



Methodology
*Canadian Wholesale Floorplan
Methodology*

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Insight beyond the rating.

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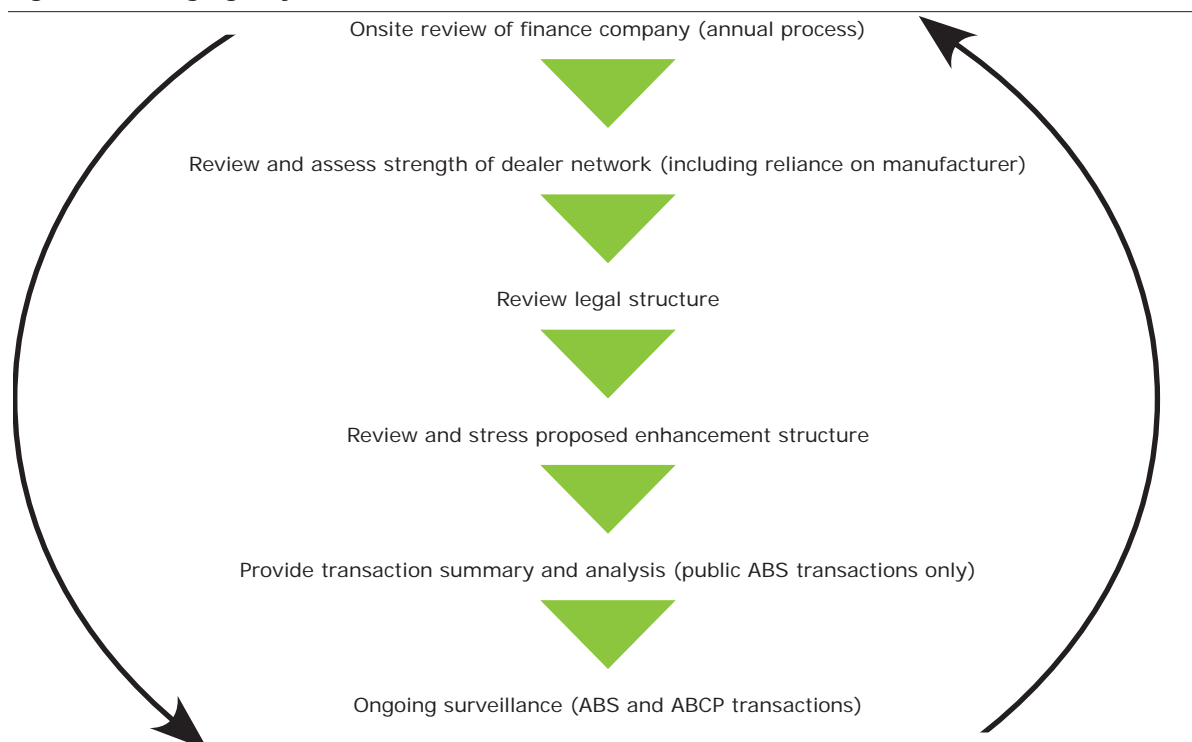
Introduction

Securitization has been an important source of liquidity for the manufacturers and finance companies of a wide range of consumer and industrial equipment, including automotive vehicles, large machinery and agricultural equipment. Often, the finance company provides its dealer or retailer network with revolving loans (interchangeably referred to as floorplan or wholesale loans) that are used to finance the purchase of inventory at wholesale rates. In providing these loans to its retailers, the finance company must establish a credit and collections policy to administer the loans to the dealers. Once the program has been established for a number of years, the manufacturers may be able to access the securitization market as a form of liquidity to support the floorplan or wholesale financing provided to their dealer networks.

While the assets supporting floorplan financing vary from consumer products to commercial equipment, to date, the Canadian securitization market has focused on floorplan transactions where the inventory has consisted of automotive vehicles and commercial equipment and their related parts. This is mainly due to the fact that a floorplan transaction requires a certain pool size and scope to attract public investor demand. Typically, for a transaction to be marketable, a diversified dealer network for a multi-national manufacturer with significant market presence and a liquid market for the underlying vehicles or equipment is necessary.

Floorplan securitization transactions have historically exhibited very low loss rates and, while payment rates and inventory levels fluctuate seasonally, the annual payment rate of floorplan loans has generally been consistent year-over-year. This excellent performance has benefited from the strong servicing capabilities of the finance companies, liquid assets supporting the loans, large solvent manufacturers and a relatively healthy economy. Absent any of these components, DBRS expects the performance of floorplan financing to stray from historic ranges; however, because DBRS methodologies are designed to rate through the economic cycle, ratings should be stable during the revolving period. Ratings stability can, however, be affected if economic fluctuations are greater than in a normal economic cycle or if sponsoring manufacturers resort to a liquidation scenario that involves bankruptcy filing. Below is an executive summary of the key steps followed in arriving at a rating for a floorplan transaction. A more detailed summary can be found in Appendix I.

