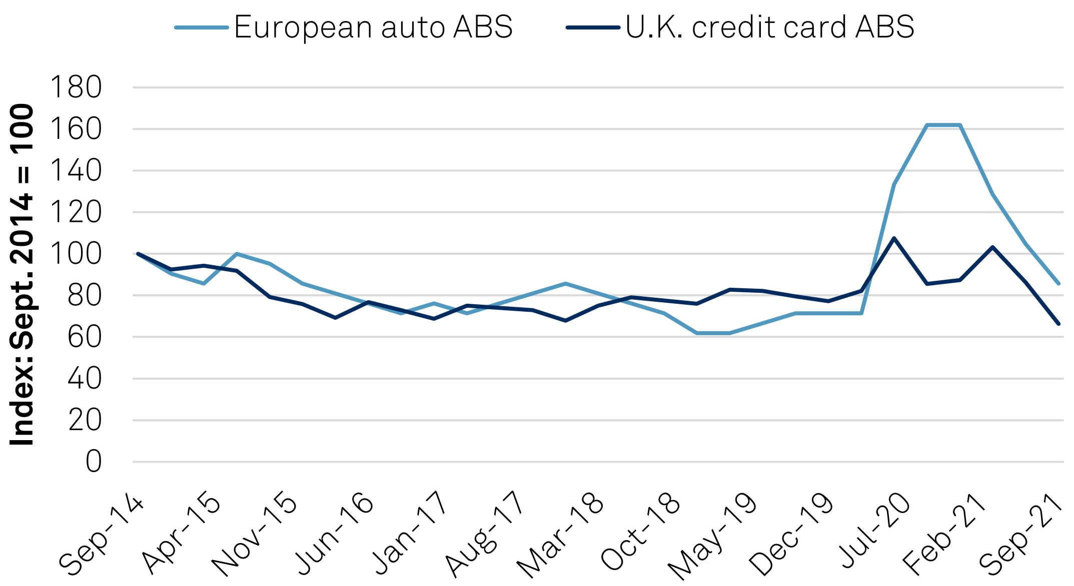


- For consumer ABS, growth in underlying lending activity should generally support issuance. Net lending to households for consumption turned negative through late 2020 and early 2021, but loan books have begun to grow again as economic conditions normalize.
- This could support further issuance recovery in consumer-related ABS sectors, notwithstanding some originators' heavy use of other funding tools, including central bank liquidity schemes.
- Even so, new auto sales and related financing have fallen, given pandemic-related supply chain disruption and a semiconductor shortage.

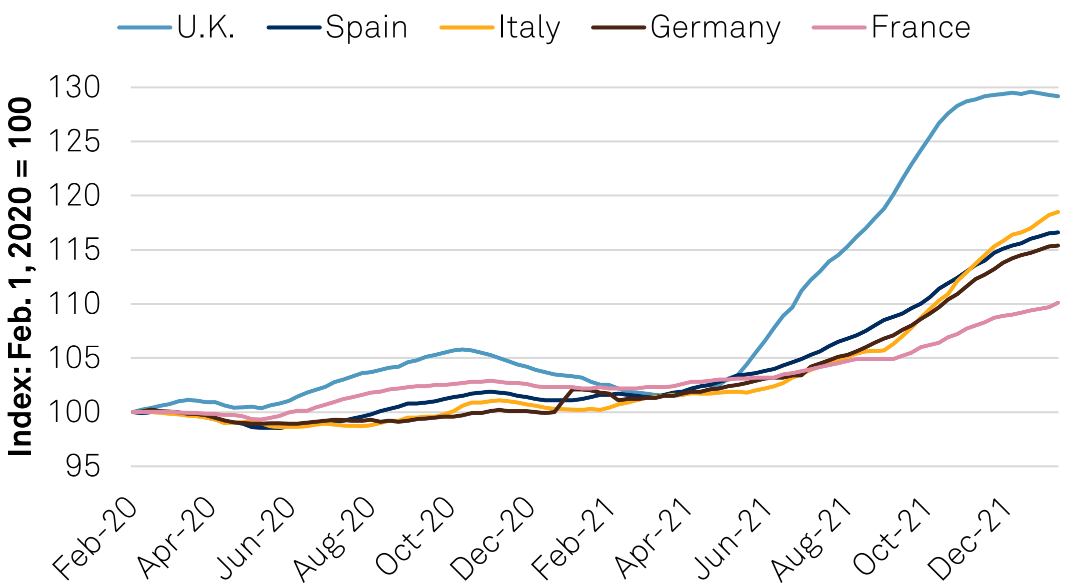
Based on lending by Eurozone banks. Source: European Central Bank, national automobile associations.

