European Structured Finance Outlook 2025

Up In The Air

Dec. 11, 2024

S&P Global Ratings

This report does not constitute a rating action

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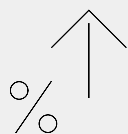
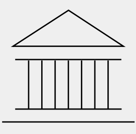
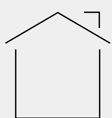
Key Takeaways



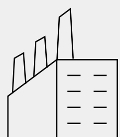
Issuance: European securitization issuance looks set to remain high at €135 billion in 2025, given a broadening base of originators and sponsors, a better outlook for most areas of underlying lending, and rising market engagement from bank originators motivated by both funding and risk transfer requirements.



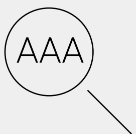
Bank funding: The end of central banks' cheap term funding schemes will likely support continued growth in bank-originated securitization supply in 2025, especially in the U.K., where many loans mature near the end of the year. That said, recovering deposit growth will reduce banks' wholesale funding needs.



Consumer: Inflation is almost back to target levels, policy rates are on the way down, and real incomes are rising. However, some pressure on collateral performance in consumer-related securitizations may persist for adverse credit borrowers and in sectors where rate rises are still feeding through to loan contracts.



Corporate: For corporate-backed transactions, credit prospects are improving as financing conditions ease, and we expect that the speculative-grade corporate default rate will begin to decline in 2025. Commercial real estate continues to face refinancing risks, although property values have likely bottomed out.

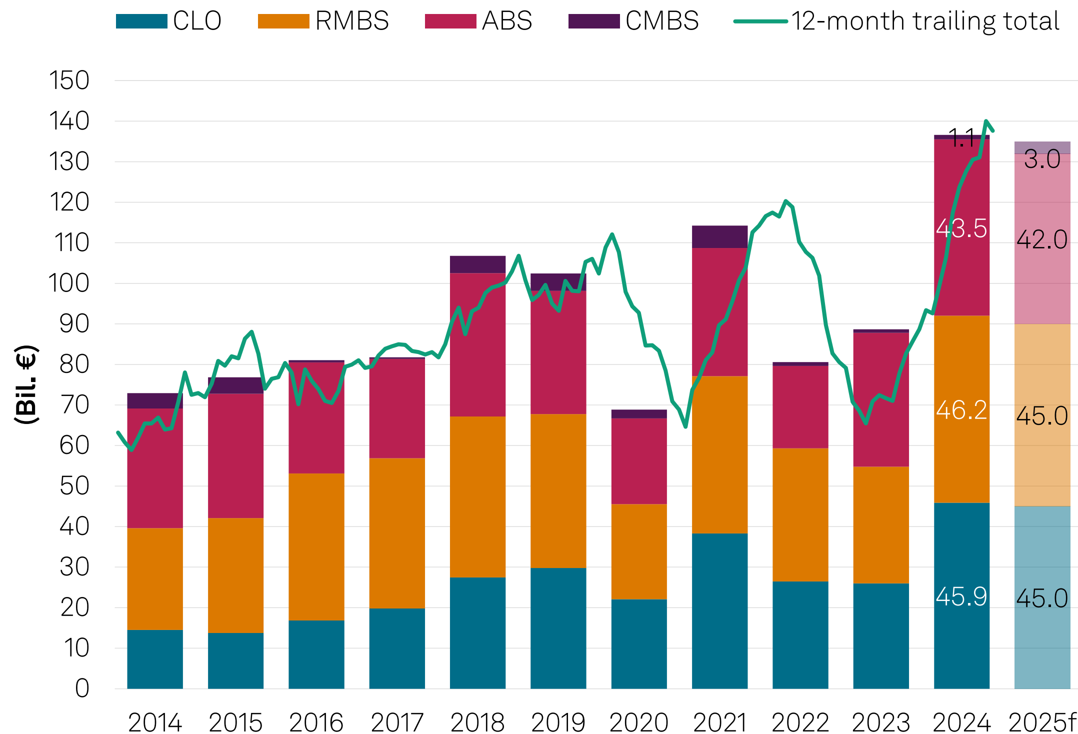


Ratings performance: Structured finance ratings have mostly weathered the effects of higher interest rates, remaining largely stable over the past year, especially at investment-grade levels.

Regulation: 2025 could be a year when regulatory developments are unusually important for European securitization markets. Developments to watch include legislative proposals based on a recent European Commission consultation on the EU securitization framework, and the bloc's implementation of Basel 3.1.

After A Post-Crisis Record In 2024, Issuance Looks Set To Remain High In 2025

European investor-placed securitization issuance



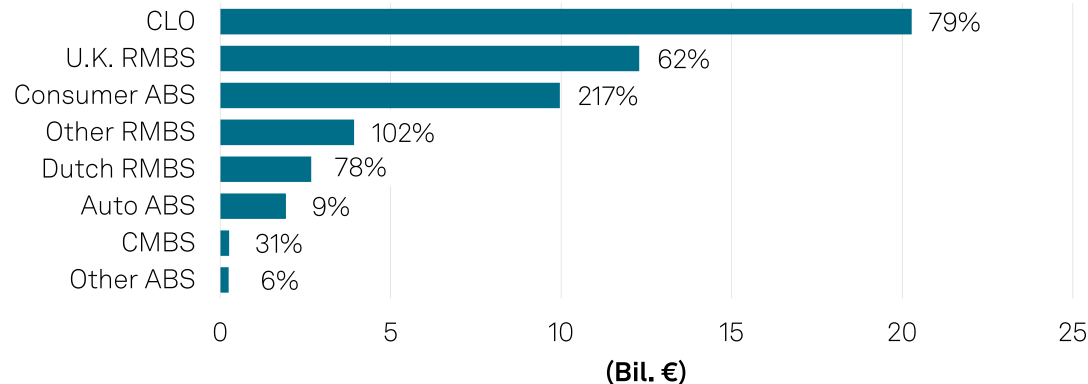
f--Forecast. 2024 figures are year-to-date as of Dec. 9. CLO figures exclude refinancings and resets. Source: S&P Global Ratings.

- Following a pickup in the second half of 2023, investor-placed European securitization issuance continued in the same vein in 2024, ending more than 50% up on 2023 volumes, at €137 billion--comfortably a new post-global financial crisis record.
- Issuance will likely remain elevated in 2025, once again reaching about €135 billion. Fewer outstanding transactions will reach their call dates in 2025, which is usually negative for volumes, but the picture for underlying credit originations is generally improving.
- In addition, bank-originated securitization issuance could grow again in 2025, having hit a 12-year high in 2024. Now that eurozone banks no longer have access to long-term central bank liquidity, securitization may constitute a greater part of their funding strategy. In the U.K., about £60 billion of central bank funding is set to mature, mostly toward the end of 2025.
- The potential for some easing of regulations in the securitization sector could also be a medium-term positive. That said, the issuance outlook is unusually clouded by wider market risks, such as in the geopolitical sphere.

Primary Market Activity Increased Across All Sectors In 2024

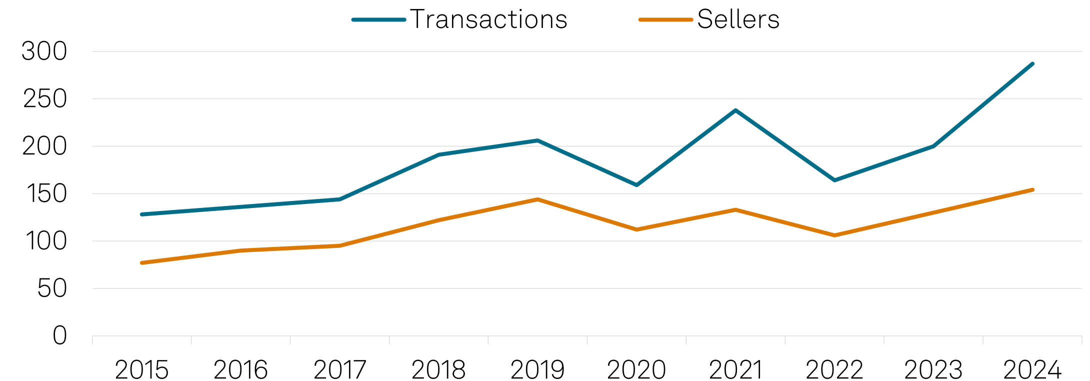
- No sector was left behind in 2024, as all European securitization asset classes saw issuance rise to differing extents. The two largest sectors--CLOs and U.K. RMBS--contributed most of the absolute volume growth, although activity remained diverse.
- New CLO issuance surprised on the upside--growing to about €46 billion--while U.K. RMBS bounced back from depressed volumes the previous year, thanks to more large refinancings of legacy UK Asset Resolution collateral originated before the financial crisis. The strongest relative growth was in the usually much smaller consumer ABS sector, with issuance tripling due to more risk transfer trades.
- Overall, issuance growth in 2024 came from a healthy combination of more sellers and more transactions per seller than in previous years, which bodes well for elevated volumes continuing in 2025.

Change in issuance, 2023 to 2024



Data labels show year-on-year growth rate. Based on investor-placed year-to-date issuance as of Dec. 9 each year. CLO figures exclude refinancings and resets. Source: S&P Global Ratings.

Trends in alternative issuance activity metrics

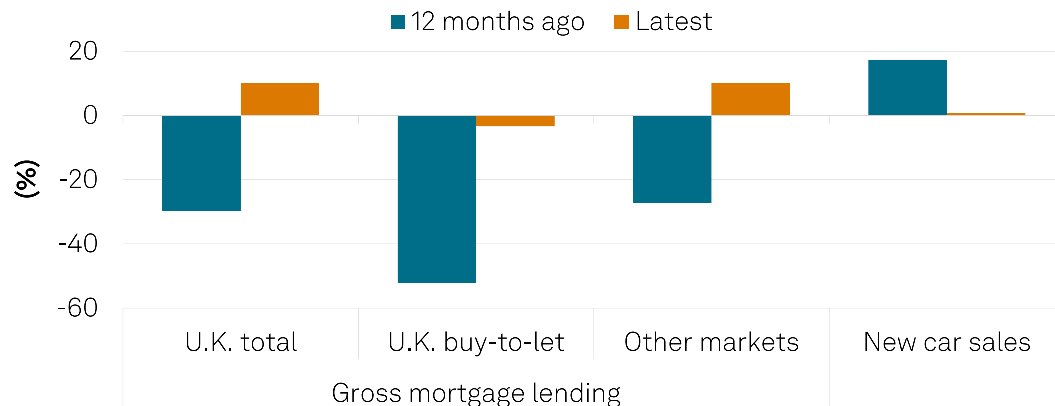


Based on investor-placed year-to-date issuance as of Dec. 9 each year. Excludes CLO refinancings and resets. Source: S&P Global Ratings.

Underlying Origination Trends For Securitizable Assets Are Mostly Improving

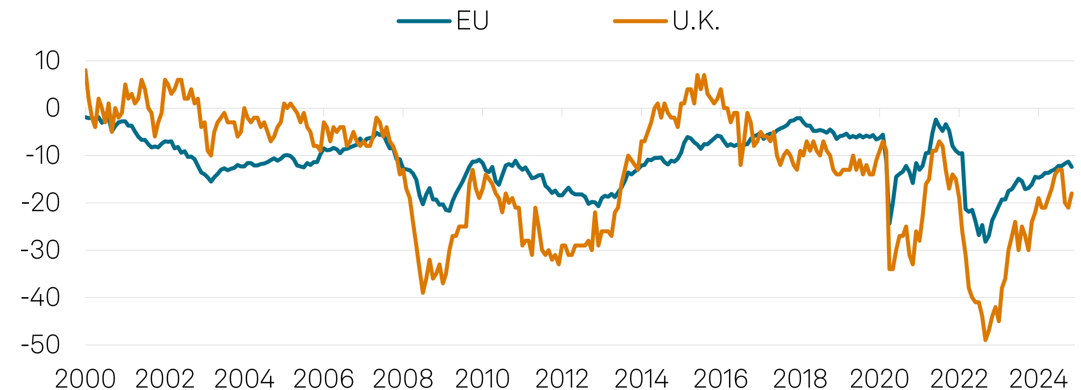
- Securitization issuance is linked to the level of activity in underlying lending markets, especially for nonbank originators. This depends on lenders' appetite for risk and balance sheet expansion, as well as borrower sentiment and willingness to take on leverage.
- In this regard, conditions are rather mixed but mostly improving. In some underlying markets that are linked to securitization--such as new auto sales--volumes are flat and depressed by historical standards. That said, U.K. mortgage lending may be turning a corner, and leveraged corporate issuance remains the key bright spot for underlying credit origination, helping to feed new CLO formation.
- Consumer confidence in both the U.K. and the EU continues to recover from all-time lows set in 2022, likely due to normalized inflation and falling policy rates, meaning that borrowers may be more willing to take on new credit.

Year-on-year change in underlying credit activity



Other mortgage markets includes the Netherlands, Ireland, France, and Spain. New car sales are registrations based on the five largest European markets. Source: Bank of England, European Central Bank, national auto trade bodies.

Consumer confidence



Source: European Commission, GfK NOP.

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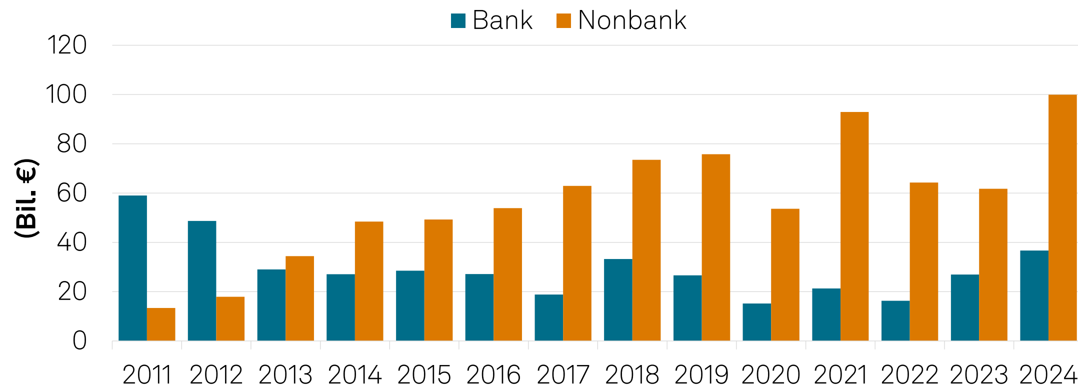
Recovery In Bank-Originated Securitization Issuance Set To Gather Pace

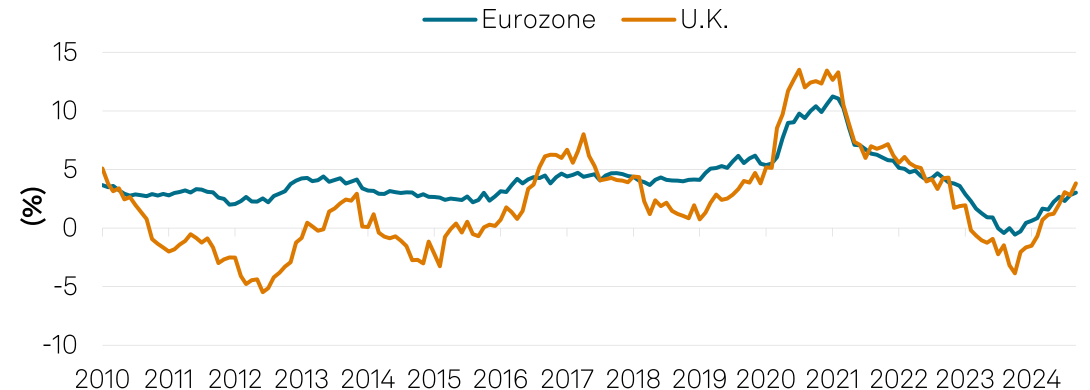
- While bank-originated securitization issuance had stagnated over the past decade, the past two years may have heralded the beginnings of a recovery, with volumes reaching a 12-year high of over €35 billion in 2024.
- Central bank liquidity schemes--providing credit institutions with cheap term funding--have for many years acted as a drag on potential securitization issuance. As the last of these schemes is now unwinding, banks' use of wholesale funding may rise. That said, the recent rebound in deposit growth reduces banks' need for wholesale funding issuance, all else being equal.
- Banks may also increasingly be tapping securitization as a means to manage their balance sheets, by selling larger portions of transaction capital structures to investors rather than only selling senior tranches for funding purposes.

