S&P Global Ratings

Research

Presale:

Pepper I-Prime 2020-1 Trust

October 18, 2020

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Preliminary Ratings

Class	Preliminary rating	Preliminary amount (A$ mil.)	Minimum credit support (%)	Credit support provided by subordination (%)
A1-s	AAA (sf)	150.00	6.00	15.01
A1-a	AAA (sf)	487.40	6.00	15.01
A2	AAA (sf)	65.00	6.00	6.35
B	AA (sf)	15.00	4.23	4.35
C	A (sf)	11.90	2.66	2.76
D	BBB (sf)	8.20	1.56	1.67
E	BB (sf)	5.20	0.87	0.97
F	B (sf)	3.80	0.41	0.47
G	NR	3.50	0.00	0.00

Note: This presale report is based on information as of Oct. 19, 2020. The ratings shown are preliminary. Subsequent information may result in the assignment of final ratings that differ from the preliminary ratings. Accordingly, the preliminary ratings should not be construed as evidence of final ratings. N/A--Not applicable.

Profile

Expected closing date	October 2020
Final maturity date	Payment date in March 2052
Collateral	Fully amortizing and interest only, reverting to amortizing Australian-dollar loans to prime-quality Australian resident borrowers secured by first-registered mortgages over Australian residential property. The loans mature no later than 18 months before final maturity of the notes.
Structure type	Prime residential mortgage-backed pass-through securities
Issuer and trustee	Permanent Custodians Ltd. as trustee for Pepper I-Prime 2020-1 Trust
Loan originator	Pepper Homeloans Pty Ltd.
Trust manager and servicer	Pepper Group Pty Ltd.
Backup servicer	BNY Trust Co. of Australia Ltd.
Security trustee	BTA Institutional Services Australia Ltd.

Profile (cont.)

Custodian	BNY Trust Co. of Australia Ltd.
Primary credit enhancement	Note subordination and excess spread, if any

Supporting Ratings

Liquidity facility provider	Appropriately rated counterparty
Bank account provider	JP Morgan Chase Bank N.A. Sydney Branch*

Note: *Rating derived from the rating on the parent entity

Loan Pool Statistics As Of Aug. 31, 2020

Total number of loans	1,555
Total value of loans (A$)	749,999,773
Current maximum loan size (A$)	1,980,281
Average loan size (A$)	482,315
Maximum current loan-to-value (LTV) ratio (%)	94.4
Weighted-average current LTV ratio (%)	71.3
Weighted-average loan seasoning (months)	8.1

Note: All portfolio statistics are calculated on a consolidated borrower basis.

Rationale

The preliminary ratings assigned by S&P Global Ratings to the prime floating-rate pass-through residential mortgage-backed securities (RMBS) to be issued by Permanent Custodians Ltd. as trustee for Pepper I-Prime 2020-1 Trust reflect the following factors.

The credit risk of the underlying collateral portfolio (discussed in more detail under "Credit Assessment") and the credit support provided to each class of rated notes are commensurate with the ratings assigned. Credit support is provided by subordination and excess spread. The credit support provided to the rated notes is sufficient to cover the assumed losses at the applicable rating levels. Our assessment of credit risk takes into account Pepper Homeloans Pty Ltd.'s underwriting standards and approval process, which are consistent with industrywide practices, and the strong servicing quality of Pepper Group Pty Ltd. (discussed in more detail under "Origination And Servicing"). We refer to Pepper Homeloans Pty Ltd. and Pepper Group Pty Ltd. collectively as Pepper in this report.

The rated notes can meet timely payment of interest and ultimate payment of principal under the rating stresses. Key rating factors are the level of subordination provided, the provision of a liquidity facility, the principal draw function, the trapping of excess spread in the yield-enhancement reserve (see "Yield-enhancement reserve"), the amortization reserve (see "Amortization reserve"), the overcollateralization amount built from excess spread after the call-option date (see "Overcollateralization amount"), and the provision of an extraordinary expense reserve funded by Pepper. Our analysis is on the basis that the rated notes are fully redeemed via the principal waterfall mechanism under the transaction documents by their legal final maturity date, and we assume the notes are not called at or beyond the call date.

Our ratings also take into account the counterparty exposure to JP Morgan Chase Bank N.A. Sydney branch as bank account provider, and an appropriately rated counterparty as liquidity facility provider. We have derived our rating on JP Morgan Chase Bank N.A. Sydney branch from our 'A+/Stable/A-1+' ratings on the parent entity. The transaction documents include downgrade language consistent with S&P Global Ratings' counterparty criteria.

We also have factored into our ratings the legal structure of the trust, which is established as a special-purpose entity and meets our criteria for insolvency remoteness.

Loss of income for borrowers in the coming months due to the effects of COVID-19 might put upward pressure on mortgage arrears over the longer term. We recently updated our outlook assumptions for Australian RMBS in response to changing macroeconomic conditions as a result of the COVID-19 outbreak. The collateral pool as of the Aug. 31, 2020, cut-off date did not include any loans that were under a COVID-19 hardship payment arrangement. Nevertheless, we undertook additional cash-flow sensitivity analysis to assess the rated notes' sensitivity to delays in borrower payments should some loans enter hardship arrangements following the cut-off date.

