

## Outlook for Asset Backed Securitization in Germany

Following a strong start in the first half of the year, the German securitization market looks set to keep pace with last year's fast growth. Total risk transfer in the ABS and CDO/CLO area already represents nearly 60 percent of last year's volume and the issuance of CMBS should also assist, as it now represents nearly 50 percent of European new issue volumes year-to-date. This is also considering that last year's ABS volumes were mainly driven by the jumbo transaction German Postal Pensions Securitisation 2 PLC and there has been no similar jumbo transaction completed this year.

Standard & Poor's Ratings Services is optimistic for the upcoming quarters when looking at the pipeline of originators and arrangers. However, if the recent reluctance that has been seen on the investor side continues, it could make it difficult to place the predicted volumes of issuance to investors. With the end of the year traditionally a very strong time for structured finance, total performance in 2007 will largely depend on investors' approach to structured finance transactions in the two final quarters of the year.

### ABS and CLO remain active

Despite the lack of any jumbo transactions so far this year, and with none in the pipeline, ABS in Germany was nevertheless a very active market in the first six months of the year. The driving asset classes were once again auto loans/leases together with SME securitizations (true sale as well as synthetic), where the market saw a combined total of 15 transactions.

The number of originators of auto loan/lease transactions increased with two originators either entering the market for the first time at all (BMW: Bavarian Sky S.A.) or after an absence from the term market

in Germany for some years (Ford: Global-drive 2007-A B.V.).

Santander Consumer Bank issued two transactions in the first half (SC Germany Auto 07-1 Ltd. and SC Germany Auto 07-2 Ltd.), making it a repeat issuer now with three transactions in the market. Volkswagen Bank GmbH continued their loan and lease programs (Driver and VCL, respectively) by issuing a further transaction for each program (Driver Four GmbH and VCL

No. 9 S.A.). The total volume of these true sale auto ABS issuances in Germany reached 5.8 billion euros.

Consumer finance in general, and car financing in particular show a strong pipeline for the coming quarters. As well as further repeat transactions in the auto segment, new originators are looking into securitization of unsecured consumer loans and at least two transactions of this type are expected over the next six to nine months.

### New players and expanded programs

Although cash SME transactions were tested earlier this year with new defaults that led to the first ratings downgrade that S&P has made in this innovative asset class (CB MezzCAP),<sup>1)</sup> the market is nonetheless very active with new players entering and existing programs being expanded. As a reaction to the defaults that have been seen in these transactions, the idea of pooling several of those programs for securitization is being intensively discussed. Given that these transactions usually show a small number of assets - mostly around 50 borrowers - pooling should help to increase diversity in the pools and reduce the impact a single default could have.

Even without several originators pooling together, we are seeing a tendency toward larger pools with reduced single borrower concentrations. Furthermore, S&P expects originators to be more conservative regarding the allowed overlap of borrowers between different platforms. Currently, there are numerous SME companies which are included in more than one existing securitization.

Of the arbitrage SME transactions four new securitizations were seen in the first

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*Auch wenn der ABS-Markt und die großen Ratingagenturen gegenwärtig viel Kritik einstecken müssen, sieht der Autor in der (quantitativen) Marktentwicklung eine aussichtsreiche Zukunft für die Verbriefung in Deutschland: Gemessen an der Zahl der Transaktionen im ersten Halbjahr werde der Markt das gute Wachstum des vorangegangenen Jahres wohl wieder erreichen können. Insbesondere Asset Backed Securities (ABS) und Collateralised Loan Obligations (CLO), so seine Bestandsaufnahme, stellen dabei aktive Treiber dar – sowohl mit neuen Akteuren wie auch erweiterten Programmen. In einem etwas geringeren Maße gelte dies auch für Commercial Mortgage Backed Securities (CMBS). Demgegenüber sieht er Residential Mortgage Backed Securities (RMBS) im Vorjahresvergleich etwas im Hintertreffen. Mittelfristig erwartet der Autor eine steigende Anzahl an True-Sale-Verbriefungen, da Originatoren ihre Portfolios erweitern und breitere Kundenschichten anlocken wollen. Ohne (offensiv) auf die gegenwärtigen Turbulenzen einzugehen impliziert er damit gleichsam die Erwartung einer Marktberuhigung. (Red.)*



half of the year (Force Two Limited Partnership, Puls CDO 2007-1 Ltd., Heat Mezzanine 3, and S-Core 2007-1 GmbH) with a total issuance volume of more than 1.3 billion euros.

