Commentary
European NPLs 2024 Outlook

Morningstar DBRS
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Summary

The European NPL securitisation landscape appears more diverse than ever. 2023 was a year where the NPL securitisation market stalled: none of the transactions that were put on hold after the European Central Bank started increasing interest rates resumed during 2023. Except for a handful of issuances concentrated in the final weeks of last year, this asset class has been quietest since issuance restarted in 2016 after the Great Financial Crisis (GFC).

In terms of rating performance, we saw a very uneventful past year with by far most rating actions being confirmations and with upgrades timidly gaining share against downgrades. Although not by much, since the pandemic started, and in relative terms, 2023 has been the year with the lowest downgrades, For the first time, upgrades outnumbered downgrades.

In terms of credit performance, the situation last year leaned more towards the negative but still without any generalised evident trend. Most of the strong performers, such as the Irish, the Portuguese, the most recent Italian, and the UK transactions, remained deleveraging with a healthy level of collections and note amortisation; however, the older Italian and Spanish NPL securitisations are still struggling to revert their previous performance deterioration, and most of them continued in their negative performance path in 2023.

According to our 2024 Sovereign Outlook, the full impact of monetary policy tightening has not yet been felt in Europe, and growth is expected to be below 1% in all the major advanced economies, so we remain cautious.

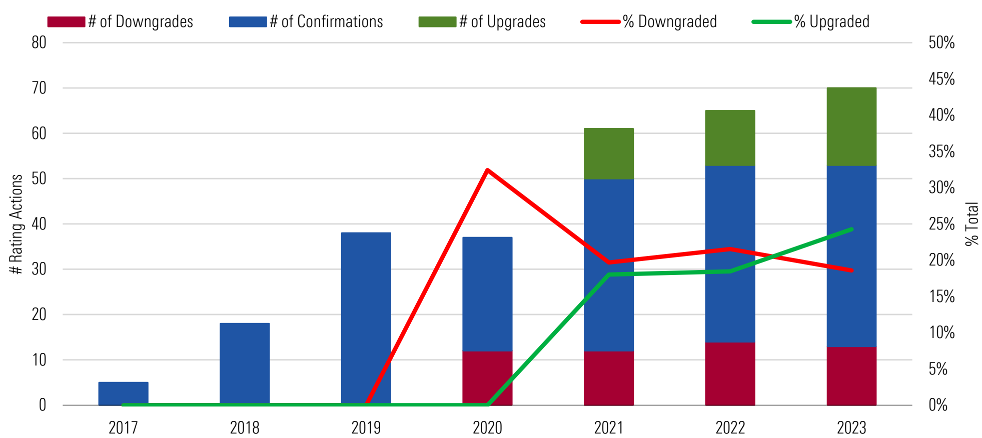
Jurisdiction	2024 Collateral Performance Outlook	2024 Credit Ratings Outlook
Cyprus (Page 4)	Stable	Stable
Ireland (Page 6)	Stable	Stable
Italy (Page 8)	**Negative**	Stable
Portugal (Page 11)	Stable	Stable
Spain (Page 13)	**Negative**	Stable
UK (Page 15)	Stable	Stable

For 2024, we expect stable ratings outlook across all of our jurisdictions and also stable credit outlooks for most of them. Spain and Italy are the two jurisdictions we maintain a negative credit outlook for, based on the struggles we have been seeing on some of our rated transactions during the last few years, including delays on the recovery prospects and, in some cases, a revised lower total recovery

amount. Compared with last year we revised the credit rating outlook for Italy to stable, considering the previous downgrades on some of the transactions.

In terms of the proportion of rating actions for publicly rated European NPL securitisations, 2023 followed a similar pattern as 2022 —but for the first time, upgrades outnumbered downgrades. In 2023, Morningstar DBRS confirmed 40 tranches of 34 transactions, upgraded 17 tranches of 12 transactions, and downgraded 13 tranches of 11 transactions. All the downgraded tranches relate to pre-pandemic and pre-GACS 2019 amendment Italian NPL securitisations, which displayed continued performance deterioration through and after the pandemic. In contrast, the 17 upgraded tranches were spread out; Italy concentrated the majority of them with nine, followed by Ireland with four and the rest being in Spain (two), Portugal (one) and the UK (one).

Exhibit 1 Morningstar DBRS European NPL Rating Activity

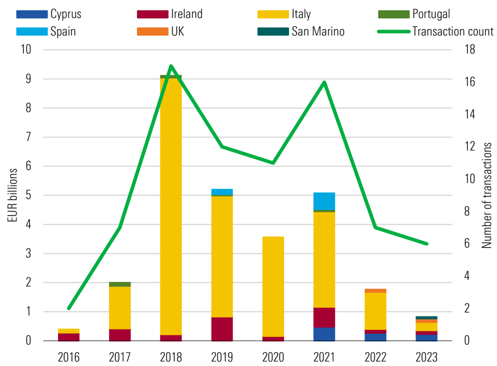


Source: Morningstar DBRS.

Morningstar DBRS Issuance's Perspective

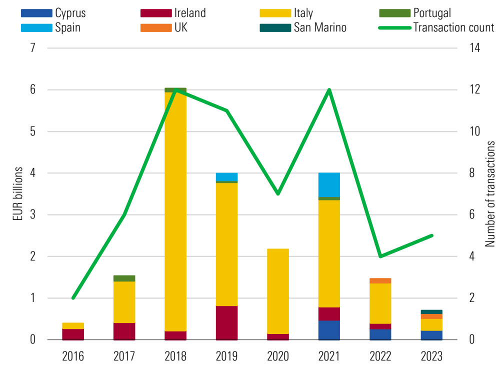
In terms of issuance volumes, in comparison with 2022, public European NPL issuance in 2023 was lower by the rated notes amount measure (EUR 0.8 billion in 2023 versus EUR 1.8 billion in 2022), but similar by number of transactions (six in 2023 versus seven in 2022). This represents a relevant reduction compared with the 2018—21 period, with an average of 14 transactions per year, and this is largely due to the reduction in the number of Italian NPL securitisations with the expiration of the Italian Garanzia Cartolarizzazione Sofferenze (GACS) asset protection scheme in June 2022.

Exhibit 2 NPL Securitisations Issued; Rated Senior Notes



Source: Morningstar DBRS, issuer reports.

Exhibit 3 NPL Securitisations Rated by Morningstar DBRS; Senior Notes



Source: Morningstar DBRS.

