Structured Finance > Mortgage Credit

GSE Mortgage Credit Risk Transfer Deals

Updated: Sep 28, 2015

Trade Idea:

- Buy GSE Mortgage Credit Risk Transfer Deals

Investment Rationale:

- Security: The bonds are unsecured debt obligations of the GSEs where the cashflows are linked to the credit and prepayment behavior of the underlying reference pool of mortgages currently held in agency MBS. These deals are linked to and designed to provide credit protection to the GSEs on the underlying reference pool of loans as mandated under Dodd-Frank. These are uncapped LIBOR-based floaters with a legal final maturity at the end of 10 years from issuance.
- Credit enhancement: These classes are the mezzanine tranches of the structure. Subordinate tranches provide credit enhancement for the senior tranche (which Freddie and Fannie retain) and for each class of more senior subordinate tranches as losses are allocated in reverse sequential order. Credit enhancement for the M-3 Notes is a first-loss piece (120bp of capital structure) with the M-2 and M-1 with 3.0% and 4.2% of credit enhancement, respectively.
- Structural attributes: Unlike typical cash transactions where investors are exposed to actual losses on the underlying pool, deal losses will be incurred upon pre-defined credit events defined as 180 days or more delinquent, short-sale, and deed in lieu of and REO. Loans will be removed from the reference pool should a credit event occur and the loss will be the net credit event amount times an applicable fixed severity based on a sliding scale, eliminating the potential for servicer action or government loss mitigation programs (ex. principal modifications) to impact ultimate losses. Performance has been very good with very few loans making it into late-stage delinquency which is attributed to the standardized pool selection criteria and positive housing market.
- Relative value: While this is a relatively new asset class, having began in 3Q 2013, we feel this sector provides value and a good way to gain exposure to mortgage credit compared to legacy RMBS and RMBS 2.0. The GSEs have committed to quarterly issuance for 2015 and we expect continued support given the FHFA's strategic goal of contracting the GSEs' dominant presence in the market and promoting risk-sharing between the GSEs and private market participants.

Recommendation(s):

View	Trade Horizon	Deal & Tranche Info	Ratings	Cusip	Average Life / Duration	Tranche Par	Discount Margin	$ Price	Yield*	Ability to Source Similar
Buy	12+ Months	STACR 2015-DN1 M3	Ba1 (M)	3137G0DW6	6.9/5.7	$345mm	410	$100-09	5.77%	Quarterly Issuance
Buy	12+ Months	STACR 2015-DN1 M2	Baa1/BBB (M/D)	3137G0DT3	2.7/2.6	$230mm	190	$101-10	2.79%	Quarterly Issuance
Buy	12+ Months	STACR 2015-DN1 M1	A2/A (M/D)	3137G0DQ9	0.7/0.7	$230mm	115	$100-02	1.54%	Quarterly Issuance

** Based on forward curve, as of 9/28/15*