MAPLES GROUP

Crystal-Balling the Markets: US CLO Warehouse Report September 2020

As many of our readers will be aware, in mid-June 2020 we issued our US CLO Warehouse – COVID-19 Health Check report[1]. The research was based upon an extensive analysis of 70+ open warehouses administered by the Maples Group – representing an overall market share of around 50% – and its focus, first and foremost, was on the effects of the loan price decline curve and its particular impacts on US CLO warehouse performance, restructurings, amendments and ultimate mortality rate, during the earlier stages of the pandemic.

Despite substantial disruption and downward pressures, our Research Highlights gave an overarching positive message and demonstrated signs of significant resilience to market adversities. Monitoring and data collection continued since publication and, in this article, we now seek to consider whether the resilience reported upon in mid-June is further supported by the new data and if there are any additional observations or trends that we are able to identify, or conclusions that we are able to draw.

"To be, or not to be...that [was] the question"

Thankfully, in most cases, the answer was (and remains) "to be"! We reported in June that approximately 75% of warehouses appeared to be unaffected. Since then we have seen over 16% of those warehouses successfully reach CLO close and a small number of additional deals (~5%) among that group have priced or are looking to price imminently. Reassuringly, from June onwards we also saw very few additional warehouses enter into difficulty or terminate and, of the 25% of 'symptomatic warehouses' exhibiting signs of being 'underwater' during the first period of analysis, remedial actions or terminations have now, for the most part, occurred. The net result is an overall slight reduction in the mortality rate of 'open' warehouses to fewer than 5% of those subject of our study.

Remedial actions...fast!

As noted in our previous report, symptomatic warehouses underwent a variety of remedial actions and amendments, including increases in commitments, equity injections and margin calls (~18%). A further 18% or so of those symptomatic warehouses were converted into static or short duration deals – thereby shortening their life – and 6% or so were merged or combined to create a viable CLO portfolio. Aside from the 'splitting' of deals (see Divide and Conquer! below) we have not observed any notable new trends established for the COVID-19 impacted deals since mid-June.

So, what has happened since the mid-June Report?

Rising of the Phoenix

During the past couple of months all symptomatic warehouses have, for the most part, continued to be subject to swift remedial actions, the vast majority of which have been completed. Indeed, in excess of 35% of those warehouses that had appeared to be struggling have, through effective remedial action, nonetheless successfully reached a CLO close. Those that showed no outward signs of difficulty have also fared reasonably well, as noted above.

[1] https://maples.com/en/Knowledge-Centre/Analysis-and-Insights/2020/06/US-CLO-Warehouses-COVID-19-Health-Check

Divide and Conquer!

One new tactic that has emerged over recent months is the splitting of assets, in particular, with the effect of separating-out the bad COVID-19 impacted assets. In these circumstances, new vehicles have been incorporated to take the 'good' and leave the 'bad' with the old vehicle, the latter being renamed and thereby freeing up the original name for the new vehicle to utilise.

New COVID-19 Focused Provisions

In warehouse transaction documentation, we have observed mechanisms that allow for additional post-pricing stepwise increases in funding commitment levels and concentration limitations being extended to cover industries that have been specifically impacted by COVID-19. This has helped introduce additional levels of protection.

Steady Increase in New Incorporations and 'Open' Warehouses

Since early June we have experienced a steady, continued, increase in new instructions and new warehouses opening. From early / mid-June onwards, those new instructions have led to an additional 15 or so open warehouses.

Shortened Warehouse Periods

A fairly striking development since mid-June are the number of new open warehouses that have rapidly priced and closed. Shortened warehouse periods have become commonplace, with durations anywhere between 10 days to 1 month not unusual. The size of the ultimate CLO issuance in those instances has tended to be smaller than traditionally would be the case, with an average in the region of roughly US$400 million. We also note, as can be seen from the chart below, that from early June onwards, the period of time taken to open a warehouse following initial instruction has been on a fairly steady decline.

Key Managers Dominating the Market

Looking at the number of warehouses opened on a per manager basis we can see that, in terms of warehouse entities administered by the Maples Group, the key players appear to be those with internal equity / funds. Beyond those, however, we see a fairly even distribution among the top 40 or so most active managers in the market.

Conclusion

While there has been very significant market disruption and pressures, the resilience of US CLO warehouse arrangements has continued to be apparent throughout COVID-19 as the impacts have rippled their way through the market and put considerable downward pressure on loan values and general collateral quality. Reassuringly, few terminations have occurred and a good proportion of deals have weathered the storm thus far in order to achieve a successful closing. What has become clear is that participants have been quick to act and to find effective workout solutions. There has also been a quick adaption to the new environment, with the splitting and downsizing of deals or combination of deals to create viable portfolios. All of this bodes well for the uncertain times ahead and, with relatively little trepidation, we can conclude from our data that there are signs for optimism as the market adjusts.

