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Related Research
• Legal Criteria for U.S. Structured Finance (July 2014)
• Operational Risk Assessment for U.S. ABS Servicers (December 2014)
• Operational Risk Assessment for U.S. ABS Originators (December 2014)
• Unified Interest Rate Model for Rating U.S. Rental Car Securitizations (February 2015)
• DBRS Master U.S. ABS Surveillance Methodology (October 2014)
• Rating U.S. Structured Finance Transactions Backed by Direct Pay Letters of Credit (May 2012)

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All DBRS ratings and research are available in hard-copy format and electronically on Bloomberg and at DBRS.com, our lead delivery tool for organized, Web-based, up-to-the-minute information. We remain committed to continuously refining our expertise in the analysis of credit quality and are dedicated to maintaining objective and credible opinions within the global financial marketplace.
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Scope and Limitations

DBRS evaluates both qualitative and quantitative factors when assigning ratings to U.S. rental car securitizations. This methodology represents the current DBRS approach for rating securitizations backed by U.S. rental cars, related lease contracts as well as other related assets and proceeds thereof. It describes the DBRS approach to analysis, which includes (i) a focus on the quality of the sponsor/manager, (ii) evaluation of the servicing capabilities and fleet composition and (iii) utilization of historically employed liquidation evaluation techniques. This report also outlines the asset class and discusses the methods DBRS typically employs when assessing a transaction and assigning a rating. It is important to note that the methods described herein may not be applicable in all cases. Further, this methodology is meant to provide guidance regarding the DBRS methods used in the sector and should not be interpreted as prescribing a rigid template, but understood in the context of the dynamic environment in which it is intended to be applied.

Executive Summary

This report outlines the typical DBRS approach for rating U.S. rental car asset-backed security (ABS) transactions. DBRS analyzes both qualitative and quantitative factors when rating U.S. rental car ABS transactions which include an assessment of the quality of the rental car operator and its ability to adequately track and maintain the fleet of vehicles supporting the transactions as well as an analysis of the purchase agreements in place with manufacturers and the exposure to the manufacturers through repurchase obligations under these contracts.

The key analytical considerations typically evaluated include the following:
- Quality of management and financial condition.
- Operational and servicing capabilities.
- Fleet composition and purchase agreements.
- Capital structure, proposed ratings and credit enhancement.
- Liquidation analysis.
- Legal structure and opinions.

DBRS reviews the potential for repayment of the transaction under the terms of the proposed financial structure. A component of the analysis is that the lessee (rental car company) becomes insolvent and the vehicles are subsequently liquidated to repay noteholders. Key factors considered in the liquidation analysis include the credit quality of the auto manufacturers for vehicles subject to repurchase agreements and timing considerations associated with gaining access to and disposing of vehicles following a bankruptcy of the rental car company.
Introduction / Industry Overview

Historically, the rental car industry can generally be divided into two main segments: the on-airport segment and the local rental segment. The on-airport segment of the industry caters to both business and leisure customers and is largely driven by airline passenger traffic, or enplanements. The local rental segment serves some commercial customers but focuses more on leisure and insurance replacement customers. A recent development in the local rental segment is the advent of companies that specialize in car sharing. The car-sharing business model typically includes a company locating vehicles in cities, airports or neighborhoods with customers able to rent cars by the hour or by the day by reserving cars online or through their smartphones. Customers can then use various forms of technology to determine vehicle availability and subsequently reserve these vehicles for use on an hourly or daily basis.

Another more recent trend in the business is companies looking to become full-spectrum rental car companies with distinctive brands that appeal to the premium, mid-tier and value segments of the market. For example, Avis Budget Group Inc. (Avis Budget) operates with Avis Rent a Car System (Avis) as its premium brand, Budget Rent a Car covering the mid-tier portion of the market and Payless Car Rental in the value sector. Comparable brands for Hertz Global Holdings Inc. (Hertz Global) are the Hertz Corporation (Hertz) brand in the premium segment, Dollar Rent A Car (Dollar) and Thrifty Car Rental (Thrifty) in the mid-tier sector and Firefly Car Rental in the value sector.

The chart below (Chart 1) shows recent revenue and fleet trends for the U.S. car rental industry. Beginning in 2003, the industry began to recover from the effects of the decline in air travel and corresponding drop in rental car demand following the September 11, 2001 (9/11) terrorist attacks. Since that time, industry revenue and fleet size increased steadily until the effects of the recent economic downturn affected the industry in 2007 and 2008. Despite the continued challenging economic conditions that have persisted since 2009, the industry recovered well with overall revenue increasing nearly 25% between 2009 and 2013, facilitated by industry consolidation and favorable pricing trends.

Chart 1: U.S. Car Rental Revenue vs. Fleet Size

![Chart showing revenue and fleet size trends from 2003 to 2013](chart1.png)

Source: Auto Rental News.
BANKRUPTCIES OF ANC RENTAL CORPORATION AND BUDGET

Industry turbulence stemming from the drastic decline in enplanements after the events of 9/11 affected the financial condition of several rental car companies and, in November 2001, ANC Rental Corporation (ANC), then owner of Alamo and National brands, filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. In July 2002, Budget Group (Budget) also filed for Chapter 11 bankruptcy protection after it was unsuccessful in restructuring its balance sheet pre-petition.

The occurrence of these bankruptcies was particularly significant to the structured finance markets as both rental car companies had several classes of outstanding rental car ABS at the time of their filings.

In the case of ANC, most of its outstanding ABS transactions were funded through ARG Funding Corporation (ARG). Following the ANC bankruptcy filing, ANC made no lease payments during the automatic 60-day stay period. As a result, reserve accounts were drawn upon to make interest payments on the ARG debt. Principal payments scheduled to begin during this time frame were also not made; however, lease payments did resume after this 60-day period as the bankruptcy court affirmed the contracts. The bankruptcy of ANC was a rapid amortization and liquidation event under the transaction documents; however, the ARG transactions did not enter into early amortization because the bond insurer in the deal, MBIA Insurance Corporation, which ultimately became the controlling party, temporarily waived the amortization event and chose not to liquidate the fleet. ANC continued to operate in bankruptcy until October 2003 when Vanguard Car Rental (Vanguard) was formed by Cerberus Capital Management, L.P. to purchase the U.S. and Canadian assets of ANC. During the bankruptcy, bondholders under the securitized transactions received timely interest and principal as scheduled (except for a delay of two months on principal due on the 1999-1 tranche).

