

# Soaring ahead: The latest trends and developments in aircraft finance

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## Introduction

The global economic landscape has undergone significant changes since our last article<sup>1</sup> on trends and developments in aircraft finance, with geopolitical shifts and disruptions impacting the aviation industry. With a history of resilience, the aviation sector continues to evolve and adapt to changing global demands, from the growth in aircraft leasing and asset-backed securities in aircraft financing, the decrease in traditional avenues of financing and the significant opportunities for alternative funding sources, to the rise of sustainable aviation.

The Cayman Islands (**Cayman**) continues to play a key role in the aviation industry. Cayman is widely recognised as having a world-class aircraft registry, robust and sophisticated legal and regulatory regimes, flexible and versatile vehicles, a politically stable climate and tax neutrality.

In this article we take a look at the notable trends we have seen over the last couple of years and the continued popularity of Cayman as a preferred jurisdiction in this sector.

## Growing demand for aircraft leasing

Aircraft leasing allows lessees to acquire and operate aircraft without the financial burden of making large upfront purchases and provides flexibility to lessees to help them manage and increase fleet size. Cayman special purpose vehicles (**SPVs**) are commonly set up and used as part of aircraft leasing transactions. We regularly assist with the incorporation of such SPVs, typically as aircraft holding companies within the lessor's corporate structure which acquire and lease the aircraft to the lessee in the transaction. As the leasing industry grows and continues to develop, we expect Cayman to continue to be a preferred jurisdiction for the incorporation of SPVs due to Cayman's ideal political, legal and fiscal environment and the quick and straightforward SPV incorporation process.

Leasing arrangements were affected by the Covid-19 pandemic, with lessors receiving requests for relief in different forms from lessees who fell behind on their rental obligations, including rent deferral arrangements, lease restructurings and, in some cases, the aircraft being returned to the lessor prior to the scheduled lease expiry date. In the case of the latter, we saw lessors putting their aircraft on short-term temporary aircraft registries, such as the Civil Aviation Authority of the Cayman Islands (**CAACI**), during that interim period between finding a new operator or selling the aircraft to a new owner.

CAACI has been a welcome solution to lessors and financiers in this situation, after launching its lease transitioning business in 2019. The growth rate for transition aircraft on the Cayman aircraft register for the year 1 January 2021 to 31 December 2021 was 95%. In 2023, we saw that this growth continued and CAACI's records show that there were 72 transition aircraft registered and 76 de-registrations, in each case as at 31 December 2023. This indicates that the level of activity of temporary aircraft registrations remains

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<sup>1</sup> Trends and Developments - Aviation Finance & Leasing 2022: Cayman Islands

strong. We have continued to receive queries from lessors regarding the Cayman transition register so we anticipate that this space will remain active in 2024.

CAACI remains focussed on this transition register offering, which is supported by highly experienced employees and full-time personnel of CAACI, who have extensive regulatory experience, and a quick, efficient and cost-competitive registration service and a smooth deregistration process for a seamless transition on and off the register.

The support that lessors provided to lessees during the pandemic, as flexible, reasonable and cooperative creditors, was key to strengthening the relationship between lessors and lessees and to the overall resilience of the aircraft leasing market. Industry leaders predict that this market will continue to increase in value and that Covid-19 will not have hindered the long-term development of the aircraft leasing industry.

### **Increased use of asset-backed securities in aircraft financing**

Funding from capital markets has grown tremendously over the years. There are well known key benefits of using the debt capital markets for aircraft financing, including potentially cheaper financing than the bank financing market, providing a financing solution for certain aircraft which can be challenging to finance (such as mid-life aircraft) and allowing sponsors to gain exposure to new lenders and investors. This said, with rising interest rates and volatile market, capital markets rates may be pricing in an additional risk premium, and we may well see a reversion back to the period where bank markets were more efficient.

Asset-backed securities (**ABS**) have been utilised for some time now for aircraft financing, with the financial instruments backed by the cash flows generated by aircraft leases. These structures begin with the creation of an SPV set up by the sponsor to be the issuer to acquire the pool of assets (in this context, the aircraft and related lease portfolio) and raise debt financing to fund the purchase of those assets through the issuance of ABS.

