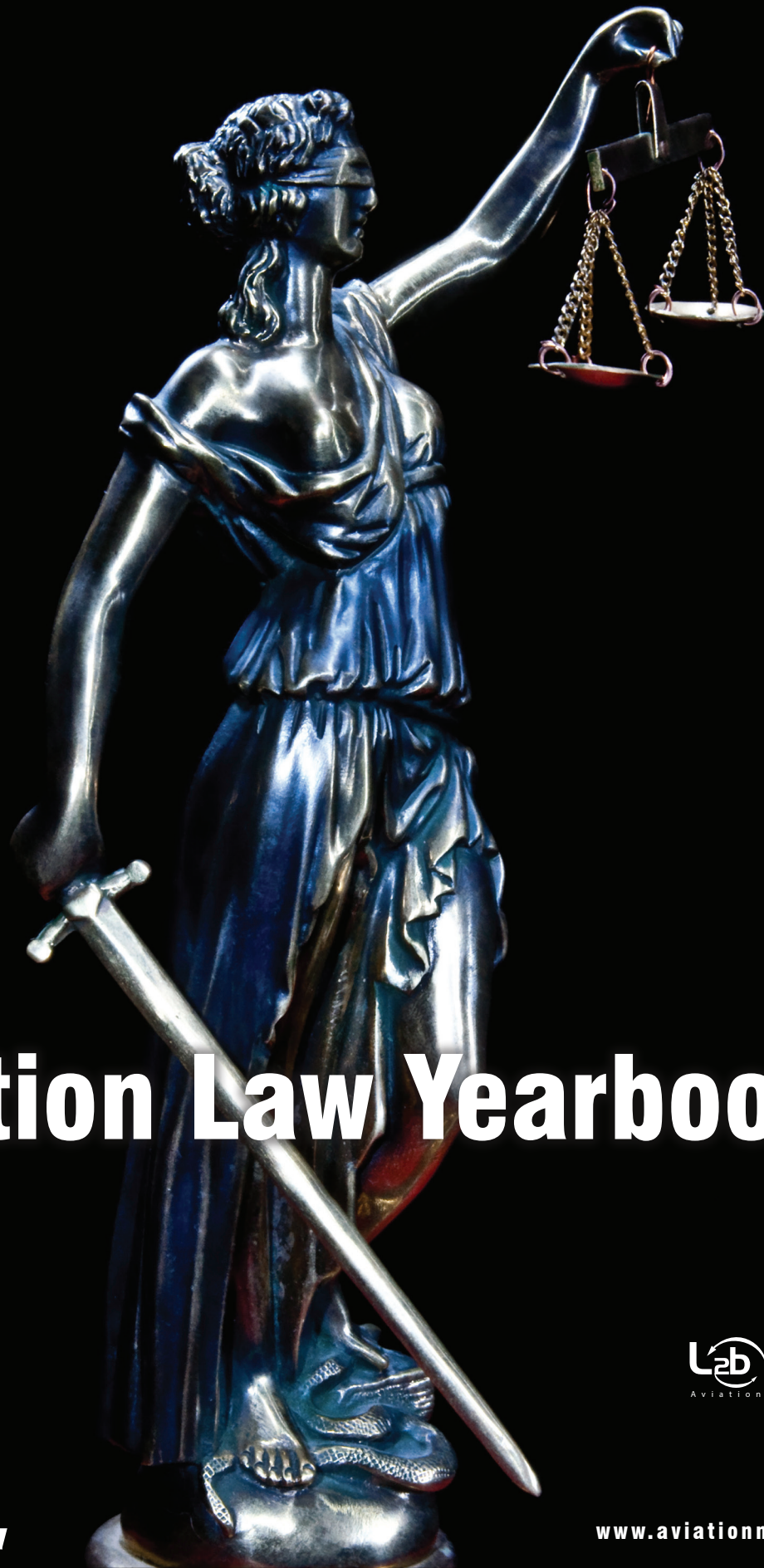



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Chinese lessors expand their reach

Debra Erni, Partner, Pillsbury Law explores the growing influence of China and Hong Kong in the aircraft leasing market



In the context of commercial aircraft financing, expanding foreign investment from Asia has seen a rapid emergence of new power houses in the leasing company space, particularly in the People's Republic of China (PRC). The PRC's financial leasing industry as a whole has continued to expand in the past 18 months with total turnover reaching around RMB 3,420bn (\$500 million) as of the end of March 2015, up about RMB 220bn (\$340 million)

compared to the end of 2014, and it is the aviation segment in particular that has witnessed continuous growth.

