The State of Securitization from SFVegas

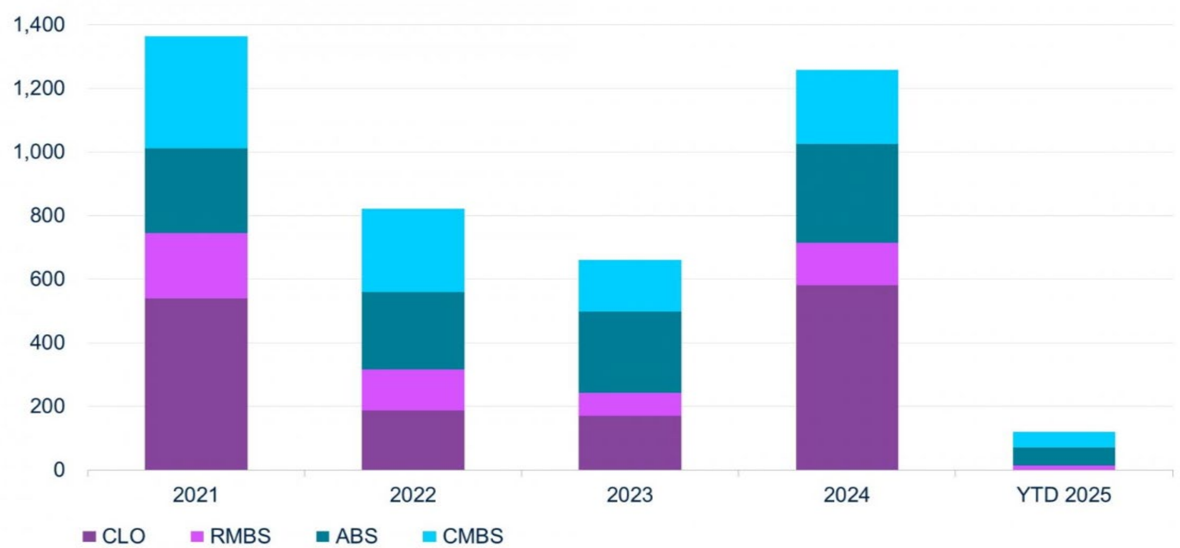
For those seeking perspective on the tailwinds behind the securitized products sector, it was evident at the industry's recent confab in Las Vegas. With more than 10,000 global participants from an array of industry roles, the attendance alone underscored the sector's position at the forefront of a rapidly evolving credit market.

Throughout our more than 150 meetings and numerous presentations, it was evident that the lines between banking and securitization, as well as public and private credit, continue to blur. The sector's expansion beyond borders was also evident given the overseas attendees and discussions regarding non-U.S. transactions. Of course, more immediate topics, such as valuations, consumer health, AI-related investments, and tariffs were also on participants' minds as referenced throughout the following perspective on the sector's various asset classes.

Key Takeaways:

- Valuations were a key theme, with general agreement among participants that spreads are tight across the entire sector.
- A strong desire to source opportunities - particularly in private, ABF-style transactions - remains.
- Issuance is also expected to continue at a strong pace across all sectors (Figure 1).
- In addition to supply and ABF opportunities, some significant credit trends were also discussed as consumer credit performance remains challenged in ABS, while CLO managers described navigating tariffs and other government policy initiatives.

FIGURE 1: Issuance Expected to Remain Strong Across All Sectors ($bn)

