Securitized Products Special Topics

Equipment ABS: Pick Your Spots Amid Diverging Collateral Trends

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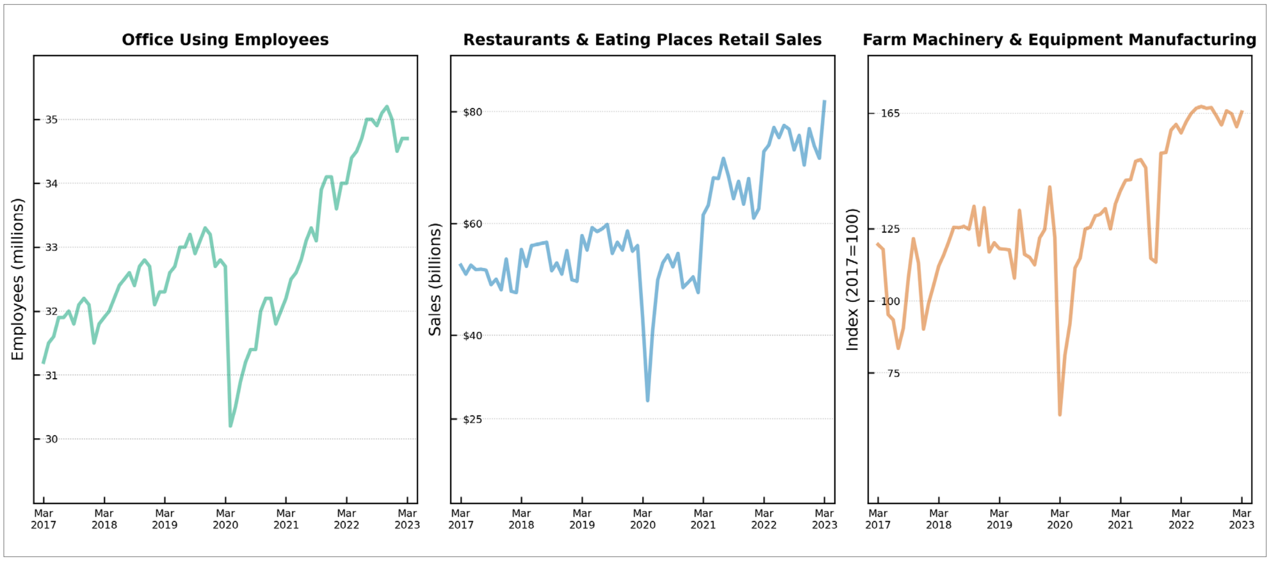
Diverse Equipment Collateral Offers Non-Cyclical Exposures

Stav Gaon
+1 (646) 768-9173
sgaon@academysecurities.com

Headquarters Address:
Academy Securities, Inc.
622 Third Avenue, 12th Fl
New York, NY 10017

Equipment ABS could be a compelling securitized segment for investors looking to diversify their portfolios and reduce exposure to headline risks. Crossover investors may be struck by the diversity of the segment. We see different dynamics impacting the wide range of equipment types backing deals. Sub-segment differences go way beyond basic distinctions such as between the so-called light duty and large-ticket equipment. For example, in the large-ticket category, agricultural equipment may have a more constructive outlook, compared to construction-related equipment. In turn, small-ticket office equipment, such as copiers and printers, may face headwinds amid corporate retrenchment and decrease in office utilization.[1] In contrast, equipment geared towards fast-recovering industries, such as restaurants and hospitality, should see better performance (Figure 1).

Figure 1. Diverging Trends for Equipment ABS Collateral



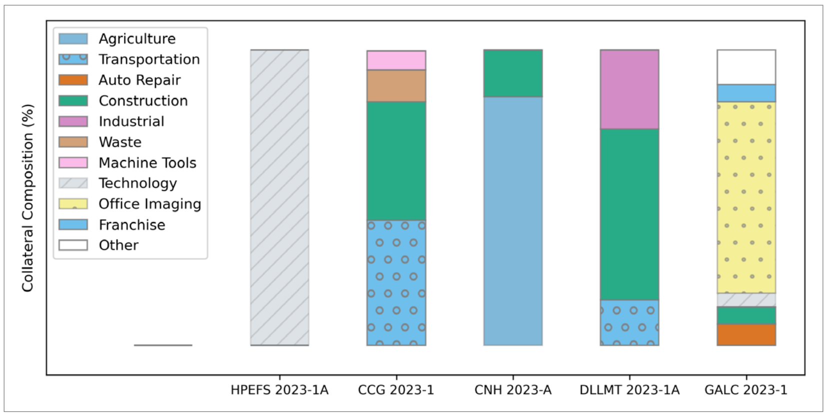
Source: U.S. Census Bureau, Federal Reserve, Bloomberg and Academy Securities

1 "Office Modifications: 285 Madison Could Offer a Blueprint for More to Come," CMBS Credit Focus, Academy Securities, October 27, 2022

Healthy Programmatic Issuance with Some Recent Newcomers

Recent equipment deals underscore the segment's diversity. For example, the $817.0 million CNH 2023-A that priced in April had 84.2% exposure to agricultural equipment, and the remainder to construction (Figure 2). The $397.1 million CCG 2023-1 had 42.3% exposure to transportation equipment, 40.1% construction, and 10.8% exposure to the non-cyclical waste segment. The deal had no exposure to agriculture. In turn, the $549.3 million GALC 2023-1, priced last month, had 64.7% exposure to office imaging equipment.

