Italian non-performing lease securitisation under the spotlight

After the recent boom years, the Italian non-performing loan (NPL) securitisation market has started to slow, prompting investors to seek opportunities in new market niches such as non-performing lease securitisation, which could see up to EUR 2bn materialise in 2020.

The market environment and a new legal framework have led to improved conditions for non-performing lease securitisations.

First of all, there is an ample stock of available assets. While the Italian banking system has seen a significant decrease in its NPL stock in the recent years, non-performing leases have decreased at a slower pace (EUR 19.2bn in 2018 vs EUR 22.9bn in 2017), with few transactions so far (Figure 1). In 2017 and 2018 around EUR 3bn[1] of non-performing leases were sold mainly through portfolio disposals, while securitisations have been limited.

The second factor is the presence of specialised servicers. Market operators have evolved and gained experience in recent years, and are now able to manage more complex assets, such as lease products.

Thirdly, there have been some positive legal developments. Policymakers, regulators and supervisors continue to be focused on reducing NPL stocks. In this context, the new provisions of the Italian securitisation law[2] overcome previous challenges to securitising lease receivables. It is now possible to set-up a LeaseCo, a bankruptcy-remote special vehicle, to acquire and manage leased assets. Proceeds from the management and disposal of the leased assets are legally segregated and available exclusively to pay down notes and securitisation costs. LeaseCos benefit from the same tax treatment as securitisation SPVs.

Challenges still remain

There are several challenges, however, to making this asset class more appealing to investors.

1. **Property price volatility.** Real-estate leases are generally on commercial and industrial properties, which are less liquid than residential assets and more exposed to collateral obsolescence. Therefore, we expect higher price volatility compared to average NPL portfolios, which usually contain a portion of residential assets (on average 42% in the portfolios securitised in 2018-2019).
2. **Asset management expertise is key**. Recovery strategies for leased assets require a higher degree of real-estate management know-how compared to other type of loans. Most recovery activities include i) active management to preserve the value of the asset and assess any capital expenditures; ii) setting the selling or rental price of the assets and a marketing strategy; iii) developing business plans and negotiating purchase offers. A widespread network of real-estate brokers can help foster the recovery process.
3. **Recovery timing mainly driven by repossession**. Recovery timing largely depends on the time to repossess the asset and the time to sell it or rent it back. The average time to complete the recovery procedure for lease receivables is usually shorter than other type of loans, which are mostly driven by the type of legal proceeding and the court to which it has been assigned. Additionally, selling repossessed assets in the open market would be beneficial for securitisations, since liquidity is better than for sales occurring within the judicial auction process.

[1] Scope calculations based on publicly-disclosed transactions.
[2] Law Decree 50 of 24 April 2017 and Law Decree 34 of 30 April 2019 (‘Growth Decree’)

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4. **Obstacles to asset transferability**. Any assignment of assets to the LeaseCo will be null and void unless certified by a public notary as validly transferable. Anomalies, such as cadastral irregularities, illegal building activity, or environmental violations will prevent or delay the transfer of the leased assets to the LeaseCo. In the context of securitisation, these obstacles might be mitigated by an adequate set of warranties and indemnities or structural features, such as a ramp-up or warehousing period.

5. **Capex to improve marketability of the assets**. Direct access to leased assets will allow the servicer to assess any capital expenditures that might improve the marketability of the assets and foster a sale in the open market. However, this creates additional costs for the SPV. Recovery expenses for non-performing lease securitisations are typically higher than NPL securitisations. In addition to capex, the servicer's net recovery projections will consider, inter alia, legal costs and taxes, property management fees, insurance premium, marketing costs and brokerage fees.

6. **Limited upside from positive real-estate market conditions**. A LeaseCo will have limited upside compared to a typical Reoco (real-estate owned company) structure on an NPL securitisation, as a LeaseCo must return to the lessee any positive difference between the asset's sale price and the total debt outstanding.

7. **Recoveries from movable assets**. A pool of movable assets may include very specialised industrial instruments, luxury yachts or energy systems, which are highly illiquid and represent weaker security for the receivables. Except for the automotive sector, there are few operators able to re-market this type of exposure. As a result, recoveries for movable leases mainly stem from voluntary payments made by lessees and guarantors.

I. Appendix. Overview of non-performing lease transactions

Figure 1: Publicly disclosed non-performing lease transactions (2017 – 2019 YTD)

Quarter	Project name	Seller	Buyer	GBV (EUR m)	Type of leases
3Q19	Not disclosed	UBI Banca	Credito Fondiario	740	Mixed
2Q19	Not disclosed	Banco BPM	Illimity	650	Mixed
1Q19	Not disclosed	Not disclosed	Illimity	40	Real Estate
4Q18	Morgana	MPS	Bain Capital	900	Mixed
4Q18	Not disclosed	UniCredit Leasing	Guber Banca	170	Unsecured
3Q18	Not disclosed	Balbec Capital	MB Credit Solutions	217	Unsecured
2Q18	Gimli 2	CreVal	Credito Fondiario	56	Real Estate
4Q17	Not disclosed	UniCredit	MB Credit Solutions	250	Unsecured
4Q17	Not disclosed	Intesa Sanpaolo	Banca Ifis	85	Unsecured
4Q17	Hemera	Intesa Sanpaolo	Bain Capital	150	Real Estate
4Q17	Not disclosed	Not disclosed	Axactor Italy	80	Unsecured
3Q17	Terzo	Hypo Alpe Adria	Bain Capital	311	Mixed
2Q17	Not disclosed	UniCredit	MB Credit Solutions	500	Unsecured
1Q17	Not disclosed	Intesa Sanpaolo Provis	Credito Fondiario	280	Mixed

Source: buyers or sellers' press releases, public press

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