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VCL Master Residual Value S.A., Compartment 2 Series B 2018-1 Auto ABS Rating Withdrawn; Existing Notes Affirmed

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Overview

- We are withdrawing our 'A+ (sf)' rating on the series B 2018-1 notes issued by VCL Master Residual Value S.A., Compartment 2 at the issuer's request. At the time of the withdrawal, the outlook on our rating on these notes was stable.
- At the same time, we are affirming our ratings on the outstanding class A and B notes.
- The transaction is a securitization of a portfolio of German auto lease residual values, which Volkswagen Leasing GmbH (VW Leasing) originated.

FRANKFURT (S&P Global Ratings) Sept. 25, 2020--S&P Global Ratings today withdrew its 'A+ (sf)' credit rating on VCL Master Residual Value S.A., Compartment 2's series B 2018-1 asset-backed floating-rate notes at the issuer's request. At the time of the withdrawal, the outlook on our rating on these notes was stable. At the same time, we have affirmed our 'AAA (sf)' and 'A+ (sf)' ratings on the issuer's remaining outstanding class A and B notes, respectively (see list).

VCL Master Residual Value S.A., Compartment 2 is a securitization of a portfolio of German auto lease residual values, which Volkswagen Leasing GmbH (VW Leasing) originated. VW Leasing is the initial servicer, and no back-up servicer was appointed at closing.

On any payment date during the revolving period, the issuer can issue new series of notes, subject to maintaining the initial required credit enhancement for both the class A and B notes. The last renewal was on March. 25, 2020, whereby the revolving period was extended by six months until September 2020. Further, additional series 2020-1 and series 2020-2 class B notes were issued in May 2020. The initial required credit enhancement level or target overcollateralization amounts on both the class A and B notes have remained unchanged since May 2020 (see "Related Research").

A combination of subordination, initial, and additional overcollateralization, and a cash reserve provide credit enhancement to the rated notes. As part of the renewal, the credit enhancement increase conditions (CEIC) were amended in relation to the required cash collateral account balance. The CEIC would now breach if the specified general cash collateral amount is below the required level for three consecutive determination dates, up from a similar requirement on each payment date previously. The condition however continues to require a minimum cash collateral balance to be available on each determination date. In our cash flow assumptions, we have therefore considered the cash collateral balance to decline to the minimum level at the start of amortization. The transaction does not have a principal deficiency ledger mechanism or any excess spread before the insolvency of the seller.

The class A notes rank senior to the class B notes, and each class of notes ranks pari passu among themselves. Under the transaction documents, amortization is sequential, but switches to pro rata once the class-specific overcollateralization target levels are reached, assuming no specific triggers have been breached. The notes may switch to sequential payment again, once certain credit enhancement increase conditions have been met. If the servicer were to become insolvent at any point in the transaction's life, the notes would permanently switch to sequential amortization.

Rating Rationale

Economic outlook

In our analysis, we considered the following economic data and their baseline effect on collateral credit quality in determining our credit assumptions (see "Related Research").

S&P Global Ratings acknowledges a high degree of uncertainty about the evolution of the coronavirus pandemic. The consensus among health experts is that the pandemic may now be at, or near, its peak in some regions but will remain a threat until a vaccine or effective treatment is widely available, which may not occur until the second half of 2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Table 1

Economic Factors

	Actual	Forecast			
	2019	2020	2021	2022	2023
Real GDP (y/y growth, %)	0.6	(5.4)	4.7	2.4	1.6
Unemployment rate (annual average, %)	3.2	4.3	4.5	4.0	3.6
CPI inflation (%)	1.4	0.0	1.1	1.5	1.5

Sources: National Statistics offices, Eurostat, S&P Global Ratings.

Compared to the eurozone, we forecast a 5.4% contraction in Germany's GDP this year, followed by a 4.7% rebound in 2021. At the same time, we expect unemployment to increase to 4.3% in 2020 and 4.5% in 2021, compared with 3.2% in 2019. In our view, the partial unemployment schemes unveiled across Europe will limit the rising unemployment. We believe changes in GDP growth and the unemployment rate largely determine portfolio default performance. European light vehicles sales will likely decline by 20%-25% in 2020 followed by single digit growth in 2021 and 2022, which could keep auto market activity dampened (see "Related Research"). We set our credit assumptions to reflect our worsened economic outlook for Germany.