Falling Arrears Rates And Strong Used Car Prices Are Credit Positive

European ABS 90+ Day Delinquency Indices



Used Car Price Index

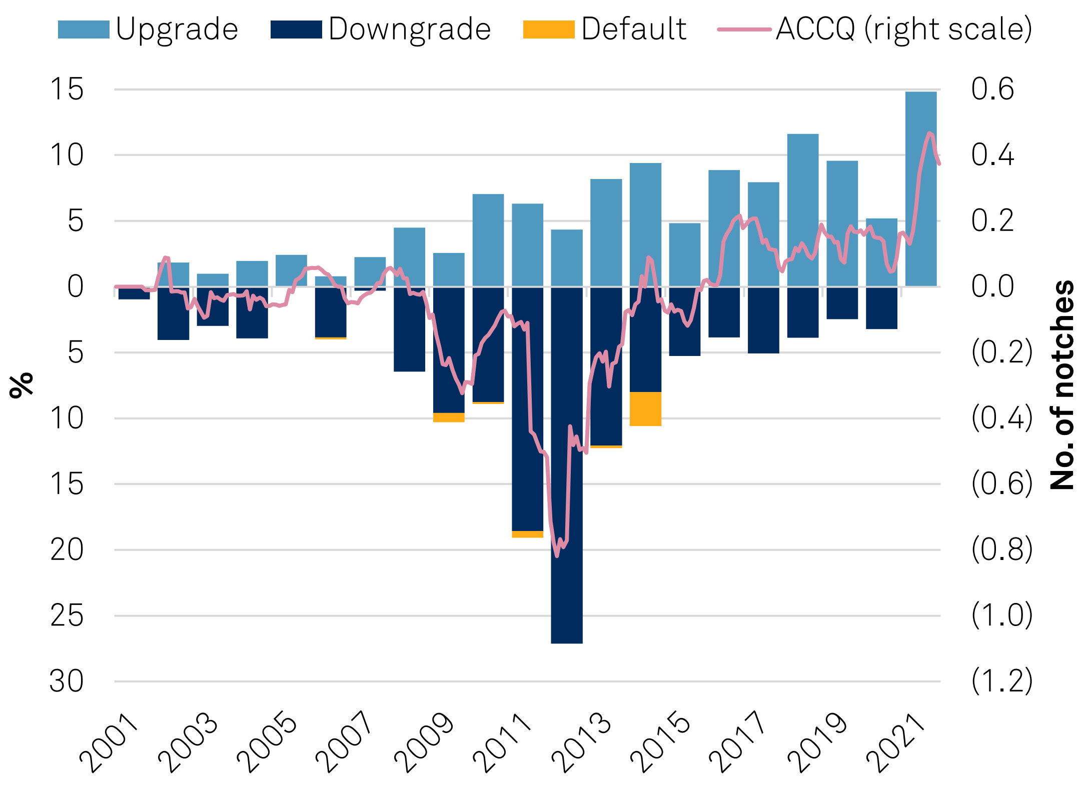


- Our delinquency indices suggest that aggregate credit performance is normalizing across the underlying collateral pools of transactions that we rate, after seeing some deterioration since the onset of the pandemic. This is consistent with falling unemployment rates.
- The trend in used vehicle prices may be a significant credit consideration in auto ABS transactions exposed to residual value risk. Data suggests that used car prices in most auto ABS markets have generally benefited from the supply chain disruption that has reduced new car sales, which is credit positive for existing transactions, especially those exposed to residual value risk.