Bank versus nonbank securitization issuance



2024 figures are year-to-date as of Dec. 9. Source: S&P Global Ratings.

12-month deposit growth

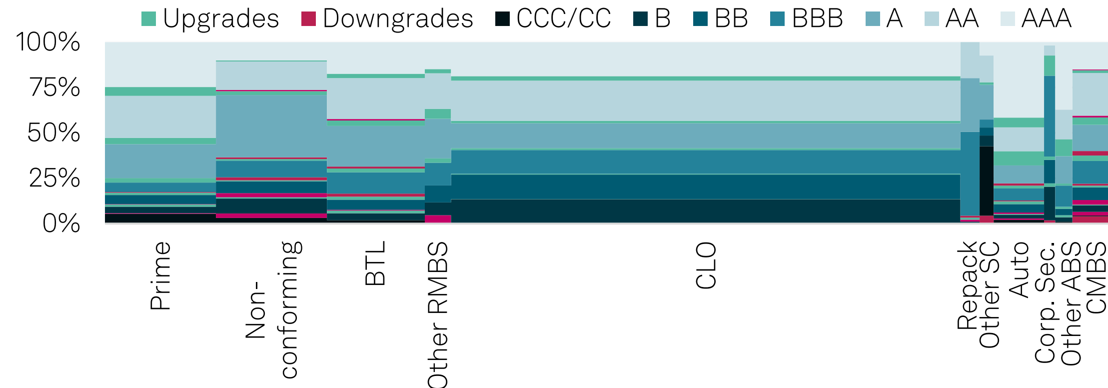


Deposit growth based on lending to households and nonfinancial corporates. Source: European Central Bank, Bank of England, S&P Global Ratings.

Ratings Remain Resilient Overall, Despite Some Pockets Of Weakness

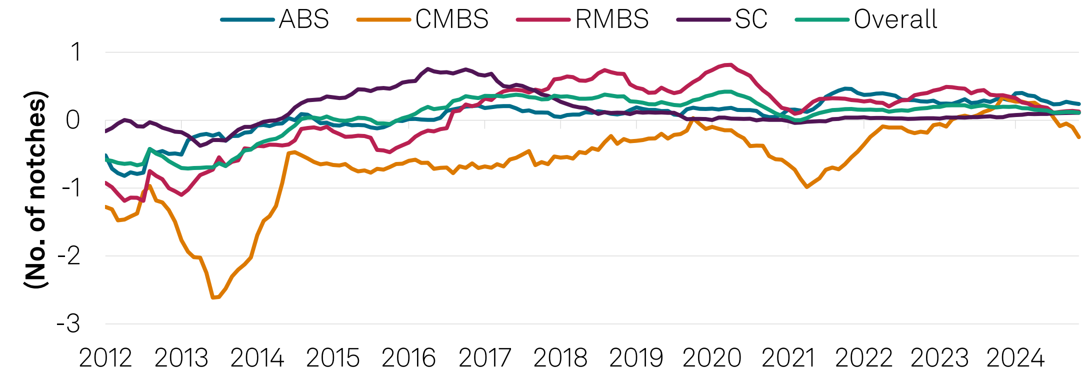
- While the situation may be improving, elevated interest rates and still-high prices mean European structured finance performance could remain under pressure in 2025. However, ratings have generally been robust across most European securitization sectors.
- In 2024, we lowered only 2.4% of our ratings on securitizations in Europe. CMBS transactions backed by office and mixed assets were most affected, but this sector constitutes a small portion of our outstanding European securitization ratings.
- Ratings rose by an average of 0.1 notches in the 12 months to the end of October 2024. For most asset classes, the 12-month trailing average change in credit quality has remained positive for several years, indicating aggregate upward rating movements, although the CMBS sector saw this measure turn negative once again during 2024.

Distribution of ratings and 2024 transitions



BTL--Buy-to-let. SC--Structured credit. Based on 12 months to Nov. 24. Excludes confidential ratings. Securities whose ratings migrated to 'NR' over the period are classified based on their rating prior to 'NR'. Source: S&P Global Ratings.

12-month average change in credit quality

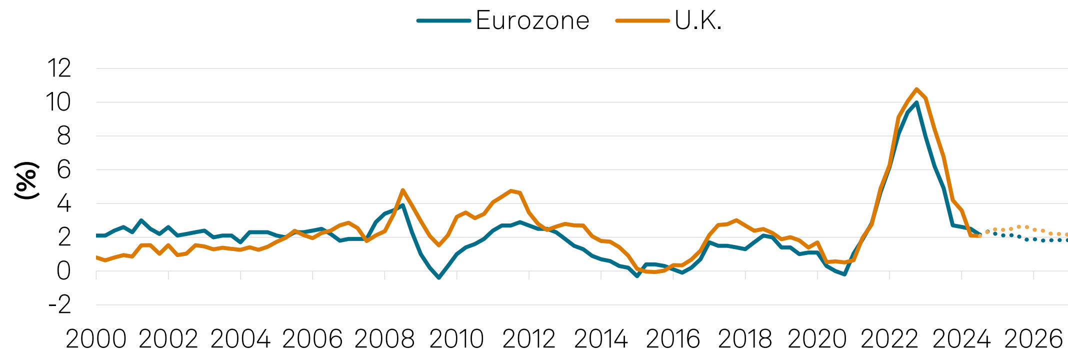


SC--Structured credit, including CLOs. Average change in credit quality is the average number of notches by which ratings changed over a trailing 12-month period. Source: S&P Global Ratings.

Inflation May Have Normalized, But Higher Rates And Prices Are Here To Stay

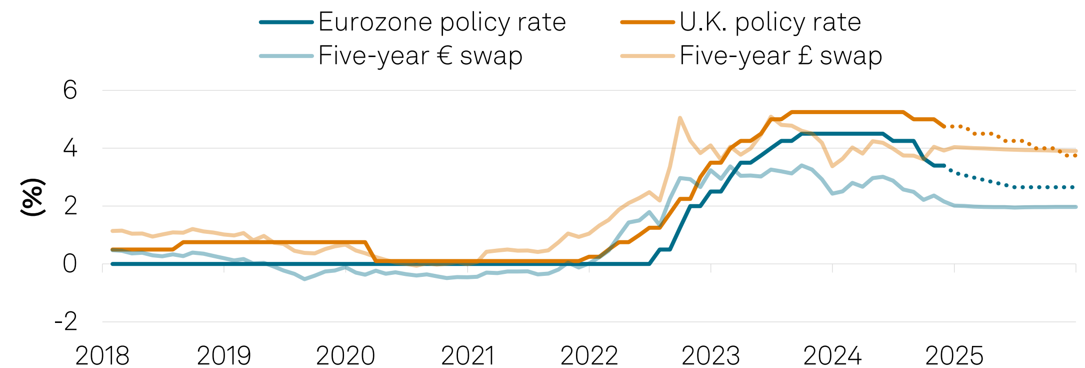
- In consumer-backed transactions, households are starting to feel an increase in their purchasing power as wages rise, and lower interest rates mean they have less incentive to save. This could help eurozone and U.K. GDP growth tick up to 1.2% and 1.5%, respectively, in 2025. Eurozone inflation should average 2.1% in 2025, while U.K. inflation will remain higher but flat, at 2.5%.
- Despite these headline positives, some pressure on credit performance in consumer-related securitizations will persist. While central banks will continue to cut policy rates in 2025, longer-term market rates will likely remain close to recent levels for an extended period, and increasing numbers of borrowers will see a payment shock as higher rates since 2022 feed through to their loan contracts.
- However, households have so far largely managed to deal with higher debt service payments by curbing consumption, for example.

Consumer price inflation



Dotted lines indicate forecast. Source: Eurostat, Office for National Statistics, S&P Global Ratings forecasts.

Interest rates



Eurozone policy rate quoted is the refi rate. Swap rate series include market-based forward rates to end-2025, as of Dec. 10, 2024. Source: Bank of England, European Central Bank, Bloomberg.

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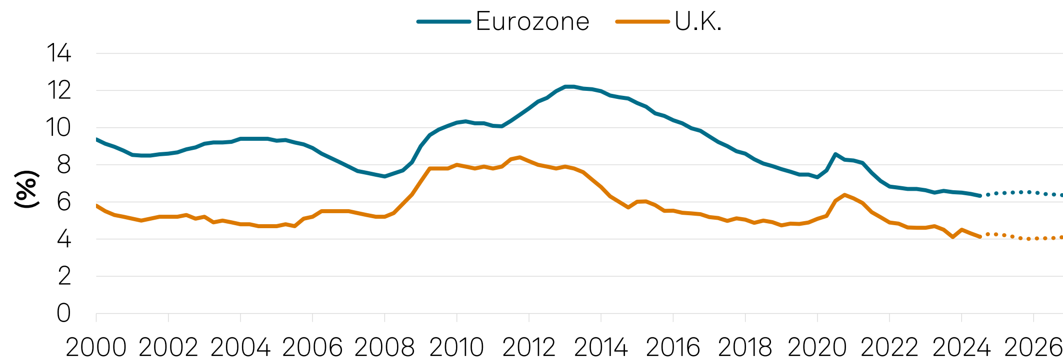
Continued Labor Market Resilience Is Helping To Limit The Credit Impact

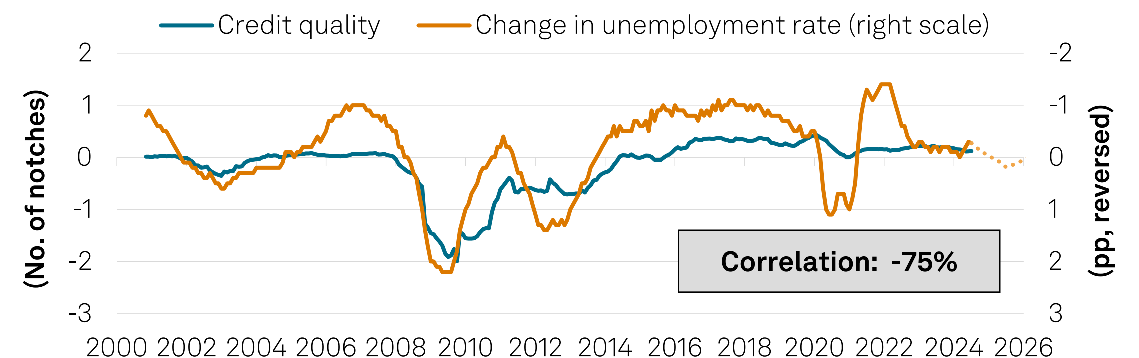
- We expect both eurozone and U.K. unemployment rates to remain stable in 2025, averaging 6.5% and 4.1%, respectively.
- However, the fact that strong eurozone disinflation since late 2022 did not result in job losses is unusual, and job vacancies have now fallen to levels similar to those that preempted a rise in unemployment in previous cycles. In the U.K., job creation is set to accelerate.
- If unemployment were to remain stable, it would bode well for structured finance ratings migration. In the past 20 years, rating movements have shown a 75% negative correlation with unemployment but a limited correlation with other macroeconomic factors.
- That said, a long period of stable macroeconomic forecasts might be coming to an end as new political leaders in the U.S. and the EU could make decisions early next year on tariffs, defense, and general spending that may reshape the economic outlook.

Unemployment



Dotted lines indicate forecast. Source: Eurostat, Office for National Statistics, S&P Global Ratings.

Ratings versus unemployment

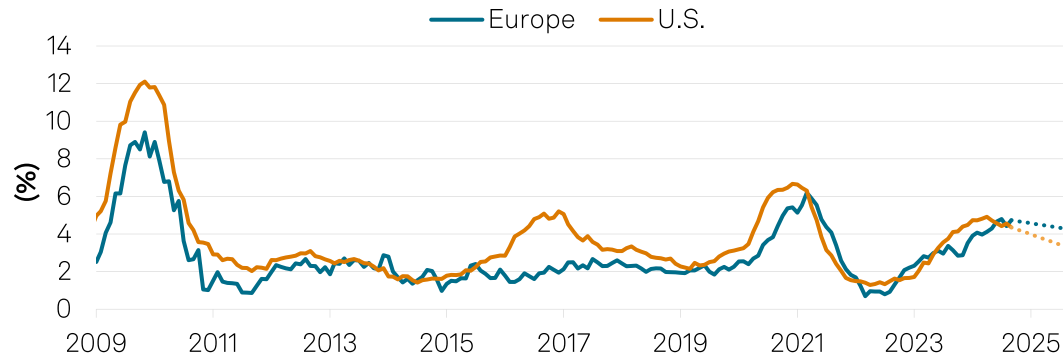


pp--Percentage points. Change in unemployment rate is annual change for the eurozone. Dotted lines indicate forecast. Source: Eurostat, S&P Global Ratings.

Easing Financing Conditions Reduce Pressure On Corporate-Backed Sectors

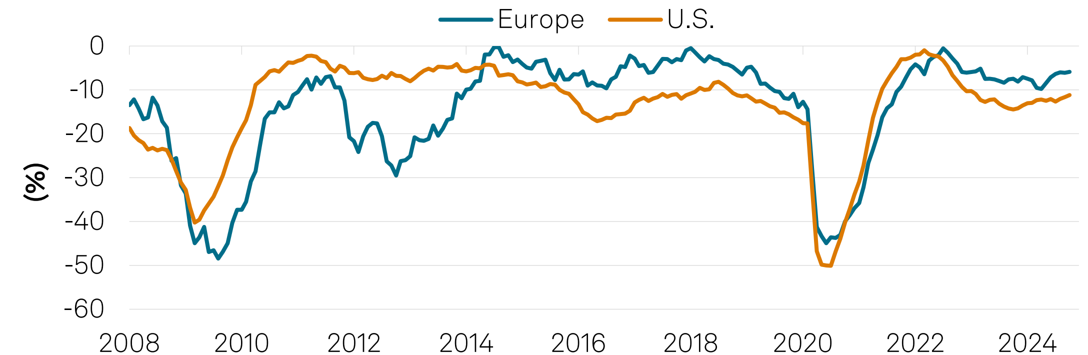
- For corporate-backed transactions, credit prospects could improve in 2025, as debt service costs gradually begin to fall.
- We expect a moderate decrease in the annualized default rate for European speculative-grade corporates to 4.25% by September 2025. However, distressed exchanges are set to remain elevated due to more challenging market conditions for lower-rated issuers, and downside risks prevail, keeping our current default rate projection above the historical average level of about 3.1%.
- On a positive note, across the universe of our speculative-grade corporate ratings, relatively few are on CreditWatch negative. Past periods with a similar corporate ratings outlook have had little effect on European CLO ratings, as collateral managers were able to mitigate credit deterioration through trading. In CMBS, falling interest rates mean that commercial real estate values are stabilizing.