Figure 1: Rating Agency Process





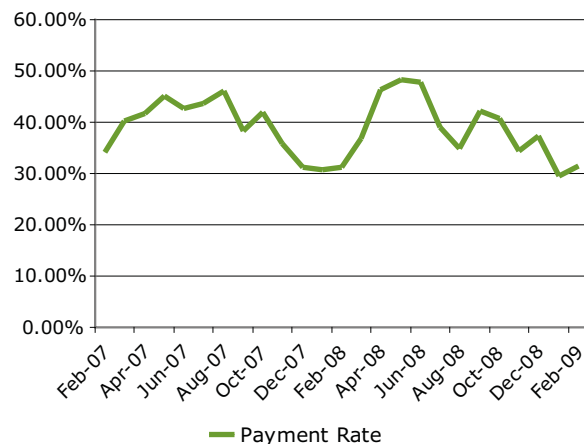
Background Information

REVOLVING NATURE OF FLOORPLAN LOANS

In establishing a methodology for floorplan securitization structures, DBRS takes into account the similarities that these structures share with other asset classes, as well as the unique characteristics specific to floorplan financing. Similar to those of other revolving asset classes (such as credit cards), floorplan loans are supported by short-term obligations that are paid off regularly, with the proceeds used to create newly generated receivables. Specifically, as the inventory turns, the proceeds from sales are used to repay the loans, and new loans are advanced as the dealer purchases new inventory from the manufacturer. As is the case with credit card securitizations, floorplan transactions rely heavily on a consistent and stable monthly payment rate to ensure timely payment of interest and ultimate repayment of principal. Close inspection of payment rates in floorplan structures will generally reveal cyclical or seasonal payment rates that reflect underlying consumer demand within the specific industry to which the floorplan loans are linked. See Figure 2 for an example of the seasonality in auto and equipment floorplan deals.

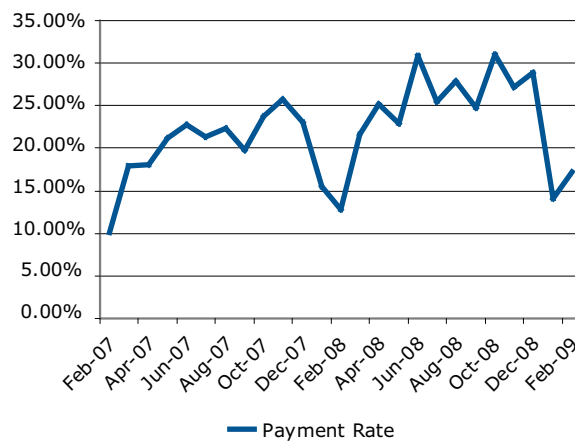
Figure 2: Examples of Payment Rate Seasonality

Asset Type: Auto



Source: DBRS

Asset Type: Equipment



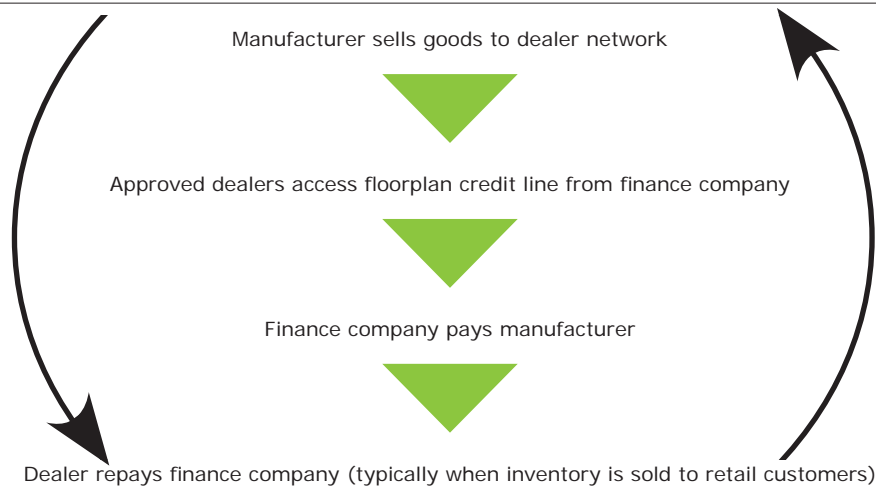
Source: DBRS

While the monthly revolving nature of the assets is similar to a credit card securitization, floorplan securitizations differ from credit card transactions in that there is a tangible asset underlying the secured obligations. As a result, comprehensive knowledge of the valuation of the specific assets involved – which may range from automotive assets to large industrial machinery – is acquired at the outset of the transaction. It is important to note that there are typically no residual value exposure considerations in floorplan transactions since the revolving loans require full repayment for the assets financed. In Canada, to determine its final rating, DBRS gains knowledge of the market value of the assets on an asset-by-asset basis at the outset of the transaction, followed by stress-testing of the asset values in a modelling scenario that reflects a wholesale and rapid liquidation of the assets.

Participants and Outline of a Floorplan Transaction

Floorplan financing can best be described as a tri-party relationship between the manufacturer, the finance company and the dealer. Figure 3 below illustrates the transaction flow:

Figure 3: Revolving Floorplan Receivables – Key Steps



As illustrated above, the dealer network provides a retail distribution channel for the manufacturer. The finance company provides the dealer network with the floorplan financing required pursuant to the finance company's credit and collection policy. Typically, the lines of credit are prime-based loans for qualified dealers, which allows for the purchase of specified inventory. The dealer network's main source of repayment arises from the sale of inventory to the retail consumer. A dealer's debt obligations are generally short-term in nature as the inventory turns over frequently.

The interest charged on floorplan loans is usually a floating rate benchmarked to the prime interest rate which begins to accrue the day following the advance. Financing terms require repayment of the advance after the retail sale of the inventory unit. Periodic payments may also be mandated by the finance company to curtail the loan value relative to depreciating or obsolete assets (please see *Curtailed: Depreciating Nature of Assets* on page 8 for a more detailed explanation).