S&P Global Ratings acknowledges a high degree of uncertainty about the evolution of the coronavirus pandemic. The current consensus among health experts is that COVID-19 will remain a threat until a vaccine or effective treatment becomes widely available, which could be around mid-2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Strengths and Weaknesses

Strengths

We have observed the following strengths in the transaction:

- The quality of the loan servicing provided by Pepper Group Pty Ltd. S&P Global Ratings has assigned Pepper Group Pty Ltd. a STRONG residential prime loan-servicer ranking, with a Stable outlook. The STRONG servicer evaluation reflects our view of Pepper Group Pty Ltd.'s clearly defined business strategy, high-quality servicing standards, strong and experienced management team, and well-designed scalable technology platform (more detail is provided in the "Origination And Servicing" section).
- For the class A1-s and the class A1-a notes, the credit support provided by note subordination significantly exceeds the level of credit support commensurate with a 'AAA (sf)' rating.

Weaknesses

Weaknesses identified with respect to the transaction are:

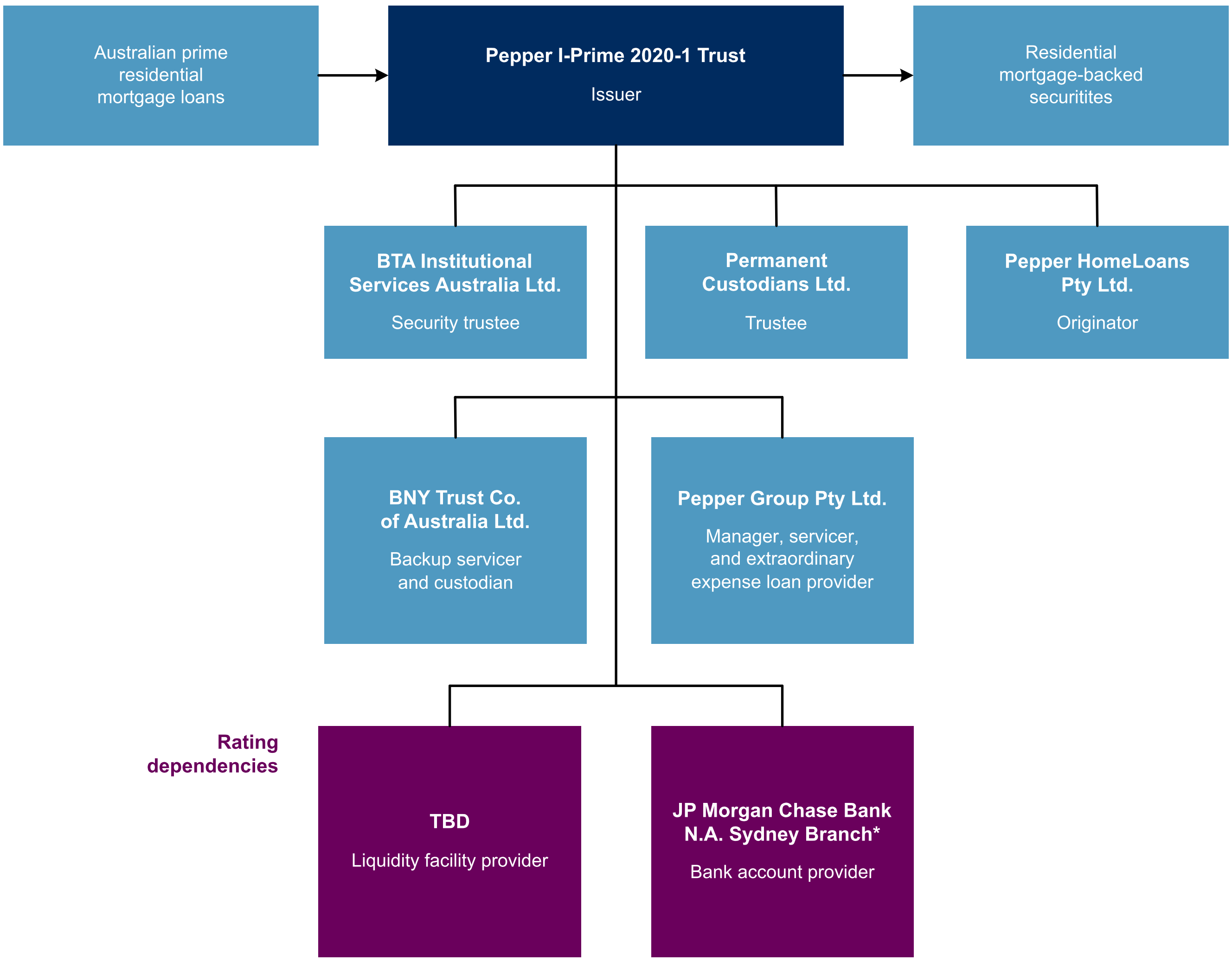
- About 54.2% of the loans in the pool, by current balance, have a current loan-to-value (LTV) ratio greater than 75%. S&P Global Ratings has increased the default frequency to capture this risk.
- Pepper has not carried out full income verification for about 5.6% of the loans in the portfolio, but has instead used alternative means to verify income. S&P Global Ratings has assumed a higher default frequency for low-documentation loans in its calculation of credit support for the corresponding rating levels. Our categorization of low-documentation loans encompasses Pepper's alternative-documentation loan products.
- About 46.5% of the loans in the portfolio are to investors. S&P Global Ratings assumes the default frequency on these loans to be higher to reflect the potential greater risk of default compared with loans for home purchases.
- Some 18.6% of the loans in the pool are to self-employed borrowers. S&P Global Ratings expects self-employed borrowers to experience higher cash-flow variability and, thus, higher loan arrears, making them more susceptible to defaults should there be a downturn in the Australian economy. S&P Global Ratings assumes higher default frequencies for such loans.
- About 33.1% of the loans in the portfolio, by current balance, have interest-only periods of up to five years. The loans convert to fully amortizing after five years. Although this somewhat tempers refinancing risk, the interest-only feature can create a payment shock when the payments revert to fully amortizing over the remaining term of the loan. S&P Global Ratings has accounted for this by assuming a higher default probability for these loans.