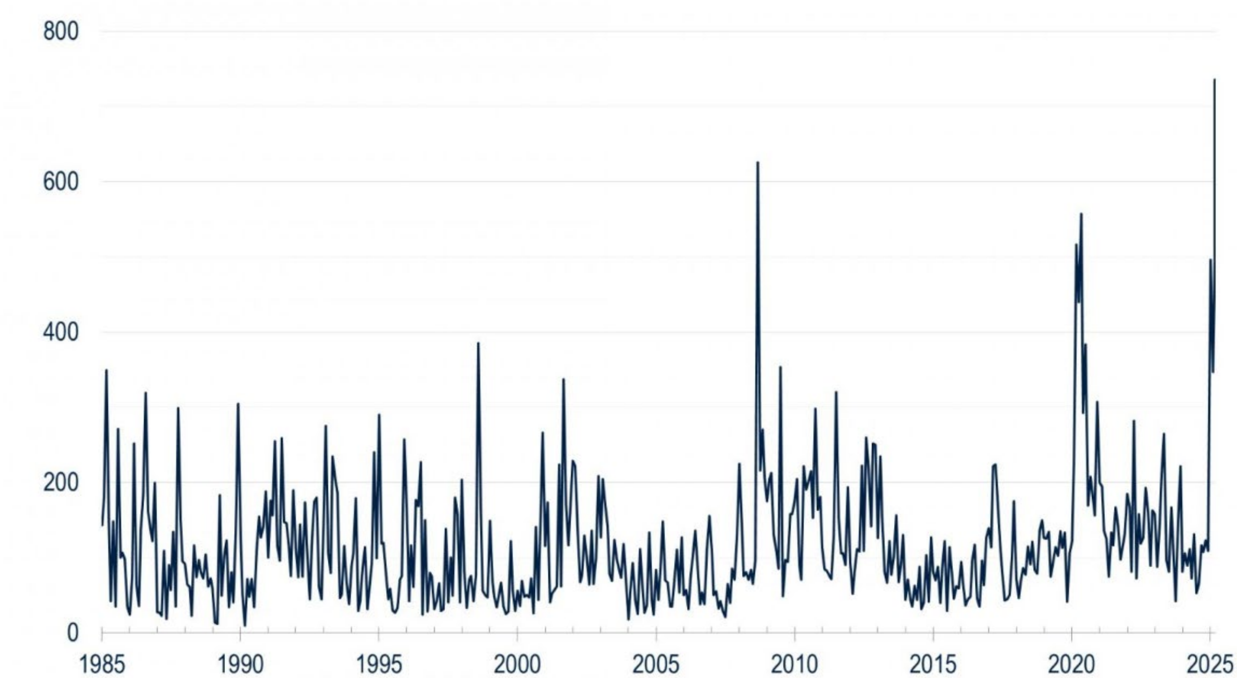


Source: JP Morgan as of February 28, 2025.

Collateralized Loan Obligations (CLOs)

- The CLO market is contending with historic levels of issuance, and some discussions focused on operational challenges at this level of issuance.
- Managers remain focused on asset sourcing, which has proved challenging. Until M&A and LBO activity picks up, leveraged loan supply is expected to come from dividend recapitalizations and refinancings of private credit deals.
- With economic policy uncertainty ratcheting higher (Fig 2), managers are scrutinizing portfolios to identify and reduce exposure to issuers exposed to tariff and government efficiency risks. Industries most exposed to tariffs are not typically large allocations in CLOs.

