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Aviation Finance & Leasing 2021

Ireland
Trends & Developments

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Introduction

The aviation industry has shown remarkable resilience in the last 12 months. The recovery is taking shape and coming within reach for many, although certain areas are still feeling pain from the grounding of the global fleet due to COVID-19. Ireland is at the heart of developments in the aviation industry and has played a key role over the past 12 months. It will continue to do so, as the sophisticated ecosystem of experienced talent, advisers and friendly business environment will be vital to a successful recovery.

We predict many new developments will fall out of the current shake-up of the industry across various aspects of the market. In this article, we focus on Ireland's role in the industry, some of the financing trends for raising capital and also recent restructuring activity.

Ireland's Role in the Industry Recovery as the Global Hub of the Aircraft-Leasing Industry

Ireland's long-established role as the global hub of the aviation leasing and financing industry means that it will play a critical part in its recovery as the world begins to emerge from the COVID-19 pandemic. Many analysts continue to predict that the percentage of leased aircraft will rise to meet 50% of the global fleet. Some even see this threshold being met faster, with the option of leasing aircraft looking more attractive to airlines that continue to manage serious capital and liquidity challenges.

Stability is needed and no jurisdiction has proven more stable than Ireland in terms of operating a leasing business or structuring aircraft leasing and financing transactions. Since the birth of the industry with Tony Ryan's Guinness Peat Aviation (GPA) in Shannon in the 1970s, most of the key players in the industry are headquartered in Ireland. We have seen their operations go from strength to strength as they have evolved beyond being significant only in the aviation industry to being key corporate players in Ireland.

Investment Opportunities and Strong Investor Demand

Access to capital is a distinguishing feature for successful companies in this industry. The current crisis has really spotlighted the importance of funding. Recent trends demonstrate the strong investor confidence in aircraft as an asset class, notwithstanding the unprecedented challenges presented by the pandemic. Ireland has featured in most of this activity and in our experience, there are a number of routes for savvy investors to take.

Capital markets

There has been no better example of investor confidence in aircraft as an investment asset class as air travel recovers than the access of larger investment-grade aircraft lessors to the unsecured debt markets. The last twelve months have seen Irish aircraft lessors such as AerCap, Air Lease Corporation, Dubai Aerospace Enterprise, China Development Bank, Aircastle and others successfully issue billions of dollars in unsecured notes in the market at increasingly competitive and, at times, even historically low prices. A very recent example is that SMBC Aviation Capital, having had its grade A-rating confirmed by S&P and Fitch, has announced the issue of USD500 million unsecured seven-year notes priced at US Treasury plus 110 basis points, representing its lowest credit spread achieved in a bond issuance.

We have now also seen the return of the aircraft asset-backed securitisation (ABS) market with the successful and oversubscribed launch of the CLAS 2021-1 ABS by Castlelake in January of this year. Many aircraft lessors have viewed access to funding through the ABS market over the last decade as a crucial component to their financing strategy. The market response to CLAS was very positive. The transaction was heavily oversubscribed, prompting Castlelake almost immediately to bring a C-note issuance to the market. The CLAS 2021-1 ABS did not fundamentally alter the aircraft ABS structural model in response to the challenges faced by the pandemic. It instead demonstrated the strength of existing models by creating some new structural features and enhancing existing structural protections using the lessons that were learned in 2020. For example, it reduced the look-back period from six months to three months in the debt service coverage ratio test, providing a more responsive sweep or trapping of cash trigger in the event that incoming cashflow through aircraft lease rentals is not sufficient to meet debt requirements.

June 2021 has seen a burst of activity in the ABS market. Sky Leasing announced its USD663 million A and B secured notes issue through SLAM 2021-1 against a portfolio of 16 predominantly narrow-body aircraft valued at approximately USD885 million. That portfolio features the youngest-ever average age for aircraft ABS at 1.6 years and a weighted average lease term of 11.1 years. This was followed by the successful launch of the MAPS 2021-1 ABS by Apollo Global Management, serviced by Merx Aviation, of USD540m A, B and C notes secured against a portfolio of 20 predominantly narrow-body aircraft with two freighters subject to 12 initial leases in ten countries. As of the time of writing, Blackbird Capital II, a joint venture of Air Lease and Napier Park Global Capital, has also just priced an issue of USD745m of A and B notes secured against a portfolio of 18 aircraft (approximately two thirds narrow-body) with Air Lease and ALC Aircraft acting as servicer. Ireland plays a key role in most ABS transactions and will play a key role in the ABS market, as the jurisdiction where the issuer of the debt, the servicer and the aircraft-owning and leasing companies are located and managed.