Source: S&P Global Ratings, Residual Value Intelligence, Autovista Group.

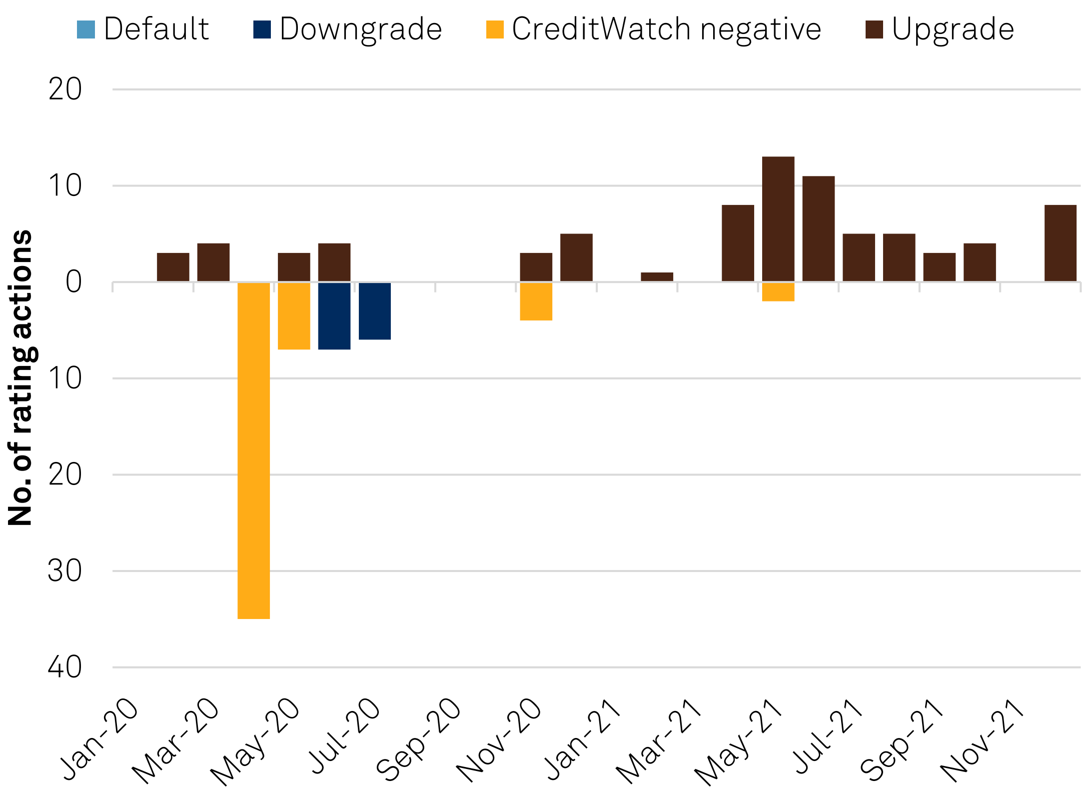
There Were No ABS Downgrades In 2021

ABS Transition Rates And Change In Credit Quality



ACCQ--Average change in credit quality, i.e., the average number of notches by which ratings changed over a trailing 12-month period. Downgrades exclude defaults. Source: S&P Global Ratings.

