

# SFA Research Corner

## Hertz's New Lease on ABS

July 19, 2021

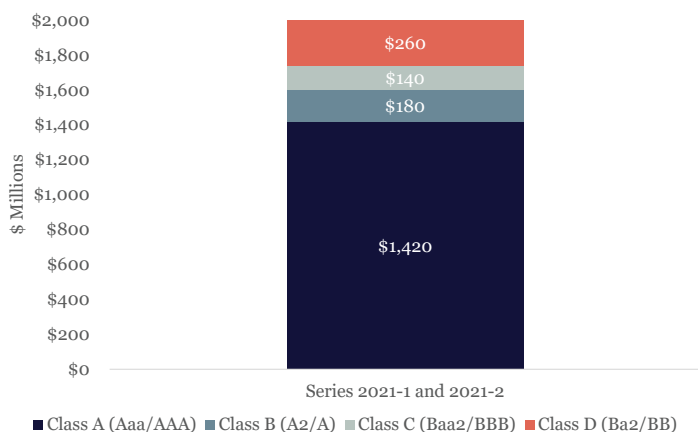


### WHAT WE'RE WATCHING

✉ [Elen Callahan](#)  
Head of Research  
203.512.0503

June activity did not disappoint. As of June 25, \$74 billion of bonds were offered across Non-Agency RMBS, CMBS, ABS, and CLOs. Arguably the capstone to June's vigorous activity are two ABS transactions totaling an impressive \$4 billion from Hertz Global Holdings, one of the largest rental car companies in the world. Hertz's offerings have pushed 2021 issuance for this subsector to a new record high of \$5.6 billion. The transactions, which were offered as Series 2021-1 and 2021-2 with tenors of three and five years, respectively, were met with strong investor demand and upsized from an original guidance of \$2.2 billion.

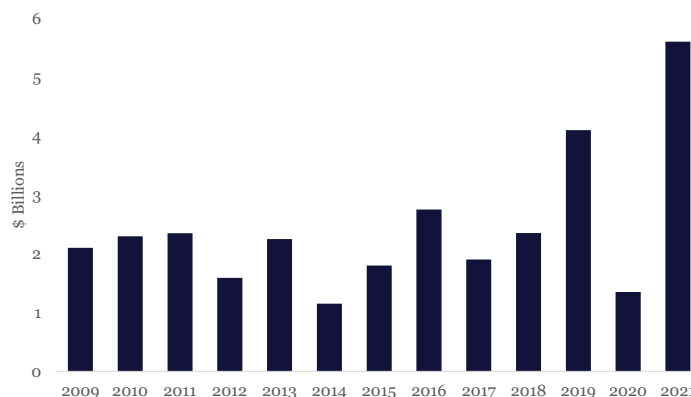
#### Hertz Vehicle Financing III LLC Series 2021-1 and 2021-2 Each Issued in Four Tranches - Total Size \$4 Billion



Ratings (Moody's/DBRS Morningstar)

Source: [Finsight](#)

#### Rental Car ABS Issuance History 2009 to 2021 YTD



Source: [Finsight](#)

As a testament to the strength of the securitization market, investors' search for yield in a prolonged low interest rate environment, and growing confidence in the recovery of the travel sector, Hertz raised this capital even as the company emerged from a highly visible Chapter 11 bankruptcy filing, a period of tumultuous leadership changes, and a global pandemic that shuttered the travel and tourism industry.

The bonds were issued through Hertz Vehicle Financing III, a newly formed bankruptcy remote special purpose vehicle stipulated under Hertz's reorganization plan. As specified in this plan, proceeds from the bond deals will be used to fund the purchase of vehicles from two earlier ABS facilities-- Hertz Vehicle Financing LLC and Hertz Vehicle Interim Financing LLC-- and to pay off the outstanding notes from Hertz Vehicle Financing II LP and Hertz Vehicle Interim Financing LLC. Remaining proceeds will be used to acquire or refinance eligible vehicles for Hertz's U.S. fleet.

Acutely impacted by a pandemic-induced drop in rental car demand, with limited clarity on timing of a recovery, on May 22, 2020, Hertz filed for bankruptcy protection under a Chapter 11 reorganization. Over 13 months later, on June 30, 2021, [Hertz](#) successfully emerged from the proceedings as a “financially and operationally stronger company.” Judge Mary Walrath, who approved the plan, described the outcome as a “fantastic result” that “surpasses any result that I’ve seen in any Chapter 11 case that I’ve faced in my 20-plus years.” Successful outcome notwithstanding, the Hertz bankruptcy was not without its challenges, particularly for ABS investors.

