Securitized Products Special Topics

Container ABS: Geopolitical Tailwinds as Issuance Picks Up

Check Lease and Container Types Amid Supportive Backdrop

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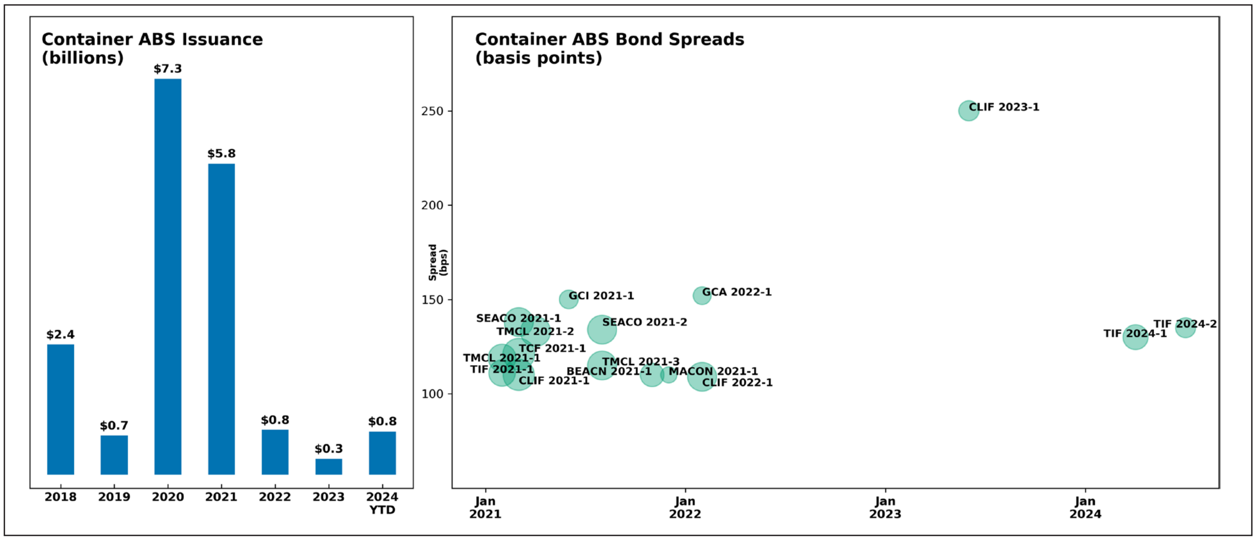
Container ABS is shaping up to be a corner of the securitized universe that is benefiting from geopolitical turmoil, as well as other recent tailwinds. The upsizing of the two Triton-sponsored deals this year suggests healthy investor demand and scarcity value. The $351.9 million TIF 2024-2 increased from $291.9 million, pricing last month its six-year double-A tranche at 135bp over Treasury. In turn, TIF 2024-1 upsized to $450 million from $300 million back in March. The double-A tranche priced at 130bp over benchmark. The 2024-vintage deal spreads tighten significantly compared to 2023 pricing (Figure 1).

Figure 1. Container ABS Issuance and Spreads



Source: Bloomberg and Academy Securities

Red Sea Conflict Drives Up Container Demand

The surge in shipping rates in 2024 YTD clearly supports container ABS collateral. Container spot rates have consistently risen for nine weeks, as of late June. It is the longest stretch of rising prices since the pandemic, based on Drewry World Container Index. The attacks of the Iran-backed

Houthis on commercial shipping in the Red Sea are directly driving recent shipping rate dynamics. To avoid possible attacks, container lines are taking longer routes around southern Africa. This keeps containers occupied longer, leading to container shortages and elevated demand.

The outlook on the conflict in the Red Sea has become integral to assessing container demand in the coming months. Academy's Geopolitical Intelligence Group (GIG) has been closely tracking the situation. The GIG believes neutralizing the Houthi threat is a multi-month effort.[1] For reference, here is the GIG's General Spider Marks view:

"The U.S. is focused on neutralizing the Houthis' aggressive (and illegal) behavior in the Red Sea. It requires a larger and more persistent military engagement that includes regional contributions (Egypt, Saudi Arabia, Kenya, GCC nations) as well as the ongoing partnerships with the UK and France to achieve a more immediate solution. However, the Houthis are not surprisingly resilient and will not be eliminated (or significantly degraded) as a threat without a full diplomatic and military campaign which is not likely given the challenges elsewhere (Gaza, Lebanon, Ukraine). This threat will remain for the near-term. The Suez is a 'global common' and as such all nations have an interest in complete access. The U.S. is the best at building coalitions of partners and is leading that effort. The risks (financial and physical) can be mitigated. This is what a "hold" action looks like - maintain the effort, continue to engage diplomatically, build consensus, get military contributions from others with shared interests, and increase pressure. This is the strategy. It will take until 2025 (post-election) to measure the effects."

