Rating Guidelines for Franchise Loan Securitizations

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**Summary**
Franchise loans are cash flow-based loans originated by commercial finance companies to franchise operators.
In this specialized market, the credit rationale for a franchise loan combines aspects of commercial lending and mortgage lending, measuring creditworthiness based on free cash flow generated by the operation, the borrower, and the property. Thus, Fitch IBCA’s rating analysis follows a similar pattern, combining aspects of both traditional asset-backed securities (ABS) analysis and commercial mortgage-backed securities (CMBS) analysis. This report outlines Fitch IBCA’s rating approach for franchise loan securitizations, highlighting Fitch IBCA’s loan default and recovery model (LDRM), which was developed as a joint effort between the ABS and CMBS groups.

The franchise loan securitization market has developed into a viable part of the fixed-income market, with 1998 year-to-date issuance of approximately $3 billion. Although franchise loan securitizations are typically seen as a new asset class, small private placement transactions were completed in the early to mid-1990s. The first franchise loans to be securitized were made exclusively to operators of quick service restaurants (QSRs). However, in the past year, loans to auto service centers, gas stations, convenience stores, auto dealerships, and car washes have emerged in securitizations, and Fitch IBCA expects continued expansion of concept types. Some of the original participants in this market are now established lenders to this sector, while several well capitalized new entrants have emerged, and startups with substantial financial resources continue to be announced.

Prior to the entry of specialty finance companies, franchise operators borrowed almost exclusively from commercial banks. However, based on the unique factors associated with chainstore operations, specialty franchise lenders offered franchisees fixed-rate, 15- to 20-year loans, as opposed to floating-rate, seven-year loans offered by the banks. As franchise operators continue to grow and consolidate, Fitch IBCA expects specialty franchise lenders to continue to enter the market and disintermediate banks in supplying capital to this sector. As growth and change in the franchise market continues, investors, rating agencies, and lenders need to be wary of the risk of overinvestment and overleverage and to begin focusing on a consistent credit standard in this market.

Since many franchise operators are not rated entities, Fitch IBCA’s LDRM analyzes each loan in the pool based on factors that infer conditional expected default frequency. These factors include fixed-charge coverage ratio (FCCR), concept strength, number of units under management for each borrower, and the borrower’s operating experience. In addition, the LDRM takes into consideration the type of collateral (i.e. fee-simple mortgages, ground leases, and enterprise loans) and other factors in determining likely recovery values for each loan in the pool. Fitch IBCA views the single most important factor for estimating defaults and recoveries in franchise loan securitizations to be the FCCR.
The rating analysis also includes many qualitative factors, such as an extensive review of the originator’s and the servicer’s business composition, financial condition, management, underwriting, credit policies, and servicing and workout capabilities. Fitch IBCA also reviews the historical performance of the issuer’s portfolio, the real estate valuations (including the scope of the analysis), environmental procedures, legal documents (including legal opinions), and the bond structure.

**Franchise Loans**

Franchise loans are generally term loans secured by one of three types of collateral — fee-simple mortgages, ground leases, or enterprise loans (equipment leases and space leases). Franchise loans are often compared to commercial mortgage loans, although they differ in many aspects. Foremost, all franchise loans are not generally secured by a first lien mortgage and, thus, in a default scenario, the recovery value of a franchise loan is typically not as high as a conventional commercial mortgage loan. Additionally, franchise loans are typically made to borrowers operating a single-use property that is not easily converted to an alternate use. Finally, loans made to franchisees are based on the cash flow stream derived from the underlying business versus the cash flow stream derived from the operation of the property.

The relationship between the franchisor and the operator can potentially provide many benefits that strengthen the operator’s credit beyond that of a typical small-business owner. In addition to the benefits associated with the use of the invested brand equity, tradename, and logo, the franchisee will generally have access to exclusive product offerings, supplier relationships, operational support, and technical assistance from the franchisor. Since the operator’s implementation of the franchise business model has the power to enhance or diminish the brand loyalty of the overall franchise, the franchisor will likely monitor the compliance of the franchisee’s operations with the franchise business model and its adherence to the franchise policies and procedures. The economic linkage among the franchise brand, the franchise location, and the operator is evidenced by the consumer’s identification of the brand with a uniform product or service offering and a consistent level of quality. Therefore, both the brand equity of the franchise and the business activities of the operator have a material economic effect on the cash flow supporting a franchise loan.

