

JOURNAL

OF EQUIPMENT LEASE FINANCING

VOLUME 38 • NUMBER 3 • FALL 2020

Articles in the Journal of Equipment Lease Financing are intended to offer responsible, timely, in-depth analysis of market segments, finance sourcing, marketing and sales opportunities, liability management, tax laws regulatory issues, and current research in the field. Controversy is not shunned. If you have something important to say and would like to be published in the industry's most valuable educational journal, call 202.238.3400.

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Introducing a Special Issue on COVID-19 and Our Industry

By Kelli Jones Nienaber, Executive Director, Equipment Leasing & Finance Foundation

COVID-19 Impact Survey Retrospective – How Has Our Industry Changed?

By Tom Ware

The Foundation's COVID Survey Steering Committee has been surveying leasing and finance executives since April. As the data demonstrates, in a bad situation, our industry usually finds ways to adapt and mitigate, and make the situation better than initially expected.

Challenges for Private Aviation Deals During Covid-19

By Joel Charles Shapiro

Risk of exposure to COVID-19 in airports and on large aircraft has many businesses thinking about acquiring private aircraft. However, the pandemic requires a lessor to secure further protections in the charter, purchase, or finance of aircraft. This article outlines some of those considerations.

COVID-19 and the Maritime Industry

By Basil M. Karatzas

At the crossroads of trade, transportation, and logistics management, the maritime industry has unquestionably faced the slings and arrows of COVID-19. This article explains the implications of the pandemic—both bad and good—for various segments of the marine market.

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Our Industry Faces up to COVID-19



Introducing a Special Issue on COVID-19 and Our Industry

Thank you for your interest in the Equipment Leasing & Finance Foundation's Journal of Equipment Lease Financing! We are especially pleased to release this special issue focused on COVID-19 content and how it pertains to the equipment finance industry.

In this issue, you will find three articles focused on aviation, maritime, and highlights of the Foundation's monthly COVID-19 Impact Survey. We hope these resources and more help you and your business navigate this global crisis.

We look forward to seeing you virtually at ELFA's 2020 Business LIVE! later this month.

Best,

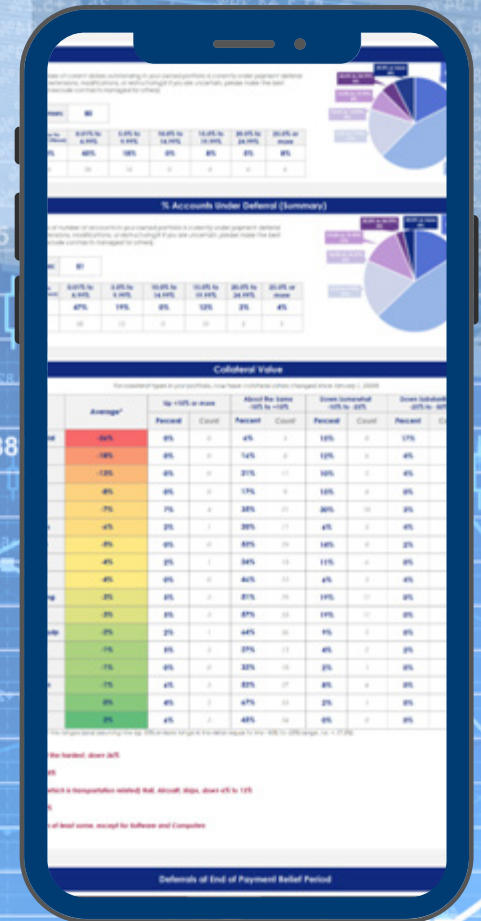


Kelli Jones Nienaber
Executive Director
Equipment Leasing & Finance Foundation

COVID-19 RESOURCES

Future-Focused Data Intelligence

The Equipment Leasing & Finance Foundation is *your* source for the most comprehensive, future-focused research and analyses available on the equipment finance industry. We offer several invaluable resources to assist you and your business in navigating COVID-19, all **FREE** to access.



Monthly COVID-19 Impact Survey

Podcast

The Equipment Leasing & Finance Foundation podcast is now available. The podcast will include up to six episodes throughout 2020 that will spotlight Foundation resources and programs, including interviews with researchers, Board of Trustees members, and more.

Episode 4: Have the Capital Markets Recovered from COVID-19?

Attention CFOs and Treasurers! In this episode, we offer a temperature reading on the health of the Capital Markets today, exploring how sick the Capital Markets were at the height of this global pandemic, whether structures and collateral pools changed during COVID-19, and much more. Three executives with Capital Markets expertise offer their unique perspectives: Du Trieu, Senior Director, Asset-Backed Securities, Fitch Ratings; Stewart Hayes, Senior Vice President, Lender Finance, Wells Fargo Commercial Capital; and Matthew Goldenberg, Treasurer, Balboa Capital.



EQUIPMENT LEASING & FINANCE FOUNDATION PODCAST
004 Have the Capital Markets Recovered from COVID-19?

30% 00:00:00 / 00:24:56 r30



Podcast Episodes



DON'T MISS!

The COVID-19 Economy and Outlook for Equipment Finance breakout session at ELFA 2020 Business LIVE! Wednesday, October 28 at 1:00 p.m. EDT.



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COVID-19 Impact Survey Retrospective – How Has Our Industry Changed?

The Foundation's COVID Survey Steering Committee has been surveying leasing and finance executives since April. As the data demonstrates, in a bad situation, our industry usually finds ways to adapt and mitigate, and make the situation better than initially expected.

By Tom Ware

In May of this year the Foundation launched a new survey of industry executives to shed light on how the pandemic was affecting our industry, with the hope that knowing how one's peers were being affected—and reacting—might lead to better decisionmaking. With five monthly surveys now completed, including a few enhancements made along the way by the COVID Survey Steering Committee, we are in a good position to look back on the data and how it has changed over time. The findings are cause for some cautious optimism.