Transaction Structure

The structure of the transaction is shown in chart 1.

Chart 1

Pepper I-Prime 2020-1 Trust
Transaction structure



Note: *--Rating derived from our rating on the parent entity.

We understand that transaction counsel will lodge the relevant financing statements on the Personal Property Securities Register in connection with the security interest.

Note Terms And Conditions

Interest payments

The notes are all floating-rate securities, with interest payable on the invested amount of the notes, unless the stated amount of a class of notes is zero, when no interest accrues. Interest payments are made sequentially to each class of notes; however, payments of interest to the class A1-s notes and class A1-a notes (collectively class A1 notes) rank pari passu. Coupon to the unrated class G noteholders ranks subordinate to the reimbursement of charge-offs to all other notes and ranks below the excess spread trapping mechanisms.

Step-up margins will apply to the class A1 and class A2 notes if the notes are not called on the call-option date.

The trust manager can elect to call the notes in full at their invested amounts on or after the call-option date. The call-option date is the earlier of the payment date in October 2025 and the payment date on which the outstanding note balance is less than or equal to 20% of the initial balance.

Principal allocation

Principal collections--after application of principal draws, if necessary, to cover any income shortfalls or to fund redraws--will be passed through to noteholders on a sequential-payment basis.

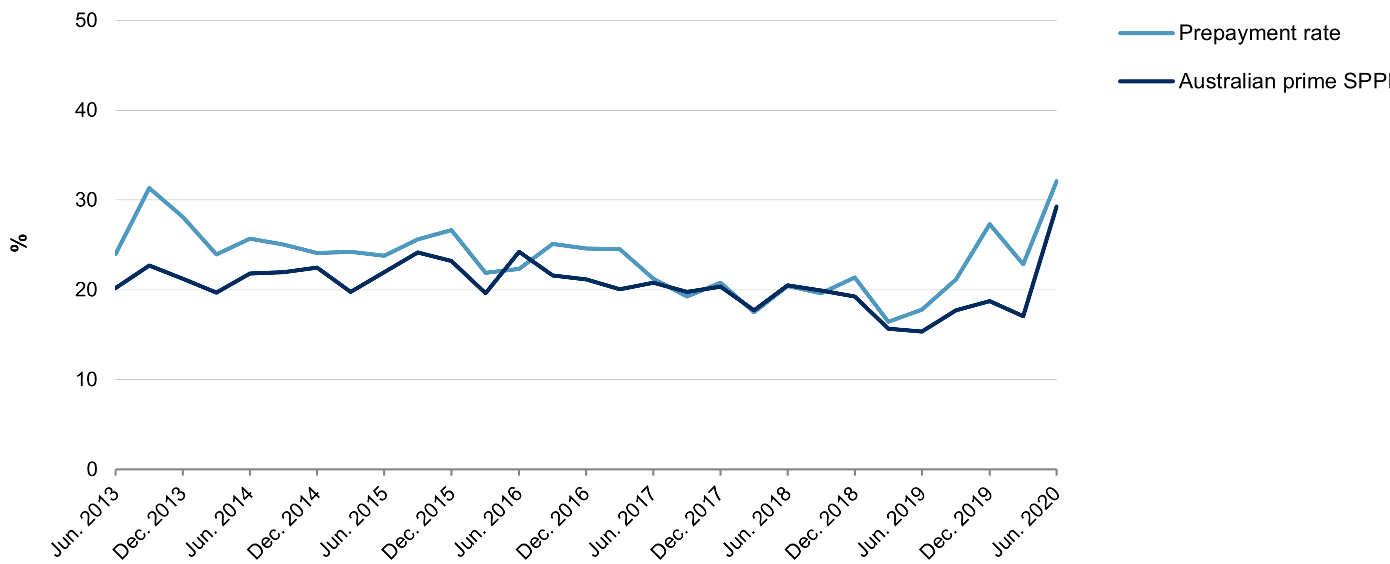
The transaction can convert to a pro-rata payment structure, in which principal would be allocated to each rated class (see "Pro-rata paydown triggers") if the principal step-down tests are met. In the pro-rata payment structure, the class G notes' portion of principal collections is allocated on a sequential basis to the rated notes from the most subordinated ranking to the most senior-ranking note outstanding at that time. In the pro-rata and sequential payment structures, payments to the class G notes will occur only after the repayment of all of the rated notes.