Sale and leasebacks (SLB)

The result from the closure of air travel routes in 2020 is that normal financial metrics in airlines were disregarded and the focus became cash burn and building liquidity. Stronger credit airlines such as Southwest Airlines have been able to raise capital successfully in the unsecured debt markets while others such as United Airlines have raised funds through innovative note issues backed against loyalty programmes and IP such as its Mileage Plus programme. Lower-tier airlines with higher levels of leverage may be disadvantaged in lacking this access to capital.

The market saw a rise in SLB activity, particularly in stronger credit and higher-tier airlines which previously did not operate in this sector. Many commentators see this SLB trend continuing. As airlines look at their order books, the option to lease, rather than buy, an aircraft looks increasingly more attractive. Leasing provides airlines with the reduced capital expenditure, and balance sheet and fleet flexibility, to navigate better the uncertainty of the current crisis. Reducing carbon emissions in the sector remains a key industry goal. This, together with any potential green incentives from regulators, will likely drive airline demand for newer, more fuel-efficient aircraft. SLB transactions have the potential to provide capital-strained airlines with access to such technology by way of lease without substantial upfront capital expenditure. While lessors are now dealing with a larger SLB market, some concerns remain that increased competition will result in smaller profit margins for leasing companies.

New leasing platforms and alternative lending vehicles

The challenges of any crisis are often viewed as opportunities by investors who can partner with the right experience and talent. The aviation leasing and finance industry has seen many examples of new investment in the last twelve months in different forms.

New aircraft-leasing platform, Vmo Aircraft Leasing, launched in January 2021, backed by Ares Management with former Vx Capital Partners management team, Bob Brown, Will Hudson and Sean Sullivan. It entered the market with an initial equity capital of USD500 million to buy a diversified portfolio of commercial aircraft. Some investors have preferred to establish partnerships, joint ventures or sidecars by partnering with established aircraft lessors as a means to access the market, with different levels of more limited exposure compared to forming a new leasing platform. PIMCO and GECAS last year partnered to create a new USD3 billion aviation-leasing platform with a focus on new and young fuel-efficient aircraft and operating initially in the narrow-body market. Kennedy Lewis and Arena Aviation Capital more recently partnered to launch a new USD1.5 billion aircraft-leasing platform called KLA Aviation Finance, with a focus on young and new narrow-body aircraft.

On the financing side, the decline in levels of funding from traditional sources, such as commercial banks in the aviation market, has seen the emergence of a number of new, more flexible alternative lending vehicles to meet the demands of the market. Castlelake, partnering with Boeing, launched its Aviation Lending Programme in November 2020 with a focus on providing a variety of financing solutions to aircraft purchasers through mezzanine financing, senior secured financing and high loan-to-value (LTV) financing. More recently, KKR announced the launch of AV AirFinance, a new commercial aviation lending and servicing platform, led by former Volito Aviation CEO, Siggi Kristinsson, which has agreed to purchase an USD800 million portfolio of aviation loans from CIT Group. Volofin has also been active in addition to new entrant Valkyrie as a source of funding. The various government-supported ECA financing and other credit-supported structures have also played, and will continue to play, an important part in supporting the industry to ensure aircraft deliveries.

Mergers and acquisitions (M&A)

Many commentators are forecasting an increase in M&A and consolidation activity in the industry. The availability of funding to airlines and lessors in the unsecured capital markets, together with the substantial governmental support the industry has received across the globe, is perhaps the reason for a restraint in M&A activity to date. A number of investors may target aircraft lessors operating in the middle or lower end of the market, which may not have the support of a strong parent bank or fund backing it, or look to acquire aircraft portfolios from capital-strained airlines or lessors.

2021 has already seen the announcement of the USD30 billion merger between the world's two largest aircraft-leasing companies, AerCap and GECAS. This monumental market event could see further consolidation as competitors react to the new lessor market landscape and has potential for significant secondary market activity in portfolio and targeted business sales as the new leasing behemoth takes shape.

