TwentyFour
ASSET MANAGEMENT

UK Mortgages Limited

30 April 2020

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

Commentary

Mortgage and Housing Market

Mortgage and housing markets essentially remained closed in April. Some remortgages were able to complete as were a very limited number of purchases (where the property was empty for example) but otherwise estate agents were closed and valuers unable to operate, and most lenders had either removed their product offerings entirely or reduced to only the lower LTV bands. Many had also increased lending rates, despite the cuts in BoE base rate.

RMBS Market

Spreads in RMBS have continued to recover, once again led by the senior prime sector. However, the primary market is still to reopen, and there is little expectation of issuance from the banks given their access to central bank funding. Whilst this is positive for non-bank spreads, they have arguably not yet recovered far enough to make full public issuance viable, particularly in non-senior tranches which are still catching up with the greater recovery at the senior end.

Fund Commentary

With the current moratorium in mortgage and housing markets there has essentially been no change to the typical portfolio metrics such as arrears, and that will continue until at least October given the most recently updated guidance to mortgage lenders from the FCA. As a result we won't be covering each portfolio individually.

However, more depth of mortgage payment holiday data has now become available across all mortgage markets as the scheme has been in place through a full monthly reporting cycle. That gives us the opportunity for the first time to analyse more closely what the impact might be, particularly with regard to how borrowers might behave at the end of their payment holiday period.

Whilst government and regulatory guidelines for dealing with the crisis have been focused on forbearance for borrowers - and this tone is likely to continue as the situation plays out - with the expected deterioration in the economy it is inevitable that some borrowers will not be able to resume payments, and this may ultimately lead to foreclosures, property sales and the potential for future loan losses.

In order to assess the potential impact on the portfolio we have evaluated a stressed scenario, in line with the recent guidance from the BoE for IFRS9 ECL provisioning. We expect to update this officially in our June-2020 year-end financial reports, by which time many payment holidays will have ended and payment resumption behaviour will be available to be analysed, but the current scenario analysis is designed to provide guidance to investors.

Put simply, for losses on loans to be realised, a combination of two things are required. Firstly, a property must be repossessed (because the borrower has stopped paying), and secondly it must then be sold (including costs) for less than the value of the loan – this would typically be caused by falls in house prices.

All our portfolios have relatively conservative LTVs (see the table below) which offers significant protection against a fall in property prices. For example, Coventry don't lend higher than 75% LTV and cap at 50% for larger loans. Whilst TML lend up to 90% LTV, this is only available for higher quality applicants and furthermore all loans are repayment mortgages so the LTV reduces over time. In the Barley Hill securitisation for example just 1.3% of the loans are in the 85% - 90% LTV bucket, and over 60% of loans that have taken a payment holiday are <75% LTV.

At the time of writing, payment holidays had been granted to just over 18% of our overall portfolio, just a 1% increase from last month, with new requests now at very low levels. This is almost exactly in line with the current industry-wide experience according to the most recent figures from the FCA.

History has shown that unemployment is typically the biggest driver of mortgage foreclosures. Looking back at the last two recessions, this peaked at 10.6% in the early 1990s and 8.43% in the last crisis. These levels of unemployment led to cumulative (over 5 or 6 years) foreclosure levels of around 2.75% and 2.2% respectively. Whilst the Covid-19 circumstances are unusual, and there is a likelihood of far greater forbearance, it would not be unrealistic to assume a worst case unemployment rate of a similar metric. Rounding up our payment holiday population (the most likely to default) to 20% and applying a 10% unemployment rate to those loans, would therefore lead to a projected foreclosure rate of 2%.

Similarly, house price declines were at their worst during those periods, with national falls of around 25% and 20% respectively. The BoE's recent credit conditions report suggested potential stressed house price falls of 15% could be seen following the pandemic. However, unpaid interest and costs could increase the net reduction in value in the event of a foreclosure and sale, so for these purposes we have added a further 10%, giving us a 75% LTV breakeven. Given the low LTVs in our portfolios, a 25% value reduction would realise very few losses, as our average LTVs are all below 75%, but in a stressed scenario it would also be prudent to assume that most losses occur on the higher LTV loans. In our overall portfolio around 17% of our loans are above 80% LTV, and that cohort has an average LTV of around 84% which we can round up to 85% to be conservative. So directing all foreclosures to loans above 80% LTV would give a Loss Severity on those loans of 10% (85% LTV – 75% breakeven).

Applying a 2% projected foreclosure rate would therefore create a Loss Given Default of 0.20%, which on our portfolio of just over £1.6bn of loans would then lead to a stressed-case loss of around £3.3m.

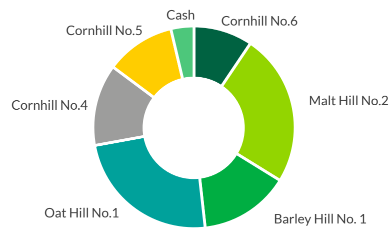
Given that our current ECL forecast (based on normal pre-Covid-19 market assumptions which would be superseded by these new assumptions) already provisions for almost £1.5m, we highlight that the above stressed scenario would lead to a modestly increased provision of about £1.8m, or less than 0.7% of NAV.

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	£173m	£340m	£487m	£220m*	£184m	£221m*
Number Accounts	963	1,947	3,829	1,020*	1,038	1,129*
Average Mortgage Size	£179k	£175k	£127k	£216k	£177k	£196k
WA Indexed LTV	61.97%	60.27%	64.82%	71.84%	65.46%	72.26%
WA Interest Rate	2.71%	2.71%	1.37%	3.43%	4.15%	3.88%
WA Remaining Term (mth)	190	218	118	268	283	313
WA Seasoning (mth)	57	39	159	6	21	5
3mth + Arrears (% balance)	0.00%	0.03%	0.63%	0.00%	1.89%	0.07%

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

as at 30/04/2020

Investment breakdown



as at 30/04/2020

Investment Outlook

As notified in our recent RNS, the Oat Hill transaction was not refinanced as originally expected in May, due to the exceptional market conditions, with RMBS markets still to re-open and pricing at a level where locking-in expensive term funding at that point would have been detrimental for the Fund. RMBS and financing markets continue to improve and work is progressing on alternative financing options.

Fund Facts

Type of Fund:	Closed-ended Investment Scheme LSE
Listing & Trading:	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:*	£113mn
Shares in Issue:	273mn
Price per Share:*	41.50p
NAV per Share:*	79.57p
NAV per Share (inc Dividend):*	102.45p
Premium / (Discount) to NAV:*	-47.84%

Source: TwentyFour Asset Management. * as at 31/03/2020

Glossary

ABS: Asset Backed Securities
RMBS: Residential Mortgage Backed Securities
BoE: Bank of England
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 ASSET MANAGEMENT

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