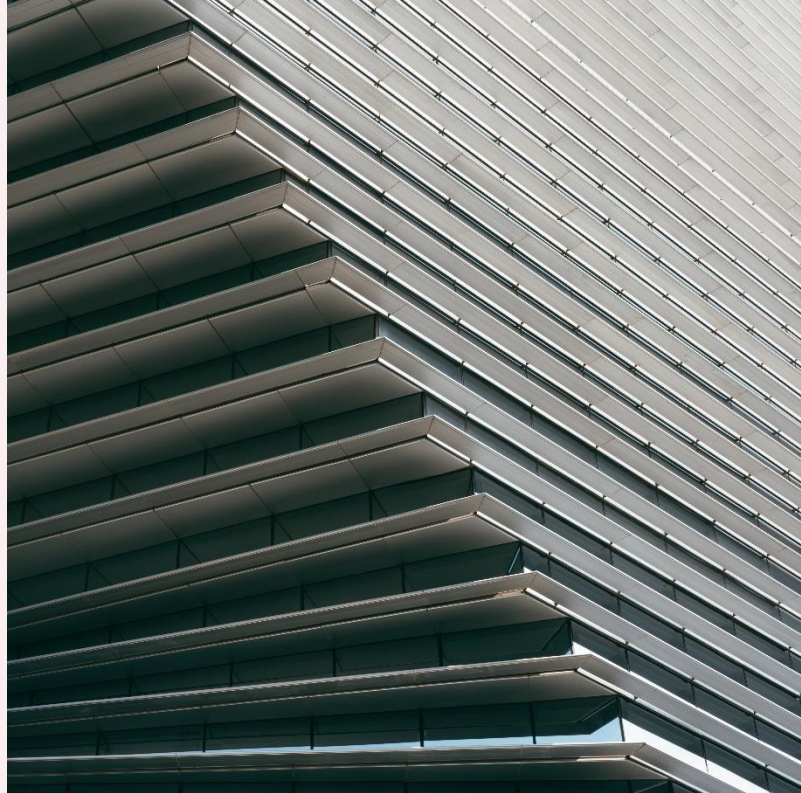




New investors and sector changes drive growth in fleet securitisation

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Further interest in vehicle fleet securitisation is growing across Europe, particularly within the car rental sector, with private credit and non-bank investors being increasingly attracted to this esoteric asset class. At the same time, the rise of specialised vehicle rental services and new offerings from tech companies, such as car sharing and subscription models, is prompting market participants to consider new financing platforms as they come of sufficient scale. Some of the first mezzanine financing transactions for these structures have also been put into place in the last 12 months, fuelled by a growing focus on non-traditional infrastructure financing, which this is increasingly seen through the lens of and which has unlocked the appetite needed from the kinds of private credit and non-bank investors referred to above.

One of the advantages of securitisation fleet financing is its ability to complement other forms of funding within a diversified capital structure. For example, some businesses have used securitisation platforms to refinance portions of their existing non-securitisation fleet financing, allowing both arrangements to operate in parallel. This is possible because securitisation fleet financing does not, typically, encumber the operating business in the same way as a traditional financing, as its sole recourse is usually (beyond an unsecured rent claim to the operating company and, perhaps, a structurally junior parent guarantee that stands behind rent payments to the AssetCo (or "FleetCo" as we commonly refer to it)), is to the vehicles and related rights that underpin the financing.

The asset-backed nature of fleet financing has recently attracted interest from participants in the entire vehicle supply chain – from car manufacturers to car dealers and auction platforms.

How are these deals typically structured?

These fleet financings are typically structured with a single borrowing entity that interacts with the external finance parties and a series of FleetCos, usually – although not always – one for each jurisdiction, to which the proceeds of the financing are on-lent for the acquisition of

vehicles. The financing is normally revolving with frequent drawings, to allow the business to up-fleet and de-fleet based on seasonality and other business patterns and needs. The vehicles, which are held by the FleetCos and have security granted over them in favour of the borrower, are then leased to the operating business under master lease terms. Rents under the master leases are sized to service the ultimate debt. The balance of the purchase price for the acquisition of vehicles – beyond that funded by the senior and mezzanine debt – is funded through junior financing, which also serves as the method for the originator entity in the corporate group to hold the 5% risk retention piece, either directly or through one of its wholly-owned subsidiaries.

Key nuances of these kinds of assets/financings

Fundamentally, these are borrowing base financings that look to the underlying value of the fleet from time to time and are not modelled on the rentals generated by the fleet from the broad base of customers; this is a common misunderstanding. This makes these kinds of deals distinct from traditional Auto ABS deals where the underlying customer leases/loans are being financed. Usually, the borrowing base in these deals is determined primarily by the net book value of “eligible vehicles”, the amount of manufacturer receivables for those vehicles which are not what are determined as “at risk”, (i.e. where there is a buyback receivable from the relevant OEM), and, dependent on the tax structure for the relevant jurisdiction, VAT receivables, where possible. Accrued and unpaid lease payments and cash in the structure will also be given credit.

