Stichting PROFILE: More PFI paper

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SMBC and NIB Capital (NIBC) have launched a £383 million synthetic securitisation of UK PFI loans through the special purpose vehicle Stichting PROFILE Securitisation I. The deal, which will reach financial close towards the end of November, is only the second PFI-backed securitisation to date, coming a year to the month after Depfa's pioneering transaction with an almost identical structure.

As with Depfa's first deal, the primary objective of the transaction for SMBC is not a refinancing gain or to free up funding but to transfer credit default risk to third parties and to lessen the bank's capital adequacy load. This is achieved through credit default swaps in which KfW, Germany's AAA-rated promotional bank, acts as an intermediary between the issuing banks and the investors.

The securitisation is split into seven tranches, with six classes of floating-rate credit-linked notes worth £32.5 million to be issued alongside a £344 million super senior swap – making for a partially funded transaction. KfW will hedge its exposure by issuing credit-linked certificates of indebtedness (Schuldscheine) that will be bought by Stichting PROFILE Securitisation I through the proceeds on the notes.

The zero risk weighting enjoyed by KfW, playing the role of swap counterparty, allows SMBC to increase the return to capital of its infrastructure financing by reducing its capital adequacy requirement from 8% of the loans' principals to zero while retaining the loans on its books.

NIBC, which lead arranged the deal, benefits from a fully funded transaction after it sold the assets it was pooling – amounting to 41.5% of the portfolio's total value – to SMBC, which will service all of the loans. Such a partnership is the only practical way of realising a fully funded solution with PFI loans because restrictions on the transfer of security in this type of asset would make a true sale to an SPV too complicated.

Under the deal's structure – developed and used in several securitsations by KfW under its "Promise" and "Provide" programmes – but not with PFI loans until Depfa's transaction – SMBC will bear the first £6.3 million of losses that might arise from a default and subsequent recovery failure on any of the 32 loans that form the underlying asset pool. The next £3.7 million of losses will be borne by the class E notes, which are rated BB by both S&P and Fitch, with higher losses accruing to the notes in reverse order of seniority. Final maturity on all of the tranches is July 2041.

There are 13 schools, 12 hospital, three transport and four other project loans in the portfolio. The loans' maturities range from 26 to 30 years with an average of 27 years. None of the loans is for more than £16 million.

Recovery rates on the loans range between 74% and 95%, while the average and minimum DSCR are on average 1.24x and 1.17x respectively.

As loans in the initial reference portfolio mature or are refinanced, they can be replaced with other PFI loans on SMBC's books, provided a set of conditions are met designed to ensure that the reference portfolio's profile remains unchanged.

Although the deal is structured in an almost identical fashion to Depfa's, which was issued through the SPV Essential Public Infrastructure Capital plc (EPIC), differences exist between the underlying loans being securitised. Depfa's pool,

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worth £391.7 million had fewer loans and was lumpier, with 24 loans being used in total, the five largest accounting for 40% of the portfolio's total value.

An even more notable difference in terms of trying to gauge the market's appetite for this new asset class is the proportion of loans still in the construction phase. Whereas only a tiny proportion of the loans in the EPIC portfolio were for projects still under construction, around two thirds of the projects under Stichting are still being built, with an average of 8.5 months remaining to completion on September 5.

There are a higher proportion of loans in Stichting where SMBC is the sole lender. Around a quarter of the loans in the portfolio are not syndicated.

Overall, the average rating for the underlying loans in the reference pool for Stichting is around BBB-/BB+. This is slightly lower than the average rating for the EPIC pool, which was around BBB/BBB-. With recovery rates broadly similar but slightly higher in EPIC, the threshold amount on the first loss, or the "equity" piece, is higher on Stichting – 1.6% of the transaction's total value compared with 1%.

Early indications are that Stichting has received plenty of interest from the market and more PFI-backed securitisations are sure to follow. Depfa have a second securitisation planned, likely to take place in the second or third quarter of next year. This transaction is likely to be larger than the £391.7 million EPIC deal, with £500 million to £1 billion required to achieve true economies of scale. This second deal will further develop this asset class that has so far been restricted to UK PFI loans by including international assets. NIBC have also indicated that it could follow up Stichting with another securitization in 2007.

Class	Preliminary amount (£m)	Fitch rating	S&P rating
Super senior swap	344.16	AAA	N/R
A+	0.1	AAA	AAA
A	17.2	AAA	AAA
B	5.4	AA	AA
C	3	A	A
D	3.1	BBB	BBB
E	3.7	BB	BB
Threshold amount	6.3	N/R	N/R

Stichting PROFILE Securitisation I
Status: In finance
Description: Synthetic securitisation of PFI loan portfolio
Originator: SMBC, NIBC
Arranger: NIBC
Credit default swap intermediary: KfW
Legal counsel: Clifford Chance

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