**Trends in the Franchise Market**

**Economies of Scale**
- Financial leverage and “deeper pockets.”
- Operating leverage via lower costs and purchasing power.

**Economies of Scope (Diversification)**
- Product synergies via co-branding.

**Strategic Positioning**
- Geographic/demographic focus (i.e. location).
- “Installed base” as a key asset.
- Convenience/market segmentation-driven consumption.

**Franchise Loan Market**

The key drivers of growth in the franchise sector of the economy are the trends toward convenience, consolidation, diversification, and strategic positioning at the borrower level. As national lifestyles become faster-paced, consumers are demanding faster service, geographic proximity, and customer choice. Operating efficiencies and cost pressures have led to market consolidation, resulting in the increasing role of multisite operators. In this market, it is not unusual to see franchisors with 150–300 units under management.

Franchisors are being forced by the equity markets to separate brand management and product placement from operations management and real estate ownership/management. Franchisors, as brand managers, seek to optimize economies of scope and focus on the real estate ownership/management by seeking to maximize “installed base” (i.e. geographic coverage and regional penetration) and manage the geography and demographics of location as a key asset. As a result, more franchisors are diversifying their franchise locations and capitalizing on product synergies by embarking on co-branding arrangements.

The increased importance of the service sector in the U.S. economy, the availability of financing for franchise lending, and the ability to securitize support estimates of the potential market size of many tens of billions of dollars.

**Franchise Loan Default and Recovery Model**

Fitch IBCA has developed an analytical model, LDRM, that combines the appropriate features of ABS and CMBS analysis for this asset class. The LDRM uses key factors to determine conditional expected default frequency and conditional expected recovery value for each loan in the pool.

The Fitch IBCA approach focuses on the proximity to default for each loan in the total pool and that loan’s relative
contribution to aggregate pool losses. The LDRM uses data for a pool of franchise loans to compute a point estimate and a range for gross defaults and net losses. The net losses calculated by the model establish a range of credit enhancement for each desired rating level. In assigning final enhancement levels, Fitch IBCA takes into consideration various qualitative factors, such as structure, servicer, and legal analysis.

The key underlying assumption for interpreting the default and recovery estimates that result from the LDRM is that all risk in the pool is systematic risk (i.e. default is due to measurable changes in the key variables and is not random nor based on hypothetical economic scenarios). This shared systematic assumption assumes changes in the underlying credit factors have a similar, but not equivalent, absolute effect on every loan in the pool, placing a higher weighting on the value of FCCR and minimizing the effect of obligor concentrations. This assumption is consistent with the notion that if any large concentration of loans in the pool is likely to default, the entire pool is subject to default but not to the same degree. This approach also eliminates the burden of trying to model or specify how the volatility of loans within the pool covary over time, or whether borrowers are correlated or uncorrelated.

Credit Factor Analysis
The LDRM credit factor analysis examines the pool on a loan-by-loan basis and then estimates a conditional expected default frequency and a conditional expected recovery rate for each loan at every rating level. These loan-by-loan estimates are then aggregated to the pool level to calculate expected losses for the pool, which, in turn, are used to size the subordination levels.

Conditional expected default frequency and conditional expected recovery are estimated on a dollar and percentage of pool basis by applying a system of empirically derived weights and coefficients to the following pool characteristics: FCCR; unit seasoning (years); concept strength; management experience (years); number of units under management by any one obligor; loan-to-value ratio (LTV); and collateral type. These credit factors can be grouped into loan-level, borrower-level, and unit-level categories. Coefficients used to adjust the baseline default and recovery level are inferred from an extensive sample of underwritten franchise and small-business loans over a 15-year period. Hence, the sample covers multiple business cycles.

The default and recovery estimates at each rating level depend on the relationship among the individual characteristics of each loan. Fitch IBCA's unconditional base case ("BB") assumes that all loans default at a 15% baseline rate and that the baseline recovery rate for defaulted loans is 40%. This baseline is then modified according to each individual loan credit factor to compute a conditional default and recovery amount for each loan within a given rating level.

Fitch IBCA believes that the single most important factor for estimating defaults in franchise loan securitizations is FCCR. Recovery is primarily a function of FCCR. The credit factor analysis infers default frequency from the interrelationship among key loan, borrower and unit factors according to the coefficients, weights, and multipliers applied at each rating level. Fitch IBCA also estimates recovery based on the going concern value of the collateral backing each loan. Additionally, by examining the pool on a loan-by-loan basis, Fitch IBCA has the ability to assess the relative contribution of each individual loan to the aggregate net losses for the pool.