Assessing the Risk Profile of a Floorplan Structure

In evaluating the credit quality of the portfolio of loans, a good understanding of the manufacturer, the finance company and the dealer network is necessary. This DBRS methodology will set out the review procedures applied to evaluate the manufacturer, the finance company and the dealer network in arriving at ratings. Important concepts to review in a floorplan securitization include:

- Manufacturer and finance company review
- Dealer network review
- Transaction structure and identification of risks
- Enhancement structure and determination
- Legal review
- Post-closing surveillance



Participants in Floorplan Financing

THE MANUFACTURERS

Manufacturers tend to be multi-national in both scope and scale and possess established retail distribution networks. Typically, the floorplan financing arrangements in the automotive and equipment manufacturing sectors are established through their captive financing subsidiaries and operate in multiple jurisdictions. The manufacturer plays a fundamental role in the process and is the key link that supplies the assets sold to the end-consumer. Retail support to the dealers is often provided at the front end of the sales process through sales incentives that include interest rate subvention and cash payments, as well as warranty programs on products and replacement parts.

Most manufacturers are also active in the back end of the sales process by creating online auctions for remarketing used equipment and by offering pull-ahead programs that encourage consumers to trade in prior to lease or loan maturity. This provides a more consistent and orderly inventory management process to the retailers dealing with customers at the end of the lease or loan. The established network provides an important foundation to effectively manage an orderly liquidation of larger numbers of assets, should problems arise that affect the health of the manufacturer or the ability for the dealer to sell the assets. An orderly distribution channel also helps to reduce the volatility of used equipment or vehicle pricing. As noted in Figure 4, floorplan transactions are much more closely linked to the health of the manufacturer and, as such, a good understanding of the ongoing viability of the manufacturer is required. A stable network of dealers, a viable and ongoing warranty program and a ready supply of replacement parts are critical assumptions in the evaluation of a floorplan securitization structure.

Figure 4: Auto Transaction Risk Matrix

	Daily Auto Rental Fleets	Retail Auto Lease	Retail Auto Loan	Wholesale Floorplan
Concentration Risk (No. of Obligors)	High One	Low 20,000-60,000	Low 20,000-60,000	High 250-500
Credit Risk	Low (0-25 BPS)	Low – Medium (10-125 BPS)	Low – Medium (10-125 BPS)	Low (0-25 BPS)
Residual Value Risk	Medium to High 25%-100% of pool balance	Medium to High 40%-60% of pool balance	N/A	N/A
Manufacturer Risk	Medium (Higher on Program Vehicles)	Medium (End of Term Considerations)	Low No reliance	High Linked closely to the Manufacturer
Maturity Features	Revolving	Amortizing	Amortizing	Revolving
Enhancement	Cash (Min 50-100 BPS) Overcollateralization Subordinated Notes Excess Spread Letters of Credit	Cash (Min 50-100 BPS) Cash (Embedded Loss) Overcollateralization Subordinated Notes Excess Spread	Cash (Min 50-100 BPS) Overcollateralization Subordinated Notes Excess Spread	Cash (Min 50-100 BPS) Overcollateralization Subordinated Notes Excess Spread



THE FINANCE COMPANY (AS SELLER/SERVICER)

The finance company provides the financing to the dealer network to purchase the assets on a revolving basis. In most cases, the finance company is established by the manufacturing entity as a captive finance arm for the purpose of supporting the sale of products to both the licensed dealers and the end-consumer. The captive finance companies operate as an independent unit from the manufacturers and their main role in a floorplan securitization is as seller and servicer of pools of wholesale floorplan loans.

DBRS pays particular attention to the finance company's capabilities as servicer for a securitization transaction. Generally, annual onsite meetings are conducted at the finance company's offices to assess their servicing capabilities. In discussions with the company's management team, DBRS seeks to understand the operational aspects of originating and adjudicating credit, monitoring pool performance, collecting loans and reporting within the context of the securitization structure. An independent assessment is conducted by DBRS's corporate analysts to assign a corporate rating to the finance company; this rating is important in determining the finance company's ability to commingle daily collections with its corporate funds (minimum rating of BBB (low)) and its survivability in the absence of the manufacturer. Key areas of review for DBRS at an onsite review session include:

Origination and Adjudication of Credit

The finance company conducts a review of each new applicant prior to approving it as a creditworthy dealer. During this process, it assesses an applicant's management experience, industry track record, financial wherewithal, operational controls, credit checks and bank references. Once approved, the applicant's credit profile is ranked pursuant to the finance company's credit and collection policy. The line of credit is determined based on the applicant's balance sheet strength, reliance on third-party lenders, supporting collateral, sales and inventory turnover volumes. As servicer, the finance company plays a pivotal role in adjudicating the established lines of credit used in the financing of inventory for the licensed dealers. The finance company supports the dealer network by actively monitoring and servicing the portfolio of floorplan loans. It is important to note that in some cases the finance company will include multi-branded dealers and even some off-brand dealers that are not associated with the sponsor manufacturer. From a risk management perspective, DBRS views this favourably, as it adds dealer, branding and manufacturer diversification to the floorplan portfolio. As part of its ongoing monitoring, DBRS seeks an annual update on the financial health of the dealer network.

