

Aviation Advocacy

Financing Contracts – Securitisation

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Safety vs Risk

- Aviation's business is safety
- Banks' business is risk
- Aircraft financing is where they meet

Introduction

- Unprecedented levels of orders for new aircraft
 - ageing fleets in North America
 - growth in emerging markets
 - demand for new technology and fuel efficient aircraft
- Against backdrop of state of industry
 - Since 1903 has lost more than it has earned
 - Disproportionately subject to external shock

Introduction

- Historically, airline balance sheets not considered when seeking financing
 - Hence need for lending institutions
 - International, so complex transactions possible
 - Focus on tax minimisation/optimisation
- Finance available through number of tools
 - Secured lending
 - ECA financing
 - EETCs
 - Operating leases

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

Issues to Consider

- Tax
- Accounting rules
- Insolvency
- Local Civil Aviation Authority
- Security

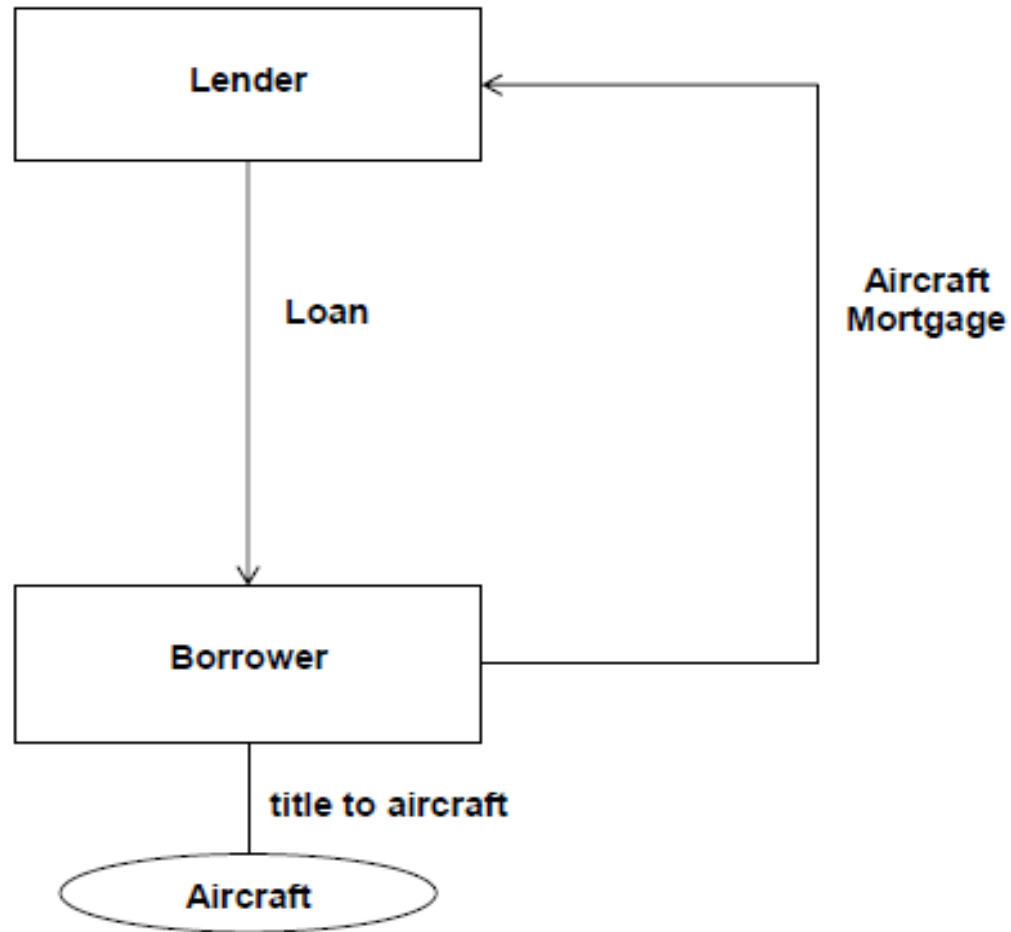
Risk?