Fixed-Charge Coverage Ratio
- Fixed-charge coverage ratio (FCCR) equals the ratio of cash flow to fixed costs.
  - Analysis of the level of operating cash flow
  - Operating cash flow is a function of revenue volatility and cost structure

- FCCR volatility is mitigated by:
  - Revenue impact of concept strength and unit seasoning
  - Cost impact of borrower experience and units under management
**Fitch IBCA Restaurant Concept Tiers**

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<thead>
<tr>
<th>Tier 1</th>
<th>Tier 2</th>
<th>Tier 3</th>
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<tbody>
<tr>
<td>McDonald's</td>
<td>Arby's</td>
<td>Dairy Queen</td>
</tr>
<tr>
<td>Burger King</td>
<td>Hardee's</td>
<td>Jack in the Box</td>
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<tr>
<td>Wendy's</td>
<td>Applebee's</td>
<td>Long John Silver's</td>
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<tr>
<td>Pizza Hut</td>
<td>Denny's</td>
<td>TGI Friday's</td>
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<tr>
<td>Taco Bell</td>
<td>Carl's Jr.</td>
<td>Sonic</td>
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<tr>
<td>KFC</td>
<td>Dunkin' Donuts</td>
<td>Bojangles</td>
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<td></td>
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<td>Houlihan's</td>
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<td></td>
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<td>Little Caesar's</td>
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<td></td>
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<td>America's Favorite Chicken (Popeye's/Church's)</td>
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**Key Borrower and Loan Factors**

**Fixed-Charge Coverage Ratio**

FCCR is the key measure of leverage and the primary factor in estimating conditional expected default frequency for a franchise loan. FCCR is the ratio of free cash flow from operations to fixed charges, such as lease expense and debt service. Free cash flow, the numerator of FCCR, is generally calculated as the sum of pretax operating income, interest, depreciation, amortization, and rent. In addition, certain nonrecurring charges and a fixed amount of discretionary corporate overhead may be added back. Fitch IBCA carefully reviews the comparability of addbacks for FCCR calculations and requires that issuers disclose their computation and any assumptions made in calculating this ratio.

As a benchmark for measuring the proximity of a loan to default, the FCCR captures the absolute level of cash flow and the cost structure and operating leverage of the business. Cash flow volatility is captured by the relationship among FCCR and the other loan factors. For example, a loan to a franchise location affiliated with a strong concept will exhibit less cash flow volatility than a loan to a franchise with the same FCCR but a weaker brand affiliation. Thus, a loan to a tier 1 concept should require a smaller debt service cushion than a loan to an otherwise comparable tier 2 concept to exhibit the same likelihood of default and the same recovery value in a default. For acquired or less seasoned units, Fitch IBCA will compare pro forma FCCRs to actual FCCRs for similar units operated by the borrower in adjacent locations and/or comparable units operated by competing franchisees in the territory. In some instances, issuers may need to provide additional historical revenue and cost information to verify the economic viability of a certain location over time.

**Concept Strength**

Concept strength tiering is a proxy for measuring brand loyalty or estimating the economic viability and sustainability of the brand concept. For default and recovery analysis, the concept tiering of brand associations is based on revenues, market share, marketing activity and brand support, capital, installed base, geographic dominance, market coverage, and regional market penetration. Concept viability corresponds to the economic influence of brand equity on revenues and cash flow (i.e. franchise or enterprise value) and to the effect of brand loyalty on consumer demand (i.e. price inelasticity).

The research for classifying concepts according to tiers focuses on the franchisor’s investment in brand equity as a capital stock and on installed base and location as the key asset. Fitch IBCA’s concept tiering acknowledges the tradeoff between national geographic coverage/diversification and regional market dominance as a positive externality. In establishing or modifying concept tiers, Fitch IBCA uses concept analyses that are based on comparable store economics according to standard metropolitan statistical areas (MSAs). The tables above and on page 5 present examples of Fitch IBCA’s concept tiering for restaurant and energy concepts.

Fitch IBCA performs in-depth industry economic analysis to adapt the existing criteria and model implementation to new industries. The industry analysis employed incorporates a comprehensive survey of industry structure, dynamics, and trends. The Fitch IBCA corporate rating group is consulted on a continual basis to monitor the financial strength and performance of the concepts seen in pools. Fitch IBCA continues to adapt the LDRM to a broader range of assets beyond restaurant and energy loans.

