

# **AN INTRODUCTION TO AIRCRAFT FINANCE**

## **and a short comparison with rolling stock financing**

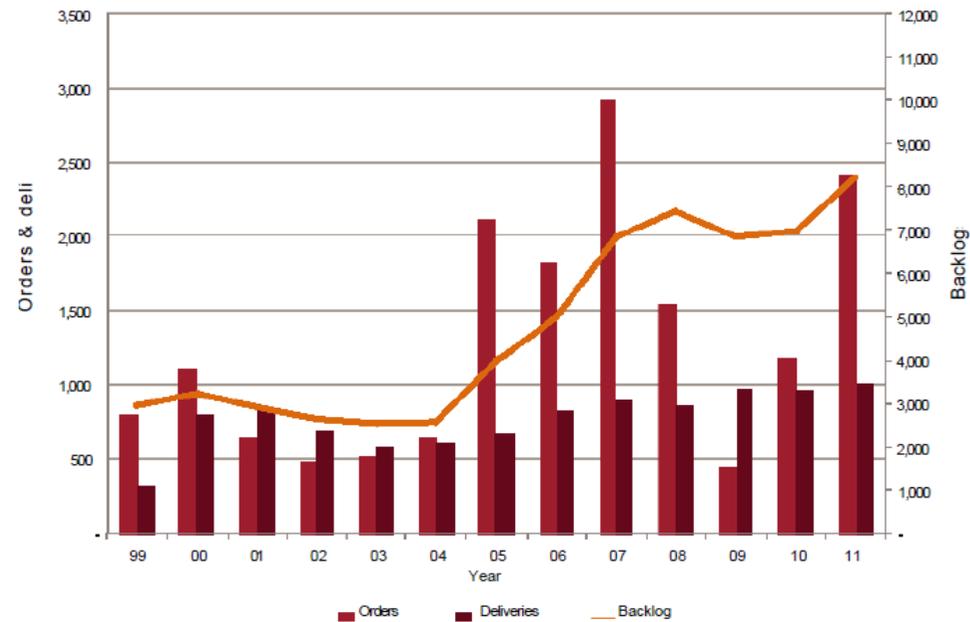
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DG MOVE  
Brussels, 17 March 2014

## Current Market Overview

- § Ordering aircraft in 'good times' – delivered in 'bad times'
- § Current backlog = 8,500 units
- § Significant order volumes pre 2008/9 crisis
- § Quieter period 2009/10
- § High order volumes in 2011/12

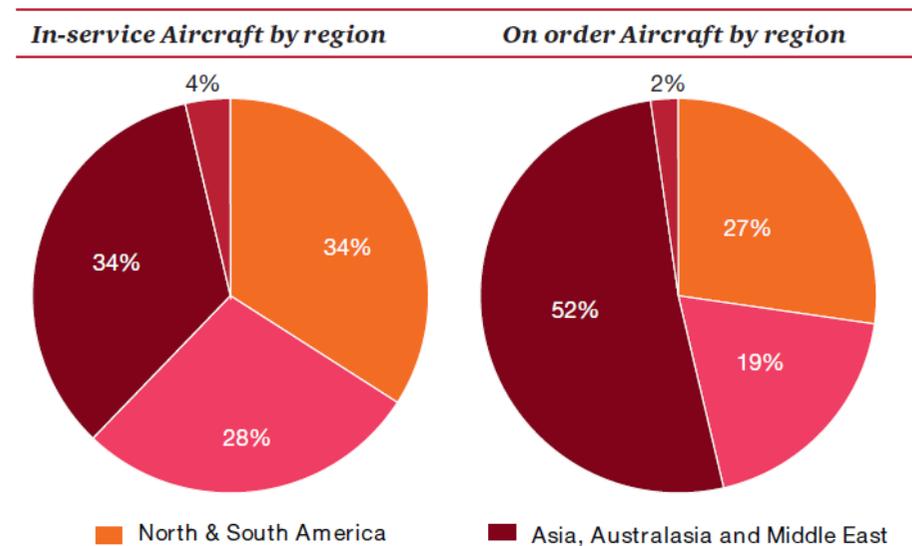
*Airbus and Boeing orders, deliveries and backlogs*



*Source: Boeing and Airbus websites, PwC analysis*

## Current Market Trends

- § Desire to drive down operational costs - high demand for aircraft with new technology
- § Strong economic growth in emerging markets
- § Reproducing successful LCC models
- § Re-fleeting of US airlines
- § Decline in second-hand market in developing countries