- Mobile nature of aircraft raises complicated multi-jurisdictional issues
- Cost of aircraft, interchangeability of components increases sensitivities to risk
- Specialised techniques associated with financing aircraft

Trends

- Transaction costs likely to increase
 - Pressures on banks re tax structuring
 - Basel Rules
 - ASU
- Second-hand market under pressure
 - Export Credit Agencies (ECA) growing for smaller airframes
- New investors arriving
 - Attracted by secure hard assets backed by Cape Town

Secured Loans



Registration – Risk

- 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?

Registration – Safety

- Registration critically important
 - Rules of state of registration govern the maintenance and safety oversight
 - State issues airworthiness certificates
- 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

De-Registration – Risk and Safety

- Chicago Convention prohibits registration in more than one jurisdiction at any one time
 - Deregistration just as important as registration
 - Failure to effect de-registration, even if the aircraft and the related records secured means next user or purchaser unable to re-register
 - Therefore unable to operate
- However, not the case for financial interests
 - Can use aircraft as security more than once

Applicable Governing Law

- Chicago Convention provides for a national system of aircraft registration
 - No registration requirement for engines, propellers, appliances, parts etc
- Cape Town Convention establishes international framework
- National law answers questions related to validity and priority of interests
 - Including tax/Eurocontrol liens etc

Chicago Convention

- Only applies to civil aircraft
- Every contracting nation has complete and exclusive sovereignty over the airspace above its territory
- Each signatory is entitled to regulate air services and cabotage within its borders

Chicago Convention

- 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

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

Other Risks?

- Registration gives banks some comfort
- Does not address all other risks
 - Recognition of their interests
 - Ability to enforce rights
 - Concerns over international consistency
 - Multiple registrations

Cape Town Convention 2001

- Aims to eliminate uncertainty surrounding international aircraft financings
- Establishes a uniform set of rights and rules for
 - Creation
 - Protection
 - Prioritisation
 - Enforcementof financial interests in aircraft
- Creates ‘international right’ for financial interests

Cape Town Convention 2001

- Umbrella agreement
- Equipment specific protocols
 - Aircraft and engines
 - Railways
 - Satellites
- Largely supersedes Geneva Convention 1948
 - Rome Convention 1933 – Preventing precautionary seizure