Given the pass-through nature of the notes, the actual date on which the principal amount of the notes will be fully repaid will be determined by the actual prepayment rate experience on the loan portfolio. As a result, the risk of mortgage prepayments is borne by the noteholders.

Chart 2 shows the prepayment rate for Pepper's securitized prime loan portfolios against Standard & Poor's Prepayment Index (SPPI), which is a measure of prepayment rates for Australian prime RMBS. The prepayment speeds encompass the unscheduled principal payments on the mortgage loans. Prime prepayment rates including noncapital market issuance measured by SPPI jumped in the second quarter of 2020, mainly due to loan maintenance activity in bank internal self-securitization programs. Increases in prepayment rates (outside of loan maintenance activity) reflect strong refinancing activity in the first half of 2020.

Chart 2

Pepper Homeloans Pty Ltd.
Average loan portfolio prepayment speeds



Source: S&P Global Ratings.

Loss allocation

Losses will be first allocated to the amortization amount ledger, until its balance is equal to zero, followed by the yield-enhancement ledger, the overcollateralization ledger, then to the class G notes until their stated amount is reduced to zero, followed by the class F, class E, class D, class C, class B, class A2, then pari passu among the class A1-s and class A1-a notes.

If losses can be reimbursed throughout the life of the transaction, then the reinstatement will occur to each class of notes in the reverse order, with the exception of the amortization amount ledger, the yield-enhancement ledger, and the overcollateralization ledger, which are not reimbursed.

Pro-rata paydown triggers

Provided certain performance triggers are met, principal repayments will occur on a pro-rata basis to all classes of notes, except for the class G notes. The triggers to allow pro-rata paydown are:

- The payment date falls on or after the second anniversary of the transaction's closing date.
- The subordination percentage for the class A1 notes is equal to or greater than 29.25%.
- Arrears greater than 90 days must not exceed 4.0% of the average of the aggregate outstanding loan amounts during the previous three months.
- The payment date is not on or after the first possible call-option date.
- There are no carryover charge-offs to any notes.

Rating-Transition Analysis

Scenario analysis: Property market value decline

S&P Global Ratings performed a scenario analysis to determine the potential impact on the ratings at transaction close if the values of every security property decreased by 10%. We applied a haircut of 10% to the original property values and increased LTV ratios for this impact. Note that this scenario does not take into account potential increases or decreases in the security property value compared to its original value, nor does it consider cash flow analysis (and therefore, the potential use of excess spread to cover losses). The implied credit assessments are set out in table 1.

Table 1

Minimum Credit Support For Credit Losses And Implied Credit Assessments Under The Scenario

Class	Minimum credit support for credit losses (%)	Implied credit assessment
A1-s	11.34	aaa
A1-a	11.34	aaa
A2	11.34	a+
B	8.19	bbb+
C	5.25	bbb-
D	3.19	bb-
E	1.88	b
F	0.94	Below b-

Origination And Servicing

We assess the quality of the origination, underwriting, and servicing of the loans as part of our credit analysis because it can affect the performance of the portfolio.

Pepper was incorporated in Australia in March 2000. It began operating in March 2001 as a specialty mortgage finance company that provides home loans to nonconforming borrowers. In 2011, Pepper began servicing prime mortgages after its acquisition of GE Capital Finance Australasia Pty Ltd. (GE)'s prime residential-mortgage portfolio. In November 2013, it launched a suite of prime residential mortgage products that are complementary to its existing nonconforming range of residential mortgages, and are able to address the retention of existing GE customers and originate loans from other potential new customers. As with the nonconforming products, Pepper funds its own prime products through warehouses, securitization programs, and whole loan sales.

This is the seventh time Pepper has issued a securitized pool of 100% prime loans that Pepper originated under its own policies. Pepper originates and underwrites these prime loans under the same processes that it uses for the nonconforming product. Further prime loans are underwritten by the same credit assessment team that underwrites the nonconforming loans. The absence of lenders' mortgage insurance (LMI) on Pepper's mortgage loans demonstrates the critical role of Pepper's credit underwriting and security valuation standards as well as its loan servicing and collections management platforms and processes.

Pepper has a well-established position as a primary servicer of nonconforming residential mortgage loans, with a high degree of industry knowledge and proficiency in the Australian servicing market. We believe the company has leveraged its nonconforming loan servicing experience to build prime loan-servicing operations comparable to its nonconforming operations.