In the case of Budget, lease payments continued even after the bankruptcy filing. Cendant Corporation (Cendant), parent of Avis at that time, purchased Budget in November 2002 and ultimately refinanced Budget’s outstanding deals.

More recently, rental car ABS transactions have been affected by the bankruptcies of General Motors Corporation (GM) and Chrysler Group LLC (Chrysler), which is discussed in the Credit Quality of the Auto Manufacturers section below.

RENTAL CAR COMPANY OWNERSHIP AND INDUSTRY CONSOLIDATION

Prior to 1996, the major car rental car companies were owned by the large domestic manufacturers with GM having a stake in Avis and National, Ford Motor Company owning Hertz and Budget and Chrysler owning Dollar and Thrifty. In the late 1990s, the manufacturers started to divest their interests in their rental car subsidiaries with GM selling its stakes in Avis and National, Ford selling Budget to Team Rental Group and Chrysler spinning off Dollar and Thrifty through a public initial public offering. Avis was subsequently purchased by Cendant in 2001, which also later purchased Budget out of bankruptcy in 2002.

Ownership changes continued to occur through the mid-2000s with Hertz’s sale in late 2005 to a consortium of private equity companies. In August 2006, Avis Budget became a public company through the split of Cendant into four separate companies. In August 2007, Vanguard was purchased by the owners of Enterprise Rent-A-Car and is currently operated separately as a subsidiary of Enterprise Holdings, Inc. The final move toward consolidation occurred in November 2012 when Dollar Thrifty Automotive Group, after being pursued by both Avis Budget and Hertz Global, was acquired by the latter. As a result of the industry consolidation, there are now three major participants in the U.S. rental car industry as noted in the table below (Table 1).
### Table 1

<table>
<thead>
<tr>
<th>Major Brands Operated</th>
<th>Enterprise Holdings</th>
<th>Avis Budget Group</th>
<th>The Hertz Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013 Fleet size (units)¹</td>
<td>1,400,000</td>
<td>487,000</td>
<td>490,000</td>
</tr>
<tr>
<td>Global 2013 Revenues²</td>
<td>$16.4 billion</td>
<td>$7.9 billion</td>
<td>$8.7 billion</td>
</tr>
<tr>
<td>Global Locations</td>
<td>8,100</td>
<td>10,000</td>
<td>10,600</td>
</tr>
<tr>
<td>2013 On Airport Market Share⁴</td>
<td>33.2%</td>
<td>26%</td>
<td>36.1%</td>
</tr>
<tr>
<td>Parent Company</td>
<td>Privately Held</td>
<td>Public Company</td>
<td>Public Company</td>
</tr>
<tr>
<td>DBRS Rating</td>
<td>NA</td>
<td>BB low (Stable)</td>
<td>BB (Negative)</td>
</tr>
</tbody>
</table>

Notes:

### Key Variables Impacting Rental Car ABS Transactions

There are typically multiple components to the DBRS review of rental car ABS transactions: 1) the quality of the rental car company as fleet servicer/operator and lessee in the transaction; 2) the credit quality of the auto manufacturers of the fleet; and 3) the residual values of the fleet during a contemplated liquidation scenario.

#### RENTAL CAR COMPANY

While the DBRS liquidation scenario generally involves an analysis of the expected vehicle proceeds after an operating company insolvency and subsequent fleet liquidation, DBRS typically considers the operational capabilities of the company to manage fleet servicing and maintenance, logistics, fleet forecasting and fleet depreciation methodology. Proper maintenance of the fleet is an important component of customer satisfaction, and vehicle condition at disposal in part determines the ultimate sales proceeds upon disposition. While the liquidation scenario contemplates an operating company insolvency, DBRS normally considers the overall financial condition of the operating company and available liquidity at the operating company since, as lessee, it is responsible for making periodic lease payments. In addition, the financial condition of the operating company may affect the ability of the ABS transaction to perform in the event of a sudden market downturn. For example, rental car structures typically have mechanisms whereby vehicle disposition proceeds are evaluated relative to their net book value (NBV) at disposal. In the event that the fleet proceeds are less than the NBV, the operating company would be expected to increase the available credit enhancement to maintain the borrowing base at the proper level. To the extent that the issuer was unable to do so, the ABS transaction would enter early amortization which could adversely affect the continuity of its ABS funding platform.

#### AUTO MANUFACTURER CREDIT QUALITY

Rental car ABS transactions are directly exposed to the creditworthiness of the auto manufacturers through repurchase obligations on program vehicles whereby the manufacturer agrees to buy back vehicles under certain terms at a specified price. Rental car ABS transactions also have indirect exposure to the credit quality of the vehicle manufacturers in the case of non-program vehicles to the extent that a manufacturer’s credit worthiness affects the residual values of its vehicles.
In bankruptcy, a manufacturer may seek to terminate its obligation to repurchase program vehicles from the rental car companies. DBRS generally expects the likelihood that a manufacturer would seek to terminate its repurchase obligations to be remote as the rental car companies still represent relatively large new vehicle purchasers for the manufacturers and can therefore be strategically important to the manufacturer. As shown in Chart 2 below, new vehicle sales into rental fleet, while down from the levels witnessed in the mid-2000s, still remain a significant portion of overall industry sales.

**Chart 2: New Vehicle Sales Into Rental and Rental Fleet Size**

![Chart 2: New Vehicle Sales Into Rental and Rental Fleet Size](image)

Source: NADA, Auto Rental News, Bobit Business Media.