**Units Under Management and Operator Experience**

Units under management and operator experience are borrower characteristics that act as proxies for cost structure advantages, operating leverage (economies of scale), and operator viability. Highly experienced borrowers with a large critical mass of established locations are generally expected to benefit from economies of scale and, hence, be less susceptible to revenue or cost volatility than a smaller or less experienced borrower. Acquisition loans should be extended to large, experienced borrow-
ers only, and should not exceed 10% of the principal amount outstanding of the total pool. All acquisition loans must be disclosed in writing, and the assumptions for any pro forma FCCRs must be provided. To verify and calibrate the pro forma FCCR, Fitch IBCA will also require corroborating comparative store economic analysis for adjacent stores operated by the existing and current borrower and by comparable stores at adjacent locations.

**Unit Seasoning**

Unit seasoning acts as a proxy for location viability and revenue sustainability. Initially, newly opened units tend to experience a pickup in traffic and store performance due to early promotions and novelty. Over time, the unit typically experiences a tapering off of sales until it settles at a long-run equilibrium level for sales and average costs. In addition, assuming stable demographics, well seasoned locations establish themselves as destinations for consumers seeking a particular franchise’s product offerings and, thereby, experience less demand fluctuation and more stable traffic patterns. Units are expected to have been operating with the existing franchise for a minimum of 12–18 months to be included in the pool. Newer units included in the pool should be operated only by experienced borrowers with a large number of units under management.

**Collateral Type**

Collateral type or seniority of claim is employed as a benchmark for assessing how much of the realized going concern value is expected to accrue to the loan under the most likely recovery scenario. Typically, franchise loan pools contain a mixture of fee-simple mortgages, ground leases, or enterprise loans. Equipment loans or leases must be cross-defaulted and cross-collateralized with the fee-simple mortgages, ground lease, or space lease on the related location, and both forms of financing must be included in the pool.

Fitch IBCA prefers the terms of ground leases to extend beyond the legal maturity of the loans in the pool.

**Loan to Value**

LTV in a cash flow-based franchise loan should be inversely proportional to unit FCCR. Since a franchise location is deemed to be a special purpose property, the best estimate of economic value is generally the going concern value. In evaluating LTV as a basis for estimating recoveries, Fitch IBCA will calibrate the LTV to the unit FCCR to verify the appropriate valuation methodology.

**Multiple of Loss Analysis**

The LDRM credit factor analysis estimates expected default and recovery for the pool on a loan-by-loan basis. Fitch IBCA validates the resulting enhancement levels by stressing expected losses on the combined pool. This approach is more consistent with other areas of structured finance, applying a fixed multiple to the total pool’s estimated base case net losses. Credit enhancement levels are estimated using a gearing approach that assigns levels upward and downward from the ‘BB’ base case level. By comparing the output from this calculation at each rating (stress) level to the output from the credit factor analysis, indications of idiosyncratic risks inherent in each loan become more apparent, and further analysis and diligence may be required.

**FCCR Default Analysis**

Since one large obligor could potentially operate many strong franchise concepts, Fitch IBCA does not automatically default the largest obligors in the franchise loan pool. Rather, this analysis groups obligors into cohorts according to their consolidated FCCR and defaults the concentrations of obligors according to their FCCR level. By using this approach, Fitch IBCA weights the likelihood of default as a function of the ratio of free cash flow to fixed charges and, hence, demonstrates the pool’s susceptibility to a cash flow induced default.

The goal of the FCCR default analysis is to not unduly penalize the larger obligors, which are often more diversified, more efficient, and lower cost operators simply because they are large. Fitch IBCA believes that in the event of default, the borrowers with the best infrastructure, the strongest installed base, and the highest free cash flow should be expected to recover close to going concern value. In contrast, concentrations of smaller, low-FCCR loans should be examined more closely as they could cause the greatest exposure.