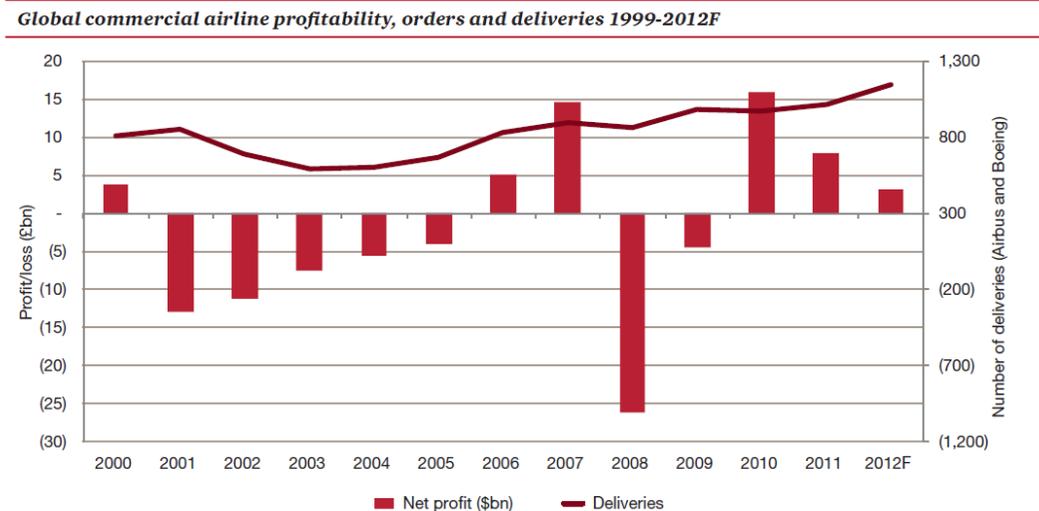


Source: Flightglobal

# The Financing Gap

- § Global losses for airlines in the past decade
- § Linked to: 9/11; SARS, swine flu, volcanic ash, economic downturn, fuel prices
- § But also : excess capacity, intense competition, rise of LCC
- § Lead to very low margins

§ Airlines seem to continue finding sources of finance

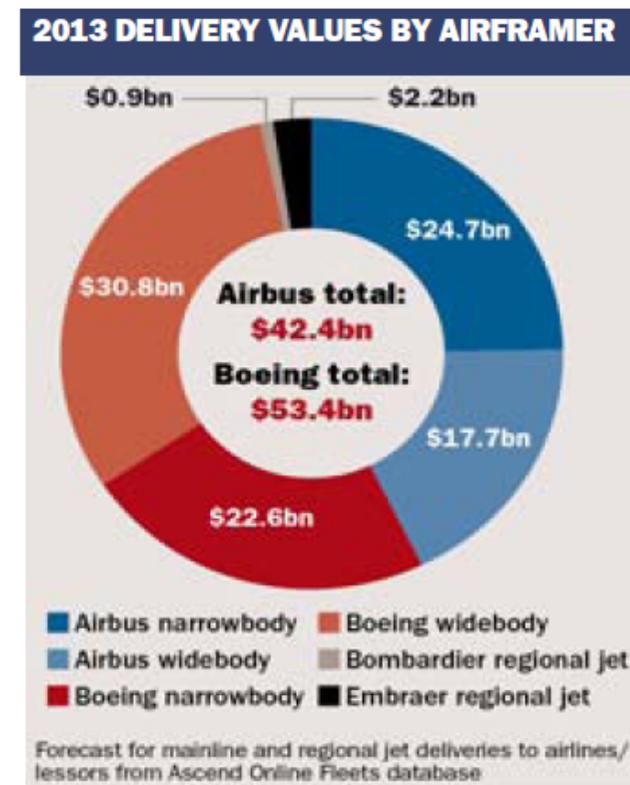


Source: Boeing, Airbus and American Airlines websites

## Manufacturers

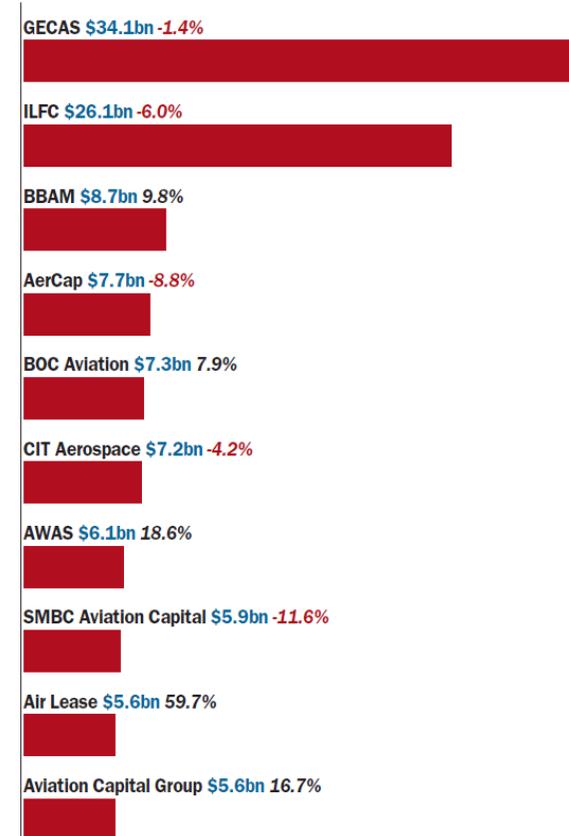
Ascend/Flightglobal's report:

