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Aviation: Finance & Leasing 2022

Ireland: Trends & Developments
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Trends and Developments

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As the global hub for aircraft leasing, Ireland enjoys a wide perspective on the trends and developments in the industry. 2021 finished on a note of optimism in terms of recovery from the unprecedented market collapse during the COVID-19 pandemic. According to the IATA, the airline industry experienced a USD137 billion net loss in 2020, a USD51 billion net loss in 2021 and a further USD11 billion loss is forecast in 2022. The scale of losses and the enduring pervasive travel restrictions has led to airline bankruptcies and restructurings, rent deferrals, and government bailouts. It was hoped, however, that 2022 would start to let the light in.

However, the global aviation industry is being called on again to demonstrate its remarkable resilience. Despite additional setbacks including the ongoing war in Ukraine and zero-COVID policies in China, the industry has regrouped and pushed towards a recovery. Air travel in May 2022 was up by 83.1% compared to May 2021, driven largely by a strong rebound in international travel, attributable to pent-up demand for leisure travel following removal of COVID-19 restrictions combined with accumulated consumer savings following extended global lockdowns. Middle seats on aircraft are no longer empty and the lines at airport security checks are getting longer and longer.

The Irish aircraft lessor community continues to play a vital role in the recovery of the global aviation sector. In this article we examine some of the key trends and developments in the aviation finance and leasing sector in Ireland, and how aircraft lessors will continue to navigate a post-pandemic industry.

Mergers and Acquisitions

2021 was the year that saw the creation of an aircraft leasing giant, with AerCap Holdings' acquisition of GE Capital Aviation Services (GECAS) from General Electric. The "mega deal", which was announced in March 2021, closed in November following regulatory and antitrust clearances from multiple jurisdictions. Completion of the deal marked a significant milestone for aviation M&A and there has followed a resurgence in deals in the sector into 2022 with no signs of activity slowing.

In May 2022 came another "mega deal" with SMBC Aviation Capital publicly announcing that it had reached an agreement with NWS Holdings Limited and Chow Tai Fook Enterprises Limited to acquire Goshawk Aviation (Goshawk), the Dublin-based global aircraft lessor. Under the terms of their deal, which is being financed through a combination of debt and equity, SMBC Aviation Capital will acquire Goshawk's Irish-incorporated operating entity, together with associated corporate assets for an enterprise value of USD6.7 billion.

SMBC Aviation Capital will acquire a portfolio of 176 owned and managed aircraft as part of the transaction, which, once completed, is being heralded as creating the largest Japanese-owned aircraft lessor and the second-largest leasing company globally. Post-close, the newly enlarged SMBC entity will continue to be incorporated and headquartered in Ireland. Completion of the transaction is subject to receipt of regulatory and antitrust approvals and is expected to occur in the second half of 2022.

On 3 May 2022, Chorus Aviation Inc announced that it had completed its acquisition of Falko Regional Aircraft Limited, which has numerous Irish subsidiaries. The completion of this transaction establishes Chorus as the world's largest aircraft lessor focused solely on investing in the regional aircraft leasing space, and results in a portfolio of 348 regional aircraft, with an aggregate value of approximately USD4.5 billion, which are owned, managed, and/or operated by Chorus subsidiaries.

The close of 2021 also saw Carlyle Aviation Partners (the commercial aviation investment and servicing arm of Carlyle's USD66 billion Global Credit platform) announce that they had agreed to acquire AMCK Aviation's portfolio of aircraft. The sale represented CK Asset Holdings' strategic exit from the aircraft leasing sector. The transaction went on to complete in April 2022. The total appraised value of the fleet portfolio was in excess of USD4 billion.

The level of M&A and consolidation activity in the sector is remarkable considering that the aviation industry was one of the worst affected by the pandemic. Despite disruptions to air travel and restrictions imposed by multiple governments worldwide, deal makers have seized opportunities to acquire strategic assets that came to market in part due to the pandemic, as evidenced by the level of activity throughout 2021 and continuing into 2022.

The outlook suggests that activity will continue, particularly in the leasing space. Recent trends indicate that further acquisitions and restructurings in the sector are likely, as aircraft leasing firms follow models established by their peers in making strategic changes to their portfolios and addressing shortfalls created by COVID-19.

