TPG

Asset-Based Credit in 2025: Powering Ahead

February 2025

TPG

Executive Summary

In 2025, we expect Asset-Based Credit (ABC) markets to power ahead, supported by the resilience of the US consumer and the continued strength of the US economy. Strong fundamentals should enable attractive risk-adjusted returns for many parts of the Asset-Based Credit complex at a moment of historically tight spreads across corporate credit markets. This comes at a time of growing recognition of the importance of ABC as a valuable diversifier for existing credit exposures and a permanent pillar of the broader private credit ecosystem.

Here's what we expect across Asset-Based Credit markets in the year ahead:

Consumer Credit: **Resilience Amid Widespread Growth**: A healthy labor market and elevated household wealth provide a strong base for the US consumer in 2025. Despite rising recession fears at times last year, the US labor market and consumer have proven remarkably resilient. We're closely monitoring the impact of tariffs and trade war risk on consumers' balance sheets and debt servicing capacity.

Credit Cards: **Delinquencies Normalizing Higher**: Headline credit card delinquencies have risen back towards pre-pandemic levels driven by a combination of more lax lending standards during the pandemic period and higher interest rates. That said, we think the reality is more benign than is being popularly portrayed and expect newer vintages to remain healthy.

Student Loans: **Minimal Consumer Impact As Payments Resume**: An end to the student loan "on-ramp", which temporarily eased the effects from the resumption of student loan payments for many borrowers, should have limited impact on the broader consumer credit outlook.

Auto Loans: **Rising Delinquencies And Policy Risks**: The auto loan sector represents a pocket of relative weakness, in our view, within the broader ABC complex due to a combination of sharply higher auto prices and riskier borrowing throughout the pandemic period. We continue to monitor for opportunities to develop but otherwise remain largely on the sidelines of this sector.

CMBS: **A Rare Pocket Of Value**: Real estate credit represents one of the few true pockets of value today across credit markets given the high valuations present for most other spread products. Modest spread compression has made refinancing more workable for worthy borrowers that were previously locked out of the market, though some parts of CRE (office in particular) still face a long road to recovery.

Data Centers: **A Growing Cross-Asset Opportunity**: Data centers have emerged as a particularly interesting new financing opportunity across both CMBS and ABS that we'll be keeping an eye on in 2025.

Housing: **Higher Rates Leave Housing Little Changed**: Elevated interest rates leave the US housing sector contending with many of the same dynamics that have prevailed in recent years–high mortgage rates, a strong disincentive to move for existing homeowners, and a significant availability of US home equity. We see an outsized opportunity in products that enable homeowners to tap into the home equity that's amassed across the US housing market.

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Consumer Credit: Resilience Amid Widespread Growth

The Fundamental Story in 2025

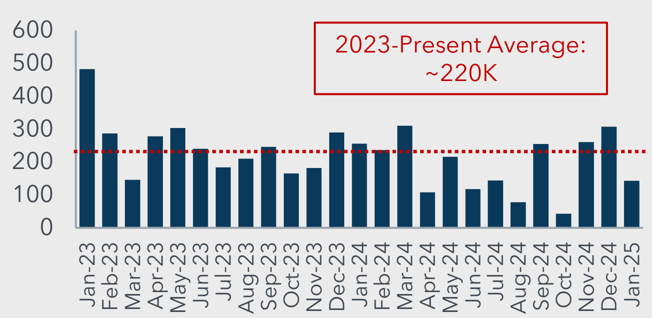
Despite periodic recession concerns last year, US growth proved resilient and powered ahead on the back of strong consumer fundamentals. We expect US consumer strength will persist in 2025, supported by a healthy labor market, solid income growth, and an elevated level of household wealth.

While the US unemployment rate crept up over the course of last year, the underlying pace of jobs and income growth has remained solid (see Exhibit 1). At the same time, US household wealth stands near all-time highs and has further boosted consumers' balance sheets (see Exhibit 2).

With this strong foundation, consumer credit has broadly performed well across most pockets of the market. **Looking ahead, we expect better underwriting and healthy consumer fundamentals will drive continued stability across Asset-Based Credit markets in 2025.**

Exhibit 1: US Labor Demand Has Remained Resilient

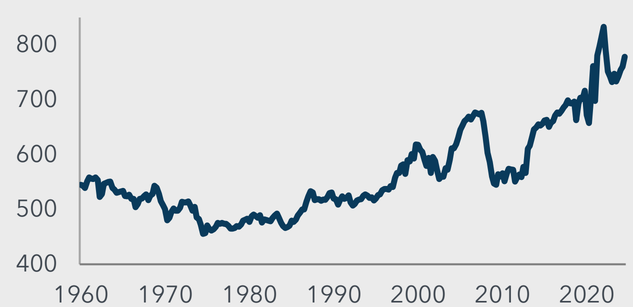
Monthly US Nonfarm Payrolls Growth, Thousands



Source: US BLS, TPG.

Exhibit 2: Household Balance Sheets Are Very Strong

US Household Wealth As A % Of Total Disposable Income, %

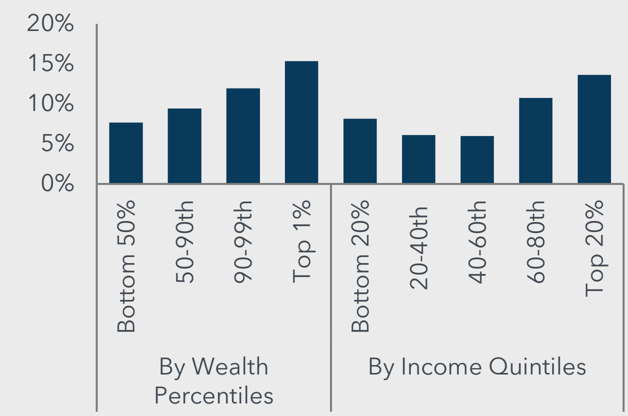


Source: US Federal Reserve, TPG.