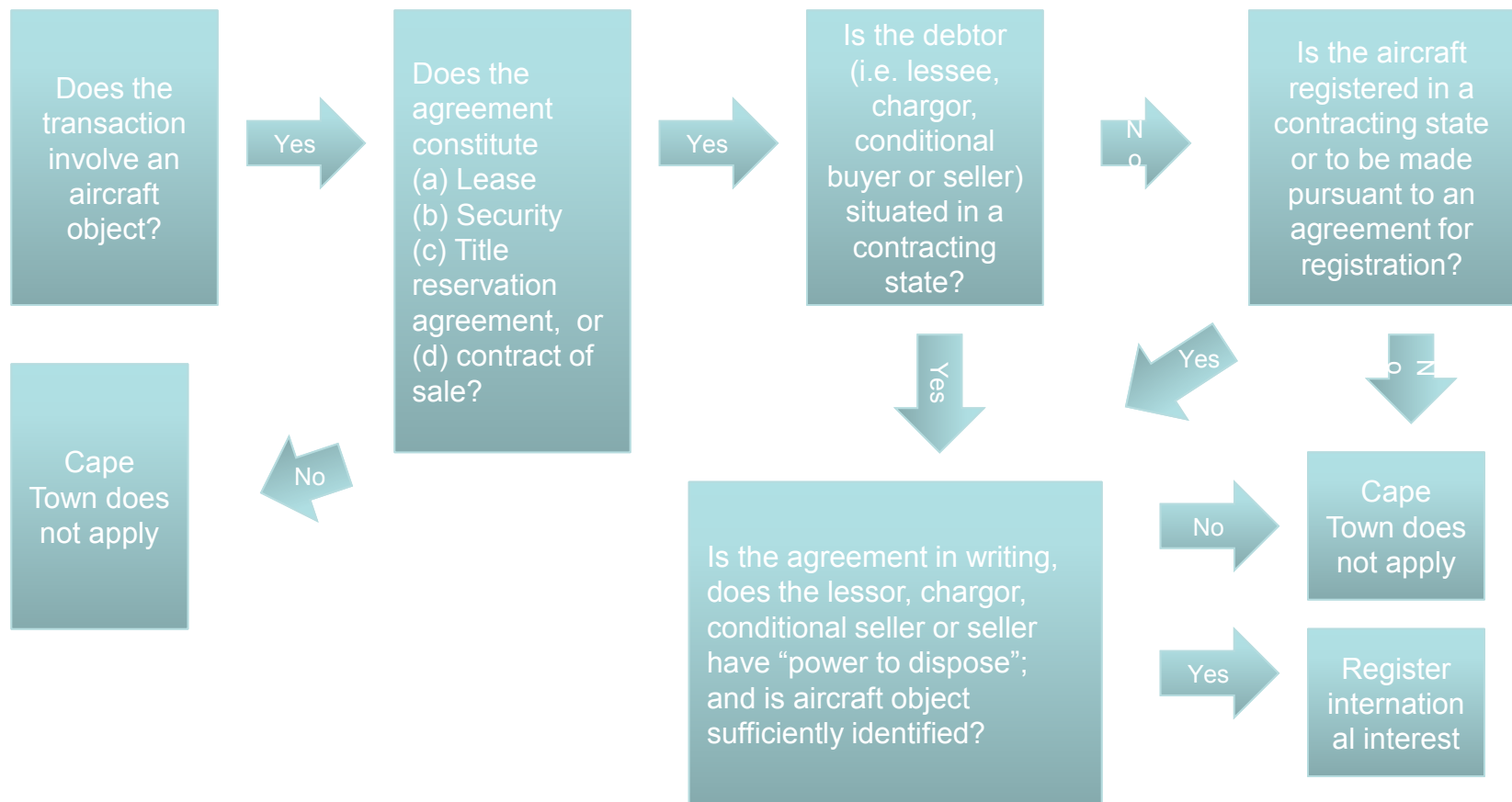
Cape Town Registration

- 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



Other Structuring Issues/Risks

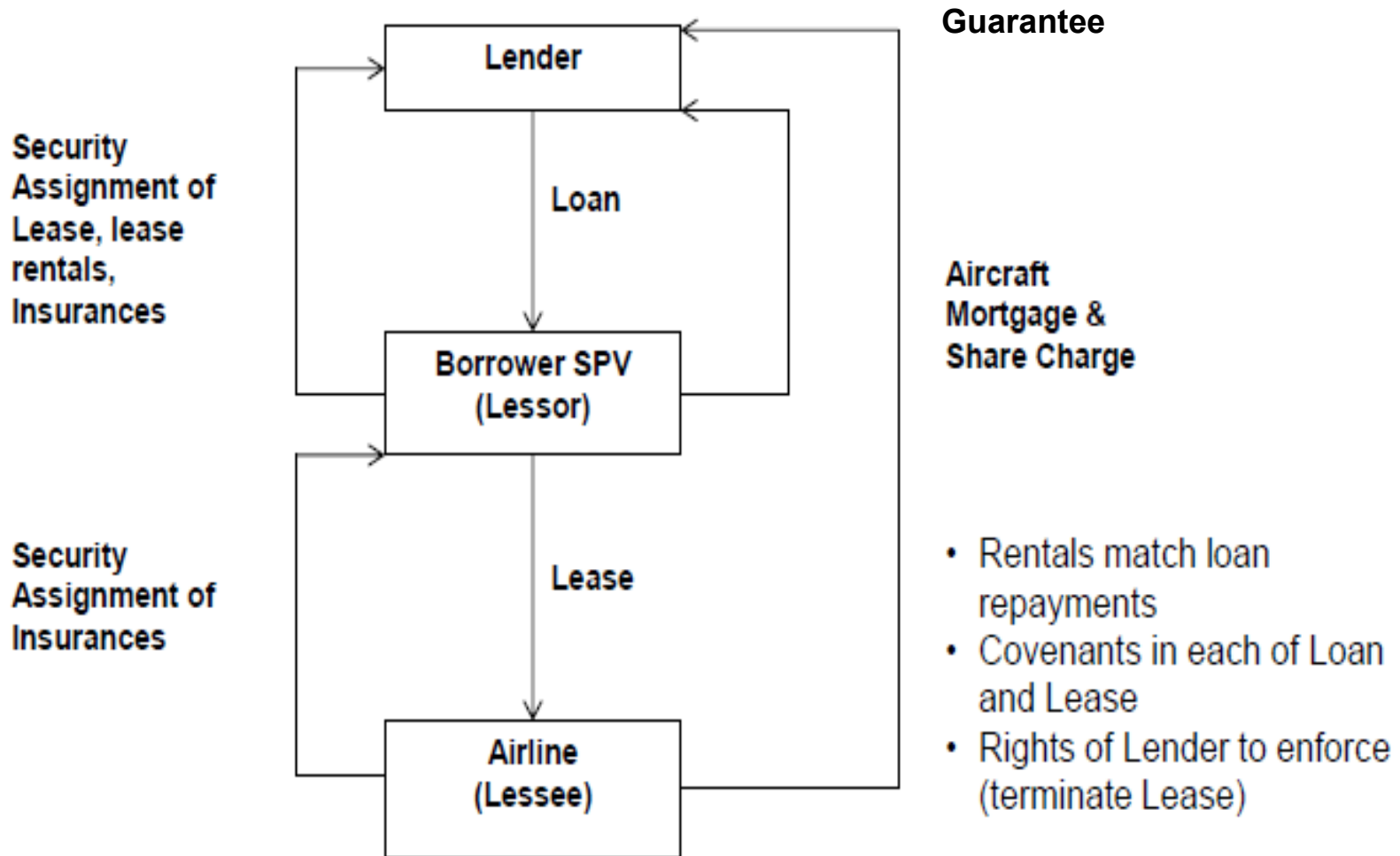
- Risk of not isolating specific assets
 - In bankruptcy
 - In event of default of other covenants
 - Disasters
- Taxation optimisation
 - VAT applicability on registration?
 - Treatment of lease payments vs loan repayment
 - Treatment of security guarantees