PAYMENT DEFERRALS

As Table 1 shows, the portion of lenders' portfolios under deferral peaked in June and has declined by 60% since then—a very healthy development. On average, it is larger transactions that are being deferred, as the dollar basis deferral percentage is higher than the count basis deferral percentage.

Table 1.

% of Portfolio Under Deferral

	April	May	June	July	Aug	Sep
Dollar basis	6.8%	10.0%	15.3%	14.0%	8.9%	6.1%
Count basis	not asked	not asked	11.8%	11.4%	6.4%	4.6%

Source: All tables and figures were provided by the author.

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Captives started deferring later than other lenders, and never reached the 15+% levels that other lenders did.

Large and middle ticket deferrals peaked in June, while small ticket, where deferrals are more common, took a little longer, until July (Table 2). Large ticket transaction deferral rates are now down 42% from their peak, while middle ticket rates are down 70%.

Table 2.

By Ticket Size, % of Portfolio Under Deferral, Dollar Basis

Ticket size	April	May	June	July	Aug	Sep
Large	5.0%	6.7%	10.0%	6.1%	4.9%	5.8%
Middle	4.7%	7.1%	14.0%	12.7%	7.4%	4.1%
Small	10.4%	15.8%	19.0%	20.1%	14.0%	9.2%

The very largest lenders were slower to begin deferrals and never reached the same magnitude; however, today deferral rates are similar across institution sizes (Table 3).

Table 3.

By Lender Volume, % of Portfolio Under Deferral, Dollar Basis

	April	May	June	July	Aug	Sep
Over \$1 billion	3.3%	7.8%	12.2%	9.0%	6.1%	6.5%
\$250 million– \$1 billion	9.7%	13.7%	16.3%	12.4%	12.2%	4.9%
\$50–\$250 million	7.2%	9.6%	15.5%	20.0%	10.9%	6.4%
Under \$50 million	8.1%	10.9%	17.7%	16.2%	6.9%	7.9%

Captives started deferring later than other lenders, and never reached the 15+% levels that other lenders did (Table 4). Currently, however banks and captives have the most deferrals outstanding, while independents have far fewer.

Table 4.

By Institution Type, % of Portfolio Under Deferral, Dollar Basis

	April	May	June	July	Aug	Sep
Bank	8.1%	10.6%	14.5%	15.9%	10.3%	8.2%
Captive	3.2%	11.3%	10.6%	11.3%	9.3%	8.4%
Independent	8.5%	11.1%	17.8%	13.1%	8.8%	3.5%

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Beginning in August, the survey also included questions about what was occurring after the initial deferral.

While zero deferrals for communications equipment, and 3% to 5% for medical, office, and software seem reasonable, the 2% statistic for aircraft is surprising (Table 5). Though to the extent that these are not aircraft for general commercial carriers but rather corporate planes, it is conceivable that demand for them could have increased. These particular statistics, however, are highly derived and limited.¹

Table 5.

Approximate Deferral % by Equipment Type

Communication	0%
Aircraft	2%
Medical	3%
Office equipment	4%
Software	5%
Railroad	5%
Alternative energy	6%
Agriculture	6%
Computers	7%
Ships and boats	9%
Materials handling	11%
Automobiles	12%
Construction	12%
Other industrial	13%
Trucks	14%
Mining & oilfield	not avail.
Retail	not avail.

After the Initial Deferral

Beginning in August, the survey also included questions about what was occurring after the initial deferral (Table 6). Were borrowers paying as agreed, becoming delinquent or defaulting, or getting a second deferral?

Table 6.

Status of Accounts After Initial Deferral

	Aug	Sep
Paying as agreed	85.1%	87.3%
Delinquent/ defaulted	5.1%	2.9%
2nd deferral	9.8%	9.8%
Total	100.0%	100.0%

Surprisingly, second deferrals did not increase from August to September, but the portion of delinquent/defaulted decreased from 5.1% to 2.9% —a very encouraging development.

The data also show that lenders with 90+% of their previously deferred portfolio paying as agreed after the end of their original deferral period (without a second deferral) increased from 57% to 64% of lenders. Lenders giving a second deferral to more than 10% of their portfolio that had been deferred decreased from 36% of lenders to 32%. However, the percentage of lenders giving no second deferrals at all decreased from 32% to 28%.

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The results show that lenders were by far the most pessimistic in May, had a much improved outlook in June, and have become slightly more optimistic in more recent months.

DEFAULTS

A significant minority of lenders do not think that the pandemic, and its impact on unemployment and GDP, will materially affect default rates (Table 7). A small minority think default rates will be lower this year than last, though that may be a function of the responding institution having unusually high defaults in 2019.

Respondents were also asked what their 2019 default rate was and what they expected their 2020 default rate to be. Lenders were grouped into default rate categories, very low to high, based on their reported 2019 default rate (to minimize the effects on the results of variations in each month's responding population). Table 8 shows the 2019 average default rate and average expected 2020 default rate, as of each survey month, for each of the lender risk level categories.¹

Table 7.

Expected Default Rate in 2020 vs. 2019

Greater	Same	Lower
73%	20%	7%

Note: Based on most recent survey results.

Table 8.

Default Rates – 2019 vs. 2020 Expected

2019 Default rate	2019 Avg.	Expected 2020 as of:				
		May	June	July	Aug	Sep
Very low (<0.5%)	0.15%	1.92%	0.77%	0.77%	0.77%	0.76%
Low (0.5%–1.5%)	0.95%	2.90%	2.35%	1.98%	1.78%	1.97%
Medium (1.5%–5%)	2.69%	5.09%	4.69%	4.40%	4.24%	4.10%
High (5%–10%)	7.11%	22.86%	10.44%	8.36%	7.30%	n.a.

The results show that lenders were by far the most pessimistic in May, had a much improved outlook in June, and have become slightly more optimistic in more recent months. The changes are small for lower-risk lenders, and become more substantial the higher the lender's general risk level.