Maples Group's Global CLO Team

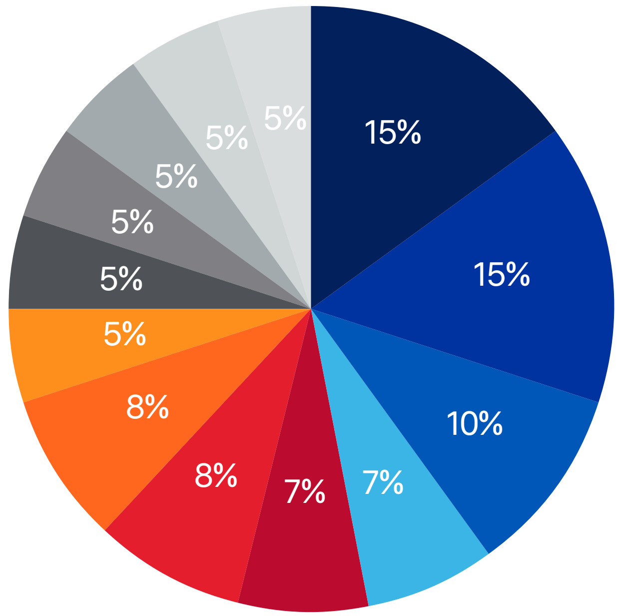
The Maples Group global CLO team provides Cayman Islands and Irish legal advice and CLO issuer / co-issuer and fiduciary services in the Cayman Islands, Delaware, Dublin, Jersey, London and the Netherlands. The team comprises 26 specialist CLO lawyers and 48 specialist CLO fiduciary professionals across our global network. Since the inception of the CLO market 25 years ago, we have provided clients with unparalleled knowledge, experience and insight into what we see across the whole structured finance market, from the latest warehousing structures, to the latest regulatory developments and how they impact CLOs, to ongoing post-closing CLO issues. For further information, please speak with your usual Maples Group contact or one of the following CLO contacts.

Contacts

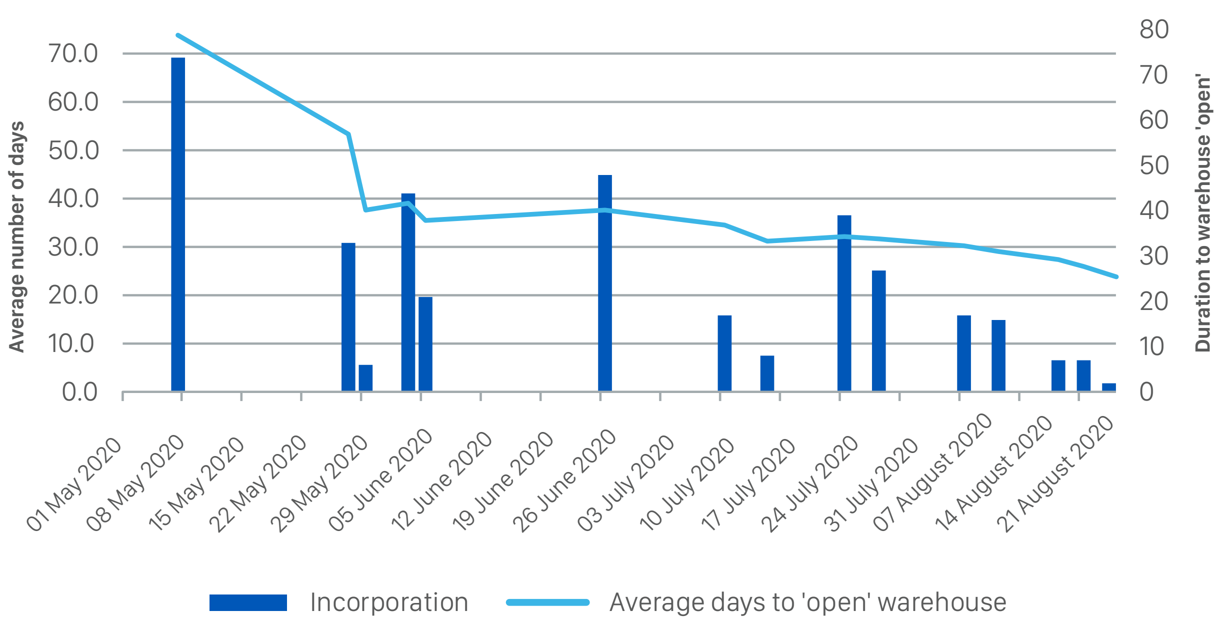
Scott Macdonald
Partner, Finance
+1 345 814 5317
scott.macdonald@maples.com

James Reeve
Partner, Finance
+1 345 814 5129
james.reeve@maples.com

Share of 'open' warehouses based on selection of most active managers



Duration of time for warehouse to 'open' based on entity incorporation date



Methodology for Research

The research was carried out during the period of 1 June – 31 August 2020 and involved an analysis of all of the warehouses that the Maples Group's fiduciary services team was administering during this period.