

## Finance Contracts

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# OVERVIEW

- I. Introduction
- II. Secured Lending
- III. Safety vs. Risk
- IV. Export Credit Agencies
- V. Enhanced Equipment Trust Certificates

# I. Introduction



# Options

- Leasing Companies
  - Airline leases from leasing company
  - Lessor retains ownership
  - Lessor has interest in rental and residual value
  - Will take security
- Finance Lease
  - Bank owns aircraft until repayment of loan
  - Bank has interest in rental and air frame
  - Will take security

## Principles of Aircraft Financing

- Overriding principle: **Asset value is key**
- Asset:
  - Source of financial gain for operating lessor or owner
  - Economic life is from 20 to 30 years
  - Can be an aircraft or engine

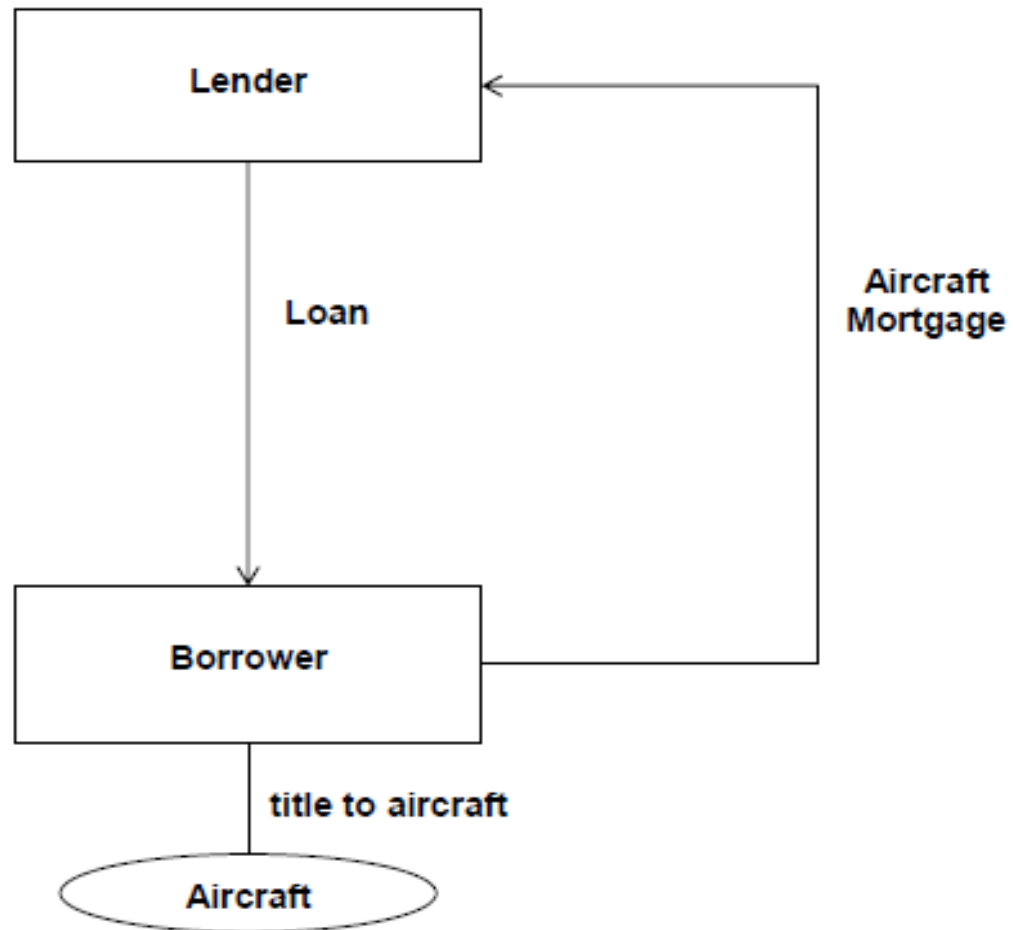


## II. Secured Lending



- **What** is Secured lending?
  - Loan secured on the asset (asset-backed security)
  - Borrower is economic owner of the asset, while the asset serves as security for the loan
  
- **Why** collateral security over the asset?
  - Enhances credit worthiness: Allows cheaper financing than the airline's credit rating would otherwise permit

## Secured Loans





## A. Primary type of secured lending

- Through loans of **differing seniority**:
  - *Senior* lending: first claim on asset
  - *Mezzanine* lending: intermediate claim on asset
  - *Junior* lending: last claim on the asset (ranks last)
- **Senior** lenders
  - Depending on the credit worthiness of the borrower, senior lenders finance 70% to 90% of price
  - Senior secured loans typically attract interest at 0.75% to 1.75%
- **Junior** lenders
  - Trade a lesser claim against the borrower for a higher rate of interest (“yield”): rates on junior secured loans may range from 3% to 6%