ABS Monthly Rating Action Count, 2020-2021



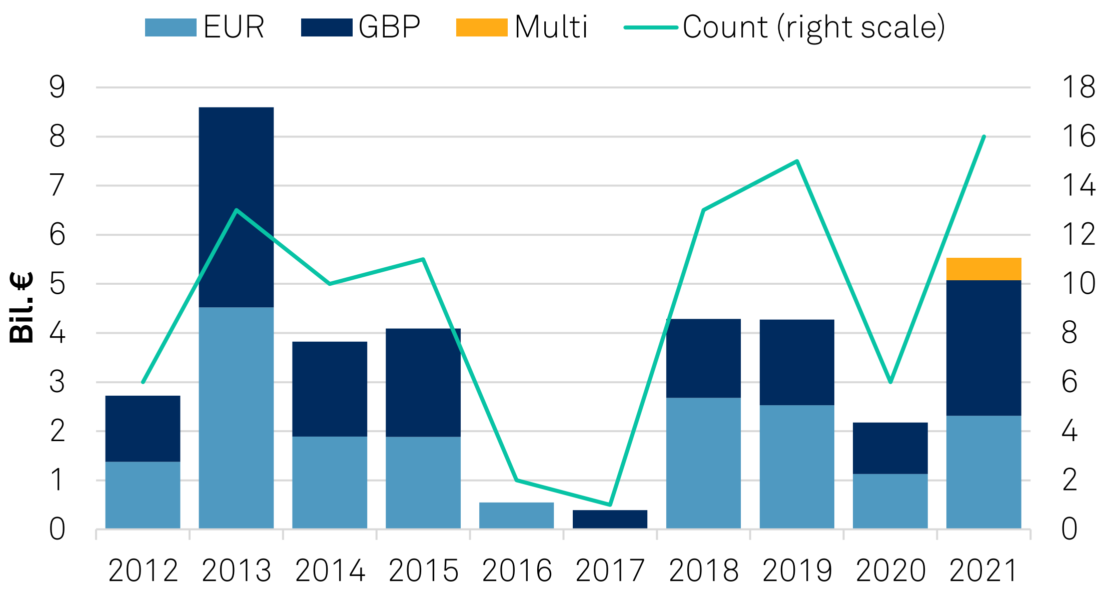
Excludes confidential ratings. Source: S&P Global Ratings.