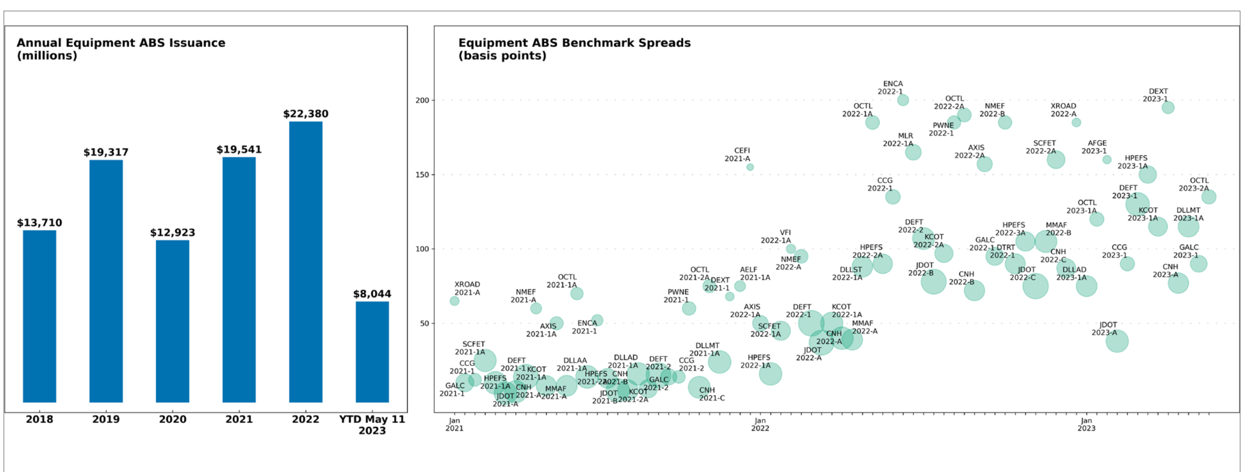
Figure 2. Recent Equipment ABS Collateral Breakdown



Source: Deal Documents, ratings agencies, and Academy Securities

Equipment ABS issuance reached $8.0 billion so far this year. This follows robust issuance in 2022 to the tune of $22.4 billion (Figure 3). Established programmatic issuers such as CNH and John Deere dominate issuance, facilitating historical deal comparisons and relatively long collateral performance data series. But we see new issuers also tapping the market. For example, Alliance Fund Group issued an inaugural $136.9 million five-class deal in February (AFG 2023-1). The pool included 1,421 contracts (both loans and leases), with an average contract balance of $81,092. It priced its $67.2 million triple-A class at 160bp over benchmark.

Figure 3. Equipment ABS Issuance and Spreads



Note: Spreads are versus benchmarks of EDSF up until 4/4/2022 (MMAF 2022-A) and UST for the period 4/27/2022 (DLLST 2022-1) and later

Source: Bloomberg and Academy Securities

Track Contract Types and Servicing Arrangements

Amid equipment ABS collateral sensitivity to varying secular trends, some of them tied to CRE industries, investors may be able to deploy existing views on market fundamentals and property type performance, as we recently discussed in the context of solar ABS.[2] We see several relevant aspects for cross-over investors as they analyze equipment collateral:

- **Loans vs. leases.** Equipment ABS deals vary in their contract type compositions (Figure 4). Some deals, such as HPEFS 2023-1A, have elevated exposure to equipment leases (91.0%). Other pools mostly include loans; for example, DLLMT 2023-1A (80.6% loans). The key aspect for investors differentiating between the collateral types is the inclusion of the equipment and any expected residual value in the deal's collateral. In leases, the deal's sponsor would retain the residual value at the conclusion of the lease period. Investors would have to evaluate residual value and aspects such as potential equipment obsolescence and re-use. Absent residual value, the analysis boils down to evaluating payment performance, and perhaps the prospects of seizing on equipment following defaults.

Figure 4. Equipment ABS Pool Characteristics

	DLLMT 2023-1A	GALC 2023-1	CNH 2023-A	HPEFS 2023-1	CCG 2023-1
Issuer	De Lage Landen	GreatAmerica	CNH Industrial	HPE Financial	Commercial Credit Group
Price Date	5/17/2023	5/17/2023	4/18/2023	3/15/2023	3/7/2023
Pool Balance ($MM)	$933.0	$580.5	$900.6	$780.0	$422.4
No. of Contracts	13,297	31,186	11,405	3,866	1,939
Wgtd. Avg. Original Term (Mos.)	57.0	55.6	61.3	45.5	51.8
Wgtd. Avg. Remaining Term (Mos.)	43.0	49.3	54.6	37.5	44.1
Wgtd. Avg. Seasoning (Mos.)	14.0	6.3	6.7	8.0	7.7
Top Obligor (%)	0.6	1.4	NA	14.1	1.5
Top-5 Obligors (%)	2.6	NA	2.0	43.0	6.1
Loans (%)	80.6	NA	100.0	9.0	NA
Leases (%)	19.4	NA	0.0	91.0	NA

Source: Ratings Agencies and Academy Securities

- **Bundling of services.** Most contracts behind equipment ABS deals contain so-called bundling of services, which combines ongoing payments of services with lease contracts. This spotlights a potential servicing risk. Lessees may withhold payments if they face service interruptions or related issues on their leased equipment. The lessees may be unwilling to pay, rather than unable to pay. The result is still a credit issue. Interestingly, some equipment types do not include servicing arrangements. For example, in HPEFS 2023-1 the technology equipment pool includes contracts that finance only completed services or just the equipment financing.

2 "Commercial Solar ABS: Emergent Segment to Alleviate Headline Risks," Securitized Products Special Topics, Academy Securities, May 11, 2023

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