



RATING ACTION COMMENTARY

Fitch Places 140 UK RMBS Ratings on RWN on Coronavirus Pandemic

Tue 21 Apr, 2020 - 10:17 AM ET

Fitch Ratings - London - 21 Apr 2020: Fitch Ratings has placed 140 ratings across 54 UK RMBS transactions on Negative Watch as coronavirus-related disruptions are likely to impact performance in the short-term.

A full list of rating actions is available by clicking on the link above.

TRANSACTION SUMMARY

The 54 transactions are securitisations of UK residential mortgage assets across the prime, buy-to-let and non-prime sectors.

KEY RATING DRIVERS

COVID-19 Stresses

The Rating Watch Negative (RWN) reflects the high probability of downgrade on the tranches as a result of the coronavirus pandemic affecting the following drivers: a) reduced available liquidity to protect noteholders if underlying

borrowers are granted and accept payment holidays; b) insufficient credit enhancement (CE) to compensate for additional projected losses on the portfolios as a result of changing macro-economic circumstances; c) larger-than-average exposure to self-employed borrowers who are viewed to be the most vulnerable in the current crisis due to income volatility and rapid job losses; and d) refinancing risk for high loan-to-value (LTV), less affordable loans due to reset to higher variable rates in 2020.

The UK government implemented lockdown measures on 23 March 2020. Fitch has made assumptions about the spread of coronavirus and the economic impact of the related containment measures. As a base-case scenario, Fitch assumes a global recession in 1H20 driven by sharp economic contractions in major economies with a rapid spike in unemployment, followed by a recovery that begins in 3Q20 as the health crisis subsides. However, if a longer lockdown period is required to contain the virus in 2H20 or the health crisis extends to 2021 because of the re-emergence of infections, a prolonged period of economic contraction will take place linked to continued job losses and depressed markets.

Commentary describing Fitch's credit views and analytical approach as a consequence of coronavirus is available within the reports "Global Economic Outlook - COVID-19 Crisis Update April 2 2020", "Coronavirus Baseline and Downside Scenarios" and "Global SF Rating Assumptions Updated to Reflect Coronavirus Risk". Additionally, analytical notes relevant for EMEA RMBS transactions are discussed in the commentary "Fitch Ratings' Approach for Addressing Coronavirus-Related Risks for EMEA RMBS."

Weaker Asset Performance Outlook

We expect a generalised weakening in borrowers' ability to keep up with mortgage payments, as large-scale job losses may take place in the manufacturing and tertiary sectors. The RWN reflect the heightened probability of downgrade in a scenario calibrated with a 15% increase of lifetime defaults versus unadjusted assumptions.

Fitch believes that excess spread notes may be particularly exposed because redemption relies on sufficient revenue funds being available at a junior position in the priority of payments. Fitch expects such available funds to decrease as arrears and payment holidays increase and funds are used to clear principal deficiency ledgers senior in the priority of payments. Further, excess spread notes in many cases cease to receive funds after the step-up date until more senior notes have been redeemed. As a result, these notes have been placed on RWN, with the exception of those where the rating is currently limited by a cap.

Affected transactions (39) are those set out in the associated rating action report save for those described separately in the sections below.

Liquidity Risk

The option for borrowers to take a three-month payment holiday on their mortgage payments has been introduced following a government initiative announced on 17 March. Fitch believes the take-up rate will be high, resulting in a reduction of available revenue funds to pay transaction senior costs and note interest. Transactions may rely on other sources of funds, such as reserve funds, to ensure timely payment of such items.

We have tested the ability of all Fitch-rated UK RMBS transactions to meet senior costs and note interest payments based on current interest rates. In the unlikely scenario of no mortgage payments being collected, the majority of transactions will be able to cover these costs from reserve and liquidity sources for at least the next nine months.

Certain investment-grade rated notes have been placed on RWN as interest deferral risk has increased and may not be commensurate with Fitch's definition of the current ratings. Affected transactions are EMF-UK 2008-1, Mortgage Funding 2008-1, Precise Mortgage Funding 2018-1B, Precise Mortgage Funding 2018-2B and Charter Mortgage Funding 2018-1.