Other Structuring Issues/Risks

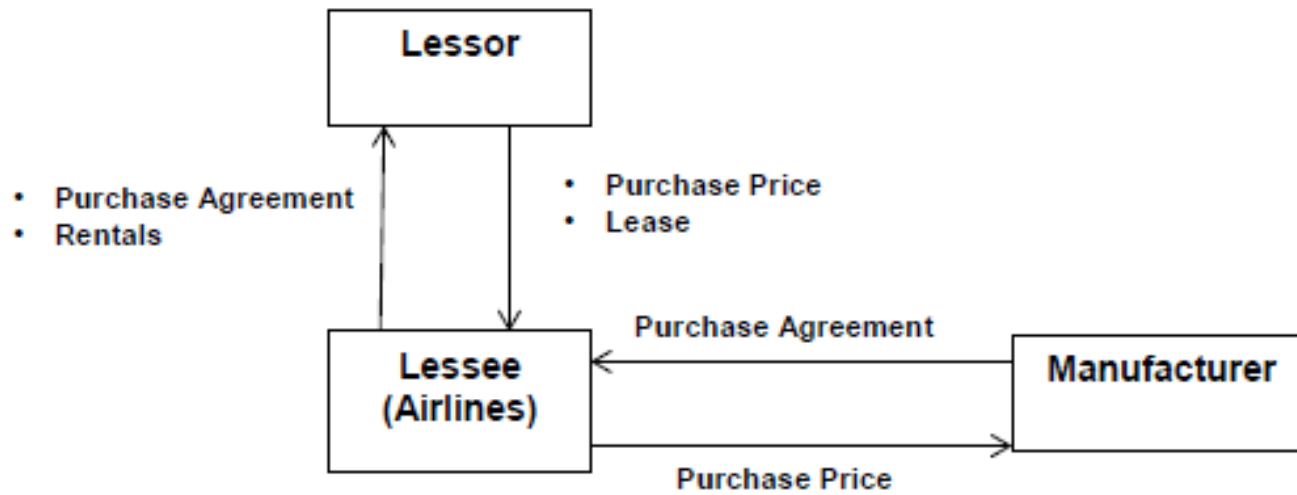
- Accounting treatment
 - Treatment of lease payments
 - On/Off balance sheet