The recent bankruptcies of GM and Chrysler illustrate the important relationship between the auto manufacturers and the rental car companies. Chrysler filed for bankruptcy on April 30, 2009, and GM filed for bankruptcy on June 1, 2009. During the bankruptcy process, both companies affirmed their contractual obligations under the vehicle repurchase agreements; however, it should be noted that rental fleet sales historically were and currently are a significant portion of sales for both manufacturers. To the extent that a manufacturer was less reliant on rental car sales, a declaration not to affirm its repurchase obligations in bankruptcy may be more likely. To mitigate manufacturer exposure, the rental car companies have sought to increase overall manufacturer diversification and have also generally reduced the percentage of program cars in the rental fleets. This was driven in part by the recent strength in the used vehicle market that has reduced the holding costs for non-program vehicles. In addition, GM and Chrysler emerged from bankruptcy with a cost structure that allowed them to rationalize production with demand and, consequently, business models were less reliant on sales into rental fleet and the terms under which program vehicles were made available to the rental car companies were generally less attractive.

**RESIDUAL VALUES OF THE VEHICLES IN THE FLEET**

Rental car transactions are exposed to the residual value risk through non-program or at-risk vehicles that are not subject to a buyback agreement with manufacturers or potentially through program vehicles that become ineligible to repurchase and are disposed by the rental car company through other channels. In rental car ABS transactions, the monthly lease payment usually consists of a portion that covers transaction expenses such as interest and fees as well as a portion that covers vehicle depreciation. Depreciation rates are established by the rental car company largely based upon a vehicle’s expected hold time, reviewed periodically and adjusted if necessary. To the extent that vehicles depreciate faster than expected and depreciation adjustments are insufficient to maintain parity between the market value and book value, there can be a loss at the time of disposition. ABS transactions typically have mechanisms that periodically check the market value of the vehicles relative to book value and, to the extent that the market value is less than the book value, the issuer would be obligated to increase credit enhancement in an amount equal to such shortfall. As a result, DBRS typically expects that, at the commencement of the liquidation
scenario, the market value and the book value of the vehicles will be equal. Given the potential market value volatility upon disposition, DBRS normally assumes various market value declines based on the targeted rating.

Chart 3 below shows the Manheim Used Vehicle Value Index which uses January 1995 as the base period (value at January 1995 = 100).

As illustrated, throughout the mid-1990s, the market generally trended upward with the first significant decline happening shortly after the events of 9/11. The used vehicle market after 9/11 was largely driven by generally tepid economic conditions, rapid de-fleeting by the rental car companies given the precipitous decline in air travel and a surge in incentives by the manufacturers to encourage sales.

From January 2003 until August 2007, used car prices again trended upwards with occasional fluctuations. In late 2007 and into 2008, the used vehicle market started to decline as recessionary conditions in the United States emerged. The largest decline in used car prices occurred in October and November 2008 when prices declined almost 6% per month; however, the market recovered quickly and used vehicle values again increased steadily into 2012 and have generally been stable throughout 2013 and 2014, outside of normal seasonal fluctuations.

As described previously, typically there are structural features included in rental car ABS transactions by issuers intended to limit the impact of sudden market value changes on non-program vehicles in ABS transactions. To date, these features have included: 1) a monthly mark-to-market test using recognized used vehicle industry guide publications and 2) a monthly test on disposition proceeds compared with the NBV of vehicles sold. Most often these tests are used concurrently and the test that indicates the greatest shortfall, if any, would apply.

In addition, issuers of rental car ABS transactions also generally incorporate structural features that are intended to address the impact of a manufacturer bankruptcy on program vehicles. Typically, after a grace period, program vehicles from bankrupt program manufacturers are included in a transaction subject to potential valuation haircuts. The grace period is designed to allow the market time to stabilize as recent experience has shown that market volatility can be short-lived. The haircuts provide ABS investors additional protection in the event that the manufacturer does not affirm the program agreements. If the bankrupt manufacturer were to affirm the manufacturer’s obligations under the program agreements, such vehicles would not be subject to any additional valuation haircuts and would receive full credit in the borrowing base. If the manufacturer were not to affirm the program agreement, then the rental car company could re-designate these vehicles as non-program vehicles, provided that it contributes an
amount equal to the difference between the vehicle’s current NBV and the vehicle’s NBV had such vehicle been a non-program vehicle as of the re-designation date as specified in the transaction.

DBRS has analyzed changes in used car values to determine the extent to which used car values may decline under a liquidation scenario. This analysis is factored into the haircuts that applied to the residual values of the collateral in determining the ratings for a transaction given the proposed credit enhancement levels.

The chart below (Chart 4) summarizes some historical data with respect to the maximum rolling declines for the Manheim Used Vehicle Value Index. As indicated by this data, the largest declines were observed during 2008.

<table>
<thead>
<tr>
<th>Year</th>
<th>1 month</th>
<th>2 month</th>
<th>3 month</th>
<th>4 month</th>
<th>5 month</th>
<th>6 month</th>
<th>7 month</th>
<th>8 month</th>
<th>9 month</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>-1.76%</td>
<td>-3.25%</td>
<td>-3.37%</td>
<td>-4.84%</td>
<td>-4.26%</td>
<td>-4.09%</td>
<td>-3.92%</td>
<td>-3.50%</td>
<td>-3.42%</td>
</tr>
<tr>
<td>2008</td>
<td>-5.96%</td>
<td>-11.28%</td>
<td>-11.55%</td>
<td>-11.47%</td>
<td>-10.83%</td>
<td>-9.09%</td>
<td>-9.32%</td>
<td>-9.59%</td>
<td>-9.07%</td>
</tr>
<tr>
<td>2009</td>
<td>-0.93%</td>
<td>-0.93%</td>
<td>-2.40%</td>
<td>-8.21%</td>
<td>-8.13%</td>
<td>-7.46%</td>
<td>-5.66%</td>
<td>-5.40%</td>
<td>-6.18%</td>
</tr>
<tr>
<td>2010</td>
<td>-1.08%</td>
<td>-1.74%</td>
<td>-1.82%</td>
<td>-1.74%</td>
<td>-1.49%</td>
<td>-0.83%</td>
<td>0.68%</td>
<td>1.11%</td>
<td>1.19%</td>
</tr>
<tr>
<td>2011</td>
<td>-1.75%</td>
<td>-2.98%</td>
<td>-3.61%</td>
<td>-3.83%</td>
<td>-3.91%</td>
<td>-3.13%</td>
<td>-2.21%</td>
<td>-1.60%</td>
<td>-1.68%</td>
</tr>
<tr>
<td>2012</td>
<td>-1.78%</td>
<td>-3.12%</td>
<td>-3.89%</td>
<td>-4.28%</td>
<td>-4.36%</td>
<td>-4.36%</td>
<td>-4.05%</td>
<td>-3.98%</td>
<td>-3.52%</td>
</tr>
<tr>
<td>2013</td>
<td>-1.31%</td>
<td>-2.43%</td>
<td>-3.40%</td>
<td>-3.95%</td>
<td>-4.03%</td>
<td>-3.55%</td>
<td>-2.58%</td>
<td>-1.80%</td>
<td>-2.48%</td>
</tr>
</tbody>
</table>

