

CORONAVIRUS AND THE IMPACT ON AIRCRAFT LESSORS

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As the novel coronavirus travels across the continents and becomes ubiquitous, the world and industry is contending with a global crisis. Within the aviation sector, a severely-reduced appetite for travel within the business and leisure sectors, government-enforced lockdowns, collapsed airlines, Moody's downgrade of airlines to "negative" (while reducing the rating for the leasing sector itself from "positive" to "stable") and the reduced capacity are just a handful of factors which are disconcerting for industry participants and stakeholders.

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While there are some early indications that the number of new cases of coronavirus in the People's Republic of China is being brought under control, the same cannot be said for Europe, the United States of America and other parts of the world. As the turbulence the aviation industry faces remains indeterminate and airline share prices are suffering greater hits than that which occurred at a similar point during the SARS crisis, it is indeed hoped that it will be the case of fight and flight. Accordingly, we consider the implications of the present crisis for aircraft lessors and reflect on how lessors can effectively manage the risks.

RESTRUCTURING OF PAYMENT OBLIGATIONS

As airline activity continues to decline, lessors will be rightly concerned about immediate cashflow issues for, and potential long-term impact on, their sector customers. It is not unexpected that some Asian and European airlines have been seeking approvals from their lessors for rental payments to be waived, restructured or deferred for a certain period, even though such payment obligations should be absolute under the terms of the lease agreement and not subject to any force majeure provisions. Lessors may be concerned as they will have stringent payment obligations under their financing arrangements and will want to avoid default and cross-default mechanisms being triggered. Lessors are nevertheless amenable to sensitively managing the relationships with their loyal airline customers. As such, they may selectively renegotiate an airline's payment obligations at this time – and for a strictly defined period – so long as they too have the rights to do so, and so long as they have the cash reserves to honour their own obligations under their financing arrangements. In any such renegotiations, lessors may cogitate on their wider commercial relationships with their customers and whether the airline is able to offer any future benefits to the lessor in order to reach a deal.

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While airlines will be exerting pressure for new payment terms to be agreed promptly for planning purposes, lessors should be cognisant that any changes to the airline's payment obligations are properly documented such that lessors fully protect their own rights and interests. Watson Farley & Williams can assist lessors with this process. Moreover, lessors should check the terms of their financing arrangements (if any) at the earliest opportunity to establish if there is any requirement to notify and/or seek consent from the facility agent vis-à-vis any changes to an airline's payment obligations. Notifying any facility agent promptly will give the facility agent time to consult the lender(s) and security agent behind the scenes and deliberate the risks. In any case, lessors negotiating new financing arrangements may consider requesting provisions requiring the relevant finance parties to give consent, acting reasonably and without unreasonable delay, to any material changes to leases constituted by a change to the airline's operations. Lessors might also call for deemed consent provisions to be included in financing documents in certain circumstances.

Lessors should also be reminded when negotiating new lease agreements to petition for the risk allocation to be balanced in their favour such that there are net lease provisions compelling airlines to fulfil their obligations without set-off, counterclaim, deduction, etc., and irrespective of market conditions or the cessation of operations. In safeguarding their interests, lessors should resist any attempts by airlines to qualify net lease provisions.

ALTERNATIVE OPTIONS AVAILABLE TO LESSORS

In view of some airlines' cash flow pressure, lessors may feel galvanised to appraise their rights under any letters of credit and lessee guarantees. Lessors could conduct audits of the letters of credits within their portfolio to establish that they are in accordance with the terms of the lease agreements, that any due for renewal are renewed, and that they have everything they need to draw them if required. Moreover, lessors may wish to examine the creditworthiness of any lessee guarantors.

Lessors negotiating new lease agreements might also ensure that there are provisions included to ensure that in the event they are, acting reasonably, concerned about an airline's credit, letters of credit are promptly replaced with cash upon demand – and this should hold true for even the most traditionally robust airlines. There should also be provisions within a lease such that any security deposit amounts are the absolute and unconditional property of the lessor and that if any cash security deposits are applied or letters of credit drawn then the airline should be obliged to restore them to their original amounts.

CONCLUDING REMARKS

Lessors should stand by for requests from airlines and carefully manage their relationships with their customers as part of a symbiotic effort in which regulators, governments and banks alike are collectively attempting to mitigate the impact of the pandemic on airlines. It may just be a matter of time until even historically robust airlines request changes to their payment obligations or become a credit concern for lessors, threatening the latter's cash flow and earnings. In the meantime, there may well be a flurry of sale-and-leaseback activity in the market as a means of easing airlines' liquidity concerns.

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In the event of a sustained crisis which engenders airlines to not honour their payment obligations on a continued basis, lessors would be prudent to have a plan and the necessary documents in hand in order to commence repossession action if necessary. Watson Farley & Williams can assist lessors with this process and advise in the event of an airline insolvency.

The UK government is working through the global pandemic with a deliberate and phased response: contain, delay, research and mitigate. Perhaps conceivably the advice to lessors at this somewhat embryonic stage – and in no particular order – is: (1) monitor your airline, (2) assist if you can and take legal advice, (3) research your options, and (4) consider risk mitigation as part of the long-term plan.

Shree Majitha, a former associate in our London office, also contributed to this article.

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