Investing in Aviation: Fund Structures

writes Donna Ager, Jonathon Meloy, Edward Rhind and James Kinsley of the Maples Group's Global Aviation Practice

The commercial lending market for aviation has changed dramatically since the start of 2020, resulting in a precipitous drop in general appetite in the commercial lending sector for aviation, with many lenders exiting the market. The banks that remain open for new aviation business are trying to adapt to a new environment where it is difficult to value their existing books, and volatility as well as future uncertainty makes it difficult to price new transactions. Even with recent market optimism surrounding the successful rollout of vaccines, air travel, especially among the business community, has been slow to return. In addition, the commercial lending market in 2021 continues to be highly selective on which deals to support. Decisions are generally "…dependent on the institutions involved, what they have in their books and what they're battling through at this time."

As always, however, the aviation finance sector remains highly resilient. Although the role of traditional banking financial institutions may have reduced for the time being, this creates significant opportunities for alternative providers of finance. Presently, money from private equity investors is playing a leading role in closing the funding gap. Aviation is not a new asset class for the private equity industry, and many of the larger private equity firms already hold strategic investments in the aircraft leasing space, as well as interests in privately owned and state owned airlines. However, more recently we have seen a number of private equity firms not only investing in successful leasing companies but also establishing their own leasing platforms, or buying entire leasing companies. Some examples include Bain Capital's partnership with Griffin Global Asset Management; Kennedy Lewis Investment Management and Arena Aviation launching KLA Aviation; Ares Management launching Vmo Aircraft Leasing; and Carlyle (having previously acquired Apollo Aviation) purchasing Fly Leasing.

From an investor perspective, as well as yielding potentially higher returns, private equity funding is attractive because it is flexible and can be readily tailored to bespoke situations. Transaction timings are dynamic, and can be executed on timetables that would be very challenging in the traditional banking market.

In this article, we explore investment fund-based aircraft financing solutions and consider why these structures are proving so attractive.

THE CAYMAN ISLANDS FUND APPROACH

The Cayman Islands is a pre-eminent investment funds jurisdiction. This, coupled with its status as a key jurisdiction for aviation financing, makes an ideal location for establishing aviation-focused private equity platforms. Private equity aviation fund based platforms commonly use Cayman Islands vehicles at the 'upstream' investor-facing fund level, with a combination of Cayman Islands special purpose vehicles ("Cayman SPVs") (some of which are Irish tax resident) and Irish Section 110 companies at the 'downstream' business end. Often, Cayman SPVs are also the preferred choice for bilateral loan transactions entered into by the fund platform, with either Irish tax resident Cayman SPVs and / or Irish Section110 companies utilised where the fund platform engages in sale and leaseback transactions.

There are a number of compelling reasons for the popularity of Cayman Islands funds vehicles and SPVs. The Cayman Islands has long been a leading domicile for globally managed private equity and other investment funds, due to its tax-neutral status, flexible structuring options, established and experienced financial services sector and professional service providers. Entity options for structuring investment funds include limited partnerships (typically the vehicle of choice for private equity funds), corporates, trusts and limited liability companies (often chosen for general partner and / or management vehicles). The Cayman funds vehicle can therefore be tailored to match, and business terms aligned with, any US or other non-Cayman funds in the structure, and sponsors, managers, and investors in all principal jurisdictions are familiar with the product.

On the Cayman SPV side, an additional attraction is the ongoing statutory requirements under Cayman Islands law. These are simple and cost-effective, and generally can be carried out outside of the Cayman Islands. This allows Cayman SPVs to, among other things:

- Benefit, as noted above, from tax neutrality: neither the Cayman SPV (or Cayman fund), nor its investors, are subject to Cayman Islands tax, and the vehicles may be eligible to 'check the box' for US federal tax purposes;
- Be structured so as to assume Irish tax residency, therefore benefiting from Ireland's double tax treaty network for sale and leaseback transactions;
- Take advantage of creditor friendly insolvency regimes including express agreement for the recognition of 'non-petition' covenants to prevent a bankruptcy remote SPV being put into liquidation by an aggrieved party, as well as express recognition of the ability of a secured party to enforce their security interest outside of any liquidation and no form of bankruptcy moratorium or stay on enforcement of a security interest;
- Dispense with annual shareholder meetings and the need for directors or officers to be resident in or meet in the Cayman Islands (save where economic substance considerations may apply). The Maples Group provides fiduciary services to the extent that local independent directors may be required;
- Maintain the share or other investor registers and minute books outside of the Cayman Islands (only the registered office and certain other registers need to be maintained in the Cayman Islands – these services can also be undertaken by the Maples Group);
- Appoint auditors located anywhere in the world and adopt IFRS, US GAAP or any other appropriate accounting standard;
- Use share premiums to fund dividends, share repurchases and share redemptions; and
- Migrate out of the Cayman Islands into any other jurisdiction that allows migration inwards; or merge with another Cayman Islands company or a company from any other jurisdiction that allows mergers, without needing to be the surviving entity.

