TruPS Towers

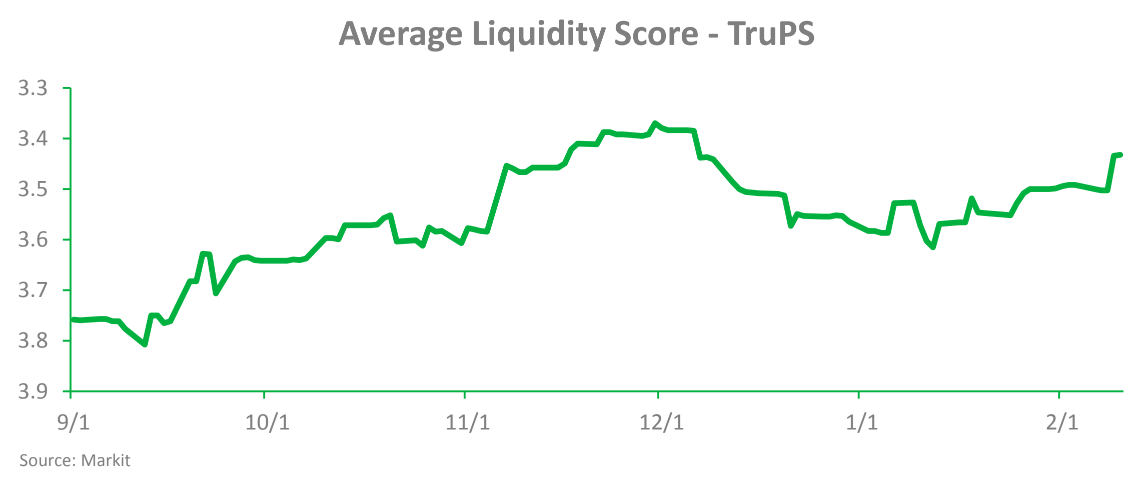
February 14th 2017

Improved fundamental spur markets

Activity Picks Up

After an extend lull in the Trust Preferred CDO (TruPS) market, activity in the first half of February has picked up at a feverish pace. The past month has brought 36 securities to market totalling over $260MM in original face. Increased demand and improved fundamentals have led to significant spread tightening across the stack. Recently PRETSL 25 A2 (74042FAB7) covered in the L60s; the bond last traded in M40s six months prior. The trend continued with ALESCO 10 A2A (01449WAB2), where the bond was talked in the M60s in February, and in November was talked in the L50s.

The dormant market has experienced a handful of new issuance deals since the financial crisis. However, the TruPS CDO universe maintains a secondary market presence, with over 700 remaining bonds totalling an outstanding balance of $38.5bn and an IHS Markit calculated market value of $20bn.



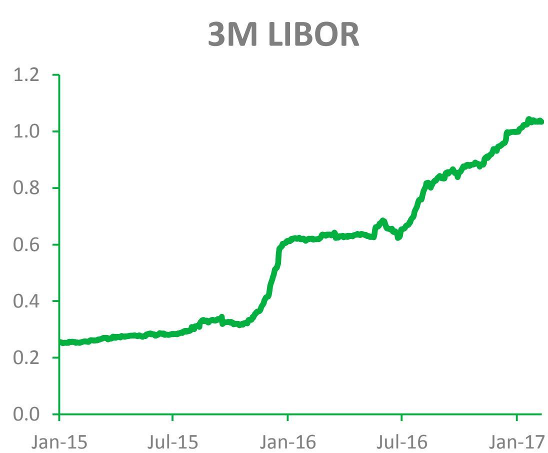
Our observable market liquidity score data shows the increase in activity for the first half of February 2017. Scoring is based on a 1-5 scale, with 1 equating to observable recent market activity on all bonds in the universe.

Rates and Ratings

Improved market confidence, coupled with rising rates and stability, has led to restored demand for TruPS bonds. The bulk of TruPS collateral is made up of preferred stock from regional banks and insurance companies. The sector was plagued by high default rates from 2008-2012, but has returned to historical average lows. Since 2016 only seven banks have appeared on the FDIC's Failed Bank List, whereas in 2010 there were more than 150 names on the list. This improvement has spurred continual ratings upgrades for tranches in the TruPS universe.

For example, TBRNA 2006-7A A1LA (873315AA3) is a REIT-backed senior tranche that recently covered at an 87H and has been upgraded twice since 2015. Originally rated Aaa, the bond dropped to Caa1 by Moody's and is now rated at Ba1. Similarly, PRETSL 25 A1 (74042FAA9) was downgraded to a below investment grade rating of Ba3 from an original Aaa rating. The bond has rallied back to an Aa3 rating after five ratings upgrades since 2012. This front pay senior tranche is backed by bank collateral that was recently covered at a 75H.

Source: Markit



Source: Markit, Tullett Prebon

The interest rate environment has also played a part in investor interest. 3M LIBOR has rallied considerably over the past year, driving interest returns higher from tranches pegged to the rate. Both PRETSL 25 A1 and TBRNA 2006-7A A1LA pay 3M LIBOR plus 29bps and 35bps, respectively. The rally in LIBOR has driven quarterly interest payments for PRETSL 25 A1 from a low of 0.52% in September 2014 to 1.25% as of December 2016. The same holds true for TBRNA 2006-7A A1LA; quarterly coupons improved from 0.587% to 1.35% in February 2017. This change in rates is more dramatic as investors move down the capital stack. ALESC 9A C3 recently covered at a 57H, and coupon improved over 63bps since September 2014. The bond paid a coupon of 2.133% in December 2016, up from a low of 1.49% in September 2014. The bond also paid off a bulk of its accumulated PIK interest over this period, lowering its tranche factor from 1.0836 to 1.009. A bond begins to PIK (Paid In Kind) when expected interest is not paid, that amount is added to the bond's outstanding balance.

Winding down

The improved collateral performance has also aided in market deal liquidations that have continued over the past few months. Liquidations can take place over several months, where portions of the collateral are auctioned off. Recently we have observed liquidation from SOLOS 2005-1, I-PRETSL 4, ATTENTUS 2, MMCAPS 17 and others. SOLOS 2005-1 saw a 75% reduction in current balance from October 2015 to December 2016, as its collateral was auctioned off. The deal had an original balance of $529.5MM, but as of December 2016 the current balance fell to $91.6MM, made up of 13 underlying securities.

Collateral performance and market conditions have played a large part in the recent appetite for TruPS collateral. The lack of supply can push prices higher as participants seek yield in a continuing low-rate macro environment. New issuance has been bleak, with only a few new deals in the past year. Regulatory pressures and a low rate situation make securitization less attractive, but potential upcoming changes to fiscal policy coupled with rising rates could help spur a new wave of issuance.

IHS Markit's Securitized Products Pricing service provides independent evaluated pricing, sector level time series and transparency metrics across Agency Pass-Through, Agency CMO, Non-Agency RMBS, Consumer ABS, European ABS, CMBS, TruPS, CDO and CLO asset classes. For further information please email: USABSPricing@Markit.com

Allan Barshtak

Director, Securitized Products

Tel: +1 212 205 1265

Email: Allan.Barshtak@IHSMarkit.com