Monitoring Pool Performance

As part of the monitoring process, the finance company reviews the activity of the dealer accounts on a daily basis, including daily remittances and reconciliation with invoices. Dealers are required to submit financial statements regularly, with the frequency of this submission dependent upon the ranking assigned to the dealer by the finance company. A lower-tiered dealer would be expected to report to the finance company on a monthly basis, whereas a more established dealer with a stronger credit profile may report on a quarterly or (rarely) on a semi-annual basis. In addition to regular reviews, on an annual basis the finance company also reassesses each dealer's creditworthiness. The scope of this review includes a meeting with the dealership's management team, review of financial records, reporting history and physical inventory audits on the dealer's premises. Typically, a securitization transaction will limit the number of dealers in the lower tiers of a finance company's credit score from participating in the securitization structure. The financing of physical assets introduces two additional risks unique to the revolving nature of the financing programs: (i) Curtailment, and (ii) Sold Out of Trust (SOT).

Curtailment – Depreciating Nature of Assets

As part of their credit and collection policy, finance companies limit the loan advance rates on the basis of the nature of the inventory. Typically, two advance rates are used, one for new assets and one for used assets. For example, the advance rate on an automobile may be 100% for new units and only 75% of the black book value on a used unit. For slower-moving inventory, and particularly for a used unit, a dealer would be required to make periodic payments to curtail the outstanding loan balance relative to the value



of the unit that is financed. This helps to protect the finance company against declining asset values should it need to liquidate the underlying vehicles or parts for repayment of its loans. Curtailment also motivates the dealer to sell the asset since the financing cost associated with that specific asset is higher.

Sold Out of Trust

From time to time, circumstances will arise when the proceeds received by a dealer from the sale of a vehicle or piece of equipment are not remitted to the finance company to repay its credit line. These are known as Sold Out of Trust (SOT) loans and may range from an oversight by the dealer's bookkeeping personnel to situations of outright fraud. As a preventive measure, the finance company monitors a dealer's sales records for paid-off inventory and payment rates. Representatives from regional offices communicate with headquarters on a frequent basis to share industry trends and their observance of any financial anomalies and payment patterns within the dealer network. Physical audits are also an important component in the monitoring process as this is the most effective method in preventing the occurrence of SOT loans. Auditors representing the finance company are assigned to a dealer's lot to conduct the audits, which may include a physical count of the inventory, reconciling invoices, tracking the remittance of cash and review of financial records. Audits are generally conducted at least on a quarterly basis for all dealers, and as frequently as monthly for those dealers ranked at the lower end of the credit spectrum. Control by serial or vehicle identification number (VIN) is especially important in cases where a dealer has multiple locations to ensure that inventory from one location is not moved to another to cover up any inventory shortfalls. If SOT loans persist, additional action may be taken, including withdrawal of the floorplan line of credit.

DEALER NETWORK REVIEW

Dealers vary in size, generally operating as licensed distributors for manufacturers. A dealer also provides parts and service on a manufacturer's warranty that may enhance the value of a product. Dealers are generally small business operators and rely on floorplan financing to fund inventory. In a securitization transaction, eligible dealer obligations come mostly from dealers ranked at the higher end of the credit spectrum based on the finance company's credit and collection policy.

For national and multi-national brands, structures exhibit a number of beneficial diversifications. With representation across the country, the finance company achieves a geographically diverse pool that can be buffered from regional differences in performance. Brand diversification is also achieved as some of the larger and stronger dealers own multiple retail locations with different brands. Finally, revenue diversification for dealers from parts and service work performed can be used to repay the floorplan financing.

The finance company further protects its interest by ensuring that the line of credit is secured by the inventory it finances and often also includes a security interest on the dealer's personal property. Additional security may also include a first charge on the dealership's real estate holdings.

The individual dealers within the dealer network are evaluated on an ongoing basis, by both the manufacturer and the finance company. DBRS also conducts periodic review of the health of the dealer network and at least annual onsite review of the seller and servicer.

Transaction Structure and the Identification of Risks

LEGAL

The first step in establishing a structure for all securitizations (including floorplan) is to ensure that the assets are transferred to a bankruptcy-remote trust. The assets in a floorplan securitization consist of all collections from an eligible pool of loans, plus any recoveries from the disposition of the inventory or the dealer's assets, insurance claims and security interest, in addition to pledged assets of the dealers. With most floorplan structures, present and future assets are transferred to a bankruptcy-remote trust, which in turn can sell different series of notes to investors, all backed by an ownership interest in a common pool of assets. Alternatively, a transaction can be funded in an asset-backed commercial paper (ABCP) conduit or assets may be sourced from a discrete pool of loans. Accounts of eligible dealers may be added or removed from a pool over the course of the transaction, subject to meeting the eligibility criteria.

REVOLVING NATURE OF STRUCTURES

Floorplan securitization structures have a revolving period during which principal collections are reinvested in new receivables on a daily basis. To the extent that there are insufficient receivables to support the outstanding notes with bullet maturities on a term transaction, the proceeds from principal collections are held in a principal collections accumulation account (separate from the cash collateral account for enhancement purposes) to support the outstanding notes funding the assets. Asset coverage tests are incorporated in a revolving structure to ensure that there are adequate floorplan receivables to support the repayment of bullet maturity notes. For a transaction funded in an ABCP conduit where the commercial paper repayment obligations are significantly shorter, principal collections are applied on a regular basis to the repayment of the commercial paper to ensure that there is an adequate level of asset coverage.