Speculative-grade corporate default rate



Trailing 12-month basis. Dotted lines indicate forecast. Source: S&P Global Ratings.

Speculative-grade corporate net ratings bias



Net ratings bias is the difference between the proportion of ratings with a positive outlook or on CreditWatch positive and the proportion of ratings with a negative outlook or on CreditWatch negative. Source: S&P Global Ratings.

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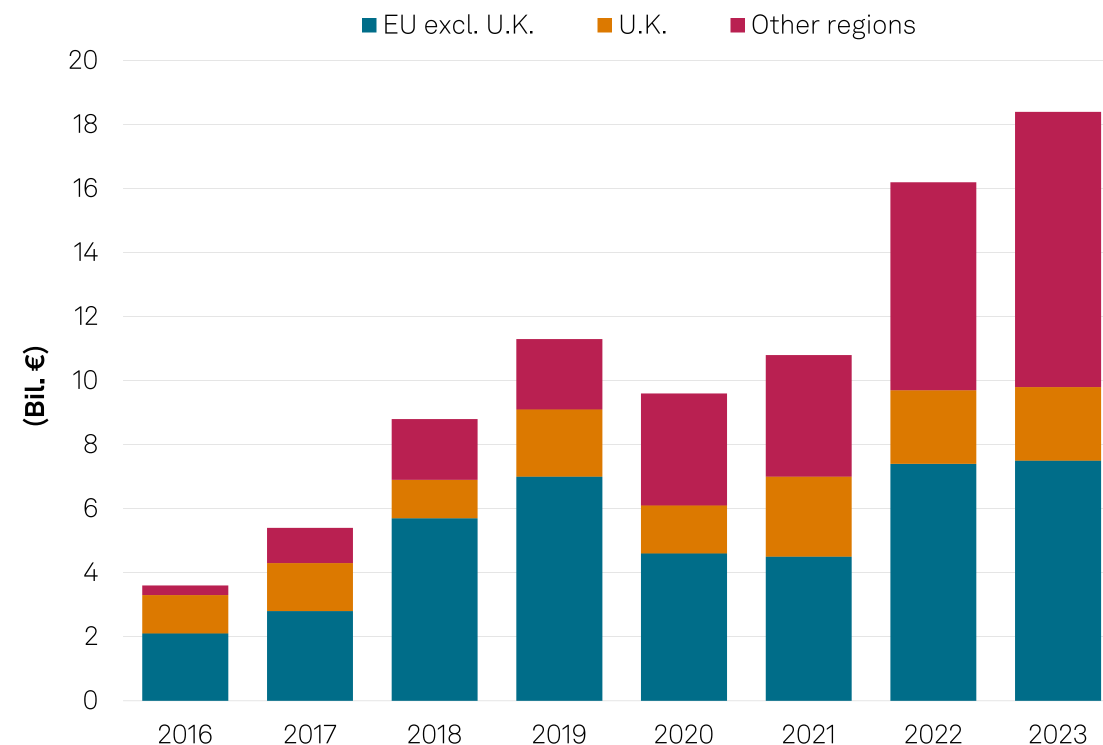
Use Of Significant Risk Transfer (SRT) Securitization Could Be Taking Off

- European banks have for many years used so-called SRT securitization as one tool to achieve regulatory capital relief.
- Many of these transactions are structured synthetically, private, and unrated, and we do not include this type in our overall securitization issuance figures.
- It's likely, however, that the volume of this activity is growing across the globe, partly due to the upcoming implementation of the final Basel III rules, also known as Basel 3.1.
- An increasing number of public cash securitizations also seem to be placing the whole capital stack with investors, suggesting that regulatory or economic risk transfer is a growing motivation for securitization, rather than just funding.
- In 2024, we also noted the relatively rare phenomenon of cash RMBS transactions, for example, where the originator placed only junior and mezzanine tranches with investors, while retaining the senior tranche.
- This is similar to typical practice for synthetic SRT trades.



Other regions include Switzerland, the U.S., Canada, and Asia. SRT--Significant risk transfer. Source: International Association of Credit Portfolio Managers.

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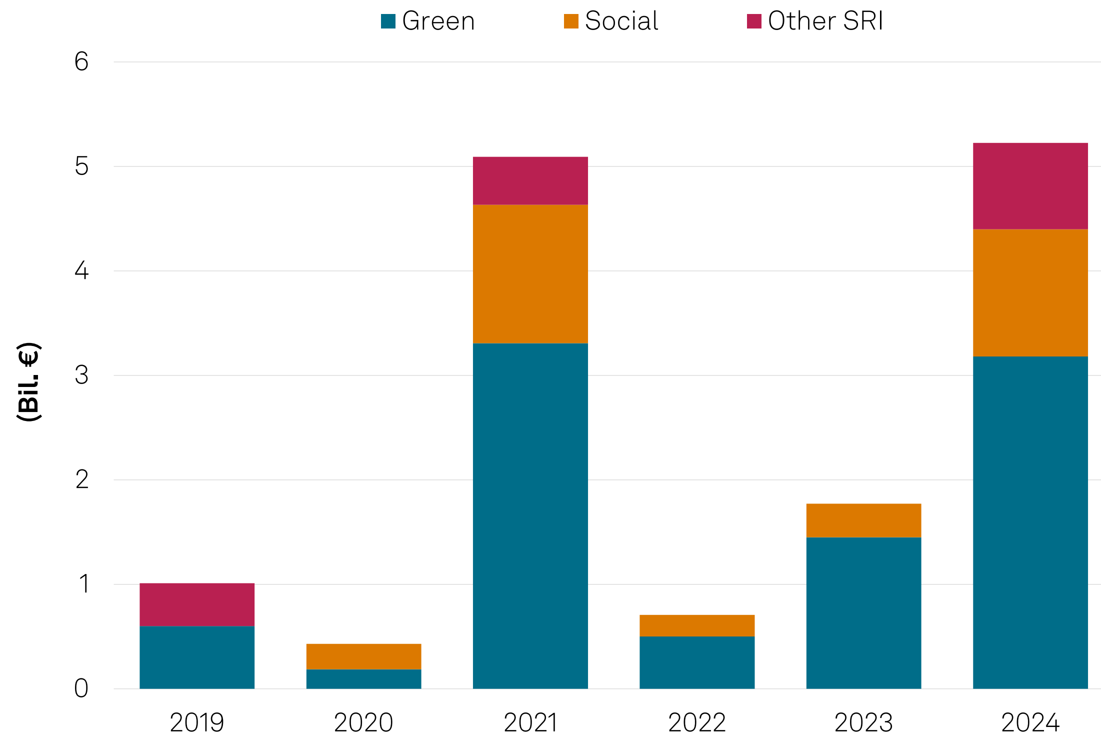
Sustainable-Labelled Issuance Has Bounced Back, Helped By Sectoral Firsts

Sustainable-labelled securitization issuance

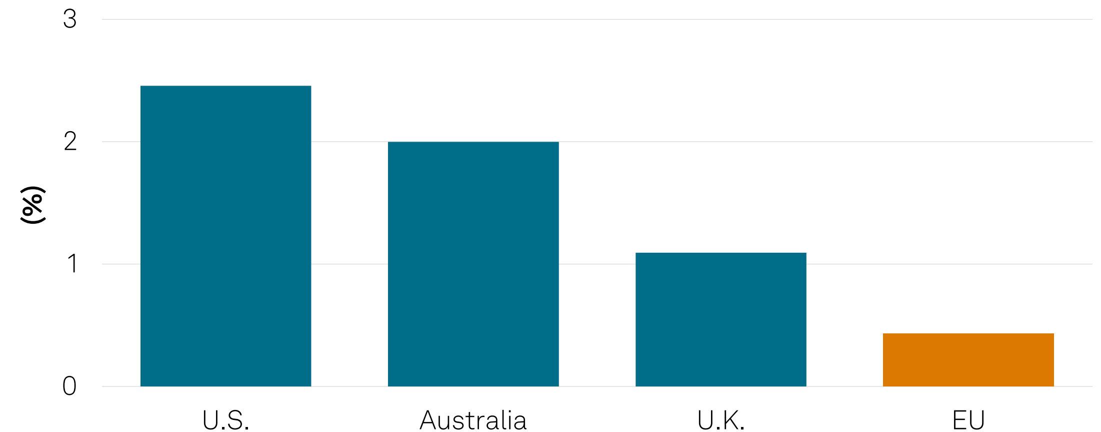


SRI--Socially responsible investment. Investor-placed issuance only. 2024 figures are year-to-date as of Dec. 9. Source: S&P Global Ratings.

- Following the watershed year in 2021, the volume of European securitization labelled as either green or social has been limited.
- However, a renewed pickup in this type of issuance to over €5 billion in 2024 suggests the potential for further growth.
- Especially notable in 2024 were first-time European issuances in both the data center and solar ABS sectors, with both these debut transactions qualifying as "green".
- The first public European solar ABS transaction had been long-awaited, given more substantial activity in the U.S. market, and could pave the way for more transactions in more countries.
- The data center transaction was structured as an ABS, although we have noted that different types of underlying financial assets and structuring considerations could lead to a variety of outcomes, some of which would be more akin to CMBS or project finance, for example.

Evolving Regulations Will Continue To Shape Securitization Markets In 2025

European Commission consultation. On Dec. 4, the European Commission closed its much-anticipated consultation on EU securitization. This follows renewed calls to revive the sector from its muted state relative to the U.S., for example, as part of wider initiatives to enhance EU competitiveness and further develop capital markets. The consultation is both broad in scope and ambitious on its timeframe. It covers substantially all the areas that market practitioners have identified as constraining issuance growth, including requirements on disclosures and investor due diligence, as well as the treatment of securitization exposures in banks' and insurers' regulatory liquidity and capital rules. The Commission has indicated that there could be a legislative proposal, based on the consultation feedback, by mid-2025.



Basel 3.1. The Jan. 1, 2025 implementation of Basel 3.1 in the EU could affect banks' use of securitization for both capital relief and funding. Higher capital charges on some securitizable collateral could incentivize more use of SRT transactions, but these will likely become more challenging and costly than under the current rules. U.K. implementation is set to be a year later and could also reflect securitization-related changes proposed in a consultation launched by the U.K.'s Prudential Regulatory Authority (PRA) in October 2024.

Solvency UK matching adjustment. The PRA has now also implemented changes to the insurance industry's Solvency UK regulation, which broaden the eligibility rules regarding which assets insurers can include in their so-called matching adjustment portfolios. These could potentially include more securitizations if transactions can be structured to have "highly predictable" cash flows. While the feasibility of this is not yet clear, it could hypothetically lead to an increase in securitization demand from insurance investors.

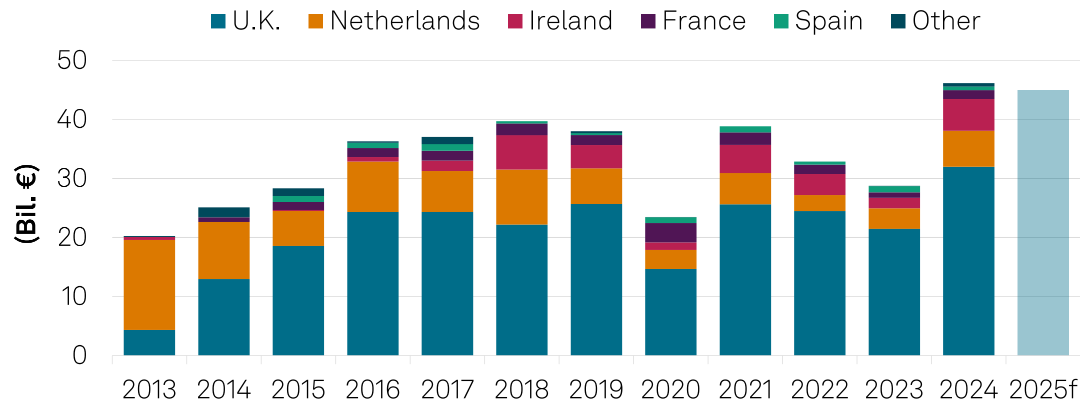
Chart based on 2018-2023 time period. Excludes U.S. agency mortgage-backed securities. Source: National statistical offices, S&P Global Ratings.

RMBS & ABS

RMBS Issuance Hit A New High In 2024 And Could Remain Robust In 2025

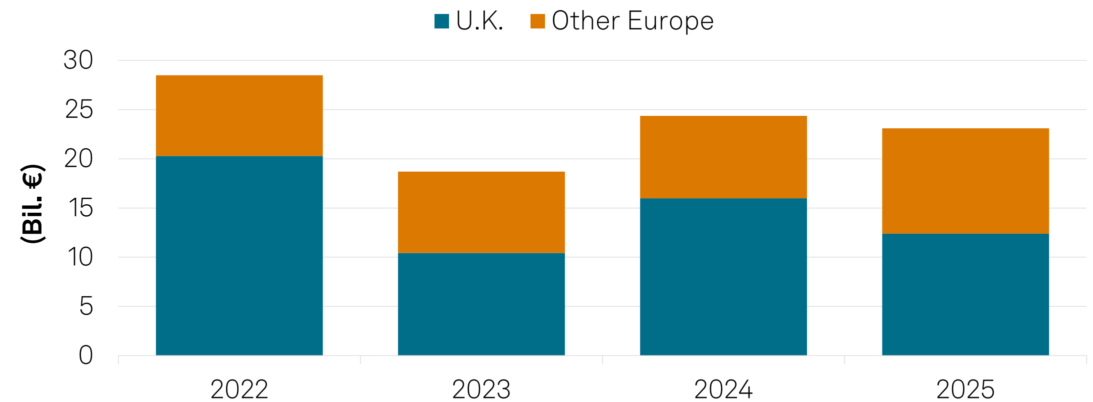
- RMBS volumes were up about 60% to €46 billion in 2024, with growth in most subsectors. The largest absolute increase was in the U.K., helped by the return of large legacy collateral refinancings but also an increase in bank and building society issuance.
- Volumes should remain strong in 2025. Fewer U.K. transactions are due to reach their call dates in 2024, and volumes are concentrated in a few transactions, some of which have delayed step-ups. However, this is partly offset by a larger call pipeline in other markets.
- Bank-originated issuance will likely continue to pick up, as more U.K. lenders repay their borrowings from the Bank of England's term funding scheme with additional incentives for small- and mid-sized enterprises (TFSME) and therefore engage further with wholesale funding markets, potentially including RMBS.

European RMBS issuance, by subsector



f--Forecast. 2024 figures are year-to-date as of Dec. 9. Investor-placed issuance only. Source: S&P Global Ratings.

