



The View from Brussels

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The European ABS industry descended on Brussels last week for the annual IMN ABS Conference. We look at a few of the themes to emerge and ask what can be concluded regarding the current state and direction of the industry.

Escape from Edgware Rd..

It has been said that the best thing to do with a free day in Brussels is take a day trip to Paris. Having just come back from a few days at the ABS conference, held at the 'Square Brussels Conference Centre', I can tell you that isn't true; you should take the train to Amsterdam. But this misses the bigger point, which is that Brussels marks a great step forward for the European ABS market from under the shadow of the Westway, the location for the same conference during the sack-cloth-and-ashes years of introspection and finger pointing. True, the focus on regulation and what needs to be fixed to bring the market back to health was always going to provide a relatively sober grounding for this year's event, but still progress of a sort.

No answer to The Tough One

Predictably there was no magic answer to the issue which constrains the current market more than anything else – the demand side of the market. With leverage having largely disappeared there simply isn't the investment capacity to deal with multi-billion issuance volumes within a short timeframe, in the way that three or four deals of >€1bln could price simultaneously pre-2007 and all expect to see excess demand. [If no answer, the conference at least provided a perfect analogy in terms of the excess supply of drinks parties thrown by investment banks on the Tuesday night. Standing in the centre of La Grand Place you could pick your bar and choose from upwards of a dozen events – but with them all coming on one night it felt like there weren't enough

investors to go round.] Instead discussions focused on what is required to bring investors back, what entices more 'real money' accounts into ABS as a product and which sectors can expect to see growing demand. 'Transparency' would be the single term that came up most frequently in the answers. But, understandably, no quick fix.

A more positive note

However there was some time taken to discuss the more positive sides of European securitisation since the crash. Researchers – and indeed regulators – commented on the fundamentally strong credit performance of the vast majority of European ABS deals. It has, in the main, been a question of volatile pricing but not principal losses. Key-note speakers in dark suits (who hadn't had to travel far) took time out from opining on what has gone wrong and what they must do to make sure that banks behave themselves in future, to note that securitisation has a role to play and serves an important economic purpose.

Less was said about the role securitisation has played in providing liquidity to the Eurozone banking system and allowing the ECB to indirectly fund institutions that would otherwise struggle for financing. The volume of securitised but retained assets, subsequently pledged to the ECB by the originating bank, still dwarfs the volume of publicly placed issuance. No risk transfer takes place, this is purely a mechanism for turning the balance sheet into much needed liquidity, and through this route the ECB has pumped money into Europe's banks. It has been the primary use of securitisation in



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Europe since the crash.

The perception of securitisation by the regulatory authorities continues to be an area of concern. The unequal treatment of RMBS when compared to covered bonds, for instance, and the competing dynamics of those two markets was the subject of more than one discussion. So assertions of the importance of securitisation, and denials of any inherent bias against the treatment of resulting assets, were worthy of note – even if not entirely unexpected given the audience.

And now for something completely different

With impeccable timing, the first true European CMBS to hit the market since 2007 priced just before the conference – DECO 2011. In re-opening the market, Deutsche provoked as many questions as they provided answers. So AAA bonds backed by a single loan and prime quality assets could seemingly price at a spread of +175; but who were the 20 or so buyers, would they go for multi-loan deals or secondary quality properties, and did the transaction structure provide a template for further issuance? These and other issues around how the existing stock of CRE¹ debt gets refinanced over the next two years were the focus of the CMBS panel discussion in which we took part. In terms of the expectations for the 'new' European CMBS market from here the panelists were cautious; currently the pricing provided by the CMBS market doesn't look particularly attractive to borrowers when compared to loan execution, and yet relative value to investors at the levels achieved by the Chiswick Park transaction doesn't appear overly generous. In essence the loan market needs to re-price, maybe when the balance sheets of current providers become congested, in order for CMBS to be compelling. Alternatively credit spreads in general need to tighten in order for the

relative value proposition for investors to improve. However, with a Greek default and potential sovereign and banking debt contagion hanging over the market, the latter doesn't seem imminent.

Part of the problem is that current investors in legacy CMBS risk are most likely not the buyers of new CMBS deals. Legacy CMBS is much more of a property play. Value is driven by views on the underlying asset values and timeline to maturity, sale or refinancing. In contrast the whole point of new structures will be to sufficiently immunise senior bond investors from idiosyncratic property risk that they can buy the bonds as a fixed income investment first, with spread driven primarily by liquidity and relative value. Many past investors in CMBS, buying AAA bonds at spreads of around L+25, found themselves unwilling investors in property risk with an insufficient return for the necessary investment in remedial due diligence, and it's hard to see them rushing back into generic, multi-loan deals without a great deal of effort to make the structures simpler and more transparent.

Much was made pre-conference of the roles of the rating agencies in the DECO 2011 transaction, particularly Fitch in releasing an unsolicited explanation of what it saw as some of the structural difficulties with the deal. For our part the open discussion of the structural developments in the market seems a necessary and welcome part of the process of gaining investor trust. This is equally true of the apparent willingness by Deutsche to engage in more of a conversation with its investors, and adapt the structure during marketing. While having to subordinate the class X may have been painful in terms of upfront realised P&L, they at least have the best set of current data with regard to investor preferences and price sensitivities – and launching a deal into a price vacuum deserves credit.

¹ Commercial Real Estate



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The future is bright, the future is ...Barcelona?

In essence, on a number of fronts and across a number of the main sub-markets that make up European securitisation, there seemed to be a constructive outlook perceptible amongst conference attendees and decision-makers. Participants, for the main, seem to have accepted that the scale of the market of 2006/7 isn't coming back, at least in the medium term. And so with sights adjusted to a 'new normal' target of achieving an equilibrium between the remaining buyers and those that wish (or need) to issue according to the new rules of the game, market participants seem to be broadly pragmatic in their approach to remaining problems. Market realism has taken hold.

Still, I heard more than once the rumour that

the conference may be heading, after a consolidation event in Brussels or Paris next year, back to its spiritual home - Barcelona. It was after all known as *the Barcelona conference*, just as much as it was the ABS conference. That would mark the end of a remarkable journey 'home'; after a couple of years of penance under the A40 flyover on the Edgware Road, via the serious-and-suited rehabilitation of Brussels, back to the sun and excess of The Arts Hotel, the Baha Beach Club and days that end at sunrise. However it seems like a plan predicated on the market having achieved a level of activity significantly above today's issuance levels, and therefore presumes that today's challenges – retained risk, PCS, transparent structuring and fundamental relative value concerns among them – are sufficiently dealt with in the coming months.

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