A main factor for this year in the European NPL space is the recent renewal of the Greece's Hellenic Asset Protection Scheme (HAPS), which was approved on 4 December 2023 with a total guaranteed amount of EUR 2 billion of securitised bonds and a new expiration date on 31 December 2024 (unless extended by a subsequent decree). We do foresee many of the Greek banks, both systemic (Alpha Bank, Eurobank, National Bank of Greece, and Piraeus Bank) and other nonsystemic banks, to take advantage of this renewal and securitise some or all of their remaining NPL stocks before the guarantee expires. The renewal of the guarantee has come with a two-notch tighter rating requirement of BB (high), as the previous program required BB (low), but similarly as before, it does not require the rating to be public, which is an important reason for the absence of public ratings on Greek NPL securitisations.

In terms of public transactions, the consensus of market participants is that a renewal of GACS is not expected this year, as such, expectations for 2024 Italian NPL issuance in terms of volumes remain low. It is possible that we will see rated transactions in new jurisdictions and, considering the limited cost for governments compared with other solutions, the introduction of schemes similar to Italy's GACS scheme and Greek's HAPS in other jurisdictions remains possible. One example of it is the latest San Marino NPL transaction Veicolo di Sistema S.r.l. issued in December 2023 , which is government guaranteed and issuer level.

The NPL securitisations outside of government asset protection programmes, observed in jurisdictions such as Cyprus, Ireland, Portugal, Spain, and the UK, are dependent on European securitisation market conditions. For these jurisdictions, Morningstar DBRS expects public senior note issuances during the course of 2024 to be broadly in line with the post-pandemic pre-Ukraine's invasion period (2021-2022) of EUR 200 to 400 million per year, now that interest rates are stabilising. The year may also see, similarly to 2023, securitisations of smaller sized NPL portfolios, reperforming loan (RPL) portfolios that may be sold out of existing securitisations and other more esoteric mixed-asset-class transactions involving nonperforming loans and unlikely-to-pay loans.

Cyprus

2024 Collateral Performance Outlook
Stable

2024 Credit Rating Outlook
Stable

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On 29 September 2023, Morningstar DBRS upgraded the Republic of Cyprus' Long-Term Foreign and Local Currency – Issuer Ratings to "BBB (high)" from BBB (DBRS Morningstar Upgrades Republic of Cyprus to BBB (high), Stable Trend), supported by a stable political environment, the government's sound fiscal and economic policies in recent years, and a favourable government debt profile. On the asset quality front, the sovereign report mentions the banking sector's strong capitalisation and very large liquidity buffers, but the NPL ratio remaining above the Euro area average, and a higher stage 2 loan proportion compared to pre-pandemic levels which could indicate rising asset quality risks.

According to the Central Bank of Cyprus data, between year-end (YE) 2017 and Q3 2023, there was a reduction of EUR 18.6 billion[1] in NPLs in authorised credit institutions (8.3% NPL ratio at Q3 2023 versus 43.7% at YE2017). This continues to be a large amount compared with the size of the economy and these loans are still being worked out.

Discussions held over the last years on the protection of vulnerable debtors led to the following developments:

- The "mortgage-to-rent" scheme went live on 4 December 2023, with applications being accepted for a nine-month period. In order to prevent foreclosures for vulnerable households, KEDIPES (the public asset management company) will acquire eligible primary residences with market value up to EUR 250,000 that have been used as collateral in NPLs and will rent these back to the owners with a buy-back option after five years. The primary residences will be acquired at 65% of the market value, with the remaining debt being written-off.
- The foreclosure legal framework was amended in an effort to protect vulnerable borrowers (primary residences with a market value up to EUR 350,000) without compromising the efficiency of the process as any arising disputes will be given priority by the Supreme Court, however this remains to be tested. Additionally, out-of-court resolutions are being encouraged by expanding the scope of the Financial Ombudsman for primary residences with a value up to EUR 350,000 and business premises with a value up to EUR 750,000. It is expected that the suspensions of the foreclosure process will come to an end with the amendment of the foreclosure framework (foreclosure freezes were implemented following the pandemic outbreak, as well as subsequent ones for primary residences with a market value up to EUR 350,000 until the framework could be agreed upon).

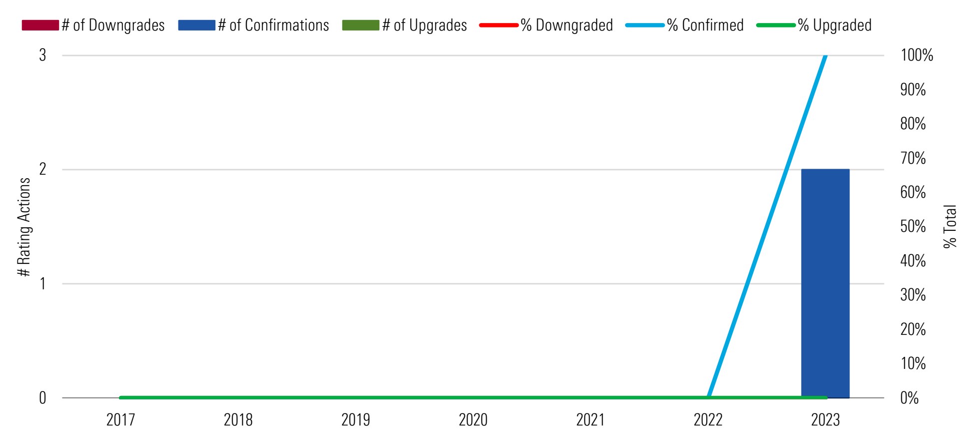
Morningstar DBRS has publicly rated three NPL securitisations in Cyprus relating to circa EUR 4.0 billion of total exposure of loans originated by Bank of Cyprus and Hellenic Bank. Excluding Capella Financing S.à r.l., for which less than a year from closing has passed, the remaining two transactions (Hestia Financing S.à r.l and Titan Financing S.à r.l.) had their ratings confirmed during 2023. Both transactions present good collateralisation and more than half of available funds have been making their way to senior note principal repayment, which is expected to increase under a cash sweep event (triggered for Hestia).

