ESF Securitisation
2008 Market Outlook

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European Securitisation Forum Forecasts Issuance to Fall to €272 Billion in 2008; Market Liquidity Expected to Begin to Recover During the Year

The European Securitisation Forum (ESF) is pleased to present the results of its annual Researchers Working Group issuance forecast survey. The forecast survey covers the range of European securitised product asset classes, including residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), consumer and corporate asset-backed securities (ABS) and collateralised debt obligations (CDO). The survey includes responses from 9 ESF member firms. The survey also asked panellists for their views on the developments in the European securitised markets, including the state of liquidity and investor demand.

The ESF survey panellists expect a general continuation of the trends in the second half of 2007 and for issuance to decline in 2008, well below the full-year 2007 volume to the lowest level since 2004. The issuance outlook is based on a number of factors, including global credit market uncertainty, the evolving risk repricing, the de-leveraging trend, a softer mortgage market in certain jurisdictions, diminished liquidity, the squeeze on Structured Investment Vehicles (SIVs) and Asset Backed Commercial Paper (ABCP), and heightened investor risk sensitivity. As we enter 2008, tighter market financing conditions and elevated funding costs lead originators and issuers to explore a range of funding alternatives, including securitisation.

The consensus view is that the current liquidity freeze will begin to melt during the course of 2008. The survey respondents noted that, despite the stressed market conditions, the underlying collateral performance has generally held up in Europe with rating upgrades exceeding downgrades in 2007. Credit quality is likely to be on the market participants' minds in 2008 based on concerns about a moderating to slower economy in 2008 after an extended period of above-trend growth in Europe, the effect of relaxed corporate debt covenants over the last few years, and some housing markets becoming pressured. (European rating downgrades, in fact, picked up in January.) Considering the operating environment, in addition to the lower volumes, issuance is expected to be characterised by simpler transactions and more conservative collateral structures, including tighter eligibility criteria, asset selection and reduced leverage.

The median survey response projects European cash funded securitisation issuance

EUROPEAN SECURITISATION ISSUANCE FORECAST
€ Billions

	2007	2008	% Change
RMBS	262	132	-50%
CDOs	101	66	-35%
CMBS	47	30	-36%
Corporate	30	24	-20%
Consumer	21	20	-5%
Total	461	272	-41%

Note:
1. The asset class 2007 actual estimate and 2008 forecast are based on median responses to the survey.
2. The total is sum of the asset classes.
3. CDO volumes are based on CDOs backed by European collateral regardless of currency of issuance.

to be €272 billion for 2008, a 41 percent decline from the 2007 level. The panellists expect a broad based volume decline in 2007 with the median issuance forecast projecting declines across collateral asset classes. The sharpest volume reduction is expected in the mortgage related sectors, particularly RMBS, and declines in corporate and consumer ABS more modest. The synthetic issuance levels are also expected to be lower in 2008.

Issuance by Collateral Asset Class

The consensus view is that mortgage and real-estate related product asset classes are most susceptible to an issuance slowdown or contraction. The median forecast for RMBS is €232 billion, approximately a 50 percent decline from full-year 2007. As in the second half of 2007, panellists expects a portion of that securitised issuance to be retained to support issuer liquidity and to be used as repo collateral rather than distributed to external investors. Despite the anticipated reduction in RMBS volume, RMBS is expected to remain the largest issuing sector and account for slightly less half of total issuance in 2008, or 48.5 percent. However, the RMBS market share dominance is going to recede relative to other assets. The panellists commented that RMBS issuance will be held back by the expectation of a slowing mortgage market and the economics of the new Basel II capital requirements under current market conditions that make it attractive to retain mortgages for highly rated tranches.

CMBS issuance is also expected to fall to € 30 billion, a 36 percent decline. The volumes will be affected by a slowing or even a reversal of the recent trend of CMBS yield compression, generally slower underlying commercial real estate fundamentals, market digestion of the sector's substantial supply growth of recent years and greater uncertainty about refinancing opportunities for more aggressively structured deals in light of the spread widening during the past year.