Maximum Decline: -5.96% - 11.28% - 11.55% - 11.47% - 10.83% - 9.09% - 9.32% - 9.59% - 9.07%

Transaction Structures

TYPE OF TRANSACTION
Rental car ABS transactions are typically financed either through asset-backed commercial paper conduits or as term transactions. Transactions have generally been structured using a master trust where the issuer may issue multiple series of either fixed- or floating-rate notes utilizing a revolving period often similar to that found in credit card master trusts. The revolving period provides the issuer with the ability to achieve longer-term funding as the rental fleets turn over quickly with vehicle holding periods ranging between five months and 24 months (depending on whether the vehicles are program or non-program). Issuance until the late 2000s was usually enhanced (wrapped) by monoline bond guarantors but, since 2009, rental car ABS transactions have been exclusively completed on a senior-subordinate basis.

Rental car ABS transactions are typically structured as a true lease. In a true lease transaction, the vehicles are titled in the name of the special-purpose entity (SPE) with the indenture trustee/custodian named as lienholder on the certificates of title. This structure should facilitate an orderly fleet liquidation in the event of an operating company bankruptcy by minimizing the probability that competing creditors would make a claim on the fleet assets.

In a transaction where the lease is a finance lease, the vehicles would be titled in the name of the lessee. In that case, the vehicles may be included in the bankruptcy estate if the rental car company were to file for bankruptcy. In such cases, it is difficult to determine the amount of time it might take to gain access to the vehicles for liquidation purposes. As a result, finance lease structures are more typically seen in commer-
cial conduit transactions where this uncertainty is addressed through the inclusion of liquidity (directly or indirectly) from the provider of the facility.

**BANKRUPTCY-REMOTE SPECIAL-PURPOSE ENTITY**
Rental car ABS transactions use a bankruptcy-remote SPE which issues securities the proceeds of which are used to purchase either non-program or program vehicles subject to purchase agreements with the manufacturer. In the case of program vehicles from eligible manufacturers, the rights under these manufacturer agreements are assigned to the SPE.

The SPE is normally administered by the rental car company under an administration agreement which specifies the responsibilities of the rental car company in the transaction. DBRS typically reviews this agreement and the responsibilities of the rental car company in connection with this agreement. A backup administrator may also be appointed by the issuer to mitigate risks related to the transfer of these functions if the rental car company goes into bankruptcy or otherwise cannot perform these functions.

Note: The structural diagram above depicts a simplified rental car ABS structure for illustrative purposes and does not include all potential parties. Each proposed rental car ABS transaction and structure is normally reviewed individually.

**LEASE PAYMENTS WITH RENTAL COMPANY**
In a typical rental car ABS transaction, the SPE enters into a lease agreement with the rental car company through which the SPE leases the vehicles it has purchased for use in the rental car company’s fleet. The rental car company is responsible for making monthly lease payments to the SPE designed to cover interest payments, vehicle depreciation, program carrying costs and other expenses associated with the transaction.

**MANUFACTURER AGREEMENTS AND RISK VEHICLES**
Under the manufacturer agreements, the servicer on behalf of the SPE will arrange for program vehicles to be returned to manufacturer designated sites. Historically, non-program (or risk) vehicles were primarily disposed of through wholesale auction. Recently, companies seeking to maximize the proceeds
of risk vehicle sales have utilized alternative distribution channels including online auctions, direct sales to dealers, rent-to-buy programs aimed at direct sales to customers and the establishment of company-owned retail outlets. A common structural feature incorporated by issuers has been the inclusion of a liquidation agent who, in the absence of an operative servicer, can facilitate the return of program vehicles to the manufacturer and otherwise dispose of risk vehicles. The liquidation agent is usually an entity with extensive automotive industry expertise, which may enhance the facilitation of an orderly fleet liquidation in the event of a rental car company bankruptcy and its potential inability to liquidate the fleet.

CREDIT ENHANCEMENT
The most common forms of credit enhancement presently seen in rental car ABS transactions include a combination of subordination, overcollateralization, letters of credit and reserve accounts. A portion of the credit enhancement is typically provided by the issuer in liquid form to address the payment of interest and expenses during the liquidation scenario. As part of the liquidation scenario, DBRS generally assumes that an automatic stay is adopted following the bankruptcy of the rental car company during which lease payments may not be made.

INTEREST RATE HEDGING
Given the low interest rate environment during the last several years, most term issuance has been on a fixed-rate basis; however, to the extent that a transaction were to issue floating-rate notes, an interest rate hedge may be included by the issuer to mitigate the risk associated with interest rate fluctuations. Interest rate hedges (e.g., caps) may create greater certainty in a transaction regarding the ability of the proposed liquidation portion of the credit enhancement to make interest payments during the assumed stay and liquidation periods. During an evaluation, DBRS generally assumes that the cap is at the strike rate specified in the hedging documentation.

For AAA-rated securities, a derivative counterparty is typically expected to maintain a DBRS credit rating consistent with the counterparty criteria per DBRS's Legal Criteria for U.S. Structured Finance.

If the proposed transaction does not include a derivative agreement to hedge interest rate risk, DBRS may apply additional stresses to the transaction cash flows to simulate a stressed interest rate environment. To quantify the effect of interest rate risk on a proposed transaction, DBRS typically applies interest rate curves based on the DBRS Unified Interest Rate Model for Rating U.S. Rental Car Securitizations, reflecting both upward and downward stresses.