Pool Notes		Structural Notes	
Positive	**Negative**	**Positive**	**Negative**
• **Real estate type**: Most of the underlying real estate collateral of Cypriot transactions is residential. Residential prices are on an upward trend, with an annual increase of 7.4% as of Q2 2023, the highest change seen in apartments (10.1%). The number of sales contracts recorded the highest number over the past 15 years, with an annual increase of 26.5% as of Q2 2023. While local buyers still represent the largest market share, foreign buyers attained the	• **Vulnerability to external shocks**: The small size of Cyprus's service-driven economy increases vulnerability to external shocks. • **NPL stock**: Cyprus decreased its NPL ratio to 8.3% in September 2023 from 43.7% in December 2017. But this ratio remains above the average NPL ratio for	• **Interest rate**: Outstanding transactions are protected from rising interest rates by either being hedged or fixed rate (two out of the three transactions have fixed rates) • **Reserves**: All transactions benefit from liquidity reserves to cover senior interest	• **Potential cash leakage to subordinated notes**: For two transactions, if no cash sweep event occurs, then some part of the available funds are used to repay the junior notes. This structure provides relatively less protection to senior noteholders than in other European NPL securitisations. • **Nonstandard legal structure**: The structures are based on a secured

1. A noteworthy part of the NPL reduction relates to the surrender of Cyprus Cooperative Bank Ltd.'s banking licence in August 2018 and the conversion of the residual entity (after the sale of certain assets and liabilities) to an asset management company renamed SEPIDES.

	biggest annual increase in sales contracts. • **Geographical area**: Most of the collateral is located in Nicosia and Limassol. These two areas are the most stable real estate markets in Cyprus. • **Amicable workout**: Servicers have flexibility to anticipate collections via amicable resolutions. • **Robust economic growth**: While moderating (2.1% Real GDP growth on a year-over-year (YOY) basis in Q2 2023), economic growth is likely to remain among the strongest in the euro area. According to DBRS Morningstar's recently published Baseline Macroeconomic Scenario, GDP growth of 2.2% and 2.4% is expected for 2023 and 2024 respectively. • **NGEU funds**: Cyprus is expected to receive a substantial amount of funds from the NGEU financial instrument (EUR 1 billion in grants and EUR 200 million in loans) during 2021–26, out of which about 20% has been received to date. These amounts are in addition to the Multiannual Financial Framework funds of EUR 1.5 billion during 2021–27.	Euro Area economies (2.5% in March 2023). • **Interest rates**: ECB's monetary tightening might also raise asset quality risks, as a large share of domestic loans have floating interest rates. • **Foreclosure delays**: A series of foreclosure suspensions have taken place in Cyprus, delaying the working out of NPLs. At the same time, frequent amendments of the foreclosure framework could be counter-productive for the resolution of NPLs. • **Portfolio type**: Portfolios are mostly a combination of secured and real estate owned (REO) with a minority of unsecured loans. There is no relevant portion of RPLs.	(ranging from 3.0% to 5.75% of the senior notes' outstanding balances). • **Real estate owned company (ReoCo):** All transactions have local ReoCo structures that protect prices in legal auctions against opportunistic offers.	loan rather than on a true sale and includes other nonstandard features that could lead to legal risks. Unlike transactions in other jurisdictions, in Cyprus, the CyCAC owns the assets part of the portfolio and has employees. The CyCAC is not a bankruptcy remote entity. • **Interest rate risk**: The hedged transaction is currently adequately hedged but is at risk of becoming underhedged. However, a coupon cap will apply in the second half of 2026. • **Inflation**: Some of the structural costs related to services may increase in light of inflation.

Exhibit 4 Morningstar DBRS Cypriot NPL Rating Activity



Source: Morningstar DBRS.

Ireland

2024 Collateral Performance Outlook
Stable

2024 Credit Rating Outlook
Stable

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Morningstar DBRS' most recent sovereign report (DBRS Morningstar Confirms Republic of Ireland at AA (low), Stable Trend) outlines that Ireland's strong public finances and domestic economy resilience offset risks arising from the effects of high inflation, tighter monetary policy, and external weakness, and that Ireland's economy is well positioned to face the headwinds given its strong labour market and continued fiscal support.

The real estate sector remains vulnerable to the rapid increase in interest rates, in particular the commercial real estate sector (CRE), but as long as nearly 100% of the loans are secured by residential assets in the portfolios that Morningstar DBRS rates, lower CRE prices do not have an impact on the portfolios credit outlook. On the residential side, however, growth of the residential property price index moderated to 0.9% in August 2023 from a 15.0% peak in March 2022, but this downward pressure on prices may be offset by a prolonged period of undersupply (see commentary "Ireland: High Building Costs Latest Threat to Housing Supply"). While lower residential prices could deteriorate the underlying value of the portfolios and are mainly a result of higher interest rates, a material percentage of the portfolio recoveries come from performing segments, which are mostly linked to variable rates, so those high interest rates also translate to higher periodic recoveries as long as the loans remain performing.

Out of the nine Irish NPL securitisations that Morningstar DBRS has rated, five are still outstanding, as shown in the commentary Irish and UK NPL Securitisations Performance — 2023 Update and all the rating discontinuations reflected the full redemption of the notes. Currently, four of them have their senior notes rated in the AA credit rating category (the remaining one is in the "A" category), mainly due to significant deleveraging resulting from portfolio sales, a mechanism that is commonly used in the Irish NPL securitisations and regulated in the legal documents. Although not all the rated portfolios have used this mechanism yet, the positive trend seen in the previous years in terms of upgrades/confirmations/downgrades seems difficult to maintain, more likely transitioning into a more stable path (more confirmations) in the upcoming years.

Pool Notes

Positive

- **Interest rates**: High interest rates translates into higher recoveries from the performing segments, which are material segments (RPLs are usually in the range of 15% to 25% in the portfolios Morningstar DBRS rates), as most of the loans are linked to variable rates. However, higher interest rates increase the re-default risk of these loans.
- **Portfolio composition**: Portfolios are almost fully secured by residential assets, avoiding the potentially higher price drop expected for CRE. While residential prices are also subject to downward pressures, this is partially offset by the housing undersupply that affects the country. Overall, the expectation for Irish

Negative

- **Pressure on real estate prices**: Prices for all type of asset typologies are under downward pressure due to the high interest rate environment, affecting the underlying asset valuations in the rated portfolios and potentially reducing the expected recoveries in the strategies where the collections come from the sale of the assets.
- **Borrowing costs and inflation**: While inflation has dropped in the recent months, it remains higher than the long-term average and adding it to the still high borrowing costs results in household economies under significant pressure.
- **No updated business plans**: Unlike other jurisdictions, in Ireland there is not usually a provision in the legal

Structural Notes

Positive

- **Sequential amortisation**: There is no leakage of funds towards principal payments of junior notes (except for portfolio sales). Credit enhancement of senior and mezzanine notes is expected to increase over time.
- **Portfolio sales**: It is market standard to have a mechanism that allows for partial or full sales of the portfolio to third parties. The sale mechanism is regulated in the legal documents via minimum price (usually 85% of the current balance of the loans) and the allocation of sale proceeds is different from the transaction waterfall. Normally the minimum price is allocated to the senior notes, while any excess is used towards the repayment of the mezzanine or junior notes.
- **Reserves**: Rated transactions have liquidity reserves to

Negative

- **Servicer remuneration not linked to performance**: The servicer fees are mostly independent from the performance of the portfolio and the fixed component is higher compared with other European jurisdictions.
- **Mezzanine interest**: In the most recent transaction, mezzanine interest is paid ahead of senior class principal if the performance trigger (the ratio between actual recoveries and expected recoveries) is not breached (the threshold for this transaction is 90% and the trigger is breached as of the date of this report, so no mezzanine interests are being paid before senior class

residential real estate prices is stable to positive.

