

Chambers

GLOBAL PRACTICE GUIDE

Definitive global law guides offering
comparative analysis from top-ranked lawyers

Aviation Finance & Leasing

Ireland: Trends & Developments
Marie O'Brien and David Berkery
A&L Goodbody (ALG)

[chambers.com](https://www.chambers.com)

2020

Trends and Developments

Contributed by:

Marie O'Brien and David Berkery

A&L Goodbody (ALG) see p.6

Introduction

Prospects have moved rapidly this year for the aviation industry. In January, the industry marked a decade of growth, noted record levels of profitability and predicted a potential slow downturn. By March, the industry faced its biggest crisis yet as much of the global fleet was grounded due to COVID-19. This article will take a look at some of the key trends and developments in the aviation finance and leasing industry in Ireland and how they may shape its future.

Trend Towards Substance

Ireland has been the centre of the global aircraft leasing industry for many decades and this position has strengthened in recent years as the aircraft leasing community trends towards increased substance in Ireland. This increased substance can be seen in a number of ways including:

- a significant increase in the number of senior and highly experienced aviation executives based in Ireland;
- Irish companies holding the ownership interest in the aircraft rather than just acting as an intermediate lessee; and
- lessors establishing full operations in Ireland with increased employees across a range of functions being located in Ireland.

All of this translates to the heart and soul of the industry now being based in Ireland.

Talent

Access to talent is a key part of Ireland's attractiveness as a location for an aircraft leasing base. Those who are ambitious about their career in aviation finance and leasing see Ireland as the place to be in order to realise that goal. Forward thinking industry leaders have invested significant time and effort into ensuring that we have a strong talent pool of new generation aircraft leasing professionals.

Key to this has been the development of innovative, industry-relevant undergraduate, post-graduate and professional training courses in Ireland. The aviation industry is in vogue and the brightest minds know of the outstanding career opportunities that it can offer people from across a range of disciplines.

Tax developments

The move to substance in Ireland is in line with recent global tax developments which require a substance threshold to be

met in order for companies to enjoy certain tax benefits. The Irish 12.5% corporate tax rate enjoyed by companies trading in Ireland is attractive for leasing companies but the key driver for Ireland's success from a tax perspective is its extensive and unparalleled double tax treaty network. An increasing number of lessee jurisdictions have insisted on proof of substance in Ireland as part of their analysis around the availability of benefits under double tax treaties.

This has become easier to satisfy as the industry has moved away from the previous lease in and lease out structures and the Irish companies own the aircraft and the lease revenues. The OECD's Base Erosion and Profit Shifting (BEPS) project focuses on aligning profits with substance and, thankfully, this is the direction the industry has moved in recent years in terms of the leasing companies established in Ireland as they responded to various indicators suggesting that substance in Ireland brings many benefits and solves many potential issues.

Aircraft leasing eco-system

The developed and supportive eco-system for aircraft leasing companies in Ireland makes the decision to base an aviation company in Ireland an easy and logical one. As the leasing companies have grown in strength and substance in Ireland they are increasingly being recognised outside the aviation industry as key corporate players in Ireland. This has been seen in terms of the expansion of their needs for legal services growing from asset finance advice to employment, property, corporate, governance and regulatory advice.

The directors on the boards of these Irish companies who manage and control the companies in Ireland have roles of increasing importance to ensure the companies are compliant with recent developments in anti-money laundering, data protection and other laws now impacting on aircraft leasing companies. They will need to respond to the drive towards meeting ESG (Environmental, Social and Governance) principles as investors become more demanding on these standards. The law around the duties of a director of an Irish company came into sharp focus in recent months as Irish boards had to consider a flood of lease deferral requests and navigate a solution that protected the solvency of the company as they considered the obligations of the company as borrower under its debt facilities.

Although there was delay of a few months in timing from when the rent deferrals were being requested, we are now seeing debt

TRENDS AND DEVELOPMENTS IRELAND

Contributed by: Marie O'Brien and David Berkery, A&L Goodbody (ALG)

restructuring discussions gather pace and lenders and borrowers try to work together to allow lessors weather this storm. Companies and their directors are being faced with challenges and legal questions they have never had to consider previously. The cross border nature of the industry adds a further layer of complexity to deciding the best strategy in terms of understanding the impact of the various different laws.