Between August and September, lenders expecting zero defaults in 2020 increased from 26% to 31% of lenders, and lenders expecting defaults of 1% or more in 2020 decreased from 47% to 35% of lenders.

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Regarding collateral values, it is also interesting that the most affected equipment types tend to be larger ticket equipment types, with the understandable exception of retail.

COLLATERAL VALUES

In August and September lenders were asked how they thought collateral values had changed since the beginning of the year for equipment types in their portfolio, and Table 9 data are calculated from those responses. In general, the results seem very intuitive. It is also interesting that the most affected equipment types tend to be larger ticket equipment types (with the understandable exception of retail).

Table 9.			
Change in Collateral Values Since Jan. 1, 2020			
Mining & oilfield	-26%	Construction	-3%
Retail	-21%	Materials handling	-3%
Railroad	-12%	Other industrial	-2%
Aircraft	-11%	Agriculture	-2%
Trucks	-8%	Alternative energy	-1%
Ships and boats	-7%	Communication	0%
Automobiles	-5%	Computers	0%
Office equipment	-5%	Software	1%
Medical	-4%		

Lenders’ collateral value responses in September were also tallied based on their reported average ticket sizes (Table 10), with results not inconsistent with the specific equipment type findings, though showing more overall impact on middle ticket.

Table 10.			
Change in Collateral Values Since Jan. 1, 2020			
Large ticket	Middle ticket	Small ticket	
-5%	-6%	-3%	

LAYOFFS AND REDUCTION IN HOURS

The survey also asked lenders if that institution had had furloughs or layoffs, and if so, what percent of the staff was impacted (Table 11).

Banks have had fewer layoffs, and what layoffs they did have took some time to occur, while independents have, except for September, had the most and were the quickest to begin layoffs.

Table 11.**% of Institutions With Layoffs**

	May	June	July	Aug	Sep
Have had layoffs	12%	19%	17%	19%	22%
% of staff laid off	11%	13%	10%	10%	11%

Table 12 shows that a majority of lenders with layoffs had done so by May, though more layoffs occurred in June and, to a lesser extent, in September.

Table 12.**Layoffs – % by Institution Type**

Have had layoffs	May	June	July	Aug	Sep
Bank	3%	8%	8%	13%	12%
Captive	17%	8%	15%	17%	43%
Independent	25%	32%	32%	27%	25%

Looking at the data by institution type, we see that banks have had fewer layoffs, and what layoffs they did have took some time to occur, while independents have in all reporting months except September, had the most and were the quickest to begin layoffs. Captives were generally in between, except in September, when a smaller but not insignificant number of captive respondents reported that three of their seven institutions had had layoffs.

Layoffs by institution size (as measured by annual origination volume) shows similar results (Table 13). However, the high correlation between institution size and type makes it unclear which is the actually the primary driver of the difference in layoffs—though it is likely that both size and type are drivers.

Table 13.**Have Had Layoffs by Institution Size**

Over \$1 billion	10%
\$50 million – \$1 billion	18%
Under \$50 million	21%

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While the situation is bad, the data here and respondents' outlooks imply the impact may not be as bad as people originally thought it might be.

The survey also asked respondents whether their institution had reduced staff hours (Table 14). Very few banks did, while a significant number of captives did. This is probably the result of the captives' manufacturing culture, where workers are generally more likely to have their hours reduced or expanded regularly to match manufacturing demand.

Table 14. Reduced Staff Hours – % by Institution Type	
Bank	2%
Captive	19%
Independent	4%
Overall	5%

CONCLUSION

The Foundation's COVID-19 Impact Survey sheds significant light on the commercial equipment leasing industry at a time unprecedented in our lifetimes. Overall, the results are somewhat positive. While the situation is bad, the data here and respondents' outlooks imply the impact may not be as bad as people originally thought it might be.

This parallels the stock market as well as the forecasts of the Fed, which just revised its June forecast for year-end unemployment from 9.3% to 7.6% and for GDP from a decrease of 6.5% to a decrease of 3.7%. The actual outcome, of course, remains to be seen: 2007/2008 simply seemed like a housing-sector problem at first.

This survey data underscores, however, that institutional positioning and strategy make a real difference, that most lenders are getting borrowers to resume paying, that not many borrowers need a second deferral, and that equipment type and borrower industry matter. ■

Endnote

1. To further reduce respondent bias from month-to-month, the 2020 expected default rates were calculated by taking each month's expected change from the responding lender's 2019 default rate to its 2020 default rate, averaging those, and then adding that to the average 2019 default rate calculated based on all monthly surveys. While there were a few respondents with 2019 default rates over 10%, there were not enough to produce meaningful statistics for them.



Tom Ware

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Tom Ware is president of Tom Ware Advisory Services LLC, based in the Milwaukee/Chicago area. For the prior 18 years, he was senior vice president of analytics and product development at PayNet, which was acquired by Equifax in April 2019. In that role, he was responsible for the development of PayNet's credit scores and probability of default models. The models have been used by hundreds of financial institutions to help decision millions of commercial loan applications worth over \$200 billion. He was also responsible for developing and managing PayNet's strategic business reviews, evaluating client lender's relative credit quality, operating performance, and market opportunities. Prior to PayNet, Mr. Ware had 18 years' experience as a small business lender with banks and finance companies, including as general manager of a billion-dollar division of J.I. Case/CNH Capital, and as chief credit officer and senior vice president, operations, of Rockford Industries (a NASDAQ-traded finance company that was acquired by American Express). Mr. Ware chairs the Foundation's Research Committee and is a member of the Foundation's Board of Trustees and its Executive Committee. He is a longtime member of the ELFA's Credit & Collections Committee, and previously served on ELFA's Small Ticket Business Council and on the Board of Governors of RMA's Washington DC, and Maryland chapter. Mr. Ware is a contributor to *Equipment Leasing Today* and the *Monitor*, where he published a three-part series of articles, "The 12 Secrets of Commercial Credit Scoring." He graduated with distinction in mathematical economics from Dartmouth College in Hanover, New Hampshire, and has an MBA from Harvard Business School.