Cayman SPVs have gained popularity as a preferred choice for the SPV in these structures. Cayman SPVs are also useful in these structures as the SPV that issues the debt is a separate legal entity from the sponsor so the assets of the SPV (being the aircraft and related lease portfolio in this case) will not be available to the sponsor's other creditors, providing ABS investors with a layer of protection from any financial stress experienced by the sponsor.

Covid-19 brought challenges to the aircraft industry, impacting leasing arrangements which in turn impacted the aircraft lease securitisation market (with the degree of impact depending on certain factors, such as the amount of rent deferrals). Now that Covid-19 travel restrictions have been lifted, travel demand has increased; however, there is still a shortage of new aircraft and engines for purchase. As a result, airlines have increased demand for leased aircraft which has driven up lease rates. Given these factors, we may see a pickup in the aircraft lease securitisation market as an increasingly important source of funding (benefiting from the positive demand in the aircraft leasing industry) and that Cayman will continue to be the jurisdiction of choice for SPVs used in these transactions.

### **Rise of alternative financing sources**

One of the challenges to the aircraft industry brought by asset-pricing uncertainty, rising interest rates and increased regulation on bank capital requirements, has been access to financing. Investors have been increasingly strategic when it comes to the transactions that they are willing to invest in, which has resulted in changes to the aviation lending market. As traditional financing has decreased, with banks focusing more on assets that are less affected by the current landscape, alternative financing sources have emerged in the aircraft finance market.

Pre Covid-19, there had been growing interest from private equity (**PE**) in the aviation industry, with the sector attracting increasing levels of attention from an investor community seeking exposure to ever more interesting alternative assets within their investment portfolios. The investment funds industry has long been interested in the aviation sector (with fund managers such as Fortress and Terra Firma leading the way) and the volume of investment has grown significantly in the past few years, as has the breadth of investment focus. The aviation industry as a whole has been willing, more than ever given the pandemic challenges, to seek alternative sources of funding, creating significant opportunities for alternative finance providers such as aviation funds.

Aviation funds have become attractive to the aviation industry because of their dynamic nature, speed of execution on transactions, access to a larger pool of investor capital and potential for attractive returns. We continue to see Cayman entities being used for aviation funds, whether being set up to acquire an operating lessor or asset investment or as a debt fund seeking to finance the acquisition of aircraft or existing platforms.

Cayman is one of the largest domiciles for private funds outside of the US<sup>2</sup>. The success of the jurisdiction has, to a large extent, been based on the sophistication of its legal regime which has constantly evolved to keep pace with the global regulatory environment and the demands of its key stakeholders.

Investment funds in Cayman are most often structured either as companies (which issue shares to investors and are operated by a board of directors) or as limited partnerships (with limited partnership interests held by investors and which are operated by a general partner – often a company which will also be registered in Cayman). Both forms derive from a statutory framework which affords flexibility for the fund and protection for investors and other counterparties. Underpinning the statutory framework is a body of established common law which is upheld by a sophisticated judicial system, with ultimate recourse to the English Privy Council, thereby allowing investors in Cayman funds high levels of confidence.

Considering the aviation industry's familiarity with Cayman (including with CAACI) for aircraft registration, financing structures and structuring of leasing companies, alongside Cayman being one of the world's leading fund domiciles, it is no surprise that aviation funds are being structured in Cayman. We have continued to assist our clients with setting up aviation funds. Many of these funds have been structured to finance the acquisition of mid-life or end-of-life aircraft, which we believe is a result of the current shortage of new aircraft and engines for purchase. We expect to see continued growth in the number of aviation funds, and diversity of trading styles adopted by those funds to meet investor needs.

### **Green skies ahead: ESG**

ESG (being the business consideration of environmental, social and governance issues) as a sector of its own has grown exponentially in recent years, with a recent emphasis on sustainability and the pursuit of eco-friendly aviation practices which influence aircraft financing decisions. The aviation industry faces increasing pressure to address its environmental impact, with investors, financial institutions and industry stakeholders placing a greater emphasis on sustainability and responsible practices.

From an aircraft finance perspective, airlines and aviation companies have been exploring green financing for renewing their fleets (with advanced technology and eco-friendly aircraft to reduce their carbon emissions and operating costs) or to raise capital for environmentally friendly initiatives. These include initiatives such as investing in more fuel-efficient aircraft, adopting sustainable biofuels, or implementing eco-friendly infrastructure. Investors are increasingly inclined to support projects that align with ESG criteria, promoting cleaner and more sustainable aviation practices.

