

# ANALYSIS: More ABSs in the pipeline but e-notes look elusive

By Oliver Clark | 04 Feb 2021 - 11:26:59 GMT

Castlelake's CLAS 2021-1 aircraft asset-backed securitisation (ABS) issuance in late January marked the return of a financing tool that some commentators had not expected to see again for years, following the pandemic. But the prospects for the ABS market reaching the heights it achieved before the crisis remain unclear.

The dual-tranche \$595 million CLAS 2021-1 was the first aircraft ABS issuance since the onset of the pandemic. The issuance was well received by investors, with the notes being oversubscribed by double-digit figures.

That outcome has driven speculation that more ABS issuers will come to market in the coming months.

"With the large qualification that nothing is predictable at the moment, I think we will see at least a few more ABS deals this year," says A&L Goodbody partner David Berkery.

"The timing of the Castlelake issuance was earlier, the market appetite for the notes was greater and the pricing was better than most people could have anticipated. The structural enhancements were endorsed by the market, and I've no doubt that other leasing companies will look at the terms achieved by Castlelake with envy and start wondering if they too could launch an ABS issuance in 2021," he adds.

Jim Bell, global aviation sector co-head at Watson Farley & Williams (WFW), also believes more issuances are on the way.

"I know there are lessors that are either considering or have begun working towards ABS transactions and so I imagine that there will be a healthy amount of appetite, but it won't be pre-Covid volumes by any stretch of the imagination," he says.

"They will be very constrained as to what can go into the portfolio, in terms of appropriate credits that are not currently going through some level of restructuring; right types of aircraft; right vintage of assets; and right diversification. There are lots of things that will need to be considered but deals will happen."

Dominic Pearson, a partner in the asset finance group at WFW, tells Cirium he would not be surprised if there were more ABS issuances this year, but adds: "Bear in mind that, compared to 2019 levels where I think we saw around 25 ABS issuances, volumes will comparatively be much lower than pre-pandemic levels."

Another factor he identifies as one potentially lowering volumes is that lessors with good corporate credit ratings have been able to tap record cheap credit in the unsecured bond market.

"Air Lease Corporation recently announced the lowest ever coupon of 0.7% on a \$750 million offering, so you have to ask yourself why similarly situated lessors would tap the ABS market at this time as a financing product," he says.

"That said, there may be strategic rather than economic reasons why such lessors may consider ABS issuances. Putting an ABS in place, holding the equity ready to sell at a later date, may be a strategically better way of selling a portfolio, for example, but I think right now ABS are competing against this extremely cheap credit environment," Pearson adds.

Ascend by Cirium valuations consultant Thomas Kaplan predicts that ABS issuance volumes are likely to be lower than in previous years.

"I don't think issuance levels will reach that of 2019 for at least the next few years. The appetite for riskier credits and lessor equity is lagging that of investor appetite for debt – there is still too much risk," he says.

During a recent ISTAT presentation, SMBC Aviation Capital head of funding, corporate tax and investor relations Eithne Manning said that the Castllake issuance had been a "very positive" step for the market.

### **CLAS 2021-1 ENHANCEMENTS**

The CLAS 2021 initially consisted of two debt tranches backed by collateral of 27 aircraft. These comprise nine Airbus A320s, two Boeing 777-300ERs, one 737-900ER, three 737-800s, five Bombardier CRJ900s, three A321s, one A330-200, two A220-100s and one 747-400 freighter.

Airline lessees include Aeroflot, Air Namibia, Delta Air Lines and Qatar Airways.

At the time it issued CLAS 2021-1, Castllake noted that it included several structural enhancements designed to address some of the challenges of the current environment.

These enhancements include an equipment-note-style structure that allocates advance rate and amortisation on an asset-by-asset basis, expanded covenants, lower starting leverage, faster amortisation, and increased cash sweeps.

Moody's rated the Class A notes at "A2" and the Class B notes "Baa2".

Tracy Rice, senior credit officer at Moody's, tells Cirium that there were some similarities to ABS issuances before the crisis, but also some differences – and these differences helped to mitigate some of the Covid asset-related risks.

"The aircraft models in the pool are pretty similar to those in prior pools, including the typical workhorse narrowbodies, the A320-200 and the 737-800, and a few widebodies. The average age of the pool is about nine years," she says.

"From that perspective, maybe there isn't so much of a difference, but what is different is that basically the top leases being strong like those to Delta and Qatar that have long tenors. So the contractual cash flow that is available from the initial leases are strong and sufficient to pay down the majority of the debt on the senior notes," Rice adds.

Compared with pre-crisis deals, this as a unique strength, says Rice, noting another important element in the deal: the pool has very few leases maturing before 2025, protecting the deal from re-leasing risk until global air travel demand returns.

Gideon Lubin, senior analyst in Moody's structured finance group, sees the large number of end-of-lease payments due from lessees as a benefit.

"On the structural side, this deal is different than a lot of the pre-Covid transactions because in this deal the end-of-lease payments prepay the notes and accelerate them ahead of schedule without a mechanism for the schedule to catch up – future note payments are not reduced to return the notes to their scheduled balance," he says.

"So in past transactions if there was a prepayment you would accelerate ahead of schedule for that period, but then in the next period or so, if you were ahead of schedule, principal payments would slow to the tranche, so the schedule would effectively catch back up.

"What is different about this transaction is that it allows you to get ahead of schedule and stay ahead of schedule. So that is one of the key strengths of this transaction versus prior ones: very large end-of-lease payments that you maintain the benefit from through the life of the transaction."

