

## COVID 19 – HOW WILL THE CORPORATE JET MARKET FARE?

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It is too early to know how the current disruption caused by Covid-19 is going to impact the corporate jet market, but some of the implications affecting financing contracts and sale and purchase agreements can already be seen or can be anticipated from past experience.

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During the financial market downturn of 2008/2009, the corporate jet market was severely impacted, and some of the issues relevant then are likely to become relevant again. While there are plenty of reasons to expect that the fallout from the Covid-19 pandemic will be less negative and enduring than that experienced in 2009, financiers and other market participants will be taking appropriate steps to protect their positions. Subsequently certain legal and contractual issues will become more important than in a 'normal' market. This note identifies some considerations which we believe are worth highlighting.

### FACTORS AFFECTING FINANCING TRANSACTIONS

While travel restrictions remain in place, new financing activity will mainly be limited to the re-financing of owned aircraft or (where manufacturing facilities remain open) the financing of the scheduled new delivery of aircraft. Most lenders will have a diminished appetite for new transactions, preferring to let the dust settle before approving significant new loans. Further, many borrowers will be busy focussing on addressing more immediate challenges relating to their own businesses, rather than pushing lenders to complete asset re-financings. Private wealth banks that have broader relationships with a client may be comfortable proceeding with some transactions, and some aircraft owners may be keen to release equity which is tied up in aircraft assets. However, the short-term impact of the market disruption will most likely lead to a much lower volume of transactions being completed.

Most existing loan (or finance lease) transactions for corporate jets include 'loan to value' (LTV) covenants (typically 70-80%). A negative market environment is likely to put pressure on asset values and therefore bring about a greater risk that LTV covenants will be breached; this will add pressure at a time when business and personal wealth related cash flows are already under strain. During the 2008/2009 market downturn, broken LTV covenants became a major problem. A number of factors had combined to cause asset values to become inflated during the preceding two or three years, and the sharp fall in markets, followed by a fall in corporate jet values, left some lenders with exposures which needed to be addressed. While it is inevitable that some transactions will trigger LTV problems if the corporate jet market turns negative, aircraft values have not, in recent years, been subject to the same hype as that which preceded the last downturn. Further, since 2009, financiers have tended to adopt a more conservative approach both to LTV thresholds, and to amortisation profiles, meaning that loan repayments should, during the life of a financing, quite quickly lower the LTV. So far it is unclear whether asset values will be negatively impacted by Covid-19 but if they are, banks will need to closely review their portfolios in order to address any LTV breaches.

Many private wealth bank financings will include an 'assets under management' (AUM) covenant, requiring the beneficial owner of the aircraft to maintain a certain value of AUM with the lender. Similarly, private wealth bank financings, which look to the wealth of the ultimate beneficial owner of an aircraft as a key credit consideration, will often also include a 'minimum net worth' covenant. Given the significant falls in company values in recent weeks, assets held by entrepreneurs are likely to be given lower valuations, potentially leading to both AUM and minimum personal net worth requirements being breached. If the debt is being regularly serviced, lenders are likely to take a view that the extreme volatility of equity markets in recent weeks makes it difficult at the moment to put a fair value on a portfolio under management, or an entrepreneur's personal net worth, and would be reluctant to press their rights under these covenants, at least in the short term. However, this may change if there is a sustained period of instability.

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## LENDERS AND AIRCRAFT OPERATORS

The relationship between lenders and those with operational responsibility for corporate jets, should always be close. In a negative market environment, the relationship between bank and operator becomes even more important, and banks may seek closer insight into the operation of aircraft in their portfolio – in particular the maintenance status and location of the aircraft. Late payments or payment defaults tend to occur between an operator and owner before they arise between an owner and its financier. Accordingly, as long as a bank has a close relationship with the aircraft operator, a payment default under the management agreement can work as an early warning system for lenders, alerting a bank to financial pressures affecting an owner. If, in the worst case, it becomes necessary for a bank to repossess and sell an aircraft, the bank may represent the best chance an operator has of recouping an unpaid debt.

Lenders and aircraft operators who closely collaborate are likely to find themselves in a relatively favourable position if the current uncertainties lead to a deterioration of market conditions.

## FACTORS AFFECTING SALE AND PURCHASE TRANSACTIONS

The current travel restrictions are having an adverse impact on the ability to progress and complete sale and purchase transactions. Aside from the turmoil in financial markets impacting purchase decisions, the practical restrictions on travel are preventing prospective buyers from viewing aircraft. Although some buyers might be willing to go ahead with a purchaser against photos or a virtual tour, most who are making a high value investment will want to touch the metal for themselves. Even if an aircraft has been inspected (physically or virtually) and a buyer has taken a decision to proceed, maintenance facilities are, if open, working at reduced capacity and the ability to source parts and manpower are subject to delays. Most aircraft purchase agreements include a back-stop date, before which time the aircraft delivery condition must be met. Given likely delays at maintenance facilities, back-stop dates may become more relevant to a seller's ability to perform on time.

Transactions which are already underway may be exposed to the threat of buyers seeking to claiming a contractual right to terminate a purchase agreement as a result of 'force majeure'. To validly invoke a force majeure provision, a party must be prevented from being able to perform through circumstances beyond their control, and circumstances which they were unable to mitigate. The specific drafting of a force majeure clause, and the specific facts surrounding the matter, will affect whether or not such a clause can be relied upon. However, given that Covid-19 is more likely to lead to delays in performance than cause it to be impossible for a party to perform, force majeure is, in itself, unlikely to allow a buyer a right to exit an aircraft purchase contract. One of the findings of the 2010 case of *Tandrin Aviation Holdings Limited v Aero Toy Store LLC* (relating to a pre-owned Bombardier Challenger 604 purchase agreement) confirmed that a crash in the financial markets making the contract unprofitable for a buyer did not entitle the buyer to invoke a right to terminate on grounds of force majeure.

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In the absence of a specific force majeure clause, a party may consider claiming it has been prevented, by the Covid-19 pandemic, from performing its contractual obligations and, under the doctrine of frustration, should be entitled to terminate the relevant contract. The evidential threshold to claim that a contract has been frustrated is high, requiring a party to prove that the circumstances of the contract have changed so dramatically as to render the original contractual obligations impossible. It is difficult to conceive of a situation caused by Covid-19 which could offer a party to an aircraft purchase agreement a valid exit route under the doctrine of frustration.

Practical challenges are also affecting the progress of transactions. Filing documents such as bills of sale and aircraft mortgages with aircraft registries has been impeded, since original documents cannot move freely, or be handled on a normal basis. Sales

tax exposures at the time of title transfer are usually able to be mitigated by locating the aircraft in a favourable jurisdiction. Since it may not be possible to move an aircraft due to the current restrictions (affecting both aircraft and crew), the tax rules applicable at the location of an aircraft, and the tax status and operations of the aircraft itself, will need to be given special consideration and may need to be addressed differently. Similarly, *lex situs* issues affecting the transfer of legal title, or the taking of English law aircraft mortgage security, cannot necessarily be addressed simply by moving an aircraft to a suitable jurisdiction.

## SUMMARY

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Although a number of new challenges are being created by Covid-19, transactions are still being progressed and closed. A key difference to the impact of the 2008/2009 financial crisis is that the current issues were not born in the financial system, and banks are in a much better position to support the corporate jet market once the current financial market volatility subsides. As travel restrictions ease and market disruptions subside, while some challenges will continue to be relevant, there will also be opportunities for financiers, owners and operators.

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