Prior to filing for bankruptcy, Hertz failed to make two full monthly lease payments to Hertz Vehicle Financing LLC, its term ABS shelf, triggering an amortization event for the ABS and a round of ratings downgrades. This was followed by another round of downgrades after Hertz filed for bankruptcy protection. Desperate times call for desperate measures and on June 11, 2020, Hertz filed a motion to reject its master lease agreement, which governed the nearly 450,000 leased vehicles serving as collateral for Hertz’s ABS trusts. The motion would have allowed Hertz to essentially remove certain vehicles from the Trust collateral pool, saving the company approximately \$80 million in monthly lease payments. ABS bondholders objected, arguing that under the master lease agreement all the vehicles under the agreement serve as collateral to secure the lease payments to the detriment of the bondholders. that Hertz owed to the ABS trust. Moreover, since this was the accepted structure for ABS, investors that bought Hertz rental car ABS provided consideration for such an arrangement. In an amicus brief, [SFA](#) submitted that “[Hertz’s] position ... is contrary to the expectations of the parties in typical rental car ABS transactions and risks establishing precedent that will ripple across the economy as lenders and credit agencies reassess the risk profile of such transactions.” SFA noted that this would ultimately limit access to securitization, on which below-investment grade companies, such as Hertz, rely heavily.

The parties ultimately came to an agreement and in July 2020, prompted by a court-approved order, Hertz embarked on a “six-month strategy to de-fleet and realign their business while paying down ABS note liabilities,” as noted in a [Fitch Ratings](#) commentary. In August, following the court order, Moody’s changed the direction of review for Hertz’s ABS to upgrade as paying down ABS note liabilities “increase[ed] credit enhancement and alleviat[ed] some performance uncertainty for senior notes.” The notes were upgraded by the rating agency in November.

The agreement, and Hertz’s subsequent follow-through, was sufficient to restore confidence to ABS investors, as indicated by the strong investor turnout for Hertz’s inaugural post-bankruptcy securitization. With a new lease on its corporate life, Hertz must now navigate the challenges of the post-pandemic world-- the first of which is how to [re-fleet](#) quickly during a global microchip shortage that has impacted the rental car industry’s ability to source new vehicles.

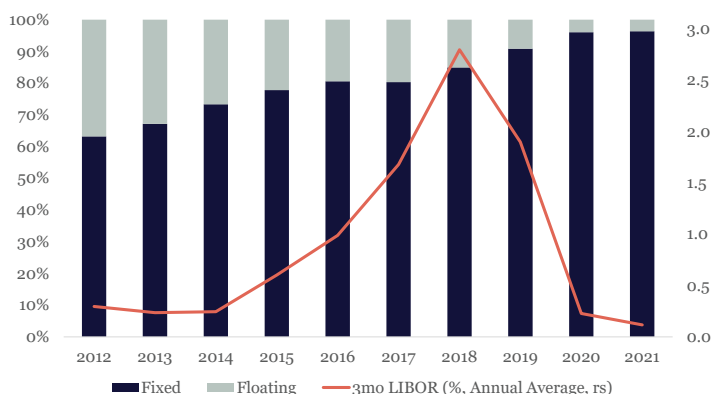
**MARKET SUMMARY**

Issuance across Non-Agency RMBS, Agency and Non-Agency CMBS, ABS and CLOs reached \$442 billion in the first half of 2021, an increase of 33% from 2019’s volume for the same period. Demand for securitized products in the secondary market has remained robust despite the surge of new-issue supply. Bond prices, and bid-ask spreads, have remained range bound.

Issuance of bonds tied to 30-day average SOFR continues apace, with Agency CMBS leading the charge. We expect SOFR-based issuance to tick up in coming months as the Alternative Reference Rate Committee (ARRC) has recommended that floating-rate securitizations, except for CLOs, issued after June 30, 2021, should not be tied LIBOR. CLOs, as recommended by the ARRC, should cease issuing LIBOR-based bonds by September 30, 2021. **Further, the U.S. regulators have strongly advised that financial institutions should stop using LIBOR in new financial contracts including underwriting new ABS transaction as soon as possible, but no later than December 31, 2021.**