ACCUMULATION PERIOD

The accumulation periods in a revolving securitization structure are designed to ensure the repayment of principal and interest to the investor for scheduled maturing term notes. Principal collections during an accumulation period are deposited to an accumulation account to make a lump sum payment to the investor on the expected maturity date.

The commencement of this period is subject to the unique payment rate within the specific floorplan transaction. The payment rate measures how fast principal collections are received from obligors of the pool of assets and can thus be accumulated to satisfy such obligations. The monthly payment rate is calculated as the sum of all collections remitted for a particular month as a percentage of the average or ending pool balance. A high payment rate would indicate robust demand for the manufacturer's product and the network of dealers' ability to turn over the inventory. A low payment rate may be due to seasonality or may be an early signal suggesting that the pool is at risk of experiencing potential defaults in the dealer networks as a result of weakening demand for the product. Moreover, the payment rate is a direct indicator of the creditworthiness of the assets as it gauges how quickly investors can be repaid before being affected by mounting losses in the pool of floorplan loans.

AMORTIZATION PERIOD

During an amortization period, principal collections are deposited to an accumulation account and then applied toward the repayment of the notes on a monthly basis. This is referred to as a controlled amortization structure. Events or triggers leading to early amortization may be trust- or series-specific. For those transactions operating under a master trust structure, whereby multiple series of notes are issued against a single master pool, trust-specific triggers are incorporated to protect all series of noteholders as a result of potential adverse performance of the pool of floorplan loans. Trust-specific amortization events typically lead to a pro-rata repayment of all series of notes in accordance with their priority, regardless of their respective scheduled maturities. Amortization triggers for a specific series of notes can also be incorpo-



rated and applicable only for that specific series of notes; in the event that a series-specific amortization trigger is breached, the trust may continue purchasing new assets for the remaining series of notes.

Amortization periods are also triggered by certain performance tests on the pool of revolving floorplan loans or certain events related to the finance company or manufacturer. Due to the rapid turnover of floorplan loans, an early amortization period is designed to pay out the investor in a relatively short time before any significant losses affect the portfolio of floorplan loans. As noted above, the payment rate is critical to ensuring timely payment of interest and ultimate repayment of principal and for this reason is benchmarked and included as a performance trigger within the securitization structure.

Other performance triggers may include loss rates, used vehicle limits, aging or default ratio limits, thresholds on draws of credit enhancement and a minimum test on the total number of receivables in the pool available to repay principal and interest. In certain transactions, the allocation of principal and interest collections from eligible and ineligible pools of receivables to repayment of outstanding notes gives the trust first access to these additional proceeds.

In addition to the performance tests, early amortization triggers are associated with the manufacturer or the finance company. Triggers may be related to the finance company's credit rating, representations and warranties, the failure to remit collections on a timely basis or cross default covenants. More importantly, events stemming from either the manufacturer or finance company filing for bankruptcy protection would cause an early amortization of the revolving structure. These additional triggers are included to help protect the trust against declining asset values should it need to liquidate the underlying vehicles or parts and serve to recognize the fact that floorplan transactions are more closely linked to the health of the asset manufacturer than are other forms of tangible asset securitizations.

Structural Risks in Floorplan Financing

SOLD OUT OF TRUST

As discussed, SOT loans are one of the more salient risks in floorplan financing, and can involve situations ranging from dealer fraud to a dealer's oversight in its financial records. Field audits are conducted regularly by the finance companies to mitigate the occurrence of SOT loans. The frequency of these audits may depend on the risk category of the dealer and its inventory turnover, payment behaviour, sales reporting pattern and vehicle registration records. Losses from SOT loans have been low, but periodically lumpy in floorplan securitization transactions and, depending on the servicing capabilities of the servicer, SOT loans may escalate under a distressed scenario. The securitization transaction documents typically ensure that any SOT assets are considered ineligible and must be bought back by the finance company.

CONCENTRATION RISK

Concentration limits on the type of collateral and maximum dealer exposures are incorporated in revolving structures to ensure that there is consistency and adequate diversification in the pool composition. Limits would also be imposed on inventory, which tends to exhibit more volatile sales volumes and for assets such as rental equipment, fleet inventory and used vehicles with higher depreciation rates.

Dealer composition in a pool of floorplan loans may be geographically diversified; however, there do tend to be concentrations of a few large dealers in most pools. Generally, a dealer that is deemed to be of higher credit quality, as determined by the finance company's credit assessment, is, based on its sales volumes and ability to turnover inventory, extended higher credit lines than its peers. The principal owners of the larger dealerships may be diversified through ownership of multi-branded dealerships. This does remove some of the exposure to a single manufacturer and consideration may be given when setting individual dealer concentration limits. Exposure to these larger dealers is limited relative to the enhancement levels in a securitization structure with minimum coverage levels required.



DEALER DEFAULTS (CREDIT LOSSES)

When a dealer defaults, it is important for a field auditor to be immediately dispatched to the location of the defaulted dealership to monitor the inventory and to ensure that proceeds from the sale of such inventory are remitted to the finance company. The finance companies, as servicers, are broadly based geographically and maintain a presence in various regions, which enables them to dispatch field auditors relatively quickly to any location; this function may also be outsourced to independent third parties. Upon repossession of the inventory, the finance company would attempt to sell the new inventory to the remaining network of dealers or back to the manufacturer under any repurchase agreement that might exist. Depending on the nature of the repurchase agreement, the manufacturer may have the right, but not the obligation, to repurchase the repossessed new inventory. Used inventory, however, would generally be sold at wholesale auctions. Further recourse would include pursuing the dealer principal to realize on any additional supporting collateral to recoup any losses net of the disposition of the inventory.