Large Exposure to Self-Employed

Notes rated up to and including the 'Asf' category of prime transactions with self-employed borrower concentrations that may cause performance volatility have been placed on RWN. At present, we believe performance of self-employed and other employment type will converge in higher investment-grade rating scenarios. In assessing tranche vulnerability Fitch has excluded notes that have materially greater credit enhancement than would be required to maintain the current ratings but are capped by payment interruption or counterparty constraints.

Fitch's Global Economic Outlook projects a sharp contraction followed by a recovery from 2H20 onwards. Income support for self-employed borrowers offered by the UK government may not be sufficient or borrowers may not be eligible during the contraction. Some self-employed borrowers will not be able to recover lost income, increasing the risk of mortgage arrears and ultimately default.

Affected transactions are Charter Mortgage Funding 2018-1, Charter Mortgage Funding 2020-1, Finsbury Square 2018-1, Finsbury Square 2018-2, Finsbury Square 2019-1, Finsbury Square 2019-2, Finsbury Square 2019-3 and Finsbury Square 2020-1.

Refinancing Risk

Notes rated up to and including the 'Asf' category of transactions where a significant proportion of loans are scheduled to revert from their introductory rates by end-2020 have been placed on RWN. The mortgage pools for these transactions contain either weaker affordability metrics (defined as debt-to-income or interest coverage ratios concentrated in the higher-risk classes under Fitch's UK RMBS Rating Criteria), or a significant proportion of loans with a current loan-to-value greater than 80%.

Many lenders have withdrawn mortgage products, including higher loan-to-value offerings, substantially reducing product switching and remortgaging options for many borrowers. Loans that are due to move to higher reversionary rates will place an increased strain on affordability at the same time as a deteriorating economic backdrop. The inability to refinance to a lower rate could lead to increased arrears and defaults having a greater-than-expected impact on transaction performance.

Affected transactions are Paragon Mortgages (No. 26), Finsbury Square 2018-1, Finsbury Square 2018-2, Finsbury Square 2019-1, Charter Mortgage Funding 2010-1, Precise Mortgage Funding 2017-1 and Precise Mortgage Funding 2019-1.

RATING SENSITIVITIES

Developments that may, individually or collectively, lead to positive rating action/upgrade or affirmations include:

- Transaction liquidity sources resilient to coronavirus-associated stresses such as payment moratoriums and new loan defaults, all else being equal. This is in connection with notes affected by liquidity and payment interruption risks.
- Credit enhancement ratios increase as the transactions deleverage to fully compensate the credit losses and cash-flow stresses that are commensurate with higher rating scenarios, all else being equal.

Developments that may, individually or collectively, lead to negative rating action/downgrade include:

- Transaction liquidity positions weaken due to large take-ups on mortgage payment moratoriums and new defaults as a consequence of the coronavirus crisis.
- A longer-than-expected recessionary period that weakens macroeconomic fundamentals beyond Fitch's current base case. Credit enhancement ratios cannot fully compensate the credit losses and cash-flow stresses associated with the current rating scenarios, all else being equal.

Fitch expects to resolve the RWN within the next six months, with a likely rating impact that could range between affirmations to multi-notch downgrades depending on the trajectory of the coronavirus crisis and the take-up rate on payment holidays.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Structured Finance transactions have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of seven notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of seven notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAAsf' to 'Dsf'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

USE OF THIRD PARTY DUE DILIGENCE PURSUANT TO SEC RULE 17G -10

Form ABS Due Diligence-15E was not provided to, or reviewed by, Fitch in relation to today's rating actions.

DATA ADEQUACY

For all transactions:

Fitch has not conducted any checks on the consistency and plausibility of the information it has received about the performance of the asset pools and the transactions. Fitch has not reviewed the results of any third-party assessment of the asset portfolio information or conducted a review of origination files as part of its ongoing monitoring.