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Challenges for Private Aviation Deals During Covid-19

Risk of exposure to COVID-19 in airports and on large aircraft has many businesses thinking about acquiring private aircraft. However, the pandemic requires a lessor to secure further protections in the charter, purchase, or finance of aircraft. This article outlines some of those considerations.

By Joel Charles Shapiro

Purchasing, financing, and chartering private aircraft during the current pandemic is presenting novel and significant challenges to various aspects of a deal that require all parties to be more flexible at all stages of the transaction. Given the COVID-19 flare-ups in various parts of the United States and the possibility of going back to partial or full lockdowns, one must plan and negotiate documents to address the significant uncertainty.

For purposes of this discussion, assume a company can charter a Challenger 350 (also known as a Bombardier BD-100-1A10) on an as-needed basis or purchase the same, and finance 90% of the purchase price.

CHARTERING

Charter bookings fell dramatically at the outset of the pandemic but

have increased in a meaningful way. Many individuals and businesses that need to travel are exploring the charter route in order to avoid increased exposure in airports and on larger aircraft.

Almost all charter operators have adopted protocols for disinfecting the aircraft after flights, together with crew and passenger safety regimes that can make a compelling case for use of private aviation. For example, a recent charter booking by a client during the pandemic has demonstrated that chartering an aircraft now has hidden financial complexities for a customer to consider.

Moreover, almost all charter agreements provide for a stepped-up forfeiture clause: as the user gets closer to the flight and cancels, the penalty becomes larger—and sometimes can even result in a complete loss of the advance payment made for the flights.

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The customer will look to the force majeure clause for an out but will most likely find no relief thereunder. That is because the governor's order does not prevent the charter operator from providing the flight.

Assume a company booked a round-trip flight from KPHL (Philadelphia airport) to KCHS (Charleston, S.C., airport) for a meeting with the head of sales for a prospective new client. Also assume that 15 days before the departure, the governor of South Carolina enters a stay-in-place order requiring all hotels, restaurants, and museums to cease operations. Moreover, any traveler arriving from Pennsylvania, New Jersey, or New York must self-quarantine for 14 days.

Ability to Terminate

Those executive orders render the trip virtually impossible to complete, so the company looks to terminate the charter. However, that ability to terminate (and receive a refund) under almost all current forms of charter agreements will be hard to do. The customer will look to the force majeure clause for an out but will most likely find no relief thereunder. (A force majeure clause permits a party to delay, defer, or decline providing or acquiring the goods or services for reasons beyond its control, such as an act of God, strikes, or government orders.) That is because the governor's order does not prevent the charter operator from providing the flight, because the aircraft is available, the private airport is open, and the pilots are available.

During the height of the current outbreak, almost all commercial airports remained open, although

many flights were canceled. In other words, the act of God (if the pandemic originates therefrom) or entry of government orders are not preventing the charter operator from performing under the contract.

Whereas either an act of God or government orders clearly impacts the planned trip (and its business and safety factor), neither prohibits the company from getting on the aircraft and traveling to KCHS. Therefore, in order to reduce the chances of this happening to a client, one might consider either (a) booking your charter last minute to make sure as best you can that the trip can be enjoyed and in a safe manner based on the current outbreak map and pending government orders, or (b) negotiating an addendum to the charter agreement that provides an out if the destination city is the subject of a stay-in-place order that materially impacts the trip.

The charter operator might also agree to delay the trip and rebook it within a certain period of time, rather than provide a refund, as a means of addressing the issue. There is no current industrywide way of addressing this issue; thus, diligence is required.

One last note on chartering during the pandemic: charter operators and brokers are not created equal. During a financial crisis like the one we are experiencing now, financial pressures are affecting parties differently. Knowing where

If stay-in-place orders are entered after the execution of the purchase agreement, does the agreement allow for movement of the aircraft to another non-locked-down state?

the prepayment is being held (in escrow, a segregated account, or commingled with other funds) is recommended. The customer does not want to be a creditor of the party holding the funds if the operator or broker is forced to seek relief under Chapter 11 of the Bankruptcy Code.

THE ANATOMY OF THE PURCHASE AGREEMENT

Back to our Challenger 350 acquisition option. Assume the customer has signed the purchase agreement, provided the escrow agent with a deposit of, let us say, \$100,000 USD, and provided a copy of the agreement to the aviation finance company it has selected to finance the purchase. The COVID-19 outbreak will impact many points in the transaction that one can try to plan for, while other challenges will arise after execution of the contract that require all parties to have more flexibility in order to consummate the transaction.

Let us start at the very beginning. Your lender and your aviation consultant need to inspect the aircraft. Think about just that sentence. Who is going to be allowed to review records and the aircraft? In what city and state will that occur, and how will those professionals travel to the selected destination? If stay-in-place orders are entered after the execution of the purchase agreement, does the agreement allow for movement of

the aircraft to another non-locked-down state to accommodate the parties to inspect the aircraft and its records (probably not, as it never happened before)?

Inserting language in the letter of intent or the purchase agreement should be considered to cover this possibility and provide for the party that will pay the transportation costs associated with the movement of the aircraft and records under this fact pattern.

Pre-buy Inspection

Next, there is the pre-buy inspection at the inspection facility. First, the parties hope the facility does not experience an outbreak that—independent of a government order—would cause a shutdown of operations and shortage of employees. Should the selection of the inspection facility now require some due diligence on safety protocols at the location to reduce risk of issues?

Second, if the inspection uncovers a squawk that requires the ordering of parts from locations throughout the United States and Canada, where the plants or suppliers might be the subject of a lockdown order, will the parties look to the force majeure clause again for relief, and does it cover this fact scenario?

