New Applications of Master Trusts: Financing Single Family Residential Rental and I-Buyer Properties

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In this article, the authors explain how master trusts provide efficiencies in connection with the financing of single-family residential rental properties and high-velocity purchase and sale arrangements for residential properties.

As the market for financing single-family residential rental properties (SFR) and high-velocity purchase and sale arrangements for residential properties (I-Buying) matures, stakeholders are looking for efficiencies in the financing process. Sponsors and originators, servicers, property managers, rating agencies, warehouse banks and securitization investors are looking to streamline the financing process to reduce overall execution expense, speed up the availability of warehouse and term financing, and free up capital to reinvest in new assets.

Master trusts, familiar in other asset classes, provide a basis for seeking these efficiencies without sacrificing the fulsome information transparency and collateral security that rating agencies, lenders and investors expect. Securitizations financing SFR in particular have historically adopted the "large loan" approach long used in commercial mortgage backed securitizations. While relatively robust, the securitization of a single-borrower loan is less flexible than a securitization backed directly by the real estate. By using this familiar master trust technology, and adapting it for the SFR and I-Buying market spaces, stakeholders can drive the efficiencies that benefit all of the market participants.

This article first describes the historic "large loan" structure and its key attributes. It then turns to the key features of a master trust structure and its benefits. This article concludes with observations about possible application in the future, including combinations with other structuring techniques, such as titling trusts.

THE CURRENT SECURITIZATION APPROACH: DESCRIPTION OF A TYPICAL LARGE LOAN STRUCTURE

In the typical structure for securitization of SFR, the properties are transferred to a special-purpose vehicle (SPV) that will act as the borrower. At the closing of the securitization, an accommodation lender, typically an af-

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filiate of the investment bank that is structuring the securitization, originates a mortgage loan (an accommodation loan) and extends the proceeds to the SPV borrower. The accommodation lender is never out-of-pocket. The accommodation loan is sold to a securitization depositor that forms a trust that is the securitization issuer, and contributes the accommodation loan to the trust in exchange for the securitization securities. The depositor, through the securitization placement agents, offers the securitization securities to investors in a typical 144A/Reg S offering. The proceeds of the securitization offering are transferred to the depositor to put it in funds sufficient to pay the accommodation lender for the acquisition of the accommodation loan.

To provide the most efficient form of financing, the securitization trust issues multiple classes of securities each bearing a different rating, interest rate, and credit attachment and detachment points. The accommodation loan is componentized at origination to match the various classes of securities (i.e., the Class A Certificates are supported by the cash flow from Component A on the loan, the Class B Certificates are supported by the cash flow from Component B on the loan, and so on.) Accordingly, rent received by the SPV borrower on the SFR properties is segregated and applied in a monthly waterfall to meet the SPV borrower's interest obligations and other payment amounts under the loan. As the securitized financial asset, the loan proceeds are then used to pay the investors holding the securitization securities.

Because the accommodation loan can be structured as a qualified mortgage loan, the securitization trust typically makes a REMIC election over the loan. While REMIC qualification results in a tax-efficient structure, using a REMIC tends to limit the financing flexibility. As a consequence of needing the loan to be REMIC-eligible, the securitization issuer holds a single loan and issues one series of securitization securities. REMIC securitization structures generally have little or no pre-funding period, and no revolving period absent certain limited substitutions including for ineligible properties. Since the securitization securities are backed by the loan, they are usually viewed as asset-backed securities under applicable Federal regulations and, accordingly, the U.S. Credit Risk Retention rules apply.[1]

MASTER TRUST STRUCTURES: FIRM, FAMILIAR AND FLEXIBLE

Master trusts have a long history in the capital markets, being used in multiple asset classes for decades. They have been used for warehouse and securitization arrangements, rated and unrated transactions, and are supported by a fully built infrastructure of active trustees and vendors necessary for their efficient deployment. Master trusts provide a solid and robust structure that is well-known in the market, and yet is flexible enough to be readily adaptable to SFR and I-Buyer financing.

In the most common version of a master trust structure, there is no need for an accommodation loan; the master trust holds the assets directly as issuer in the financing. Master trusts can and do issue additional securities in multiple series from time to time as more assets are transferred to the issuer trust. This is so whether the assets being transferred to the trust are familiar and frequent users of master trusts (such as credit card receivables) or leased "hard" assets (such as railcars or containers). The same principle applies for SFR and I-Buyer properties; as properties are acquired by the issuer trust, new securities are issued to fund their acquisition, subject to compliance with preagreed eligibility guidelines and advance rates.