CMBS

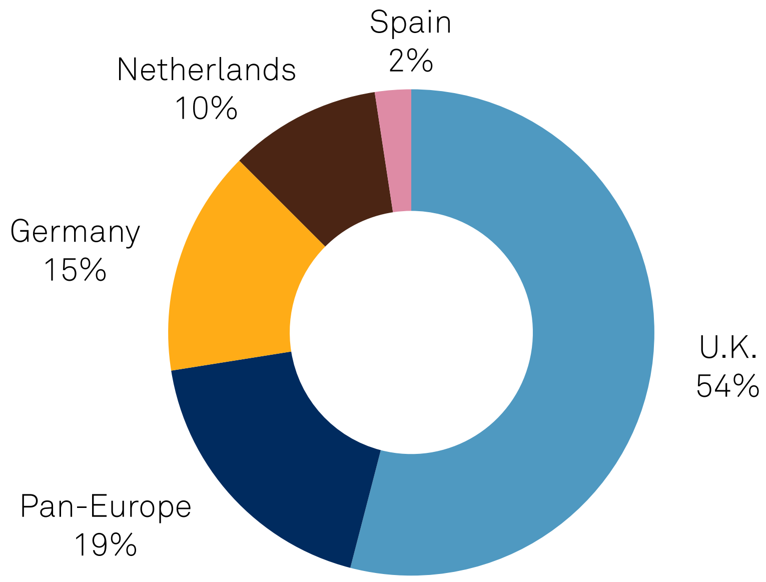
S&P Global
Ratings

CMBS Issuance Recovered To An Eight-Year High In 2021

European CMBS Issuance, By Currency Format



2021 European CMBS Issuance, By Country

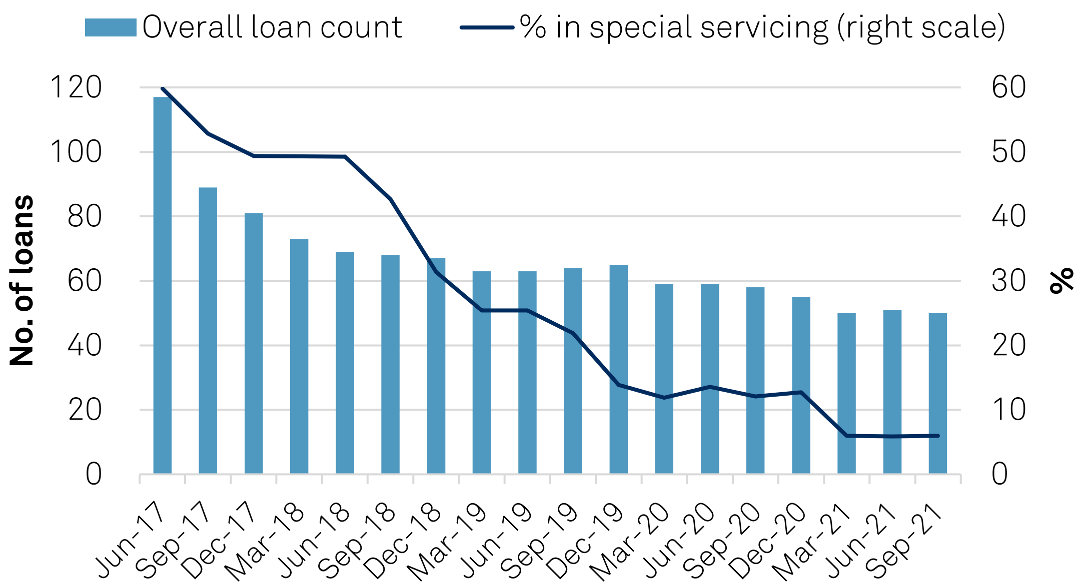


- In 2021, European CMBS volumes topped €5 billion for the first time since 2013, with 11 transactions closing.
- Innovations included the use of multi-currency structures as a means of securitizing mixed-loan pools.
- Issuance is likely to rise further in 2022, with more multi-loan transactions, given strong underlying real estate fundamentals outside the retail sector.

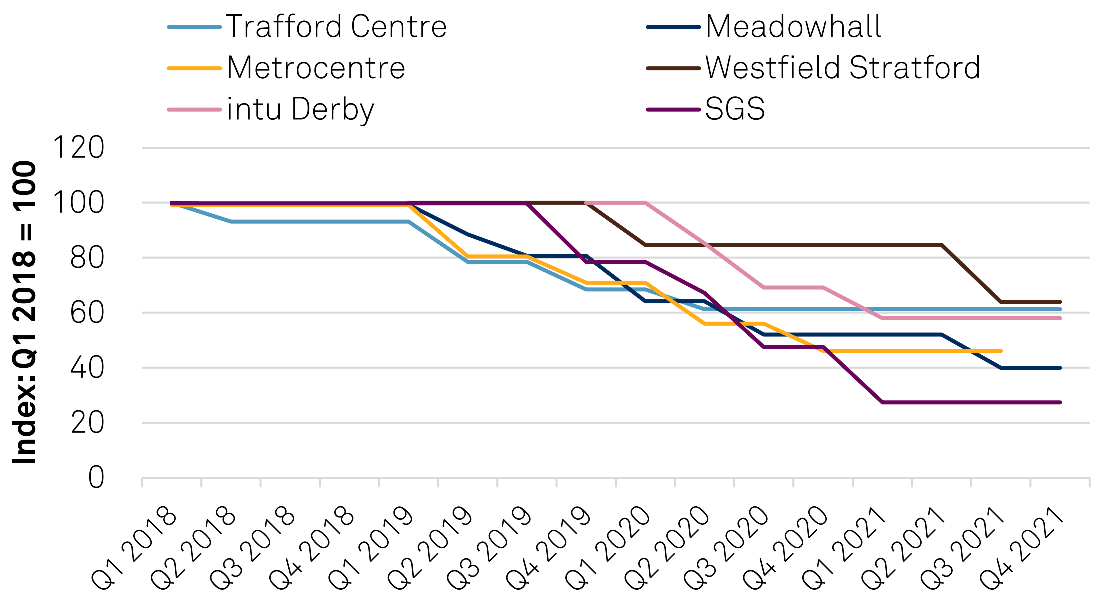
Investor-placed issuance only. Source: S&P Global Ratings