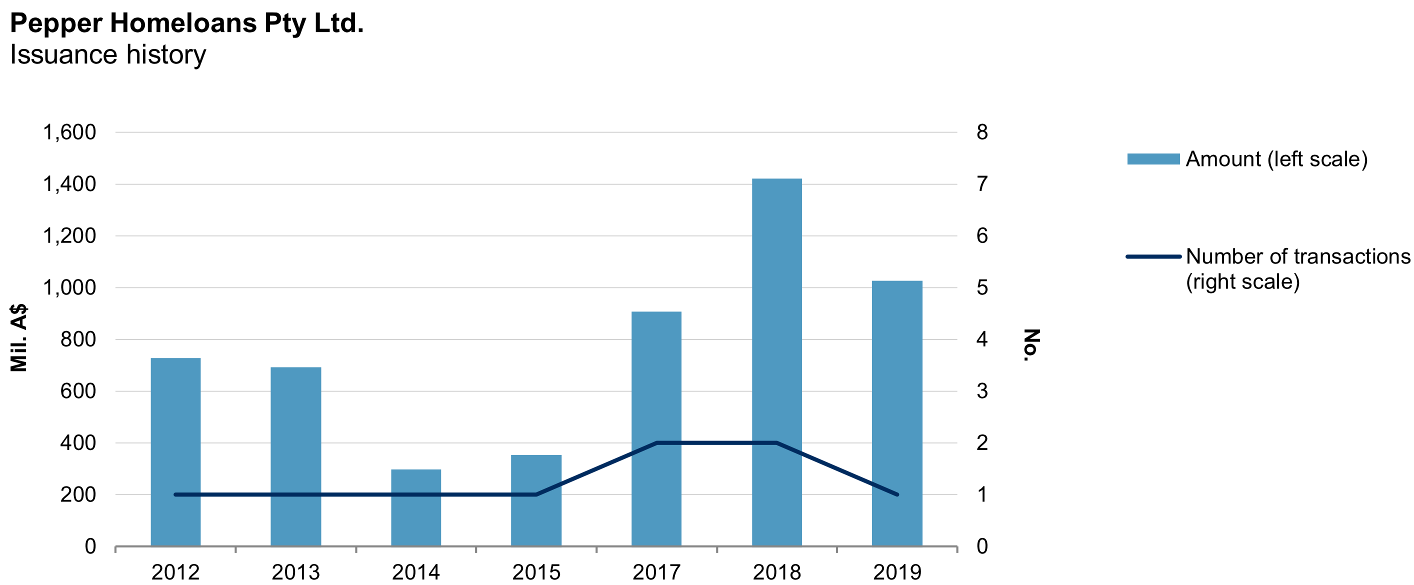
Pepper has developed an extensive network of accredited mortgage brokers and financial planners throughout Australia to distribute its home-loan products. Pepper assesses all loan applications for completeness and compliance with stringent acceptance parameters before passing them to the central underwriting group in Sydney. Pepper controls all aspects of the underwriting and credit-assessment processes. Pepper's underwriting function also controls all aspects of the security-valuation process, which is conducted under Pepper's instructions by its panel valuers. Pepper obtains full property valuations for all loans. Second valuations are conducted on a random sample of 5% of loan applications. In addition, audit valuations are ordered for some of the larger loan sizes.

Pepper Group Pty Ltd., which has a STRONG residential prime loan servicer ranking, conducts post-settlement servicing of the loan portfolio. The servicer evaluation report is available on S&P Global Ratings' website, at https://www.capitaliq.com. In sizing the credit support for the collateral pool, S&P Global Ratings has taken into account Pepper's underwriting and servicing platforms and historical arrears performance.

BNY Trust Co. of Australia Ltd. (BNY Trust) provides backup servicing to the loan pool, should Pepper be replaced as servicer. BNY Trust has authorization to access the daily backup tapes from Pepper's loan-servicing system, which is in an off-site storage location in Sydney.

This is Pepper's 10th issue of domestic RMBS backed by prime residential mortgage loans. The first three issuances were securitizations of prime residential-mortgage loan portfolios originated by GE. Chart 3 illustrates Pepper's prime issuance history, as rated by S&P Global Ratings. The issuance volume reflects note reissues, which is a feature of a number of RMBS issued by Pepper.