DILUTIONS

Dilutions resulting from in-transit inventory, product warranty claims and promotional discounts are non-credit reduction items that would reduce the pool of outstanding receivables supporting a securitization transaction. A revolving structure can provide for this by pledging additional loan receivables beyond the overcollateralization amount to the trust, also known as the seller's ownership interest.

SERVICER RISK

Since the finance company plays an integral role in the servicing of a floorplan transaction, financial difficulties at the finance company may affect its ability to service the portfolio, impacting how the underlying assets perform. To help insulate the investor from servicer risk, triggers are incorporated to replace the finance company as the servicer in a securitization transaction. Some of these triggers include breach of representations and warranties to the trust by the finance company, failure to remit collections to the trust in a specified time frame, cross defaults to other creditor agreements, breach of financial covenants, and bankruptcy filings of the manufacturer and/or the finance company itself.

COMMINGLING RISK

For servicers in a floorplan securitization transaction which have an investment-grade rating of BBB (low) or higher, the proceeds received from the dealer networks may be commingled in the servicer's general operating account and remitted each month on the settlement date. If the servicer is not rated investment grade, DBRS expects the proceeds collected by the servicer to be deposited into a separate account (typically in the name of the conduit/trust) within two business days of receipt in order to avoid the risk that the proceeds cannot be separated from the servicer's own funds and may be captured in any bankruptcy proceedings. This is generally referred to as commingling risk.

Since floorplan loans are short term in nature and payment rates are high, commingling risk associated with a non-investment grade servicer is significant. In the instance where a servicer's rating is below investment grade, several additional measures would need to be in place to mitigate commingling risk. These may include more frequent reporting, a standby replacement servicer, perfection of the security interest given over the collections account if the account is not in the name of the conduit/trust, and a lock-box agreement or blocked account agreement to enable the indenture trustee to assume control over the account when necessary. Overall, mitigating factors with respect to lower-rated servicers are addressed on a case-by-case basis.

BANKRUPTCY REMOTENESS RISK

As noted previously, the structure of the transaction requires a "true sale" from a legal perspective in order to limit the reach of the court under a bankruptcy filing by either the servicer or the manufacturer. "Stay risk" is the risk that exists where a stay of proceedings may be instituted against the bankrupt entity and any related companies. Any collections that are in an account in the name the party subject to the stay of proceedings may not be withdrawn or transferred until the stay is lifted or the court determines that the proceeds rightfully belong to the conduit/trust. In all transactions, DBRS reviews the form and substance of the structure and the legal opinions provided that indicate the transaction represents a true sale from the Seller/Servicer perspective.



Components of Credit Enhancement

EXCESS SPREAD

Excess spread is the amount by which the weighted average interest on the pool of floorplan loans exceeds the sum of the trust's funding costs, net losses, servicing fees (if applicable) and other trust fees. Excess spread absorbs the first level of losses incurred by the pool of assets. In Canada, floorplan loans are usually benchmarked to the floating prime rate while the funding costs of the trust are typically based on CDOR plus a spread. The subordination of certain trust-related fees would be given credit in the determination of the level of excess spread available to support a transaction. In addition, an indemnity or hedging instrument from an appropriately rated counterparty to mitigate potential spread compression may be taken into consideration.

CASH RESERVE ACCOUNT

Similar to other securitization transactions, a cash reserve account (CRA) is included in a revolving floorplan structure for credit enhancement purposes. The CRA is usually seeded upfront and may increase due to the trapping of excess spread and other non-principal collections (if available) subsequent to the occurrence of certain events such as an incremental reduction in the reported payment rate of a transaction. During an accumulation period, the CRA may increase from the original seeded amount and is designed to provide additional liquidity to the transaction during amortization.

OVERCOLLATERALIZATION

Overcollateralization is most often the largest single component in the overall credit enhancement structure of a floorplan securitization transaction. Overcollateralization is created by the inclusion of eligible receivable loans in excess of the aggregate outstanding funded principal balance. Not only does overcollateralization provide credit support to the trust, the collections forming part of the trust's interest from the additional assets may assist in the rapid amortization of the outstanding notes in a revolving structure.

SUBORDINATION

Subordinated notes in certain transactions provide credit enhancement for the senior notes by absorbing losses (up to the subordinated principal amount) and allowing the senior notes preferential access to the cash flows. The level of enhancement for the subordinated notes, however, will be subject to cash flow stress levels in order to achieve their respective ratings and is subject to investor demand.

Determining Credit Enhancement

The assets of floorplan securitization transactions are, primarily, the obligations of the eligible dealers secured by their financed inventory. The performance of such assets depends on a viable dealer network, supported by a healthy manufacturer and finance company. These assets may experience a high frequency of default and severity of losses resulting from the potential bankruptcy filing of the manufacturer or the financing company. For each new transaction, DBRS evaluates the ensuing consequences with respect to the inability of the manufacturer to back product warranties and to provide inventory to the dealer network. DBRS assumes that this would result in a decline in demand for the product, compression in inventory values and, ultimately, an impact on the survivability of the dealer network.