ESG has long been factored into our fund manager or investor clients' strategies and policies. Now, many fund managers are moving beyond ESG screening/reporting on their investments and are creating their own funds with a dedicated investment focus on sustainable investing, and we have specifically seen an increase in funds that have an investment focus in sustainability focused aviation projects. Funds dedicated to sustainable or impact investing are becoming far more mainstream in the alternative funds universe as fund managers respond to the concerns of investors, employees and other stakeholders. We have continued to work alongside our clients to launch impact funds and other investment vehicles dedicated to sustainable outcomes, particularly in the aviation space.

The Cayman Islands Monetary Authority (**CIMA**), which is the primary financial services regulator for Cayman, places ESG regulation as a top item on its agenda and issued an information circular on ESG on 13 April 2022 (**Circular**)<sup>3</sup>. The Circular provided that ESG considerations, or sustainable investing, is increasingly becoming the fastest growing investment strategy within the financial services sector and noted that sustainable investing is a complex and developing subject which is rapidly evolving as an investment approach. CIMA also noted the urgent need for robust investor education related to the evolving risks and

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<sup>2</sup> <https://www.cima.ky/investment-statistics>

<sup>3</sup> <https://www.cima.ky/environmental-social-and-governance-and-sustainable-investing>

issues associated with ESG-type investments and outlined CIMA's aim to develop a suitable regulatory and supervisory approach for climate-related risks and other ESG-related risks.

In light of the Circular, it is clear that Cayman has ESG on its radar and we continue to watch this space as ESG continues to shape investment decisions and industry standards. Aircraft finance will undoubtedly evolve to embrace a greener and more sustainable future.

## Conclusion

The aviation industry has a history of resilience, and this has been particularly evident over the last three years. Following the unexpected downturn resulting from the Covid-19 pandemic and other geopolitical factors, we can see that the market is bouncing back with the demand for aircraft leasing continuing to grow, the increased use of ABS in aircraft financing, the boost in capital injection from alternative financing sources (such as aviation funds) and the growing significance of ESG considerations.

Cayman continues to be a preferred jurisdiction for the incorporation of SPVs in this space (for aircraft leasing transactions and ABS structures and transactions) and has been popular in the structuring of aviation funds. The rise of sustainable aviation practices has emerged as a powerful force, influencing investment decisions and financing strategies across the board. ESG considerations have not only become a moral imperative but a key driver of financial choices, fostering the development of greener and more responsible aviation projects. We expect that Cayman will continue to adopt global best practices in relation to the regulation of investment funds in the ESG space.

As we look ahead, the future of aircraft finance looks exciting and from the trends discussed in this article, we look towards a more resilient, responsible and prosperous future, soaring to new heights in the world of aircraft finance.

## Our asset finance team

Mourant has an international reputation for having one of the leading offshore asset finance practices, advising on the laws of the British Virgin Islands, Cayman Islands, Jersey, Guernsey and Luxembourg. We act for a diverse set of arrangers, banks, non-bank lenders and borrowers on asset-based lending transactions, including aircraft finance and shipping finance. Our team has a deep knowledge and experience across a broad range of assets, advising across the lifecycle of transactions from structuring and negotiation through to restructurings and insolvency.

We specialise in advising on the financing and leasing of commercial aircraft, corporate jets and other related assets, including engines and helicopters. Our team have advised the world's leading financial institutions, airlines, operating lessors and private equity investors on a variety of structures, including debt financing, pre-delivery payment financing, cross border leasing, operating leasing, sale and leasebacks, export-import and export credit financings. We offer a 'one-stop shop' service, providing clients with a single point of contact for access to an integrated suite of legal and global corporate and SPV management services for the transaction, including registered office, professional directors, share trustee and Cape Town Convention services.

Our team at Mourant is increasingly called upon to help launch offshore funds for investment in diverse areas, including aviation funds. Our holistic approach means we support our clients at every stage of the offshore fund cycle – from the structuring and formation process, through the investment phase, up to the realisation of profits and, if applicable, exit or fund termination.

## Contacts

A full list of contacts specialising in asset finance can be found [here](#).

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