

# THE LIFT-OFF

Yves Germeaux, Head of Aviation Finance at ATOZ Luxembourg, says aircraft financing requires focused expertise to optimize costs. Interview.



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## Why does aircraft financing require such specific expertise?

Aircraft are high-value assets as purchase prices are very often above USD 150 million. Optimizing the financing cost is therefore of key importance, a few basis points more or less in the overall interest rate having a significant impact on the company's bottom-line result.

This explains why aircraft financings often consist in a series of different debt tranches. Some of them make use of the capital markets and may even reach out to small, private investors. Structures may include tax optimization elements that are available for certain types of investments in a number of countries. And, most importantly, one has to connect the right investor category to a given asset. Not only does aircraft financing relate to new or used aircraft, it also covers engines and even advance payments to manufacturers. The security package offered to lenders usually plays a major role in a financing negotiation. By the

way, aircraft are, together with ships, the only movable assets which can be mortgaged. An international treaty, the Cape Town Convention, ratified by Luxembourg in 2008, has created global standards for registering security interests in aircraft and facilitates the repossession in case of a default. Luxembourg ratified the Convention in 2008. However, regardless of what financing structure is used, having the financing in place when the asset gets delivered is absolutely crucial as any delay in delivery due to the financing would generate a high cost to the airline.

## What is the role of ATOZ?

Some airlines have quite a strong expertise when it comes to aircraft financing and they have specific teams in charge of it. But even those airlines are always in search of new ideas. Others have decided to outsource this activity or they simply do not have the experience in this matter while having ordered a large number of new aircraft. ATOZ helps

them take care of reaching out to the right parties, making recommendations for structures, performing the modeling and analysis work, comparing leasing versus ownership alternatives, negotiating term sheets and the documentation, and proposing alternatives in case of bottlenecks. The role of ATOZ though is not limited to the financing. We also advise clients on aircraft purchases, on strategic projects such as M&A transactions or business planning activities, as well as on risk management strategies in order to mitigate the client's foreign exchange, interest rate or fuel price exposures. One of our strengths is to have a team with a strong airline background and which understands well what an airline requires. Currently 25,000 commercial aircraft are in service, 17,000 additional ones are on order. In 2018, Airbus and Boeing will deliver aircraft for a total value of about USD 150 billion. This means that there is quite a lot of demand for financing in our sector.

## What are key aspects one has to focus on in aircraft financing?

Often people only think about the price, i.e. the margin, when comparing financing structures. But there is much more to it. As already mentioned earlier, one question an airline needs to ask itself is: what are the chances that the financing will actually be available when the aircraft gets delivered? Some financing structures indeed present quite high closing risks that either one needs to be aware of or one should maybe not accept.

Other key questions when it comes to financing high-value assets such as aircraft are:

- How much cash is the airline willing or able to put into the investment? If cash is an issue, an operating lease structure may be the preferred solution.
- What about the term and the payment profile? Should it be a 5-year or a 12-year financing?
- Does the airline want to reduce or eliminate the residual value risk of the aircraft? There again, an operating lease takes care of this risk although it generally comes at a price. As an alternative, the airline may also purchase residual value guarantees in the market.
- What level of transaction costs is one to expect? Some structures may generate the lowest margin but they may be so complex to document, that legal fees and other structuring fees may skyrocket.
- In the presence of a tax structure, are there any risks that the tax advantage may be challenged over time by tax authorities?

The above questions illustrate well, I believe, that the best financing is not necessarily the one showing the cheapest margin.

## Why do you do this activity out of Luxembourg?

The aviation market being a worldwide market, the location of an advisory team is not very important. The key reason for us being established here is that the current team members are originally from Luxembourg. But Luxembourg does also have a number of very positive features for our business. It is very centrally located in Europe, and European banks and investors still play a key role in aviation financing, despite the fact that there is an increasing number of Asian banks and lessors active in this business. There is a potential to develop certain aviation products and investment vehicles in Luxembourg, as some of these products already exist but have never or very rarely been set up in the context of an aircraft financing structure. Finally, one should not forget the local players, and there are a number of them beside the traditional commercial airlines, Cargolux and Luxair. —