

MILBANK AVIATION

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2011 AIRCRAFT SECTOR UNDERSTANDING

The Gentleman's Agreement

A new Aviation Section Understanding on Export Credits for Civil Aircraft (the "2011 ASU") replaced the 2007 Aviation Sector Understanding ("2007 ASU") on February 1, 2011. This non-binding "gentlemen's agreement" has been agreed to by Australia, Brazil, Canada, the European Union, Brazil, Japan, Korea, New Zealand, Norway, Switzerland and the United States (the "Participants"). The 2011 ASU is intended to level the playing field for aircraft manufacturers, aircraft purchasers (including airlines and aircraft lessees) and governments by prescribing a set of uniform terms for aircraft-related financing transactions that are supported by a Participant's export credit agency ("ECA") and by closing the pricing gap between the ECA and commercial financing markets. Additionally, through the elimination of aircraft categories, the new terms are also designed to address and remove any actual or perceived advantage enjoyed by manufacturers of smaller aircraft over manufacturers of larger or regional aircraft under the 2007 ASU. Whether the 2011 ASU will be successful in accomplishing these goals will not be known for a few years, given that the 2011 ASU includes generous grandfathering terms that will permit a significant volume of supported transactions to be governed by the 2007 ASU.

PARIS AIR SHOW

Airbus recorded 730 orders worth \$70B. **Boeing** recorded 142 orders worth \$22B. The A320neo received 667 orders, making it, according to Airbus, the bestselling commercial aircraft at any air show ever.

CAPE TOWN

The Cape Town Convention and related Protocol on Aircraft Equipment (the "Cape Town Convention") will enter into force in the Russian Federation and Tajikistan on September 1, 2011. The Russian Federation and Tajikistan have each elected to apply Alternative A to their respective insolvency proceedings. Like most Contracting States that have opted for Alternative A, they have each also declared a waiting period of 60 days. Currently, only a handful of Contracting States have a waiting period that is or could potentially be less than 60 days: (1) Ethiopia (no more than 30 working days), (2) India (2 calendar months), (3) Malaysia (40 working days), (4) Nigeria (30 calendar days), (5) Senegal (30 calendar days), (6) Singapore (30 calendar days), (7) South Africa (30 calendar days) and (8) the United Republic of Tanzania (30 calendar days).

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The following are summaries of (1) the major changes from the 2007 ASU and (2) the grandfathering provisions of the 2011 ASU.

SUMMARY OF MAJOR CHANGES FROM 2007 ASU

Removal of Categories

The 2007 ASU divided aircraft into three categories: Category 1 (large aircraft), Category 2 (regional aircraft) and Category 3 (smaller aircraft). The application of certain provisions varied for each category; the most significant distinctions were between Category 1, on the one hand, and Categories 2 and 3, on the other. The 2011 ASU eliminates the concept of aircraft categories, subjecting all types of aircraft to the same treatment. The impact of the elimination of aircraft categories on certain provisions is shown in Table 1.

Minimum Premium Rates

The minimum premium rate (“MPR”) is the minimum amount required to be charged by an ECA as a fee for its guarantee of the repayment of a buyer/borrower’s facility. The fee can be paid either as an upfront fee or as an annual spread over the interest rate of the supported facility. In order to qualify for the MPR, the buyer/borrower must satisfy certain prerequisites. The 2011 ASU adds two new prerequisites: (i) if a lease financing structure is used, the lease payments must be subject to an assignment or a first priority security interest and (ii) all of the aircraft and engines owned by a party under the proposed financing must be cross-collateralized and subject to cross-default. Furthermore, the 2011 ASU modifies the method of calculating MPRs. Under the 2007 ASU, each transaction’s MPR depended on the Risk Category of the buyer/borrower and this is still true under the 2011 ASU. The 2011 ASU, however, expands the number of Risk Categories from 5 to 8 classifications, and is based on the senior unsecured corporate credit rating of each buyer/borrower. The “risk mitigant” concept has also been expanded by the introduction of a “B” risk mitigant category. The following are possible risk mitigants under the new “B” risk mitigant category: (i) security deposits, (ii) lease payments paid in advance and (iii) best-practice maintenance reserves. For buyers/borrowers in Risk Categories 4 through 8, at least one “B” risk mitigant must be present for such buyers/borrowers to qualify for the minimum MPR.