The credit enhancement is structured and consists of a variety of forms of enhancement to mitigate the risks arising from SOT assets, dilutions, interest carry during stay proceedings caused by finance company or manufacturer bankruptcy filings, and any base loss assumptions derived from a review of the portfolio's historic performance.



DEALER CONCENTRATION SCENARIO

DBRS's approach to determining the minimum credit enhancement for floorplan securitization transactions begins with a review of the dealer concentration levels. The minimum credit enhancement coverage for each respective rating level is tabled below:

Minimum Credit Enhancement Coverage

Rating Category	Dealer Concentration
AAA	Top 6-8 Dealers
AA	Top 5-6 Dealers
A	Top 4-5 Dealers

In this scenario, total enhancement required for a AAA rating can be no less than the total percentage of assets that the top six dealers account for in the securitized pool of assets.

Credit enhancement serves to mitigate a number of risks inherent in floorplan securitization structures:

- Dealer concentration levels tend to be larger in most floorplan portfolios; consequently, the seller typically pledges additional loans to the trust as additional overcollateralization to cover floorplan loans in excess of the concentration levels.
- Additional receivables may be pledged to the trust as the seller's interest to mitigate potential dilutionary and ineligible items if the seller is not an investment-grade-rated entity. However, DBRS will consider an indemnity from an investment-grade entity to the trust to be an acceptable form of mitigant as well. This buffer provides an extra layer of protection resulting from non-credit-related losses in the underlying portfolio of floorplan receivables.
- A replacement servicer reserve is typically required in the form of overcollateralization to provision for the cost of replacing the initial servicer. While replacement of the initial servicer is rare, the additional level of collateralization, usually estimated at 1% of the funded amount, ensures that the replacement costs of servicing the portfolio of floorplan receivables are captured in the transaction structure.
- In an amortization period, credit enhancement in the form of excess spread and cash is designed to provide liquidity to the program to cover the cost of funds on the outstanding obligations.

CASH FLOW STRESS SCENARIOS

The adequacy of the amount of enhancement determined under the dealer concentration scenario is evaluated by applying a cash flow stress scenario whereby conservative assumptions are made with regard to the various model inputs. The objective is to get a view of how deterioration in the credit quality of the dealer obligors and the weakening of the manufacturer and brand may impact asset sales and the ability of the dealers to repay the floorplan loans.

Prior to determining base loss level expectations for modelling cash flows in a floorplan transaction, DBRS reviews the historical performance of the owned and managed pool to determine the expected and potential worst-case performance. Data capturing of at least one economic cycle would be the minimum time frame when assessing performance. Discussions with the finance company on its operational capabilities in servicing the pool, especially under a distress scenario, would be explored to determine additional risk inherent in the transaction. DBRS will also review the covenant package as it relates to insolvency and bankruptcy events affecting both the manufacturer and the finance company. Trigger levels relating to the performance of the underlying assets are an important component in the covenant package when reviewing stress levels. The triggers must be conservative enough to ensure that investors are repaid under a distressed scenario but flexible enough to allow for normal performance variations caused by seasonality.



DBRS's cash flow analysis incorporates the elements of the transaction structure, including any triggers or covenants that may affect cash flows and result in early amortization. The frequency of dealer defaults and the severity of losses are expected to increase under this scenario. Although investors are entitled to the current and future cash flows in a revolving floorplan structure, DBRS models the performance on an amortization basis, resulting in an immediate decline in the pool balance.

To reflect a distressed scenario, stresses are applied to the monthly payment rate, defaults, recoveries, and timing of recoveries in order to determine the robustness of the enhancement structure. The enhancement levels are initially determined based on the top dealer concentrations and the risk elements referred to above.

PAYMENT RATES

In a revolving structure, the monthly payment rate determines how fast an investor can be repaid from the monthly cash flows before being affected the adverse performance of the underlying assets. Payment rates on floorplan assets are generally much higher than the trigger levels established for each transaction. As a starting point, DBRS stress-testing would assume the payment rate starts at the minimum payment rate trigger level and begins an immediate and steady decline to reflect waning demand for the manufacturer's product. Typically, for a AAA stress, this would decline to a monthly payment rate of 50% to 60% below the payment rate trigger. See the table below for thresholds for each ratings category.

% Decline from Payment Rate Trigger

	Ranges
AAA	50%-60%
AA	45%-55%
A	40%-50%
BBB	35%-45%

DEFAULTS AND RECOVERIES

Stressed defaults, recoveries and the timing of these recoveries are reviewed for each transaction. Generally, the performance of the manufacturer and the captive finance company is closely correlated to the dealer's survival. DBRS views a pool composed of multi-branded dealers with access to alternative financing and less exposure to any one manufacturer as more likely to experience lower levels of default than a pool of dealers with heavier reliance on a single manufacturer and its captive finance company. Annualized defaults, and the velocity with which these defaults would occur immediately after an amortization event has been triggered, would be partly dependent on the level of the dealers' diversification. Historic default rates are low for ongoing floorplan deals. Under a stressed scenario, it is assumed that the default levels will increase substantially month over month. Typically, DBRS would increase the default levels on the remaining pool balances in 2.5% to 5% increments, with a maximum level being achieved in the nine-to-twelve month time frame if the program has not paid out by then. The table below shows the ranges of annualized stressed default rates applied to each month's outstanding pool balance under each rating category.