The maturity and significance of the aircraft leasing companies in Ireland now compared to a decade ago during the global financial crisis is marked and means they will play a greater role in shaping the recovery.

ABS Developments

Pre-COVID-19

2020 had been on track for another record-setting year for aircraft asset backed securitisation (ABS) deals. The first eight weeks of the year saw five ABS deals come to market, AASET 2020-1 (Carlyle Aviation Management), Sapphire II (Avolon), Lunar 2020-1 (DVB/Sculptor Asset Management), WEST V (Willis Lease Finance Corp) and Sunbird Engine Finance 2020-1 (Total Engine Asset Management). Ireland plays a key role in most ABS transactions and is the jurisdiction where the issuer of the debt, the servicer and the aircraft owning and leasing companies are located and managed.

However, as soon as travel routes were restricted and airlines were partly grounded by COVID-19, it became clear that liquidity was going to be a big issue for airlines and by extension leasing companies arising out of the pandemic.

During the peak of COVID-19

March and April 2020 saw a huge number of rent deferral requests from airlines who had seen passenger numbers and ticket bookings plummet and who understandably sought breathing space and forbearance from their lessors. A combination of strong customer relationships, an understanding that this was a crisis like no other the aviation industry had seen and, frankly, a lack of remarketing alternatives saw lessors largely go along with these requests and share some of the pain of the airlines.

Cash flows

As aircraft lease cash flows stuttered and stalled there was an immediate focus on the financial product in our industry which probably relies on steady lease cash flows more than any other – the ABS. With an estimated 80% of the world's airlines seeking rent deferrals, how could a special purpose issuer continue to make its contractual debt payments or were we about to see a series of defaults on ABS notes? In a number of cases, reduced debt service coverage ratios triggered the sweeping or trapping of cash (to the extent that it was available) and rating agencies

moved to either downgrade notes or place them on negative watch.

However, no aviation ABS notes actually defaulted. While the pandemic certainly put pressure on ABS structures, the availability of a revolving liquidity facility (sized at an amount equal to nine months' worth of interest on the senior notes) meant that even if none of the leases in the portfolio were performing, there would be sufficient cash available to the issuer to meet its senior interest obligations (and therefore avoid any default on the notes) until early 2021.

ABS portfolios

In reality, no ABS portfolio suffered a 100% reduction in lease income and even into March and April 2020 some ABS portfolios were collecting up to 50% of expected lease rentals. As the first liquidity facility drawdowns began, it was clear that most existing ABS deals would be able to stave off a default for at least 12-15 months and all indicators pointed to a return to some degree of normality in the industry by then.

The secondary trading of ABS notes has been quite telling. Newer investors in the industry were quick to sell their positions at distressed prices while more experienced industry participants tended to either retain their existing notes or even buy additional ABS debt such as has been their confidence in the market.

Nonetheless, it is as clear that there will be no market for new aviation ABS issuances in the short term (even if you could find a portfolio of aircraft with current leases attached). It is likely that we will not see any more aviation ABS deals coming to market in 2020 and those deals (hopefully) coming to market in 2021 are likely to raise debt only and not issue equity notes.

Post-COVID-19

The first problem centres around liquidity, nine months' of senior interest may have seemed like more than enough to handle regular, cyclical airline defaults; global recessions like that seen in the aftermath of the 2008 credit crisis and even industry-specific shocks like that resulting from 9/11 or even SARS, we are now in a world where pandemic risk will be a real factor in all future investments in our industry for some time.

This is likely to result in structural changes to future ABS deals designed to increase the available liquidity of the issuer vehicle. In addition to the traditional liquidity facility covering senior interest and sized at nine months' worth of senior interest (although that size may increase), there may be a second, subordinated liquidity facility, which would be much larger in size and which would cover not just senior interest but scheduled principal for a certain period also. The question would arise as to who could provide such a facility and at what cost.

IRELAND TRENDS AND DEVELOPMENTS

Contributed by: Marie O'Brien and David Berkery, A&L Goodbody (ALG)

One solution may be for the leasing company sponsoring the transaction to itself act in this role. We have seen this type of subordinated sponsor credit support used outside of aviation in structured finance deals and it may offer a potential solution to restart the aviation ABS market also.