- **Workout strategy**: The recovery process in Ireland is regulated under the framework provided by the Irish Central bank with the objective of helping debtors meet their mortgage obligations (Code of Conduct on Mortgage Arrears or CCMA), so most of the Servicer's focus is to transform the nonperforming loans into performing, while there are available alternative resolution strategies as DPOs, loan sales, and judicial procedures, among others.
- The Irish unemployment rate remains low, leaving behind the increase due to the pandemic (peak of 7.6%). The recently published Morningstar DBRS Baseline Macroeconomic Scenarios forecast unemployment at 4.3% for YE2023 and 4.5% for YE2024

documents for the servicers to deliver periodic updates to the initial business plans, which could cause initial business plans to become obsolete in terms of asset valuations, strategies and updated expected recoveries.

- **Portfolio performance**: Leaving aside the partial portfolio sales mechanism, which gives liquidity and anticipates collections, we observe slower timing of recoveries than the ones reflected in the initial business plans (e.g., in loans that were restructured where their original strategies were repossessions and sale of the assets).

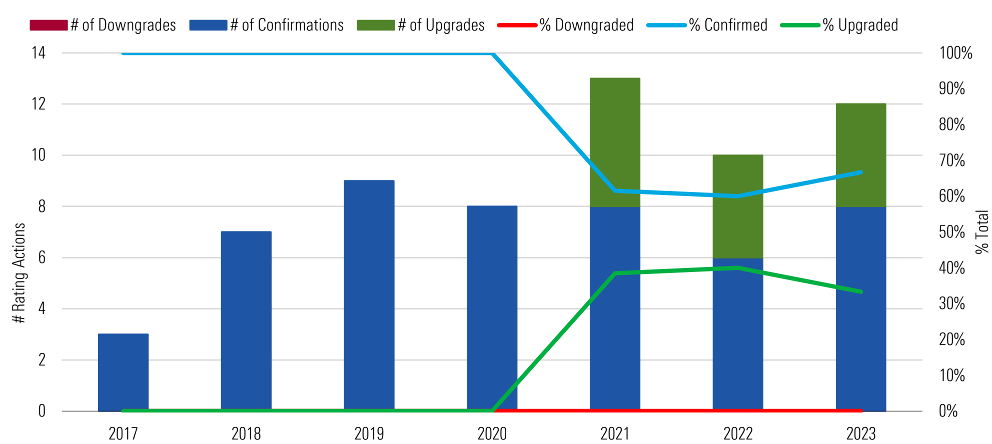
cover senior interest (normally in the range of 4% to 6%) and there are also smaller expenses reserves to cover for the recovery costs. Mezzanine and junior notes of all but one Irish transaction rated by Morningstar DBRS have dedicated nonamortising interest reserves replenished from the interest rate cap payments, if available. As such, there is often no cash flow leakage to mezzanine interest prior to Class A principal for these transactions.

- **Hedging**: Interest rate risk is mitigated with an interest rate cap agreement. The notional is sized equal to the rated notes balance at issuance and has a predetermined amortisation schedule. Transactions are currently fully hedged and most of the cap agreements are in the money.

principal at the moment).

- **Inflation**: Some of the structural costs or fees related to services provided to the special-purpose vehicle (SPV) may increase in light of inflation.

Exhibit 5 Morningstar DBRS Irish NPL Rating Activity



Source: Morningstar DBRS.

Italy

2024 Collateral Performance Outlook
Negative

2024 Credit Rating Outlook
Stable

In 2023, the Italian NPL market was not particularly active and new issuances were very limited, with three[2] new ratings assigned by Morningstar DBRS. Since the expiration of the Garanzia per la Cartolarizzazione delle Sofferenze (GACS) scheme, Italian banks seemed hesitant in the establishment of publicly rated new securitization transactions, with few exceptions. Such hesitation is probably due to their expectation of a possible renewal of the GACS scheme, which has been uncertain for a while. Additionally, the high inflation and interest rates and the economic consequences of the geopolitical issues played a crucial role in such uncertainty. Furthermore, the level of nonperforming loans in the Italian banking system has continued to decrease up to the second quarter of 2023, although most of them have not been eliminated yet from the Italian economic system.

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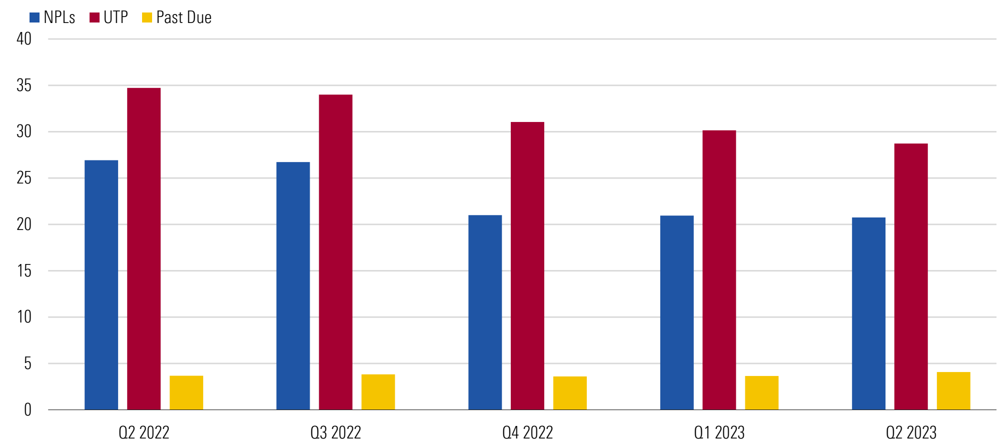
Exhibit 6 Volumes of non-performing exposures in the Italian banking system (EUR bn)



Source: Bank of Italy, Morningstar DBRS.