## **B. Other types of secured lending:**

- **Bond financing:**

- Eg. EETC Securitization: tranches of debt with different rights to claims (US bond market)

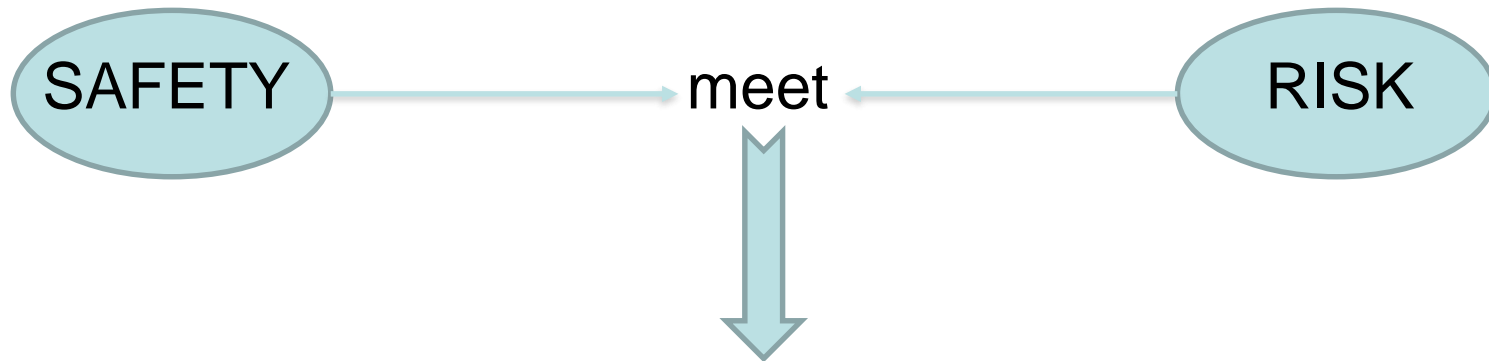
- **Finance lease:**

- Lessee acquires the asset at the end of the lease by exercising an option to purchase it

### III. Safety vs. Risk

Aviation's business

Bank's business



**Aircraft financing**



## Registration

- Critically important to financiers
  - State of registration governs maintenance and safety oversight
  - Issues airworthiness certificate
- Every aircraft must carry
  - Certificate of registration
  - Certificate of airworthiness
- Registration requires nexus with jurisdiction
  - Place of business/citizenship etc
- Each registry decides on name of owner or operator

## Aircraft Registration – Safety

- Registration critically important
  - State issues airworthiness certificates
  - Rules of state of registration govern maintenance and safety oversight
- Every aircraft must carry certificate of registration and certificate of airworthiness
- There must be nexus to registration jurisdiction
  - Registration normally in name of owner or operator



## Aircraft Registration – Risk

- Registration as a proof of ownership
- Regulated by the Chicago Convention
  - Aircraft have the nationality of the applicable State of registration and therefore the national laws of such State of registration govern aircraft registration and changes therein
- Practice of each state varies
  - No consistency on registration of financial interests, liens etc.
  - Situation with tax obligations, Eurocontrol etc.?

## De-Registration – Risk & Safety

- Chicago Convention prohibits registration in more than 1 jurisdiction simultaneously
- Deregistration just as important as registration:
  - Failure to effect de-registration, even if the aircraft and the related records secured, means that the next user or purchaser will be unable to re-register and therefore unable to operate
- **However**, not the case for financial interests
  - Can use aircraft as security more than once

## Registration gives banks some comfort BUT ...

### ... Does NOT address ALL other risks

- Recognition of their interests
- Ability to enforce rights
- Concerns over international consistency
- Multiple registrations





## Chicago Convention 83 bis

*“The State of registry of aircraft operated pursuant to a lease by an operator who has his principal place of business in another contracting State, may, by agreement with such other State, transfer to it all or part of its functions and duties as State of registry”*

- Signed Oct 1980; Came into effect 1997
- Facilitates lending to developing world carriers
  - Introduces safety and operational oversight with which banks are more familiar

→ Popular in Europe: Irish registration common



## Cape Town Convention 2001

- Aims to **eliminate uncertainty** surrounding international aircraft financings, by addressing the risk of providing priority of financial interests in high value, but mobile (eg. aircraft)
- Establishes a **uniform set of rights and rules** for
  - Creation
  - Protection
  - Prioritisation
  - Enforcement of financial interests in aircraft
- Creates '**international right**' for financial interests