**Fitch IBCA Energy Concept Tiers**

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<tr>
<th>Tier 1</th>
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<th>Tier 3</th>
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<tbody>
<tr>
<td>Exxon</td>
<td>Coastal</td>
<td>Quaker</td>
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<tr>
<td>Mobil</td>
<td>Diamond/Ultranar</td>
<td>Sinclair</td>
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<tr>
<td>Texaco</td>
<td>Tosco</td>
<td>USA Petroleum</td>
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<tr>
<td>Chevron</td>
<td>Sun</td>
<td>Beacon</td>
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<tr>
<td>Amoco</td>
<td>Amerada Hess</td>
<td>Independent/Private Label</td>
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<tr>
<td>Shell</td>
<td>Unocal</td>
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<tr>
<td>Conoco (DuPont)</td>
<td>FINA</td>
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<tr>
<td>Arco</td>
<td>MAPCO</td>
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<tr>
<td>Phillips/Phillips 66</td>
<td>Total</td>
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<tr>
<td>Marathon (USX)</td>
<td>Pennzoil</td>
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<td>Ashland</td>
<td>Murphy’s</td>
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<td>Citgo</td>
<td>Kerr McGee</td>
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to losses in the pool. This is a direct result of these loans’ proximity to the default trigger and, hence, likelihood of default. Under more stringent economic circumstances (from investment-grade to ‘AAA’ stress), the lower FCCR loans will have lower recoveries. The graphs above and on page 7 illustrate borrower FCCRs on a cumulative and marginal basis.

- **Credit Enhancement**
  Of the three analyses performed to estimate net losses, the LDRM credit factor analysis is the dominant method. The multiple of loss analysis and the FCCR default analysis are used to calibrate enhancement ranges established by the LDRM credit factor analysis and to confirm, reject, or highlight aspects of the pool that might not be captured in a loan-by-loan analysis. Based on the output from the credit factor analysis compared to the other two analyses, Fitch IBCA can fix an objective benchmark for appropriately sizing credit enhancement. To determine final enhancement levels within the benchmark range, Fitch IBCA incorporates the influence of qualitative factors relating to the transaction structure, the originator, the servicer, and environmental and legal issues.

- **Transaction Structures**
  In a typical structure, the originator will sell the franchise loans to a bankruptcy-remote special purpose entity (SPE). The SPE will then sell the loans to a master, owner, or grantor trust, which issues the securities. The trust becomes the new lender under the franchise loan documents, while the original lender typically continues to act as servicer. The original lender and the SPE should provide the appropriate representations and warranties relating to the ownership of the loans, properties, and equipment, and confirm that all appropriate Uniform Commercial Code filings have been made.

The majority of franchise loan transactions are senior/subordinate structures and tranching with multiple classes and multiple ratings. Credit enhancement is generally achieved through subordination of junior classes. A portion of the interest on the underlying loans may be stripped off to create an interest-only (I/O) class or classified as excess spread. Fitch IBCA will generally apply a haircut to the excess spread allowable as a form of credit enhancement, increasing the haircut as the rating levels get higher.

- **Originator Review**
  The loan originators will generally be specialty commercial finance companies, many of which are small and unrated. Since the originator performs the initial underwriting of all loans in the pool and will normally act as servicer for the transaction, Fitch IBCA will review the company’s credit quality and, frequently, assign an internal or “shadow” rating. While minimum standards will be determined on a case-by-case basis, the originator should have a stable operating history, an adequate equity base, a viable strategy, and an experienced management team. Originators with a smaller capital base or shorter operating history may gain credit support through a significant equity investment from a larger company with long-term strategic interests in the market. In performing the credit analysis of the originator, Fitch IBCA’s structured finance group works closely with the financial institutions group, which has significant expertise in analyzing finance companies.

- **Credit Underwriting**
  Since the credit quality of the loans in the pool will depend on the initial underwriting practices of the originator, it is important for the originator to have a formalized credit process and established lending criteria. These credit underwriting practices should mirror the components used in the LDRM to reunderwrite each loan, such as requirements for minimum FCCRs, maximum LTVs, information on the experience of management, strength of the franchise, number of years in business, and number of units under management. Exceptions to credit policy will be a concern, since they are usually an indication of possible portfolio deterioration. It is important to note that while Fitch IBCA deems the originator’s strong credit policies to be critical to anticipating performance of a franchise loan pool, the LDRM analysis
will assign weightings to each credit factor in determining each loan’s relative contribution to the pool.

Subordinated loans and second mortgages are generally not permitted unless the related senior loans are also in the same pool. In this situation, the senior loans will have absolute first priority and the subordinated debt and/or second mortgages must be deeply subordinated. The language for all subordinated debt in the securitization will also be verified. Multiple loans in the pool to an individual borrower or affiliate must be cross-defaulted and cross-collateralized, with the loans to affiliates disclosed in writing. Debt service for subordinated loans and loans to related parties must be included in the FCCR calculation and also disclosed by the issuer.