Unlike the 2007 ASU, which provided for a fixed MPR for each Risk Category, the 2011 ASU provides for baseline MPRs coupled with a formula for the periodic setting of these rates. This formula includes two factors: a risk-based rate (“RBR”) and a market reflective surcharge (“MRS”). The RBR is based on Moody’s annual 4-year moving average of the loss given default for first lien senior secured bank loans; beginning April 15, 2011, this factor will be reset annually. The MRS is based on several factors, including the Risk Category, the RBR and the 90-day moving average of Moody’s median credit spreads, with an average life of 7 years. The MRS is updated quarterly, but it will not be applied (i) unless it is positive and exceeds 25bps and (ii) to the extent that the new MPR would exceed the previous MPR by 10%. After the application of both of these factors, the new MPR cannot exceed the RBR by more than 100%.

As of the first adjustment date (April 15, 2011), the MPR was reduced by approximately 2% for each of Risk Categories 2 through 8 as a result of the first annual RBR adjustment.

The 2011 ASU continues to provide reductions to the MPR for asset-backed transactions if certain requirements under the Cape Town Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters Specific to Aircraft Equipment can be satisfied (the “*Cape Town discount*”). The 2011 ASU provides for a maximum Cape Town discount of 10% of the MPR under the 2007 ASU, the Cape Town discount varied from 5%-20% (depending on the buyer/borrower’s Risk Category).



Minimum Interest Rates for Direct Financing Support

In addition to providing guarantees (or pure cover), ECAs are also permitted to provide direct financing support to buyers/borrowers. The 2007 ASU allowed direct financing support of fixed interest rate transactions for all 3 aircraft categories; direct financing support for floating interest rate transactions was only provided in respect of aircraft in Categories 2 and 3. The 2011 ASU provides for direct financing support for both fixed and floating interest rate transactions across all types of aircraft.

Minimum fixed interest rates for direct financing support under the 2007 ASU were based on either (i) the yield rate of government bonds plus a spread (the Commercial Interest Reference Rate) or (ii) swap rates (floating to fixed); this remains generally unchanged under the 2011 ASU, although a “margin benchmark” has been added to such rates. This margin benchmark is based on the three-month average of the lowest 50% of the margins over LIBOR charged for certain officially supported transactions and is reset monthly. In cases where the fixed rate is based on the Commercial Interest Reference Rate, the 2011 ASU limits official financing support, in the case of aircraft with a net price of US\$35M or more, to exceptional circumstances and with prior notice to the other Participants.

The minimum floating interest rate for direct financing support under the 2007 ASU was based on LIBOR, whereas in the 2011 ASU, this rate is based on either LIBOR or EURIBOR, as appropriate, plus the margin benchmark. The 2011 ASU also contains an express provision that offers a buyer/borrower the option to switch from a floating interest rate loan to a fixed interest rate loan under the following conditions: (i) the rate must be based on the swap rate and (ii) the option is exercised once, upon request, and reported to the Secretariat.

Down Payments: The 2007 ASU provided for a maximum official support of 85% of the net price of the aircraft. Although this is still the case in the 2011 ASU, the maximum support for buyers/borrowers in Risk Category 1 is now reduced to 80%.