The use of the ABS product as a source of low-cost financing is extremely important to the aviation leasing industry. Although the current crisis makes new issuances temporarily impossible, industry minds are already at work to find solutions to address concerns about issuer liquidity and other risks for investors to facilitate the return of the ABS product or perhaps even a new improved version of it.

Going Digital

The relative success or failure of many industries during the COVID-19 crisis centred on the ability to continue some degree of “business as usual” during the pandemic. Those areas which embraced working from home, Zoom meetings and electronic transactions were always going to feel the impact of COVID-19 less than those areas which needed face-to-face contact in order to continue.

GATS

The launch of the Aviation Working Group’s Global Aircraft Trading System (GATS) on 1 June 2020 was very timely. The wholly-electronic platform allows participants to buy, sell and secure economic ownership of aircraft from the safety and security of their laptop and minimises the negotiation involved in completing aircraft trades.

GATS is based on a central concept that all aircraft on the platform are held in trusts (governed by the laws of Ireland, Singapore, Delaware or Utah) and economic ownership is transferred through the assignment of the beneficial interest in the trust rather than conveying legal title (which would remain with the trustee of the trust). This means that the existing lease chain between the trustee (acting as lessor) and the airline (acting as lessee) remains unaffected by the transfer.

Using GATS

GATS uses fixed form instruments to affect transactions and only factual information (such as party names, details of aircraft equipment and dates) varies from deal to deal. Schedules to the standard form documents will be populated with such factual information automatically by the platform to reflect responses provided by the user to a series of prompts. Once the GATS instruments have been fully populated, each party is sent a copy and asked to execute the instrument.

The GATS platform uses digital signatures and electronic delivery so no “wet ink” signatures should be required. Once a trans-

action has been completed through the platform, high-level, non-sensitive information is recorded on a searchable electronic ledger to provide enhanced transparency of aircraft ownership.

Until recently, the aviation leasing and financing industry had been slow to embrace technology for trading of aircraft and aircraft transfers had used the same inefficient processes and procedures as those used in the 1990s. GATS is an enormous leap forward in the industry’s move towards digital solutions and will significantly increase the efficiency of aircraft transfers during and beyond the COVID-19 crisis.

Climate Action Targets

Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) is the global offsetting CO2 emissions scheme adopted in October 2016 by the International Civil Aviation Organization (ICAO) which will require aircraft operators to buy and surrender emission units representing CO2 emission reductions generated by non-aviation projects in other sectors.

CORSIA sets a baseline emissions level and airlines will be required to buy and surrender emission units to offset their share of any increase in CO2 emissions from the baseline emissions of the international aviation sector.

The baseline level to be used is to be calculated as the average of CO2 emissions from routes covered by the scheme for the years 2019 and 2020.

COVID-19 and CORSIA

As the current CORSIA provisions call for 2020 emissions (along with 2019 emissions) to be used in determining the baseline for CORSIA an unforeseen consequence has resulted from the impact of COVID-19 on air travel. The reduction in flight traffic and emissions as a result of the pandemic will significantly lower the baseline to be used going forward compared to what was projected as a basis for adopting CORSIA. This will result in significantly higher offsetting requirements (estimated to be approximately 30% more stringent) when air traffic levels return to previous levels.

The greater the offsetting requirements, the higher the costs for the airlines and this could increase the risk of non-payment. The potential results of that could be that liens would be placed on the aircraft by the relevant monitoring authority.

CORSIA does not revise the baseline each year so the levels set for 2019/2020 would continue to apply for years to come likely setting an impossible standard for airlines to reach.

TRENDS AND DEVELOPMENTS IRELAND

Contributed by: Marie O'Brien and David Berkery, A&L Goodbody (ALG)

ICAO

Airlines have been petitioning ICAO to calculate the baseline using 2019 emissions levels only (disregarding 2020 levels) but have faced significant opposition from an assembly of non-governmental organisations led by the Environmental Defence Fund.

There is no doubt that the majority of participants in aviation are committed to a greener industry but it remains to be seen whether the artificially low emissions baseline resulting from travel restrictions arising from COVID-19 will apply going forward (likely at significant cost to airlines) or will the baseline be adjusted by ICAO in spite of the objections from climate activists.