Maximum Monthly Defaults (Annualized Rates)

	Ranges
AAA	45%-60%
AA	40%-55%
A	35%-50%
BBB	30%-45%



In the absence of a solvent dealer, the extent and timing of recovery depends on the nature of the collateral. For example, recoveries on automotive vehicles should be realized one to three months after a dealer has defaulted. In contrast to this, agricultural and heavy construction equipment is more susceptible to seasonality and obsolescence, and would require a much longer time horizon to resell in the downstream market. Under normal conditions, the recovery value of the underlying collateral, when remarketed via retail channels, would provide a recovery value greater than the wholesale price. Under a distress scenario with waning demand for a product, the realized price is likely to fall below the wholesale price.

It is anticipated that the time frame for recoveries would also be extended. DBRS incorporates a lag of three to 12 months to the timing of recoveries to reflect the flood of inventory in the downstream markets and dampened demand under a liquidation scenario. Additional lags may also be incorporated to reflect the seasonality of the underpinning asset.

Recovery Rates

	Ranges
AAA	20%-40%
AA	30%-50%
A	40%-60%
BBB	50%-70%

EXCESS SPREAD AND REPLACEMENT SERVICER FEES

The yield on the assets is stressed based on the review of the underlying pool of loans and with reference to any hedges in place to protect the spread. The adequacy of an appropriate indemnity, counterparty or subordination of certain administrative fees would be taken into consideration in the modelling of the underlying cash flows. However, replacement servicer fees are modelled at the top of the waterfall, regardless of whether or not the original servicer has been replaced under an early amortization event.

Post-Closing Surveillance

DBRS's methodology assumes that if the manufacturer or finance company were to experience severe financial distress, it would initiate a filing for bankruptcy protection which would allow for the reorganization of the company instead of entering directly into the liquidation and wind-down of its business. This reorganization would by necessity have a longer time frame than that of a forced liquidation of the company, but would lead to a rapid and orderly amortization of the securitized floorplan assets.

A filing for bankruptcy may require DBRS to initiate a transaction review. Specifically, due to the tri-party relationship of floorplan transactions referred to at the outset of this methodology, there are a number of entities that could file for bankruptcy and precipitate a DBRS rating action. Because the details of the bankruptcy may have a significant impact on the credit quality of the outstanding notes, time will be needed to review the specific details of the bankruptcy filing. Until such time as the details can be obtained and an informed decision be made, it is possible that DBRS would place any affected notes Under Review with Developing Implications in a restructuring scenario or Under Review with Negative Implications in a wind-down or liquidation scenario. Depending on the details of the liquidation, recovery assumptions and the viability of the dealer network would have to be re-assessed, which may ultimately affect the rating.



Conclusion

Floorplan financing obligations ultimately belong to the dealers. These short-term obligations are supported by the inventory that is being financed and, in many cases, ancillary support from a security interest in the dealership's principal's personal property and the dealership's assets. Even though the underlying assets are bankruptcy remote, the ongoing performance of floorplan securitization structures depends on the general health of the manufacturer that provides the inventory, replacement parts, accessories, product warranty, marketing and dealer and after-sales incentives to support the product. Since the finance company plays a pivotal role between the manufacturer and the dealer network as seller and servicer in securitization transactions, DBRS focuses on its servicing capabilities, especially under a distress scenario. Said scenario may include some or all of the following pressures: weakening demand for the manufacturer's product, price compression on the underlying inventory, dealer defaults, dilutions, SOT loans, and manufacturer and finance company bankruptcies. In conjunction with this, a review of the dealer concentrations relative to the credit enhancements available to the trust and the cash flow stress scenarios during an amortization event provides the basis for the rating process.



Appendix

Floorplan Methodology Executive Summary

Onsite review (servicer risk)

Assess strength of finance company and its credit-related processes as an originator of floorplan dealer loans.

Assess finance company's portfolio of loans (credit risk)

- (1) Total number of dealers (size and scope).
- (2) Manufacturer diversification – Number of dealers with multiple manufacturer brands.
- (3) Geographic diversification – Locations of dealer network.
- (4) Dealer financial strength – Review extent and value of additional security pledged to finance company by the dealer as security for the loans. Review credit history of dealers as assigned by the finance company.
- (5) Portfolio performance – Loss and delinquency history, sold out of trust history.
- (6) Dilutions – Promotional discounts, warranty claims, in-transit inventory (i.e., items that reduce the pool of outstanding receivables supporting repayment of the securitized debt).

Determining amount and components of credit enhancement

- (1) Review dealer concentrations in the floorplan portfolio and ensure that total credit enhancement proposed is commensurate with the corresponding rating level.
- (2) Stress the available enhancement using the DBRS cash flow stress model in line with minimum thresholds outlined in the methodology.
- (3) Excess spread – Available for month-to-month absorption of credit losses and cost of funds. Hedging arrangements may be included to structurally ensure a minimum level of excess spread is available during the revolving period.
- (4) Cash reserve account – Funded upfront, a minimum level of cash must be available for repayments ranging from covering any stay risk arising from a bankruptcy of the finance company, or the cash is available in the event of performance triggers being breached.
- (5) Overcollateralization – Enhancement created by the addition of receivables in excess of the aggregate funding pursuant to the securitization. Additional receivables in the form of a Seller's Interest may be added to be available for dilutions and ineligible assets, if any.
- (6) Subordination – Junior tranche notes can be issued (subject to market demand) and act as further credit enhancement to the senior rated notes by absorbing losses up to the subordinated principal.

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