European RMBS call pipeline

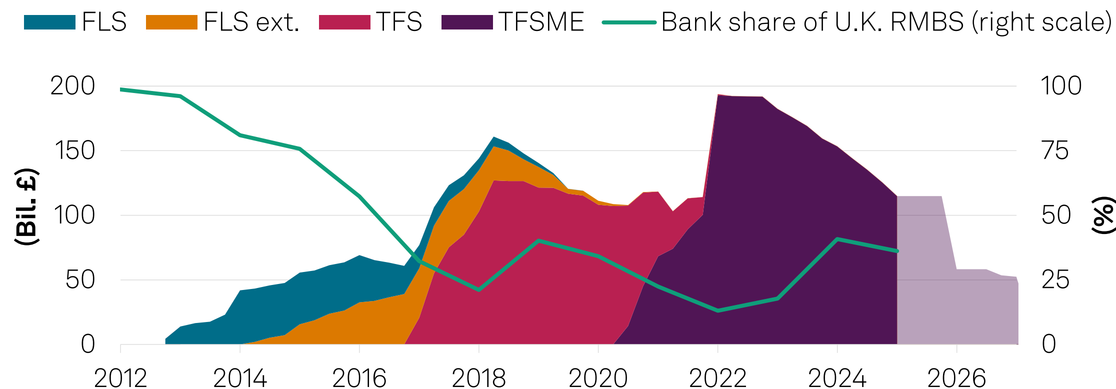


Based on outstanding balances as of approximately mid-December for transactions with first optional redemption dates in the following year. Investor-placed issuance only. Source: Bloomberg, S&P Global Ratings.

The Looming Maturity Of Central Bank Funding Supports U.K. RMBS Issuance

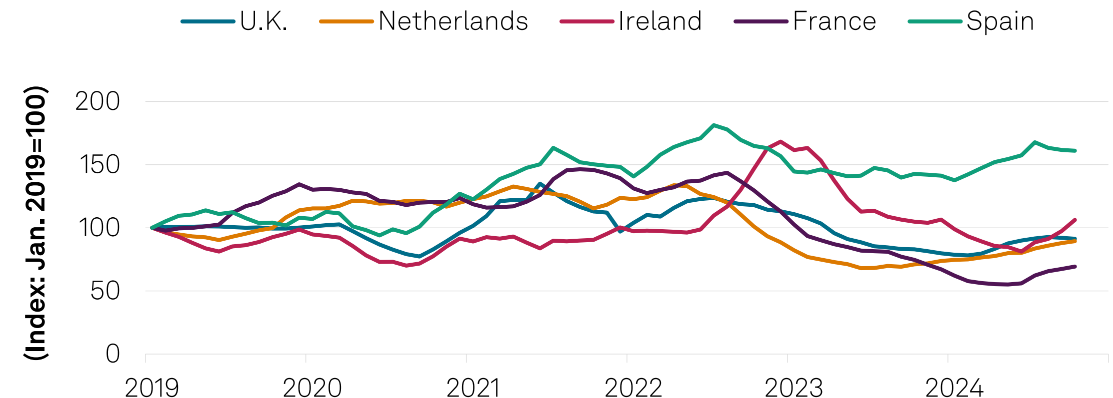
- We estimate that £60 billion of borrowings from the Bank of England's TFSME will mature at the end of 2025. While banks will not need to refinance all of their drawings under the scheme, even a small portion of the outstanding £115 billion would be material in the context of the U.K. RMBS market. Most of the financial institutions with outstanding borrowings have previously issued securitizations, and the bank-originated share of new U.K. RMBS supply has risen slightly since TFSME funding peaked.
- Some larger banks' wholesale funding alternatives may include covered bonds, although persistently widening spreads in the broader European covered bond markets may mean that issuers favor securitization for now--another positive for RMBS issuance prospects.
- That said, mortgage originations in the U.K. and most other RMBS markets remain subdued at or below pre-pandemic levels.

Central bank borrowing versus bank U.K. RMBS issuance



FLS (ext.)--Funding for Lending Scheme (and extension). TFS(ME)--Term Funding Scheme (with additional incentives for small- and mid-sized enterprises). Figures after mid-2024 are estimates. Source: Bank of England, S&P Global Ratings.

Trend in gross mortgage lending, top RMBS markets



Based on six-month trailing lending totals. Source: European Central Bank, Bank of England, S&P Global Ratings.

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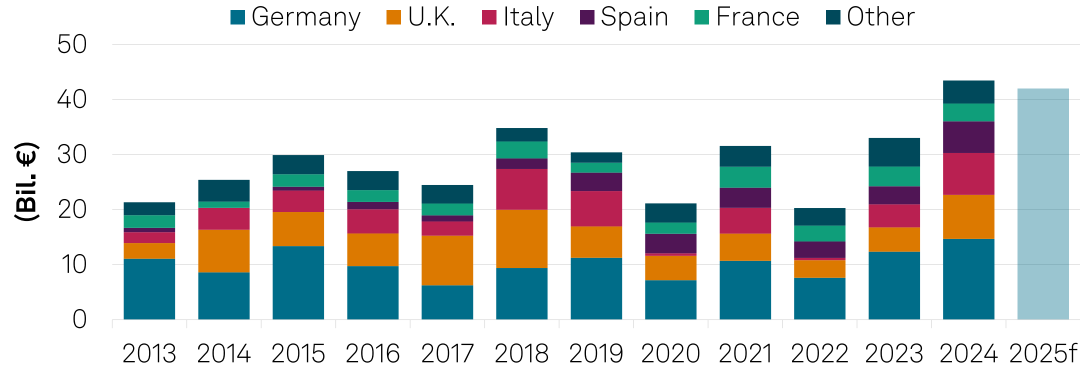
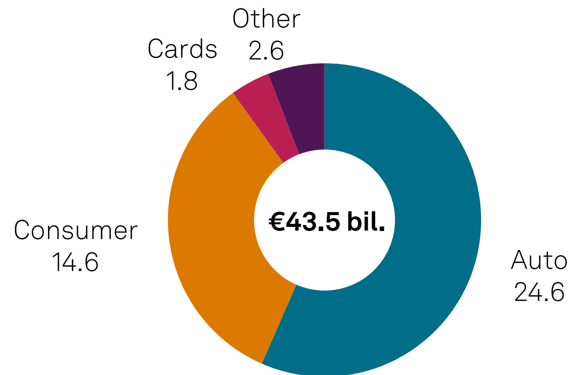
ABS Issuance Hit A Multiyear High In 2024, Due To The Consumer Subsector

European ABS issuance, by country

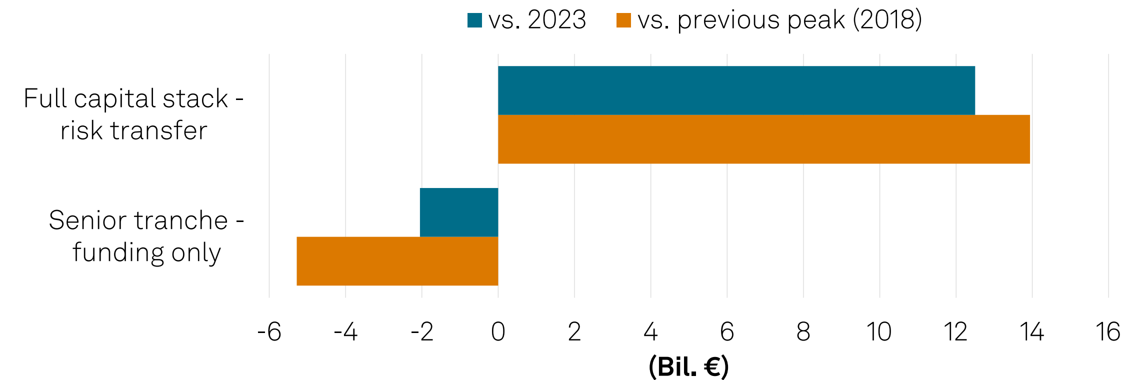


- In 2024, investor-placed ABS issuance jumped to €43 billion from €33 billion in 2023, with most traditional collateral types and countries represented. Transactions backed by auto loan and lease collateral dominated, with issuance from eight countries.
- However, most of the year-on-year growth was due to other consumer ABS, where volumes reached a record of nearly €15 billion. In general, there was a sharp uptick in originators selling a full capital structure to investors to achieve greater risk transfer, rather than selling only senior tranches for funding purposes.

2024 issuance mix, by subsector (bil. €)



2024 change in ABS issuance, by transaction type/purpose

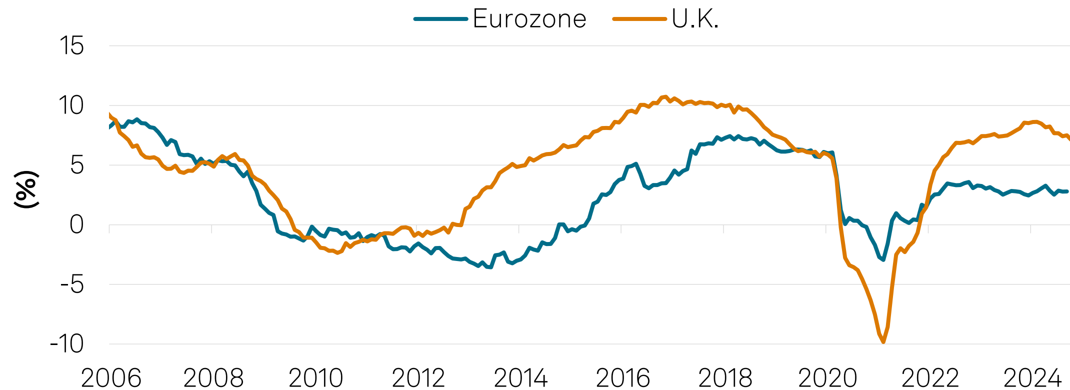


f--Forecast. 2024 figures are year-to-date as of Dec. 9. Investor-placed issuance only. Source: S&P Global Ratings.

Slowing Demand For Consumer Credit May Lead To Steadier ABS Issuance

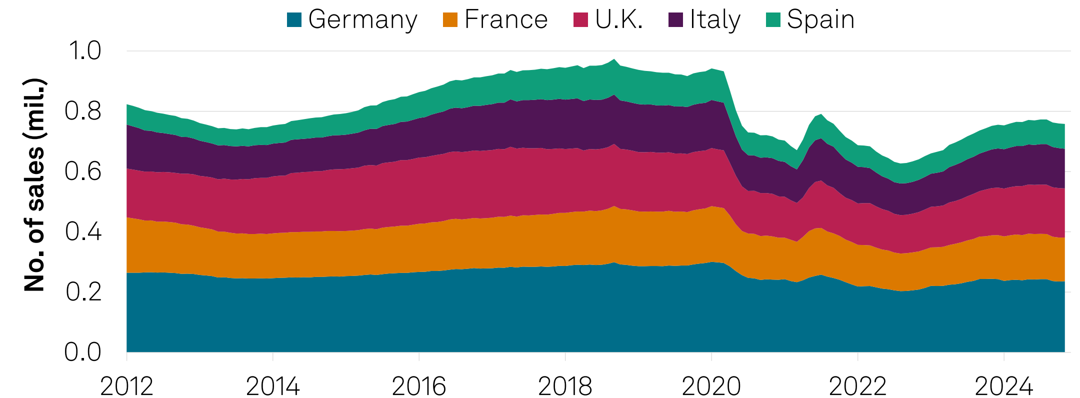
- Origination volumes for the types of lending that back consumer ABS have benefited from normalizing inflation, falling interest rates, and real income growth. However, there are signs that this trend may be losing steam, which would be negative for ABS supply.
- In the U.K. and eurozone, banks' net lending to households for consumption remained steady through 2024. However, the recovery in sales of new passenger vehicles in major auto ABS markets has slowed or even reversed in some countries, and auto sales remain substantially lower than before the pandemic. In the U.K., auto finance has been disrupted after a court ruling on dealer commissions.
- While these factors may cause a slowdown in traditional ABS issuance in 2025, the sector is also undergoing innovations that could eventually lead to new issuance streams. For example, 2024 saw the first public European solar and data center ABS come to market.

Growth in lending to households for consumption



Source: European Central Bank, Bank of England, S&P Global Ratings.

Monthly new auto sales volumes



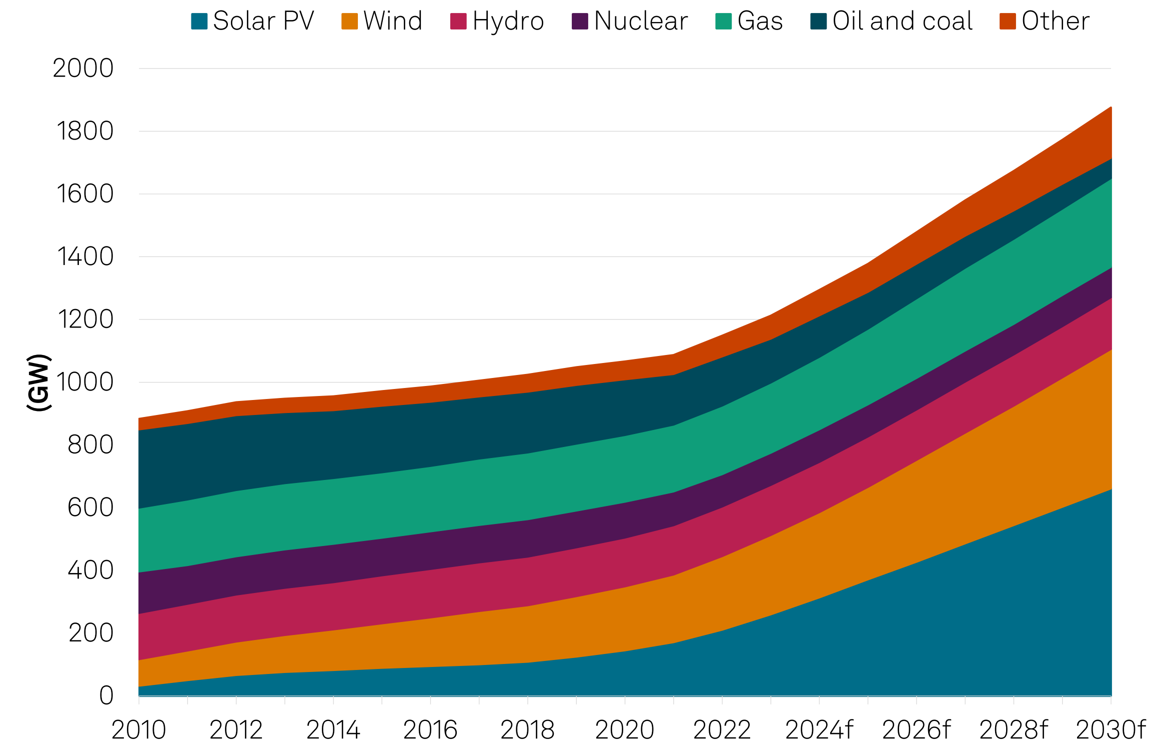
Based on 12-month rolling averages. Source: National automobile associations.