Although it is unlikely that the Italian Government will renew the GACS scheme in 2024, Italian banks will probably continue their activity of de-risking through securitisation transactions even without the support of the state. In particular, in the next few years Italian banks could be required to manage the stock of loans originated during the coronavirus pandemic. The Italian economy has demonstrated a high degree of resilience despite the energy price shock; however, a challenge for debtors could be the continuing of the interest rate increase occurred in 2023. Indeed, the delta between the cost of credit as at the origination date compared to the relevant cost as at today could worsen the capacity of debtors to repay their loans.

Moreover, Q3 2023 was characterised by a political discussion on a draft bill presented by certain members of the Italian Parliament belonging to the majority supporting the Government. Such draft bill was aimed at accelerating the recoveries of securitised NPLs by allowing the debtors to repay their defaulted loans for an amount equal to the purchase price paid by the SPV plus to 20% of such price. However, the Italian Prime Minister declared that such measure was not a priority for the Government, hence this draft bill should not affect the performance of Italian outstanding transactions in 2024. For more information on this bill, please see our commentary titled Proposed Legislation No Boon to Italian NPLs Securitisation Market.

In terms of performance, Italian transactions displayed a more stable rating performance that in previous years. Of 48 rated tranches of notes (35 senior tranches and 13 mezzanine or junior tranches), 26 were confirmed, nine were upgraded, and 13 were downgraded (refer to our commentary Italian Nonperforming Loan Securitisations Performance—2023 Update), still resulting in a negative rating drift (more downgrades than upgrades).

[2] A transaction rated in the Republic of San Marino has been included in this count due to the strictly correlation with the Republic of Italy.

Pool Notes

Positive

- **Stability of the Residential Real Estate Market (RREM) prices:** the Italian RREM is stable and the Italian house price index[3] increased to 71.7 from 76.4 in one-year period (from 30 June 2022 to 30 June 2023).
- **Performance after pandemic**: For the transactions issued after the end of the pandemic, from H2 2021 onwards, current performance is strong and we can observe a clearly positive evolution in terms of gross cumulative collection ratio (GCCR). The average GCCR was 205.8%, which represents an increase of 29.9 percentage points compared with the average of 175.9% one year ago.
- **Strong NPLs management for Italian banks**: Over the past years, Italian banks have developed robust proceedings for the management of their NPLs stocks also due to the calendar provisioning.
- **Profitability:** Over 35 rated transactions, the average NPV ratio was 117.1 % as of the relevant last IPD. For transactions issued between H2 2019 and H1 2021, the average NPV ratio was 120.9% as of the last IPD. For the transactions issued from H2 2021 onwards,

Negative

- **Negative development of the Commercial Real Estate (CRE) market:** In 2022, the space of newly rented commercial premises is approximately 10.3 million square metres, down 3.7[4] per cent compared with 2021. Considering the current macro-economic scenario, it is possible that the CRE market will follow the same trend also for 2024.
- **Lower gross cumulative collection ratio (GCCR)**: GCCR has, on average, decreased by 3.6% compared with the previous year. As of June 2023, the average GCCR stood at 66.4%, compared with the 70.0% recorded as of June 2022.
- **Business Plan Downward Revisions.** Servicers continue to revise their expectations downwards, in some cases materially. The average business plan reduction for transactions issued up to H2 2019 (pre-pandemic) is 12.8% and 2.9% for the remaining transactions (3.3% and 2.3% for securitsations issued during and after the pandemic, respectively)
- **Political influences**: discussions by the Italian government on a possible draft bill affecting the Italian NPLs market could have an impact on the

Structural Notes

Positive

- **Sequential amortisation**: Junior classes start to amortise after the full payment of the senior notes, leading to increased credit enhancement for the senior notes over time.
- **ReoCos**: In the last three years, more transactions have been amended to include ReoCo structures. Furthermore, latest rated transactions include provisions for a smooth activation of a ReoCo structure by agreeing at issuance the relevant ReoCo transaction documents.
- **Hedging structure**: As of the last IPD, for all 33 transactions rated by Morningstar DBRS with an interest rate cap agreement, the derivative was in the money and generating positive proceeds as part of the issuer available funds.
- **Subordination trigger**: Subordination triggers protects senior noteholders and allows a faster amortisation of the senior notes and, as of the latest relevant IPD, 12 of the 35 transactions rated up to the end of 2022 breached their respective CCR subordination trigger.

Negative

- **Moderate amortisation**: the underperformance of most transactions rated before the coronavirus pandemic outbreak resulted in a moderate amortisation of the senior notes, which, in turn, prompted increased structural costs, a lower conversion rate of collections into principal repayment, and increased exposure to interest rates fluctuations, because of underhedging.
- **Increasing GACS fees** Morningstar DBRS notes that in Italian transactions that it rates, the GACS fee increases over time, making the effect of delays in recoveries even more pronounced.
- **Underhedged transactions:** A few rated transactions, were underhedged as of the last IPD because the senior notes amortised slower than the cap notional schedule, resulting in exposure to current higher interest rates.
- **Loan Note Sale**: as an alternative avenue for recovery, an average of 7.5% of the total gross collections as of Q2 2023 arises from the sale of receivables. However, it should be noted that from one side, this alternative avenue can accelerate the recovery timing,

[3] Source: Bank for International Settlements (Index 2010=100)

[4] Source: Rapporto Immobiliare 2023 published by the Italian Tax Authority

the average NPV ratio was 134.5%. Out of the 35 transactions rated by Morningstar DBRS, only 3 transactions breached their respective NPV subordination triggers. Therefore, the profitability is overall robust.

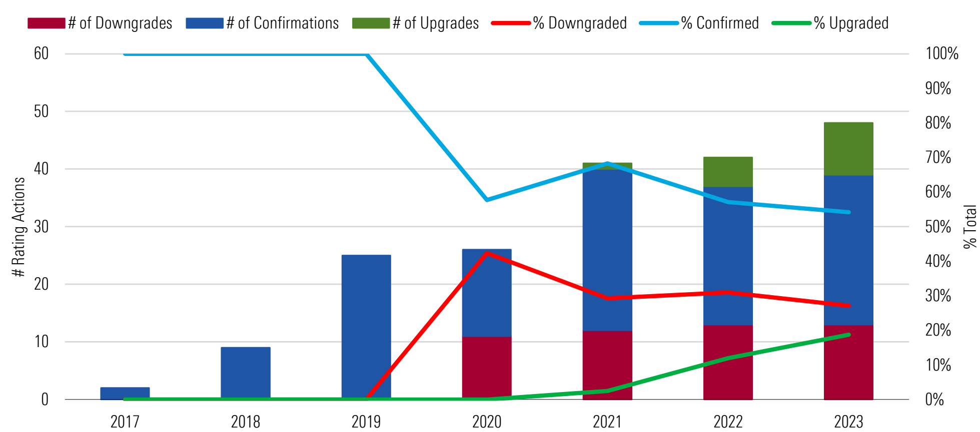
recoveries of the outstanding Italian NPLs transactions.