While aggregate consumer debt levels have been rising across the US economy, consumer debt-to-income ratios have remained fairly stable as a result of strong real disposable income gains in recent years. Wealth gains have been widespread across the income distribution (see Exhibit 3), further supporting consumer balance sheets.

Exhibit 3: Wealth Gains Have Been Fairly Widespread

Change In Wealth, year-over year



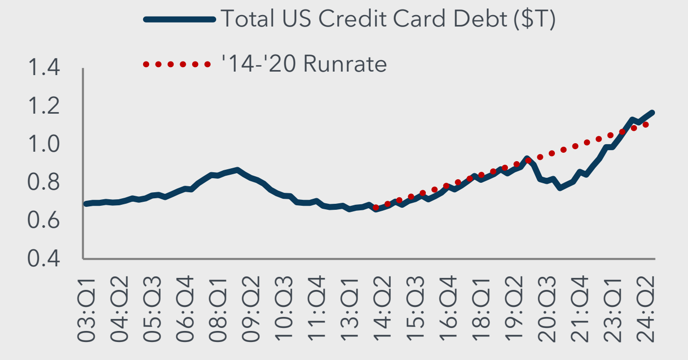
Note: Year-over-year change as of Nov 2024.
Source: Goldman Sachs GIR, TPG.

According to the NY Fed's Household Debt & Credit report, the aggregate credit card utilization rate—the ratio of total unpaid balances to total credit limits—has returned to pre-pandemic levels after declining due to deleveraging and income growth. However, we view this as relatively benign.

The level of total credit card debt outstanding made some headlines in 2024, rising to a record $1.17 trillion in the third quarter, according to the NY Fed. While surpassing the $1 trillion threshold holds some psychological significance, this milestone alone does not necessarily indicate consumers are overleveraged, particularly amid the rise in wages.

Additionally, the increase follows a unique period of deleveraging in the wake of pandemic-era shutdowns and stimulus-driven saving. In fact, when extrapolating the pre-pandemic growth trajectory from 2014-20, outstanding current credit card debt is just modestly higher than that trend: $1.17 trillion vs. $1.11 trillion (see Exhibit 4 – next page).

Exhibit 4: Credit Card Balances Are In Line With The 2014-20 Trend



Note: Data as of November 2024.
Source: New York Fed, TPG.

Given these factors and a still-expanding economy, we believe the consumer credit landscape is well-positioned for 2025, though we will closely monitor for signs of a faster-than-expected cooling of the labor market and more persistent inflation–whether from a possible increase in tariffs or other factors–which could erode real wage growth and strain consumers' debt-servicing capacity.

Rising trade conflict and the prospect of tit-for-tat trade war raise the risk of an increase in consumer and other goods prices given such goods represent a large share of US imports. Import content from China accounts for 7% of the producer value of all US goods consumption, and around 80% of this represents final consumer goods that are exported to the US (as opposed to inputs), according to Goldman Sachs Global Investment Research.

But we see more limited risk that tariffs will constrain consumers' ability to continue to service their debts. As a starting point, recent data from Equifax shows that consumer debt delinquency rates have been trending downward in recent months across personal loans, bank cards, and private label cards, suggesting better starting fundamentals. At the same time, the underlying pace of US growth should remain supportive of ongoing consumer debt service in 2025 (with consensus expectations for 2+% real US GDP growth).

Additionally, we would note that the experience during the 2018-19 US-China trade conflict was that delinquencies were stable across most ABC segments.

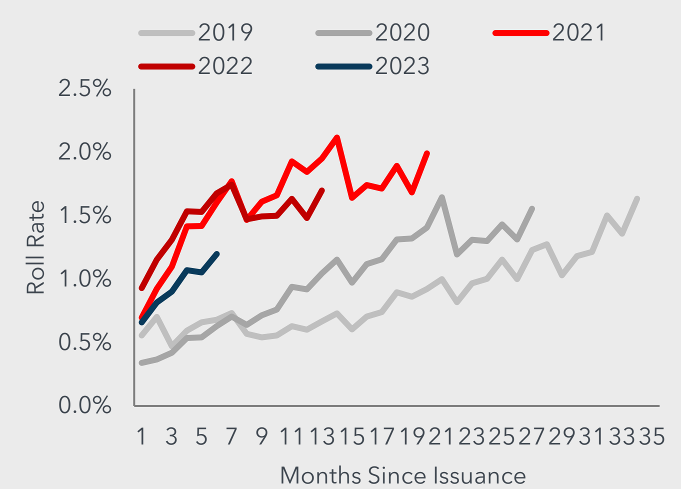
Asset Selection In Focus

The strong aggregate performance of most Asset-Based Credit markets masks a more complex picture across different securitized product vintages. Our previous outlook rightfully cautioned against the 2022 vintages of unsecured consumer loans, for example, as both 2021 and 2022 experienced looser underwriting standards and significant increases in origination volumes.

We can observe through original FICO scores how lenders have been tightening credit standards since 2022 and continued to do so through the first half of 2024. Vintages typically experience "credit burnout" as they age, meaning that as loans get older, the number transitioning from current to delinquent typically declines after reaching a peak between 18 and 24 months.

However, the 2021 and 2022 consumer loan vintages have not yet shown a slowdown in their "roll rates" (i.e., those transitioning from "current" to "delinquent"). In contrast, 2023 vintages have exhibited a somewhat healthier trend, with roll rates improving relative to their trend during the pandemic period.