PAYMENTS TERMS UNDER REPURCHASE AGREEMENTS – RECEIVABLES FROM MANUFACTURERS
Prior to the financial difficulties experienced by the large domestic auto manufacturers (which ultimately led to the bankruptcies of GM and Chrysler), program vehicles were commonly purchased under repurchase agreements whereby the manufacturer agreed to a repurchase price, subject to certain limitations involving holding time and wear and tear. To mitigate exposure to the declining financial health of certain manufacturers, rental car companies began to shift from guaranteed repurchase programs to guaranteed depreciation programs (GDPs). Under GDPs, the manufacturer and rental car company agree to a depreciation schedule for a vehicle and after the vehicle is disposed of either at auction or otherwise, the manufacturer is obligated to remit any shortfalls based on the agreed upon depreciation rates and the sales proceeds. These programs effectively reduce the amount of the receivable due from the manufacturer (netting amount to be paid against amounts received at disposition). In addition, to mitigate exposure to manufacturer credit risk, manufacturer agreements may include provisions whereby the rental car company, SPE or auction house retains title to the vehicle until repayment of the manufacturer receivable.

RENTAL CAR ABS TRANSACTION FEATURES

Rental car transactions typically include a revolving period, a controlled amortization period and a rapid amortization period.

Revolving Period
During the revolving period of the transaction, interest payments are made on the notes but no principal payments are made. Principal proceeds from lease payments and vehicle sales are used to purchase new vehicles (or pay down other series of notes that have reached an amortization period).

Controlled Amortization Period
The controlled amortization period follows the revolving period as long as no rapid amortization event has occurred. During the controlled amortization period, there are scheduled principal payments on the notes in addition to ongoing interest payments. New vehicle purchases may occur to the extent that there are funds in excess of those necessary to pay the scheduled principal and interest payments. The controlled amortization period is generally between six months and 12 months in length and is typically designed to fully repay the notes by the expected final distribution date.

Rapid Amortization Period
A rapid amortization period takes place if certain adverse events occur such as the breach of an early amortization trigger or an event of default. Typical transaction rapid amortization triggers are outlined below in the Lease Events of Default and Early Amortization Events sections. Breaching one of these triggers usually terminates the revolving period, resulting in no new vehicle purchases and any outstanding notes being repaid on an accelerated basis as the fleet is liquidated. Disposition timing depends on fleet size, bankruptcy issues and the ability of the lessee/servicer or other disposition agent to liquidate the fleet.

Legal Final Maturity Date
The legal final maturity date is normally set by the issuer to be one year after the expected final payment date of a transaction. If the notes are not repaid by the expected final distribution date, then an early amortization event goes into effect to facilitate repayment prior to the legal final maturity date.

BORROWING BASE
A borrowing base is normally maintained in a rental car ABS transaction to provide adequate assets to repay the asset-backed notes if there is a bankruptcy of the rental car company and liquidation of the fleet.

The borrowing base calculation typically consists of the following:
1. The NBV of program vehicles;
2. The NBV on non-program vehicles;
3. The accrued and unpaid lease payments due from the rental car company;
4. Receivables due from the manufacturers for program vehicles returned;
5. Receivables due from auctions; and
6. Cash and permitted investments on deposit in the collection account.

Generally, borrowing base credit is only given for receivables from investment grade manufacturers; however, recent events have shown that there is strong motivation for manufacturers to maintain their relationship with the rental car companies as evidenced by both Chrysler and GM affirming their program agreements during bankruptcy. As a result, in certain circumstances where there are sufficient structural protections, consideration may be given to receivables from non-investment-grade manufacturers. In such case, structural protections may be included by an issuer that consist of limits related to manufacturer rating, receivable size and aging.
TRANSACTION TRIGGERS

Lease Events of Default
Under the lease agreement with the rental car company, there should be certain events of default under which the SPE is no longer permitted to purchase additional vehicles. These events usually include the following:

1. Failure of the rental car company to pay principal or interest on any lease following the applicable grace period;

2. Certain events of bankruptcy proceedings are initiated against the rental car company;

3. Failure of the rental car company to comply with any provision of the applicable lease agreement that continues after the applicable grace period;

4. Material breach of a representation or warranty of the rental car company as per the applicable lease agreement;

5. Failure to maintain insurance on the vehicles as specified by transaction documentation; and

6. Unauthorized transfer or assignment of the lease by the lessee.

If a lease default occurs and continues following the applicable grace period, then an early amortization event would generally occur unless waived by the requisite investors.

Early Amortization Events
Rental car ABS transactions usually include certain events which terminate the revolving period and commence repayment of the notes. Typically, rental car ABS transactions include the following rapid amortization events:

1. The issuer defaults in the payment of any interest owed on the notes and that default continues after an applicable grace period;

2. The issuer defaults in the payment of any principal due on the notes and that default continues after an applicable grace period;

3. The issuer fails to comply with any other agreements, covenants or provisions of a series that materially and adversely affect the interest of the noteholder of any series after an applicable grace period;

4. A borrowing base deficiency exists and continues after an applicable grace period;

5. The liquidity amount is less than the liquidity amount specified in the transaction;

6. A lease event of default occurs and is continuing following the applicable grace period;

7. The commencement of bankruptcy of the issuer or the rental car company which continues following any applicable grace period;

8. Any representation or warranty made by the issuer is materially false and adversely affects the interest of the noteholders and is not cured after an applicable grace period following written notice by the trustee on behalf of the noteholders.

Manufacturer Event of Default
The bankruptcy of a manufacturer supplying program vehicles in a rental car ABS transaction is generally considered a manufacturer event of default. Transaction documents normally specify whether the conse-
quences of such default are effective immediately or subject to a grace period. Such consequences usually include provisions for the rental car company to continue to include program vehicles from bankrupt manufacturers that do not affirm the related program agreements in the transaction; however, transaction documents usually include a mechanism whereby the rental car company can elect to re-designate such vehicles as non-program vehicles. In that case, the vehicles are usually re-depreciated as if they were non-program vehicles, with the rental car company obligated to contribute any resulting shortfall as credit enhancement.

