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STOCKING FINANCE

Stock funding comes of age

Several automotive industry events are conspiring to bring changes to motor dealer stocking finance. These include ongoing industry consolidation, software development and the current credit squeeze. Brian Rogerson examines the market

The bigger groups break the mould

Industry consolidation has been a principal driver in changes to the way stocking finance (SF) is delivered to the market in recent times. Tony Allen, business unit director of APAK Group, whose SF system is widely used throughout the industry, explains: "Perhaps the most significant change in the sector has been the evolution of the major dealer groups. Their presence and growth has served to reduce the influence of the manufacturers' captives over the dealers.

"Where in the past the captives would have supplied all the new and consignment stocking, and thus have almost complete control over the finance of the dealer network, the large dealer groups now have a lot more bargaining power and can exert pressure on the captives," Allen continues.

Whereas not so long ago it would have been unthinkable for franchised dealers to adopt SF from anywhere other than their franchisers, there is increasing evidence of dealer groups now going to the open market to get the best finance deal once the manufacturer's interest-free period is up.

"This, of course," Allen says, "is now playing into the hands of the independent finance companies who are able to fund vehicle stock much earlier in the life-cycle than was traditionally the case."

The Retail Automotive Alliance (RAA) is a corporate identity formed in 2003 consisting of 20 independent motor dealer groups. Collectively, the RAA is a very big player in the UK marketplace with a combined turnover of £2.3bn, which places it second only to Pendragon in the UK retail motor industry turnover league tables - and gives an indication of the group's enormous buying power. Since its formation, apart from negotiating preferential deals with parts suppliers, oil companies, insurance providers and used car auctions, it has also established arrangements with Bank of Scotland Dealer Finance (BoSDF) for all-product support. This led a spokesman for BoSDF to comment on the "terrific increase in levels of business we have seen with RAA members since 2006".

A rather different product

Once perceived as a drab, grudgingly-offered gracelessly-accepted but necessary part of a motor dealer's working environment, SF is nowadays a far more sophisticated multi-purpose product.

Toyota Financial Service (TFS) typically funds in excess of £300m of vehicles at any one time for its Toyota and Lexus franchised dealers. Paul Waters, centre funding credit manager at TFS, tells *Motor Finance* that since establishing its own stock finance systems in 2003, which had previously been outsourced through Black Horse, the company has expanded its range of products to include a full portfolio of dealer support.

"Through our Centre Funding department," he says, "we are able to provide new and used car stocking as well as lines for demonstrator, courtesy and rental cars. At Toyota every single new vehicle for sale goes through our system. We can also make available mortgages for property purchase or development as well as corporate identity loans and funding for all types of ad hoc equipment needed in the modern car dealership."

Stephen Dawson, associate solicitor at Shoosmiths, heads a team which advises on retail and stocking finance. He confirms that the principal structures of

DEALER STOCKING SECURITISATION – A WAY FORWARD?

It is some two years since the €850m (£595m) Cars Alliance Funding plc securitisation of Renault and Nissan dealers stocking credit lines won an award as the *"Most Innovative Asset-backed Deal of the Year"*. Since then the market for securitising SF lines seems to have remained quiet, certainly in Europe.

And yet they seem to make sense. Securitised dealer SF loans usually have prime-based floating rates and are revolving – dealers can repeatedly borrow and repay part or the entire credit limit. Because the loans are collateralised by vehicles in stock, floor plan loans experience low loss rates and enjoy high repayment rates.

In the US floor-plan securitisations are structured much like credit-card securities and incorporate a revolving period, an accumulation period and a "bullet" principal repayment. Floor plan securitisations have unique investor protection features based on the nature of the security, such as provisions to repay investors early if the dealer has an abnormally high concentration of used cars in stock.

"It is a particularly complex market and the auto-backed securities deals we hear about are painfully detailed and costly to structure," Shoosmiths' Stephen Dawson explains. "This market is going to see some challenges as historic structures are re-examined and new structures considered. These deals clearly depend heavily on the volume and quality assets backing the structure; both of these requirements of quality and volume may be difficult to locate in the short term."

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Stephen Dawson

Tony Allen

SF most commonly seen are unit stocking, term loans, overdraft, advance commission and advance-on-advance (the latter two being where a dealership anticipates its annual commission earnings and receives sums due to it early).

"What appear to be less popular at present," he says, "are term loans secured by property. We are noticing that at present, lenders are less likely to seek security with bricks and mortar than previously. It is unclear whether this is due to the costs of completing the security or because dealers are less willing to offer SF on this basis.

"Unit stocking plans nowadays are very popular. The technology behind them is so developed that the process requires a lot less paper. However, despite their sophistication and their variety of operation there is still the possibility of a vehicle being sold out of trust or double funded. The fraud factor can never be removed entirely."

What – no retail support?

The vexed question of SF products standing alone without retail support is back in the frame with reports that GE Capital has launched a SF plan which is offered without the reciprocal need for retail support from the dealer. Such unlinked schemes cause regular automotive lenders to scratch their heads in disbelief.

It should be added, however, that SF linked to retail support does not always enjoy unmitigated support from dealers. One dealer principal tells *Motor Finance* that problems arise when lenders increase their rates or tighten their terms. The accusation is that when lenders' retail packages become "uncompetitive" in the marketplace, and customers opt elsewhere for cheaper or more easily obtainable deals, then the stocking finance charge comes at a premium price.

Stephen Dawson says: "There has always been a linkage between SF and retail return, whether or not it is widely advertised by the lender, and there are signs emerging that the linkage is becoming popular again. I was recently requested by a non-captive lender to draw up a dealer agreement that included retail return. We are also looking at the idea in more detail for other captives."