Exhibit 5: Market Place Loans Have Recently Shown A Healthier Trend



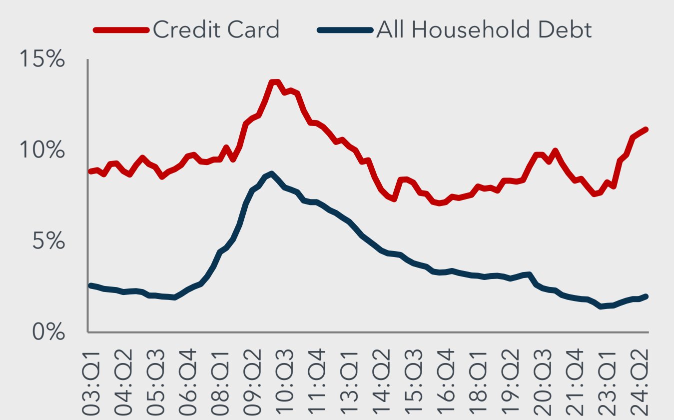
Note: As of December 2024.
Source: dv01, TPG.

Credit Cards: Delinquencies Normalizing Higher

Credit card delinquencies have risen to levels matching or marginally surpassing their pre-pandemic level. We believe this likely reflects a combination of both the easier lending standards that prevailed throughout the pandemic period and higher interest rates, which increase the cost to consumers of servicing their credit card debt. **That said, while several news articles have reported on rising credit card delinquency rates and charge-off volumes, we believe the reality may be more benign than is being portrayed.**

Exhibit 6: Headline Fed Data Likely Overstates Credit Card Delinquency Rates

Percent of Balance 90+ Days Delinquent By Loan Type



Note: Data as of November 2024.
Source: New York Fed, TPG.

Credit card delinquencies as reported by the Federal Reserve Bank of New York (FRBNY) tend to be overstated because of the inclusion of loans in "severe derogatory" status, according to research from Citi.

In other words, loans that are charged-off (i.e., the lender has already written them off and taken a loss) remain in the dataset for 26 months on average, distorting the overall picture of the pace of new delinquencies. When this distortion is accounted for, some 80% of the delinquent balances are removed, according to the Citi research report.

Policy Risk: A Proposed 10% Credit Card Interest Rate Cap

In a September 2024 pre-election rally, President Trump suggested his support for a temporary interest rate cap on credit cards at 10%. Several media outlets picked up on the statement, and following the election, Senator Bernie Sanders echoed President Trump's suggestion, calling the 10% cap "a very good idea," per media reports. There is currently no federal cap on credit card interest rates.

Such a provision was deliberately avoided in the Dodd-Frank Wall Street Reform and Consumer Protection Act (2010), a bill that was largely championed and voted through by members of the Democratic Party. Federal lawmakers have historically taken the position that interest rate caps should be decided at the state level. While there have been several attempts throughout history to implement a national interest rate cap (typically at 36%), those attempts have been successfully opposed by industry representatives and Congress.

In our view, the imposition of a 10% rate cap on credit cards is highly unlikely for several business, political, and legal reasons:

- Politically, such a proposal would require bipartisan support, and many Republicans in Congress are unlikely to support such a measure, including the lawmakers serving in South Dakota and Utah, which have enacted favorable lending laws and host the credit card operations of many major lenders.
- Multiple powerful industry groups with influential constituencies would likely respond forcefully against any federal interest rate cap on credit cards.
- There are very high procedural hurdles to instituting such a cap, as any such measure would have to go through the agency rulemaking channel (e.g., through the CFPB), and the only path for the interest rate cap is legislation through a closely divided Congress where Republicans hold a slim majority.

Student Loans: Minimal Consumer Impact as Payments Resume

We continue to believe that the end of the federal student loan "on-ramp", which temporarily relieved borrowers from the general consequences of late or missed payment, at the end of September of last year, will have little effect on overall consumer debt performance. Several surveys and studies have shown that student loans tend to be low in the payment hierarchy of household debts (housing, credit cards, auto loans and leases, unsecured loans, among others).

Additionally, generous income-driven repayment plans provided by the federal government are expected to help contain repayment disruption. As a result, we do not believe the resumption of student loan debts will be very impactful for the service of other household debt categories.

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One such program—"SAVE"—was introduced by the Biden administration in 2023 and has nearly 8M borrowers who are enrolled. The loans of these borrowers are currently placed in forbearance due to ongoing legal challenges.

No payments are therefore required from them, and no interest accrues on their loans during this period as the case proceeds through the courts. In contrast to SAVE, the original IBR program isn't subject to similar legal challenges since it was approved by Congress.

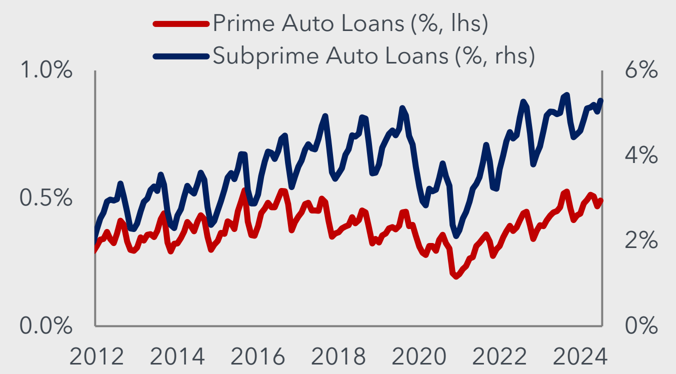
If the SAVE program is eliminated by the courts, the most likely outcome would be a return to the original IBR program. A rollback to Income-Based Repayment (IBR) for student loans would only be marginally negative for consumer credit markets.

While the SAVE program is more generous, a reversion to IBR wouldn't be catastrophic. It would still allow for payments below the minimum requirement, offering some relief, but the overall burden on some borrowers would likely increase.

Auto Loans: Rising Delinquencies and Policy Risks

Auto lending represents a pocket of weakness amid broadly stable consumer credit markets, in our view. Delinquency rates on both prime and subprime auto loans have risen steadily from the lows experienced during the pandemic, though there have recently been some signs of stability. Certain subprime auto originators have consistently underperformed historical benchmarks, and the auto ABS sector faces both fundamental and technical challenges such as a surge in supply.

Exhibit 7: Auto Delinquency Rates Rising



Note: Data as of January 2025.
Source: Intex, TPG.