## Cape Town Registration

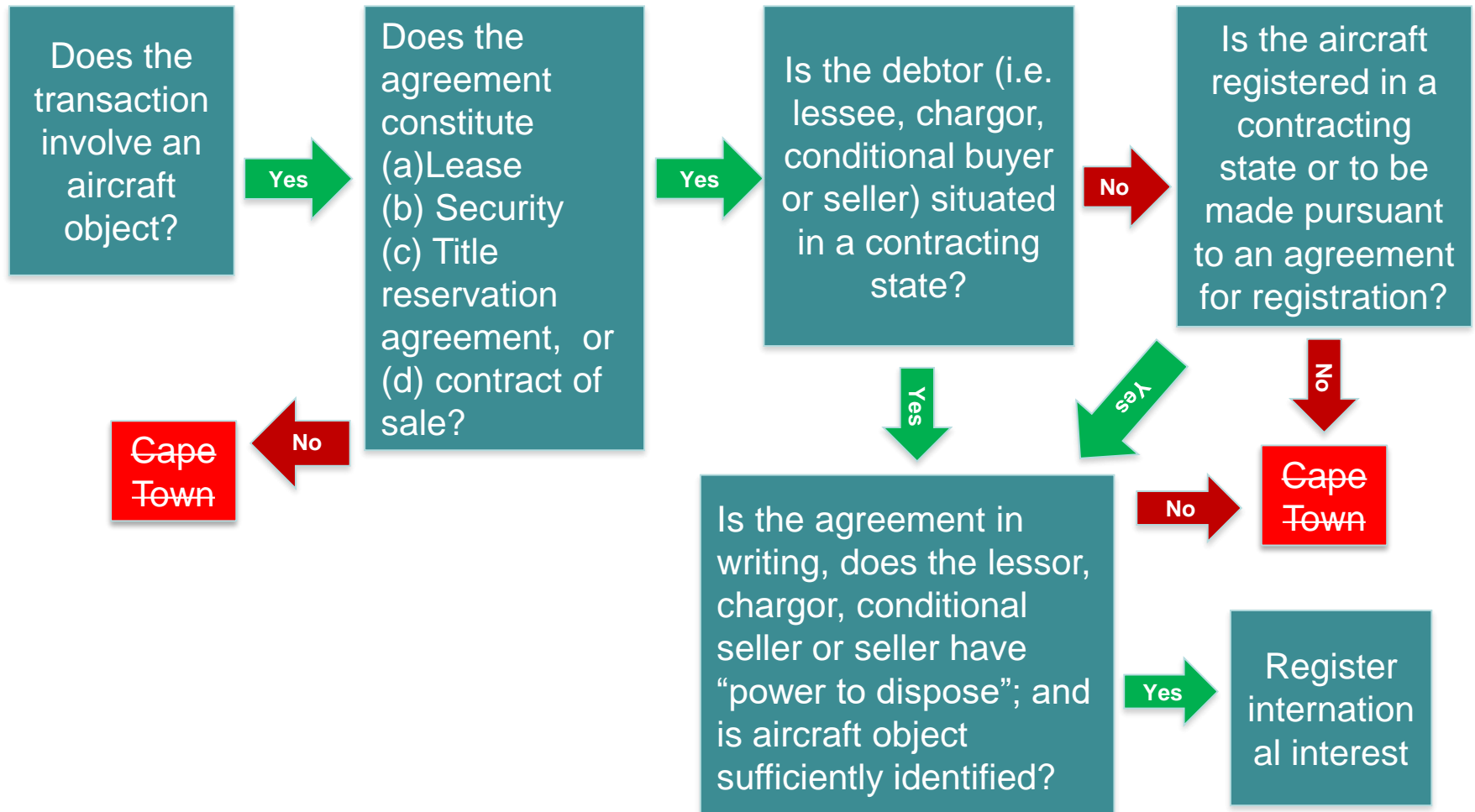
- International aircraft registry
  - Based in Dublin
- Registers international interests
  - Security interests
  - Leases and similar interests
- Registered by manufacturer's serial number
  - Subject to certain local priorities
- Priority based on order of registration
  - First to register has priority



