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Warehouse funding

倉儲性融資

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Legal Overview

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The prevalence of warehouse funding amongst non-banks in Asia-Pacific has been growing in popularity. It is used to help non-banks grow and also brings benefits to the real economy, as it is most commonly used to fund businesses providing consumer finance such as personal loans, auto finance, credit cards and even mortgage loans, all core drivers of real economic activity.

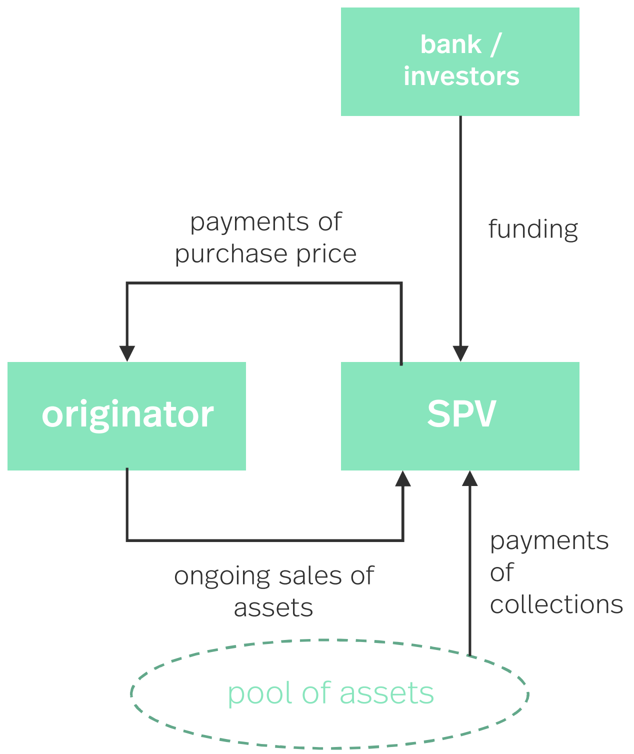
Let's consider a case study. A non-bank has a personal loan business and currently has a portfolio of around US$10 to 20 million of personal loans. There is growing demand from customers for personal loans and the non-bank needs access to funding to fund advances of new loans to its customers. That funding is not easily available from its shareholders or normal bank lenders because (as is very normal for a non-bank financial institution) its existing assets probably only just exceed its existing liabilities and the shareholders or normal bank lenders to not fancy taking on additional credit risk to the non-bank. Nor can the non-bank access the capital markets with a public securitisation transaction given the small size of its existing loan book.

The structure of a warehouse

Warehouse funding provides a source of funding to the non-bank in a way which does not expose the warehouse lenders to the credit risk of the non-bank. It does this by using a series of securitisation techniques:

- first, the non-bank sets up an insolvency remote special purpose vehicle (SPV). It's the SPV which is commonly referred to as the warehouse;
- second, the SPV puts in place at least two funding lines. Typically, a senior funding line from a bank or other investor and a junior funding line from the non-bank itself. The funding lines are flexible, setting a maximum overall limit but allowing drawdowns on a regular basis so funding can be accessed as and when needed, rather than in one lump sum. The senior funding line will set an advance rate, limiting the amount that can be drawn to a particular % of the assets in the warehouse;
- third, the SPV enters into a loan purchase agreement with the non-bank, agreeing to purchase newly originated loans. To pay the purchase price for the loans, the SPV will draw on its funding lines;
- fourth, a servicing arrangement will be put in place whereby the non-bank agrees to collect the amounts due on the underlying loans and transfer those collections to the SPV; and
- finally, the collections that are received by the SPV are used to pay interest on the funding lines. During the life of the warehouse, collections can also be used to pay the purchase price for further loan purchases and, when the warehouse has come to an end, collections are used to repay the funding lines - first the senior funding line and then the junior funding line.

a typical warehouse



Balance sheet treatment

It is sometimes possible for originators to achieve off-balance sheet treatment with warehouse transactions if they are able to find an investor to take the junior exposure. A "control party" who has the option to remove the originator acting as servicer may have a similar accounting effect.

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Credit risk

The sale of the loans to the SPV - which would be structured as a true sale - results in the warehouse lenders being exposed to the credit risk of those loans but not being exposed to the credit risk of the non-bank. If the non-bank were to go insolvent, the loans (and their collections) would belong to the SPV and would not be available to the creditors of the non-bank.

For this reason the warehouse lenders would be making their decision about whether or not to extend the warehouse funding line based on the make-up of the pool of loans. They would set eligibility criteria which the loans would all need to meet - criteria around the underlying debtors, the minimum and maximum size of the loans, the maturity date of the loans, the terms which apply to the loans and the underwriting process which the non-bank uses to make them. Regular due diligence would be conducted on the pool to ensure that the loans in it are eligible. Any ineligible loans would be excluded from the funding arrangements.

The warehouse lenders will also require frequent reporting on the pool of loans and the collections received and the non-bank will need to ensure it has systems in place which can handle the data which the warehouse lenders require.

Portfolio acquisitions

Portfolio Acquisitions: A further example is in the context of a portfolio acquisition. Take for example a bank which has an equipment leasing business. The bank may be de-leveraging and wishes to sell that business. On paper, that business may be of a sufficient size to attract capital markets funding but the systems which have been tracking the equipment leases and their collections may not be detailed enough to provide the type of reporting which capital markets investors would need. A warehouse funding line could be put in place by a purchaser of that portfolio to fund the equipment leases on a transitional basis, during which the systems are upgraded and the quality of data about the leases is improved. Rating agencies may even begin assessing the characteristics of the pool during this warehousing phase. Once the systems and data upgrade has been completed, the warehouse funding could then be replaced with capital markets funding.the warehouse lenders require.

Growing volume of stock

Over time, the volume of loans in the warehouse will grow and, at some point, will reach a critical mass where there are sufficient loans to undertake a public securitisation. At this point in time the loans in the warehouse would be sold to a new insolvency remote SPV which would issue notes to capital markets investors - the notes would be backed by the pool of loans. The proceeds would be passed back to the warehouse and used to pay down the warehouse funding lines. At this point in time the warehouse is often reset and would start again from scratch to build up another pool of loans.

This approach to funding has a very distinctive life cycle. Early in the life of the non-bank's business there is only shareholder and normal bank funding. As it grows, warehouse funding drives that growth and, once a sufficient size is reached, the capital markets can provide funding too. As the business continues, there will then be a diversified mix of funding the business has - with some loans funded by the capital markets and others funded in warehouses, waiting until there is sufficient volume to further tap the capital markets.

Private securitisations

Private Arrangement: Another example of "warehouse funding" may be a portfolio of assets which is of a size and quality possible to put into a public capital markets arrangement, however, the originator may have found a particular investor or small pool of investors and directly agreed pricing and other terms satisfactory to it. A private securitisation could be undertaken between the originator and those investors without any public listings or ratings and this private arrangement is also referred to as warehouse funding. This is very common in the auto-loan market.

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