On a more positive note, recent auto ABS vintages have benefitted from tighter credit standards on new originations, with some ABS sponsors now outperforming their historical averages. Moreover, data from the Fed's Senior Loan Officer Opinion Survey (SLOOS) indicates an overall tightening in the market, suggesting a better balance of risk and potential opportunities in certain segments moving ahead.

On the policy front, proposals by the Trump administration will have a mixed impact on auto sales. On the one hand, automobiles, with their long and complex supply chains, are at risk from potential tariffs. On the other hand, as a candidate, President Trump expressed support for making interest on car loans fully deductible, similar to mortgage interest.

We believe such a deduction is unlikely to have a significant effect on the subprime segment where customers typically do not itemize their taxes, but it could boost sales of more expensive luxury vehicles, both new and used. Still, any changes to the tax code would need to go through Congress.

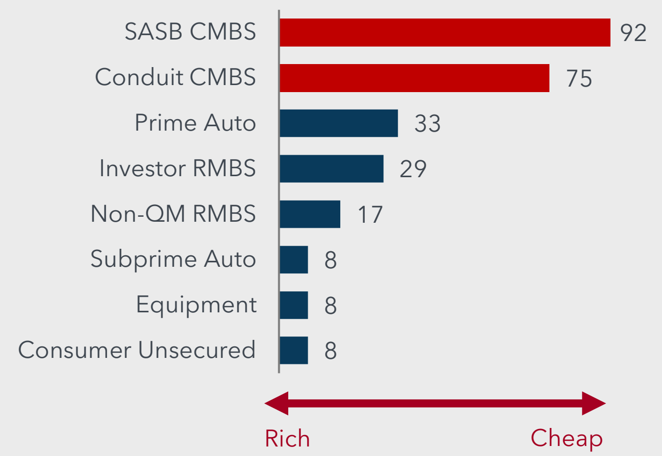
CMBS: A Rare Pocket Of Value

We expect the market to turn more constructive on the commercial mortgage-backed securities (CMBS) market in 2025. CMBS remains one of the few pockets of value across US spread products (see Exhibit 8), which should attract greater inflows, and supply dynamics have been highly favorable in recent years, with negative net issuance over each of the past two years.

That said, we remain highly focused on challenged loan performance across both single-asset single-borrower (SASB) and conduit deals.

Exhibit 8: CMBS Valuation Remains Attractive Both On A Historical Basis And Relative To The Rest Of The Structured Credit Complex

Percentile Ranks Of BBB/AAA Spread Ratio (Post-2021)



Note: Data as of Feb 2025. Source: Goldman Sachs GIR, TPG.

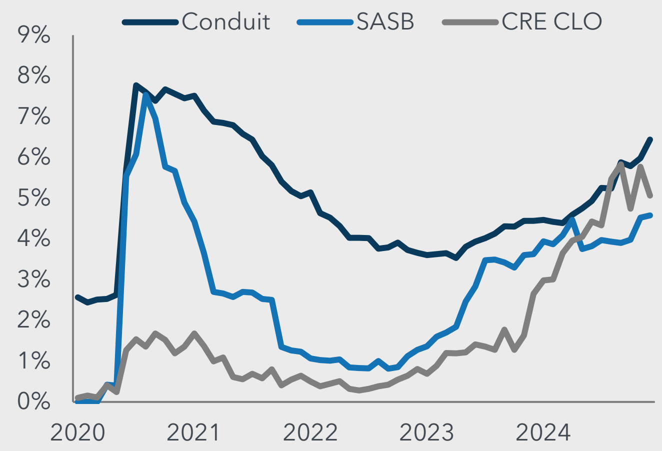
In December of last year, CMBS delinquency rates moved higher across almost all property types apart from industrial, with a particularly sharp rise in multifamily and office delinquencies. At the same time, this has not translated into higher realized loan losses, and distressed sales in 2024 were below pre-Covid levels, according to Goldman Sachs Global Investment Research.

This lower level of distressed sales is likely due in part to increased cooperation between lenders and borrowers to extend maturities. We expect delinquencies will continue to rise for properties where the underlying cash flow cannot improve and loans have exhausted extensions.

Despite overall strength in the residential housing market, a persistent oversupply of multifamily units has capped rent growth in many markets and accordingly some operators have struggled.

Exhibit 9: CMBS Delinquencies Have Been Trending Higher

60+ CMBS Delinquencies by Product Type (incl. FC/REO)



Source: JP Morgan, TPG.

Spread compression in 2024 alongside a move lower in benchmark rates helped CMBS financing become more workable for borrowers that were previously locked out last year amid fears around the health of commercial real estate (CRE).

However, while financing conditions have improved, seriously underperforming loans cannot count on tighter spreads and lower benchmark rates prior to maturity to create a workable loan coupon at their existing basis.

Consequently, we have seen a rationalization in property values as loan extensions and modifications have begun to run out and borrowers opt or are forced to refinance at lower valuations or sell their assets. There is still a tail of assets in CMBS deals that will continue to bide their time by using extensions, but the rubber has hit the road for many commercial property operators.

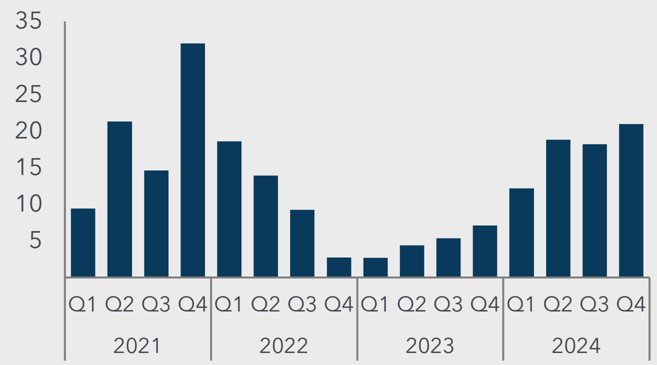
While rates have remained stubbornly high, comfort with CRE lending continues to improve, which should translate into strong 2025 issuance volume. Additionally, we expect CMBS market issuance volumes to continue to benefit from the regional bank pullback in commercial real estate lending as borrowers seek financing elsewhere, which should result in higher securitized CRE volume.