## INVESTOR APPETITE AND E-NOTES

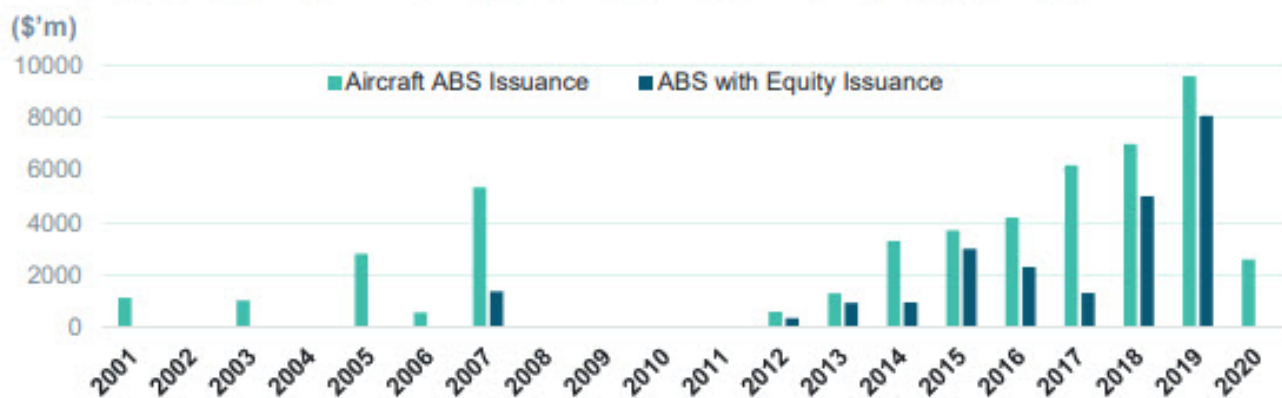
A growing trend in the ABS market in recent years had been the sale of the equity, or e-notes, in the aircraft by the issuer.

During her ISTAT presentation, Manning noted the ABS market had been buoyant during the last cycle, leading to greater investor appetite for aircraft ABS, right through the capital stack, and driving demand for the e-notes.

"It was used both as a funding vehicle for mid-life assets, but also as a distribution channel for larger leasing companies that were selling the majority of the e-note or the equity in the transaction," she says. "The development and growth of the ABS market was really interesting because the level of liquidity that it provided, together with the liquidity in other funding markets, really drove a very strong secondary aircraft trading market".

Manning believes that this facilitated lessors in recycling their capital, allowing them to monetise some of the "inherent gains" in their portfolio that might have depreciated and providing a "really important portfolio-management tool".

## Aircraft Backed ABS Issuance: 2001-2019 Volumes



Source: SMBC Aviation Capital

Some \$43 billion of aircraft-backed securities were issued in the last cycle, she says.

Cirium fleets data records 17 commercial aircraft ABS issuances in 2019, backed by 291 aircraft and 213 operators. In 2020 there were three aircraft ABS issuances: Carlyle Aviation Partners AASET 2020-1, DVB Bank's Lunar 2020-1, and Avolon's SAPA 2020-1. In the 2015-20 period, 2019 provided the peak in ABS issuances.

The return of investor appetite for new ABS paper comes despite the downgrade of notes linked to numerous existing ABS vehicles. While many ABSs remain on negative watch by ratings agencies, none have so far collapsed under the pressures of airline deferrals.

Rice, of Moody's, says few ABS structures have been forced to tap their liquidity facilities to make scheduled payments during the crisis.

Drew Fine, a partner with law firm Milbank, sees continued appetite from investors for aircraft ABS as a function of the liquidity that has been pumped into the global financial markets since the start of the crisis.

"The last time that [aircraft] ABS totally stopped was 2008-2013: there was a true credit crisis and there was a lack of liquidity in the market. Now there has been lots of liquidity in the market, there's loads of money, interest rates are incredibly low, and fund managers and people who otherwise manage money need to put the money someplace."

For investors faced with the choice of investing in corporate credits or asset-backed notes, the latter offers opportunities from a yield perspective, Fine believes. Progress with Covid-19 vaccination programmes and the prospect of "light at the end of the tunnel" for aviation also provide comfort to investors.

SMBC Aviation Capital's Manning points out that after spreads on A-tranche aircraft ABS notes widened by 1,600 basis points, they have since come down by 1,200 but they remain at "elevated levels".

Principal and interest payments are behind schedule for B and C notes, although principal payments on some A notes have recently caught up. Cash flows for most e-notes have been shut off since April 2020.

Fine believes that the ABS market will be bifurcated into two camps: those aircraft leasing companies that need to sell aircraft, and therefore the e-notes; and those seeking straight financing.

He says that currently it is "unclear whether the e-note market is accretive", adding that it "might be at some point later this year".

"Many of the larger issuers, if you look at their transactions, probably half of the deals over the last couple of years, not only was the debt sold and the equity was sold, and the reason the equity sold is that those aircraft leasing companies were actually selling those planes and getting sales treatment," says Fine.

"So for the ones that just need financing, ABS provides a really great source of long-term well-priced financing that provides a lot of stability. There is a lot of flexibility once you do an ABS to

service the portfolio without going back to the noteholders all the time," he adds.

Ascend by Cirium's Kaplan believes that despite the strong appetite for lessor debt he doesn't think the market will react as favourably to equity for riskier mid-life aircraft on lease.

"Equity sales will come later when there is a bit more certainty about the recovery," he says.

Kaplan points out that the lessor market in general has been reducing transactions of equity since the pandemic.

Cirium fleets data shows that the number of older aircraft transacted with lease attached in 2020 had very low activity levels.

"Nearly half of 2020's activity occurred in the first three months of the year, before the pandemic hit in earnest. Aircraft with lease attached sales are representative of leased aircraft equity sales. So if lessors are buying fewer leased assets from other lessors, it's unlikely the average ABS investor will have that much more confidence to buy e-notes," says Kaplan.



Source: Cirium fleets data