However, the suspicion remains that unlinked SF will command a premium price in the marketplace. Lenders invariably offer stand-alone SF at a premium charge – often as much as three or four percent above Finance House Base Rate.

Waters stresses: "Although we would always prefer to obtain retail support for our SF, if the product makes commercial sense then we will go ahead with it."

Hugh Denton is wholesale relationship manager with Black Horse Motor and Leisure Finance (Black Horse). Black Horse has new-car joint venture SF arrangements with Suzuki, Lotus, Proton, Hyundai and

SPONSOR'S COMMENT: NORDEA GOES LIVE WITH APAK

Jukka Salomen

Nordea's Specialised Financial Services (SFS) has adopted APAK's wholesale finance system (WFS) across the four countries of its Nordic region – Denmark, Sweden, Norway and Finland.

Jukka Salonen, head of SFS told *Motor Finance* that in 2007 Nordea financial services had a loan portfolio of €13.3bn of which €8.1bn represented new sales. A total of 513,000 assets comprise its book of which around 231,700 are cars.

The company also has a joint venture with ALD Automotive in the Nordic region and ownership of ALD Baltic in Estonia, Latvia and Lithuania.

As part of its strategy to expand its asset-finance business, initially amongst its supporting motor dealer groups, Salonen explained that the company (which previously utilised a factoring-based stock funding plan) required a sophisticated unit stocking facility that would enhance wholesale finance service for its customers.

Nordea SFS's retail automotive relationship is pre-dominantly with multi-franchised dealers and the company works with importing companies to provide manufacturers' branded services for dealer groups. In short, it provides retail and stocking finance in the absence of manufacturers' captive packages.

Salonen said: "Following an extensive selection process APAK was chosen for its in-depth knowledge of automotive finance which was gained from its long-term experience of implementing stock finance systems. WFS provides customers with a web enabled, fully integrated stock finance system in their own language – and via a web browser."

He added: "Importantly, WFS interfaces with the company's international payments system, Corporate E-Gateway, which automates all incoming and outgoing payments from one centralised point across all countries. This gives Nordea customers the choice of using direct debit or instigating payments themselves. Regardless of the payment method, WFS supports the automatic allocation of funds."

Equally crucially, Salonen explained that WFS is set to act as a platform for growth and extend into the non-wheeled asset sector as well as commercial vehicles. "Nordea is a company which prides itself on its high degree of technology usage," he said, "and APAK's sophisticated use of technology matched our requirements."

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Shogun as well as many caravan manufacturers. Although having offered used-car stocking for a number of years the lender's commanding size in the UK car sector has warranted the formation of a used-car SF plan, Successor.

He explains: "Dealers purchase their used-car stock in the usual way by auctions, trade or part exchange, and must be loaded on the system within 30 days of purchase. We value the vehicle against CAP and usually advance the dealer up to 80 per cent of the cost. They then have up to 150 days in which to sell the unit and repay the amount owed."

The title of each vehicle remains with Black Horse until the vehicle is sold which Denton believes gives dealers greater flexibility and helps to reduce the additional costs associated with secured lending products. However he adds: "We always seek to link the SF to retail support."

The impact of the credit squeeze

Although it is still early days, industry opinion seems to confirm that the current restriction on credit and subsequent shortage of liquidity will have a positive impact on demand for SF.

"In the current climate," says James Szerdy, banking and finance partner at DWF, "the motor sector is generally not attractive to a number of banks. Where standard working capital and other clearing bank facilities are becoming increasingly restricted, and more expensive, wholesale SF can provide dealers with extremely good loan-to-value funding ratios as well as generous funding periods. This inevitably assists liquidity and stock management."

Szerdy stresses that, given the current financial climate, he believes it inevitable that dealers are likely to see an increase in the cost of these facilities and, equally inevitably, a greater use by lenders of non-utilisation fees.

Waters says: "There is every indication that dealers are seeking extra funding at the present time, especially since banks are tightening their lending and are not prepared to lend on their previous rates and terms. Specialist providers of SF are an integral part of meeting dealers' cash flow requirements and with the tightening credit market there is every indication that dealers will be calling for extra support from stock financiers who will be in greater demand in the foreseeable future."

"If the credit squeeze leads to consumers cutting spending on cars," Tony Allen adds, "there will be a build-up of stock in showrooms. In such circumstances, SF lines will be crucial in supporting dealers through a period of slowdown. We are also likely to see increased auditing by lenders in the future."

New developments

Tony Allen is looking forward to new additions to APAK Group's wholesale stocking system. He says: "We are planning the ability to collect finance lease and rental agreements. Also new legislative issues are ever present and Basel II requires greater accessibility for auditors to information relating to regulatory compliance."

Paul Waters's team is in the final stages of developing an automated used-vehicle funding product which is, as yet, unnamed. "The dealers' management system will forward relevant vehicle data to our SF system every evening," he said. "New vehicles are added to the scheme and sold ones are subtracted. An automatic credit or debit is activated through the banking system the next day for the aggregate difference."

Meanwhile Hugh Denton's team is developing further its Batch Used Inventory Funding for its car supermarket customers. Black Horse currently deals with five car supermarkets including Motorpoint. An integral element of car supermarkets' success is the committed use of point-of-sale finance and rapid turnover of stock.

"As you can imagine," he says, "volumes are big and standard systems can not cope with such numbers of stock movement. The dealers forward us a daily snapshot of their stock which is fed onto our APAK system and stock payment adjustments are made on an aggregate basis daily."