Chart 3

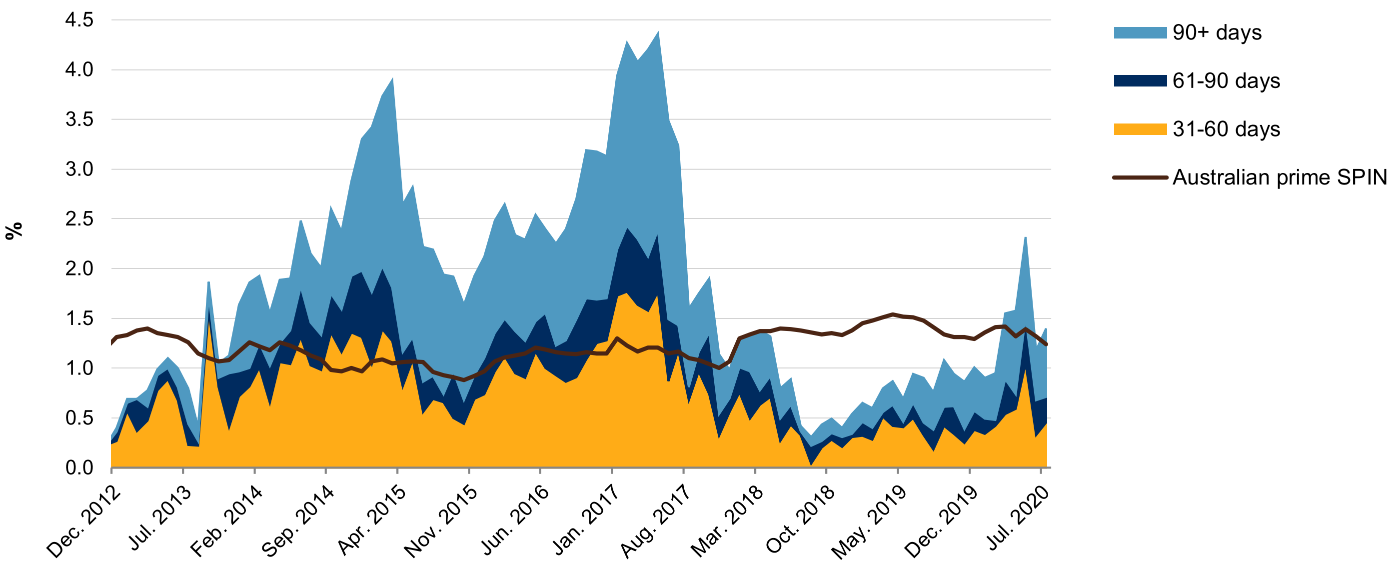


Source: S&P Global Ratings.

Chart 4 compares the level of arrears on Pepper's securitized prime mortgage loans, including GE Prime-originated, with the Standard & Poor's Performance Index (SPIN) for Australian prime mortgages. Pepper measures loan arrears on a "missed payments" basis. The spike in arrears around May 2020 was primarily driven by COVID-19 and the reporting of COVID-19 forbearance loans in arrears. The arrears have since decreased, following a correction in Pepper's COVID-19 forbearance loan reporting, in line with industry standards.

Chart 4

Pepper Homeloans Pty Ltd.
Performance of loans against the Australian prime SPIN



Source: S&P Global Ratings.

Credit Assessment

The portfolio contains full- and alternative-documentation prime residential mortgage loans originated by Pepper Homeloans Pty Ltd. S&P Global Ratings uses the classification of low-documentation for what Pepper calls alternative-documentation loans. Within these two broad loan product categories are a range of products that Pepper offers, characterized by a range of applicable LTV ratios. The alternative-documentation product is available to self-employed borrowers only, and allows the borrower to declare his or her income; however, borrowers provide business bank statements for a minimum of six months, business activity statements, or an accountant's letter so that Pepper can perform alternative income verification. This is a closed pool, which means no additional loans will be assigned to the trust after the closing date.

S&P Global Ratings' credit assessment is based on the current balance of the loans. Borrowers can redraw prepaid principal amounts up to the scheduled balance of the loan. Further advances are not permitted. S&P Global Ratings has increased the minimum level of credit support for the transaction to reflect borrowers' ability to redraw on their loans.

The pool is well diversified geographically throughout each Australian state and territory and by postcode. There are no state or postcode concentrations that exceed S&P Global Ratings' benchmark residential mortgage loan pool.

About 17.4% of the portfolio is secured over properties in nonmetropolitan areas. S&P Global Ratings adjusts the default frequency on loans in nonmetropolitan areas because loans in these areas historically have demonstrated a higher probability of default. We also have increased the recovery period for loans in these areas to reflect the lower demand for property in regional areas.

Approximately 44.3% of the loans in the portfolio are for refinance debt-consolidation purposes. S&P Global Ratings assumes a higher default frequency for such loans.

To calculate the minimum credit support levels, we compare the characteristics of the portfolio with an archetypical pool and apply multiples as a way to increase or decrease credit support levels to reflect higher or lower credit risk compared with the characteristics of the archetypical pool. The credit support levels comprise default frequency and loss severity. A summary of this calculation is shown in table 2. Table 3 lists the main default frequency characteristics that have deviated from the archetypical pool.

Table 2

Summary Credit Assessment

	AAA	AA	A	BBB	BB	B
Default frequency (%)	15.49	11.84	8.12	5.45	3.72	2.21
Loss severity (%)	38.74	35.68	32.68	28.58	23.47	18.61
Minimum credit support (%)	6.00	4.23	2.66	1.56	0.87	0.41
Assumptions						
Market value decline (%)	45.0	43.0	41.0	38.0	34.0	30.0
Weighted-average recovery period (months)	14.8	14.8	14.8	14.8	14.8	14.8
Interest rate through recovery period (%)	8.00	7.50	7.00	6.50	6.00	5.50

Table 3

Rating Default Multiples

Criteria	Default frequency multiple for total pool (x)
Loan-to-value	1.118
Borrower employment	1.094
Property occupancy	1.047
Reduced documentation: income verification	1.019
Repayment method	1.033

Note: Default multiples weighted by each loan's current balance.

Loan Pool Profile

The pool as of Aug. 31, 2020, is summarized in table 4. All portfolio statistics are calculated on a consolidated borrower basis.

