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Tighter Aircraft Market Demands Creative Restructuring Solutions

Kelly DiBlasi
Weil, Gotshal & Manges

Bloomberg Law

- *Weil's Kelly DiBlasi examines changes in aviation industry*
- *Distressed operators require careful planning, guidance*

With aircraft manufacturers significantly decreasing production and experiencing delivery delays, the market for new and used aircraft has tightened in recent years. This has shifted negotiating leverage in favor of aircraft lessors and finance parties, affecting such parties' behavior in response to defaults and restructurings.

The new environment may even accelerate or deepen existing distress in aviation companies, which may be less likely to succeed in negotiating consensual resolutions and amending aircraft agreement terms.

Aircraft operators facing financial challenges will need careful planning and legal guidance to navigate any performance issues under their aircraft agreements and develop and implement fleet restructuring strategies.

Escalating Distress

Air travel has recovered to near pre-pandemic levels, creating demand for aircraft. At the same time, airlines and aircraft operators are competing to secure orders from a limited supply of new aircraft or look to extend existing lease terms to retain equipment or enter into new leases.

Many airlines and aircraft operators are struggling to contend with increased competition, materially higher labor costs, higher interest rates, and rising fuel costs and other expenses. The changing landscape in the aircraft market may further strain these companies' resources. Aircraft operators may be forced to acquire and retain aircraft at a premium.

Lessors can demand higher lease rates, and new aircraft are purchased and financed at a greater cost, putting additional pressure on aircraft operators' financial condition. This may accelerate or intensify existing stress experienced by such companies. In recent weeks, many airlines around the world have issued profit warnings on softening demand and higher costs.

Altering Behavior

It's reasonable to expect parties to behave more aggressively in response to a payment or other default by an aircraft counterparty when aircraft lessors and finance parties have more flexibility to market and place equipment and take advantage of higher lease rates and other improved economic terms.

Lessors and aircraft financiers faced a user market with significantly lower demand in the Covid-19 pandemic years, when air travel shrunk and was slow to recover. These creditors were more inclined to grant relief to airlines and operators who breached or were anticipated to breach aircraft leases or financing arrangements.

Finance parties and lessors had less incentive to exercise remedies and take back equipment when there were lower market lease rates and interest rates, coupled with the difficulty and cost of reconfiguring and placing aircraft with new customers. These creditors were more willing to grant waivers or forbearances, defer rent or mortgage payments, extend terms, and execute amendments, including to reduce rates.

These parties may be less inclined to work cooperatively to grant accommodations going forward. There is more incentive to enforce remedies quickly to take back equipment when it can be leased or sold more easily, and potentially with improved economic terms.

Airlines and aircraft operators must be cautious to avoid defaults and be prepared to enact protective measures quickly. This includes careful liquidity planning, regular monitoring of cash flows and covenant compliance, and potentially hiring financial and legal advisers to understand the company's risks and options and develop contingency plans.

Airlines and aircraft operators are well-advised to seek waivers or forbearances before or during the grace period of a default. They also should be wary of relying on informal handshake assurances that counterparties won't exercise remedies without such protections.

If aircraft counterparties refuse to grant consensual relief, the company may require an in-court insolvency proceeding with a stay of enforcement of creditor remedies to provide breathing room to restructure the fleet and other liabilities. Restructuring strategies take time to prepare and implement, so advance planning is critical.

Effect on Restructurings

Pandemic and post-pandemic era restructurings saw many aircraft lessors and finance parties willing to renegotiate lower lease rates, provide better financing terms, allow operators additional time to decide whether to retain or return aircraft, and otherwise accommodate operators rather than get stuck with returned equipment.

In the current market, lessors and finance parties are more likely to take a different, more aggressive approach. These parties may demand higher rates and greater economic terms, strictly enforce waiting periods, and object to restructuring plans, particularly if the equipment model is in high demand and they can take possession and place it with a new operator for profit.

This, in turn, may make it more challenging for aviation debtors to restructure successfully and may require additional measures, such as downsizing operations, adjusting fleet plans, selling assets, and securing larger capital injections.

Outlook

Participants in the aviation industry should be mindful of changing trends in a tightened (or deteriorating) aircraft market and the potential implications for airlines and aircraft operators in distress.

These changes call for vigilant monitoring of the company's financial situation, diligent planning, and proper professional guidance to develop and implement creative and practical restructuring solutions.

> ***Kelly DiBlasi*** *is partner in the restructuring department at Weil, Gotshal & Manges. She advises debtors, creditors, equity interest holders, and other constituents in domestic and international restructurings and crisis management, with particular expertise in aviation restructurings.*