- **Implementation of Directive on servicers and NPLs purchaser**: The internal provision for the implementation of Directive EU 2021/2167 should be included in the Italian Delegation European Law; however, it is not clear how this implementation could affect the regulation applicable to servicers.

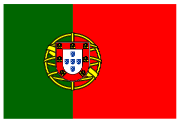
while from another side collected amounts can be lower than the outstanding amount of the sold receivable, even if present value profitability improves, depending on discount rate and previously expected time to recovery.

- **Inflation**: Some of the structural costs related to services may increase in light of inflation.

Exhibit 7 Morningstar DBRS Italian NPL Rating Activity



Source: Morningstar DBRS.



Portugal

2024 Collateral Performance Outlook
Stable

2024 Credit Rating Outlook
Stable

On 21 July 2023, Morningstar DBRS upgraded the Republic of Portugal's Long-Term Foreign and Local Currency – Issuer Ratings to "A" from A (low) (DBRS Morningstar Upgrades Portugal to "A", Stable Trend), driven by material improvements in fiscal and debt outcomes.

Similarly, Portuguese NPL securitisations rated by Morningstar DBRS have displayed a strong performance with all the rated notes (relating to four transactions) being fully repaid.

Potential risks include, mostly for future transactions:
- The slowdown of residential property prices following the interest rate hikes. Property prices still increased by 8.7% in the second quarter of 2023 compared with a year before, versus 13.2% in the second quarter of 2022.
- A prolonged period of high inflation and mortgage rates could apply stresses to the system, especially given the vast majority of variable-rate mortgage lending in the economy. Vulnerabilities are becoming visible, with new measures introduced in September 2023 to support households that face increased financial pressure (Portugal - New Measures for Mortgages Signal Higher Pressure on Households).
- As highlighted in our foreclosures and bankruptcies commentary, longer legal timings and an accumulation of foreclosure and bankruptcy cases could potentially affect performance and place additional importance to the servicer's capacity in achieving out-of-court solutions.

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Pool Notes

Positive
- **Real Estate type**: Most of the underlying real estate collateral is residential. During the second quarter of 2023, house prices increased 8.7% YOY[5].
- **Amicable workout**: Servicers have flexibility to anticipate collections via amicable resolutions.
- **Unemployment**: Unemployment is expected to stabilise at 6.5% for YE2024 from 6.6% for YE2023, (see Morningstar DBRS' latest release of its Baseline Macroeconomic Scenarios).

Negative
- **Real estate and interest rates**: The vast majority of mortgages in Portugal are at variable rates, so a rapid rise in interest rates could put further stress on borrowers. In addition, higher interest rates could put pressure on real estate values.
- **Debtor type**: Most of the portfolio's outstanding balance are corporate loans. However, in terms of the number of borrowers, the majority of loans are held by individuals.
- **Portfolio type**: Portfolios are mostly 50/50 split by secured and unsecured nonperforming loans. There is no relevant proportion of RPLs. Unsecured loans are more exposed to changes in GDP and unemployment while secured loan recoveries are exposed to the effects of rising

Structural Notes

Positive
- **Sequential amortisation**: There is no leakage of funds towards principal payments of junior notes. Credit enhancement of senior and mezzanine notes is expected to increase over time.
- **Servicer alignment of interest**: In case of transaction underperformance (measured against the initial business plan recovery expectations), some of the servicer fees are deferred and paid junior to the senior notes.
- **Reserves**: Rated transactions have liquidity reserves to cover senior interest (normally at 3%) and there are also smaller expense reserves for the recovery costs.
- **Hedging**: Interest rate risk is mitigated with an interest rate cap. agreement. The notional is sized equal to the rated

Negative
- **Mezzanine interest** is paid ahead of senior class principal if the performance triggers (threshold at 90%) are not breached. Usual mezzanine coupons are floating based on Euribor plus a 6% margin, so despite the small mezzanine balance (15% to 30% of the senior note balance), the leakage can result in a sizeable payment on each payment date.
- **Inflation**: Some of the structural costs related to services may increase in light of inflation.

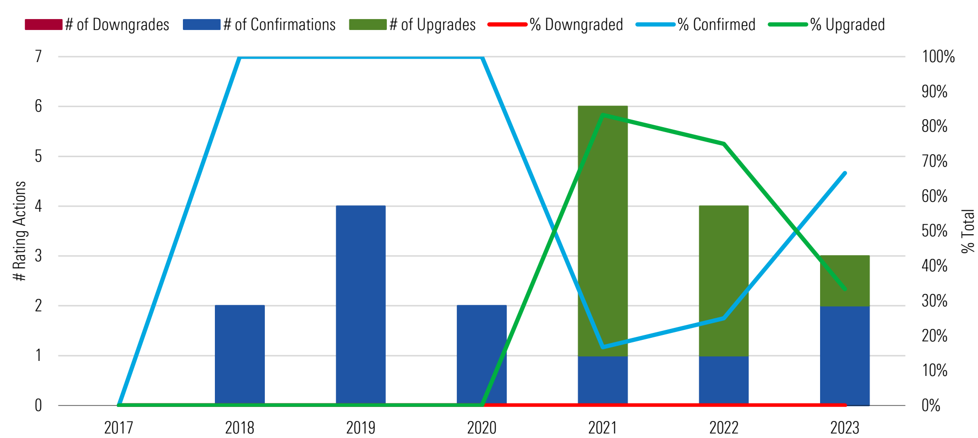
[5] Source: Bank for International Settlements

interest rates on property prices.

notes balance at issuance and has a pre-determined amortisation schedule. The past good performance of Portuguese transactions reduces the risk of under-hedging.

- **ReoCo**: Most servicers have local ReoCo structures that protect prices in legal auctions against opportunistic offers.

Exhibit 8 Morningstar DBRS Portuguese NPL Rating Activity



Source: Morningstar DBRS.

Spain

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2024 Collateral Performance Outlook
Negative

2024 Credit Rating Outlook
Stable

During the last 12 months, Spanish NPL securitisations have been under pressure and their performance has been either flat or deteriorating. We expect these headwinds to continue throughout 2024.