S&P Global Ratings

Solar ABS Could Become A New Subsector, After First Public Transaction

- As part of the European Commission's REPowerEU Plan, the EU is dedicated to accelerating the rollout of solar photovoltaic (PV) energy systems and is aiming to add 700 gigawatts (GW) of capacity by 2030, up from the estimated 300 GW installed at the end of 2024. A large portion of this deployment is expected to be achieved through the installation of solar PV systems on rooftops.
- Similarly, to meet the number of heat pumps required to achieve its 2030 climate targets, the EU needs to more than double the annual rate of deployment, rolling out close to six million new hydronic and air-to-air heat pumps each year from 2025 onward.
- It remains to be seen to what extent these energy transition investments can be funded through securitization, but the first public European solar ABS transaction closed in 2024. We believe that solar ABS transactions will become more common, along with securitizations backed by related asset types, such as heat pump and battery storage financing.

Installed capacity for power generation, by source

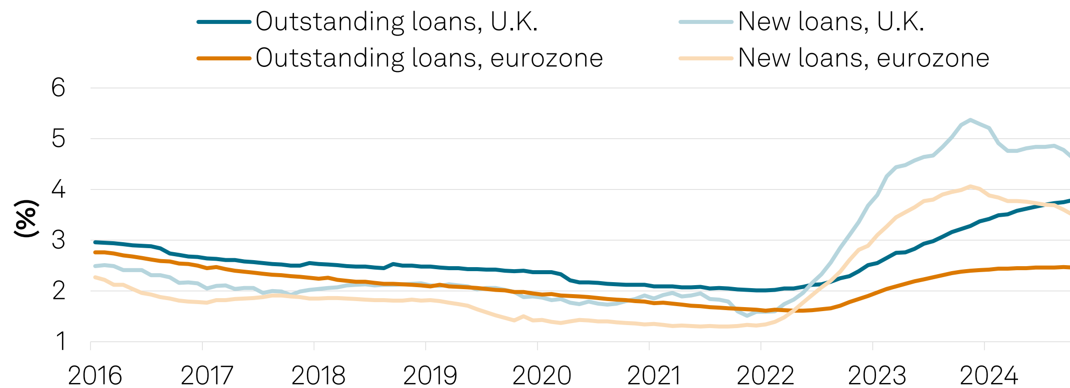


GW--Gigawatts. f--Forecast. Source: S&P Global Commodity Insights.

Fixed-Rate Loans Are Acting As A Shock Absorber For Some European RMBS

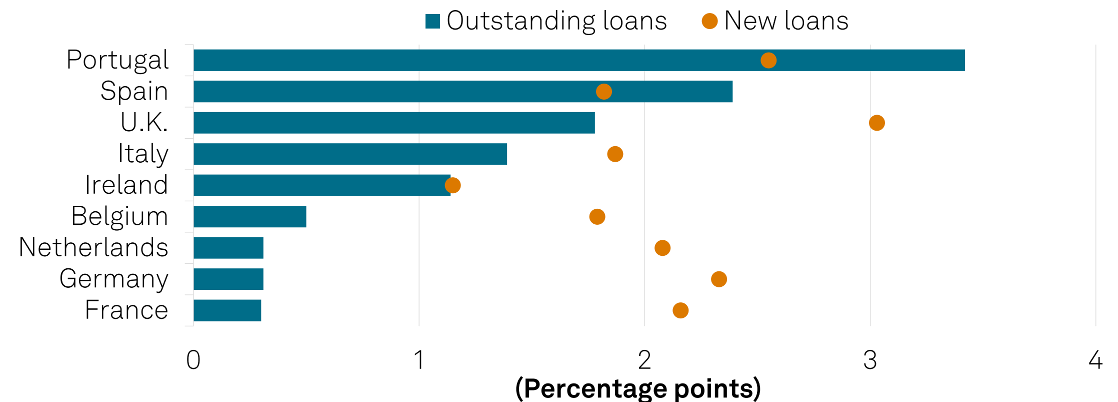
- Although interest rates on new mortgage lending stabilized and began to decline in 2024, many borrowers with outstanding loans have still not been exposed to an increase in their monthly payments, given the prevalence of fixed-rate products in many countries.
- Among RMBS markets, this lag effect is now arguably largest in the Netherlands, where the average existing borrower has suffered a rate shock of only 0.3 percentage points--much less than the 2.1 percentage point increase on new lending over the same period. In markets like this, borrowers' ability to service their debt has increased, due to wage growth, before they are exposed to higher rates. In Spain and Portugal, by contrast, rate rises passed through quickly, but many borrowers are already benefiting from subsequent cuts.
- In the U.K.--where shorter-term rate fixes are common--we estimate that only 25% of borrowers are still on a pre-2022 fixed-rate loan.

Mortgage rates, new versus outstanding lending



Sources: European Central Bank, Bank of England, S&P Global Ratings.

Mortgage rate shock, 2021-2024, by country



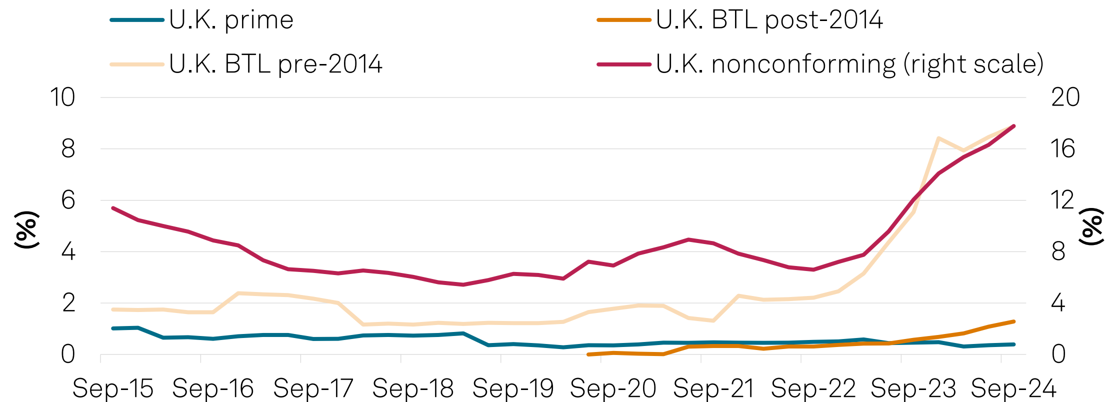
Rate shock is defined as the increase in average rate from end-2021 to the latest available data point as of end-October 2024. Source: S&P Global Ratings.

S&P Global Ratings

Trends In RMBS Pool Arrears Have Diverged Between Subsectors

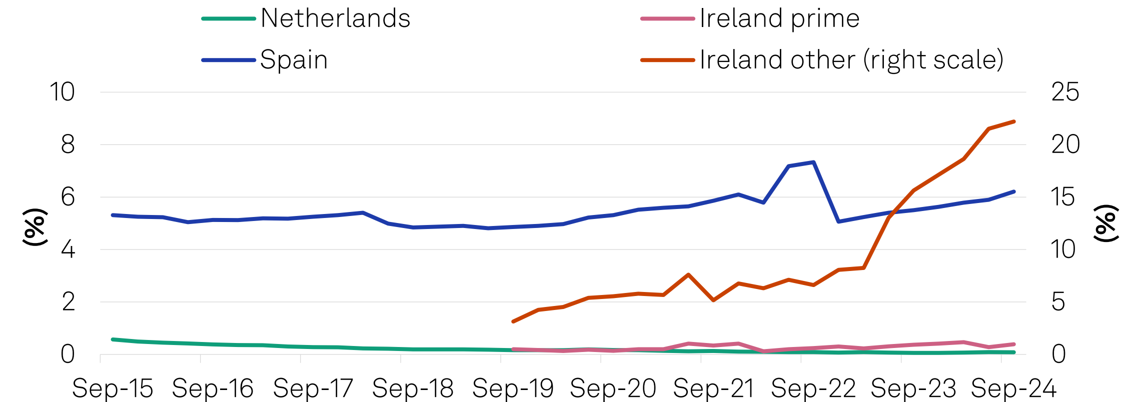
- Arrears reported for prime and owner-occupier mortgage pools backing RMBS have not increased much since rates started to rise.
- But delinquencies have increased for the U.K. nonconforming, U.K. legacy buy-to-let (BTL), and Irish reperforming subsectors, where more prevalent floating-rate and interest-only loans, and limited refinancing prospects, have exposed borrowers to higher payments.
- Although falling policy rates should begin to help make monthly payments easier for borrowers in these sectors, we expect that a material portion's affordability position will not improve sufficiently to clear arrears balances quickly.
- Outside the U.K., collateral tends to be long-term fixed (e.g., the Netherlands) or highly seasoned (e.g., Spain), limiting deterioration.

U.K. RMBS 90+ day arrears indices



BTL--Buy-to-let. Source: S&P Global Ratings.

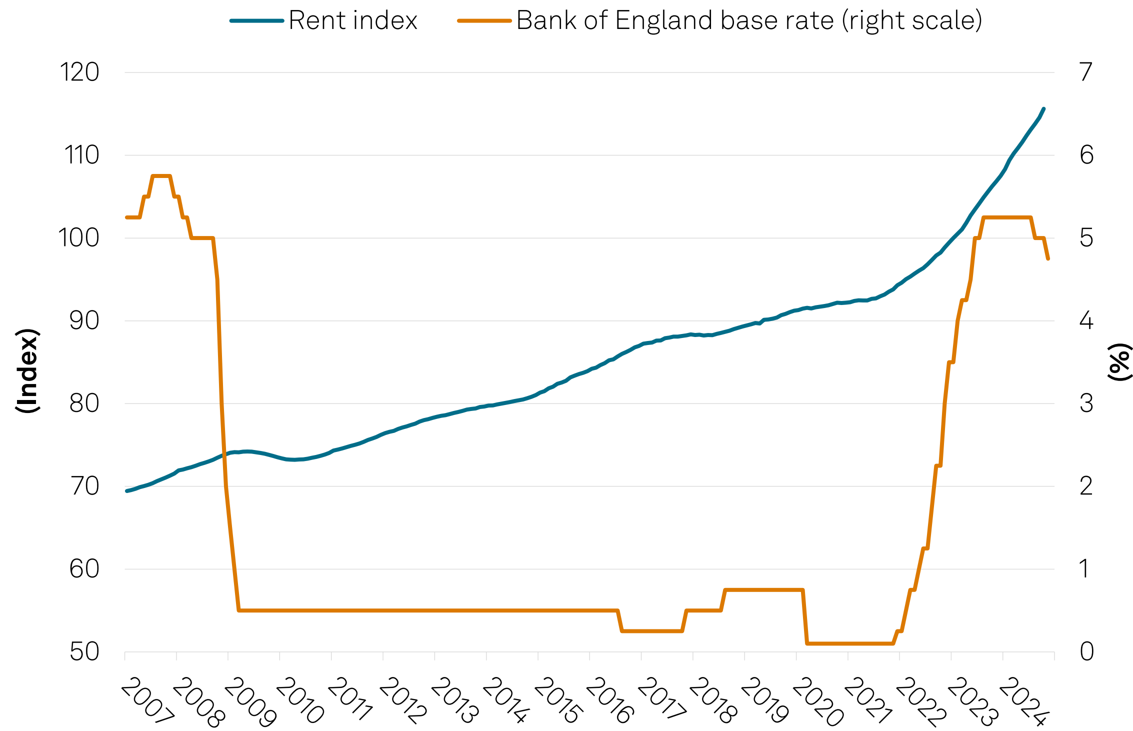
Other European RMBS 90+ day arrears indices



Source: S&P Global Ratings.

Long-Term Arrears Have Built Up In Legacy U.K. BTL RMBS, Despite Rent Rises

U.K. policy rate versus private housing rent index

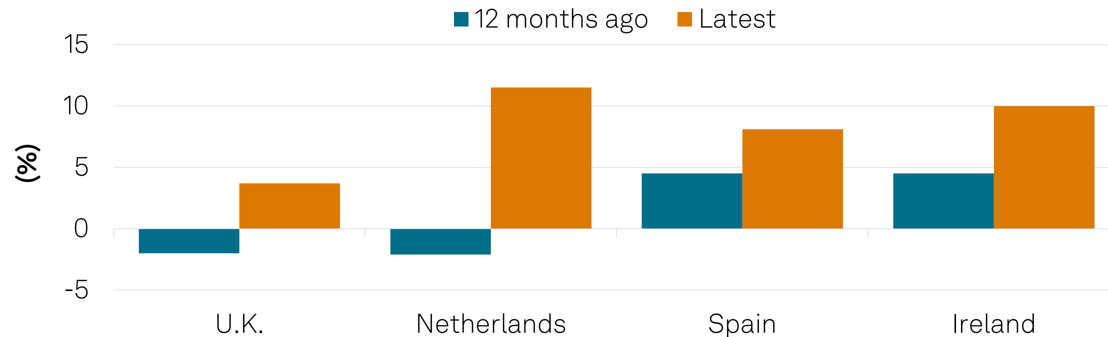


Rent index is for England only. Source: Office for National Statistics, S&P Global Ratings.

- We estimate that one in every five loans backing legacy U.K. BTL RMBS that we rate and that is 90+ days in arrears is more than 12 months in arrears. This build-up of late-stage delinquencies may have several causes.
- Although interest rates have increased rapidly since 2022, the absolute level is similar to rates that loans backing legacy U.K. BTL RMBS were paying when they were originated. Rents have also increased substantially over the same period.
- Servicers are reporting that smaller BTL investors have been using rental properties as their primary personal income source, have been unable to pass on rate rises to tenants, and have prioritized personal spending over keeping up-to-date on their BTL mortgage payments.
- The build-up of loans in arrears for longer than three months will become a key transaction performance metric, as it may indicate that the appointment of a receiver of rent is not economically viable. We expect losses to accelerate in legacy RMBS as servicers liquidate underlying properties.

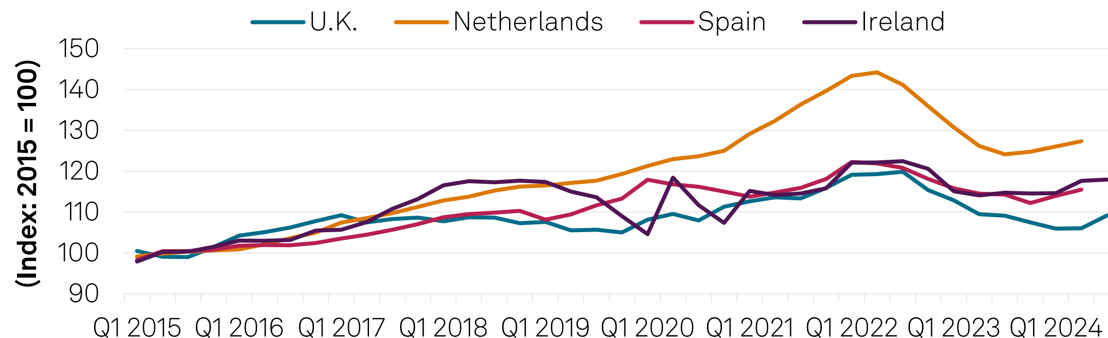
House Prices Have Bounced Back But Affordability Has Improved Too

Year-on-year house price growth for RMBS markets



Source: Nationwide (U.K.), Dutch Statistics Office, INE (Spain), Central Statistics Office (Ireland), S&P Global Ratings.