FIGURE 2: U.S. Policy Uncertainty Continues to Rise

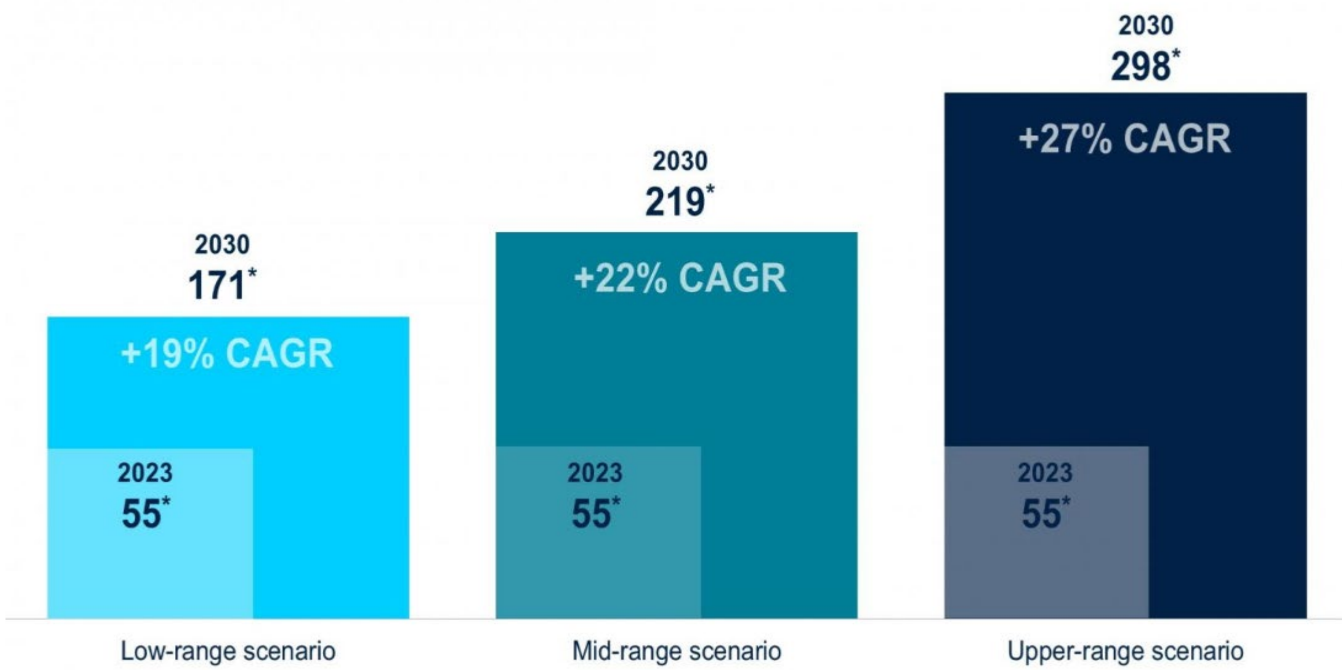


Source: Federal Reserve Bank of St. Louis, as of March 3, 2025. Economic Policy Uncertainty Index for U.S. (USEPUINDXD)

CMBS, Specifically Data Centers[1]

- Despite the recent headlines around DeepSeek and Microsoft's lease cancellations, sentiment around data center fundamentals remains positive (Fig 3). Regarding DeepSeek's impact, most market participants expressed the view that the increased cost efficiency will lead to greater demand. Power continues to be the principal constraining factor on new supply, with several operators considering on-site generation as a bridge solution.
- Capital and financing needs in the sector continue to grow. Operators have utilized a variety of financing structures including ABS, CMBS, project finance, commercial property assessed clean energy (C-PACE), and private syndications to date. With the recent widening in CMBS data center deals, ABS execution has gotten far more favorable.

FIGURE 3: Global demand for data center capacity expected to rise sharply (gigawatts)*



Source: McKinsey, as of October 29, 2024. *Three scenarios showing the upper-, low-, and midrange estimates of demand, based on analysis of AI adoption trends; growth in shipments of different types of chips (application-specific integrated circuits, graphics processing units etc.) and associated power consumptions; and the typical compute, storage, and network needs of AI workloads. Demand is measured by power consumption to reflect the number of servers a facility can house.

ABS

- Consumer credit performance is still challenged, with no clear driver for improvement. Most originators discussed tightening their "credit box" to cure underperformance from 2022 and 2023 originations.
- Issuance is likely to remain strong (Fig 3), with expectations of a steady supply of private opportunities from operators seeking funding diversification. Other operators are looking to expand traditional ABS issuance to complement early-stage private financings and warehouses.
- Bank card yields remain relatively high and challengers are looking to chip away at the profitable $1 trillion market. Even a small pullback from banks would create a sizeable opportunity. However, the buy now, pay later (BNPL) lenders will challenge banks for the same customer's business.
- Banks are increasingly competing with investors for lending opportunities (e.g., fleet, whole business securitization, equipment, aircraft), and this could compress spreads and limit available supply.
- The commercial/corporate sector is not experiencing any specific weakness by industry type and lenders are avoiding the lowest-quality credits within industries.
- Commercial/corporate origination volumes by issuers have generally seen steady growth and performance has not deteriorated except for select captive finance equipment issuers with farm economy exposure.

RMBS

- Insurance companies' interest in mortgage credit is especially evident in residential mortgage whole loans.
- Mortgage credit investors are monitoring the rise in non-qualified mortgage (QM) delinquencies, which are mostly stemming from the lower FICO and cash-out refi cohorts. However, these are not resulting in material losses due to low loan-to-value ratios and a strong housing market.

1. The Wall Street Journal, "They Crashed the Economy in 2008. Now They're Back and Bigger Than Ever," February 28, 2025.

Important Information

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