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THE REDESIGN OF THE AUTO ABS MARKET

The auto asset-backed securities (ABS) market is experiencing negative pressures as a result of the prolonged convergence of deteriorating macroeconomic and consumer credit conditions; record-high, although recently moderating, gas prices; and strategic changes in auto industry business strategies. In response to these trends and issues, lenders have tightened underwriting standards at all points in the auto ABS chain, including vehicle manufacturers, finance companies, dealers and consumers.

At the top of the chain, manufacturers have suffered from lower vehicle sales, higher manufacturing supply costs, more expensive financing and problems related to overproduction and production of commercially undesirable vehicles. In response to shifts in consumer preferences for smaller, more fuel-efficient vehicles, manufacturers (with assistance of loans from the federal government) are re-allocating their product mix and rationalizing output volumes. Industry-projected new vehicle sales for 2008 are on pace to be at or below 14 million units – the lowest level in 15 years. Vehicles sold in the wholesale market are expected to be lower than last year's level of 9.5 million units.

Bank-affiliated lenders have been the victims of broader mortgage-related bank troubles, leading several to exit the indirect business (e.g., Wachovia Corporation). Stand-alone auto finance companies, traditionally heavily reliant on securitization, have either ceased indirect operations (e.g., Triad Financial Corporation) or significantly reduced origination volumes (e.g., AmeriCredit Corp.).

Subprime lenders have virtually withdrawn from the securitization market due to the failure of the monoline insurers to maintain the AAA ratings that served as credit enhancement for debt issuances and to a lack of investor appetite for assets in the subprime sector.

Certain other lenders, including GMAC LLC, DaimlerChrysler Financial Services Americas LLC and Wells Fargo and Company, ceased providing lease financing this past summer, primarily due to the risks associated with the uncertainty in vehicle residual values at lease turn-in, with others scaling back significantly.

Dealers are experiencing difficulties in obtaining new floorplan loans used to finance showroom inventory. Some of the weaker new car dealerships may have difficulties maintaining their floorplan loans and used car dealerships are facing similar difficulties.

U.S. consumers continue to face a challenging economy. The job market remains weak, as evidenced by the unemployment rate staying at 6.1% in September after having risen to that level in August from 5.7% in July[1]; consumer bankruptcy filings remain elevated, having increased 28.6% in September from the same period a year ago[2]; and the price of consumer goods and services increased 5.4% year over year in August.[3] As a corollary, collateral performance metrics in existing auto ABS transactions have shown increases in 60-plus day delinquencies and loan defaults. These factors, combined with dramatic declines in vehicle recovery values for certain segments, have also led to increased net losses reported by auto lenders across the sector. DBRS expects performance on existing auto ABS vintages to continue to be pressured in the near term.

On a positive note, used vehicle prices in the wholesale market are beginning to stabilize and have improved in certain product sectors that were negatively affected (e.g., full-size SUVs), although prices remain at historically low levels. In addition, new auto ABS is expected to be issued with higher credit-quality collateral due to the tightening of underwriting criteria by lenders and higher levels of credit enhancement to compensate for current and prospective auto industry issues and deteriorating macroeconomic conditions. Please see www.dbrs.com/par for performance information on all outstanding public auto ABS transaction rated by DBRS.

For questions or comments, please contact Rich Bianchi at rbianchi@dbrs.com or Dave Hartung at dhartung@dbrs.com.

1. Bureau of Labor Statistics of the U.S. Department of Labor.
2. American Bankruptcy Institute.
3. Bureau of Labor Statistics of the U.S. Department of Labor.