

# ABS promise in booming Asia air finance market

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## TMF Group

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Asset-backed securitisation (ABS) has been common practice for the aviation industry in Europe and North America for decades. In Asia, however, the market remains relatively underdeveloped and untapped but it is beginning to gain traction, as noted by a panel of experts in TMF Group's recent 'Aircraft lease securitisation' webinar, organised in association with *Airfinance Journal*.

The key trends driving this growth are a widening range of investors, greater scope for ABS in financing a variety of aircraft and equipment, and the rise of tradeable equity in ABS transactions.

### Growing investor interest

Interest in ABS in Asia goes back to 2015 when BOC Aviation became the first Asian issuer of an aircraft ABS. Since then, more deals have helped spark demand from a wide range of investors, including hedge funds, private equity firms, asset managers, family offices and sovereign wealth funds.

Crossover investors, such as those from the shipping sector, also are eager to take advantage of ABS, drawn to benefits such as reliable supply, lower volatility and consistent growth over the last 40 years - which is expected to continue, according to Standard Chartered's head of capital markets aircraft financing, Weili Chen.

"[The aviation leasing sector] has been seeing very steady [growth], roughly two times GDP growth rate, and that is not really expected to deviate that much if you look out over the next 20-30 years," he says. "So, I think there are a lot of very attractive characteristics of this asset class - on top of which this is a very liquid, dollar-based asset."

The increased ease in leasing or trading the underlying collateral has also boosted the popularity of ABS, Chen says, as have efforts by organisations like the Aviation Working Group to make title transfers simpler.

For institutional investors, the long-term stable cash flow associated with an ABS is of particular value, as are the facts that the collateral is liquid and can be moved globally, says Eric Blau, treasurer at lessor Aviation Capital Group. He points out that the ABS market meets multiple strategic purposes, including portfolio management.

"A lot of us view ourselves as asset managers as well as aircraft lessors, so in the context of managing a portfolio of aircraft you can use the ABS market to share the risk in your portfolio with a broader investor base while maintaining the same customer relationships," Blau says, adding: "You can use the ABS market to manage concentrations. You can use it to manage exposure to different areas of the world and different aircraft types so that you can continue to grow your own portfolio as well as your managed portfolio for a third party."

### ABS trends

Johnny Lau, a chief consultant at PwC's Aviation Business Services, says recent years have seen numerous enquiries from institutional investors in Japan, China, South Korea and Singapore expressing interest in purchasing aviation debt and equity products without the complication of setting up their own leasing firm or hiring an expert team.

"I'm sure that if we have good plans and also good issuers, then we would be able to find in those countries new sources of investors," he says, noting this is especially true for cash-rich Chinese firms.

"They need to invest somewhere, and they are bound by some very rigid outbound investment rules. And it seems that aircraft is one of the things that they are allowed to invest in, and the government may feel comfortable to approve such investments," he says. "I'm sure that if we can do [a domestic ABS deal] in mainland China, I think that will be a very successful transaction."

Drew Fine, partner at the New York office of law firm Milbank, says the US aircraft ABS market - which typically saw three or four ABS

transactions a year – has been “incredibly robust” in the last couple of years with 2019 on track to continue this trend.

In his view, the market has changed since the time when most ABS consisted of very liquid, relatively young Boeing and Airbus aircraft, with the average portfolio being perhaps five years old.

“This has evolved – we have had deals with aircraft engines, freighters, a lot of mid-life aircraft deals, regional aircraft, turboprops, finance leases and even aircraft-secured loans,” Fine says. “Basically, as long as we can find a reliable cash flow, then we can put together an ABS.”

One growing trend, he says, is for larger leasing firms to use ABS to sell the debt and equity side of a portfolio while continuing to service the aircraft and often retain an ownership stake. Yet another area that has evolved – and one that directly involves Asia – is the source of third-party equity, according to Fine. The rise of tradeable equity has allowed shares of ABS equity to be sold in the \$5 million-to-\$10 million range, moving the industry away from its reliance on large private equity firms and towards a diverse pool of investors.

“There have been six of these tradeable equity deals done so far, and many more to come,” Fine says.

One region worth watching, he thinks, is South Korea, which recently saw two ABS deals where equity was obtained from the local market and then sold in senior and sub-tranches to groups of 10 to 15 investors.

“I think sooner rather than later we will see a combination of an ABS and a Japanese lease – and that will also be a very popular market,” he says.

### **What ratings agencies look for in an ABS portfolio**

Investors should look for the same aspects in an ABS portfolio as rating agencies do, according to Fine. They are:

- diversification in terms of lessees, countries and regions;
- no single airline comprising more than 10-15% of a portfolio;
- liquid aircraft types – the most popular models that can be remarketed if necessary - with at least 15 aircraft;
- an experienced servicer; and
- aircraft leased into countries with a good history of repossession;

Moderator Kevin Butler, managing director, TMF Group, UK and Ireland, says: “There will clearly continue to be opportunity and growth in the China aircraft leasing market, and ABS is likely to become increasingly important in providing the diversified funding that it needs. What is certain is that China, and the entire Asia-Pacific region, will drive growth in air travel for the next two decades and investors need to find ways in which to secure a place in this stable growth market.”

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