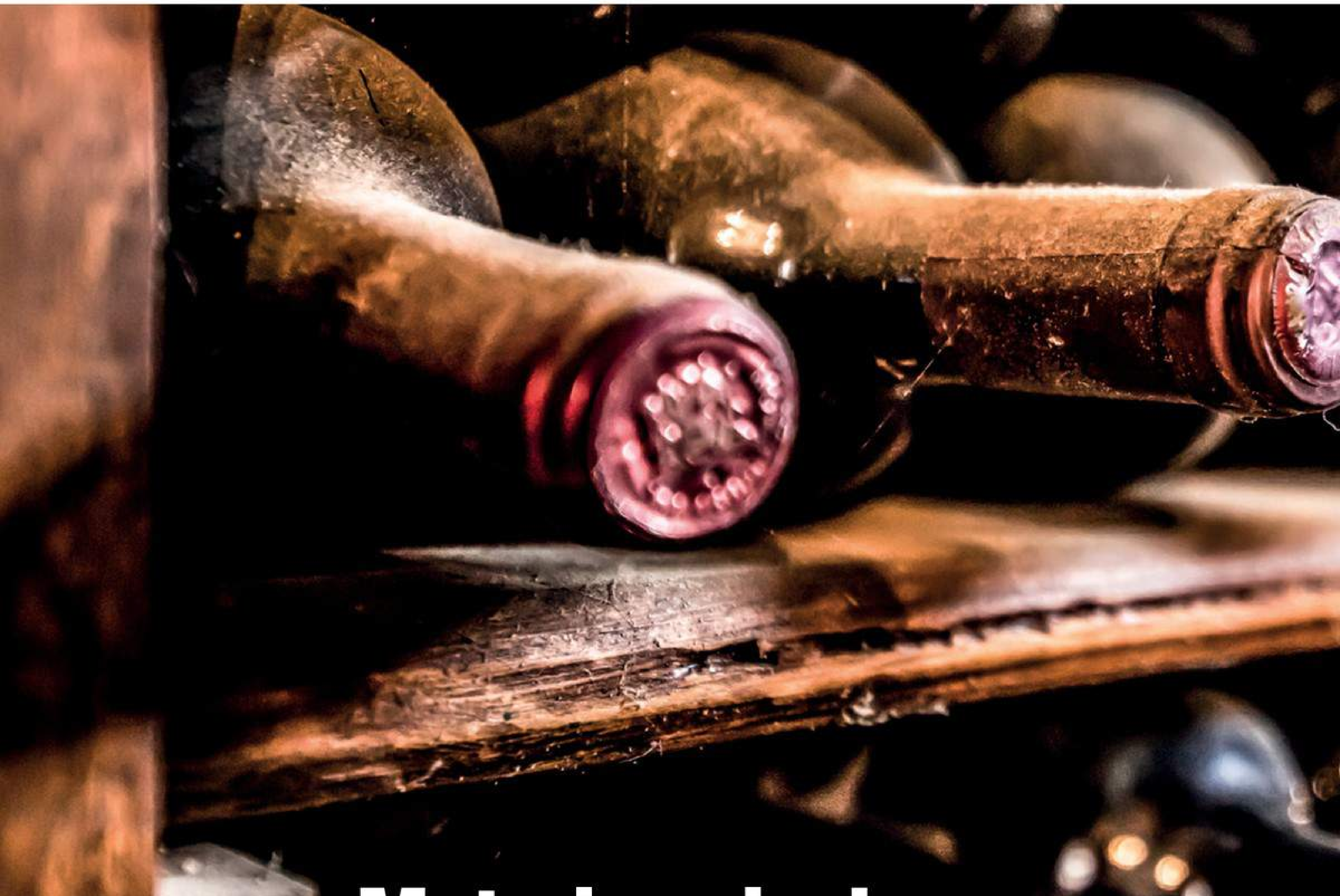

Maturing nicely

Crianza Aviation continues to innovate and pursue opportunities in a challenging market. Victoria Tozer-Pennington reports.

Crianza Aviation – the aircraft leasing company created in 2016 with the express aim of becoming a leasing entity in Korea for the Korean market – made headlines this last quarter with the announcement that it had successfully arranged the world's first sustainability linked operating leases with a global airline, in relation to Boeing 787 and Airbus A350 aircraft.

Although sustainability-linked aviation finance deals have been closed and are becoming more popular as the industry's sustainability efforts improve, to date this is the first known operating lease to be linked to an airline's performance on environment, social and governance – ESG – issues.

The operating lease – signed with the unnamed airline earlier in 2021 – include a two-way step-up / step-down pricing mechanism, to incentivise improvements in the airline's ESG performance and demonstrate commitment to its sustainability strategy. Banco Santander acted as the ESG Structurer of the deal.