Real Estate Credit Fundamentals Are Weakest In Retail

European CMBS Loans In Special Servicing



U.K. CMBS Shopping Center Valuations

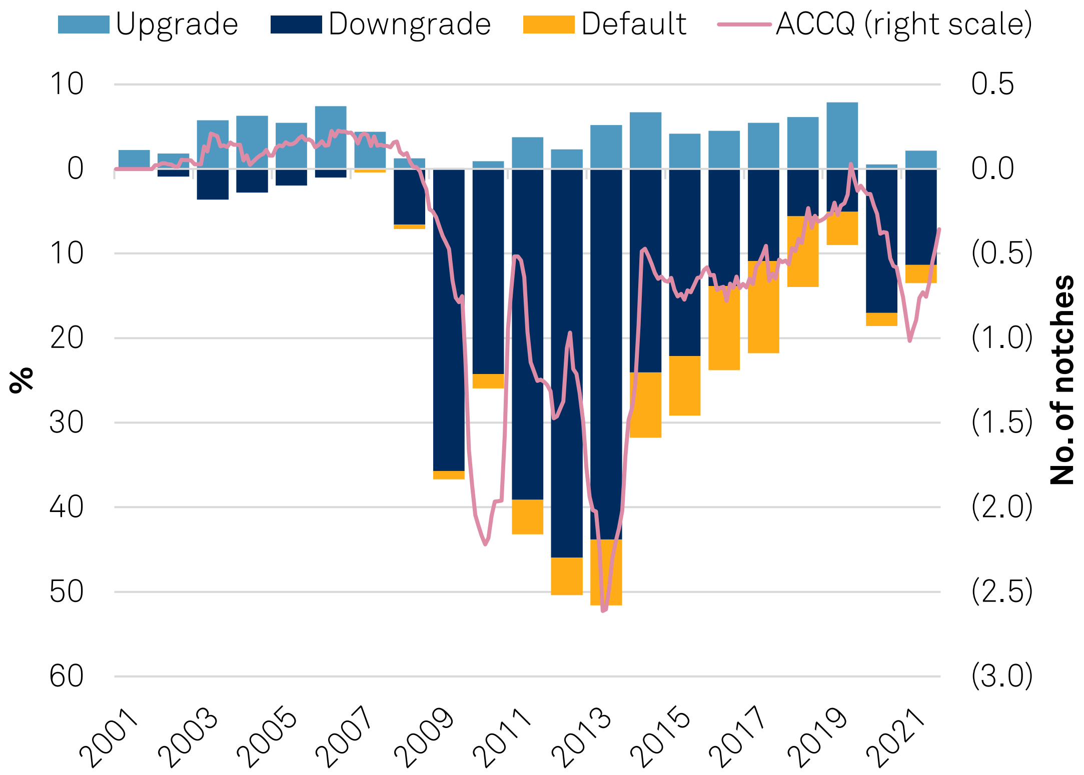


– Across the transactions that we rate, there has been a steady downward trend in the number and proportion of underlying loans that are in special servicing.
– That said, in the retail sector, valuations have been steadily declining on some key properties that back U.K. CMBS, and this has been the area of greatest ratings weakness.

Based on loans backing European CMBS rated by S&P Global Ratings. We no longer rate Metrocentre. Q--Quarter. Source: S&P Global Ratings.