Table 4

Loan Pool Characteristics

	Value of loans (%)
Current loan size distribution (A$)	
Less than or equal to 100,000	0.2
Greater than 100,000 and less than or equal to 200,000	2.4
Greater than 200,000 and less than or equal to 300,000	7.7
Greater than 300,000 and less than or equal to 400,000	14.9
Greater than 400,000 and less than or equal to 600,000	31.9
Greater than 600,000 and less than or equal to 800,000	20.1
Greater than 800,000 and less than or equal to 1,000,000	10.4
Greater than 1,000,000 and less than or equal to 1,500,000	11.4
Greater than 1,500,000	0.9
Current loan-to-value ratio (LTV) distribution (%)	
Less than or equal to 50	12.8
Greater than 50 and less than or equal to 60	6.2
Greater than 60 and less than or equal to 70	13.5
Greater than 70 and less than or equal to 80	44.1
Greater than 80 and less than or equal to 90	21.4
Greater than 90 and less than or equal to 95	1.9
Geographic distribution (by state)	
New South Wales and Australian Capital Territory	46.0
Victoria	28.6
Queensland	14.3
Western Australia	4.9
South Australia	5.3
Tasmania and Northern Territory	0.9
Geographic distribution (metro/nonmetro)	
Inner city	0.1
Metropolitan	82.6
Nonmetropolitan	17.4
Seasoning	
Less than or equal to six months	40.8
Six months – one year	46.1

Table 4

Loan Pool Characteristics (cont.)

	Value of loans (%)
1-2 years	10.4
2-3 years	2.3
3-4 years	0.5
4-5 years	0.0
Greater than five years	0.0
Principal amortization	
Fully amortizing	66.9
Interest-only for up to five years, reverting to fully amortizing	33.1
Occupancy	
Owner-occupied	53.5
Investment	46.5
Borrower employment	
Pay-as-you-go borrowers (full time, part time)	77.8
Pay-as-you-go borrowers (casual)	2.2
Self-employed borrowers	18.6
Other	1.4
Rate type	
Variable rate	100.0
Fixed rate	0.0
Residency	
Australian resident	100.0
Nonresident	0.0
Loan documentation	
Full-documentation	94.4
Alternative-documentation	5.6
Loan purpose	
Purchase	55.7
Refinance for debt consolidation	44.3

Note: As of Aug. 31, 2020, there were no loans with COVID-19-related hardship arrangements in the pool. Lenders are not required to report loans under COVID-19 arrangements as being in arrears during the defined mortgage-relief period. S&P Global expects lenders will report on this measure separately.

Cash-Flow Analysis

Our cash-flow analysis shows that the transaction has sufficient income to support timely payment of interest and ultimate repayment of principal to the rated notes under various stress scenarios commensurate with the ratings assigned.

Liquidity assessment

If there are insufficient interest collections, then liquidity support to meet senior fees, expenses, and interest on the notes, excluding the class G notes, is first provided through the yield-enhancement reserve (discussed in more detail under "Yield-enhancement reserve"). Principal draws will be available if interest collections and the yield-enhancement reserve are insufficient. In addition, a liquidity facility provided by an appropriately rated counterparty is available if there is a further shortfall.

The liquidity facility will represent 2.2% of the initial aggregate amount of all the notes. This will amortize with the note balance, subject to a floor of A$1,650,000.

The yield-enhancement reserve, principal draw mechanism, and liquidity facility will not be available to meet interest shortfalls on the class B, class C, class D, class E, and class F notes if at any time that class has any unreimbursed charge-offs.

The class A1-s, class A1-a, and class A2 notes are at no time restricted from the use of liquidity support while the class G notes are excluded from required payments under the income waterfall, and hence, liquidity support.

Yield-enhancement reserve

While the class A1-s, class A1-a, and class A2 notes (class A notes) are outstanding, there will be a yield-enhancement reserve that traps available excess spread, subject to meeting certain conditions. This reserve is available to cover senior expenses and interest shortfalls on the rated notes. The yield-enhancement reserve balance initially will be nil. Subject to meeting the yield-enhancement reserve trapping condition, 70% of available excess spread will be trapped in the reserve account on each payment date up to a maximum limit of A$2,500,000.

The yield-enhancement reserve will be released when the class A notes have been fully repaid. When released, any amount in the yield-enhancement reserve is applied as principal repayment in the order of the class F notes until their stated amount is reduced to zero, followed by the class E, class D, class C, then class B notes. The overcollateralization of this one-time payment is recorded in a yield-enhancement ledger, where losses are allocated initially before being allocated to the notes (see "Loss allocation").

Amortization reserve

There will be an amortization reserve account that traps available excess spread, subject to meeting certain conditions. The amortization reserve account balance initially will be nil. Before the call-option date and subject to meeting the amortization reserve trapping conditions, available excess spread will be trapped in the amortization reserve account on each payment date, up to a maximum limit of A$800,000. The amortization reserve account can be utilized to cover losses on the notes.

On the call-option date, the amortization reserve account will be released and any amount in the amortization reserve account will be applied as principal repayment in the order of the class F notes until their stated amount is reduced to zero, followed by the class E, class D, class C, class B, class A2, then pari passu between the class A1-s and class A1-a notes. The overcollateralization of this one-time payment is recorded in an amortization amount ledger, where losses are allocated initially before being allocated to the notes (see "Loss allocation").