Nominal house price to income ratio



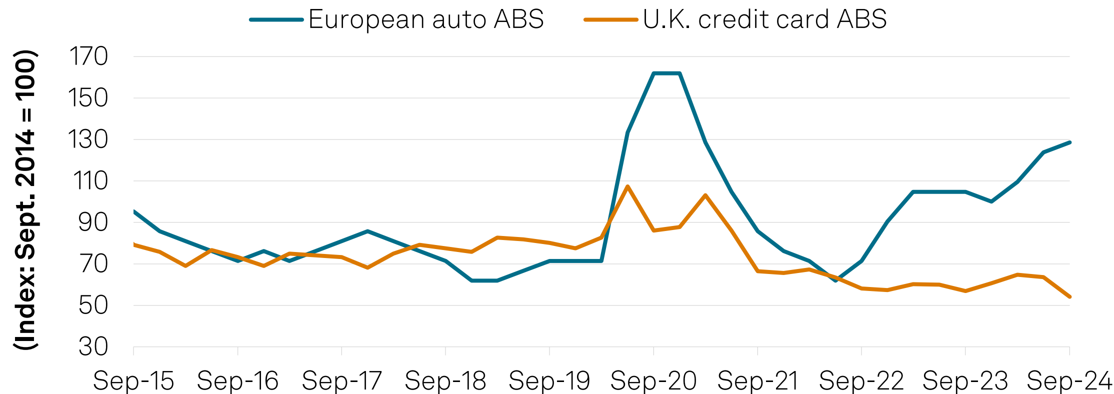
Q--Quarter. Source: OECD, S&P Global Ratings.

- After generally stalling through 2022 and 2023, nominal house prices in all the major RMBS markets have now returned to higher levels of growth.
- Prices have proven resilient as net mortgage lending has recovered on the back of rate cuts more quickly than in previous cycles, likely due to stronger labor markets.
- Although house prices are rising again, a combination of the earlier slowdown and robust wage growth in the face of high consumer price inflation has meant that housing affordability has improved.
- For example, the average nominal house price to income ratio in RMBS markets is back down to four- or five-year lows, according to data from the OECD. This bodes well for the house price outlook in the short term, although affordability measures that include debt service costs are less favorable.
- In the longer term, structural factors will continue to drive housing demand, while easing supply constraints could contain price increases.

ABS Arrears Are Still Stable; High Used Car Prices Support Residual Values

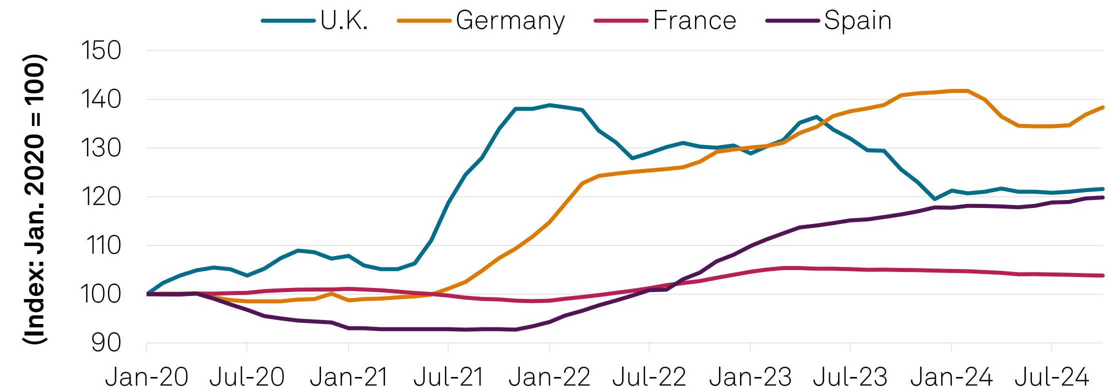
- Average total arrears in prime auto ABS have remained low and broadly stable at under 1% since late 2021, although 90+ day arrears have recently been trending higher since rates started rising in 2022.
- In the U.K., auto ABS are mainly backed by personal contract purchase (PCP) schemes, and we also rate several European auto lease ABS. In these transactions, there may be residual value risk, linked to trends in used vehicle values. These were buoyant post-pandemic in some European countries, but have since shown some signs of pressure due to a normalization in new vehicle supply.
- Credit card ABS performance also remains resilient. In the U.K. and the rest of Europe, total delinquencies are only 1.3% and 1.9%, respectively, and other performance indicators, such as payment rates and yield, also remain robust.

European ABS 90+ day delinquency indices



Source: S&P Global Ratings.

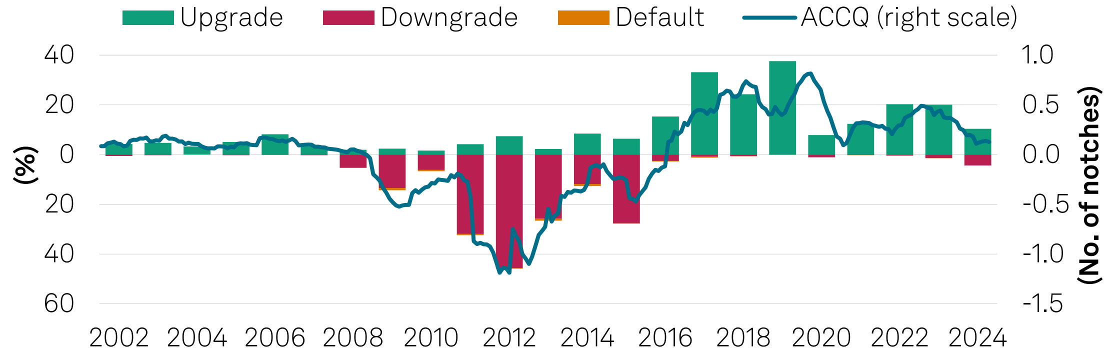
Used car price index



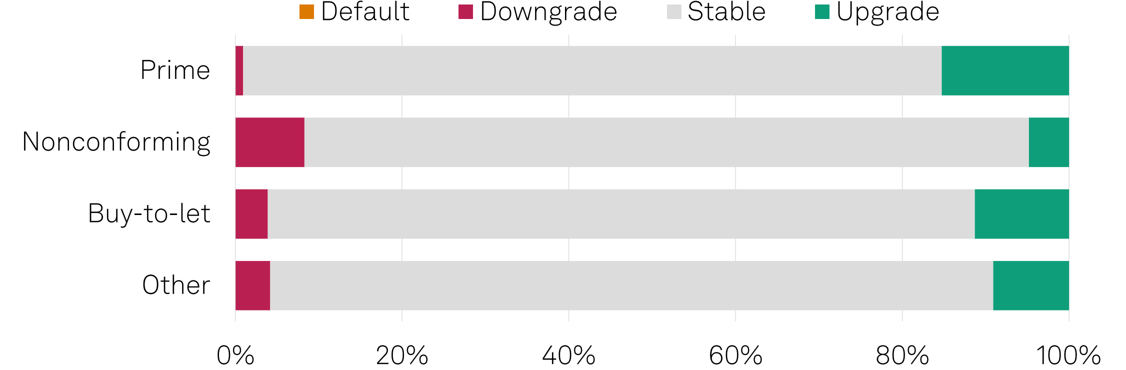
Source: National statistical offices.

Upgrades Still Dominate Recent RMBS And ABS Rating Actions

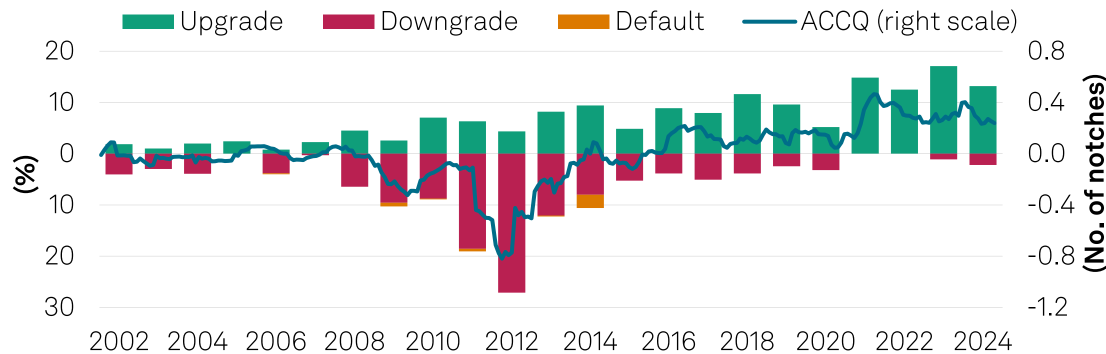
RMBS transition rates and change in credit quality



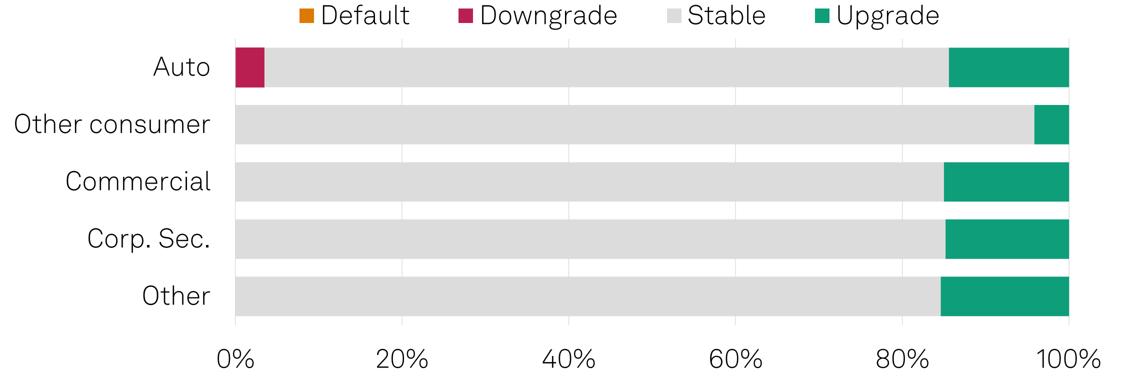
RMBS subsector rating transitions, 2024



ABS transition rates and change in credit quality



ABS subsector rating transitions, 2024



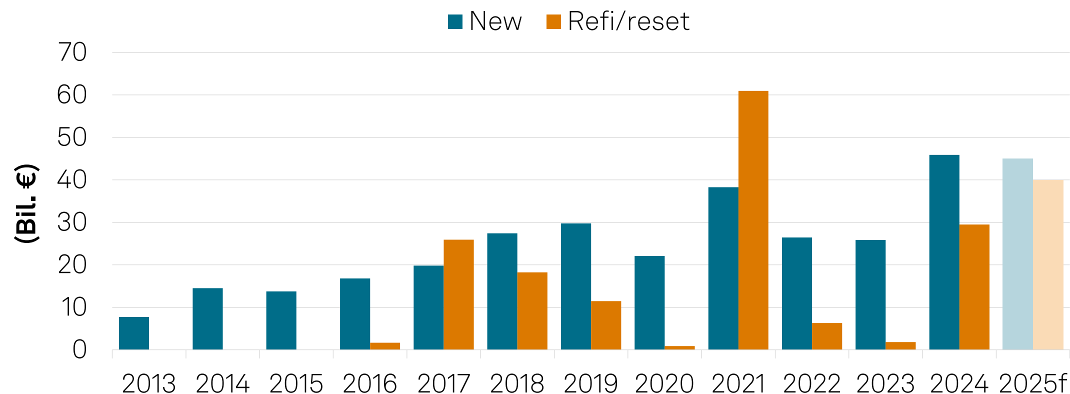
ACCQ--Average change in credit quality, i.e., the average number of notches by which ratings changed over a trailing 12-month period. Downgrades exclude defaults. 2024 based on data to end-November. Source: S&P Global Ratings.

CLO

CLO Issuance Breaks Records As Leveraged Finance Activity Bounces Back

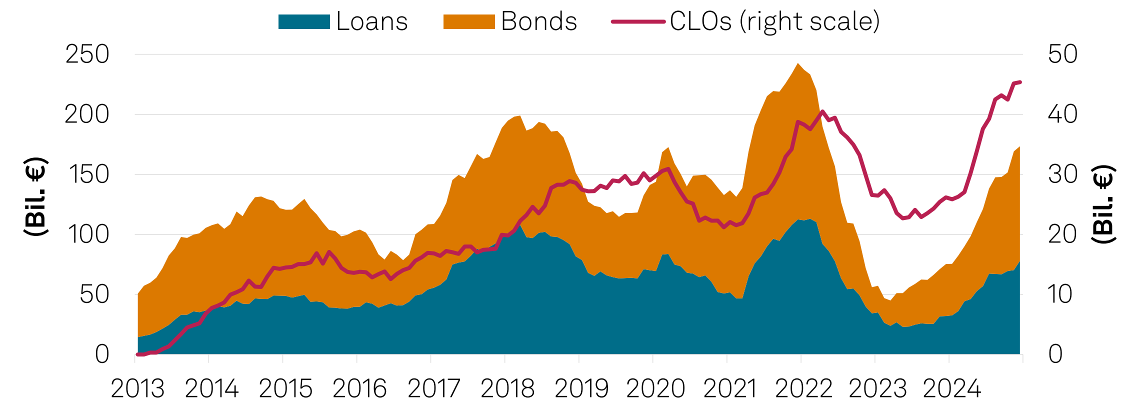
- European CLO issuance hit a new high of €46 billion in 2024, supported by continued growth in underlying leveraged finance originations, as well as higher CLO amortizations and liquidations putting cash back with investors and adding collateral availability.
- We estimate that about 25% of CLOs that we rate are now out of their reinvestment periods, with another 17% due to exit in 2025.
- This could mean that CLO volumes keep pace with the recent record level in 2025, especially if mergers and acquisitions activity picks up as rates stabilize.
- In addition, if CLO spreads remain at current levels or tighten further, more managers will have an economic incentive to refinance or reset transactions that have exited their non-call periods, especially if they have also begun to amortize.

European CLO issuance



f--Forecast. 2024 figures are year-to-date as of Dec. 9. Source: S&P Global Ratings, Pitchbook LCD.

European leveraged finance versus CLO volumes



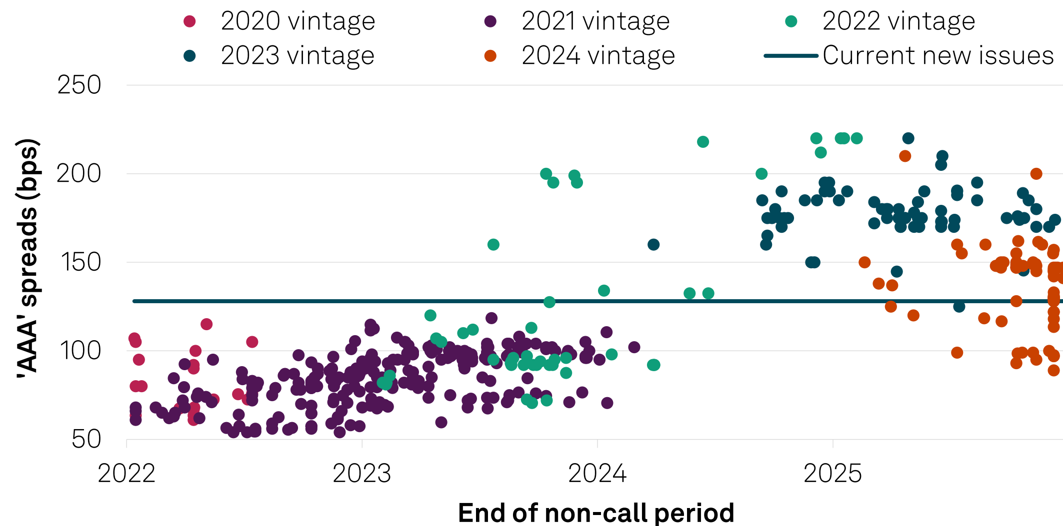
12-month rolling basis. Loan figures are institutional only. Source: S&P Global Ratings, Pitchbook LCD.