Market Trends

Ireland's role as a hub of aircraft leasing provides a wide lens as to trends generally in the market as so many deals flow through Ireland in some form. The direction the market was predicted to take in January of this year has been seriously distorted by the COVID-19 crisis. The current wave of rent deferrals, lease extensions and debt restructurings are expected to give way to a wave of lessor consolidation through corporate acquisition or joint venture activity, larger solvent and insolvent restructurings and sale and leaseback transactions.

The sale and leaseback transactions have already started and will become a feature of the landscape for at least the remainder of this year. The move towards sale and leaseback transactions and the lack of liquidity in certain pockets is likely to drive an increase in airlines leasing rather than owning aircraft. Such a model will provide airlines with greater flexibility and assist with their cash flow issues. Ireland will play a key role in these transactions as it holds approximately 65% of the leasing market.

Acquisitions and joint ventures

The acquisitions/joint venture activity is still mainly at discussion stage as investors wait for some volatility to leave the market and asset values to be recalibrated. There is still confidence in the market with many expecting that the demand for flying will return. Liquidity is available for investment and the deep experience required is there to manage the industry through this, so the medium to long term prospects for the industry are positive.

New investors are actively looking to enter the market and experienced investors will realise the long-term value being created and the opportunity it represents. The timeline for when such investments are likely through consolidations and restructurings will take place is not certain but is likely to kick off to some degree in the last quarter of the year. Experience, liquidity and agility will be key factors in determining which companies will survive this crisis and indeed which ones will thrive.

Conclusion

We have only been able to touch on some of the trends and developments in the industry and there are many more which may impact the future recovery of the industry greatly such as Brexit, political upheavals and trade wars. Many of the trends and developments currently at play in the market did not arise because of COVID-19 but were accelerated or highlighted in recent months. There are green shoots of a recovery now being seen and the industry is holding its breath that a second wave will not break out to damage this.

It is likely that there are some seriously bumpy months ahead for the industry but resilience and the ability to innovate has never been in short supply in the aircraft leasing world and these qualities will be essential again to move the industry forward. One thing that is guaranteed is that Ireland as a stable and reliable jurisdiction will continue to support the industry and remain centre stage for its recovery and future success.

IRELAND TRENDS AND DEVELOPMENTS

Contributed by: Marie O'Brien and David Berkery, A&L Goodbody (ALG)

A&L Goodbody (ALG) is one of Ireland's leading Irish corporate law firms, with over 800 staff. The six-partner aviation and transport finance team has extensive experience when it comes to advice on Irish aircraft leasing transactions, ABSs, financing structures and sophisticated and innovative financing products (AFIC-support, EETCs, Islamic financing). The team works with clients in Asia, the United States and the Middle East looking to start or expand their business through a pres-

ence in Ireland and has helped them navigate the Irish legal, tax and regulatory environment. With a dedicated partner-led aviation team in New York, the firm can offer Irish legal support throughout the US business day. Furthermore, as one of the largest aviation teams in Ireland, the firm has the experience and bandwidth to advise on the largest and most complex transactions and place a focus on delivering client-first, solution-based Irish legal advice.

Authors



Marie O'Brien is a partner in A&L Goodbody's finance department, and head of aviation and transport finance. Marie is highly experienced in advising in relation to the acquisition, leasing, financing and trading of a variety of asset classes including aircraft, engines, helicopters,

ship, rail, machinery and equipment. Marie advises lenders, lessors and investors in relation to the establishment and growth of aircraft leasing platforms in Ireland. Marie is also head of A&L Goodbody's Chinese lawyer's placement programme and China business group.



David Berkery is a partner in A&L Goodbody's finance department, specialising in aviation and transportation finance. David has over 14 years' experience working in Dublin, London and New York. He spent six years based in the USA, advising many of the world's

leading financial institutions, airlines, aircraft lessors, investment banks and private investors on all aspects of the acquisition, leasing, financing and trading of aircraft, vessels and rolling stock. David has a particular focus on asset-backed securitisations (ABSs), private placements, Enhanced Equipment Trust Certificate (EETC) offerings, secured and unsecured lending, portfolio sales and industry-specific joint ventures, mergers and acquisitions.

A&L Goodbody (ALG)

International Financial Services Centre
North Wall Quay
Dublin 1
D01H104
Ireland

Tel: +353 1 649 2000
Web: www.algoodbody.com

A&L Goodbody