Demand Recovers: A Rebound in CMBS Issuance To Continue

The strong market demand for CMBS is evidenced by the strong pricing and significant pickup in issuance last year. Single-asset single-borrower (SASB) transactions are biased towards large, well-performing assets with strong sponsors. This sector of the market has bounced back first and in a dramatic fashion. Total issuance of SASB transactions in 2024 was $70.1 billion, a massive improvement (+259%) over the $19.6 billion in 2023.

Exhibit 10: CMBS SASB Issuance Has Picked Up

Quarterly CMBS SASB Issuance, $B



Source: JP Morgan, TPG.

In October, Tishman Speyer successfully priced a $3.4 billion deal backed by Rockefeller Center at a $6.1 billion valuation. In addition to increased volume, pricing has been very strong at the top end of the quality spectrum as well. While admittedly somewhat of an outlier, SL Green sold a piece of their interest in One Vanderbilt for just over $2800/sqft, representative of the strength of valuations for well-regarded properties.

Conduit issuance ($33.4 billion, +69%) and CRE CLOs ($8.3 billion YTD, +37%) also saw increased activity. CRE loan origination volumes for the third quarter of 2024 increased +59% over 2023-Q3, led by health care (+510%), hotels (+99%), and retail (+57%), reflecting growing confidence in the market, based on data from JPMorgan and the Mortgage Bankers Association.

We expect to see strong transaction volumes in 2025. In addition to refinancing well-performing assets, a growing volume of delinquent loans should result in an increase in distressed sales at levels that will make financing accretive.

Office: Optimism Amid Increased Distress

Office performance in CMBS deals continues to deteriorate. As of Q3 2024, the volume of office loans with special servicers has increased more than 45% since the start of the year, according to Trepp.

At the same time, improving sentiment around the office sector is visible in the pickup of issuance in the SASB market over last year, though this is biased towards higher-quality assets.

There were 6 office SASB deals in 2024, which is an improvement over the single partial-office deal in 2023 (BLP 2023-IND) but still down from the 8 deals issued in 2022 and 30 in 2021.

The increase in issuance has been supported by the growing embrace of stricter return to office mandates from large firms including JPMorgan, Amazon, Salesforce, Disney, and Barclays who have asked employees to be present 4 or 5 days in the office starting in 2025.

Relatedly, we have seen leasing momentum for the highest tier of properties accelerate, as Class-A buildings have been able to command strong rents amid low vacancy whereas Class-B and lower properties continue to face leasing challenges. CBRE reported that high-end office properties saw 2.4% ann. rent growth in the 1st half of 2024, while rents for low-end properties declined by 1.2%.

In 2025, they expect rents for higher-tier properties to hold up, with some moderation of concessions, but a more severe drop for lower-tier properties. **Overall, we expect two opposing dynamics to play out for office in 2025—delinquency rates and realized losses are likely to keep growing in CMBS deals, while transactions and leasing volume should both continue to gain momentum.**

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Data Centers: A Growing Cross-Asset Opportunity

In 2024, the data center sector saw record issuance in the asset-backed securities (ABS) market, with 18 ABS deals pricing as compared to only three single-asset single-borrower (SASB) CMBS deals. Noteworthy first-time issuers in the data center space included Centersquare, Cloud Capital, Compass, and Switch.

Data center issuers have increasingly opted for the ABS market given the negative sentiment around CMBS that persisted through last year and to take advantage of the efficiencies that issuing through a master trust structure can offer as compared to one-off CMBS deals.

In ABS deals, issuers pledge their fee simple or leasehold interest in one or more data center properties along with the contractual lease payments owed to them to a bankruptcy remote master trust. The trust then issues a series of notes to investors and is typically capable of accepting additional collateral and issuing additional notes in follow-on offerings.

In contrast, the cash flows in CMBS deals are derived from the underlying mortgage note that is owned by the issuing trust and is secured by the physical property. The issuing trust generally isn't able to issue additional debt.

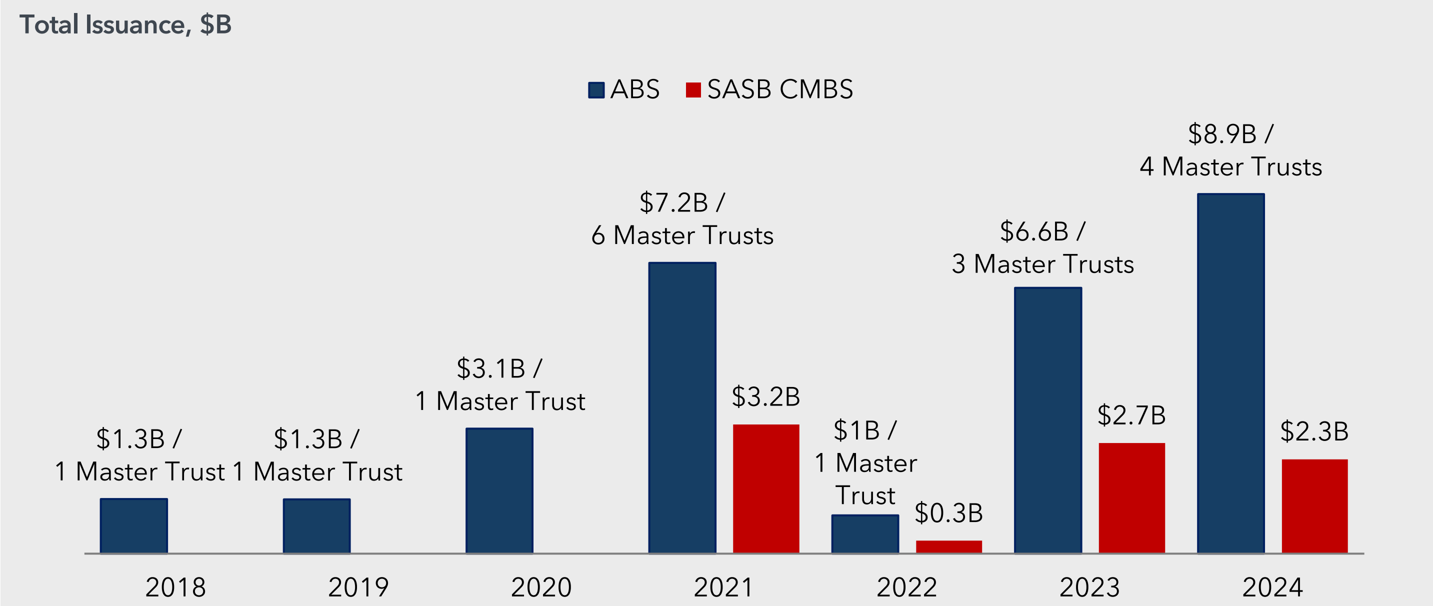
CBRE reported a +24.4% YoY growth in North American data center inventory from the first quarter of 2023 to the first quarter of 2024. Northern Virginia, considered the data center capital of the world, saw its vacancy rate decline from 1.8% to 0.9% despite a +18% increase in inventory, absorbing over 400MW of net capacity.