Servicer Review
As stated, the originator will generally act as servicer in the transaction, responsible for monitoring loan performance, tracking collections and delinquencies, pursuing collections, reporting on pool performance, managing workout situations, and advancing principal and interest. The role of servicer requires specialized industry knowledge and sophisticated systems. Thus, many smaller originators may use third-party servicers with broader technical capabilities. Fitch IBCA performs a full due diligence on each servicer prior to rating a franchise loan transaction and will frequently require that third-party servicers be rated by the CMBS group.

The servicer must have adequate systems capabilities and staff expertise to track performance on a loan-by-loan basis and to provide consolidated pool reports to the trustee and rating agencies. In addition, the servicer should have a sound procedure for pursuing delinquent accounts and working with borrowers to ensure timely payment.

Fitch IBCA will require historical pool data evidencing the servicer’s overall portfolio delinquency experience and any historical delinquency experience of loans in the pool.

Servicers are typically required to advance both principal and interest to the amount deemed recoverable in the event that sufficient funds are not available to make payments to bondholders. In the event of a servicer default or if the servicer is unable to advance, the trustee is required to advance principal and interest payments to the amount deemed recoverable.

In workout situations, the servicer or special servicer, depending on the transaction, will be responsible for determining the optimal source of repayment through coordination with the franchisor, the franchisee, and the bondholders. Default by a franchise borrower will not necessarily result in liquidation of the mortgaged property. Since franchise locations are considered single-use properties, which have typically been chosen through sophisticated location analysis performed by the franchisor, the optimal workout solution will likely involve the renegotiation of terms with the franchise owner. Since the franchisor will likely have a vested interest in maintaining the subject location, it may provide support to the defaulting franchisee and could be a party to the workout plan.

In a liquidation scenario, a strong franchisor will be incented to support its brand name at the subject location and may assist in finding an alternate operator to assume the defaulting operation. Barring assistance from the franchisor, such as in the case of independent or unbranded gasoline concepts, the market for franchise businesses is relatively liquid and the servicer should be able to find many potential purchasers for a strong franchise in a good location. However, this reinforces the need for strong initial credit standards by the originator and loan reunderwriting in the rating process. Weak loans will not

Key Qualitative Factors
➢ Transaction Structure
➢ Originator Review
➢ Servicer Review
➢ Environmental
➢ Legal Issues
only be more likely to default but the subject locations will be fundamentally more difficult to place in the market.

- **Environmental Analysis**
  For many businesses included in a franchise pool loan, environmental issues represent material risks. Environmental risk varies according to the industry sector and, therefore, accepted practices for environmental due diligence may range from vista searches to Phase I and II investigations. Fitch IBCA assesses the environmental due diligence performed by the originator using a commercial mortgage standard to verify the level of environmental protection required in each industry. Generally, Phase I audits are required, but exceptions can be made where there is a high level of environmental diligence performed by the originator.

- **Legal Issues**
  Fitch IBCA reviews all legal opinions related to the perfection of security interest by the originator/servicer and the assignment of that security interest to the trust. Fitch IBCA also requires that the security documents be recorded in the name of the trust.

  The franchise agreement is the operative document governing the brand affiliation between the franchisor and the franchisee. The franchise agreement sets the terms for royalty payments, advertising contributions, and the respective duties, representations, and warranties of the franchisor and the franchisee. Associated with and in support of the brandname, logo, and trademark, the operating policies and procedures of the franchise agreement typically represent and enforce a uniform and consistent product quality and type, service standard, location or store configuration, and business format.

  In many circumstances, the franchise agreement is further supplemented by an operating agreement. The operating agreement incorporates policies and procedures manuals while the intercreditor agreement declares and specifies rights and responsibilities of franchisor and franchisee with respect to creditors formally recognized by the franchisor. The Uniform Franchise Offering Circular, the information memorandum legally required to be circulated by the franchisor, is the primary source of publicly available information on the franchisor.

  Fitch IBCA requires that issuers disclose in writing if there is a leasehold or franchise agreement that expires prior to the maturity of the loan without a guaranteed renewal. Fitch IBCA will modify subordination levels accordingly to account for the risk of nonrenewal. In single-obligor transactions, or where a single obligor constitutes greater than 40% of the principal amount outstanding of a pool, Fitch IBCA will review the terms and conditions of the intercreditor agreement (if one exists between the franchisor and franchisee) to see if the loan originator/servicer has been declared a recognized creditor by the franchisor. Fitch IBCA will also review the terms and conditions of the intercreditor agreement, as well as the respective rights and duties of the franchisor, the franchisee, and the loan originator/servicer in the event of a default or the disposition of the loan.