Panellists commented that CDO and corporate ABS may pick up as Basel II capital requirements make it relatively attractive to securitise corporate assets. Nevertheless, CDO issuance is projected to decline to by 35 percent to €66 billion but still rank second. The consensus view is that the arbitrage CDO volume will decline more than balance sheet CDO volume in 2008. As fourth quarter CDO volume has been supported by warehoused and discounted collateral, there is a question of the how much of these legacy assets remain to be sold in structured transactions. The critical issues behind the CDO forecast relates to the return of investor demand for the CDO structure and corporate debt, including leveraged loan, credit performance after an extended period of strong credit quality metrics. Panellists indicated that their assessment took into account a balancing of a potentially less favourable outlook than 2007 on collateral credit quality metrics against the potential for improvement in market technical's leading to lower cost liability funding and tighter spreads later in 2008 relative to late 2007. Panellists did express the view that there will be fewer CDO managers able to issue in the coming year as investors become more discriminating and selective.

Corporate ABS issuance is expected to decline by less than the larger product sectors, by 20 percent, to €24 billion. Survey respondents commented that some corporate issuers are expected to find securitisation an attractive funding source. Further, there were comments that the corporate ABS investor base had been less affected than other sectors by SIV and ABCP shrinkage.

Consumer ABS is expected to be €20 billion, including auto loans and credit card receivables, a modest 5 percent decline compared to 2007. Several panellists also offered a view that certain consumer ABS issuer segments may be relatively well positioned based on existing investor demand for some short-dated, senior paper. Consumer issuance is expected to gain repeat issuance from captive auto finance companies. Basel II capital requirements will be an important factor in which assets to securitise.

Country of Collateral

Survey respondents expected the more established and larger country of collateral sectors to be lower because of the prominence of mortgage-related securitisation issuance in those markets. The UK is expected continue to be the largest country of collateral issuer. Panellists did comment that that UK, especially non-conforming, and certain regional Spanish RMBS were most vulnerable to an issuance volume reduction, while recognising that Spanish collateral has performed well to date.

Emerging market Eastern and Central European countries were expected to increase issuance volumes as securitisation is a relatively inexpensive funding source. Those developed countries with lower securitisation penetration rates such as Greece and Belgium were also seen as countries in which issuance volume may grow in 2008.

Market Liquidity

As we enter 2008, secondary market liquidity remains thin amid the market dislocation and wider spreads. Liquidity will continue to be constrained by restrained investor demand compared to the early 2007 levels and by the contraction of certain investor groups such as SIVs and some market value sensitive investors. Panellists generally expect secondary market liquidity to begin to open up and improve during the course of 2008, although there was a difference of opinion as to whether the increased liquidity will take place in the first half or the second half of 2008. The panellists base their view regarding a return of liquidity on reduced new issuance supply which would focus more investor attention on the secondary market. A substantial number of investors will probably stay on the sidelines, and there is an expectation of improved technicals during the course of 2008. Finally, the pace of the anticipated evolution of the structured product investor base and the rising role of distressed buyers, some yield motivated buyers and sovereign credit funds will affect market liquidity conditions.

However, the liquidity will not return to the levels of early 2007. A relative improvement in liquidity will be accompanied with heightened volatility. In such an environment, higher quality and more stable products are likely to benefit and generate greater investor interest. When liquidity returns, investors are likely to prefer higher rated, less credit exposed products to higher yielding issues with more credit risk exposure, more price tiering and presence of a “complexity” premium. The panellists indicated that Basel II capital requirements makes it more attractive for banks to buy RMBS and other ABS, but other factors are expected to overwhelm the Basel effect, including the level of non-bank investor demand.

Forecast Assumptions and Risks

The survey results identified a number of factors that could affect the forecast. The most frequently mentioned downside risk to the forecasts related to strong corrections the UK non-conforming market and certain Spanish regions. Panellists also cited the risk of an economic slowdown, additional selling by SIVs, the effect of rating reviews of monoline bond insurers and deterioration in unsecured credit. Other downside risks to the forecast are continued volatile market spreads; limited or no return of the conduits as buyers; reduced primary market loan originations leading to less lender demand for issuance and funding; and uncertainty regarding the implementation of the Capital Requirements Directive.

Issuance may be higher than expected if credit spreads tighten sufficiently and conditions normalise to attract issuers and investors back to the market and an overall positive economic tone including a soft landing of the main housing markets. Also mentioned are circumstances that could affect investor demand, including entry of new investors, regulatory initiatives and valuation methodology evolution, including a reassessment of the role of indices.