- § 2013: almost \$100 billion worth of aircraft ordered
- § 2/5 of financing requirements from Asia (i.e. 18% higher than 2012)
- § Europe accounts for a 20%: i.e. \$20 billion
- § 80% of assets will be 'liquid', i.e. easy to finance
  
- § Support offered by manufacturers:
  - residual value guarantees
  
- § Obstacles to buying:
  - high pre-delivery payments (e.g. \$15/20 mio over 3 years in advance of delivery for aircraft worth \$75 mio)



# Lessors

- § Lessors place large orders with manufacturers
- § Then lease aircraft to airlines
- § Lessors' financing needs are met in similar ways as airlines relying on:
  - equity/cash
  - export credit
  - bank debt
  - capital markets
- § Role of lessors: very creative
- § First port of call for many airlines
- § See section on case studies



# Airlines

Main sources of financing for airlines:

- § Cash: cheapest way to finance, but only for profitable or State-owned airlines. The residual value risk remain high
- § Operating lease/sale and lease back transactions: similar to car hire and very frequently used. It is a flexible and relatively cheap source of financing
- § Bank loan/finance leases: like mortgages. A finance lease is based on the same principle as a loan
- § Export Credit Guaranteed loans: Ex-Im Bank in the US (for Boeing), Coface/ECGD (for Airbus). The relevant agency guarantees the loan. This system is not available to 'national' airlines
- § Manufacturer support: residual value guarantees. This covers the price that the manufacturer will pay to buy the aircraft at lease end

# Leasing – a flexible solution

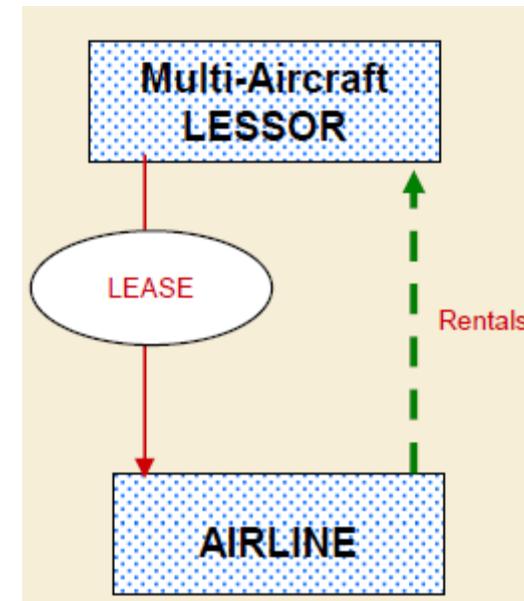
§ Straight forward operating lease

§ **Main elements:**

- payment of up-front deposit
- the economic risk remains with the lessor
- strong focus on maintenance and redelivery conditions
- the risk of loss of the aircraft remains with the lessee

§ **Advantages of operating leases:**

- they could be short term, wet leases, etc
- lease rentals are 'debts' on the balance sheet
- Flexible to meet operational constraints and seasonal needs



# Leasing – Various options

## § Possible support:

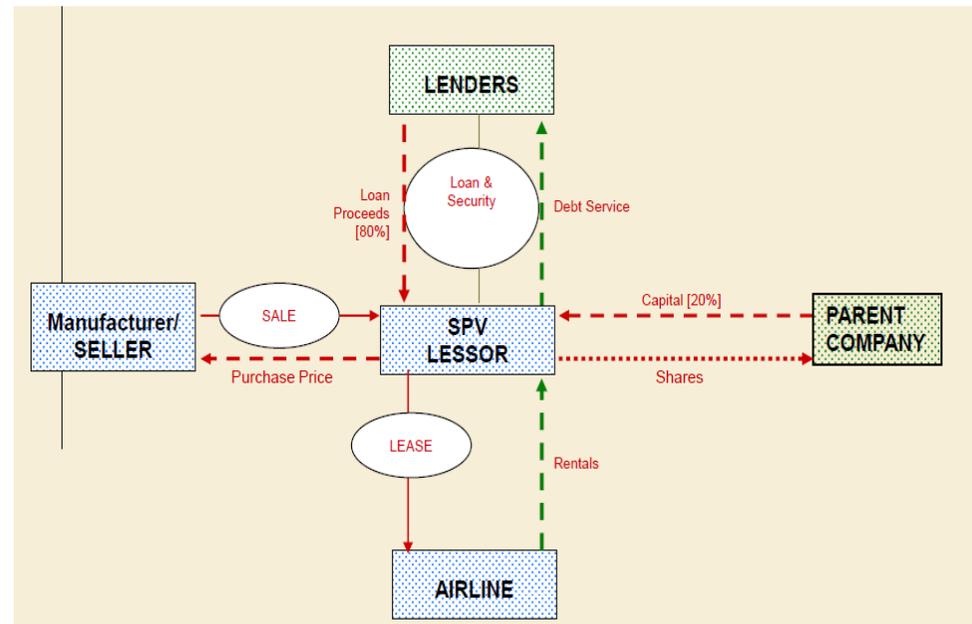
- Export Credit Agencies guaranteeing the lenders

