Reflections on the revolution in leasing

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William Glaister was until the end of April 2023 head of Clifford Chance's global asset finance group specialising in advising financiers, lessors and operators on all aspects of big-ticket asset finance transactions.

He is a one-career person having joined Clifford Chance in 1991. He graduated from University College London in 1989 with a BA reading history. He was admitted as a solicitor in England and Wales in 1993. Glaister was seconded to the firm's Singapore office in 1996-97 and the Hong Kong SAR office btween 1997 and 2001. He became a partner in 2000.

Glaister headed a team of 16 partners across the world with offices in New York, Hong Kong SAR, Singapore and Dubai, and passed the baton to Zarrar Sehgal, from the New York office, at the end of April.



Zarrar Sehgal succeeded William Glaister as Clifford Chance's head of the global asset finance group earlier this month.

Glaister agrees the move to appoint a new global head in North America represents a "shift" for Clifford Chance. He says it reflects the significance of the US market for the practice.

"The practice is still very global and undoubtedly remains the pre-eminent global aviation finance practice. We have partners in New York, London and Asia and some great junior talent emerging but certainly the more complex structured finance transactions in the capital markets, in particular, are tilting towards the US market. It is now more US driven than it ever was," he says.

Clifford Chance has over the years developed its US practice ahead of UK firms that do not necessarily have that level of aviation finance presence in New York. In 1991, the firm had an office in the US market but did not have a dedicated asset finance presence there.

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“That really developed when the firm hired John Howitt in 2006 and, with the arrival of Zarrar Sehgal around the same time, it really launched our practice. When I look back, this was the most significant development that propelled us to allow the firm to do big-ticket transactions,” he comments.

Glaister believes the capital markets will be there in the future, whether it is public or private.

“It is a dollar industry, and it will remain a dollar-funded industry for many years. I don’t see that predominance of the US dollar in our industry moving away anytime soon and the US capital markets will remain the centre of funding in our industry. Funding in other currencies should develop and, in a way, it is surprising that those have not accounted for more.”

He recalls that the European capital markets are nowhere as deep and sophisticated as the US market to the extent there is lots of funding from pension funds. “I don’t think they are so keen on some of the aviation assets.”

Glaister adds: “The bank market is stronger on euro-denominated lending by definition and capital market transactions are uncompetitive pricing-wise for euro debt. They are certainly more expensive to put in place as the deal execution is more costly. The combination of those things means the lack of appetite for it in Europe when the bank market remains competitive.

“In the early ’90s, the Japanese banks really started to become active in aviation alongside the Japanese leveraged lease product. Likewise, the French and German banks were more aligned to tax products at the time.

“The capital market products have been hindered because the banks have remained so strong in Europe, although the growth of the ABS [asset-backed securities] market has shown demand for capital markets when the conditions are right.”

The main change in the banking market has been the gradual withdrawal of the tax allowances to finance the aviation space, with the exception of Japan and, to some extent, the French market.

“When I started, almost every financing for British Airways was a Japanese leveraged lease,” he says. “Many banks were offering tax lease-linked products but as the industry developed in the late 2000s, appetite for those products was eroded by legislative crackdowns. Now we are just left mainly with the Japanese products.”



Glaister agrees aviation banks will continue to fund the market, but he points out that the regulators “are not encouraging them to do long-term secured lending” particularly on assets that are not core infrastructure.

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He says: “The regulatory cost of that kind of lending by banks will increase as the Basel rules evolve. In addition, the regulators will get involved in emissionsrelated issues (especially in Europe) and will dissuade banks from lending against assets that they don’t regard as ‘clean’. It is already an issue for certain banks with their shareholders, but that will become increasingly governed by the regulators.”

The current debate over the EU taxonomy, and whether even brand-new, fuel-efficient aircraft are “green” or even “transitional” is evidence of this.

“I don’t think they will never prohibit financing against aviation assets, but they will impose more capital requirements,” he comments.

For Glaister, this provides more opportunities to alternative lenders.

"It comes back to the capital markets as most of those lenders are funding in the capital markets,” he says. “They are better at intermediating the funds between the capital markets and the customers and have very little regulatory constraints.”

Glaister started to work with alternative lenders in 1999 with PK Airfinance (now Apollo) but he confirms that alternative lenders are representative of the current trend of moving away from financing just mature aircraft towards brand-new asset deliveries with top-tier airlines.

“It is an attractive asset class for some alternative lenders with good security and returns. It is a good hedge within their portfolios on the global economy. They have gone through Covid and are here to stay. That is not only a trend within aviation but also in other sectors like real estate,” he comments.

Glaister believes that insurancesupported financing products are allowing banks to remain active in the sector because it addresses the regulatory capital requirements and the credit diversification.

