

Securitization on Provenance: Saluda Grade (GRADE 2020-FIG1)

INTRODUCTION

On August 31, 2020, Saluda Grade Asset Management LLC (“Saluda Grade”) closed the largest HELOC securitization (“GRADE 2020-FIG1”) in the US since the Global Financial Crisis of 2007-2008, as well as the largest securitization backed by loans originated, serviced, financed, and sold using blockchain technology. The transaction was also the first third-party securitization using Provenance. Raymond James & Associates, Inc. (“Raymond James”) served as Initial Purchaser of the transaction, becoming the latest broker-dealer to participate in a securitization using Provenance. Wilmington Savings Fund Society, FSB (“WSFS”) performed the role of Trustee, and Mphasis Digital Risk (“Digital Risk”) completed loan-level diligence as Third-Party Loan Auditor. The transaction demonstrated significant progress since Figure’s inaugural HELOC securitization in March of this year (“FLOC 2020-1”). Notable highlights of the transaction included:

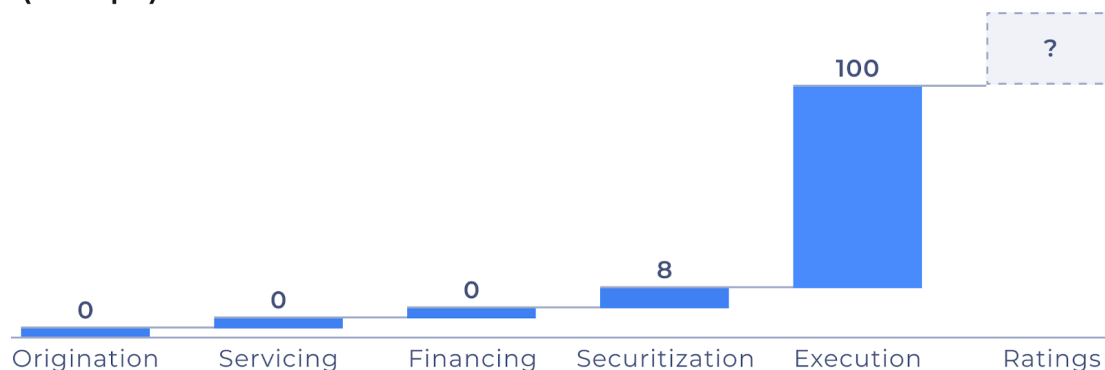
- Reduction of third-party loan audit cost by 8bps in transaction expenses
- Decrease in transaction closing timeline for a first-time issuer from up to 180 days to 27 days
- Increase in number of new issue bond investors in Figure HELOCs from 2 to 15
- Improvement in financing terms and gross execution; the deal achieved 0.14% lower cost of debt, 5.00% higher advance rate, 7.23% higher return on equity, and 100bps higher implied gross execution relative to FLOC 2020-1
- The GRADE 2020-FIG1 transaction demonstrated an overall cost savings and execution benefit of 108bps relative to FLOC 2020-1

This case study serves as an overview of the GRADE 2020-FIG1 transaction, as well as a summary of progress made since FLOC 2020-1, the last HELOC securitization on Provenance.

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**Blockchain Margin Improvement
of GRADE 20-FIG1 vs. FLOC 20-1
(108bps)**



TRANSACTION DETAILS

GRADE 2020-FIG1 (\$308+mm)					
Class	CCY	Size	WAL*	CE	CPN
A1	USD	\$215.89MM	2.85	30.0%	3.5%
A2	USD	\$30.84MM	2.85	20.0%	4.0%
A3	USD	\$15.42MM	2.85	15.0%	5.0%
M1	USD	\$15.42MM	5.99	10.0%	7.0%
C	USD	Notional	N/A	0.0%	N/A

* Assumes 15% CPR to Issuer Optional Redemption

Originator and Servicer	Figure Lending LLC
Sponsor and Seller	Saluda Grade Opportunities Fund LLC
Administrator	Saluda Grade Asset Management LLC
Initial Purchaser	Raymond James & Associates, Inc.
Trustee	Wilmington Savings Fund Society, FSB

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Third-Party Loan Auditor	Mphasis Digital Risk
Issuer, Originator and Servicer Counsel	Dentons US LLP
Initial Purchaser Counsel	Dechert LLP

TRANSACTION HIGHLIGHTS & PROGRESS

- Further Reduction of Third-Party Loan Audit Cost:**

Mphasis Digital Risk (“Digital Risk”) participated in GRADE 2020-FIG1 as Third-Party Loan Auditor. The role and responsibility of loan auditor is to conduct a review on a portion of the pool of assets designed and effected to provide reasonable assurance that the disclosure regarding the pool of assets is accurate in all material respects, including credit and compliance components and data integrity review. This process typically requires significant manual effort. In a traditional securitization, an auditor manually reviews thousands of pages of loan documents in order to complete their evaluation. The cost for loan audit can be upwards of \$400 per loan, and was 8bps higher in FLOC 2020-1.