The parties should anticipate this event in the purchase agreement and provide for a delay (without a termination of the agreement) to allow the inspection facility some additional time to locate the parts

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Some states have exemptions from their quarantine orders for pilots and crews, while other states are silent on the matter. For those states with exemptions, some are far from clear as to whether they apply to private pilots.

required to remediate the issues discovered during the pre-buy inspection.

Pilots and Crews

The aircraft is now ready for a test-flight prior to the execution of the technical acceptance letter. But wait: who conducts that flight? The seller's crew (for insurance purposes) almost always conducts it, so now the seller needs to ferry its pilots back to the inspection facility to conduct the test-flight. But if the inspection facility is located in a state that requires people to quarantine for 14 days upon arrival from certain states (which includes the state where the seller's pilots are based), then does the seller risk sending its pilots for the test-flight but lose the ability to utilize them again for 14 days?

Some states have exemptions from their quarantine orders for pilots and crews, while other states are silent on the matter. For those states with exemptions, some are far from clear as to whether they apply to private pilots flying under Part 91 (aircraft that are operated by the owner for no compensation) of the Federal Aviation Regulations (FARs), so diligence is required before the parties commit. Should language be added in the purchase agreement to cover these issues or should the buyer consider deferring the test flight and acceptance?

Ready to Close

We have now arrived at the stage where the parties are ready to

close. The lender wires the closing funds into the escrow agent's account. Now the parties are moving the aircraft to the delivery location, which was selected based on favorable sales/use tax treatment for the transaction by that state.

The first problem is, you guessed it, the pilots. In a recent transaction, the parties had agreed in the purchase agreement to ferry the aircraft from the inspection facility to the state of New York, where the closing would occur. Then the purchaser would have its pilots ferry the aircraft to its new home base in Florida.

However, at that time in the pandemic cycle, travelers into Florida originating from New York were required to self-quarantine for 14 days upon arrival in Florida. (You get what you give, so now visitors from Florida entering New York must self-quarantine for 14 days.) That means the purchaser's pilots could be out of commission during their quarantine, which was not an acceptable outcome for the purchaser.

The parties addressed this situation by moving the delivery location to Delaware to avoid the pilot quarantine issue, but it required thought and planning (and a desire to consummate the transaction) to get that resolved. Again, expanding the language in the purchase agreement to allow for sudden changes to the delivery location, based on the COVID-19 outbreak

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At the inception of the pandemic in the United States in March 2020, the FAA window restricted filings and interactions between parties such that recordings for transfer of title and perfection of security interests after funding were substantially delayed.

map and restrictions, should be considered.

Flow of Funds, Document Recordation

The second issue regarding the closing is the flow of funds and document recordation. In a typical pre-pandemic transaction in February 2020, the purchase price was wired to the seller, and almost immediately thereafter the escrow agent recorded the (a) FAA Form 8050-2, Bill of Sale, (b) FAA Form 8050-1, Application for Registration, and (c) the Aircraft Security Agreement. These will be followed by the filing of an international interest in the airframe and engines in favor of the lender on the International Registry (IR), because perfection of a security interest in the airframe and engines may require dual filing in certain instances.

However, at the inception of the pandemic in the United States in March 2020, the FAA window restricted filings and interactions between parties such that recordings for transfer of title and perfection of security interests after funding were substantially delayed (sometimes more than a day), thus placing the parties at heightened risk all the way around.

During the gap following funding and before recordation, it is possible (but very unlikely) that an intervening lien could arise (but recordation of that should be behind the first lien unless it is

a possessory lien). Alternatively, the seller could file a Chapter 11 petition, thus raising the issue of whether title had completely passed to the buyer.

In the first Eclipse Aviation bankruptcy case,¹ a buyer wired the purchase price to Eclipse and agreed to overnight the FAA documents to Oklahoma City for recordation the next day. However, approximately 25 minutes after payment and as the purchased aircraft was taxiing out of the delivery location, Eclipse filed its Chapter 11 petition. Eclipse took the position that title had not been transferred at the time of its petition, since the FAA documents were in a FedEx envelope and had not been recorded.

Ultimately, the purchaser prevailed in the dispute. However, avoiding or minimizing a gap period between funding and recording is always advisable. The good news is that the FAA has worked hard to reduce the gap period and, depending on the time of month, it is now down substantially to a matter of an hour or hours at most. Still, we are not where we were before the pandemic started.

This means the company's standard language in the purchase agreement—that money is wired and documents are filed and stamped at the same time—needs possible modification or flexible interpretation in order to consummate the transaction.

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All parties must appreciate that further flexibility is required in order to consummate sales and financing. Charter of an aircraft under Part 135 of the FARs is readily available.

Some lenders are requesting the filing of a prospective international interest on the IR in order to note their lien earlier in the process. However, that action may violate a clause in the purchase agreement that prohibits the purchaser (and its lender) from filing any prospective interests prior to closing.

Therefore, it might be appropriate to consider additional or alternative language in the purchase agreement to cover these novel fact patterns that have arisen under COVID-19.

CONCLUSIONS

In the final analysis, transactions for the charter, purchase, and finance of aircraft are occurring with regularity in the marketplace, notwithstanding the complications

arising from COVID-19. At this point in the pandemic, those difficulties can be anticipated and addressed in the applicable agreements.

All parties must appreciate that further flexibility is required in order to consummate sales and financing. Charter of an aircraft under Part 135 of the FARs is readily available. That said, it requires the customer and the charter operator to have an honest discussion on possible limitations on travel, which can pop up at any time, including how the limitations are going to be handled in the applicable documents. ■

Endnote

1. *In re* Eclipse Aviation Corp., 08-13031-MFW (District of Delaware). A second case, pending, is *In re* One Aviation Corp., 18-12309-CSS (District of Delaware).



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COVID-19 and the Maritime Industry

At the crossroads of trade, transportation, and logistics management, the maritime industry has unquestionably faced the slings and arrows of COVID-19. This article explains the implications of the pandemic—both bad and good—for various segments of the marine market.