“Those products will definitely remain and address that pocket of risk exposure that insurance companies don’t want to fund themselves. Insurance companies normally buy bonds, and financing aircraft individual loans is not their core business. They won’t manage aircraft portfolios
and therefore gaining exposure on an unfunded basis fits their strategy whilst allowing banks to obtain better reg cap treatment,” he says.

Glaister has worked with the export credit agencies (ECAs) for most of his career and is not surprised by their retrenchment.

“The ECAs have moved back to their primary role: being a lender of the last resort. The development of the insurance products and the increasing role of alternative lenders has allowed them to retreat to that role,” he adds.

For him, from a tax-payer perspective, this is fair. He does not see the current changes in benchmark regulation, with US dollar Libor being replaced by the secured overnight financing rate (SOFR), as affecting any of these trends.

“The drive towards SOFR is driven by a specific regulatory concern over the calculation of Libor and risk of manipulation of that calculation. The desire for a term SOFR product to provide certainty has to be balanced against the regulators’ desire for transparency which the overnight SOFR rates provide.”

He notes that the process is less than perfect and the way in which the swaps market and the loan market have gone down slightly different paths on some issues is unhelpful. Having identified the problem, he believes the regulators should have been more proactive in implementing the solution.

But while the benchmark changes will be permanent once the change process has been completed, in a few years’ time, he does not see it as being an issue of contention going forwards. “The contentious issue is going to be the regulatory influences around emissions,” he says.

Operating lessors

But for Glaister, the main change in funding the industry has been the growth of the operating lessor.

“They hardly existed back then. After barely a year at the firm, I started working on the GPA initial public offering. This was my first introduction of operating lessors and one of the first matters I worked on. Unfortunately, it fell over and spawned into the financing of the GPA ALPS 92-1 issuance, the first-ever aircraft ABS.”

While GPA difficulties caused it to fracture into Aerfi (Aercap) and GECAS (owned by General Electric), ILFC was growing significantly at that time and there were also big Japanese leasing firms which started moving into the sector.

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The formation of Singapore Aircraft Leasing Enterprise (now BOC Aviation) in the mid-1990s was unique in that it showed state interest in aircraft leasing (something now more prevalent).

The lessor was first founded by Singapore Airlines and US lessor Boullioun Aviation Services, and the company's shareholder base broadened when Temasek Holdings and the Government of Singapore Investment Corporation invested in 1997.

The growth of operating lessors is evidenced by their share of commercial aircraft moving from high single digits in the early 1990s to now more than 50% by value.

As lessors have grown, the friction cost of moving aircraft around has come down. The nature of financing has become commoditised and implementation is relatively cheap.

"There is no novelty in doing a secured loan for an asset; it is a well-trod path. But, at the same time, the stronger lessors, those with investment-grade ratings, are funding themselves through unsecured paper. That massively reduces the friction cost of moving assets around and that
gives a more competitive advantage versus secured funding.

"The operating leasing industry is where growth has most significantly impacted our sector over the past 30 years."

Glaister believes there will be a natural cap because some well-funded carriers inevitably are keen to own their assets, especially if those are core to the fleet.

But he says it is not a coincidence that the growth of operating lessors over the years has allowed the development of lowcost carriers.

"Obtaining an aircraft was always a barrier to entry for the airline industry and the operating lessors reduced that barrier," he says.

To Glaister, the dynamics of the operating lessor industry has changed over the years in terms of the new inventory lessors need to place. And their risk tolerance has extended to weaker credits as the legal environment has allowed lessors to take more risk.

"That has been facilitated on the legal side by the development of processes around aircraft repossessions. The Cape Town Convention has greatly helped but even in some jurisdictions where there is not Cape Town, the process of repossessing an aircraft 25 years ago was a massive and complex exercise for lessors. Today, lessors can repossess an asset within a few weeks if not days," he explains.

Glaister sees more consolidation activity among lessors.

"We have seen an increasing consolidation trend amongst the lessors and the increasing cost of capital, inflation in SG&A and staff costs has pushed a need to fund on unsecured basis to be competitive, and that means more consolidation is inevitable. The acquisition of GECAS by Aercap is evidence of this trend," he says.

It has almost come full circle for Glaister: from the collapse of the GPA initial public offering in 1992 to the acquisition in 2021 that has propelled Aercap into being the world's biggest lessor.

But, he believes the environmental issues will be the main challenge going forward for aviation.

"The cost of capital into the aviation industry is going to change and be increasingly affected by environmental issues," he says. "Newer assets will have a cheaper cost of capital relative to older assets, but it will still in absolute terms be higher than today; and if we think about what that means for the industry, it is raising a barrier to entry to new entrants, both for airlines and lessors.

"Unwittingly, perhaps, I think this is going to drive consolidation and reduce competition."

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