

# U.S. Structured Finance Newsletter

Volume 4, Issue 29, July 21, 2008



## Claire Mezzanotte

Managing Director, ABS/RMBS  
U.S. Structured Finance,  
+1 212 806 3272  
[cmezzanotte@dbrs.com](mailto:cmezzanotte@dbrs.com)

## Jan Buckler

Senior Vice President,  
Research and Modeling  
U.S. Structured Finance  
+1 212 806 3925  
[jbuckler@dbrs.com](mailto:jbuckler@dbrs.com)

## David Hartung

Senior Vice President, ABS  
U.S. Structured Finance  
+1 212 806 3269  
[dhartung@dbrs.com](mailto:dhartung@dbrs.com)

## Quincy Tang

Senior Vice President, RMBS  
U.S. Structured Finance  
+1 212 806 3256  
[qtang@dbrs.com](mailto:qtang@dbrs.com)

## Kathleen Tillwitz

Senior Vice President,  
Operational Risk  
U.S. Structured Finance  
+1 212 806 3265  
[ktillwitz@dbrs.com](mailto:ktillwitz@dbrs.com)

## Toronto

DBRS Tower  
181 University Avenue  
Suite 700  
Toronto, ON M5H 3M7  
+1 416 593 5577

## New York

140 Broadway, 35th Floor  
New York, NY 10005  
+1 212 806 3277

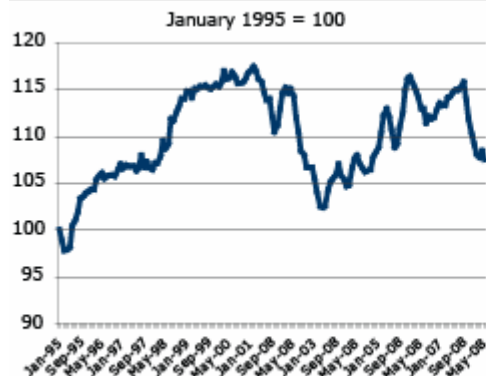
## Chicago

101 North Wacker Drive  
Suite 100  
Chicago, IL 60606  
+1 312 332 3429

## NEGATIVE EQUITY

Manheim and Adessa, the two largest used vehicle auction companies, have both indicated that stark changes have occurred in the used car market with regard to used car prices. Trucks and sports utility vehicles (SUVs) have been hit the hardest, but the pileup of inventory at the auction houses includes many other vehicle types that are approaching decreasing price points as well. These conditions affect both existing auto ABS transactions and future auto ABS transactions.

### Manheim Used Vehicle Value Index



Source: Manheim Consulting.

### Price Changes for Selective Market Classes



Source: Manheim Consulting.

In existing auto loan ABS transactions, net losses are impacted by the values realized from selling repossessed vehicles, often at auction. In auto lease ABS transactions, cash flows from disposing vehicles at the end of their lease terms, usually at auction, are a primary source of repayment for bonds. A weakening used car market can have a significant impact on auto ABS performance in the event used vehicle prices decline more severely than normal. For future auto ABS transactions, used vehicle prices have an impact on the loss severities related to obligor defaults and vehicle dispositions upon lease maturities.

Given common business practices in the auto finance industry that allow obligors to trade in vehicles to purchase new ones prior to full payment of the original loans, the following scenario is an example of how declining used vehicle prices could significantly affect ABS performance: (1) an obligor who has purchased a \$30,000 vehicle by taking a 72-month loan for the full value of the vehicle pays the loan down to \$22,000 after two years; (2) the obligor seeks to trade in the vehicle and purchase a new one; (3) the old vehicle is sold at auction at a depressed resale price of \$12,000, which is applied to pay down the existing loan, but leaves an existing balance of \$10,000 on the original loan; (4) the obligor buys a new \$30,000 vehicle and receives a new loan for \$40,000 to finance the price of the new vehicle plus the amount owed on the original loan.

As a result, before the second vehicle is driven off the dealer's lot, the loan-to-value (LTV) of the second loan is 133% (in this example, DBRS has made the assumption that the value is equal to the sale price as opposed to the lower invoice price as is typically the case), and the obligor has negative equity in the vehicle from day one. This circumstance is exacerbated by the fact that new vehicles depreciate dramatically once driven off the dealer's lot. DBRS believes the inclusion of additional LTV information and, although difficult to obtain, LTV updates to ABS pools will lead to more informed decisions by investors.

For questions or comments, please contact Chris O'Connell at [coconnell@dbrs.com](mailto:coconnell@dbrs.com).