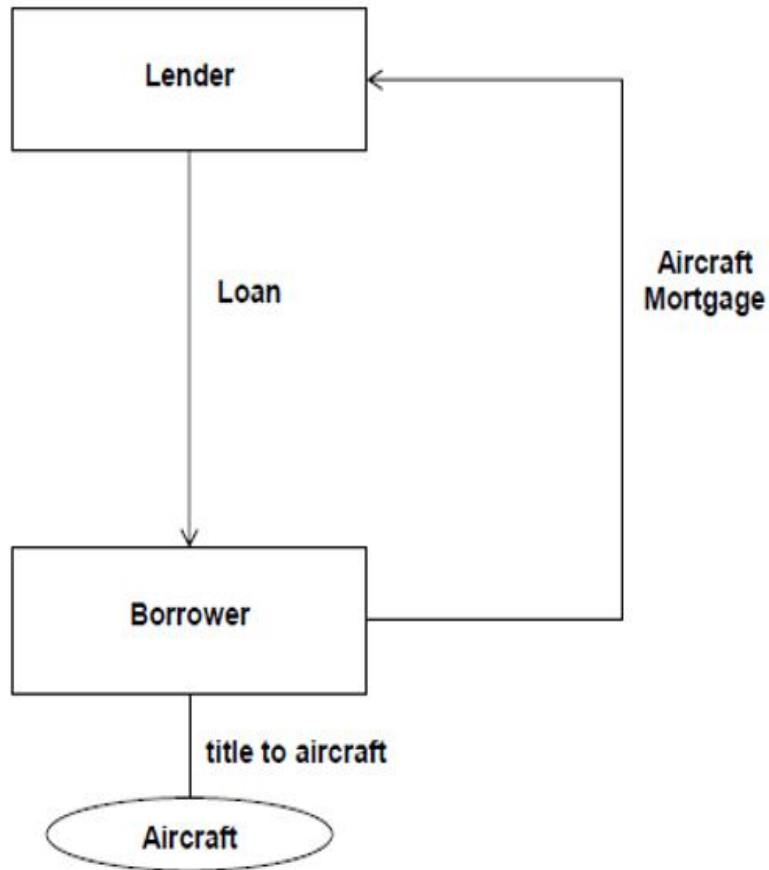
## Cape Town Enforcement

- Creditors have specific remedies
- Most important – Speedy judicial relief
  - Allows enforcement of remedies
  - On proof of default/insolvency
  - Registration sufficient to provide standing
  - Allows rapid interim action and aircraft recovery
  - Pending final determination on merits
- Debtor must be in signatory state
  - Huge pressure from banks for ratification