- Currency risk

Financing Loan and Lease



Sale and Lease Back



Export Credit Agencies

- 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

Export Credit Agencies

- 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

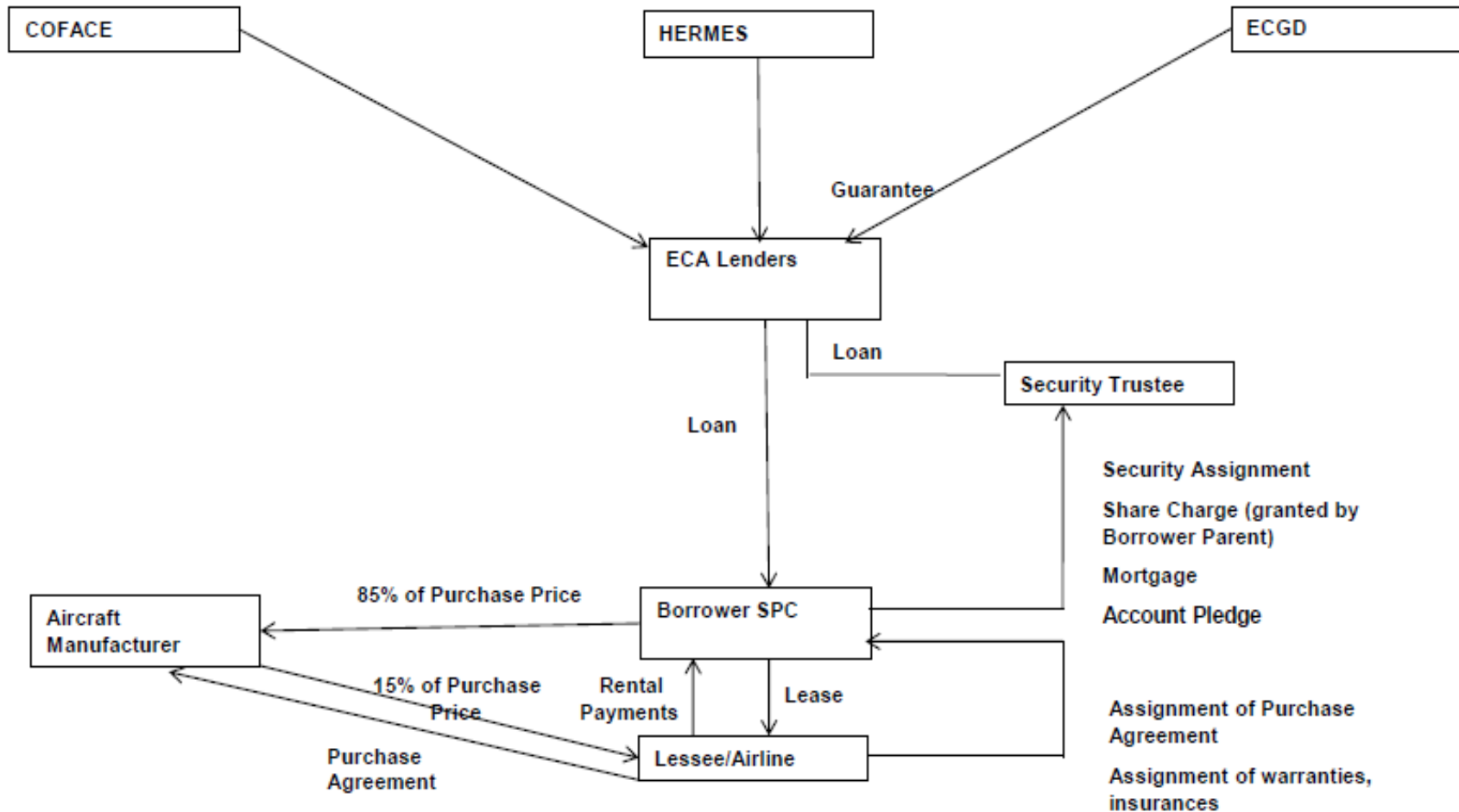
Aircraft Sector Understanding

- Developed by OECD
- Establishes uniform terms and conditions for financing of aircraft 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