In 2007, the PRC permitted state banks to have leasing units, resulting in all five state banks and one of the major policy banks forming new aircraft lessors in a space of less than 18 months. In December 2013 the central government again stated its desire for PRC lessors to become some of the biggest in the world by 2030. There were reportedly only 20 domestic lessors in the PRC in 2013 and

whilst the current number is not entirely clear, the major players in the field are going from strength to strength with the civil aircraft leasing market expected to reach \$130bn by 2025. At the end of September 2014, China's civil aviation industry had nearly 2,200 passenger planes in service, of which 1,500 planes were leased (40% via finance leases).

The rapid domestic growth forecast in China is not the sole driver and the rising number and activity of PRC lessors follows express government

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the industry. Coupled with this, their acquisition of, and investment into, established foreign leasing companies has provided immediate access to management experience and a wider customer base.

CDB Leasing is arguably the best known of the PRC lessors, leasing to 43 airlines (including all the main airlines in the PRC as well as lessees in another 23 countries). The lessor used a Japanese operating lease with call option (Jolco) in 2012 to finance aircraft for Japan Airlines and it has been looking at using ECA financing from Natixis to expand its portfolio. Reports throughout 2015 highlighted that it was also exploring the option of listing on the HKSE. In addition to its three domestic platforms in the PRC, it also operates out of Dublin.

ICBC Financial Leasing has the largest asset base of the PRC lessors (including ships) and currently owns and manages just over 300 aircraft. In March, it signed a purchase order with the Chinese manufacturer COMAC for 30 ARJ21-700 aircraft (following an order for four C919s in 2011), and it has also recently completed the first ever cross border lease into Nepal of

an Airbus A320-200 to Himalaya Airlines, adopting a novel structure with the use of a Chinese special purpose vehicle (SPV).

A now established name in the industry, Minsheng Financial Leasing, is looking to move into the Hong Kong market. The lessor has also been active in the US market, signing up to a \$300 million financing of eight Gulfstream aircraft, using a US Ex-Im Bank guarantee and a memorandum of understanding with Boeing for 30 737s, a number which would more than double its current portfolio. In 2014, the lessor counted full-service carriers, such as China Eastern and China Airlines, and low-cost carriers, such as Ryanair and Norwegian Air, among its customers.

The PRC top ten is completed by CMB Financial Leasing, Bank of Communications Financial Leasing, CCB Financial Leasing, ABC Financial Leasing, Changjiang Leasing (its parent company, HNA Capital, also has a share in Hong Kong Aviation Capital) and AVIC Leasing, all of whom have been involved in a range of transactions in the past 18 months, and finally Bohai Leasing, one of the main shareholders of Hong Kong Aviation Capital (HKAC) and the successful bidder of a 20% stake in Irish lessor Avolon in September 2015. It is currently the only listed leasing company in the PRC.

Reports have also highlighted that a new start-up Rongzhong International Financial Leasing commenced trading in February 2015 and another name to watch in 2016 will be the Shanghai-based aviation division of Ping An International Financial Leasing, a wholly owned subsidiary of Ping An Insurance Group – the largest non-state company in China. In addition to a sizeable order of COMAC aircraft made in June 2016, this new entrant is due to expand its portfolio in the first part of 2016 with the arrival of reportedly 30 Boeing and Airbus aircraft via sale and lease back transactions. It also established an Irish subsidiary in September 2015 and is currently building up a Dublin based team