S&P Global Ratings

There Is A Substantial Stock Of CLOs That Are Candidates For A Reset

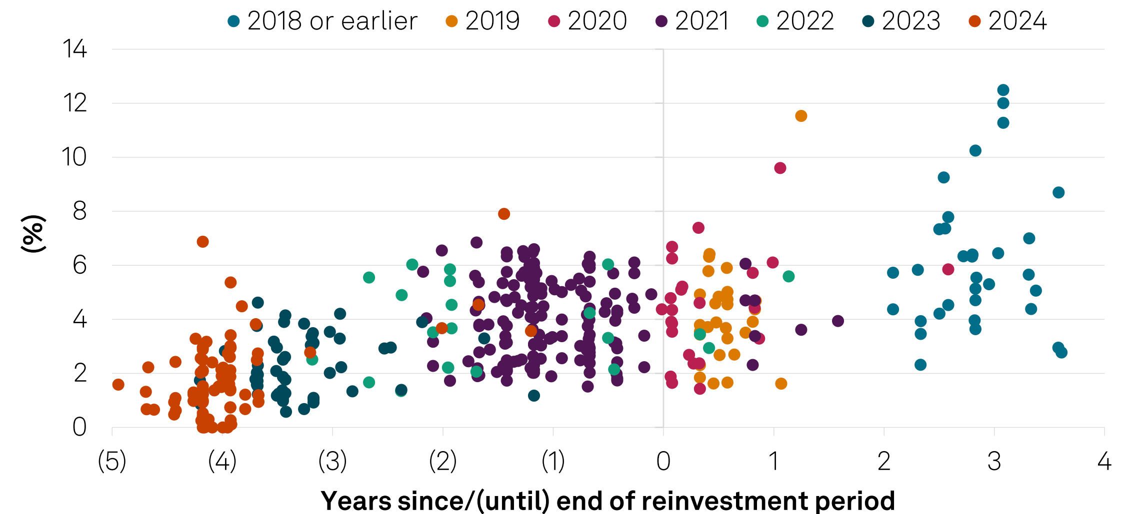
- CLO refinancing and reset volumes jumped from close to zero in 2023 to hit about €30 billion in 2024, and they will likely be another bright spot in 2025, possibly accounting for €40 billion in further issuance activity.
- For example, €35 billion of 2023 vintage CLOs have non-call end dates in late-2024 or 2025 and appear comfortably "in the money". Even earlier "out of the money" vintages could be reset candidates if they are no longer reinvesting and collateral quality is declining.

Refi/reset candidates: existing versus current 'AAA' spreads



bps--Basis points. Source: Pitchbook LCD, S&P Global Ratings.

'CCC' obligor exposure relative to RP end date, by vintage



RP--Reinvestment period. Based on CLOs rated by S&P Global Ratings and outstanding as of end-November 2024. Source: S&P Global Ratings.

Middle Market CLOs Backed By Private Credit Are A New Strand Of Issuance

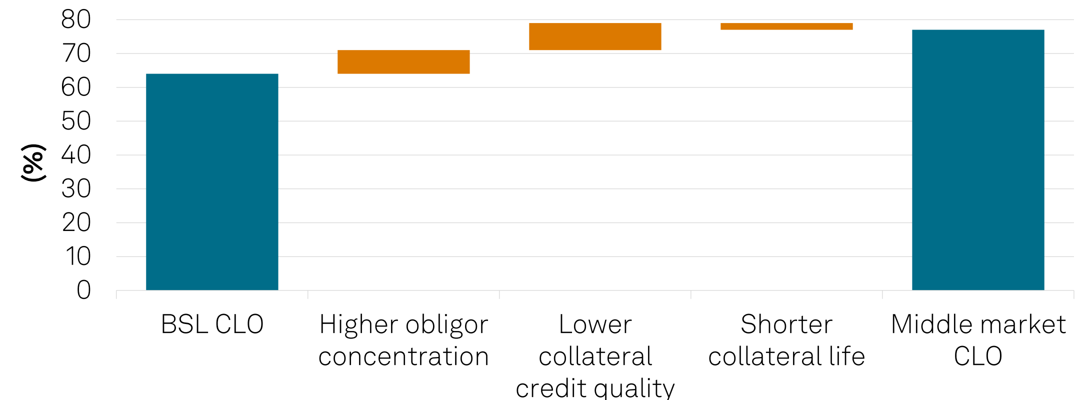
- In the U.S., middle market (MM) CLOs have been an established asset class since at least 2004, and volumes continue to grow as mid-sized corporates seek alternative funding sources. But 2024 also saw the long-awaited debut of a publicly-rated MM CLO in Europe.
- Compared with broadly syndicated loan CLOs, MM collateral pools tend to have riskier characteristics, in our view, including higher concentration and lower obligor credit quality. However, this could be partially offset by credit-positive factors, including higher spreads and assumed recovery rates. The recent debut transaction also included some broadly syndicated loans in its collateral pool.
- Now that the concept has been proven in Europe for the first time, we may see more managers bringing MM CLOs to market. That said, this will likely be limited to larger managers that have their own direct private lending capabilities.

Comparison of generic portfolio characteristics

	Middle market CLO	Broadly-syndicated loan CLO	Difference	Credit effect
Obligor count	40	150	-110	-
SPWARF	3,600	2,900	+700	-
WAL (years)	4.3	4.7	-0.4	+
Portfolio WARR (%)	39.0	37.7	+1.3	+
Portfolio WAS (%)	6.0	4.4	+1.6	+

SPWARF--S&P Global Ratings' weighted-average rating factor. WAL--Weighted-average life. WARR--Weighted-average recovery rate (assuming covenant-lite loans). WAS--Weighted-average spread. Source: S&P Global Ratings.

Stylized differences in 'AAA' scenario default rate

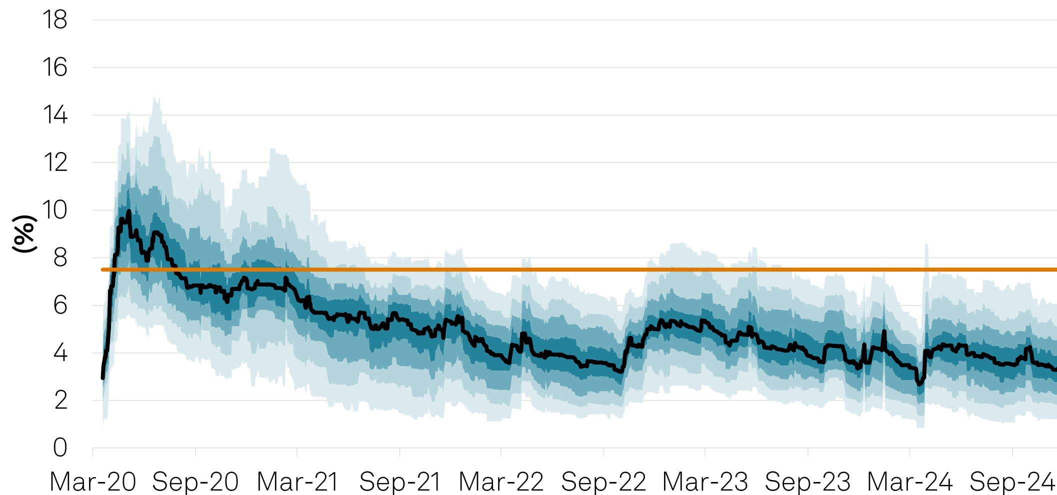


BSL--Broadly syndicated loan. Based on hypothetical BSL and middle market CLO portfolios. 'AAA' scenario default rate is the gross default rate stress we would apply to model a 'AAA' rating scenario. Source: S&P Global Ratings.

Key Credit Metrics For CLO Portfolios Are Still Seeing Little Deterioration

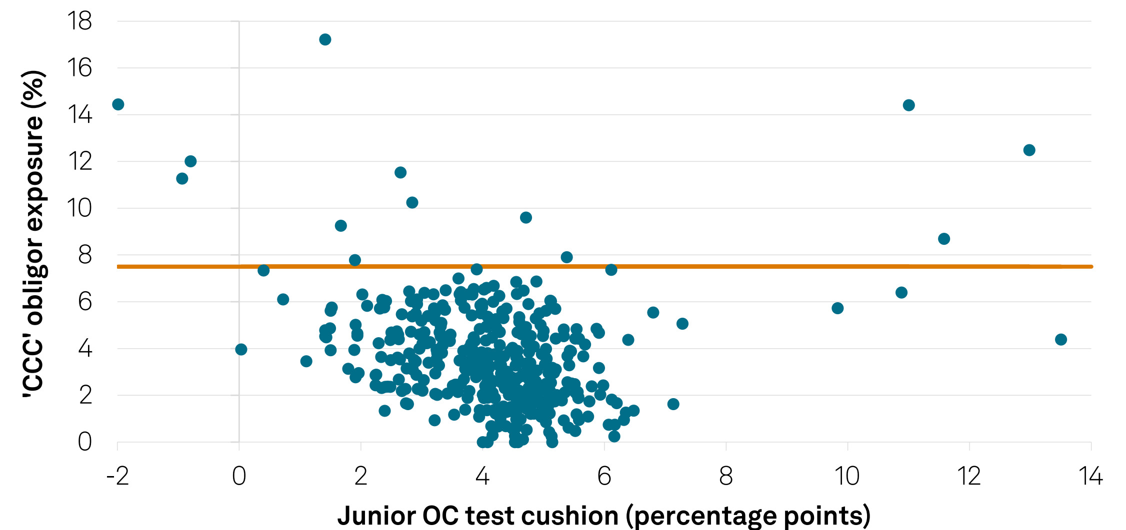
- In European CLOs that we rate, the median exposure to obligors rated in the 'CCC' category remains stable at close to 4%. Only 3.0% of transactions have this statistic higher than 7.5%, meaning some assets are carried at market value in overcollateralization (OC) tests.
- Most transactions are passing junior overcollateralization tests by a comfortable margin. Some transactions with more 'CCC' exposure are now out of their reinvestment periods, and structural amortization is therefore helping to support overcollateralization ratios.

European CLO exposure to 'CCC' category obligors



Solid blue line is the median, with each band representing a decile, from 10th to 90th percentiles. Estimates based on portfolios from latest available trustee reports, with ratings updated. Source: S&P Global Ratings.

'CCC' obligor exposure versus junior OC test cushion

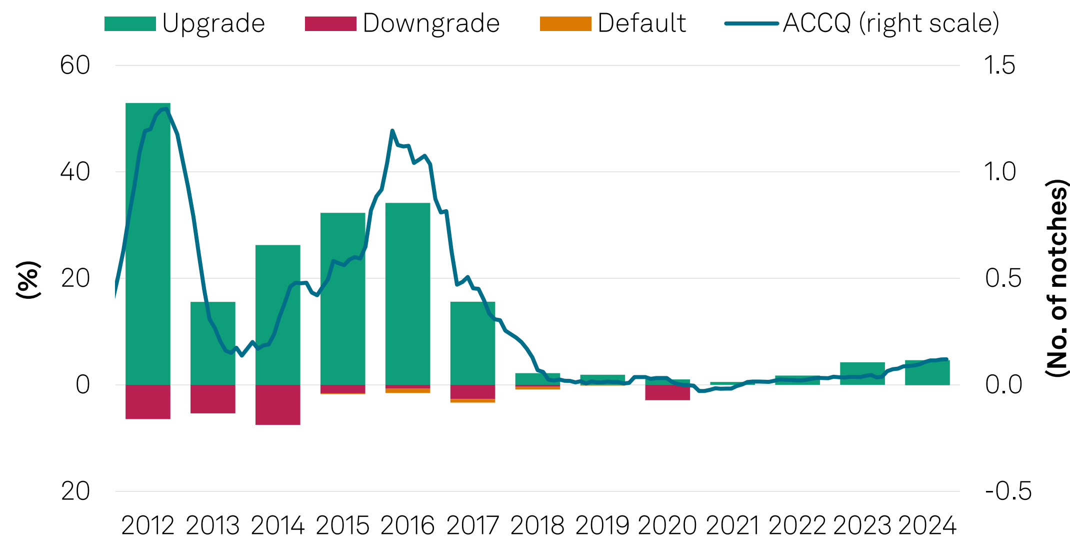


OC--Overcollateralization. Based on CLOs rated by S&P Global Ratings and outstanding as of end-November 2024. Source: S&P Global Ratings.

CLO Ratings Have Been Stable, With Some Upgrades For Amortizing Vintages

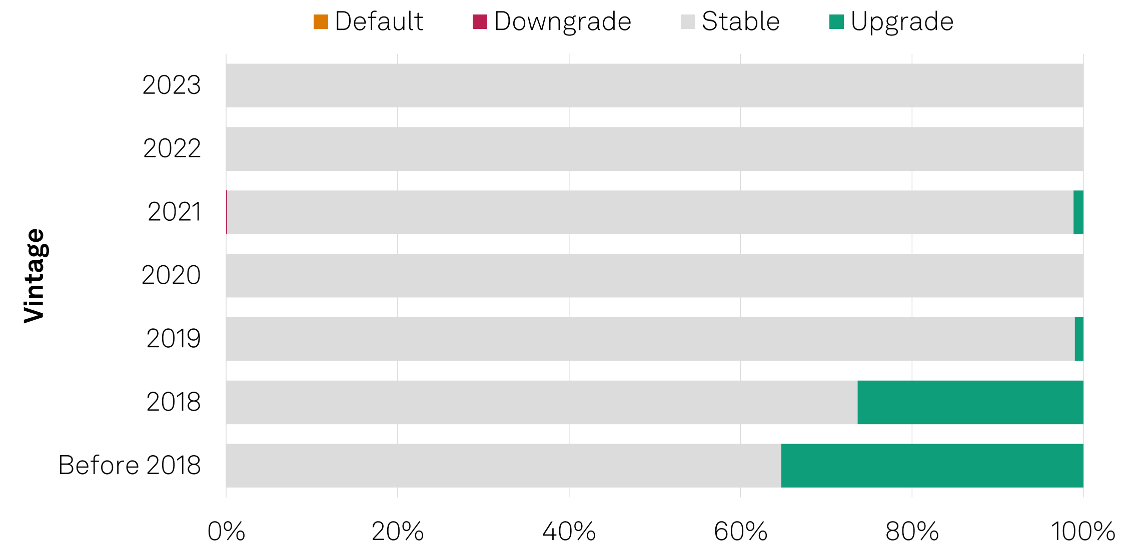
- European leveraged loan CLOs have seen very few downgrades over the past seven years--even through the pandemic--partly due to collateral managers' ability to actively trade out of credits and sectors should they come under stress.
- Ever since refinancings and resets became common in 2017, upgrades have been limited, as few transactions reached an amortization phase. However, now that more transactions are out of their reinvestment periods, upgrades are rising for older vintages.