## Cape Town Convention Applicability

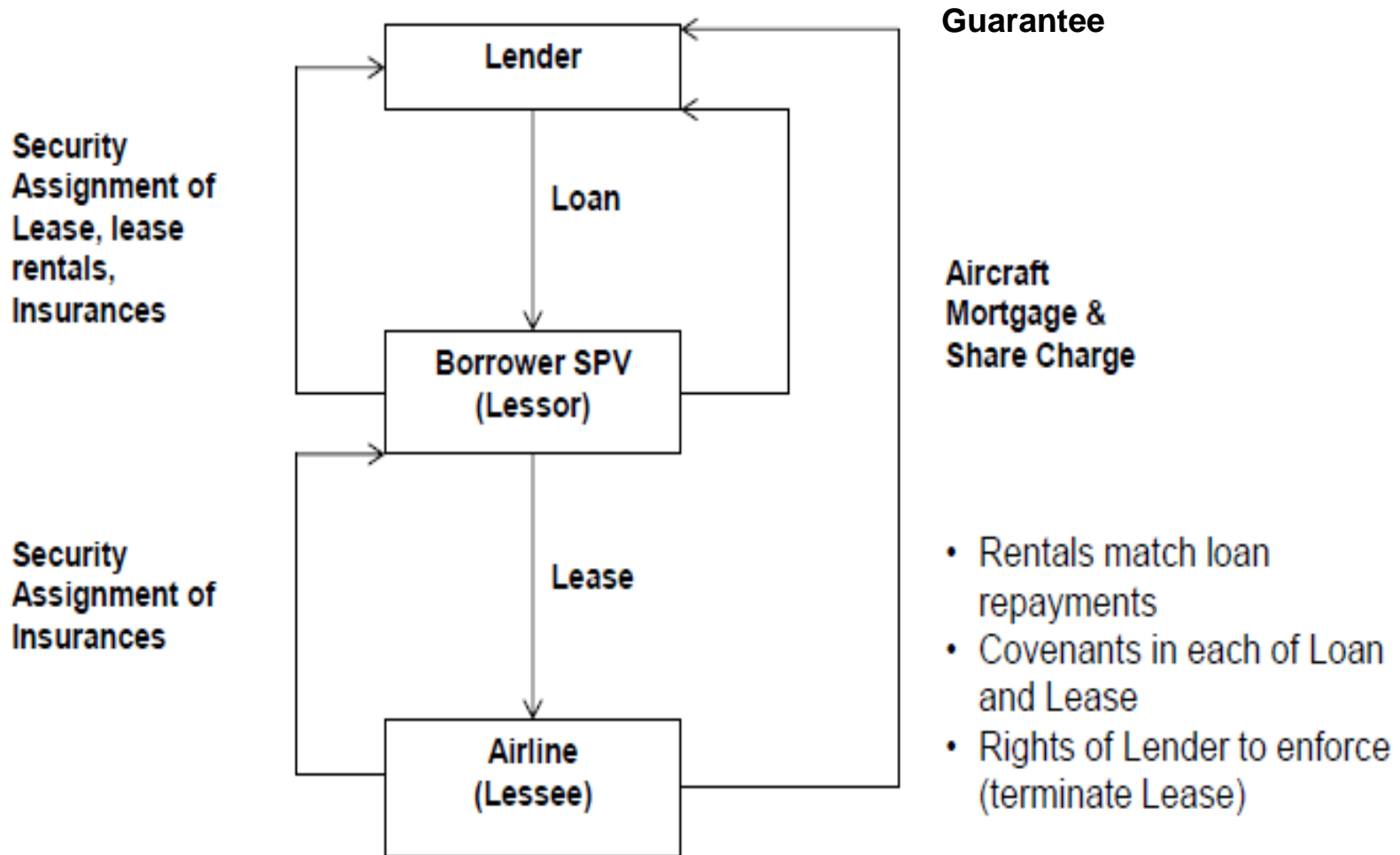


## Asset-backed security



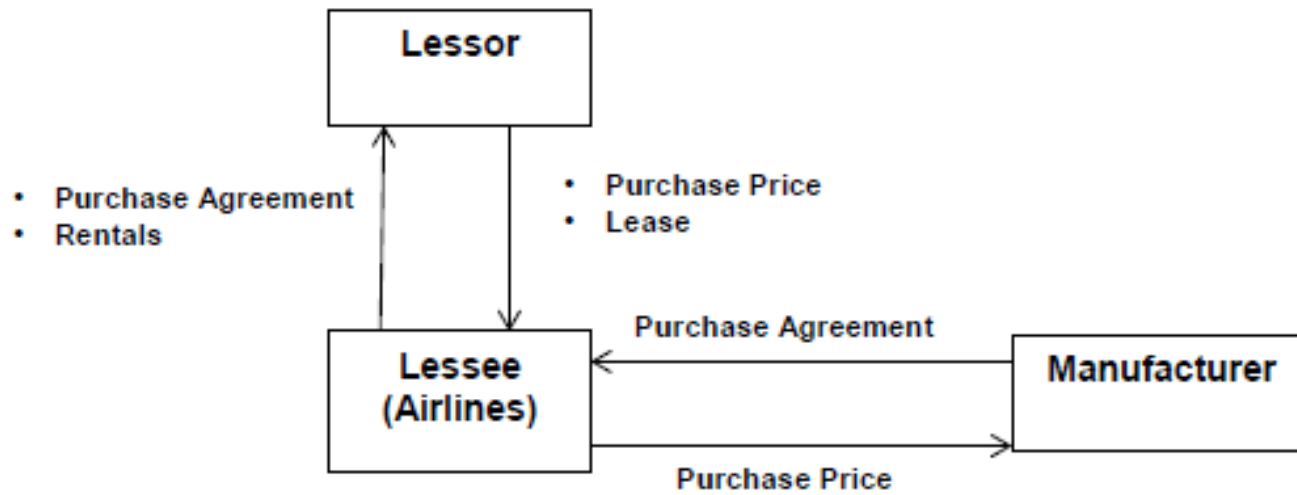
- Security over your property in return for loan
- However, risk that aircraft can be flown outside of the jurisdiction: risk that banks need to mitigate (Cape Town Convention 2001 addresses the risk of proving priority of financial interests in high value, but mobile assets as aircraft)
- Banks more likely to lend to airlines in countries with respected maintenance and airworthiness systems