Despite the fact that most of the Chinese entities are connected to the state through their parent corporation being a state owned bank or corporation, they

encouragement to grow and diversify internationally. While the historical trend was always for PRC based leasing companies to focus on inter-state leasing, reflecting previous regulatory limitations and the availability of the free trade zones (Tianjin, Shanghai, Fujian and Guangdong), Chinese lessors have now become conspicuous in their aggressive pursuit of assets with leases attached to foreign airlines as a means to expand their portfolios and enhance bargaining power and influence in



have resorted to using traditional means for funding their aircraft purchases; as mentioned above Minsheng Financial Leasing has used US Ex-Im guarantees for purchase orders having previously had a bridge facility with DVB Bank, in August 2015 CMB Financial Leasing refinanced three aircraft using DVB Bank and Morgan Stanley debt and CDB Leasing is in talks with Natixis regarding ECA financing for Airbus and Boeing deliveries.

The Hong Kong lessor base continues to develop with BOC Aviation and China Aircraft Leasing (CALC) very active in the market. BOC Aviation owns/manages more than 250 aircraft with 200 currently on order and it recently extended its \$2bn revolving credit facility which matures in 2022 with Bank of China. It has 60 airlines on its books.

CALC is Hong Kong based and listed with offices in four PRC cities and is marketed as “the largest aircraft operating lessor in China, in terms of new aircraft import under lease each year”. It completed a \$224 million ECA backed facility in April 2015 that will cover 5 A320s and it has a further 100 A320s on order after signing a new purchase order with Airbus in Paris in 2015.

Hong Kong Aviation Capital (HKAC) has been very public in its intention to expand over the next two years saying

it aims to boost its portfolio by about \$2bn to \$5bn by the end of 2016. It signed a purchase order for 70 A320s in 2014 and in 2015 delivered both Airbus and Boeing aircraft to a range of airlines including Volaris, SriLankan and Jetstar. Financing has come through ECA support and it has PDP financings (with Natixis) listed on its website. It also secured \$300 million in funding from shareholder Bohai Leasing in July 2015.

Two new lessors entered the market in 2015, Hong Kong financial group Bridge Partners opened up an aviation division in July and Astro Aircraft Leasing also launched, although neither have any deals in the public domain as of yet.

Hong Kong has been very open about its intention to become more of a rival to Singapore and Ireland and it has recently introduced withholding tax reductions aimed at establishing the city as an aircraft leasing and financial hub. Designed to make the city more desirable and competitive, tax on Hong Kong-PRC transactions has been reduced from 7% to 5% meaning the Hong Kong based lessors can now offer more attractive rates to PRC airlines.

Last and certainly not least, we must make mention of the fairly recent entry of two very high profile individuals into the aircraft leasing market. Cheung Kong Holdings’ owner, Li Ka-shing, (Asia’s richest man) has courted much press

attention through significant expansion of his holdings within the aircraft leasing business in the past 18 months and a number of articles have suggested that his involvement in the market could spur others into seeking out targets as aviation is seen as a more stable and possibly profitable investment than real estate. Cheng Yu-Tung is such a case in point. Hong Kong’s fourth richest man has, via Chow Tai Fook and NWS Holdings invested in start-up Goshawk Aviation, a JV formed in late 2013 with Investec Bank. Having secured a \$605 million non-recourse secured loan facility in July 2015 the Dublin based lessor has recently ramped up staff numbers and will be a name to watch in 2016. Cheung Kong, through its Dublin-headquartered Accipiter Holdings, bought 18 planes from units of GE Capital Aviation Services for around \$714.8 million in 2014 and reportedly struck a deal to buy 60 aircraft from AWAS before being outbid by Macquarie for the portfolio. Cheung Kong also entered into a JV with MCAP in March 2015 (50% Cheung Kong, 10% Li Ka Shing Foundation and 40% MCAP), creating Vermillion Aviation. Vermillion purchased 15 vintage aircraft from MCAP in February 2015 with its Irish entity (Vermillion Aviation Holdings Ireland Limited) and concluded a purchase and leaseback arrangement with Avianca Brasil for new Airbus A320-200 in August 2015.