Although this ESG-linked deal is a fantastic endorsement of Crianza's innovative team, it only further enhances the quality of Crianza's portfolio, which has performed robustly during the pandemic.

"We are very pleased having been able to implement this novel structure based on the strong relationship and close collaboration between the teams involved," says Baldur Vander, CEO of Crianza Aviation. "It provides an excellent example of Crianza's strategy of providing added value to its airline clients and actively addressing a global topic of key importance for its clients as well as the whole aviation industry."

Airline Economics has followed the fortunes of Crianza Aviation since its inception in 2016. In 2018, this magazine reported on how the maturing leasing company had expanded with the acquisition of a majority stake in East Merchant forming an integrated lessir group. As the company name suggests, the team has continued to mature and has engaged its deep industry experience gained from a number of economic cycles to manage its portfolio successfully through the challenging pandemic period.

Vander has also had an optimistic outlook of the industry and presenting at an *Airline Economics* virtual event in March 2020, he remained confident that the fundamental industry drivers would ensure the resilience of the industry going into the pandemic. Speaking to *Airline Economics* in December 2021,

Baldur Vander

Vander remains optimistic but more realistic in the wake of close to two years of restrictions on air travel and a barrage of pandemic-related global headwinds impacting the aviation market. "Despite the radically changed operating environment, we remain positive regarding those industry drivers," he says. "I am confident that the industry will return to 2019 levels of air travel at some point. But those levels may not even be a good measure of economic success anymore since any well-managed airline will have changed its economic operations during the crisis and I would expect them to be profitable at a much lower traffic level than 2019 – maybe back to 2014 or 2015 levels."

It's a valid point. The entire air travel industry has set 2019 air travel and profitability levels as the benchmark for when it can confidently declare an end to the recovery period. But as Vander says, those levels may no longer make sense for any airline or leasing company for that matter, which have all become more efficient and flexible businesses that are (hopefully) better prepared for future exogenous shocks.

For Crianza Aviation, its strategy has remained the same since its inception – focus on prime airlines, with long-term leases, and modern widebody aircraft essential to an airline's fleet, as well as staggering the leases to ensure the company is not overwhelmed by leases maturity at the same time. "This strategy has worked well for us throughout the pandemic period since all of our airline customers have the financials and the shareholder support to weather the crisis," says Vander. "The long-term leases were absolutely key to bridging the crisis. The fact that our airlines need their aircraft as a backbone of the fleet has created stability."

As a widebody investor, despite expert commentary to the contrary, Crianza Aviation has not been impacted by the general decline in current market widebody values. "Appraisal numbers haven't worried us so much due to the long-term nature of our investments. I'm convinced market values will rise. The fluctuation in values in no surprise, we've seen it before after 9/11 and the Global Financial Crisis. Short-term fluctuations like these do not impact long-term leases."

Managing aviation assets through a crisis is baked into the DNA of the Crianza team. Indeed, as EastMerchant managing directors, Vander and Patrick Giese, benefitted from the Global Financial Crisis in 2009 to lead the management buyout of the EastMerchant Leipzig aircraft portfolio to create East Merchant Capital that advises on aviation finance throughout the value chain of a transaction.

Being so close to their clients has enabled Vander to maintain a comprehensive view of how the industry has been preforming over the crisis period and his experience of several cycles has enabled him and the team to distil facts and figures through an experience lens in regular updates to shareholders. "When the crisis hit, we entered into a very short term reporting cycle to our investors," shares Vander, which normally took place every three months. "We moved to bi-weekly reporting on our customers but we also started reporting on all the peer airlines of our clients. We covered about almost 20 airlines every two week so we could provide our stakeholders with a comprehensive picture of the industry."

At the same time, the team foresaw a liquidity crisis on the immediate horizon and worked to get ahead of the crowd: "We started working with our Korean partners to try to create a pocket of liquidity that we could have in place to provide support for our clients," Vander explains. "In a way this was a better quality defensive measure for us since our transactions are so highly structured, often including currency elements and swaps, if we had to defer lease payments that would break our swaps and the cost of that versus assisting our clients with liquidity needs would be exceeded vastly by the damage done."

The Crianza team took the proactive decision to help keep the cashflows in the structured lease agreements intact and assist their airline clients with their liquidity needs in other parts of their business. "We told our clients that if they had liquidity issues, that we would help with financing rather than change the lease," he says. "This approach may be unique to Crianza but keeping the lease cashflow intact was in our client's interest, and our Korean investors, which would not have appreciated cashflows being disrupted and they also have a long memory."