## Financing Loan and Lease





## Sale and Lease Back



## IV. Export Credit Agencies



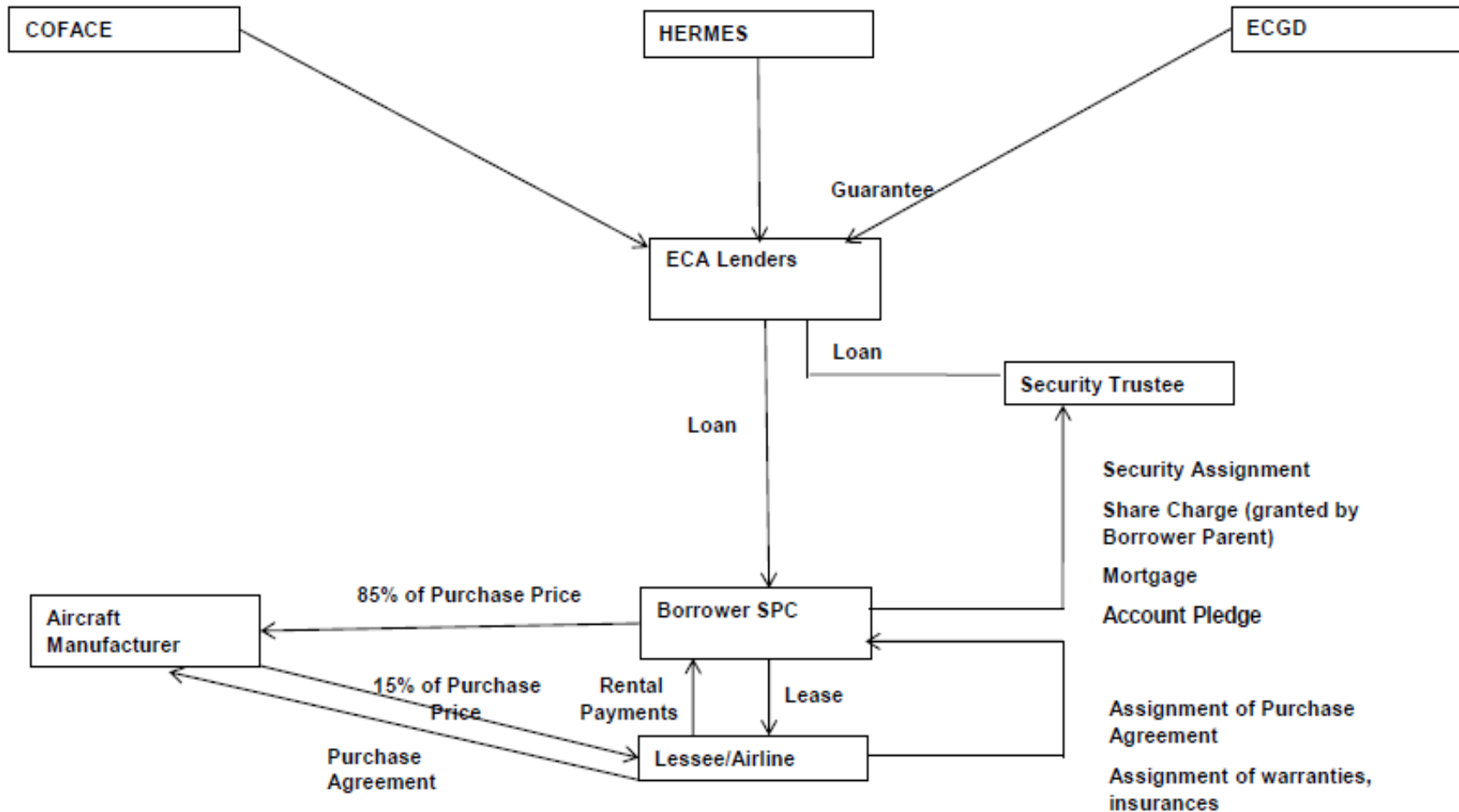
## A. What?

- Airframe and engine manufacturing countries (US, UK, Canada, Germany etc) assist in financing the export of goods and services to support their national economy
- Offer guarantees to banks when lending to less secure foreign airlines
- Usually limited to 85% of cost
- Additional methods include insurance programs and direct lending, financial intermediary loans and interest rate support
- Traditionally, a back-up source, now finance mechanism of choice
- Increasingly political