Aviation Restructuring

A further demonstration of the industry's resilience in the last 12 months has been its efforts to find restructuring solutions to problems posed by COVID-19. To implement those solutions and, given the central role that Ireland plays in the industry, it is unsurprising that aviation professionals have had to reacquaint themselves with Irish restructuring processes.

Prior to the pandemic, in other sectors of the economy, Ireland had established itself as a venue in which stakeholders can have confidence in the restructuring options available as well as the manner of implementation via the courts. Since Ireland made a declaration in 2017 adopting Alternative A under the Aircraft Protocol to the Cape Town Convention, the additional protections afforded to aircraft creditors in an insolvency had not come before the Irish courts. 2020 brought these provisions of the Aircraft Protocol (and their practical application) into sharp focus. Ultimately, the last 12 months have shown that those restructuring options can be effectively relied upon by the aviation industry, as it continues to grapple with the fall-out from the pandemic.

Lessor restructurings

Voyager Aviation

Voyager Aviation is an aircraft-leasing company with assets of approximately USD2 billion consisting of primarily young and modern aircraft. Voyager Aviation Holdings, LLC is a US company but the group has a significant presence in Ireland. As a consequence of the pandemic, it was anticipated that Voyager would be unable to refinance or repay balloon repayments on its 8.5% senior notes due in August 2021.

Voyager successfully restructured its senior notes through an out-of-court US exchange offer on 9 May 2021, thereby avoiding any default under the senior notes. The restructuring proposal to creditors included an option for Voyager to pivot to an in-court restructuring to implement the senior note exchange, by way of a scheme of arrangement of a dormant Irish (non-issuer) subsidiary.

A scheme of arrangement (under Part 9 of the Companies Act 2014) provides a mechanism for a company to reach agreement with its shareholders and/or creditors in relation to the restructuring of its obligations. A scheme is an effective way of overriding voting thresholds in finance documents. If 75% in value and a majority in number of creditors (in each class) vote in favour of the scheme, the scheme will become binding on all creditors, with court sanction (even if the amendments proposed would have required unanimous creditor consent under the financing documents).

While the Irish scheme of arrangement was not ultimately needed by Voyager, the threat of the Irish scheme was essential to the successful implementation of the out-of-court restructuring as it demonstrated to creditors a clear route to implementation if the requisite consent threshold for the out-of-court Exchange Offer was not reached. Voyager offered note-holders an "early bird" fee to support the amendments out of court and obtained support from 98.49% of holders of the senior notes for the out-of-court exchange offer. While it is not particularly unusual for the implementation of out-of-court restructurings to be eased by clearly communicated contingency planning, this was the first time that an Irish scheme was used to facilitate the "carrot-and-stick" implementation of a US exchange offer. Although the voting threshold needed to implement an Irish scheme (75% in value) is greater than that needed for a Chapter 11 plan (66.66%), the speed and lower costs involved in implementing through a scheme made it an attractive contingency to an out-of-court agreement.

Nordic Aviation Capital

Shortly following the outbreak of the pandemic, the world's largest regional aircraft lessor, Nordic Aviation Capital DAC, was faced with anticipated breaches of financial covenants, the subsequent triggering of acceleration events and defaults within its wider group. 65 out of the group's 75 customers had officially requested various degrees of lease concessions, extending all the way to a complete standstill in payments. This resulted in the group collecting just 23%, 20% and 34% of billed payments for April, May, and June, respectively.

Nordic sought to implement a series of arrangements with its lenders to defer the payment of principal and interest and final maturity amounts under its financing agreements and to waive any enforcement events which had already arisen or which might otherwise arise. After lengthy negotiations with principal stakeholders, Nordic successfully applied to the Irish High Court to restructure its financial position by way of a scheme of arrangement. The scheme was approved by the requisite statutory majority, before being sanctioned by the Court, thereby binding all creditors. The court process (which lasted less than six weeks) resulted in Nordic's creditors acceding to Nordic's request for a 12-month standstill of financial covenants and a deferral of approximately USD6 billion of secured and unsecured debt.