As of the fourth quarter of 2023, S&P estimates there are over 2,000 operational data centers in the US, with approximately 300 more planned or under construction. The rapid expansion in data center capacity has been driven by strong demand for computing power amid the growth of artificial intelligence (AI), momentum in leasing growth, and increasing investor interest in data centers and digital infrastructure more broadly.

A notable development in the sector was the strategic partnership announced on December 10th between Intersect Power, Google, and TPG's Rise Climate II fund. This partnership aims to provide renewable power and energy storage solutions to new data centers, targeting $20 billion in investment by the end of the decade.

Power remains a limiting factor for new data center buildouts. However, digital infrastructure assets, including data centers and fiber (often in ABS), continue to show sizable growth potential, driven by the ongoing AI boom.

Exhibit 11: Data Center Debt Issuance — ABS vs. CMBS



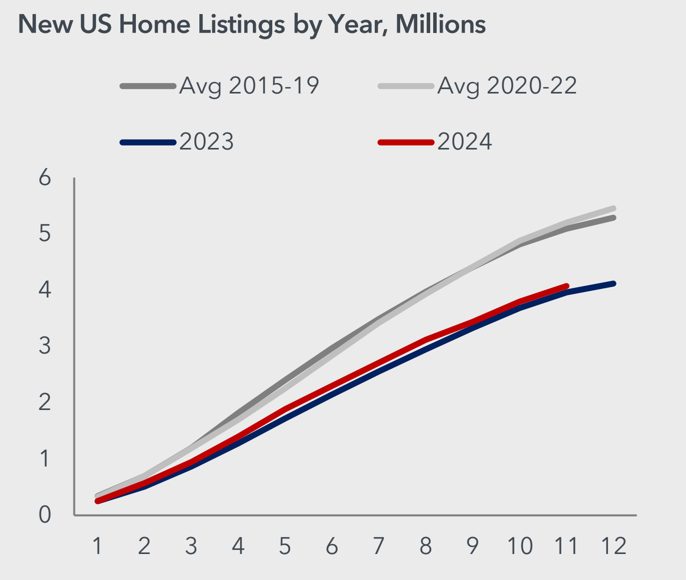
Source: BBG, Intex.

Housing: Higher Rates Leave Housing Little Changed

Many of the housing conditions that have prevailed over the last two years–elevated mortgage rates and strong disincentives for homeowners to move–will likely continue in 2025. At the moment, the market seems to have converged around the expectation that elevated interest rates are likely to persist and largely faded the prospect for significant rate cuts in the year ahead. These conditions bode well for home equity origination volume but are somewhat negative for overall housing activity.

For most of the US, the impact of these dynamics on housing markets will be limited activity, steady home price appreciation, and low levels of affordability. When it comes to affordability, higher property taxes and insurance (escrow) payments will continue to be headwinds for certain pockets of the US. However, many of those same areas present opportunities to participate in the creation of much-needed new home supply.

Exhibit 12: New Listings Have Been ~1M Short On Average In Recent Years

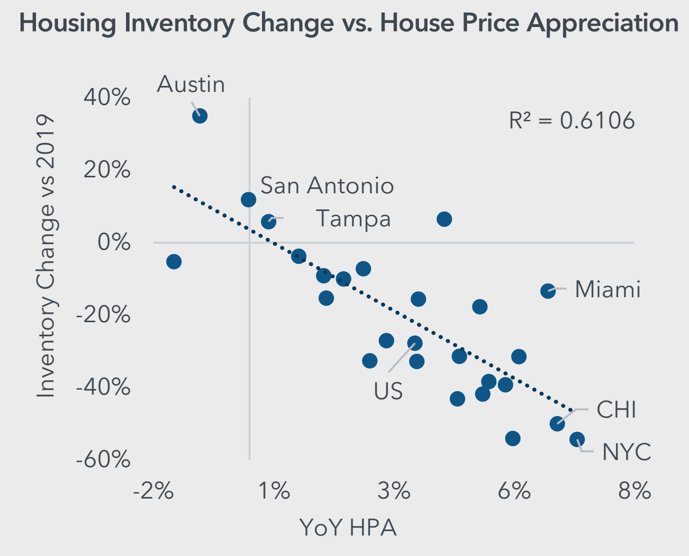


Note: Data as of December 2024.
Source: Bloomberg, National Association of Realtors, TPG.

New listing activity provides a useful gauge of general housing conditions. Through November 2024, national listings were more than 1 million short of the average yearly pace experienced from 2015-22, with the pre-pandemic years likely serving as a baseline for homebuyer expectations for what constitutes "normal" (see Exhibit 12).