New Entrants

While there is consensus that more consolidation is likely, the larger scale portfolios are unlikely to be as readily available for sale. As predicted last year, the trend for new entrants to establish aircraft leasing or financing platforms continues into 2022.

Ireland has been the focal point of the aircraft leasing industry for decades, and as the current aviation market swings strongly towards leasing rather than aircraft ownership for airlines, Ireland will play an increasingly important role. The challenges facing airlines highlighted the need and importance of aircraft lessors and this balancing between airline and lessor ultimately strengthens the industry as a whole. The value placed on aircraft lessors has never been higher and this presents opportunities for well-organised and well-funded lessors to grow. In a time of uncertainty, it is wise to look to stability and a proven track record. Capital and investors continue to turn their eyes to Ireland, and it can be seen that the appetite for investment in and establishment of aircraft leasing and financing platforms remains strong.

Most of this appetite is coming from US private equity sources, but as the market reacts to current pressures we expect the industry to attract the attention of a broader set of investors. This is a market where a strategy is needed for the short, medium and long term, and certain investors thrive on a market that requires a long-term view and commitment. It is important to remember that the drivers for investment in the aircraft leasing industry are both driven by performance of the industry itself but also by its performance relative to other asset classes. The aviation industry may be under pressure from a number of factors, but it remains a solid investment and more favourable than other asset classes in uncertain times. We see investors returning to first principles and looking to understand what

they can control and what aspects are outside of their control, and how to best hedge their risks.

Interesting discussions are ongoing on a potential queue of investors seeking to establish aircraft leasing platforms in Ireland. The rumours suggest US private equity remains confident in the sector, but further Asian investment in this sector should also not be dismissed. Acquiring the right metal and team are the two key factors that will determine success. The availability of highly experienced and talented senior aviation executives in Ireland is helping new entrants hit the ground running with new platforms. The sale and leaseback market remains active and competitive, and is essential for airlines to manage their capital. In fact, one of the biggest issues currently facing lessors is securing an aircraft portfolio due to strong demand, and therefore order books of lessors and airlines are very attractive.

Alternative Lenders and the Rise in ECA Financing

Last year we saw a much-stronger-than-expected return to the ABS market for lessors. Although Carlyle launched a USD522 million ABS in June this year, the current market conditions suggest that 2022 is unlikely to be a repeat of 2021 in terms of ABS issuances. High interest rates and market volatility make it a market for the brave, although given the popularity of the ABS product, many will be preparing behind the scenes and will be ready for its return.

Aircraft still need to be financed for delivery, and therefore the current trends are:

- continued engagement with new entrant alternative lenders;
- maintaining strong relationships with existing financiers to avail of refinancing with increased facilities and extensions;

- the return of export credit agency (ECA) financing.

Many lessors have turned to the new entrant alternative lenders such as Volofin, Ashland Place, Av Airfinance or Valkyrie to meet financing requirements for their commitments. These lenders are able to react quickly and be nimble, which is appreciated by the industry. Although relatively new to the industry, the alternative lenders are quickly building up a loyal customer base and their strategy has been welcomed by many lessors.

We are seeing a rising demand for ECA financing which has not been a material feature of the industry for a number of years. In many ways, the return of ECA financing came later than some may have expected post-COVID-19, but it is likely to play an increasingly important role for the next 12 months, particularly as other government support is pulled back. Recent Ex-Im Bank approvals for KLM and Korean Air financings signalled a step towards a more active role for the bank. We are seeing similar increased activity levels for the European ECAs.

ECA financing plays a pivotal role for the aircraft industry, particularly in an industry which can be somewhat dislocated due to various crises. Aircraft values remain high, airline negotiating power for leases appears strong, aircraft financing costs are increasing, airline operating costs are soaring and the value of aircraft order books is huge – to the outsider these factors are hard to reconcile. ECA financing may offer a release valve for certain pressure points. The availability of AFIC and Balthazar-supported financings will also be valuable sources of capital.

The value of strong relationships will be realised as many will revert to existing financiers and agree refinancing and extensions where possible. For some, the current cost of financing

means that they will seek to delay financing as long as possible; however, other commentators would argue that if you need financing in the short to medium term then now is the best time as the market is unlikely to improve quickly. Those with strong trusted relationships with their lenders are engaging early to agree refinancing terms as soon as possible.