For transactions Eurosail 2006-1, Eurosail 2006-3 NC, Eurosail Prime-UK 2007-A, Eurosail-UK 2007-1 NC, Eurosail-UK 2007-5 NP, Eurosail-UK 2007-6 NC, Eurosail-UK 07-3 BL, Eurosail-UK 07-4 BL, Ludgate Funding Series 2006 FF1, Ludgate Funding Series 2007 FF1, Ludgate Funding Series 2008-W1, EMF-UK 2008-1, Mansard Mortgages 2007-1, Preferred Residential Securities 05-2, Preferred Residential Securities 06-1, Paragon Mortgages (No. 12), Eurohome UK Mortgages 2007-1, Southern Pacific Financing 05-B, Southern Pacific Securities 06-1, Newgate Funding Series 2007-1, Newgate Funding Series 2007-2, Business Mortgage Finance 4, Business Mortgage Finance 5, Business Mortgage Finance 7, Landmark Mortgage Securities No.2, Mortgage Funding 2008-1:

Fitch did not undertake a review of the information provided about the underlying asset pools ahead of the transactions' initial closing. The subsequent performance of the transactions over the years is consistent with the agency's expectations given the operating environment and Fitch is therefore satisfied that the asset pool information relied upon for its initial rating analysis was adequately reliable.

For all other transactions:

Prior to the transactions' closing, Fitch reviewed the results of a third-party assessment conducted on the asset portfolio information and concluded that there were no findings that affected the rating analysis.

Prior to the transactions' closing, Fitch conducted a review of a small targeted sample of the originator's origination files and found the information contained in the reviewed files to be adequately consistent with the originator's policies and practices and the other information provided to the agency about the asset portfolio.

For all transactions:

Overall, Fitch's assessment of the information relied upon for the agency's rating analysis according to its applicable rating methodologies indicates that it is adequately reliable.

SOURCES OF INFORMATION

NA

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria listed below. In addition, the following sources of information that are not discussed in the criteria were used:

COVID-19: support for businesses, sourced from www.gov.uk.

MODELS

No models were used in the analysis of this rating action.

[VIEW ADDITIONAL RATING DETAILS](#)

FITCH RATINGS ANALYSTS

Sara Mariani

Associate Director

Primary Rating Analyst

+44 20 3530 1540

Fitch Ratings Ltd 30 North Colonnade, Canary Wharf London E14 5GN

Alex Veiga Guimil

Senior Analyst

Surveillance Rating Analyst

+44 20 3530 1559

Fitch Ratings Ltd 30 North Colonnade, Canary Wharf London E14 5GN

Alessandro Pighi
 Head of RMBS
 Committee Chairperson
 +44 20 3530 1794

MEDIA CONTACTS

Athos Larkou
 London
 +44 20 3530 1549
 athos.larkou@thefitchgroup.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

[Global Structured Finance Rating Criteria \(pub. 02 May 2019\) \(including rating assumption sensitivity\)](#)

[UK RMBS Rating Criteria \(pub. 04 Oct 2019\) \(including rating assumption sensitivity\)](#)

[Fitch Ratings Interest Rate Stress Assumptions for Structured Finance and Covered Bonds \(Excel\) \(pub. 06 Dec 2019\)](#)

[Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria \(pub. 06 Dec 2019\)](#)

[Structured Finance and Covered Bonds Counterparty Rating Criteria \(pub. 29 Jan 2020\)](#)

[Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum \(pub. 29 Jan 2020\)](#)

ADDITIONAL DISCLOSURES

[Solicitation Status](#)

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ENDORSEMENT STATUS

Business Mortgage Finance 4 Plc	EU Issued
Business Mortgage Finance 5 PLC	EU Issued
Business Mortgage Finance 7 Plc	EU Issued
Canterbury Finance No.1 PLC	EU Issued
Charter Mortgage Funding 2018-1 plc	EU Issued
CMF 2020-1 PLC	EU Issued
Elvet Mortgages 2019-1 plc	EU Issued
EMF-UK 2008-1 Plc	-

Eurohome UK Mortgages 2007-1 plc	-
Eurosail 2006-1 Plc	-
Eurosail 2006-3 NC Plc	-
Eurosail Prime-UK 2007-A PLC	EU Issued
Eurosail-UK 07-1 NC Plc	-
Eurosail-UK 07-3 BL Plc	EU Issued
Eurosail-UK 07-4 BL Plc	-
Eurosail-UK 07-5NP Plc	-
Eurosail-UK 07-6NC Plc	-
Finsbury Square 2018-1 plc	EU Issued
Finsbury Square 2018-2 PLC	EU Issued
Finsbury Square 2019-1 PLC	-
Finsbury Square 2019-2 PLC	EU Issued

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