Operational risk

VW Leasing has underwritten auto leasing contracts in Germany since 1966. In our view, the company's track record of stable, strong quality asset origination is among the best of all European auto ABS issuers. Our ratings on the class A and B notes reflect our assessment of the company's origination policies, as well as our evaluation of VW Leasing's ability to fulfill its role as servicer under the transaction documents. There is no back-up servicer. For our analysis, we rely on the general availability of servicing in the German market and have also incorporated assumptions in our cash flow analysis, to analyze any potential impact from servicer disruption risk.

The collateral in this pool comprises expectancy rights related to prime auto leases. Under our operational risk criteria, we therefore consider the severity risk to be moderate and portability risk as low. We assess the disruption risk of servicer as low. Therefore, the criteria do not impose any cap on the maximum achievable rating due to operational risks (see "Related Criteria").

Credit risk

The portfolio consists of residual values, which are subject to market value decline risk. We reviewed our market value decline assumptions in view of the current dampened auto market and consequent impact on used car values. We consider our market value decline assumptions for rating stresses of 'BBB' and above as already including the stress levels we expect to see in used car markets. We assumed a residual value loss of 42% and 31.4% in the 'AAA' and 'A+' rating scenarios, which remains comparable with our previous assumptions.

In addition, the transaction is exposed to lessee default risk. In light of our current recessionary outlook for Europe, we have increased our base-case default rate assumption for the securitized pool by 0.25% to 2.88% from 2.63% in our previous review. In our view, government actions taken so far to bolster European economies from the effects of COVID-19 will support ABS performance. Unemployment is one of the primary triggers of auto ABS defaults, and many of the support measures, such as partial unemployment schemes, aim to prevent unemployment from spiking. While we expect higher base-case defaults because of COVID-19, we do not believe that the expected level of macroeconomic stress warrants an overarching revision to the stressed default assumptions at the 'BBB' rating level or higher, although that could change. Hence, we have lowered the multiples to 4.0x and 2.65x, from 4.4x and 2.9x at 'AAA' and 'A+', respectively, reflecting the increase in our base-case assumption. Therefore, in the 'AAA' and 'A+' rating scenarios, our stressed gross loss assumptions remain unchanged, from the renewal in March 2020.

Moreover, we sized stressed recoveries of 40% for all rating levels, based on recovery data provided for previous VCL transactions and a peer comparison with other German auto leasing transactions. However, to reflect current disruptions to collections and workout efforts, we have extended recovery timing assumed in our cash flows by 50%.

We have analyzed credit risk by applying our criteria for European auto ABS, using historical loss data for VW Leasing's book and performance data from previous VCL leasing transactions and residual value risk by applying our European consumer finance criteria (see "Related Criteria").

Cash flow analysis

We have assessed the transaction's documented payment structure, and assumed the notes will have the minimum required credit enhancement in our cash flow analysis. The issuer can extend the transaction's revolving period several times. Once the revolving period ends, the transaction amortizes sequentially until certain overcollateralization targets for the class A and B notes are reached. However, the amortization between the class A and B notes and the subordinated loan switches to pro rata amortization from sequential if certain conditions (for instance, the credit enhancement increase condition not being in effect) are fulfilled, or when class-specific target overcollateralization levels are reached. Our analysis indicates that the minimum available credit enhancement for the class A and B notes is sufficient to withstand the credit and cash flow stresses that we apply at the respective rating levels.

Counterparty risk

Our ratings on the class A and B notes also consider that the replacement mechanisms implemented in the transaction documents adequately mitigate the counterparty risks to which the transaction is exposed. We have analyzed these counterparty risks by applying our counterparty criteria (see "Related Criteria"). Our ratings on the notes reflect that the swap agreements are in line with our counterparty criteria.

Legal risk

We consider the issuer to be bankruptcy-remote, in line with our European legal criteria (see "Related Criteria"). We have received a transaction legal opinion on the September 2020 renewal, which provides assurance that the structure achieves a valid and effective sale of assets, and we believe that the sale of the assets would survive the seller's insolvency.

We consider that the transaction may be exposed to trade tax risk. We have sized the unmitigated exposure as an additional loss.

Sovereign risk

Under our structured finance sovereign risk criteria, the maximum differential between the rating on the security and the rating on the sovereign depends on the asset sensitivity to country risk and the sovereign rating. We view the asset sensitivity to the country risk as low, and our long-term unsolicited sovereign rating on Germany is 'AAA'. Consequently, our sovereign risk criteria do not cap our ratings on the rated notes.

Rating stability

We analyzed the effect of a moderate stress on the credit variables and their ultimate effect on our ratings on the notes, the results of which indicate no material deterioration on the ratings on the class A and B notes compared to thresholds under our criteria.

Related Criteria

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Related Research

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