Usually, a manufacturer event of default does not occur until some specified grace period after the bankruptcy filing. During this period, should the bankrupt manufacturer affirm their buyback obligations in court, then a manufacturer event of default would not be deemed to have occurred.

Operational Risk Review – Originator and Servicer

In a typical ABS transaction, the originator and servicer review process evaluates the quality of the parties that originate and service the assets that are about to be securitized in a transaction rated by DBRS. While DBRS does not assign formal ratings to these processes, it typically conducts operational risk reviews to assess if an originator is acceptable and incorporates the results of the review into the rating process. Unlike a typical ABS transaction where the underlying asset supporting the ABS transaction consists of a loan or a lease originated by the sponsor, in rental car ABS, the originated asset supporting repayment of the notes generally consists of automobiles that are acquired by the transaction sponsor pursuant to purchase agreements with the respective manufacturers.

DBRS usually begins the initial originator review process by sending a questionnaire to the company that outlines the topics to be covered during the discussion with management and includes a list of documents to be provided such as organizational charts, financial statements and rental process guidelines. In instances where DBRS determines that the originator is below average, issuers may incorporate certain structural enhancements into a proposed transaction such as additional credit support so that DBRS can rate the transaction. In the event that DBRS determines that an originator is unacceptable, it may refuse to rate the deal.

The originator review process typically involves a review and analysis of the following:

- Company and management
- Financial condition
- Controls and compliance
- Origination and sourcing
- Rental process
- Technology

For details on the originator review process, please refer to the DBRS methodology *Operational Risk Assessment for U.S. ABS Originators*.

The servicer review process evaluates the quality of the parties that service or may conduct backup servicing functions related to the assets being securitized in a transaction rated by DBRS. DBRS typically begins the initial servicer review process by sending a questionnaire to the company that outlines the topics to be covered during the discussion with management and includes a list of documents to be provided such as organizational charts, financial statements and performance statistics. In instances where DBRS determines that the servicer is below average, issuers may incorporate certain structural enhancements into a proposed transaction such as additional credit support, dynamic triggers or the presence of a warm or hot backup servicer so that DBRS can rate the transaction.
The servicer review process typically involves an analysis of the following:

• Company and management
• Financial condition
• Controls and compliance
• Rental process
• Vehicle maintenance and tracking
• Vehicle turnback and remarketing
• Investor reporting
• Technology

For details on the servicer review process, please refer to the DBRS methodology *Operational Risk Assessment for U.S. ABS Servicers*.

## Fleet Assets

DBRS fleet analysis normally considers the type of vehicle acquisition agreements, the credit quality of the manufacturer and the vehicle type. The types of agreement include: (i) vehicles which are acquired under repurchase or guaranteed depreciation programs, both generally referred to as program vehicles; and (ii) vehicles acquired under contracts without any manufacturer repurchase or non-program or at-risk vehicles. DBRS assesses the potential impact of any manufacturer concentrations and how the manufacturer’s credit rating might affect residual values. Typically, rental car companies seek to build the fleet that complements customer demand. For example, airport locations generally might consist primarily of mid-sized vehicles while vacation destinations may have relatively more sport-utility vehicles or minivans to accommodate the needs of traveling families. DBRS considers any significant vehicle type concentrations or vehicle geographic concentrations that might affect fleet residual values under a liquidation scenario.

The proportion of non-program and program vehicles in a company’s rental fleet depends on the company’s fleet strategy which will be driven, in part, by the expected holding costs of program vehicles versus non-program vehicles. Expected holding costs could also be affected by a manufacturer’s financial condition and concerns regarding its ability to repurchase vehicles. Concerns regarding the ongoing viability of a manufacturer could also deter consumers from purchasing such vehicles, with the decreased demand adversely affecting residual values. While program vehicles enhance fleet flexibility to meet seasonal demand and eliminate residual value risk, such vehicles usually come with exposure to the credit condition of the manufacturer. On the other hand, while non-program vehicles reduce manufacturer credit exposure, such vehicles usually increase exposure to conditions in the used vehicle market.

DBRS is generally skeptical about fleet composition between program vehicles and non-program vehicles as DBRS criteria and analysis explicitly incorporate the unique risks inherent for each type of vehicle, detailed below in the Liquidation Analysis and Credit Enhancement section.

### Program Vehicles

Program vehicles are acquired from an eligible manufacturer under agreements which state the terms and conditions under which a vehicle may be repurchased by the auto manufacturer. The terms and conditions in these agreements typically include timing of return, mileage limitations and damage standards designed to exclude normal wear and tear. Program agreements also generally specify financial parameters such as the amount and timing of payment. To the extent that return conditions are not fulfilled, financial penalties may result or the vehicles may be declared ineligible for return. As described earlier, to mitigate manufacturer credit risk, most program vehicles today are purchased under guaranteed depreciation programs versus repurchase programs.
Program agreements are generally negotiated annually between the rental car company and the auto manufacturer. The terms and conditions are proposed by the manufacturers ahead of the expected delivery of any vehicles for that model year. DBRS typically reviews the general terms and conditions of these contracts and features, if any, that may have an impact during a potential liquidation scenario.

Non-Program Vehicles
Non-program vehicles or at-risk vehicles are purchased without any buyback obligation from the manufacturer, so the rental car company must dispose of those vehicles into the used car market and bear any gain or loss on the sale of those vehicles. Historically, rental car companies have included a majority of program vehicles in their fleets; however, over the past several years, the percentage of non-program vehicles has increased substantially as discussed above in the Auto Manufacturers Credit Quality section.

Manufacturer Risk
When analyzing the underlying fleet supporting a rental car ABS transaction, DBRS generally considers the financial condition of the various manufacturers in the fleet. Manufacturer risk can be direct, as is the case for program vehicles, or indirect, as concerns over a manufacturer’s ongoing viability could lead to market dislocation and may adversely affect the residual value of such vehicles. To evaluate these risks, DBRS usually reviews the fleet breakdown between investment-grade and non-investment-grade manufacturers for both program vehicles and non-program vehicles.