Plethora of Shipping Disruptions

Other shipping disruptions join the Red Sea conflict in buttressing container demand. We note developments such as the collapse of the Francis Scott Key Bridge near the Port of Baltimore back in March of this year, or potential dockworker strikes at ports along the US East and Gulf coasts. The dockworkers contract expires on September 30th, according to press reports. Port congestions is also adding pressure. For example, congestion in Singapore, the world's second-busiest container port, has reached a critical level, according to Linerlytica data. Container ships have to wait up to seven days to berth in Singapore, recently seeing up to 450,000 20-foot-equivalent unit (TEU) of vessels in the queue. All told, while we cannot quantify the implications of such events on container rates, the common thread is that logistical issues drive up demand for containers, leading to a rise in leasing rates.

Pool Variations Could Drive Relative Value

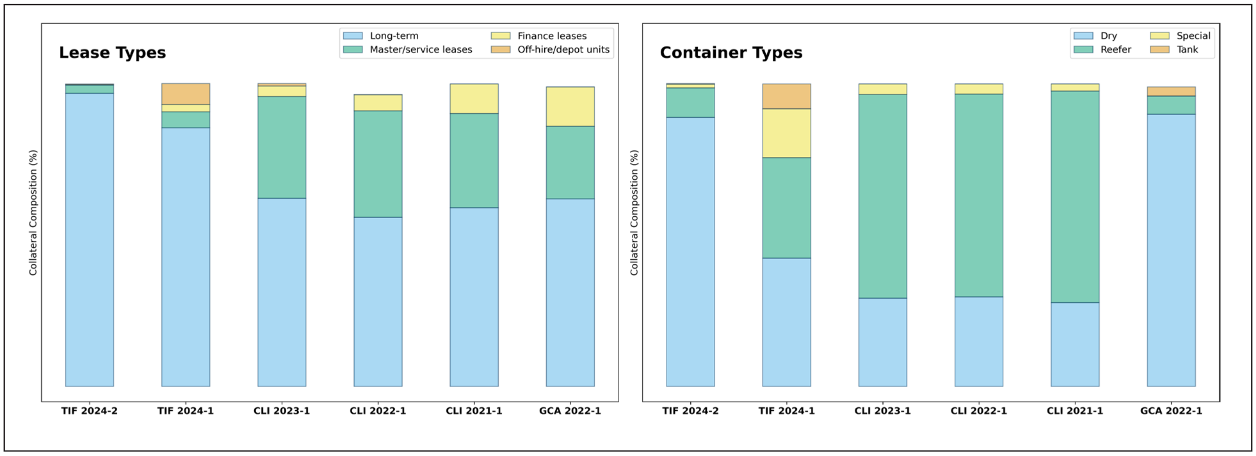
Amid the supportive backdrop for container leasing demand and rates, container ABS pools feature attributes that could facilitate relative value across deals. In particular, we identify the following:

- **Short- vs long-term leases.** Pools vary quite a bit in their lease type composition (Figure 2, left). Container operating leases can be short-term (less than one year) or long-term (typically five to seven years). Longer-term leases are generally credit positive. The long

1 "Around the World with Academy Securities," June 26, 2024

lease tenor shields them from rate reductions during a downturn, according to rating agencies. Recent lease composition has tilted towards longer lease terms. In CLI 2024-2, for example, the pool features 97% long-term leases (by net book value). Earlier deals had a long-term lease percentage hovering at 60%. Still, the same way long-term leases may be somewhat insulated during downturns, long-term lessors may see limited benefits during peak rate periods such as the one the sector currently experiences. Interestingly, high-capacity utilization could restrict lessors ability to take advantage of the current shortage, according to press reports citing lessors earnings. For example, Triton reported spare capacity of only ~3% as of Q2 2023. Textainer, another lessor, had just 1% spare capacity at the end of December 2023. Lastly, container ABS pools can also include direct finance leases (DFLs), where the lessee can purchase the container at a price specified in the lease. DFLs may introduce some recovery timing risk if the lessee files for bankruptcy. If DFLs are re-characterized as loans, the lessors may be deemed secured creditors and face recovery delays.

Figure 2. Container ABS Lease and Container Type Breakdowns



Source: Deal Documents, Presales, and Academy Securities

- **Check container types.** We also see variation across pools on container types. The major container types are so-called dry and reefers. A reefer container is used to ship cargo such as frozen/chilled meat, fish, fruit, and vegetables. Other smaller container types include tanks and “special” (Figure 2, right). The demand for reefer containers tends to be more steady than dry containers, according to rating agencies. But longer routes and other shipping disruptions may have varied impact on container types. In such case, we could see varied pool performance across deals such as TIF 2024-2 that features 88.9% dry containers versus deals such as CLI 2021-1, which has nearly 70% reefers in its pool.

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