DYNAMIC CREDIT

1 August 2020

Alternative Lending Market Update

US Consumer MoM Origination Up 20%, Still down 50% from 2019 Levels, Modified Loans Showing Reperformance

Overall, prime and super-prime consumer loans continue to outperform both expectations and other consumer asset classes. The number of COVID-19 cases has now reached the grim milestone of 20 million, with some resurgence in parts of Europe alongside continued spread in the Americas and parts of Asia. While this was expected to occur due to easing of lockdown measures combined with the summer holiday period, the effect across countries has been varied. Parts of Eastern Europe have experienced drastic increases in case numbers, contrasting with countries in Western Europe where the resurgence remains far below March and April levels. The trend is similar in the US where cases in the Northeast, which was hit the hardest, have stabilized while the rest of the country continues to deal with the first wave of infections. This has lent credence to the idea that the infection rate needed to reach some form of herd immunity may be significantly lower than many estimates of 60-80%. Still, we expect soft restrictions on movement and activities to remain in place until there is a widely distributed vaccine. Despite announcements of a Russian vaccine and agreements with various pharmaceutical firms to supply vaccine doses, we remain cautious on timing with any widespread vaccination unlikely to occur before Q1 2021. As expected on the macroeconomic front, reports pointed to the euro zone economy contracting by 12.1% q-o-q in Q2 with the Spanish economy contracting by 18.5% compared to Germany, which was down 10.1% for the same period. This compares to a 20.4% decline in the UK and 9.5% in the US, highlighting a significant dispersion across Western economies in what is generally expected to be the bottom as we transition into a slow and uneven recovery in the second half of the year.

While progress on additional fiscal policy measures have stalled since the unprecedented CARES stimulus package was passed at the end of March (along with numerous state and local measures to alleviate financial stress on households), it remains likely that another, albeit smaller, stimulus package will be provided. At this point the size of any package remains to be determined, but will realistically end up between the $3.4 trillion level proposed by Democrats and the Republican counter-offer of $1 trillion. In the face of rising COVID-19 cases, unemployment rates have continued downward. Both U-3 (the official unemployment rate) and U-6 (which measures underemployment as well) have declined to 10.2% and 16.5% in July, respectively, from 11.1% and 18.0%, respectively, in June. Unemployment filings in the first week of August also show a slow continued improvement with continuing claims for unemployment insurance falling by over 600,000.

Although unemployment remains above the March U-3 and U-6 rates of 4.4% and 8.7%, respectively, US consumer loans as a whole have continued to post strong performance in relative terms, with loan impairment rates falling again by almost two points to 9.5% in July from 11.4% in June[1]. While this remains significantly elevated from 6% in March, this continues to compare very favorably to US mortgage performance where the delinquency rate fell slightly to 7.6% in June from 7.8% in July[2]. This strong performance is due to the combination of new loan forbearance requests falling below 5% of levels seen in March while 70% of modified loans have resumed some repayments.

The performance of Prosper loans has been in line with this trend, with 62% of modified loans having already resumed full repayments and another 28% having made a partial or scheduled payment. While we have yet to experience any delinquencies due to the age of the portfolio, the overall trend of performance adds to our confidence in the quality of underwriting in the face of significant economic turmoil.

Loan issuance has remained more than 50% lower than 2019 levels as underwriting criteria have gotten considerably tighter and borrowers have become more conservative in taking on new debt. Still, origination increased approximately 20% m-o-m as some investors increased their participation. Banks and credit unions remain the most significant buyers of consumer loans due to attractive net interest margins, while some real money buyers trickle back into the space as performance stabilizes and coupons increase alongside higher credit quality. Further recovery in origination volumes will likely depend on the continued strong performance of loans throughout the second half of 2020.

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[1]dv01 Insights COVID-19 Performance Report Volume 10
[2]Black Knight Mortgage Monitor, June 2020

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