The Cayman Islands has been affirmed by the European Union to be a fully cooperative jurisdiction for tax purposes, which recognises Cayman's commitment to implementing international tax transparency standards.

THE IRISH FUND APPROACH

Irish collective asset-management vehicles, commonly referred to as "ICAVs", are also frequently employed in aviation fund structures. The ICAV is a corporate legal entity specifically designed for investment funds, which is authorised and regulated by the Central Bank of Ireland and offers a number of attractive features as a fund-raising vehicle, including:

- Brand recognition: the ICAV has become the default option in the Irish investment funds market and is familiar to many institutional investors as a robustly regulated investment product, subject to independent depositary oversight and a number of investor protection mechanisms;
- Distribution and marketing scope: an ICAV can be structured to avail of the AIFMD marketing 'passport', by which it may be distributed to professional investors across the European Economic Area without the need for additional local Member State approvals;
- Structuring flexibility: an ICAV authorised in this manner is not subject to any legal or regulatory limits

on liquidity, asset diversification, leverage etc. Provided that the terms of investment are clearly disclosed in the offering documents, there is significant flexibility in how to structure the investment terms;

- Tax neutrality: neither the ICAV nor non-Irish investors in an ICAV are subject to Irish tax, rendering it a tax-efficient vehicle for pooling investment. In addition, an ICAV is eligible to 'check the box' for US federal tax purposes; and
- Cost and operational economies of scale: most ICAVs are structured as umbrella platforms comprising separate legally ring-fenced sub-funds holding different portfolios of assets. In the aviation space, this facilitates sponsors to house each asset in a segregated sub-fund, potentially with different financing counterparties, and to offer investors exposure to various combinations of underlying assets.


Donna Ager, Asset Finance Partner and European head of Aviation


Jonathon Meloy, Partner and co-head of the Asset Finance practice in the Cayman Islands


Edward Rhind, Associate


James Kinsley, Partner

AIRCRAFT LEASING PLATFORMS

Today, Ireland is recognised as the global hub for aircraft leasing. The leasing of aircraft from Ireland is often a requirement of an airline, as the parties benefit from Ireland's extensive international double tax treaty network, which operates to reduce withholding on lease payments, often to zero.

Whether investing through one or more Cayman Islands funds or ICAVs, the structure to create an aircraft leasing platform is essentially the same. Typically, this will involve, below the 'fund' level: (i) a holding company, which is often Irish-incorporated, or Cayman-incorporated / Irish tax resident (the "Holdco"); and (ii) a direct subsidiary of the Holdco (which may be a pass through entity for tax or holding purposes) (the "Subco").

The Subco or the Holdco (where there is no Subco) will hold a number of Irish or Cayman-incorporated / Irish tax resident SPVs (each an "AOE"), which will hold title to the underlying aircraft and lease the aircraft to airline operators.

The movement of monies from the fund level to the Holdco and, in turn, the Subco (where applicable) has traditionally been implemented through profit participating notes, save where trading companies are employed. With the changing tax landscape, however, we are seeing greater use of investor or shareholder loans (which ware subordinated where there is external debt) and pure equity capital contributions or E notes as a means to move funds through the structure. Increasingly, these funding instruments are listed on a recognised stock exchange, such as the Cayman Islands or Irish Stock Exchange. The Holdco or Subco (where utilised) will deploy the capital which has been transferred to it from investor moneys consolidated at the Holdco and Subco may then be strategically deployed to the AOEs. Investor moneys consolidated at the Holdco and Subco (where utilities) may then be strategically deployed to the AOEs. The AOEs will utilise these funds to procure the aircraft and then directly or indirectly (depending of the operator's jurisdiction) lease the aircraft to the airline(s).

Fund structures of the type described above can be the base for developing a fully-fledged leasing company, or alternatively as a means of investing in aviation assets to create a portfolio which is then sold or refinanced, often in the capital markets.

CONCLUSION

Despite the unprecedented challenges which the aviation sector has faced as a result of COVID-19, interest in the aviation asset class remains robust, demonstrating confidence that the market will return to pre-pandemic levels as travel restrictions ease and consumer confidence grows. Fund based structures present an efficient means for those wishing to invest in the space, combined with potentially attractive returns on capital invested.

The Maples Group global Aviation team are experts in the structuring and establishment of these funds and related platforms and are uniquely placed to offer legal, tax advisory, fund administration and entity management services to see the deal through its life cycle. If you are interested in finding out more about how these structures might be employed to benefit your business, please contact us at aviation@maples.com or email your usual Maples Group contact.