Figure’s digital origination process and Provenance’s blockchain system allowed Digital Risk to cut out many of the operationally intensive front-end processes, resulting in its ability to increase productivity three-fold and decrease the audit timeline down to less than two weeks. Additionally, the automated file creation process created a consistent and complete loan file, which allowed Digital Risk to move quickly through the files and limited the possibility for errors. Lastly, the availability of key data elements electronically on Provenance minimized the manual effort required to ensure compliance. The implied audit cost per loan for GRADE 2020-FIG1 was reduced, which created a 44% reduction in cost versus that of FLOC 2020-1, or 8bps savings in transaction expenses.

Figure’s digital origination process and Provenance blockchain system allowed for a dramatically more efficient loan audit process that was completed 3 times faster and 2/3 cheaper than a typical audit process for mortgage securitizations.

- Significant Decrease in Transaction Closing Timeline:**

Historically, the time to complete a new securitization program by a first-time issuer can take up to 180 days. There were three key components of the securitization issuance and closing process that allowed for the completion of GRADE 2020-FIG1 (a first-time issuer of Figure HELOCs) in 27 days.

First, the loan audit process was completed in 13 days, which is $\frac{1}{3}$ of the time required to complete for a traditional RMBS. This was possible for two reasons:

1. Investors were comfortable with a 10.7% loan sample for audit, which is a considerably smaller loan sample than what is typically required for mortgage securitizations (ex. 34.4% of the loans in FLOC 2020-1 were audited). The reduced loan sample size was due to increased confidence in the automated, digital nature of Figure's loan origination and blockchain validation process, which audits the mortgage loan input at source and is immutably recorded onto Provenance at origination.
2. Figure's digital origination process and blockchain system allowed the Third-Party Loan Auditor to eliminate many of the manual, front-end processes, and ingest all of the loan data immutably recorded on Provenance into its proprietary system and finalize audit review for the Initial Purchaser quickly and efficiently.

Second, for a traditional RMBS, the Servicer manually prints, signs and ships all physical assignments of mortgage after which the Trustee manually verifies each signed copy and stores them in a vault for safekeeping. This process can take up to 6 weeks to complete, and may experience multiple iterations and subsequent delays if the documents or signatures are misplaced or damaged. For GRADE 2020-FIG1, only the signature page was manually signed and notarized. Scanned copies of this document, combined with the other auto-generated pages were uploaded in bulk to each individual loan file on Provenance. Once the assignments were uploaded, the documents were electronically distributed across all stakeholders and verified by WSFS through an automated validation report, which is coded into Provenance to check for specific documents in the loan file. This entire process took one week to complete with significantly less operational burden and expense (\$9,000 of direct cost savings) versus the manual process.

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Third, because asset ownership is electronically recorded and transferred using Provenance, the transaction closing process is further streamlined. The trade settlement aspect of Provenance allowed for an efficient closing process on a complex transaction.

GRADE 2020-FIG1 had multiple loan contributors, some of which owned loans that were being financed in multiple warehouse facilities. Additionally, there were multiple entities including a Seller, a Depositor, and an Issuer/Sponsor that the loans flowed through to prior to reaching the securitization trust. The flow of assets and funds was elaborate, and would normally require significant time, cooperation, and trust in order to effectuate an analog securitization. Provenance's automated, trustless, and immutable ledger technology contributed to a seamless, expedient and cost-effective transfer of assets and funds, which allowed the transaction to close in 27 days for a first-time issuer.

- **Marked Improvement in HELOC Financing Terms and Gross Execution:**

While GRADE 2020-1 was issued only 6 months after FLOC 2020-1, the deal achieved a marked improvement in financing terms and gross execution. This was attributed to Figure's automated, data-driven underwriting process, as well as the availability of real-time servicing data that provides instant visibility to collateral performance. For reference, FLOC 2020-1, received an 85% advance rate at a 4.04% cost of debt, which was reasonable at the time given the limited performance history of the program and being a first-time issuance by a new originator by a relatively new originator. By comparison, GRADE 2020-1, which closed in August 2020, received a 90% advance rate at a 3.90% cost of debt (i.e. 5.00% and 0.14% improvement respectively). Assuming a 6.37% unlevered return on the underlying HELOCs, the improvement in financing would produce an incremental levered return of +7.23%, and a total return on equity of 23.22%. Stated differently, the improved financing terms of GRADE relative to that of FLOC equates to a 100bps increase in gross execution when solving for a similar ROE with the same credit and collateral assumptions. There are two main reasons why the financing terms improved:

1. Figure HELOC collateral performance has, thus far through the Covid-19 pandemic, outperformed the broader mortgage market in terms of forbearance and severe delinquency rates at 3+% and <1% respectively. Figure's origination process makes it easy for high-quality borrowers to tap into their

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home equity and does so with minimal credit exceptions or underwriting errors. All of the GRADE 2020-FIG1 deal participants attribute the lower cost of financing of the deal to these factors.

2. Investors benefit from the transparency of real-time servicing data to obtain current performance of collateral, allowing for a more informed prediction of future performance.

The underwriting accuracy and precision of Figure's Loan Origination System, as well as collateral transparency afforded by Provenance, clearly led to more favorable financing terms, of which GRADE 2020-FIG1 was the direct beneficiary.

CONCLUSION

Saluda Grade's issuance of GRADE 2020-FIG1 is notable for three reasons:

1. It is the largest securitization backed by loans originated on a blockchain
2. It is the largest HELOC securitization since 2008
3. It demonstrates +108bps of margin benefit relative to FLOC 2020-1

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