Manufacturer Eligibility
Transaction documentation generally specifies any applicable concentration limits for eligible manufacturers or manufacturer groups. Concentrations limits typically consider historical and projected fleet purchases and provide the rental car company with sufficient operating flexibility, yet serve to mitigate concentration risks. Transaction documentation may allow for the inclusion of vehicles from non-eligible manufacturers, though such limits are usually of a de minimis nature.

Historical Fleet Performance
To assist in the review of a rental car ABS transaction, DBRS requests three to five years of fleet performance data that normally includes the following:
1. Gains and losses on the sale of risk vehicles by manufacturer, generally on a model year;
2. Disposition history for program vehicles by model year detailing any historical loss experience associated with vehicle return;
3. Salvage and theft/conversion history for program and non-program vehicles;
4. Historical fleet depreciation experience for program and non-program vehicles, generally on a manufacturer-by-manufacturer basis;
5. Capitalized cost for program and non-program, vehicles, generally on a manufacturer by manufacturer basis; and
6. Additional information that may assist with analysis of a potential fleet liquidation including details relating to interest rate hedging, if applicable, and transaction expenses such as trustee, administrative or liquidation agent or other fees.
Liquidation Analysis and Credit Enhancement

DBRS analysis of rental car ABS transactions typically includes an assumption that the rental car company becomes insolvent and, after an automatic stay period, vehicles are liquidated to repay any outstanding ABS notes. DBRS generally assumes that the automatic stay period will last 60 days from the bankruptcy filing, consistent with Section 362 of the U.S. Bankruptcy Code. After the expiration of the automatic stay period, DBRS normally assumes that the primary source of funds to repay noteholders is from a liquidation of the fleet assets. DBRS analysis considers the ability of the proposed liquid credit enhancement to maintain current interest payments to investors and to pay other transaction expenses during the automatic stay period as it is assumed that the rental car company elects not to make lease payments during the automatic stay period. DBRS also considers the credit enhancement available to relative to expected fleet depreciation from bankruptcy until ultimate disposition of the vehicles as well as other potential losses relating to the return or disposition of program vehicles and the sale of non-program vehicles.

HOLDING PERIOD – INVESTMENT GRADE PROGRAM VEHICLES
With respect to investment-grade manufacturers and program vehicles, DBRS usually assumes that such manufacturers will have the financial ability to make any and all payments due under the terms of their respective program agreements. DBRS’s review typically considers the standards for vehicle return, minimum holding periods and the ability of the rental car operator to manage the fleet relative to the parameters specified in the program agreements. DBRS reviews historical fleet age and purchasing patterns to assess whether program vehicles are likely to be subject to any minimum holding period charges upon their return. In addition, for program vehicles, DBRS considers potential reconditioning expenses, other incidental expenses and historical experience for program vehicles returned to the manufacturer. Such vehicles may generate losses because of noncompliance with the terms of the program agreements for reasons such as excess wear and tear or excess mileage. Normally, the aforementioned losses and expenses are stressed based on the requested rating as shown in the chart below. Table 2 indicates the typical stress range multiples for U.S. rental cars. The multiples are designed to capture uncertainties and variables that may affect future transaction performance. The multiples in Table 3 are a guideline and may not be applicable in all transactions.

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<tr>
<th>Stress Range</th>
<th>BBB</th>
<th>A</th>
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<tr>
<td>Maximum</td>
<td>2.5x</td>
<td>3.25x</td>
<td>4.0x</td>
<td>4.75x</td>
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<tr>
<td>Minimum</td>
<td>2.0x</td>
<td>2.5x</td>
<td>3.25x</td>
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BANKRUPTCY STAY PERIOD
In developing an expectation of the bankruptcy stay period following the bankruptcy of the rental car operator, DBRS may request a memorandum from the appropriate counsel in the transaction indicating the counsel’s view as to how long it would take for the appropriate party to obtain possession of the vehicles in the event of the bankruptcy of the rental car company.

As previously described, based on current bankruptcy laws in the United States and precedent bankruptcy cases in the rental car industry, DBRS typically assumes that no lease payments are made during the 60-day automatic stay period. Based on the ANC and Budget bankruptcies, following the 60-day automatic stay period, DBRS generally expects that the rental car company will either: (i) resume lease payments and continue to use the fleet of cars or (ii) comply with transaction provisions that specify the mechanics by which the vehicles can be secured and liquidated to repay noteholders.
LIQUIDATION PERIOD FOLLOWING STAY
DBRS typically reviews the operational expertise of the rental car company and its ability to liquidate the fleet of vehicles within a short time frame under stressful conditions as well as any other structural provisions such as the inclusion of a liquidation agent to facilitate a potential fleet liquidation. In addition, DBRS considers any geographic concentrations or any other unique transaction characteristics that could potentially affect fleet liquidation timing. The used vehicle market in the United States is quite large, with total used vehicles running at approximately 40 million units during the last several years. Generally, approximately 20% of the total used vehicle market is represented by current model year or one-year prior vehicles, which constitute the vast majority of the rental fleets for the major rental car companies. The used vehicle market in the United States is a sizable, liquid and efficient market with companies like Manheim, Inc. selling in excess of seven million vehicles annually. As a result, DBRS generally expects that the used vehicle market would be able to absorb the fleet liquidation of a major rental car company in a reasonable period of time.

Table 3 below shows the normal amount of time by rating category that DBRS usually assumes would be necessary to liquidate a typical rental car fleet. These timelines may be adjusted based on DBRS’s review of transaction structural features or fleet characteristics that could positively or negatively affect the expected liquidation timing. In addition, when evaluating the proposed credit enhancement for a transaction, DBRS typically assumes that sales are spread evenly over the assumed liquidation horizon, although DBRS may consider other potential liquidation patterns that are less uniform. The time periods are designed to capture the potential for increased market dislocation at higher rating categories and are intended as a guideline, which may not be applicable for all transactions.