This unique approach from Crianza protected the leasing business, the investors and the airlines but most importantly protected the Korean investor base that was only just beginning to open back up to aviation investment. "If we has started breaking our leases, there would probably not be a quick back in to the Korean market," says Vander. "This process was very time and labor extensive, but the bottom line today is that we did not have one single payment delayed. We did not have one single cashflow reduced. And our investors continue to receive their stable long-term cash flows."

This radical approach was perhaps even more unexpected since it was the leasing company proactively approaching clients to offer this additional aid. "Even when clients had not asked for restructuring help, we approached all of our customers,

including those where we were 100% sure that they didnt need our assistance, to tell them that we understood that the crisis was a very special situation we are all in together and that we would like to help."

Vander describes this as a by-pass or complementary solution that has worked well for its Korean investors who were willing to provide more liquidity for top tier airlines. "Despite the pandemic, our Korean investors remained absolutely convinced of the credits of our airline clients, and although we were rather cautious at the outset of asking for additional mandates, we were actually finally asked to increase the mandate by investors."

STRUCTURING THE SIA DEAL

Alongside managing its excising portfolio and assisting clients with their liquidity issues, the team have also been on high alert for the many opportunities to broaden the portfolio with prime assets and top tier airline credits.

"We increased our push in late June by showing transactions which had been closed successfully in the meantime and providing a matrix reflecting various degrees of asset risk and credit risk," says Vander. "This proved to have been a good thing, when we started considering a transaction for Singapore Airlines in August. Based on the 11 SIA aircraft we had already closed in the past, our initial approach was to try to regroup our regular team of partners. Due to the crisis environment, this proved to be significantly more complex than in the past, as we found that many banks were not willing to support new aviation transactions at that time."

Crianza's initial approach was its "traditional" three-layer structure with ca. 65% debt, 20% balloon-mezzanine and 15% equity. But the team was "quickly sent back to the drawing board" because at that stage Korean investors were digesting issues encountered in other transactions. The team quickly changed the scope to increasing the senior loan and involving parties offering junior loans based on debt funds. The complexity of the deal was also compounded by the fact that Crianza was targeting widebodies aircraft assets, which required a significant overall financing amount, and also by mixed preferences of lender committees for either Boeing or Airbus aircraft.

"By late October, we were settled with the new structure but shortly before we could formalize them, interest rates had moved so significantly in January, that we had to go back to the drawing board once again," shares Vender. "As it turned out, adding an additional layer of support by AFIC/Balthazar, where we had initially shied away from due to the complexity, allowed us to readjust our financial model and achieve the structural gains needed to make up for higher interest rates."

The Singapore Airlines (SIA) sale-leaseback transactions for 11 aircraft, comprising seven Airbus A350-900s and four Boeing 787-10s, raising approximately S$2.0 billion in total, was arranged by four different parties including Crianza Aviation/ EastMerchant.

EastMerchant and Crianza Aviation purchased two 787-10s 9 (MSN 60263/60264) and one A350-900 (MSN 379). This transaction featured a novel, multi-layered financing structure with the senior financing being supported by KfW IPEX-Bank / Balthazar for the Airbus A350-900 and the two Boeing 787-10 financed by AFIC / Natixis Singapore and Apple Bank, which is complemented by Korean mezzanine debt raised by Seoul based Cerritos Holdings as well as equity from Korean investors together with Crianza.

This deal was the first operating lease that has been supported by Balthazar and is the first time that AFIC has supported a 787-10 aircraft and the first time it has supported a sale-leaseback deal on a limited recourse basis. This is the first time that both AFIC and Balthazar have worked with SIA.

"We had initially not expected for a transaction for Singapore Airlines to turn into a supported transaction, especially as neither AFIC nor KFW/ Balthazar had previously supported a limited recourse structure," says Vander. "But the immense energy and effort shown by all parties involved allowed us to quickly regain traction to meet the airline's closing day requirements."

This transaction combined Crianza's crisis proven investment strategy with EastMerchant's 20 years history and proven record of managing and remarketing widebody aircraft, which is what gave both AFIC and KfW/ Balthazar the confidence to enter into their first limited recourse transaction in the context of an operating lease.

Crianza is clearly moving ahead with its ground-breaking ESG-linked operating lease but it is also maintaining its focus on investing into widebody aircraft for top tier names with long-term leases, even though as Vander warns the market currently is "clearly overheated for good credits", noting that Crianza is "maintaining investment discipline" going forwards. Taking its most recent transactions as a template, Crianza is confident it will continue to be able to offer an attractive mix of bespoke leasing modules to airlines in the range of customized, structured lease transactions, possibly even with multiple currencies and various lease options, supported financings, sustainability linked features, and/or hybrid PDP solutions.