## § Possible alternatives for liquidity needs:

- Sale and lease back transactions

## § Tax driven structures:

- Japanese Operating Leases
- French Leveraged Leases
- Spanish Operating Leases



## Corporate jet financing – a world apart

- § Not comparable with commercial airlines financing
- § More manufacturers (Piaggio, Honda, Pilatus, Dassault, Bombardier, Agusta, etc.)
- § Size of ‘users’ may vary from 1 aircraft to an entire fleet – lack of consolidation
- § Not ‘asset-based finance’ but mortgage/loan transactions coupled with security interests on owner’s private fortune
  
- § Problematic areas:
  - identification of ‘private operations’ as opposed to ‘commercial’;
  - types of aircraft which may operate commercially in one country and not in another (see case of Pilatus PC12);
  - different types of aircraft registries (e.g. Belgium)

# Protection of lessors' and banks' rights

## § Issues of Private International Law:

- would the right of ownership, leasing, mortgage or pledge over the aircraft be recognised and enforced in a different jurisdiction?
- What remedies will be available?
- Lex rei sitae v. lex registry approach
- Blue Sky judgement

## § International conventions:

- 1948 Geneva Convention on the international recognition of rights in aircraft (e.g. of Belgium)
- Cape Town Convention on International Interests on Mobile Equipment (aircraft, rolling stocks, space objects)

# The Cape Town Convention

- § Scope: engines and aircraft
- § Purpose: harmonisation of rules
- § Protocols' structure: aircraft, rolling stocks and space objects
- § Convention introduces new international interest – international registry (in Ireland) and unified interim measures and enforcement measures
- § Answering needs of predictable outcome in case of seizure of aircraft in different jurisdictions
- § Current status:
  - aircraft protocol ratified by 60 states
  - acceded to by the European Union (mixed competence)
  - EU Member States: Ireland, Luxembourg, Malta, the Netherlands (Aruba, Curaçao, etc.)
- § Intergration of the Convention in the ASU for Export Credit financing
- § Rail Protocol: accession procedure blocked at EU Council level

# Rail Operators and the European Market

- § Most Member States share common track gauge and loading gauge
- § European rolling stocks are ageing
- § Need for new rolling stock for safety reasons
- § Traditionally: rail services operate within one Member State
- § Expansion of cross-border services
- § New entrants in the market (e.g. NTV)

# Old v. New – available sources of financing

## § Old situation:

- State owned rail operators
- Long term players
- Large access to government funding or government guarantees
- Good credit rating when borrowing on financial markets

## § New situation:

- New players entering the market
- Franchising and concessions – terms and duration
- Reduced availability of funds at State level

## § Available sources of financing:

- State funds / EU funds
- Eurofima loans: only available to state-owned operators
- Private loans
- Emergence of ROSCOs (Rolling Stock Leasing Companies)

## Cape Town and rolling stock financing

- § Rolling stock financing is traditionally linked to State / EU funding
- § Entry of new players leads to a need for new sources of financing
- § Private capital enter the market leading to development of leasing market
- § Banks and ROSCOs needs to rely on the value and 'liquidity' of the financed assets
- § Same international private law problems as in aircraft financing
- § Same solutions
- § Cape Town could contribute in:
  - Making private funding more appealing
  - Developing a leasing market
  - Developing a sub-leasing market

# Rail and aircraft finance: comparable markets?

## § Aircraft finance:

- Leasing is preferred option
- State funding is the exception
- Liquidity of the asset
- Very sophisticated and mature market

## § Rolling stock finance:

- State and EU funding
- Eurofima lending
- State guarantees
- New entrants lead to a need for new financing resources
- Development of a leasing market

## § New possibilities

- Making assets more 'liquid'
- Opening of new markets for subleasing and re-selling (Africa)?

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# Thank you for your attention

## Questions ?

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