Table 1: Summary of Major Changes

Provision	2007 ASU			2011 ASU
	Category 1	Category 2	Category 3	All Aircraft
Maximum Repayment Term	12 years	15 years	10 years	12 years; extension to 15 years in exceptional circumstances with notice and a 35% premium to MPR
Periodic Payments	At least every 3 months	At least every 6 months	At least every 6 months	At least every 3 months; extension to 6 months in exceptional circumstances with notice and a 15% premium to MPR
Minimum Premium Rates (MPR)	Up-Front: 4%-7.5% (3.8%-6% with Cape Town discount)	Spread: 12-276bps <i>per annum</i> (11-248bps with Cape Town discount)	Spread: 12-276bps <i>per annum</i> (11-248bps with Cape Town discount)	Up Front: 7.72%-14.74% (6.95%-13.27% with Cape Town discount) Spread: 137-257bps <i>per annum</i> (123-231bps with Cape Town discount)
Fixed Interest Rate (direct financing support)	7-year government bonds + 120bps	Swap rate or 5- or 7-year government bonds + 100bps	Swap rate or 5- or 7-year government bonds + 100bps	Swap rate or 5-, 7- or 9-year government bonds + 120bps + margin benchmark
Floating Interest Rate (direct financing support)	Not provided	LIBOR	LIBOR	LIBOR or EURIBOR + (in each case) margin benchmark

2011 ASU GRANDFATHERING TERMS

The 2011 ASU provides for a transitional period during which certain transactions may be entered into under the terms of the 2007 ASU if certain conditions are met: (1) the goods and services must be subject to a contract that was concluded on or before December 31, 2010, (2) the goods and services must be physically delivered no later than December 31, 2012 for Category 1 aircraft and December 31, 2013 for Category 2 and 3 aircraft, and (3) a 20 basis points per annum commitment fee must be charged. Additional ECA supported transactions may be entered into on the terms of the 2007 ASU, or on the terms of the ASU prevailing prior to the 2007 ASU, if: (i) the goods and services are subject to a contract concluded by December 31, 2010; (ii) official support is limited to deliveries of 69 Category 1 aircraft per Participant and 92 Category 2 aircraft per Participant; (iii) such aircraft are notified by the Participants to the Secretariat prior to the entry into force of the 2011 ASU; (iv) other specified information in respect of the transaction is shared with all Participants; and (v) additional commitment fees are paid. All grandfathered transactions must be reported to the OECD Secretariat and the other Participants.

DEAL ROUNDUP

On June 1, **Emirates** issued a \$1B five-year unrated bond with a fixed-rate coupon of 5.125%. It will be listed on the London Stock Exchange. Emirates plans to use the proceeds for general corporate purposes.

On June 3, **AWAS** re-priced its outstanding 2010 \$500MM B term loan at LIBOR plus 400 basis points and 1.25% LIBOR floor. The original term loan was for \$530MM and priced at LIBOR plus 575 bps with a 2% LIBOR floor.

On June 8, **Air Lease Corporation** (ALC) issued \$120MM of senior unsecured notes with a coupon rate of 5% and maturity date of June 6, 2016. The notes were issued in a private placement with institutional investors.

On June 13, **AWAS** secured a five-year \$500MM non-recourse warehouse facility with a two-year draw period and three-year term. The eligible pool of aircraft in the warehouse was not defined. Proceeds from the facility will be used to acquire new and used aircraft.

On June 21, **Jackson Square Aviation** (JSA) secured a \$220MM warehouse facility. The drawing period expires in 2012 with a term-out option extending to 2019. Proceeds of the warehouse will finance a combination of pre-committed and future narrowbody deliveries from Airbus and Boeing.

On June 24, **GE Capital Aviation Services** (GECAS) closed on a \$290MM asset-backed securitization backed by a pool of 30 aircraft engines. The deal also included the issuance of E notes. The Series A Notes were rated **A (sf)** by S&P and the Series B Notes were rated **BBB (sf)** by S&P. The deal is the first aviation securitization since 2007.

On June 24, **US Airways** priced \$83.2MM of Class C notes at 10.875% and maturing on October 14, 2012. The Class C notes, which will not have a liquidity facility, were issued as part of an enhanced equipment trust certificate comprised of Class A notes worth \$294MM at 7.125% and Class B notes worth \$94MM at 9.75%. The EETCs are secured by nine aircraft. US Airways will use the proceeds from the issuances to refinance aircraft and to finance new deliveries.

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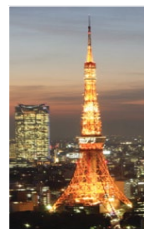
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