

# Waterfall makes most of early mover advantage in growing forward flow sector

Banks and private credit funds ramp up buying assets directly from lenders as others look to replicate asset manager's forward thinking

Just a few years ago, private credit was pretty much a synonym for direct lending, but with fund managers looking to deploy more and more capital in the sector, asset backed finance and in particular forward flow deals have surged in popularity.

The deals are private, so it is hard to get a precise idea of scale, but *GlobalCapital* sources generally agree the market is now particularly busy. As one ABS investor put it, "direct lending is saturated" and money is moving into new opportunities.

In the last year, the forward flow market has become so competitive, one UK specialist lender told *GlobalCapital*, that it is limiting the need to rely on public securitization markets or warehouse financing.

That makes a marked contrast from a few years ago.

"It's hard to believe [now], but if you were just starting out as a lender five years ago, forward flows weren't much of an option," another lender said.

Under a forward flow deal, asset buyers agree with originators to take assets off their hands as they are originated, subject to criteria.

Originators can run their platforms with less capital using forward flows as they do not need to hold 5% risk retention or they can use the deals to diversify their funding sources, while investors get direct access to a decent size portfolio of assets and negotiate bespoke terms with the seller.

As well as alternative credit funds, challenger banks awash with liquidity are using forward flows to put their balance sheets to work before ramping up their own origination capabilities. Even bigger banks are all competing aggressively in sectors of the forward flow market, despite their capital constraints.

"Recently we've actually seen a number of banks come out to play a lot more in taking principal exposure to assets," Andrew Vickery, partner at Linklaters, said in July.

In July for example, NatWest entered the UK buy-to-let mortgage market, via a forward flow with UK fintech Landbay.

## Making a trade of it

But many assets snapped up by banks are less interesting from a securitization perspective,



as they are likely to be deposit funded and sit on balance sheets.

There are exceptions to that, particularly among US banks. Citi and JP Morgan, for instance, each have long running programs of buying buy-to-let mortgages and securitizing them.

Assets bought by credit funds also have more chance of reaching the public market as many funds use leverage and increasingly refinance portfolios in the securitization market, with the hope of benefitting from better pricing.

Waterfall Asset Management is a leading example when it comes to taking out forward flow assets in the public ABS market.

In the last 18 months, the New York-headquartered fund manager has executed at least four such trades: two backed by collateral sourced from UK SME lender Funding Circle and one each from UK mortgage lenders Pepper and Selina Finance.

"We don't have to sell [portfolios]," said James Cuby, managing director at Waterfall. "We can sell when we view the market bid to be very strong, but we have pockets that can take either public or private exposure. Deals need to work without relying on securitization, however, if we can securitize on top of that, even better."

## Circle of life

Waterfall renewed its forward flow deal with UK SME lender Funding Circle for another £750m in September this year. That continued a funding relationship which began in 2018, with £1bn of forward flows over two years.

The deal, which has led to numerous issuances from Funding Circle's SBolt ABS shelf, is now seen by many as one of the prime examples of how forward flows can work.

"Everyone is now looking for the next Funding Circle," one transaction advisor told *GlobalCapital*.

For Funding Circle, the 2018 deal was significant step up in scale and significant portion of its funding. To illustrate, according to its 2018 accounts, originations for that year totalled £1.5bn. The first Waterfall sponsored SBolt transaction followed in 2019.

It was one of the first European forward flows deals of "that size and tenor", one source said.

"When we started in London about 10 years ago, most of the private activity was people buying portfolios of mortgages or non-performing loans," Cuby said. "We were getting into processes as one of five, a 20% hit rate."

“People weren’t really looking at the new assets being generated and there were a lot of platforms that needed capital. We set ourselves up to be able to fund daily and make our forward flows a smooth process.

“We picked one of the largest non-bank SME lenders, one of the largest unsecured consumer lenders and one of the largest non-bank mortgage lenders. We’ve just grown with them. That track record gives people confidence.”

### Staying ahead

The question will be whether Waterfall can stay ahead, as the market hots up.

Cuby pushed back on the idea that market’s popularity was making more difficult to find opportunities.

“The market demand for forward flows has gone up and down over the years as investors are always looking for value across ABF sectors,” he said. “The perception right now is that you can buy assets, securitize them and make money. The market does feel more crowded at the moment, but we don’t feel like there’s a huge amount of competition for us. In the end, it comes down to the few people who can actually transact.”

Nevertheless, Waterfall does have some other key edges on much of its newer competition.

“It helps to have a track record,” one of the specialist lenders said. “Waterfall can

point to the Funding Circle deal that has now run for eight years as a sign that issuers like working with them and want to keep renewing, because it’s hard to tell in the negotiation phase what a funding partner is going to be like.”

“There’s a reason why they get so much repeat business,” another lender agreed.

Indeed, Waterfall is still sourcing deals. It struck a new forward flow deal with UK development finance lender Atelier in February, adding to its track record of funding lenders in different vehicles — some warehouses and some forward flows.

Publicised partnerships include deals with Lendable in 2017, Puma Property Finance and Gen H in 2022, Gain Credit and iwoca in 2024 and PremFina agreed this year.

There is a clear willingness to back innovators and disruptors like Selina Finance, which recently securitized Helocs (home equity lines of credit) for the first time in Europe in September; like Gen H, which offers innovative mortgage products to help deposit or affordability constrained borrowers; or PremFina which is attempting disrupt the insurance premium financing market, currently dominated by Close Brothers Premium Finance and securitization issuer Premium Credit.

But what is notable about that list is that Waterfall has been able to fund lenders in similar markets, like Atelier and Puma, or

Pepper and Selina. It’s often tricky to fund competing lenders, given the amount of data a lender has to give to a forward flow provider.

It points another of Waterfall’s edges. There are numerous examples of forward flow providers using the deals to gain exposure to an asset class while building their own origination platform or negotiating a deal to buy another lender.

“Giving away so much data is a real concern,” one specialist lender said. “Some people would treat it as a cost of doing business. You have to hope [that if a forward flow buyer was going to compete against you] you’re 12 months ahead and you can build enough of a moat.”

Waterfall has a track record to prove that to issuers who work with them that they have no intention of competing with them.

“One thing people worry about is that they’re giving you all their data and you’re going to start competing,” Cuby said. “We have said we won’t compete with any of our clients and we will not. This ultimately helps us win more deals in the sector.

“In our market, we can compete because it’s not so much about pricing. It’s all about relationships and being somebody who can help [lenders] along their journey. If we say we’re going to do something we stick to it. We don’t play games. That’s a short term strategy.” ©