CLO transition rates and change in credit quality



ACCQ--Average change in credit quality, i.e., the average number of notches by which ratings changed over a trailing 12-month period. Downgrades exclude defaults. 2024 based on data to end-November. Source: S&P Global Ratings.

CLO subsector rating transitions, by vintage, 2024



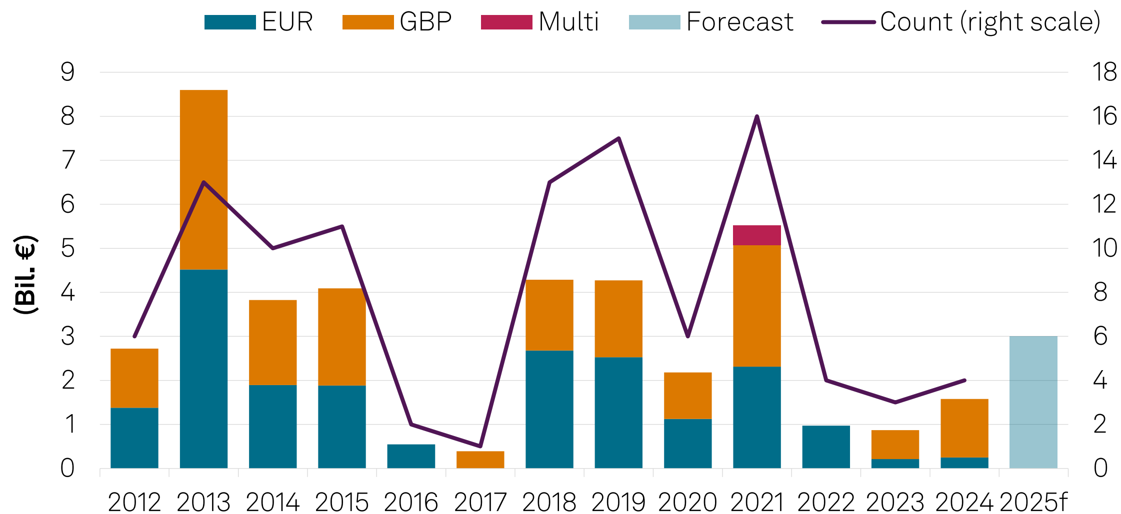
Downgrades exclude defaults. Based on data to end-November. Source: S&P Global Ratings.

CMBS

Stabilizing Real Estate Fundamentals Could Mean More CMBS Issuance

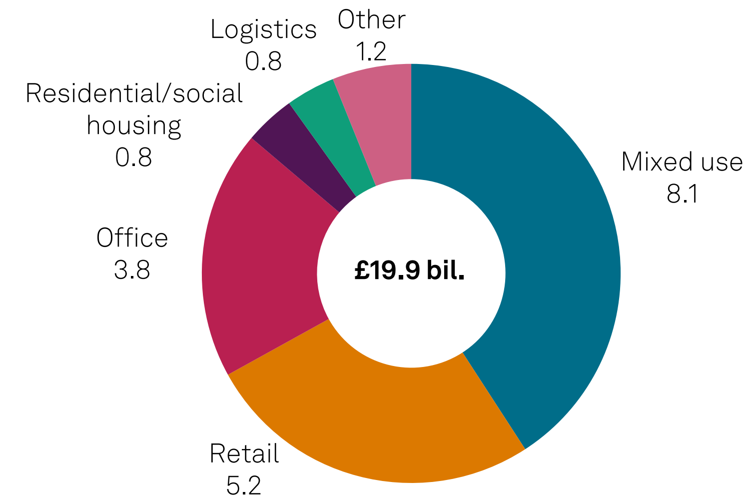
- In 2024, European CMBS issuance remained subdued at less than €2 billion, in line with our expectations at the beginning of the year.
- That said, much of this activity was in the second half of the year, suggesting that momentum for the asset class could be improving.
- Our outlook for 2025 assumes that gradually falling interest rates and a bottoming out of commercial real estate prices will lead to a further modest pickup in volumes.

European CMBS issuance, by currency



f--Forecast. 2024 figures are year-to-date as of Dec. 9. Investor-placed issuance only. Source: S&P Global Ratings.

European CMBS outstanding, by collateral type (bil. £)

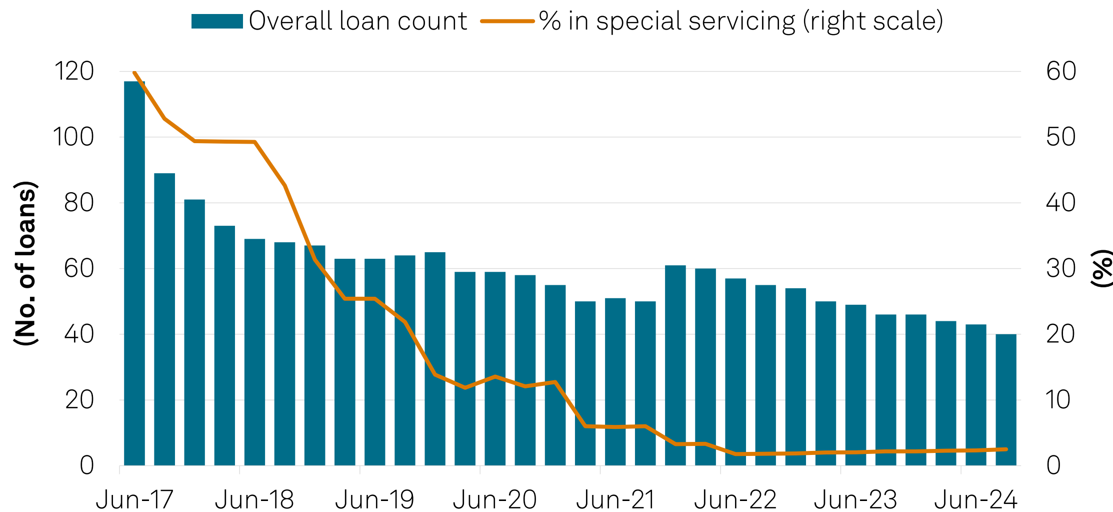


Outstanding balances as of Sept. 30, 2024 and rated by S&P Global Ratings. Source: S&P Global Ratings.

Few Loan Defaults In CMBS, Although Refinancing Remains A Risk For Some

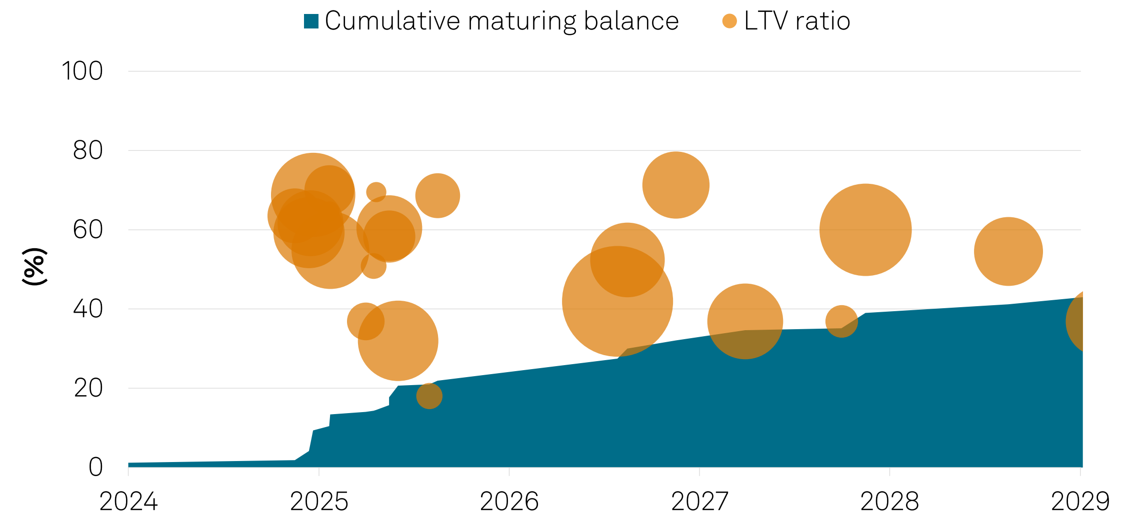
- There are few loans in special servicing as some had their maturities extended and others were repaid. The extensions mean that more loans now mature by the end of 2025 and those with higher loan-to-value ratios are more susceptible to refinancing risk.
- That said, when the underlying real estate is appraised at current market values, most maturing loans have a loan-to-value ratio of less than 60%, meaning that while defaults may rise, widespread losses are unlikely.

European CMBS loans in special servicing



Based on loans backing European CMBS that we rated as of Sept. 30, 2024. Source: S&P Global Ratings.

European CMBS loan maturity profile

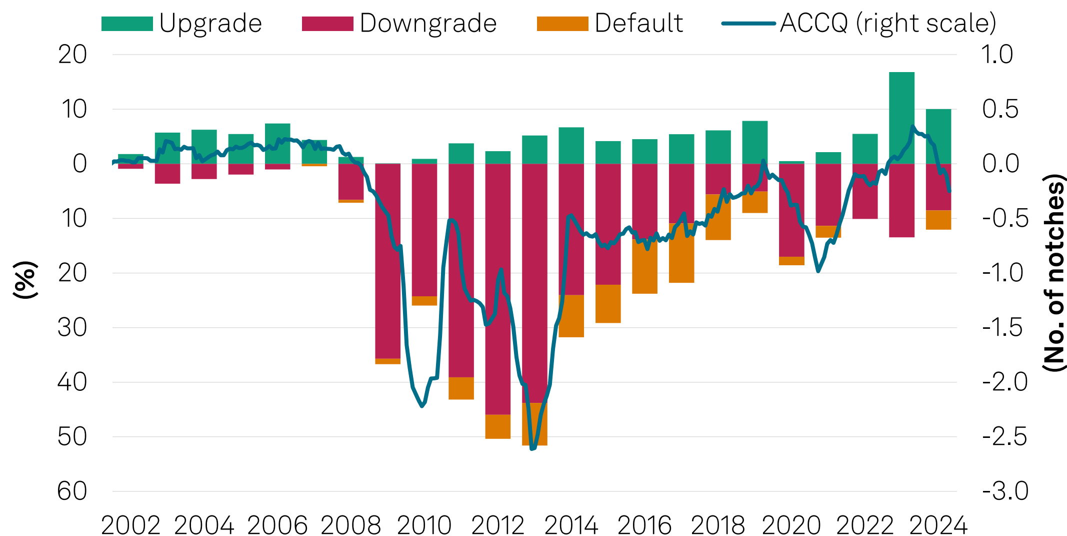


LTV--Loan to value. Bubble size corresponds to loan balance. Based on loans backing European CMBS that we rated as of Sept. 30, 2024. Source: S&P Global Ratings.

CMBS Ratings Movements Mixed, With Some Defaults But Also Upgrades

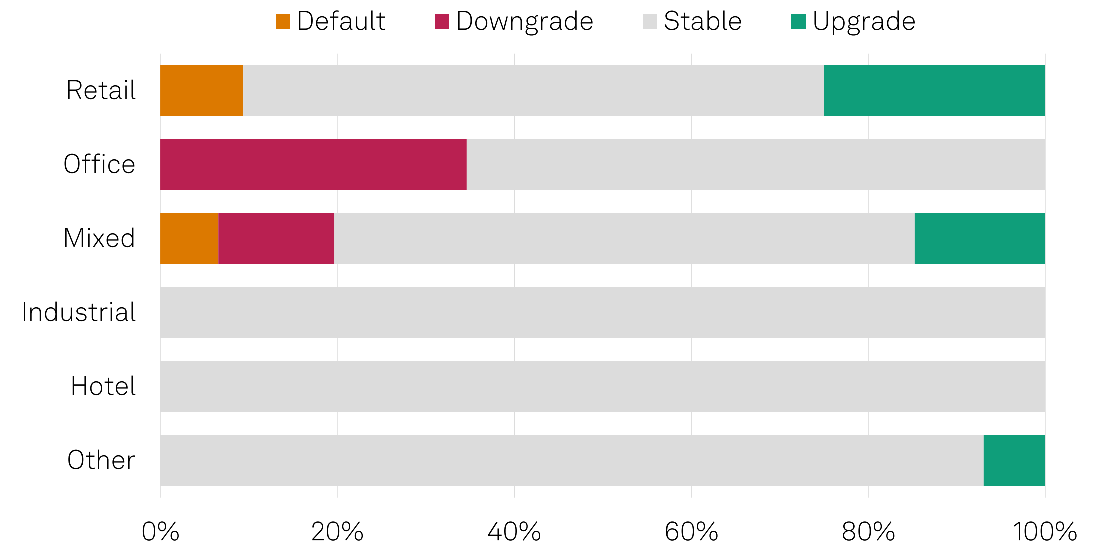
- There were seven tranche defaults for European CMBS in 2024, following interest shortfalls on a defaulted U.K. retail loan--which is the last loan remaining in a mixed collateral transaction--and the restructuring of a transaction backed by U.K. shopping centers.
- However, despite recent declines in commercial real estate valuations and consequent pressure on some borrowers at loan maturity, where refinancing has succeeded and structures have delivered, there have been some CMBS tranche upgrades.

CMBS transition rates and change in credit quality



ACCQ--Average change in credit quality, i.e., the average number of notches by which ratings changed over a trailing 12-month period. Downgrades exclude defaults. 2024 based on data to Dec. 4, 2024. Source: S&P Global Ratings.

CMBS subsector rating transitions, 2024



Downgrades exclude defaults. Based on data to Dec. 4, 2024. Source: S&P Global Ratings.

Recent Research & Contacts

Recent Research

- Credit FAQ: How We Rate ABS And RMBS Transactions In Non-Established Markets, Dec. 3, 2024
- U.K. Legacy RMBS Arrears To Be Higher For Longer, Nov. 28, 2024
- European RMBS Index Report Q3 2024, Nov. 14, 2024
- European And U.K. Credit Card ABS Index Report Q3 2024, Nov. 13, 2024
- European Auto ABS Index Report Q3 2024, Nov. 13, 2024
- EMEA RMBS And ABS Monitor Q3 2024, Oct. 23, 2024
- U.K. Second-Lien Monitor Q3 2024, Nov. 7, 2024
- European CMBS Monitor Q3 2024, Oct. 21, 2024
- Dutch Buy-To-Let RMBS Withstand Rate Hikes And Tighter Regulations, Oct. 21, 2024
- Credit FAQ: Solar ABS Trends: Partially Cloudy Skies, Oct. 17, 2024
- European CLO Monitor Q3 2024, Oct. 7, 2024
- EMEA ABS And RMBS Counterparty Monitor Q3 2024, Oct. 2, 2024
- U.K. Corporate Securitization Issuers Can Withstand Higher Refinancing Rates, Sept. 18, 2024
- Highlights From S&P Global Ratings' European Structured Finance Conference 2024 , Sept. 9, 2024
- ABS Frontiers: The Credit DNA Of Synthetic Risk Transfer Securitizations, Sept. 3, 2024
- European CLOs: Awash With Cash, Sept. 3, 2024

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