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'Fix and Flip' RMBS Gets First Credit Ratings: Structured Weekly

- Toorak Capital Partners is marketing $192m bond rated by DBRS
- Residential transition loan deal to draw more investor dollars

By Scott Carpenter

(Bloomberg) -- A type of bond that packages together loans used to renovate houses is being rated for the first time, a potential boost for the niche sector as it opens it up to a broader base of investors.

The $192 million residential transition bond offering by KKR-backed Toorak Capital Partners is composed of hundreds of mortgages, including many so-called "fix and flip" loans where borrowers buy a property with plans to renovate and resell it for a profit. It's the latest in a series of deals that have gained momentum in recent years.

The limited number of banks that specialize in residential transition loans have pulled back amid deposit outflows, while banks in general are wary of the capital penalties that loans with construction components can bring to their balance sheets, according to Toorak's Chief Executive Officer John Beacham. That's left the door open to more non-bank investors to sink money into the space, he said.

"What's driving the increase in deals is that since 2016 there's been little institutional capital in the space," said Beacham in an interview. "Now we're seeing more big investors find ways to invest."

The deal, a kind of residential mortgage-backed securities offering, received preliminary credit ratings ranging from the low end of the single A tier to the bottom of the single B group across several tranches from DBRS Morningstar. That mark from a recognized credit ratings company opens it to investment by a broader range of investors than unrated bonds.

Most loans in residential transitional loan bonds are fix and flip loans, where investors obtain a loan with a plan to renovate all or part of a home and resell it at a profit. As that borrower executes on their renovation plan, he or she asks the lender to release additional portions of the loan. The fixed-rate loan remains outstanding for around one year on average, Beacham said.

Playing a largely behind-the-scenes role, companies like Toorak buy loans such as these from networks of lenders and then package them into securitizations. Unlike in typical securitizations, they include a revolving period where additional loans can be added to the securitization.

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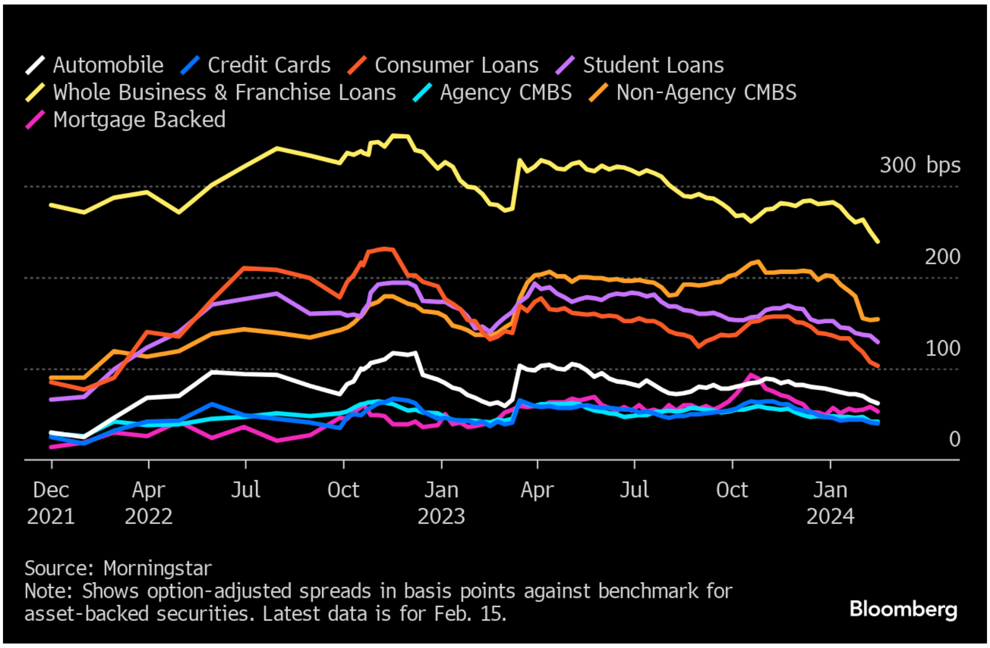
Spreads Change



Relative Value

Barclays strategists recommend investors look outside CMBS for relative value, even as spreads may have some room to tighten, according to a note dated Feb. 16 by strategists Lea Overby and Anuj Jain.

- "The strong PPI print this morning and subsequent selloff in rates was yet another reminder that higher inflation remains a risk and rates may remain higher for longer," they wrote. "As we have noted repeatedly, this is a negative for commercial real estate pricing and can lead to an increase in delinquencies, especially for floating-rate loans"
- CMBS spreads could still tighten based on comparable securities, and CMBS stands to benefit from the flow of capital into fixed income
- "However, we do not expect a lot of tightening, as headlines risks remain elevated and AAA CMBS is not necessarily cheap"
- The Fed is closely watching bank CRE loans, and CRE exposure at regional banks is a clear driver of valuations
- Expect delinquency rates to keep increasing this year across all products

What's Next

A day after Kobalt Music Group began premarketing a debut music royalty trade, Westlake Flooring Services announced plans to sell its inaugural dealer floorplan ABS during the holiday-shortened Presidents' Day week.

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