TwentyFour
ASSET MANAGEMENT

UK Mortgages Limited

29 May 2020

UK Mortgages Limited is a LSE-quoted listed closed-ended fund managed by TwentyFour Asset Management LLP.

Commentary

Mortgage and Housing Market

Unsurprisingly data releases have been somewhat variable in their results due to the vacuum of information following the 3 month effective shutdown. However in general, with mortgage and housing markets beginning to reopen there is some evidence that most likely a combination of uncompleted transactions from prior to the Covid-19 outbreak and/or pent-up demand that has built up in the meantime has meant that housing markets have reopened with more optimism than might have been expected at the depths of the lockdown.

Zoopla reported that property sales in most of England have swiftly rebounded to the same levels they were just before the lockdown, albeit mortgage approvals plummeted through the period according to BoE figures, backed up by HMRC and Land Registry numbers, although both showed an increase in May compared to April. On the house price front, Rightmove even reported that house prices had increased by 1.9% from March to June, although other measures such as Nationwide's index showed a net 0.8% fall across April and May, but most surveys showed that some of worst fears of severe house price falls as a result of the shutdown had now dissipated with typical results paring back previous doomsayer predictions to a range centered around the -5% area. UK Finance reported updated figures for payment holidays with the number granted increasing by just 0.1m to 1.9m in the last month, confirming our own experience that new demand had slowed to a trickle. In fact, it was also reported that the majority, 1.2m, were approved during the first three weeks of the scheme.

RMBS Market

The RMBS market has continued its recovery, and the primary UK RMBS market reopened after almost 3 months. Spreads in the senior prime sector have essentially retraced back to pre-pandemic levels, albeit on low secondary turnover, and driven particularly by expectations of little or no publicly issued primary supply whilst the high street banks and building societies benefit from the ultra-low funding levels of the TFSME. This was evidenced by the fully retained Brass No. 9 deal from Yorkshire Building Society. Whilst portions of this type of deal are often retained for central bank liquidity purposes, previous deals have typically always contained a publicly placed tranche, including the most recent Brass No. 8 deal in September last year.

In the non-bank sector, spreads have also been recovering, although still remain wider than before the Covid-19 outbreak and also with a steeper credit curve. That said, they have recovered enough for new issues to be viable once again, and two new deals came in quick succession. The first was something of an orphan, albeit debut transaction given that it securitised a pool of BTL loans originated by the now closed Axis Bank, but nonetheless received a good reception and priced at a small yield premium to secondary markets reflecting the likely one-off nature. More importantly this was followed by a deal from bellwether issuer Kensington Mortgages with a typical pool containing a mixture of BTL and owner-occupied loans, but with 28% of the pool currently taking a payment holiday. To give themselves certainty of execution, they took the route of pre-sounding some larger investors and ultimately pre-placing all of the mezzanine notes and 75% of the senior notes. The small rump of senior notes attracted strong interest and was oversubscribed by more than 5x. Their pricing came in 10bps tighter than the Axis Bank deal at the senior end and 40bps tighter for the BBB-rated notes.

Fund Commentary

As previously, with the current moratorium in mortgage lending and servicing there has essentially been no change to the typical portfolio metrics such as arrears, and that will continue until at least October given the extension of the government's forbearance guidance, and so there is no real update on the individual portfolios to cover.

Regarding payment holidays, it's still too early to see firm data on those borrowers who began their holidays in late March and early April and are beginning to come to the end of their initial 3 month deferral period. However, early reports from lenders suggest that more than 50% of them are likely to start making payments again rather than take an extension to their holiday.

This most likely reflects those businesses which have been able to restart, bringing employees back from furlough, as well as a number of borrowers who may have taken the deferral option as a precaution now being more comfortable that they can resume payments.

We'll have more colour on this next month, but clearly with many business not yet re-open it's likely that a number of borrowers will extend their deferrals for as much as a further 3 months.

What is clear though is that there is no correlation between borrowers' exposure and payment holiday take-up. For example the spread of payment holidays granted falls right across the LTV spectrum, with no concentration at the higher end. This contrasts with the loss expectation examples we gave last month where to give a conservative estimation we concentrated our stresses on the higher LTV population of our pools.

Investment Outlook

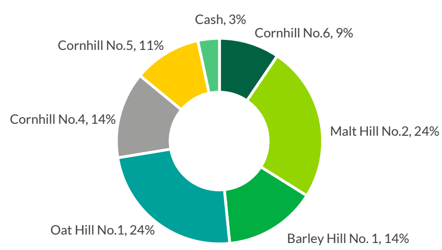
The reopening of primary RMBS markets is a really positive step in the market's recovery, as is the ongoing tightening of spreads. Having been unable to refinance the Oat Hill transaction as originally expected in May, due to the exceptional market conditions at the time, and the subsequent expensive term funding that would have been detrimental for the Fund to lock in had it been possible at all, it is now encouraging to see RMBS and financing market conditions continue to improve and whilst the existing transaction remains outstanding and secure, work is progressing on alternative financing options.