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<tr>
<td>Liquidation Period</td>
<td>1.5 months</td>
<td>3.0 months</td>
<td>5.0 months</td>
<td>7.0 months</td>
</tr>
<tr>
<td>Bankruptcy plus liquidation period</td>
<td>3.5 months</td>
<td>5.0 months</td>
<td>7.0 months</td>
<td>9.0 months</td>
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RESIDUAL VALUES DURING A LIQUIDATION
In the normal course of business, most rental car companies strive to depreciate their non-program vehicles in a manner that results in minimal or no gain or loss upon disposition; thus, under normal conditions with a stable used vehicle market, in the event of a fleet liquidation, the NBV and market value of the vehicles are expected to be substantially identical.

The ratings assigned by DBRS are, however, typically for investment-grade rated securities ranging from BBB (low) to AAA. Accordingly, to assess the potential stresses necessary for each assigned rating, DBRS has analyzed the used car market during historical periods of market dislocation based on information from auto industry sources such as Manheim Consulting, Adesa Analytical Services, Automotive Lease Guide and non-program vehicle disposition history provided by certain rental car companies. This analysis revealed that some of the most stressful periods in the used vehicle market were following the events of 9/11 and late 2008 into early 2009 as recessionary conditions took hold on the U.S. economy.

2. CNW Marketing Research, Inc.
Based on DBRS’s review of price changes during these stressful periods, DBRS developed market value haircuts by rating category to assess potential market value declines. Table 4 indicates the typical market value declines for non-program vehicles from investment-grade rated manufacturers during liquidation for U.S. rental cars. The declines are designed to capture uncertainties and variables that may affect future transaction performance. The market value declines for non-program vehicles from investment-grade rated manufacturers during liquidation in Table 4 are a guideline and may not be applicable in all transactions.

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<tr>
<td>Maximum</td>
<td>15.0%</td>
<td>19.5%</td>
<td>24.0%</td>
<td>28.5%</td>
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<tr>
<td>Minimum</td>
<td>12.0%</td>
<td>15.0%</td>
<td>19.5%</td>
<td>24.0%</td>
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To address the possibility that a manufacturer’s deteriorating financial health adversely affects its vehicle values concurrent with a fleet liquidation, DBRS typically applies an additional haircut to non-program vehicles from below investment-grade manufacturers. The same haircuts are generally applicable to program vehicles from non-investment-grade manufacturers and DBRS generally assumes that these manufacturers are unable to fulfill their repurchase obligations under the program agreements. Table 5 indicates the typical additional market value declines for vehicles from non-investment-grade rated manufacturers during liquidation for U.S. rental cars. The declines are designed to capture uncertainties and variables that may affect future transaction performance. The additional market value declines for vehicles from non-investment-grade rated manufacturers during liquidation in Table 5 are a guideline and may not be applicable in all transactions.

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<tr>
<td>Maximum</td>
<td>7.5%</td>
<td>10.0%</td>
<td>12.0%</td>
<td>14.5%</td>
</tr>
<tr>
<td>Minimum</td>
<td>6.0%</td>
<td>7.5%</td>
<td>10.0%</td>
<td>12.0%</td>
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TRANSACTION FUNDING COSTS AND EXPENSES.
DBRS typically reviews the transaction costs and expenses such as servicing and administrative fees, interest and liquidity fees as well as any other applicable fees such as those for the liquidation agent to evaluate whether these expenses can be covered following a rental car company bankruptcy and subsequent liquidation scenario and the potential impact on payments of interest plus principal.

CREDIT ENHANCEMENT
Generally, for assigned ratings, DBRS receives a request containing a proposed level of credit enhancement based on whether vehicles are from program or non-program manufacturers and whether the manufacturer is investment grade or non-investment grade. In addition, requests may contain a proposal for credit enhancement for any manufacturer receivables resulting from manufacturer repurchase or guaranteed depreciation programs. As a result of the foregoing, credit enhancement in rental car ABS transactions is dynamic based on the characteristics of the underlying fleet collateral.

In addition, in rental car ABS transactions, the credit enhancement for those vehicles which would be disposed in the used car market will be subject to certain tests which are intended to true up the enhancement in the transaction to the extent that either: (i) the market value of the vehicles in the fleet falls below the book value of the fleet or (ii) the actual disposition value received on vehicles sold falls below the book value of those vehicles.
Legal Considerations

DBRS’s review of a rental car ABS transaction will generally include a review of various legal opinions consistent with its Legal Criteria for U.S. Structured Finance. In addition, rental car ABS transactions may result in additional legal considerations. Rental car ABS transactions may include provisions for the rental car company to appoint a nominee that acts as nominee titleholder for the vehicles. In such cases, DBRS typically reviews a legal opinion relating to the potential bankruptcy of the nominee. Such opinion normally provides that the nominee has only bare title to the vehicle and no beneficial economic interest and that, in the event of the nominee’s bankruptcy, the vehicles would not become part of the nominee’s bankruptcy estate.

Another common feature in rental car ABS transactions is the presence of like-kind exchange programs (LKEs). LKE programs allow for vehicles being leased to be exchanged for replacement vehicles in transactions qualifying for non-recognition of gain or loss under Section 1031 of the Internal Revenue Code and the related Treasury Regulations. Under a LKE program, there is typically a Master Exchange Agreement where an intermediary has agreed to act as a qualified intermediary (as such term is used in Treasury Regulation Section 1.1031(k)-1 (g)(4)) for the purpose of effectuating such non-recognition transactions. Under the tax code, no rental car company controlled entities are allowed to be in constructive receipt of funds relating to exchanged vehicles. To satisfy this provision of the tax code, the qualified intermediary is owned by an outside entity that specializes in these types of arrangements. As a result, there is a risk that the assets and liabilities of the qualified intermediary could be combined with those of the qualified intermediary’s parent in the event of a bankruptcy relating to the qualified intermediary’s parent. Accordingly, in such circumstances, DBRS typically reviews a non-consolidation opinion relating to the qualified intermediary.

Please refer to the Legal Criteria for U.S. Structured Finance for a more detailed discussion of DBRS legal criteria.

Surveillance

DBRS describes its approach to surveilling U.S. rental car securitizations in the DBRS Master U.S. ABS Surveillance Methodology.