Structuring around residual value (that is, value of the vehicle fleet after the agreed use period) is often a key feature of these financings.

It will be established at the outset what portion of the fleet will be subject to arrangements with manufacturers that contain a buyback as opposed to “at risk” vehicles which will need to be sold in the open market through dealers and auction houses, where there is greater volatility in the sales prices that may be achieved. Market value tests therefore require careful consideration, particularly where there is not an established second-hand car market for certain types of vehicles (for example, EVs). Concentration limits will typically regulate the level of “programme” versus “at risk” elements of the fleet, and there will be concentration limits relating to manufacturers as well as provisions around their credit ratings. Other controls will include, limits and conditions around matters such as the subletting of vehicles within the corporate group and jurisdictions.

How do fleet financing features differ across jurisdictions?

While the overall economic effect of the structure in each jurisdiction is generally aimed at achieving the same outcome, there are differences in implementation from jurisdiction to jurisdiction. At the financing level, for example, an FCT structure is typically used in France, while in Italy we have undertaken a significant amount of work on these platforms implementing dedicated Law 130 financing structures for the Italian leg of the transaction. For the latter, a key feature is that the asset-level documents are usually more isolated from the financing-level documents to maintain separation.

These cross-border financings often require very detailed legal, regulatory and tax analyses, as the correct treatment of leases from a regulatory and

tax perspective varies significantly across Europe. Where possible, these deals are structured to avoid unnecessary tax leakage. The need for such analyses means that although pan-European fleet securitisation may appear similar to US deals, the actual fleet acquisition, lease and servicing structures used are very different.

Insolvency and repossession risk

A key focus for lenders in this type of financing is the insolvency and repossession analysis provided by legal advisers. This focuses on the ability of the FleetCo to repossess the vehicle fleet from a lessee – the operating company – in an insolvency scenario in each relevant jurisdiction, and how long this is likely to take to liquidate/dispose of the vehicle fleet. This will factor in the various stay and moratorium features of the different local insolvency regimes. Credit enhancement in the financing will normally be sized to assume the operating business will not pay rent that would otherwise service the financing during any stay and liquidation period.

In addition to the usual suite of opinions and memoranda you would expect to receive for a financing of this nature, counsel will also provide memoranda on other aspects of the structure that might impact repossession and disposition of the fleet. These include memoranda on rights to vehicles that are parked on third-party premises where the operating business fails to pay rent, retention of title to the vehicles in the event of manufacturer insolvency where the full amount of a repurchase price has not been paid to the FleetCo, and the effectiveness of any waiver of set-off provisions included in agreements with manufacturers and dealers. While delivery of these memoranda is typically a prerequisite for obtaining a rating for the financing, even on unrated deals the lenders will want most of these matters covered as they are fundamental to the structural viability of the deal in a distressed scenario.

The insolvency remoteness of the SPVs themselves will also typically need to be addressed, as well as an analysis of the tax implications which may arise as a result of liquidating the fleet in the relevant jurisdictions. Ongoing tax risks identified in the structure will be managed through either reserves or appropriate protections in a tax deed of covenant.

Why mezzanine investors are turning to fleet financing

As mentioned earlier, there is an increased interest from mezzanine investors in these structures. The concept of adding mezzanine debt on these kinds of financings is some ways not entirely new – Europcar's high yield, for example, has, shared in the pool under its European platform for many years on what is effectively a mezzanine basis. But the transactions we have seen recently are of course different. There are two facets driving this: first, a mezzanine tranche can help bridge some of the gap in the advance rate and free up capital that would otherwise be required to be applied under the subordinated financing; secondly, there is increasing participation from a wider spectrum of investors.

What intercreditor considerations are there from a mezzanine perspective for these types of deals?

There are typical pinch points around intercreditor issues that you would expect when bringing a mezzanine investor into an existing financing, but

noting that we have seen a wide variation in approach on these deals with no uniform or market position. For example, we have seen a mezzanine investor accept a very simple set of basic terms modifications as entrenched rights and another mezzanine investor, on a different deal, ask for a far more extensive set of entrenched rights and controls, particularly around vehicle fleet disposition.

While the latter should arguably always be a key focus for a mezzanine investor in one of these deals, particularly around maximisation of value on disposals of the fleet in a distressed scenario, the level of entrenched rights will depend on a variety of factors including whether the mezzanine investor wishes to play a more active relationship role in the financing or prefers a more passive role, with the senior banks continuing to manage the day-to-day aspects of the programme through their relationship with treasury.

What about ratings?

A number of these fleet financings have been rated, with rating agencies placing significant emphasis on the comfort package around insolvency remoteness and repossession. Regardless of whether the platform is rated or not, lenders typically expect the full suite of fundamental memoranda referenced earlier. In some cases, platforms are established with all the memoranda and legal comfort required by rating agencies, anticipating that a rating may be sought at a later date, with credit enhancement sized accordingly.

Clifford Chance has leading expertise in fleet financing, with members of our team having structured and worked on most of the largest existing platforms, including those of Avis, Hertz and Europcar.

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