Listing activity has historically shown an inverse relationship with house price appreciation (HPA), and limited turnover will continue to be supportive of national home prices, even if at lower levels of growth than in recent years (see Exhibit 13).

Exhibit 13: Limited Turnover Should Support House Prices in Most Geographies



Note: As of December 2024.
Source: BofA Global Research, TPG.

Still, we expect the lock-in effect of higher interest rates, which reduce homeowners' incentive to move because doing so would require taking on a more costly mortgage at a higher cost, to decay over time for 2020-22 borrowers. Compared to 2019, listings have grown in some parts of the country, mostly concentrated in Florida and to a lesser extent Texas. We attribute higher listings, in comparison to baseline 2019 levels, as having a sharp negative impact on home prices.

Higher Home Purchase Costs Worsen Affordability

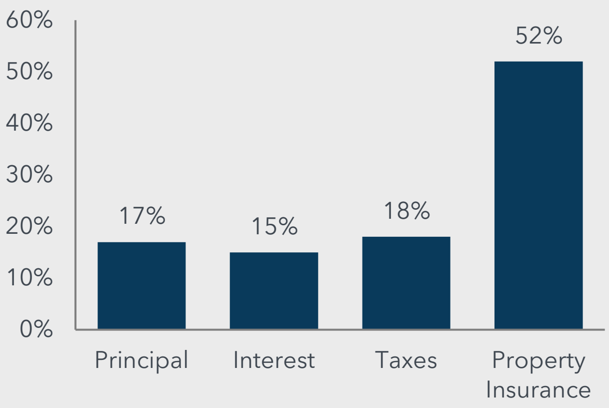
We expect the ongoing increase in escrow payments will continue to put upward pressure on new listing volume, particularly in the areas most impacted by rising insurance. A [recent report] from ICE Mortgage Technology estimates that the typical mortgage payment of a recent borrower, inclusive of principal, interest, taxes and insurance is $2,600 per month, roughly $600 more than borrowers from 2020-21.

As shown in Exhibit 14, property insurance payments are over 50% higher since 2019 and appear poised to only rise further. Consider a report from S&P Global which states that the "homeowners insurance industry posted its worst underwriting results in over a decade in 2023" as the net combined ratio rose to 110.5%.[1] The combined ratio measures the overall profitability of insurance underwriting activity (i.e., losses and expenses against premiums collected) and has been over 100% for six of the last seven years.

We think this is a strong indication that property insurance is likely to rise, bringing higher escrow payments, which we believe is a strong driver of listing activity in these regions.

Exhibit 14: US Property Insurance Payments Are Up >50% Since 2019

Change in Property Insurance and Components Since 2019



Note: Data as of November 2024.
Source: ICE McDash + Property Insurance, TPG.

Cross-Asset Focus: Home Equity Products

A strong increase in home improvement ABS issuance in 2024 was driven in large part by the well-publicized mortgage lock-in effect, which keeps people "locked-in" to their existing homes to maintain the rock-bottom mortgage rates they received between 2020-22.

A recent report from the Urban Institute shows some 78% of "outstanding agency borrowers have a rate at or below 5%", and the share of agency mortgages where it made sense for the borrower to refinance was near 1% in January 2025.

This sizable universe of "locked-in" borrowers across the US will continue to prefer various forms of home equity and home improvement loans—which enable them to gain liquidity from home equity values that have typically risen in recent years—to moving to a different home and being forced to undertake an uneconomic refinancing (see Exhibit 15 – next page).

Of the $35 trillion of owners' equity in US real estate, some $2 trillion of home equity can be accessed by conventional borrowers alone and up to $17 trillion when including unmortgaged properties among others, according to Bank of America. If mortgage rates remain sticky above 5.5%, we expect new existing home listings and housing turnover to continue to be suppressed compared to pre-pandemic levels. This would, in turn, be good for home equity origination for seasoned borrowers.

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Exhibit 15: A Comparison Of Popular Home Equity Products

	Home Improvement	CES	HELOC
Amount	Avg $12-14k	Avg $50-$100k	Avg $50-$100k
Credit Score	Avg 750	Mid 700s	Mid 700s
Rate Type	Fixed	Fixed	Prime
Amortization	Draws and repayment	Amortizing	Draws and repayment
Security	Unsecured, UCC	Lien	Lien
Lender Type	Non-banks thru merchant/contractor	Non-bank & bank	Non-bank & bank
Underwriting	Alternative	Full and Alternative	Full and Alternative
Other	Can have interest rate discounts	Mostly owner but some 2nd home and investor	Mostly owner but some 2nd home and investor

New Homes and Financing Land Development

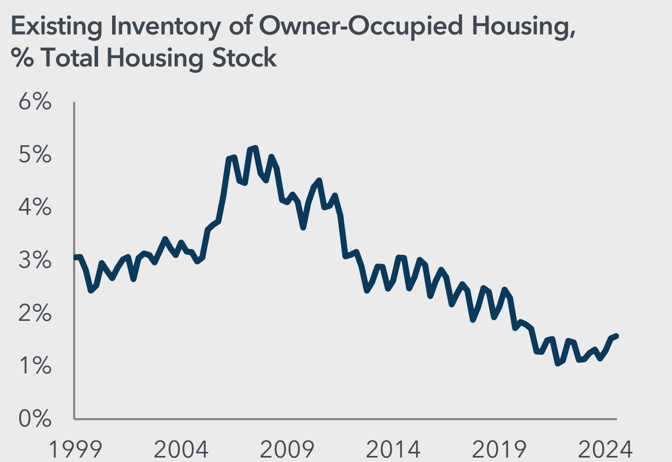
There has been no lack of media coverage of the ongoing housing shortage in the US, particularly entry level and other affordable housing. To provide more affordable homes across the US, builders have been constructing smaller homes on smaller lots. This has proven popular as buyer preferences have evolved to favor such homes.