### **Risk management rather than refinancing tools**

Moreover, we saw another four German balance-sheet SME and corporate loan transactions (Cart 1 Ltd., Cosmo Finance 2007-1 Ltd., Geldilux-TS-2007 S.A., and Sigma Finance Inc.) plus one Swiss (Clock Finance No. 1 B.V.) with a total issuance volume of notes of 4.9 billion euros and total risk transfer of 11.0 billion euros. With the exception of Geldilux, all of these are synthetic transactions being used as risk management tools rather than refinancing assets.

Similar already existing large, well-diversified transactions have historically had more stable performance than the above-mentioned arbitrage transactions: the former showed consistently stable performance, with the ratings on notes in three transactions (Promise XXS 2003-1, Promise Color 2003-1, and Promise Z 2001) being raised in the first six months of the year. Both SME types are showing a strong pipeline for the rest of the year with up to seven transactions currently being marketed or in the pipeline.

### **CMBS still growing, but multifamily assets no longer dominant**

In addition to the well-established asset classes of consumer finance and SME, more infrequent asset classes like project finance loans or shipping loans are beginning to get greater attention from originators and arrangers. Given that there are only a limited number of comparable transactions, the implementation and set-up of such securitizations is quite complex and time-consuming.

The issuance of German Commercial Mortgage Backed Securities (CMBS) transactions continued to grow strongly. In the first six months of 2007, approximately 14.7 billion euros of issued notes were secured by German collateral, which represented nearly half of European CMBS issuance. Of 157 billion euros of total European CMBS notes outstanding, approximately 27 percent are secured by German commercial properties. This reflects a five percentage points increase since December 2006.

This growth is a result of the strong performance of the German property investment market. Non-domestic investors were very active during the first half of 2007 and acquired large volumes of German commercial real estate. Compared with previous years, the dominance of multifamily assets has decreased because of a higher interest in retail and office properties. Additionally, current securitizations increasingly included refinance loans replacing loans in earlier transactions.

### **Improved granularity in conduit programs**

S&P expects the German CMBS market to continue to perform at a sound level, as international conduit lenders are very active in this market. Overall, the granularity in conduit programs seems to have improved as the number of securitized loans increased. Also, German banks are expected to continue to transfer credit risk in synthetic transactions to optimize their balance sheets.

However, the performance and issuance of the CMBS notes secured by German collateral is closely linked to ongoing investments in German commercial properties and the performance of the German economy. Notably, a high portion of current transactions is represented by loans funding property investments of international

sponsors. As such, a change in market activity, (due to rising interest rates, for example), is likely to have an impact on issuance volumes. Despite a healthy pipeline of above nine billion euros, it is difficult to estimate the active portion of this in the current market environment.

### **Residential Mortgage Backed Securities lagging behind**

With only one RMBS transaction this year that included German mortgages, the RMBS sector was clearly left lagging behind in the first six months of 2007. The pipeline for the second half of the year looks more promising. If all transactions in the pipeline come to market this year as targeted by the originators, regardless of the weak start we could well see a significant increase in total risk transfer compared with last year. For several transactions the regulatory call was exercised with the start of the transition of originators from Basel I to Basel II and we expect more of these calls as further originators get approved by the German regulator to switch to Basel II.

The performance of the existing German RMBS transactions has been stable throughout the first half of this year with two upgrades. Despite the general stability, we have observed credit deterioration and first-loss piece erosion in selected, more seasoned, transactions. Currently, S&P has one "credit watch" with negative implications placement outstanding, which is expected to resolve in the next few weeks.

In the medium term we expect to see more true-sale transactions, as several originators are looking into expanding their product portfolio and beginning to target nonconforming borrowers.

### **Footnote**

<sup>1)</sup> See „Ratings On CB MezzCAP Class D And E Notes Lowered On Erich Rohde KG Insolvency" published by Standard & Poor's on June 15, 2007.