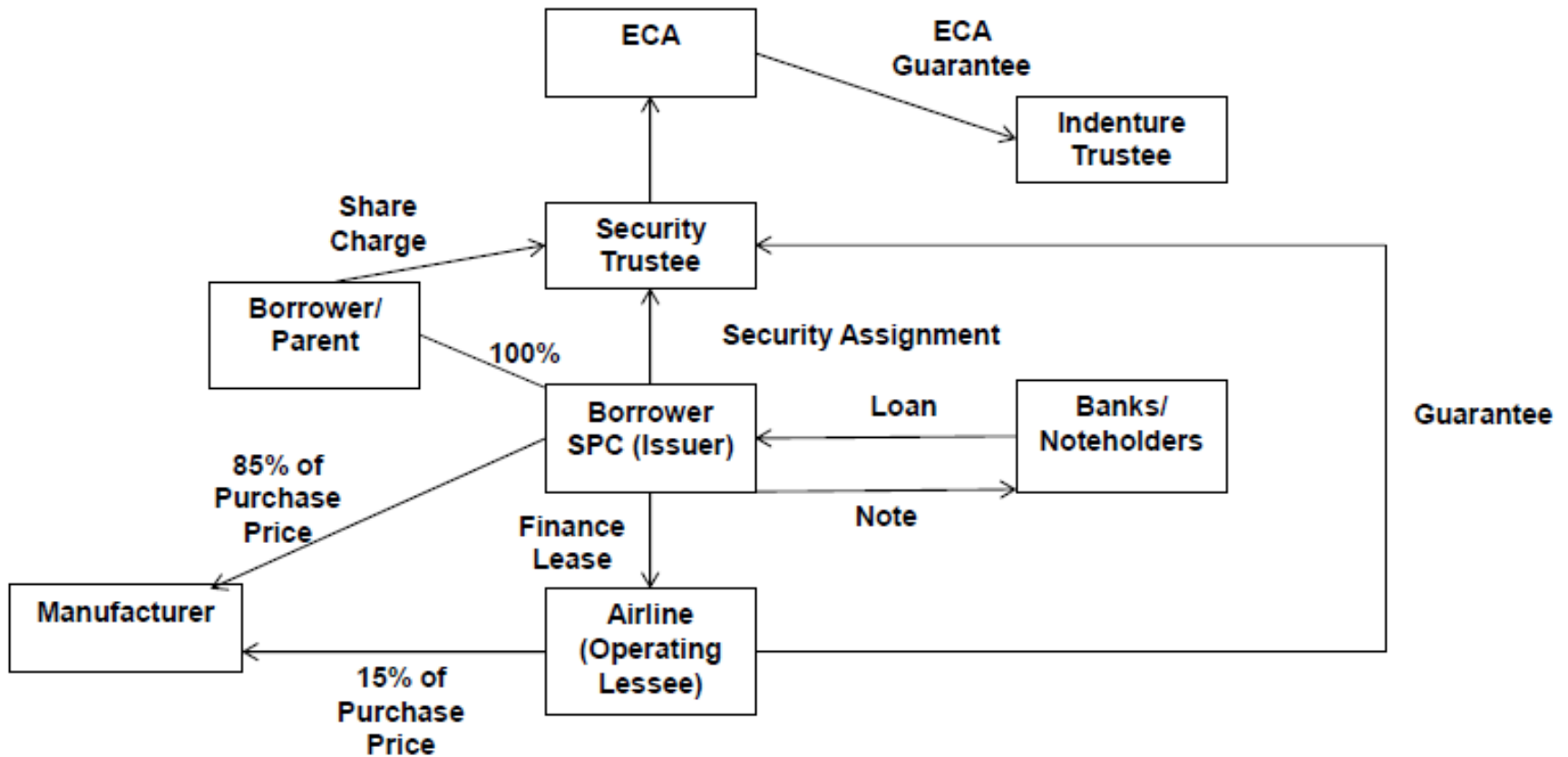
## B. Aircraft Sector Understanding

- Developed by OECD (Organisation for Economic Co-operation & Development)
- Establishes uniform terms & conditions for aircraft financing through ECA
  - Minimum interest rates
  - Maximum repayment terms
  - Risk categories and financing according to risk
  - Align finance with market rates
- Expected to increase cost of ECA financing
- Came in force in 2013. Signatories:
  - Australia, Brazil, Canada, EU, Japan, Korea, New Zealand, Norway, Switzerland, US
  - NOT China or Russia