By Basil M. Karatzas

Being at the crossroads of trade, transportation, and logistics management, the maritime industry has had a most profound exposure to COVID-19. Both internationally and domestically, the current pandemic has affected many aspects of the industry, from operations to financing to demand shifts. Certain segments of the maritime industry—when selectively viewed by cargo type or by geography—have fared better than others. Those segments may claim they have benefited, at least in the short term.

Still, the long-term impact on the industry is unknown: a novel risk such as COVID-19 entails contemporaneously dealing with and adapting to unprecedented operational and managerial factors.

The fact that the pathology of the coronavirus SARS-CoV-2 is not yet fully understood hinders projections for a vaccine, not to

mention transport of every sort. The implications are significant for lifestyle travel and for business travel; mostly, new lifestyle trends and new business practices materially impact demand in cargoes to support such ensuing changes.

Aside from operational challenges in the short term, maritime leasing and financing faces changes in demand, financing, and technology.

Sectors of the maritime industry that preponderantly depend on the human factor (whether as passengers or seafarers) have been most affected. Aspects of the marine industry and marine sectors that depend less on the human element have managed to scrape by with less damage, possibly benefiting from disruptions in other industries (such as the oil industry for the tanker market).

For both the international and the domestic maritime markets, this article will attempt to assess the

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Most countries—including those considered maritime hubs, like Singapore—have prohibited crew changes at their ports in an effort to contain the spread of the COVID-19 virus in their jurisdictions.

impact of COVID-19 on the major marine market aspects, segments, and businesses, and draw conclusions for the future course.

THE MARITIME INDUSTRY AND THE HUMAN ELEMENT AT THE AGE OF COVID-19

The Human Element as Crewing

Unlike other industries where telecommuting has been an option, for the maritime industry and its worldwide footprint of vessels, there is a constant need for seafarers, longshoremen, and service providers (ship chandlers, surveyors, customs and immigration officers). These professionals need to be able to fully and competently access the vessels at all times, entailing safe and prompt transit to port facilities from one's home (or even from another country).

In the United States, on March 19, 2020, the Cybersecurity and Infrastructure Security Agency, operating under the Department of Homeland Security, identified "transportation and logistics" and "critical manufacturing" workers as essential to continued critical infrastructure viability, therefore exempting seafarers and transport employees from travel restrictions.

In terms of U.S. marine transportation, workforce-related disruptions have stemmed from air travel availability and travel

interconnectivity more so than with seafarers and service providers in the marine industry.

However, internationally, the human element is of much more concern, as most countries—including those considered maritime hubs, like Singapore—have prohibited crew changes at their ports in an effort to contain the spread of the COVID-19 virus in their jurisdictions.

The International Maritime Organization, the United Nations body responsible for the international maritime industry, has called it a "humanitarian crisis," as more than 200,000 seafarers worldwide are currently stranded at sea, several months after COVID-19 was declared a pandemic and several months past the maturity of their original employment contracts. Having crew members away from their families unexpectedly for prolonged periods can take a human toll on both these seafarers and their families back home. This crisis has a potential effect on vessel operations and safety.

The sinking of the 200,000 deadweight Newcastlemac¹ vessel MV Wakashio in Mauritius recently made front-page news for its pollution of a pristine coral reef. It will take a year for the accident report to be finalized, but two of the crewmembers have been onboard the vessel for more than a

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year and unable to take leave. The accident has not been attributed to crew fatigue, at least not yet, but the accident investigation committee must diligently investigate that possibility.

Moreover, on its most recent quarterly earnings report in mid-August, A.P. Moeller Maersk—the world’s largest containership owner—named crewing and the ability to make crew changes as its biggest threat to operations.

The Human Element as Passengers

No marine sector has been so profoundly impacted by COVID-19 as the cruise ship market, where the human element has been the heart of the business in terms of both cargo (passengers) and crewing. (Large cruise ships have several thousand crewmembers, versus 24 crewmembers for a standard cargo vessel.)

Several months after the inception of the pandemic, the pictures of cruise ships on TV still reverberate, as they showed thousands of passengers onboard, stranded on the high seas, some enduring inclement weather, with no port (or country) allowing them to dock.

It is no surprise that the 2020 cruise-ship season has been worse than 2001, after 9/11. The Port of Miami has run out of docking space for idling cruise ships, even as the Centers for Disease Control

and Prevention and the U.S. Coast Guard keep extending their “no sail” orders for cruise ships.

Internationally, a couple of foreign cruise-ship sailings in the summer ended up in disaster as several passengers developed COVID-19 while onboard, despite updated testing and health protocols.

One thing is for certain, though: in 2020 so far, eight cruise ships have demonstrably been sold for scrap, with an average age of 25 years. Almost as many cruise ships were sold for demolition in the three-year period 2016-2019 and having an average age of 36 years at scrap. Two 3000-berth cruise ships, originally under contract to be sold in January 2020 at \$120 million en bloc, presently are again on the market for sale at \$18 million en bloc, since the original buyer walked away from the transaction (and forfeited its deposit). The current asking price is marginally above the vessels’ scrap price.

Although the share prices of the Royal Caribbean Group (RCL), Carnival (CCL), and Norwegian Cruise Line (NCLH) have bounced off the bottom, they are still 50% lower than in early 2020. Cruise-line companies worldwide have stopped making payments on their contractual obligations and have frozen any dry-docking. Some have rushed to raise billions in new capital to buy them enough runway until a market recovery.

COVID-19 obviously brought a collapse in oil and petroleum product demand as people stopped commuting (think of gasoline and diesel fuel, approximately 58% of refinery output) and flying.

Cruising with smaller and boutique pleasure boats, especially in regional markets, has shown signs of an earlier recovery than the megaship cruise-ship market. On a business trip to the Netherlands and France this summer, the author observed that small riverboats and dayboats were busy (and apparently alarmingly overcrowded), while in the United States, steamboat, riverboat, and dayboat companies slowly are coming back online.