Portfolio Summary	Buy-to-Let				Owner Occupied	
	Purchased			Forward Flow Originated		
	Cornhill 6	Malt Hill 2	Oat Hill 1	Cornhill 4	Barley Hill 1	Cornhill 5
Originator	Coventry Building Society	Coventry Building Society	Capital Home Loans	Keystone Property Finance	The Mortgage Lender	The Mortgage Lender
Outstanding Balance	£171m	£339m	£486m	£237m*	£179m	£227m*
Number Accounts	957	1,944	3,816	1,084*	1,023	1,158*
Average Mortgage Size	£179k	£175k	£127k	£219k	£175k	£196k
WA Indexed LTV	61.91%	60.27%	64.79%	71.56%	65.43%	72.20%
WA Interest Rate	2.68%	2.71%	1.37%	3.42%	4.18%	3.88%
WA Remaining Term (mth)	189	217	117	267	282	312
WA Seasoning (mth)	58	40	160	7	22	6
3mth + Arrears (% balance)	0.00%	0.03%	0.77%	0.00%	1.42%	0.19%

* from February 2020, pipeline has been excluded and figure refers to completed loans only

as at 29/05/2020

Investment breakdown



as at 29/05/2020

Fund Facts

Type of Fund:	Closed-ended Investment Scheme
Listing & Trading:	LSE Specialist Fund Market
ISA & SIPP Eligible:	Yes
Launch Date:	7th July 2015
Currency:	£ denominated
NAV Calculation:	As of the last business day of each month
Dealing:	Daily during LSE opening hours
Dividend:	Quarterly from April 2016
Market Capitalisation:*	£136mn
Shares in Issue:	273mn
Price per Share:*	49.75p
NAV per Share:*	79.43p
NAV per Share (inc Dividend):*	102.68p
Premium / (Discount) to NAV:*	-37.37%

Source: TwentyFour Asset Management. * as at 30/04/2020

Glossary

ABS: Asset Backed Securities
RMBS: Residential Mortgage Backed Securities
BoE: Bank of England
TFSME: Term Funding Scheme with special provision for SMEs
ECL: Estimated Credit Loss
LTV: Loan to Value
TML: The Mortgage Lender

Trading Information

TIDM	UKML
ISIN	GG00BXDZMK63
SEDOL	BXDZMK6
AMC (%)	0.60

Investment Objective

The Company aims to provide Shareholders with stable income returns through low leveraged exposure to portfolios of loans secured against UK residential property.

Investment Policy

The Company's investment policy is to invest in a diversified portfolio of UK residential mortgages.

- The Company will purchase legacy portfolios with strong observable performance histories or new portfolios with robust underwriting standards
- Primary origination mechanism may also be put in place
- Leverage will be used, initially via a banking facility, before fully securitized term structure put in place

This is only a summary; details of the Company's investment policy, including investment restrictions, are set out in the Prospectus.

IFRS 9

With regards to IFRS 9 – the company has been reporting its results in accordance with IFRS 9 since 1 July 2018. When making future loss provisions under IFRS 9 the low level of historic defaults in the UK mortgage sector and the credit protection afforded by the low LTV of the loans within our portfolio is factored into our provision calculations. The impact of IFRS 9 has been calculated at 0.48% on the Fund's NAV, in the 30 June 2019 year-end accounts. The impact of expected credit losses is already modelled in the IRR calculations for our portfolios and is also included in our portfolio dividend and NAV models

Key Risks

- **All financial investment involves risk. The value of your investment isn't guaranteed, and its value and income will rise and fall. Investors may not get back the full amount invested.**
- Past performance is not a reliable indicator of future performance, and the Fund may not achieve its investment objective.
- The fund can invest in portfolios of mortgages or the equivalent risk. The lenders of such products may not receive in full the amounts owed to them by underlying borrowers, affecting the performance of the Fund.
- Prepayment risks also vary and can impact returns.
- The fund employs leverage, which may increase volatility of the Net Asset Value.

OCF Breakdown

UK Mortgages Ltd	0.80%
UK Mortgages DAC and SPVs (excl. servicing and transaction costs)	0.17%
Total	**0.97%**
Servicing and Transaction costs (for information)*	2.11%

*Servicing and transaction costs are provided for information only as deal specific servicing and other transaction costs are included in IRR projections per investment. As at 29/02/2020.

Fund Managers

Robert Ford
Partner, Portfolio Management, industry experience since 1986. Previously a Managing Director and Head of European ABS Trading at Barclays Capital.

Ben Hayward
Partner, Portfolio Management, industry experience since 1998. Previously he was a senior fund manager to four portfolios at Citi Alternatives.

Douglas Charleston
Portfolio Management, industry experience since 2006. Previous roles include structuring ABS at Lloyds, ratings analyst at S&P and a portfolio manager at Nationwide.

Silvia Piva
Portfolio Management, industry experience since 2007. Previously she was a structurer and originator at RBS covering UK financial institutions.

Shilpa Pathak
Portfolio Assistant, industry experience since 2013. Previous roles include an application development consultant at Dow Jones and a software developer at Dell.

Further Information

TwentyFour AM
John Magrath
Tel. 020 7015 8912
john.magrath@twentyfouram.com

Numis Securities
Chris Gook
Tel. 020 7260 1378
c.gook@numis.com