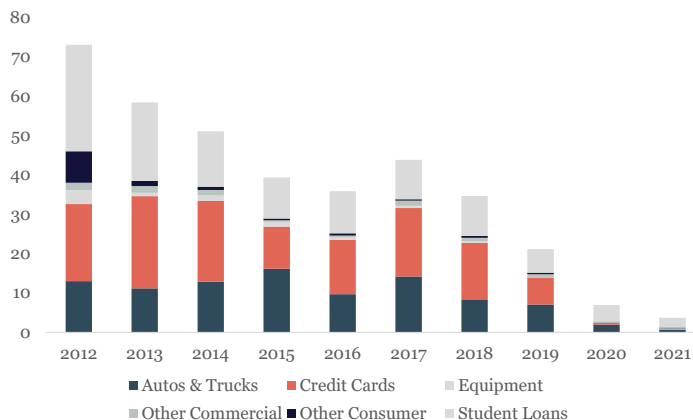
Issuance of LIBOR-based floating rate ABS has been on the decline since the FCA’s 2017 announcement that LIBOR would be discontinued. Prior to that, LIBOR had comprised between 20-40% of the new-issue ABS market. Post-2017, issuance of floating-rate ABS declined markedly and has contributed less than 5% of annual issuance in 2020 and year-to-date 2021. In a recent research report, Kayvan Darouian, head of ABS Research at Deutsche Bank, wrote that “[t]he drop in FFELP [student loan] ABS and credit card ABS issuance has led to lower floating rate ABS supply, although floating rate auto ABS has also diminished in recent years.” Darouian notes that “[it’s] not clear whether widespread adoption of SOFR or one of its alternatives will spur on new issuance of floating rate ABS as FFELP supply should continue to taper off [and] credit card ABS issuance overall is clearly in decline.” However, Darouian continues, “demand for floating rate paper could rise as rates migrate higher.”

**ABS Issuance – Fixed Versus Floating**  
Floating Rate ABS Issuance Has Been on the Decline for Years



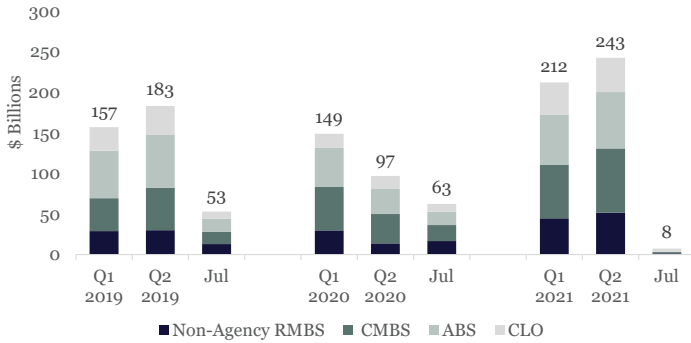
Source: Deutsche Bank

**Drop in FFELP Student Loan ABS and Credit Card ABS Issuance Has Led to Lower Floating Rate ABS Supply (\$ BNS)**



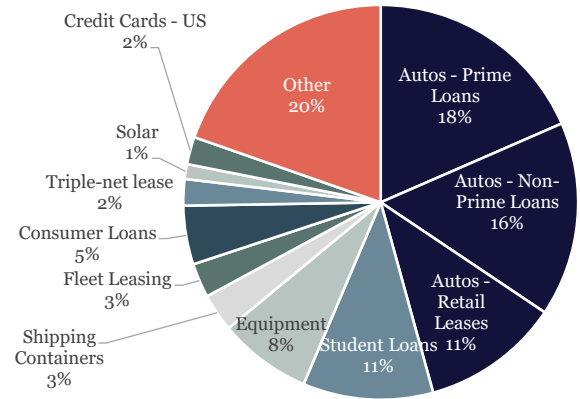
Source: Deutsche Bank

**Issuance\* for Non-Agency RMBS, CMBS, ABS, and CLO  
2021 (\$442 Billion) Versus 2019, 2020**



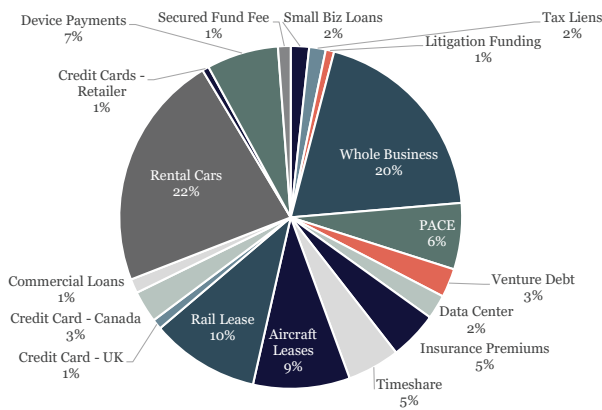
\*Revised to include Agency CMBS issuance and updated Non-Agency RMBS.  
Source: Deutsche Bank, Market Compilation