However, adhering to local orders is challenging. For example, recently the owners and the captain of a pleasure dayboat in New York City were arrested after concerned local residents called the police to report a seemingly overcrowded day pleasure trip.

MARITIME SECTORS EXPOSED TO THE ENERGY INDUSTRY

The Tanker Market

COVID-19 obviously brought a collapse in oil and petroleum product demand as people stopped commuting (think of gasoline and diesel fuel, approximately 58% of refinery output) and flying (think of jet fuel, approximately 12% of the international petroleum products market).

Logically, tanker demand would decline under such circumstances. However, oil companies, refineries, and traders were found with so much excess inventory on their hands that tanker owners were virtually “printing money” between February and June 2020, just for



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In Better Days, Three Cruise Ships at Georgetown, Grand Cayman

Grand Cayman is the largest island in the Cayman Islands, a British Overseas Territory in the Caribbean. (Photo courtesy of the author.)

As supply chains adjust for lower demand, expectations and excess inventory have worked their way through the system.

using their tankers as floating storage space.

Very large crude oil carriers (VLCCs, tankers capable of holding 2 million barrels of oil) saw their daily rates jump from \$30,000 per diem (pd) at Christmastime to almost \$200,000 pd in March, not on account of transport demand but on account of storage space.

However, as supply chains adjust for lower demand, expectations and excess inventory have worked their way through the system, and tanker rates have finally started reflecting a period of lower demand. VLCCs once again earn approximately \$30,000 pd.

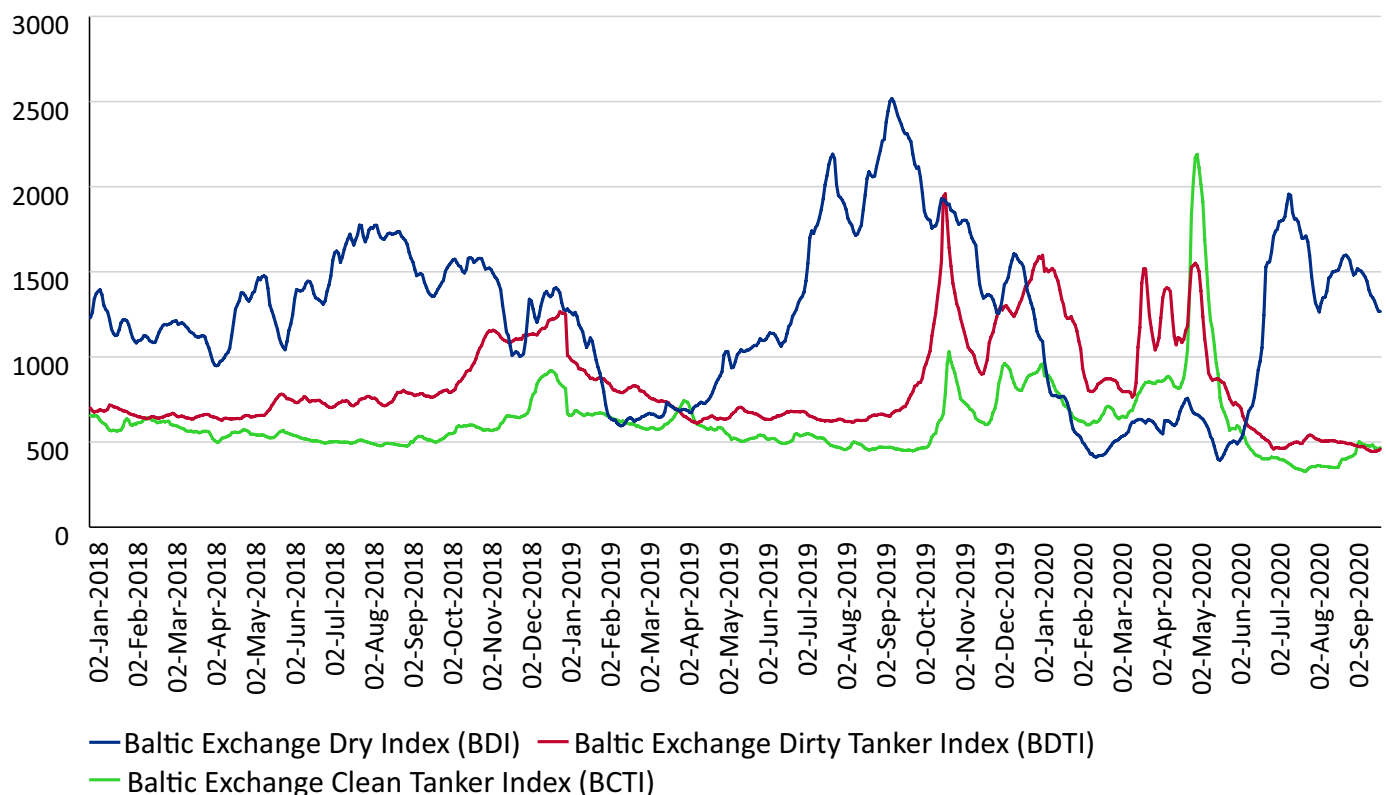
All good things, so to speak, come to an end, and it is hard to be overly optimistic on the tanker sector under the specter of COVID-19.

Figure 1 shows the Baltic Exchange freight indices for “dirty tankers” (crude oil tankers) and “clean tankers” (petroleum products and chemicals), Baltic Dirty Tanker Index (BDTI) and Baltic Clean Tanker Index (BCTI), along with the better known Baltic Dry Index (BDI) for the dry bulk market. Clearly, after the initial jump on contango, the tanker market has collapsed, while the dry bulk market looks in better shape (but seasonality may partially explain some of the strength).