Growth in the Cargo Business

Although not immune to many of the pressures faced by commercial aviation, it is worth noting that the cargo aviation business could be described as thriving and Ireland also provides a stable base for this section of the industry. Consumer demand remains strong and the cargo aircraft conversion pipeline is highly valued. The authors expect that the aviation cargo business will play a prominent part in the positive aviation stories of 2022. This sector of the industry boasts some of the most long-standing and highly experienced talent in the industry who are well placed to maximise the opportunities that the current environment offers.

Green Aviation

The decline in the availability of finance from commercial banks coupled with increasing interest rates, soaring fuel prices and fixed rate leases are key drivers in necessitating the need for more innovative methods of securing debt, which is leading to the greening of the aviation sector.

Increasingly, financial institutions are offering green and sustainability-linked financing products to acquiesce to regulatory and public pressure to consider environmental, social and governance (ESG) issues in their investments.

Green Bonds and Green Loans require that funds are used for projects with a positive environmental impact, whereas sustainability-linked loans allow the borrower much greater flexibility

as to how loan proceeds are used; the borrower's overall corporate performance is assessed against ESG targets. The extent to which the borrower meets its sustainability targets determines the loan's pricing, an attractive opportunity for aircraft lessors and airlines.

The aviation industry has seen an increase in "green financing" over the last number of years, and January 2022 saw the first sustainability-linked aircraft-secured loan provided to an airline by Air-France-KLM and SocGen. In addition, Rockton, a Swedish regional-focused boutique aircraft asset manager, launched the industry's first sustainable aviation fund.

Although green aviation and ESG factors may have been background considerations for credit committees in the aviation sector in the past, attitudes are shifting. As the global aviation industry recovers from travel restrictions, the worsening impact of climate change has led to a sharp focus on the aviation industry's CO₂ emissions, and its future growth and sustainability. Indeed, the industry has recently committed to "net zero" carbon emissions by 2050 – a radical step in the context of current technological capabilities – and challenges the major aircraft manufacturers to deliver fundamental technological change in the coming decades.

The Irish aviation lessors acting through Aircraft Leasing Ireland (ALI) are paving the way in this area. In January 2022, ALI announced that its 31 members will collaborate and use their influence as industry leaders towards a sustainable future. They are committed to taking tangible steps to support the aviation industry achieving its net carbon emissions target by 2050.

Conclusion

While 2022 has seen a welcome increase in travel due to the success of COVID-19 vaccinations, mitigation strategies, and the subsequent

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loosening of government restrictions which have been gratefully welcomed across the aviation sector, the industry is negotiating a convergence of significant challenges in the form of sanctions imposed as a result of the war in Ukraine, soaring fuel prices, increasing interest rates and deferred aircraft orders.

When looking at the industry last year, it was hoped that 2022 would present a more straightforward trajectory of recovery – but instead new challenges were presented. The underlying market concept is solid, the underlying custom-

er demand is strong, and therefore recovery is certain – but the path to it a little unclear.

For many in the industry, the months ahead may be turbulent ones as they grapple with near-term difficulties, but others may have an opportunity for growth and expansion. As Asia slowly starts to open up to traffic again this will open the door to recovery even wider. The ability to innovate will be a key driving factor for every lessor. One guarantee is that Ireland will remain a reliable and trusted jurisdiction that will continue to support the industry in its future success.

A&L Goodbody LLP is one of Ireland's leading corporate law firms, with over 800 staff. Its Aviation & Transport Finance team is led by partners Marie O'Brien, Séamus Ó Cróinín and Maria McElhinney, along with consultant Catherine Duffy. Collectively, it has unparalleled experience when advising on Irish aircraft leasing transactions, aviation ABS deals, financing structures and sophisticated financing products (AFIC support, EETCs, Islamic financing). The firm works closely with clients in Asia, Europe,

the USA and the Middle East to start or expand their businesses through presence in Ireland, helping them navigate the Irish legal, tax and regulatory environment. With a dedicated partner-led aviation team in New York, the firm offers Irish legal support throughout the US business day. As the largest aviation team in Ireland, A&L Goodbody LLP has the experience to advise on the largest and most complex transactions with a focus on delivering client-first, solution-based Irish legal advice.

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