



EUROPEAN INVESTMENT BANK (EIB)



Summary of ERA's work with the EIB to provide more access to finance for regional aircraft

SUMMARY AND BACKGROUND

Following the global economic downturn after the US subprime mortgage crisis between 2007 and 2010, which contributed to the recession in the US from December 2007 to June 2009, traditional financing sources for many European regional airlines and leasing organisations almost completely dried up. Simultaneously, legislation was produced that created a need for EU regional operators to equip their fleets with modern communication, navigation and surveillance equipment as mandated under the Single European Sky. For ERA member airlines,

upgrading aircraft was difficult, disproportionately expensive and, in a few cases, practically technically impossible. The need to replace ageing aircraft with aircraft either incorporating the required technology or with capability for retrofit, and with greater load factor capability, performance and overall fuel efficiency became apparent. A significant obstacle was that regional aviation was seen by financiers as having a small market share and little financial market value compared to the market share offered by larger commercial operators.

THE CASE FOR FINANCING

In 2014, the ERA Chief Financial Officers' Group commissioned a study, *The Case for Investing in the Regional Airline Industry*, which aimed to:

- clarify the case for investing in, or lending, against regional jets and turboprops; and
- demonstrate the sound business rationale for this financing.

The study showed that the perception of regional aviation by many in the financing industry was skewed by the influence of mainline operators – the opinion that regional aviation serves only short, low-yield routes

that feed directly into the larger carrier networks. In fact, regional aviation in Europe is a niche industry that has grown considerably in recent decades. Turboprop aircraft can now have up to 70 seats and jets upwards of 80 to 100 seats.

Case studies in the report highlighted the following:

- The nature of the operation, route structure and fleet composition of a cross section of ERA members.
- Liquidity of aircraft type as vital investment criteria.
- Aircraft value performance over time.

The report also examined the status of the regional aircraft finance market, reviewed the mix of leases, loans and export credit on offer and assessed the main providers.



EUROPEAN INVESTMENT BANK

The European Investment Bank (EIB) is owned by and represents the interests of the European Union member states, working closely with other EU institutions to implement EU policy. As the world's largest multilateral borrower and lender, the bank provides finance and expertise for sustainable investment projects that contribute to EU policy objectives.

More than 90 per cent of the bank's activity is in Europe, and it typically finances one third of each selected project, although in some cases as much as 50 per cent. All the financed projects must be bankable and comply with strict technical, environmental and social standards. Such long-term, supportive financing encourages private and public sector investors to invest and the bank makes an excellent ally in strengthening the case for investing in regional aviation.

THE CAMPAIGN

Following a meeting between ERA and the EIB and further meetings with the relevant EIB divisions, ERA, along with members – particularly airlines, lessors, aircraft manufacturers and legal, insurance and financial services suppliers – sought to provide expertise and data to strengthen the case for financing to meet the EIB's technical, environmental and social criteria.

ERA invited member airlines and manufacturers to write to their local state finance ministers and heads of treasury in support of encouraging the EIB Board of Governors – comprised of members of EU member state finance ministers – to recognise the need for regional airline financing at a future EIB Management Board meeting.

Following many months of correspondence, discussions and physical meetings, the EIB Aviation, Maritime and Innovation Transport Division team presented a case to the EIB Management Board describing the credit gap in regional airline market. The reaction from the board was positive and this opened the door to further work by ERA to collect data from members to prepare a case study for the EIB board meeting in June 2016.

THE CHALLENGE

The EIB aviation team then prepared a test case to demonstrate the viability of a potential lending mechanism to which ERA provided input by supplying data from relevant members. The success of the study relied on a case where an operator was subjected to a number of strict eligibility tests, including the following:

- the borrower had to show that they have difficulty accessing financing elsewhere and therefore the EIB's involvement would benefit the interests of EU regional aviation;
- the operator was required to demonstrate territorial integrity – operations had to be regional in nature, serving destinations with limited access or not served readily by other transport means;
- consistency with EU's climate change policy covered by the EU ETS (or its successor scheme) and any capacity increase inherent in the project, rather than just replacement, to be carbon neutral; and
- demonstrating improved environmental performance; showing evidence of emissions reduction or fuel burn advantage over and above the aircraft being replaced.

The test case, successfully presented to the EIB Board at its July 2016 meeting, resulted in an acknowledgement that a credit gap for regional aircraft existed. The board adopted a lending guideline which stated the qualifying criteria and the type of operation which constitutes an exceptional case for supporting aircraft financing under the EIB Transport Lending Policy. The board also agreed to widen the eligibility to other intermediaries such as leasing companies and decided that there would be a review to assess the application of its policies following a notional three-year period on the basis of a cap of four to five operators or a cumulative amount of €1bn of loans, whichever came first.

SUCCESS FOR ERA MEMBERS

The decision by the EIB has signified a turning point in European airline financing and is great news for our members that seek to fly modern, more environmentally friendly and fuel-efficient aircraft.

The project has already begun to yield benefits; following highly detailed preparation and successful bids by ERA members KLM Cityhopper and Air Nostrum, the airlines have had a total of €546m financing approved in principle to purchase new Embraer and Bombardier aircraft.

ERA is looking forward to working with more members to encourage them to pursue similar financing from the €1bn pilot that the bank apportioned for regional fleet renewal. There is still funding available from the original cumulative total and ERA is continuing to help facilitate access to funding for members through the EIB and other sources.

For further information, please contact russell.dudley@eraa.org

FUTURE DEVELOPMENTS

The future growth and success of the business relies upon our airlines to be able to fly efficiently and economically providing the citizens of Europe with cost effective and efficient travel options. This initial pilot scheme has heralded an important turning point in financing for the regional airline industry and the successes achieved so far by two ERA airline members is significant.

Funds are still available from the initial allocation of €1bn but it is hoped that there will be additional

funding available at a later date. ERA will continue to support ERA members and facilitate the relationships between ERA members and the bank.

ERA's Policy and Technical department will continue to run its Chief Financial Officers' group to support ERA's airline members in improving their efficiency, performance and financial management in key focussed areas, including where possible meetings which include updates from the bank itself.



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