Overcollateralization amount

From the call-option date, all of the available excess income, minus the company tax rate, will be applied with principal collections through the principal waterfall. The overcollateralization is recorded in an overcollateralization ledger, where losses are allocated initially before being allocated to the notes (see "Loss allocation").

Extraordinary expense reserve

On the closing date of the transaction, Pepper will deposit an amount of A$150,000, to be held to cover any extraordinary expenses that might arise. This reserve will be maintained and topped up to A$150,000, where possible, through the life of the transaction.

Cash-flow modeling assumptions

The key rating stresses and assumptions modeled at each rating level are:

- Analyzing and modeling the structure of the transaction to include all note balances and margins, trust expenses, liquidity mechanisms within the structure, the priority of payments for both income and principal, and loss mechanism, as described in the transaction documents.
- Default frequency and loss severity assumed at each rating level.
- Timing of defaults. S&P Global Ratings assumes most defaults would likely occur within the first few years of the transaction. We have run three default curve assumptions: a front-end default curve whereby most of the expected losses occur earlier in the first few years of the transaction's life, a base-case default curve, and a back-end default curve whereby losses occur later within the first five years of the transaction's life (table 5).
- Time to recovery of sale proceeds from defaulted loans. A key driver in the cash-flow model is the time it takes to foreclose and recover monies from the defaulted borrower. We have assumed a recovery period of 15 months.
- Loan prepayment rates. S&P Global Ratings has considered various prepayment rates when modeling the cash flows of the underlying mortgage loans to assess the impact on the ability of the trust to meet its obligations. S&P Global Ratings has modeled a low, constant, and high prepayment rate. The prepayment stresses assumed are shown in table 6. These rates include voluntary and involuntary (default) prepayments.
- Modeling the cash flows of the assets based on the characteristics of the underlying collateral pool, and the margin set on all loans.
- Interest rates, by varying the bank-bill swap rate curves at each rating level.
- A replacement servicer fee of 0.35% should it be necessary for Pepper to be replaced as servicer.
- The sequential and pro-rata principal payment structure of the notes.
- COVID-19 liquidity stress that assumes a portion of interest and principal collections are delayed for the first six months and are recovered in the following 12 months. This scenario tests the robustness of the rated notes to potential granting of payment holidays or reduced payments under COVID-19 hardship arrangements following the cut-off date of the pool.

Table 5

Assumed Default Curves For Prime Loans

Month	Front-ended default curve (%)	Back-ended default curve (%)	Base-case default curve (%)
7	10		10
12	25	5	15
18		15	
24	30	25	25
36	20	25	25
48	10	15	15
60	5	10	10
72		5	

Table 6

Assumed Constant Prepayment Rates (CPR) For Prime Loans

Transaction seasoning	High CPR (%)	Low CPR (%)	Constant (%)
1-12 months	20	5	20
12-18 months	25	5	20
18-36 months	35	5	20
36+ months	40	5	20

Note: Total CPR shown is inclusive of voluntary and involuntary (defaults) prepayments.

Legal and Counterparty Risks

In our view, the issuer has features consistent with our criteria on special-purpose entities, including the restrictions on objects and powers, debt limitations, independence, and separateness.

The transaction will have counterparty exposure to JP Morgan Chase Bank N.A. Sydney Branch as bank account provider and an appropriately rated counterparty as liquidity facility provider. We have derived our rating on JP Morgan Chase Bank N.A. Sydney branch from our 'A+/Stable/A-1+' ratings on the parent entity. The documentation of these roles requires replacement and/or posting of collateral if the rating on these entities falls below certain levels; these mechanisms are consistent with S&P Global Ratings' counterparty criteria.

Issuer Disclosure

The issuer has not informed S&P Global Ratings Australia Pty Ltd. whether the issuer is publically disclosing all relevant information about the structured finance instruments that are subject to this rating report or whether relevant information remains nonpublic.

Related Criteria

- Criteria | Structured Finance | General: Methodology To Derive Stressed Interest Rates In Structured Finance, Oct. 18, 2019
- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
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- Criteria | Structured Finance | RMBS: Assumptions: Australian RMBS Postcode Classification Assumptions, July 10, 2013
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Related Research

- How Will COVID-19 Affect Australian RMBS Ratings?, May 25, 2020
- 2020 Outlook Assumptions For The Australian Residential Mortgage Market, May 19, 2020
- An Overview Of Australia's Housing Market And Residential Mortgage-Backed Securities, Nov. 14, 2019
- Why Australian RMBS Ratings Are Less Reliant On Lenders' Mortgage Insurance, June 12, 2018
- Australia And New Zealand Structured Finance Scenario And Sensitivity Analysis: Understanding The Effects Of Macroeconomic Factors On Credit Quality, April 17, 2017
- Global Structured Finance Scenario And Sensitivity Analysis 2016: The Effects Of The Top Five Macroeconomic Factors, Dec. 16, 2016
- RMBS Performance Watch: Australia, published quarterly
- RMBS Arrears Statistics: Australia, published monthly

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