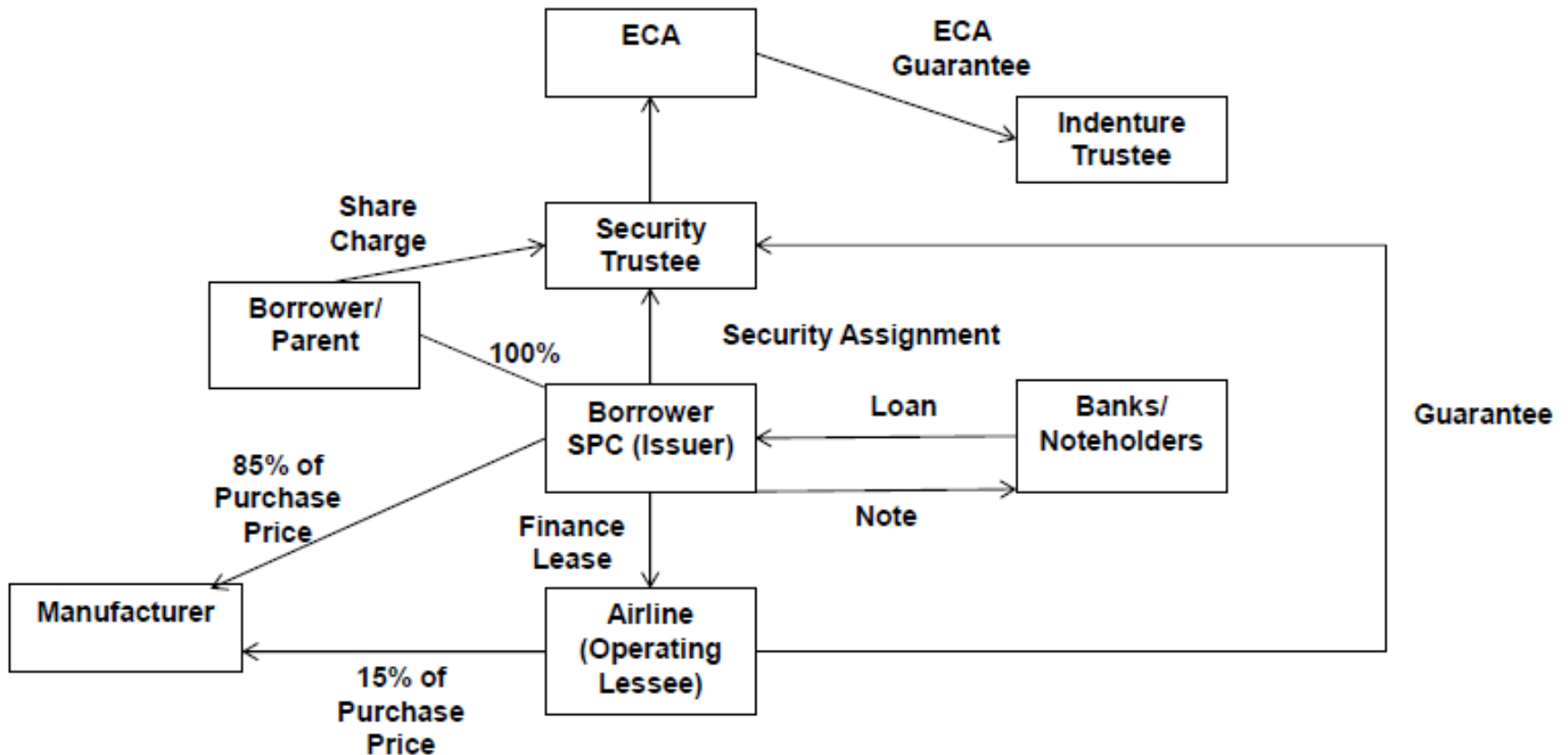
Aircraft Sector Understanding

- Came into force in 2013
- Signatories
 - Australia, Brazil
 - Canada, EU
 - Japan, Korea
 - New Zealand, Norway
 - Switzerland, US
- Not China or Russia

