

6<sup>th</sup> March 2019

## **Apollo RMBS in the spotlight – “Suncorp mortgage bond failure” – Cause for Concern?**

An article published in The Australian on the 5<sup>th</sup> March 2019 titled “Suncorp mortgage bond failure ‘a canary’” has generated some questions from clients of Gryphon Capital Investments Pty Ltd (Gryphon). We wanted to provide some useful background and most importantly detail the actual facts of such an occurrence.

**Please note that Gryphon has NO exposure to Apollo 2010-1 in any of its managed portfolios, including GCIT.**

### **Suncorp Announcement**

A Suncorp RMBS (Apollo 2010-1) failed its 60+ days delinquency triggers and because one of the bonds is listed on the ASX, Suncorp made an announcement that the deal has failed its delinquency trigger. Below is the link to the ASX announcement.

<https://www.asx.com.au/asxpdf/20190304/pdf/44360wypr8v3j.pdf>

### ***What are the characteristics of the home loan portfolio securing the Apollo 2010-1 RMBS?***

Loan Balance	119,228,621
No. of Underlying Loans	1,008
Weighted Average Underlying Loan Balance	118,282
Weighted Average LVR	50.12%
Weighted Average Seasoning	12.3 Years
Weighted Average Interest Rate	4.76%
Loans insured by Mortgage Insurance	100.00%

*Source: Apollo 2010-1 Investor Report for the period ended 3<sup>rd</sup> March 2019.*

### **Background Q&A**

We outline below answers to the questions most likely on investors’ minds following Suncorp’s announcement.

#### ***Has Suncorp’s Apollo 2010-1 RMBS transaction failed and does this mean there will be losses for investors***

The Suncorp Apollo 2010-1 RMBS transaction has **NOT** failed and importantly just because an RMBS transaction has failed a delinquency trigger doesn’t imply there would be losses or a write down for any investor.

All Bondholders are continuing to receive interest and principal in accordance with the RMBS transaction agreement.

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## ***What does failing triggers actually mean?***

All RMBS transactions have inbuilt safety features designed to protect senior bondholders, which, if “triggered” diverts the principal repayments received each month to be paid “sequentially” to the most senior class of bonds outstanding. For the Apollo 2010-1 RMBS transaction, this means the Class A2 bond will receive all of the principal receipts prior to the Class AB and B bonds.

As can be seen below, the trigger event has had a very small impact to the expected weighted average life (WAL) of each bond.

<b>Apollo 2010-1</b>				
<b>Class</b>	<b>Original Balance A\$million</b>	<b>Current Balance A\$million</b>	<b>WAL Years Triggers Pass</b>	<b>WAL Years Triggers Fail</b>
Class A1	630.0	-	-	-
Class A2	300.0	103.5	0.9	0.8
Class AB	50.0	12.1	0.9	1.0
Class B	20.0	4.8	0.9	1.0
	<b>1,000.0</b>	<b>120.5</b>		

Source: Apollo 2010-1 Investor Report for the period ended 3<sup>rd</sup> March 2019.

## ***What is the impact of triggers not passing?***

Under this scenario, all principal is diverted to repay the senior bondholder prior to the junior bondholders. Bank Issuers of Australian RMBS have a right to call the bonds when the mortgage loan pool is reduced to below 10% of its original size (“clean up call”). Suncorp has announced the 10% clean up call for the RMBS transaction is expected to be exercised in late 2019, therefore impacting the return of bondholder’s principal (WAL) only very marginally, with the Class AB WAL extending 0.1 of a year.

## ***Is failing delinquency triggers common for Prime RMBS transactions?***

When investing in the RMBS market, a key consideration is the size of the RMBS pool. In this case, the Apollo 2010-1 issued a \$1bn pool and now is only \$120 million (12% of the original size) and so as the pool shrinks (due to the repayment of loans) the failing of triggers is not without precedent, although it is still relatively uncommon. For Apollo 2010-1 RMBS pool, there are only 22 mortgage loans which are 60+ days delinquent out of more than 1,000 outstanding loans.

At Gryphon, we monitor and reconcile all triggers for every RMBS transaction we invest in as part of our very detailed surveillance process.

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***Do all bondholders continue to receive interest?***

Yes, all bondholders will continue to receive interest.

***Does Suncorp continue to receive its profit?***

Yes, but importantly only after all bondholders receive their interest and then Suncorp continues to receive its Residual Income.

***Has any bondholder incurred a loss of principal?***

No

***When are the bondholders expected to receive their principal?***

There are three outstanding classes of bonds in this RMBS transaction, assuming triggers fail for the remainder of the bonds' life:

Class A2 - receives principal each month and then is expected to receive the balance when Suncorp calls the RMBS at the 10% clean up call

Class AB - receives principal when Suncorp calls the RMBS at the 10% clean up call

Class B - receives principal when Suncorp calls the RMBS at the 10% clean up call

Suncorp announced the expectation of the 10% clean up call option will be triggered at the end of 2019.

***What are the current Bondholder protections in Apollo 2010-1?***

- The Weighted Average LVR is 50.12%
- 100% of the deal has mortgage Insurance
- The average borrower in the pool has been paying their home loan repayments for over 12 years
- No claim on mortgage insurance has been made on any loan since Suncorp issued the RMBS transaction in 2010
- Excess Spread (Suncorp's profit) which is only received by Suncorp after the Bondholders receive their interest and any losses are met.

***Has a bondholder ever lost principal from any rated Australian RMBS transaction?***

No

S&P's most recent RMBS Performance Watch noted "All gross losses to date in prime and nonconforming Australian RMBS transactions have been covered by lenders' mortgage insurance (LMI) claims paid and excess spread.

# Gryphon Capital Income Trust (GCIT)

ARSN 623 308 850

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