Large, sprawling homes have largely fallen out of favor in many markets, and 43% of new construction buyers cited "move-in ready" status as the primary driver of new home choice. That compares to the median age of the housing stock estimated to be around 40 years. New homes have the additional benefit of being built to the latest municipal code, possibly helping with rising escrow costs, particularly in states like Florida.

In 2024, several reports noted that the price premium for new homes over existing homes had disappeared, leaving new homes as more affordable and inverting the normal relationship. But most of this analysis focused on median existing and new home prices, an approach we believe is simplified and ignores the multitude of factors that determine home prices, whether new or existing. Still, we do generally agree with the argument that new homes often present a more compelling buying opportunity for prospective homebuyers. Additionally, amid high prevailing mortgages, homebuilders have been willing to offer incentives like rate buydowns to prospective buyers in an effort to maintain affordability.

To gain exposure to the theme of increased new home demand across the US, we have favored partnerships with real estate land developers in desirable geographies, mostly across the southeastern US. In our partnerships, we provide financing for the acquisition and horizontal development of land in order to prepare it for well-known homebuilders to construct single-family homes and establish new residential communities.

Exhibit 16: Housing Inventory Has Fallen Steadily



Note: Data as of December 2024.
Source: Bloomberg, National Association of Realtors, U.S. Census Bureau, TPG.

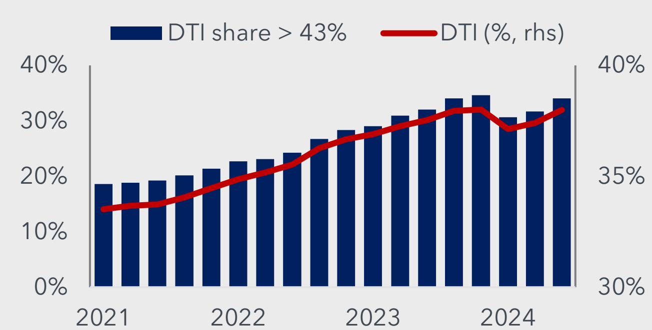
Underwriting Matters

We expect housing to continue to be a source of financial stability for US households, though we see reasons to scrutinize mortgage pools even more in 2025. For one, mortgage rates have more than doubled in recent years, hampering the ability of recent homeowners to organically build home equity while home price growth is likely to be limited or even negative in some areas.

Additionally, with mortgage rates and escrow payments elevated, debt-to-income (DTI) ratios have become a more important assessor of risk. DTI ratios measure the total mortgage payment, inclusive of insurance and taxes, in addition to the borrower's other debts against their income.

We can observe that DTI ratios have been rising, and the share of higher DTI loans has also grown. Conventional wisdom has long held that the DTI ratio is a weaker predictor of credit performance than FICO scores or LTV ratios. While this still generally holds true in our view, we have put additional scrutiny and model overlays on loans with higher DTI ratios when the loan amount is large or where additional risk factors are present.

Exhibit 17: DTI Ratios Are Rising Amid A Larger Share Of High DTI Loans



Note: As of January 2025; CAS issuance since 2021.
Source: Fannie Mae, TPG.

The Impact of Policy on Housing:

GSE Reform & The MBS Market

Since the Global Financial Crisis (GFC), there have been multiple proposals to return Fannie Mae and Freddie Mac back to the hands of the private market. While some small steps have been made toward that goal over the last few years, these government-sponsored enterprises (GSEs) remain firmly within federal government control.

Following the US election and recent policy changes, speculation surrounding the possible privatization of the GSEs and the impact on the MBS market have resumed. Such ambitions are beyond the scope of this paper, but we think that absent some form of an explicit full faith, US government guarantee—which is a tall order—most proposals will fall short of MBS investor expectations. There are over $6.5 trillion of MBS outstanding between Fannie and Freddie, and the pre-GFC "implicit guarantee" is not a viable solution, in our view.[4]

We do not expect meaningful, if any, progress towards privatization until the fourth year of President Trump's term, ultimately setting up a passing of the baton to the next administration. More likely, we expect the most concrete advances to shrink the "footprint" of Fannie and Freddie in the coming years where they may limit their activities in non-core products, in our view.[5] Additionally, we look for limitations to products that may be deemed non-core or beyond the mission of the GSEs such as cash-out refinancing or the previously scrapped 7% non-owner-occupied cap.[6]

Immigration Policy & Housing Supply

The prospect of major changes in US immigration policy in the coming year could impact the outlook for housing supply. We will limit our comments to data sourced by the Harvard Joint Center for Housing Studies (JCHS), which shows that some 34% of workers in construction trades were foreign born in 2023. There are high concentrations of foreign-born trade workers in California, Texas and Florida, regions with higher homebuilding activity where land remains available, as well as New Jersey, New York and Maryland. The JCHS shows that over half of the workers in these trades like plaster/stucco, drywall, roofers and painters are foreign born as well.

Two possible implications of a reduction in foreign-born workers come to mind: a decline in the construction of new housing, a net positive to home prices given additional scarcity, and lower home demand given fewer people to occupy existing homes, whether rented or owned. Additionally, less skilled labor for housing rehab will put downward pressure on housing turnover if the costs to refresh a house prior to listing for sale become burdensome (e.g., fresh paint, plumbing repairs, etc.)

Endnotes

1. https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-homeowners-insurers-net-combined-ratio-surges-past-110-81711947

2. https://www.zillow.com/research/new-con-existing-price-34235/

3. https://www.nahb.org/news-and-economics/press-releases/2024/08/median-priced-existing-homes-less-affordable-than-new-homes-in-second-quarter

4. https://www.newyorkfed.org/medialibrary/media/research/epr/2018/EPR_2018_gse-guarantees_passmore.pdf?sc_lang=en

5. https://www.fhfa.gov/news/news-release/fhfa-announces-conditional-approval-of-freddie-mac-pilot-to-purchase-second-mortgages

6. https://sf.freddiemac.com/articles/news/update-on-the-cap-for-second-homes-and-investment-property-mortgages

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