ECA Financing



ECA Bond-Based Finance

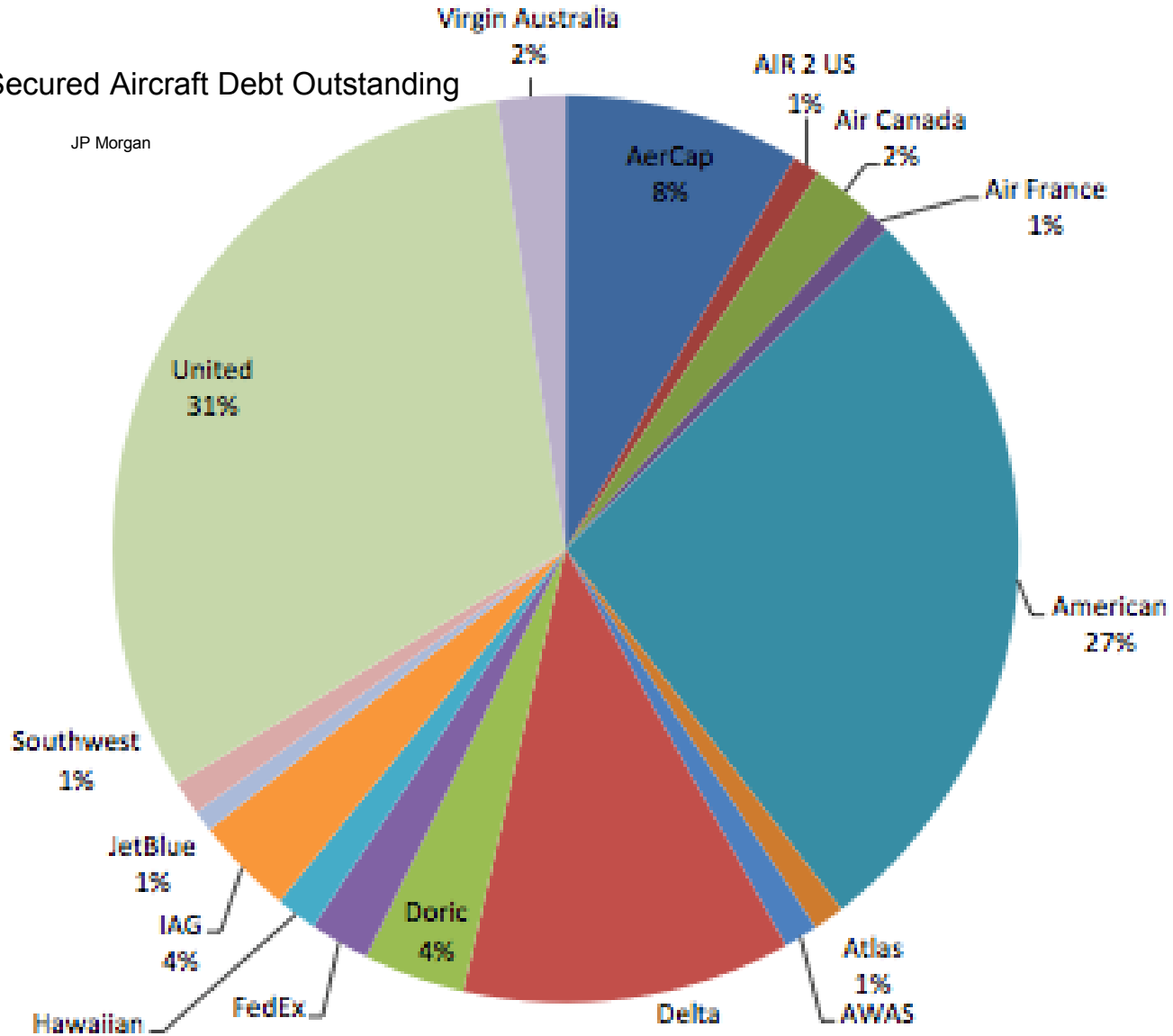


Enhanced Equipment Trust Certificates

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

% of Total - By \$ amount

CURRENT EETCs/Secured Aircraft Debt Outstanding by Issuer



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⁽¹⁾**
- **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⁽²⁾**
- **9 new Embraer ERJ 175 LR aircraft scheduled for delivery between March 2014 and March 2015⁽³⁾**

Lead Bookrunners: Morgan Stanley, Credit Suisse

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

EETC – Example - United Airlines

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

Operational Leases

- Wet leases
 - ACMI
- Dry leases
 - Damp leases
- Charters

General Lease Provisions

- Operation
 - Restrictions on operations in certain circumstances
- Maintenance
 - Maintenance Reserve
- Prohibition on subleasing and reregistration
- Possession
- Replacement on Events of Loss
- Insurance
- Return Conditions

Aviation Insurance

- Hull
- Liability and Third Party
- War and Allied Perils
- Political Risk
- Breach of Warranty

- AVN67C
 - Standard form
 - Standard to be required as security for financing

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