MAPLES GROUP

US CLO Warehouses – COVID-19 Health Check

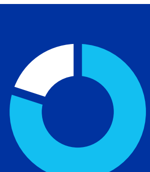
As the market continues to deal with the unprecedented impact of the pandemic on the global economy, we considered the resilience of US CLOs, which were still in the warehouse stage when COVID-19 hit. Since that date, CLO managers have been extremely focused on and, based on our analysis below, largely successful in, flattening the effects of the loan price decline curve.

We analysed 70+ open warehouses administered by the Maples Group's fiduciary services team at the start of the pandemic. If we assume that the Group's market share of the US CLO market is around 50%, which has been a reasonably consistent statistic, the following numbers will provide a good indication of warehouse resilience across the market. These warehouses represent 46 different CLO managers and 14 warehouse providers. The number of warehouses being managed by a single CLO manager ranged generally from one to six, with the average being approximately two.

While the downward pressure on leveraged loan prices was sharp and market-wide, a large proportion of warehouses appeared to be unaffected. 75% of warehouses avoided crisis situations and around 26% of those have evolved into a successfully 'priced' deal or issued CLO. Overall, however, around 25% were required to take remedial actions and / or seek amendments to warehouse agreements, with over a quarter of such 'symptomatic warehouses' requiring an increase in equity commitment. In addition, CLO deal terms were revised to include features such as lower leverage, short non-call periods and even a tranche of delayed-draw notes.

Around 18% of the 'symptomatic warehouses' did suffer margin calls and required financial intervention in the form of equity injections to keep them alive. Fortunately, such interventions were all temporary in nature, their performance quickly improved and funds were returned to the equity investors. Additionally, the life expectancy of 17-18% of these warehouses was reduced as they were converted into static or short duration deals. The overall warehouse mortality rate was, however, thankfully low. Only around 5% succumbed to outright termination, although a further 6% or so were either merged or combined to create a viable CLO portfolio. Overall, pre-COVID-19 warehouses have fared well, and have adapted and responded to extreme market conditions with the assistance and support of both senior and junior credit providers.

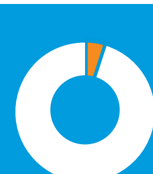
Research Highlights



75% of warehouses avoided the emergency room

26%

of warehouses have issued



Only around 5% of warehouses terminated

18%

of 'symptomatic warehouses' had margin calls

The main area of concern is the significant increase in the average warehouse period for the remaining pre-pandemic warehouses. While the recent rebound in loan prices will certainly improve the chances of a successful exit, prices are still well below the high 90s level at which some warehouses started to ramp up. The managers of these warehouses, possibly under pressure from the warehouse provider, must be considering the options of winding-down the warehouse to sell into the market rally, converting the warehouse into a CLO or holding on to allow loan prices and funding costs to improve further.

While acknowledging that not all of the remaining warehouses will successfully convert into a CLO, and the extended recovery period for the economy as a whole, the prognosis for the CLO market is reasonably positive. Although CLO issuance and warehouse formation are both down to around 20% of 2019 numbers, there are signs of life from a broad base of managers and arrangers. US CLO issuance in May was up nearly 60% on April issuance. We are also seeing an increase in the establishment of TALF related structures following the recent rule revisions, which could provide further support for the CLO market.

This outlook can also be applied to the Cayman Islands, which we are pleased to report has shown great resilience to the threat of COVID-19. The financial sector pivoted to remote working quickly and efficiently, and the Cayman Islands Government took proactive measures, including strictly enforced curfews that successfully flattened the curve, ensuring that the jurisdiction is well-positioned for an expected strong recovery.

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.

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Methodology for Research
The research was carried out during the period of 1 March – 12 June and involved an analysis of all of the warehouses that the Maples Group's fiduciary services team was administering during this period.