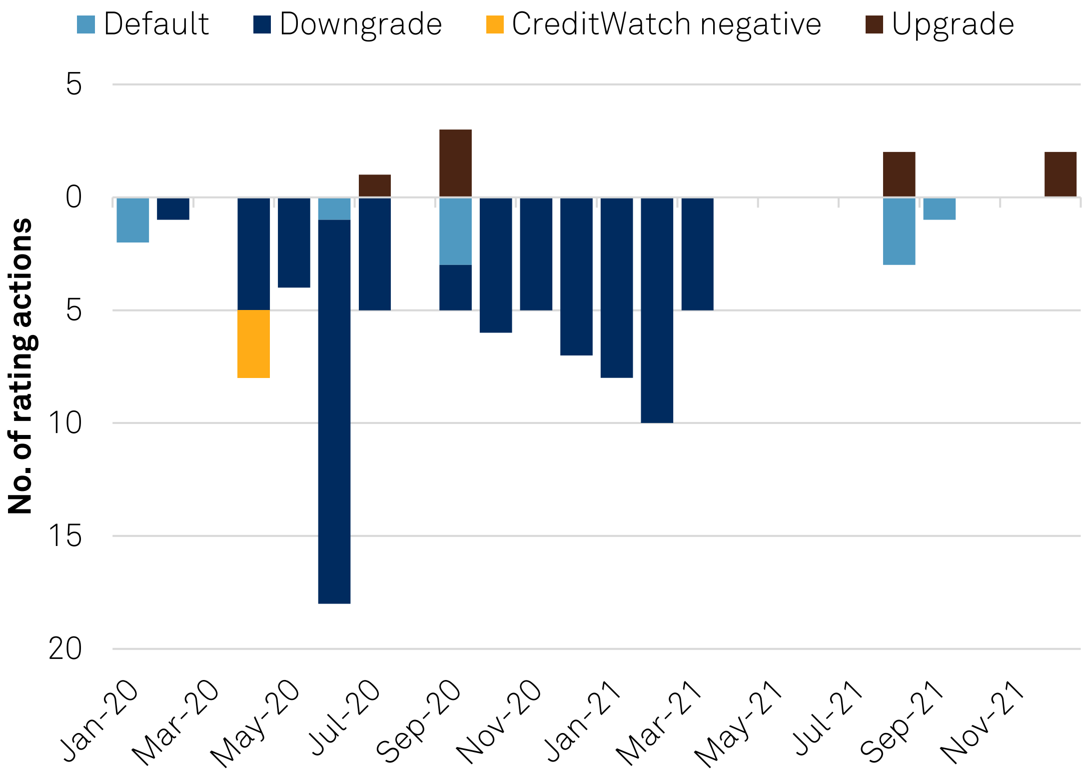
CMBS Ratings Have Fallen, But Few Downgrades Since Early 2021

CMBS Transition Rates And Change In Credit Quality



ACCQ--Average change in credit quality, i.e., the average number of notches by which ratings changed over a trailing 12-month period. Downgrades exclude defaults. Source: S&P Global Ratings.

CMBS Monthly Rating Action Count, 2020-2021



Excludes confidential ratings. Source: S&P Global Ratings.

Recent Research

- Credit FAQ: How We Analyze Small Ticket Commercial Real Estate Assets In European Structured Finance, Jan. 19, 2022
- European Auto ABS Index Report Q3 2021, Dec. 14, 2021
- European And U.K. Credit Card ABS Index Report Q3 2021, Dec. 14, 2021
- Global Covered Bond Insights Q4 2021, Dec. 13, 2021
- Covered Bonds Outlook 2022: Performance Stable As Support Schemes Wind Down, Dec. 9, 2021
- EMEA Structured Finance Chart Book: December 2021, Dec. 2, 2021
- What's It Worth? The Rise Of Electric Vehicles In European Auto ABS, Nov. 30, 2021
- European RMBS Market Update Q3 2021, Nov. 24, 2021
- Sustainable Covered Bonds: A Primer, Nov. 17, 2021
- European RMBS Index Report Q3 2021, Nov. 9, 2021
- Dutch Covered Bond Market Insights 2021, Nov. 8, 2021
- Danish Covered Bond Market Insights 2021, Nov. 2, 2021
- European Housing Market Inflation Is Here To Stay, Nov. 2, 2021
- European CMBS Monitor Q3 2021, Oct. 14, 2021
- German Covered Bond Market Insights 2021, Oct. 11, 2021

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