The waiver and deferral has afforded Nordic breathing space to negotiate a further more substantive restructuring with lenders - at the time of writing, these negotiations are ongoing. The means of implementation remains to be seen, but it is possible that the Irish scheme could again feature.

Nordic raised a point to the court that, for purposes of the Cape Town Convention and, in particular, the applicability of the enhanced creditor protections afforded where the primary insolvency jurisdiction has made an Alternative A declaration, Irish schemes of arrangement do not constitute insolvency proceedings or insolvency-related events. However, on the basis that no creditor of Nordic voted against the scheme, nor did any of them assert a Cape Town Convention protection, the Irish Court exercised judicial restraint and elected not to make any determination on the question.

Airline restructurings – Norwegian Air and CityJet

Whereas schemes of arrangement provide a useful means of restructuring financial obligations, examinership is a more attractive option where an operational as well as a financial restructuring is required, all within a prompt timeframe. In addition, examinership requires a lower support threshold of 50% in value and number of creditors in one impaired class only. The examinerships of Norwegian Air Group and CityJet are good examples of where the process was used to implement deep operational restructurings with significant fleet reductions.

Norwegian Air Group's revenue in the third quarter of 2020 was down by 91% as against 2019, with passenger numbers falling by approximately 78% year-on-year compared to 2019. Compounding this was the Norwegian government's decision in November 2020 to withdraw financial support to the group, leading to an examinership filing in Ireland of a number of companies in the group, as well as the Oslo-based parent company of the group, Norwegian Air Shuttle ASA (NAS).

With the examiner's scheme becoming effective on 26 May 2021, the "New Norwegian" sees a significant scaling back on its operations and material changes to its capital structure, including:

- a shift in focus to the Nordics market;
- discontinuation of the group's long haul operations;
- a reduction in its fleet from 140 to circa 50 aircraft (now using just narrow-bodied aircraft 787-800s);
- new power-by-the-hour lease arrangements until March 2022;
- a reduction in headcount to circa 2,800;
- a cutting of aircraft debt by circa 85% resulting in total debt across of the group of less than NK20b (circa EUR2 billion).

The Irish High Court exercised its discretion to accede to the companies' request to repudiate a wide range of contracts, including:

- operational contracts relating to ground-handling and fuel line services;
- head leases with aircraft lessors and associated sub-leases;
- guarantees given by NAS or Arctic Aviation Assets DAC relating to the obligations of operating companies within the group in favour of lessors or other finance parties.

While various counterparties objected, the Court ultimately concluded that termination of the contracts was necessary to allow the examiner to formulate schemes of arrangement to facilitate the survival of the group.

Earlier in 2020, a slimmed-down CityJet also successfully emerged from examinership on a solid financial footing. Entering the process, CityJet had debts of EUR500 million and a net deficit of liabilities over assets on a going-concern basis of EUR186 million. CityJet emerged:

- with a fleet reduced from 32 to 17;
- a cut in overall staff numbers across its international business from 1,175 to 370;
- a debt write-off of circa EUR500 million.

In both the Norwegian Group and CityJet examinerships, there was no argument that those proceedings did not constitute insolvency proceedings for purposes of the Cape Town Convention, so the enhanced protections afforded by the Aircraft Protocol applied to aircraft creditors. However, in reality, the prevailing market conditions meant that aircraft lessors were not incentivised to push for a quick return of their aircraft.

Conclusion

Despite a resumption in the flow of revenues, we are likely to see further restructuring activity in the sector as stakeholders seek to repair the damage to capital structures as a result of the pandemic. However, unlike in the 2008 financial crisis, although cash is tight for airlines, liquidity and appetite for investment is strong at the investor level and this will fuel a strong recovery. The industry has attracted new players, new structures and new business modelling in response to the crisis. The distress experienced across the sector will drive innovation as everyone tries to position themselves on the upward curve of recovery.

A&L Goodbody LLP is one of Ireland's leading corporate law firms, with over 800 staff. The firm's aviation and transport finance team is led by partners Marie O'Brien, Séamus Ó Cróinín, David Berkery and Maria McElhinney, along with consultant Catherine Duffy. Collectively, the team 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 team works closely with clients in Asia, Europe, the USA and the Middle East to start or expand their business through a 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 USA business day. As the largest in Ireland, the aviation team 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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