Amicable workout resolutions will be under pressure due to the reduced purchasing power of households, especially those most vulnerable. Workout strategies that consist ultimately of selling the underlying real estate (i.e., sale-at-auction, deed-in-lieu, power of attorney, and REO strategies) will continue to experience delays compared to initial expectations due to the generalised real estate market slowdown, caused by increased funding costs and unaffected (high) prices due to a limited supply in the offer side: hence the performance of a number of transactions is sharply declining in the free market, and it is also affecting the REO market. In this respect, we do not foresee these fundamentals to change during 2024, so the servicers will need to explain (via updated business plans) how they plan to address the trade-off between recovery levels and timely execution.

In terms of average duration of foreclosures, as detailed in our commentary Spain Foreclosures and Bankruptcies: Is the System Ready for an Uptick?, legal timings are close to historical highs with very low number of newly declared foreclosures, so it seems that the judicial system is still tensioned and could deteriorate quickly if foreclosures start to pick up. A potential increase in foreclosures during 2024 is a realistic possibility due to majority of floating rate mortgages in the Spanish mortgage stock.

Current Morningstar DBRS ratings of Spanish NPL securitisations proved to be resilient. During 2023, we saw confirmations and upgrades despite the relevant underperformance of some of our rated transactions (refer to our commentary Spanish, Portuguese, and Cypriot NPL Securitisations Performance – 2023 Update). We conduct surveillance reviews on ratings that leverage the updated future expectations of the servicers, so in 2024, it is possible to see some punctual negative rating actions on specific tranches, but we do not foresee any generalised rating adjustment.

Pool Notes

Positive

- **Real estate type**: Majority of the underlying real estate collateral is residential, which is more resilient compared to other more cyclical types such as commercial real estate.
- **Residential prices withstand the increasing funding costs**: the quarterly house price index reached its ten-year highs around Q4 2022 and so far throughout 2023 has maintained at those levels. While growth is slowing down, prices are expected to hold up well in 2024.
- **Portfolio type**: Portfolios are mostly a combination of secured and REO with a minority of unsecured loans.
- **Legal status**: Most of the loans are already undergoing a judicial procedure so volatility

Negative

- **Sharp decline in new residential mortgages:** According to INE, as of September 2023, the cumulative number of new mortgages has dropped by 17.8% compared with the same period in 2022.
-
- **Debtor type**: While in terms of the number of borrowers, the majority of loans are held by individuals, most of the portfolio outstanding balance comprises corporate loans, more exposed to shocks in the business cycle
- **Default vintage and LTV**: Securitised NPLs mostly comprise aged debt defaulted as a consequence of the global financial crisis, so loan-to-values (LTV) are high (200%+ on average).

Structural Notes

Positive

- **Mezzanine interest subordination**: In all transactions, mezzanine interest is fully subordinated to the repayment of senior note principal. This is due to performance related triggers being already breached or subordination 'by design'.
- **Sequential amortisation**: There is no leakage of funds towards principal payments of junior notes. Credit enhancement of senior and mezzanine notes is expected to increase over time.
- **Servicer alignment of interest**: In case of transaction underperformance (measured against the initial business plan recovery expectations), some of the servicer fees are deferred and paid junior to the senior note principal.
- **Reserves**: Rated transactions have liquidity

Negative

- **Underhedging**: Slower-than-anticipated note amortisation caused by transaction underperformance could lead to underhedging in cap agreements with fixed notional schedules. In the current rising interest rate environment this would put extra stress on the transactions.
- **Inflation**: Some of the structural costs related to services may increase in light of inflation.

around recovery timings is more limited.

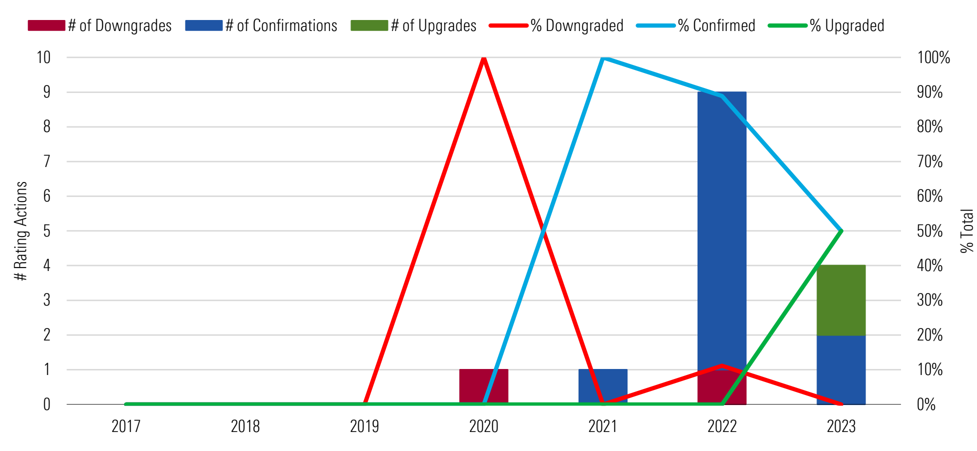
- **Amicable workout**: Servicers have flexibility to anticipate collections via amicable resolutions.
- **NGEU funds**: Positive effects on potential growth and economic resiliency from the NGEU programme.
- **Positive GDP growth and lower unemployment**: Unemployment is expected to further decrease to 11.8% in 2024 from 12.1% in 2023 (decade's lowest but still the highest among our rated European sovereigns). In terms of GDP growth, it is expected to moderate in 2024 to 1.3% compared with a positive 2.4% in 2023, which was not expected a year ago (see Morningstar DBRS' latest release of its Baseline Macroeconomic Scenarios).
- **Tensioned judicial system**: Foreclosure durations are at its maximum in most regions while the number of declared foreclosures is quite low.
- **Bankruptcies (Individuals)**: While company bankruptcies remain fairly stable, individuals declared bankrupt (including self-employed) are experiencing a surge.

reserves to cover senior interest (ranging from 4.5% to 5.0%) and there are also smaller expense reserves to cover for the SPV and the ReoCo's recovery expenses.

- **Hedging**: Interest rate risk is mitigated with an interest rate cap agreement. The notional was sized equal to the rated note balance at issuance and has a pre-determined amortisation schedule. As of the latest IPD, all rated transactions are overhedged, and cap agreements are in the money, providing extra funding to the structure.

ReoCo: All transactions have local ReoCo structures that protect prices in legal auctions against opportunistic offers.