One point of flexibility in a master trust is that each new series can be collateralized by all the properties in the trust, or be segregated such that each new series finances a defined subset of properties (e.g. properties under renovation, or properties that have become seasoned). Each series can encompass different classes and charging, different interest rates (including fixed or floating rates) and use different credit enhancement, all as the market conditions warrant. To mimic the flexibility of a credit line, master trusts can issue series in the form of a variable funding note, alongside traditional term debt.

Master trusts, by their nature, are not bound by the need to have a certain asset type. So long as the cash flows are captured and applied in a waterfall, a master trust can accommodate single-family residential properties (including their lease income and, when used as a form of warehouse financing, proceeds of sale such as to a joint venture or permanent financing vehicle) or I-Buyer properties pending sale where the proceeds of sale are reinvested in new, eligible properties or used to repay the debt.

Master trusts are generally structured as debt-for-tax rather a REMIC and, accordingly, are not bound by the requirements of a REMIC. Master trusts can have unlimited revolving or prefunding periods, subject only to investor appetites and sponsor needs. Within the bounds of eligibility and advance rate requirements, generally properties can be added to and removed from the master trust; when properties are sold, their asset value is replaced with cash and accordingly master trust investors are always fully collateralized. Combining these flexible features mean that master trusts can be utilized in lieu of traditional warehouse financing, or serve as term financing.

Master trusts typically use master program documents (such as an indenture) and short supplements (for each series). For capital markets transactions, this is often mirrored by a base prospectus or other offering document, and a prospectus supplement or similar document that describes the particular features of the series. As such, the time to market and the inherent expense of each offering should be materially less than would be the case with repeat large loan securitizations.

In a master trust structure as described, the assets held by the trusts would be SFR or I-Buyer properties; that is, physical real estate. U.S. Credit Risk Retention rules generally would not be expected to be applicable as the securities issued by the master trust would not be "asset-backed securities" in that they are not repaid primarily with the proceeds of a self-liquidating financial asset.

POSSIBLE FURTHER ADAPTATIONS FOR MASTER TRUSTS FOR SFR AND I-BUYERS

Master trust structures to date in the SFR and I-Buyer spaces have been structured primarily as warehouse financing, and, accordingly, have not been rated and have not utilized mortgages. In a rated, term securitization of SFR properties, it has been desirable that the properties be secured by mortgages to better support the ratings sought on the securities.

Delaware statutory trusts are widely used as titling trusts, to own and facilitate financing of assets assigned to a separate series of the trust that is generally treated as separate from other series under law. In order to be a financeable asset, the property must be owned by the borrower; however, there is friction and significant expense involved in retitling assets through the warehouse and securitization or term-financing phases. While use of a "recycled SPV" that meets rating agency requirements can ameliorate this issue to a degree, it nevertheless represents a significant execution cost in forming every securitization pool. Using a titling trust - the premise of which is this segregation among series but no change in the trust's legal title ownership - would significantly simplify the warehouse financing of assets and the subsequent formation of each securitization pool and its financing. Each series of the trust would issue a beneficial interest that can be held by a bank or be used as collateral for a term-financing or securitization of the properties. The individual properties can be moved from one series (e.g., a bank warehouse line) to another series that is a master trust or other securitization on the books and records of the trust without a new deed, recordation or related taxes.

CONCLUSION

With the maturation and development of the market for financing SFR and I-Buyer properties, stakeholders are looking for efficiencies in the financing process. Master trusts can provide efficient financing structures that can be tailored to the needs of sponsors and issuers while providing investors and lenders with the robust collateral security they require. Master trusts can help provide a seasoned and well-understood method of financing by series in a manner that achieves the optimal outcome with the least friction (in time and money) possible.

NOTES:

[1]Historically, SFR securitizations have been marketed to Reg. S investors in the European Union and United Kingdom, although no specific compliance with the transparency requirements has been undertaken by issuers or sponsors. With recent European Commission guidance on the EU Securitisation Regulation, compliance by affected European investors with the EU Securitisation Regulation will be difficult in the context of SFR securitizations. Whether there will be a divergence between the EU Securitisation Regulation and the United Kingdom's approach remains to be seen, as the UK is looking to revoke its retained EU financial services law, and replace it with UK domestic law.