## C. ECA Financing



## D. ECA Bond-Based Finance

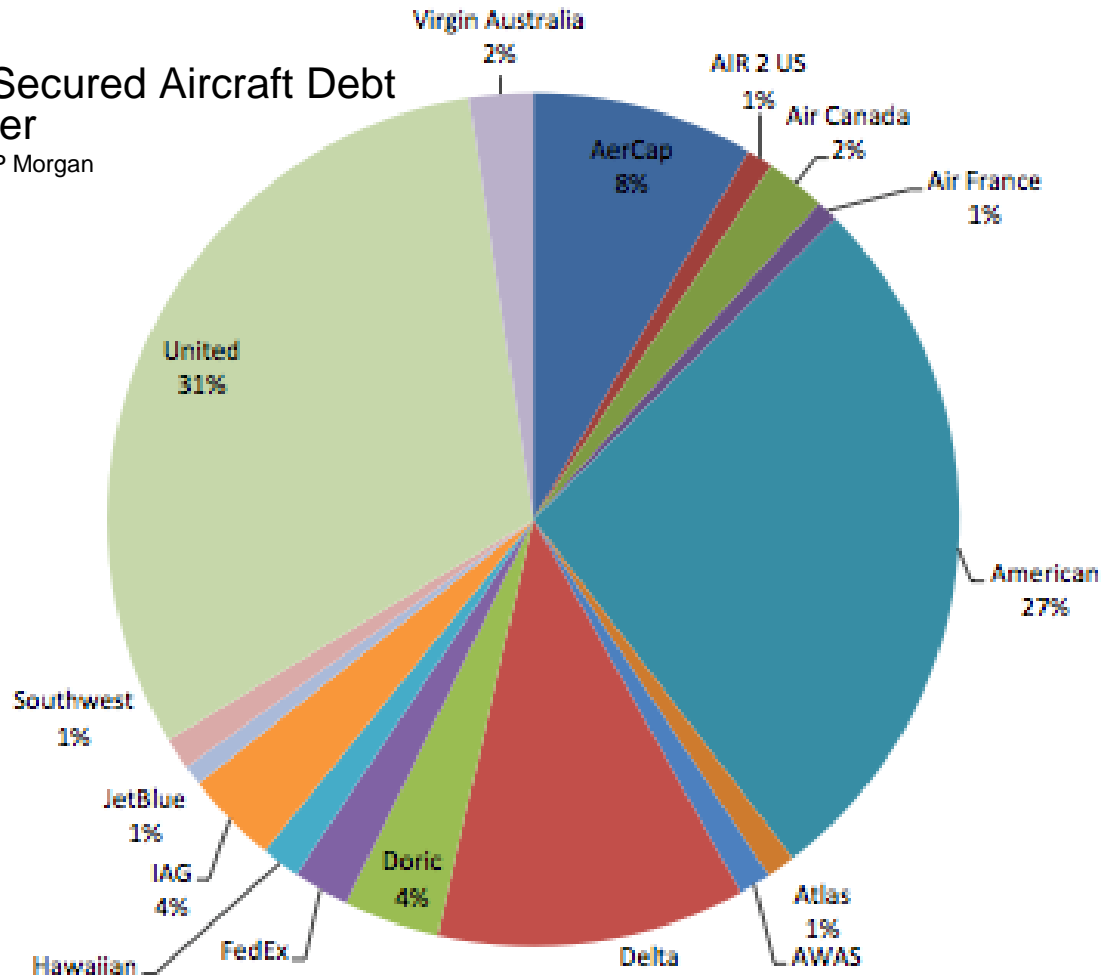


# V. Enhanced Equipment Trust Certificates

% of Total - By \$ amount

CURRENT EETCs/Secured Aircraft Debt Outstanding by Issuer

- JP Morgan



- **Investors pool funds**
  - Airlines raise finance
- **Purchase aircraft**
- **Lease operator**
  - Qualification that airline receives title on performance of lease



## EETC – Example - United Airlines

United Airlines, Inc. (“United”) intends to raise \$949,459,000 of Pass Through Certificates, Series 2014-1 in two classes:

- Class A of \$736,647,000
- Class B of \$212,812,000

The proceeds from the offering will be used by United to finance 25 aircraft:

- 13 new Boeing 737-924ER aircraft scheduled for delivery between June 2014 and March 2015<sup>(1)</sup>
- 2 new Boeing 787-8 aircraft scheduled for delivery between May and October 2014
- 1 new Boeing 787-9 aircraft scheduled for delivery between September 2014 and March 2015<sup>(2)</sup>
- 9 new Embraer ERJ 175 LR aircraft scheduled for delivery between March 2014 and March 2015<sup>(3)</sup>

Lead Bookrunners: Morgan Stanley, Credit Suisse

Bookrunners: Deutsche Bank Securities, Citigroup Global Markets, Barclays, Goldman Sachs & Co., Credit Agricole Securities

	<u>Class A</u>	<u>Class B</u>
<b>Face Amount</b>	\$736,647,000	\$212,812,000
<b>Expected Ratings (S&amp;P / Fitch)</b>	A- / A	BB+ / BB+
<b>Initial LTV<sup>(1)</sup></b>	55.1%	71.0%
<b>Interest Rate</b>	Fixed, semi-annual, 30/360 day count	
<b>Initial Average Life (in years)</b>	8.8	5.9
<b>Regular Distribution Dates</b>	April 11 & October 11	
<b>Expected Principal Distribution Window (in years)</b>	1.5 – 12.0	1.5 – 8.0
<b>Final Expected Distribution Date</b>	April 11, 2026	April 11, 2022
<b>Final Maturity Date</b>	October 11, 2027	October 11, 2023
<b>Section 1110 Protection</b>	Yes	Yes
<b>Liquidity Facility</b>	3 semi-annual interest payments	3 semi-annual interest payments

# Aviation Advocacy

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