**ABS Only  
2021 YTD: \$131 Billion**



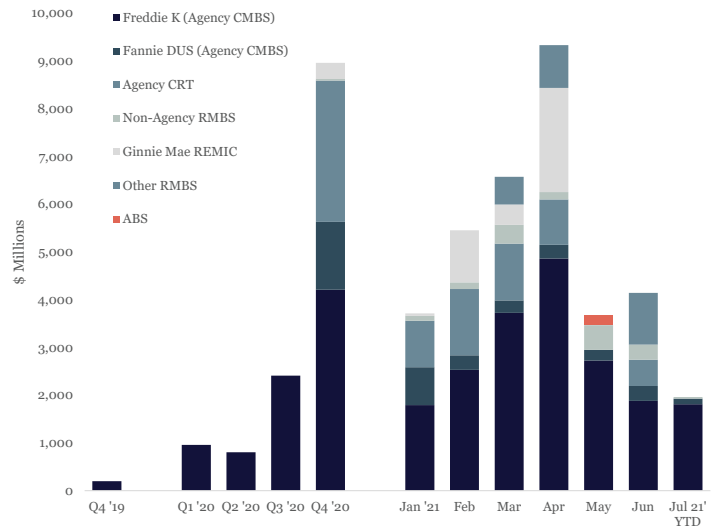
Source: Deutsche Bank, Market Compilation

**Other ABS Only  
2021 YTD: \$25.1 Billion**

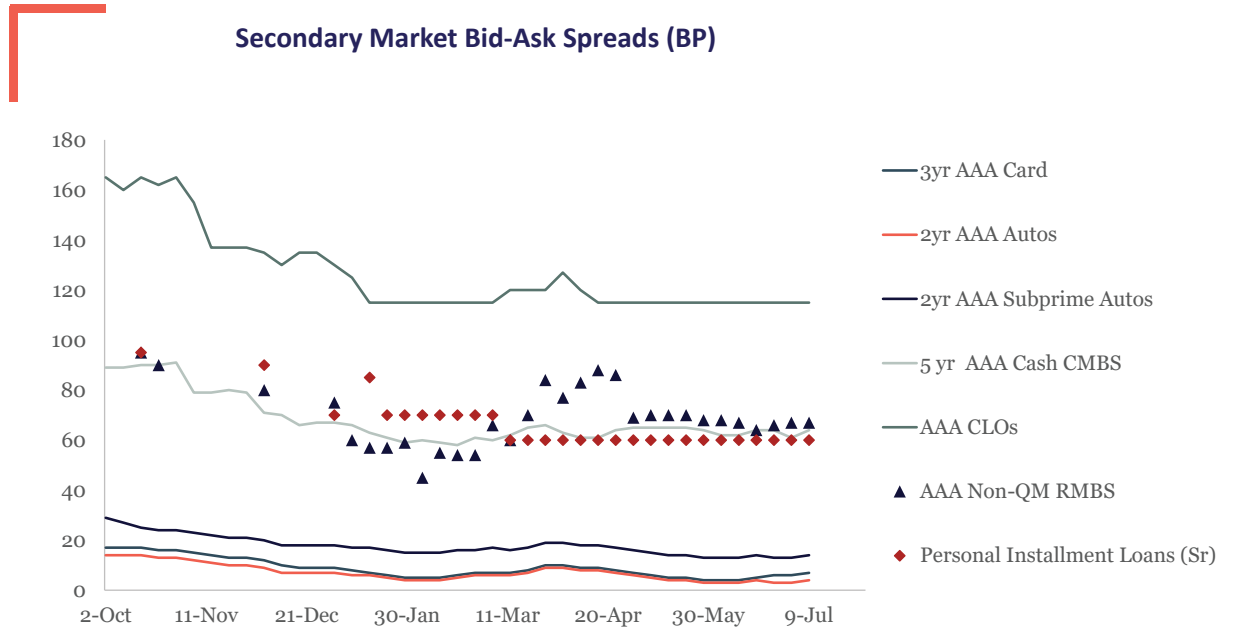


Source: Deutsche Bank, Market Compilation

**SOFR (30 Day Average) Securitizations  
2019 to 2021 YTD: \$48.2 Billion**



Other RMBS includes mortgage insurance-linked securities.  
Data begins Q3 2019.  
Source: Market Compilation



Source: Market Compilation

Secondary Market Bid-Ask Spreads		
(bps)	9-Jul	2-Jul
3yr AAA Card	7	6
2yr AAA Prime Autos	4	3
2yr AAA Subprime Autos	14	13
5yr AAA Cash CMBS	64	61
AAA CLOs	115	115

Source: Market Compilation