Exhibit 9 Morningstar DBRS Spanish NPL Rating Activity



Source: Morningstar DBRS.

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2024 Collateral Performance Outlook
Stable

2024 Credit Rating Outlook
Stable

Tight financial conditions and persistent inflation have hindered the growth of the UK economy in 2023. The IMF is forecasting the GDP to grow by 0.5% in 2023, in contrast to the 4.1% attained in 2022. Regarding unemployment, the IMF projects a 2023 rate of 4.2%, representing a 0.5% increase from the 3.7% recorded in 2022. Nevertheless, the inflation has now started to fall more rapidly and the Bank of England's policy rate has remained constant since August, indicating the end of the monetary tightening cycle. For further details on Morningstar DBRS's macroeconomic outlook, please see our commentary 2024 Sovereign Outlook: Higher Rates and Slowing Economies, but Stable Credit Ratings.

The H1 2023 results from the UK's four largest banks indicate strong performance, primarily due to a rise in net interest income (NII). However, the NII growth has slowed down compared to last year's second half. This is due to the banks' increased funding costs, as indicated in Morningstar DBRS's commentary UK Banks Report Solid H1 2023 Results; Signs of Asset Quality Deterioration and NII Growth Slow Down. We expect this trend to continue in the upcoming year driven by the customers demand for higher yields on deposits and regulatory pressure on banks to pass on the higher interest rates to their depositors. The weak macroeconomic environment has started to put pressure on households to service their debts, with NPL levels at the UK's four major banks rising since the beginning of 2023 and expected to rise further as a result of price inflation and continued high interest rates.

In April 2022, Morningstar DBRS publicly rated the senior notes of Wolf Receivables Financing Plc (Wolf I), a securitisation collateralised by a pool of UK reperforming unsecured receivables. The receivables contain a wide range of product types (catalogue credit, credit cards, personal unsecured loans, and telecommunications service agreements) acquired over time. After 19 monthly interest payment dates, the senior notes have already amortised by 82%. Despite the difficult economic climate, the transaction is performing above the business plan expectations. In April 2023, the transaction's rating was upgraded due to its previously mentioned excellent performance. Therefore, despite the economic climate, our credit outlook for rated NPL transactions in the UK is stable. On December 2023, the same originator issued notes for a second portfolio, Wolf Receivables Financing III Plc, with very similar characteristics. We do not rate UK NPL securitisation backed by secured loans, hence the UK NPL securitisation market is not affected by potential weakness in the UK residential housing market.

Pool Notes

Positive

- **Affordability**: Low monthly borrower payments in the collateral pool are sized with affordability in mind.
- **Diversity**: The pool comprises circa 357,000 borrower accounts ranging in size between GBP 50 and GBP 33,500.
- **Selection criteria**: The subject pool collateralising the securitisation is a better-performing subsection of the total receivables book.
  Low unemployment rates: Despite the declining economic climate, the unemployment rate is low at 4.2% and is only expected to increase slightly by YE2024,

Negative

- **Economic slowdown:** After rebounding 7.5% in 2021, UK real GDP growth slowed down to 4.1% in 2022 and to 0.5% byYE2023. By YE2024, GDP growth is expected to fall slightly to 0.4% (see Morningstar DBRS' latest release of its Baseline Macroeconomic Scenarios).
- **Energy prices, inflation, interest rates, and increased taxes**: Increased pressure on consumers and businesses from energy price increases, high inflation, rapid increase in interest rates, and extra taxes from the new revised budget.
- **Increased mortgage rates and mortgages**

Structural Notes

Positive

- **Sequential amortisation**: There is no leakage of funds towards principal payments of junior notes. Credit enhancement of senior notes is expected to increase over time.
- **Liquidity reserve**: Transactions benefit from liquidity reserves available to cover senior fees and expenses as well as interest due on the senior notes.
- **Junior cure rights**: The junior noteholders may increase their junior notes at a minimum of 5% of the outstanding balance each time to cure any note default. Junior cure rights are limited to two occasions unless senior noteholders provide a written consent.
- **Hedging**: Interest rate risk is mitigated with an interest

Negative

- **Junior base note interest** is paid ahead of senior class principal if the performance triggers (threshold at 90%) are not breached.
- **The servicer is part of the seller group**: Performance-related fee subordination rules mitigate this risk.

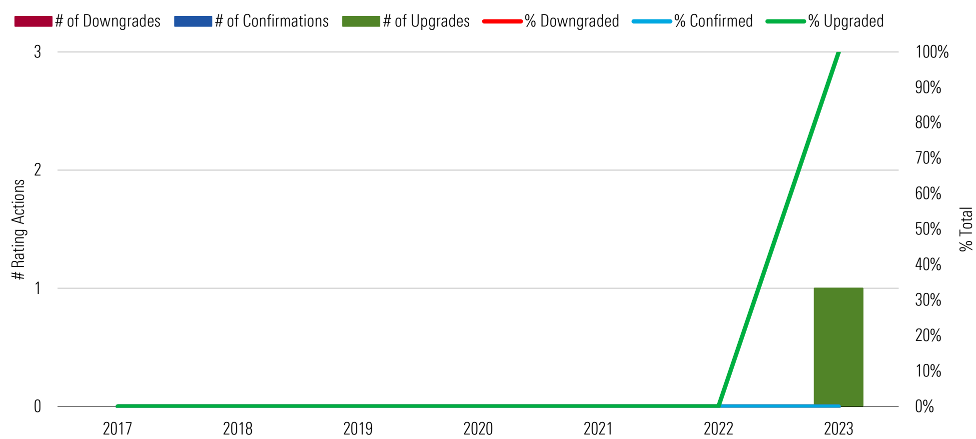
reaching a level of 4.6%. (see Morningstar DBRS' latest release of its Baseline Macroeconomic Scenarios).

reverting to floating after a limited fixed-rate term: The BBA mortgage rate, which was 3.67% at the start of 2022, increased to 6.41% at the end of the year and peaked in October at 8.05% and has since then slightly decreased to 8.03%. This increase will put further burden on the consumers and can affect borrowers under unsecured loans that also have a mortgage.

rate cap agreement. The notional is sized equal to the rated note balance at issuance and has a predetermined amortisation schedule. Wolf I is currently overhedged and its cap agreement is in the money, providing additional liquidity to the structure.

- **Low transaction costs**: Majority of the receivables pay on direct debit. Any future recovery costs are covered by the seller outside of the securitisation structure.

Exhibit 10 Morningstar DBRS UK NPL Rating Activity



Source: Morningstar DBRS.

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