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Figure 1. Baltic Exchange Tanker and Dry Bulk Freight Indices



Data courtesy of the Baltic Exchange, of which Karatzas Marine Advisors & Co. is a member. www.balticexchange.com/en/index.html

The offshore drilling market had barely been at break-even levels, with 20% to 30% of the world's offshore fleet having been idled.

The Offshore Market

In the last couple of years of low oil prices, high-cost offshore drilling was limited to existing projects, with no new capacity coming to the market and several aging platforms getting dismantled.

The offshore drilling market—whether for drillships and semi-submersibles or the myriad of offshore, crew, platform support vessels, anchor handling tugs, and so on that feed on them—had barely been at break-even levels, with 20% to 30% of the world's offshore fleet having been idled.

Many drilling and offshore companies, both in the United States and internationally, were holding on for dear life, expecting that 2020 would be a year of market recovery. COVID-

19 and the collapse for energy demand just killed any hope for an immediate recovery, so much so that even speculators do not want to buy offshore vessels at scrap price and wait for a recovery (something done in the past with swashbuckling entrepreneurs).

COVID-19 has not killed the offshore market—rates and asset prices were so low that they have little more room to drop—but it clearly has killed any hope for recovery and runway. So far in 2020, several offshore companies have sought some sort of court protection from their creditors (Hornbeck, Noble, Hermitage, Valaris, Diamond Offshore, etc.).

Looking forward, the prospects do not look bright for the offshore



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Six Idled Drillships

These drillships are idled at Las Palmas, Gran Canaria, in the Canary Islands (Spain). (Photo courtesy of the author.)

Although not as bad as in the dry bulk barge market, utilization for inland and coastal tank barges stands overall at mid-80%, much lower than the beginning of the year.

industry, whether in the United States and the Gulf of Mexico or internationally (North Sea, Nigeria, Brazil, etc.) under COVID-19. This fact compounds structural problems in the offshore drilling market and competition from cheaper shale oil and a gradual shift to renewables.

THE JONES ACT AND THE U.S. MARINE MARKET

2020 started with great hopes for the marine industry in the United States. This was premised on greater shale drilling and more movement of crude oil and petroleum products within U.S. waters—especially in a growing economy in a U.S. presidential election year. Internationally, the marine industry anticipated more exports of oil and energy products (shale oil to China, liquefied natural gas and liquefied petroleum products to countries of the Pacific Rim).

Exports would have taken place on foreign-flagged vessels (boosting primarily the international tanker market). However, some spillover was expected for the domestic market, with more active coastal trade and port operations, and the potential need for building modern harbor tugs to accommodate high-risk and expensive vessels and cargoes.

In addition, the Phase I trade agreement between the United States and China provided for more energy exports to China,

and, critically, more than \$80 billion in 2020-2021 of agricultural product exports (primarily grains and soybeans) to China. Again, such exports would have occurred on foreign-flag vessels, but towing grain products from the breadbasket of the Midwest to New Orleans via the Mighty Mississippi was expected to boost the inland barge market, which had a challenging 2019.

So far in 2020, China has only bought approximately 26% of its \$37 billion U.S. agricultural quota for this year, based on data compiled from the U.S. Department of Agriculture, reflecting poorly on the inland barge market. There have been reports that utilization for dry bulk inland barges has dropped to as low as 70% of the fleet, with a tantamount collapse in freight rates and asset prices.

Likewise, for the tank barge market, whether for inland or coastal, once demand for storage subsided, direct demand for shipment of crude and for petroleum products and chemicals brought the market to a standstill. Although not as bad as in the dry bulk barge market, utilization for inland and coastal tank barges stands overall at mid-80%, much lower than the beginning of the year.

In a weak market with many idling barges, asset pricing has come down, as potential buyers prefer cash preservation in an uncertain market, unless they see highly

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Lower structural demand leads to decreased demand for trade and shipment, which eventually leads to lower freight rates.

opportunistic transactions at distressed pricing.

A SILVER LINING

Once the “noise” of higher demand from disrupted supply chains is removed from the market and there is an adjustment to lower demand, it is hard to see how COVID-19 can be beneficial for the maritime industry. Lower structural demand leads to decreased demand for trade and shipment, which eventually leads to lower freight rates. The trend has been clear in May to July this year, despite the fact that the market has anemically bounced from the absolute bottom.

However, the news is not as abysmal as it would appear. The U.S. Federal Reserve and central banks worldwide have kept interest rates extremely low, thereby allowing for cheap access to capital, at least for the well-capitalized shipowners, and for competitively-priced rental payments for qualified lessees. With low inflation and soft marine asset prices, COVID-19 offers a great opportunity for fleet renewal and growth for the companies that see beyond the current crisis.

Furthermore, as a result of limitations imposed due to COVID-19, there has been a renewed effort to adopt technology faster in the marine industry, in areas ranging from compliance to operations to commercial aspects of the industry.

More importantly, COVID-19, as a novel risk, has given people a pause to think deeper than business as usual. If a pandemic on this order can wreak havoc on our lives and business, how much more might an even bigger crisis affect our lives—or even human life on earth? We do not want to get too speculative or philosophical, but it would appear that COVID-19 is accelerating in-the-bud environment, society, and governance (ESG) initiatives.

At least for the U.S. maritime market, new licenses, new contracts, and a multibillion offshore wind market have taken off, a development that will be cataclysmic for decades to come.

SUMMARY — COVID-19 AND MARITIME LEASING AND FINANCING

Clearly, the COVID-19 pandemic has slashed demand for raw materials and end products, and as a result, demand for transport. As freight rates have softened, both internationally and domestically, borrowers in the marine industry have had difficulty making prompt payments to their banks.

Equipment financiers and lessors and lenders have been on alert since April with their marine, as with their clients in other industries. However, recognizing that COVID-19 is a novel risk and no one’s fault, financiers so far seem accommodating and patient. (Contrast this situation with the

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As spot freight rates have materially declined, operators with long-term contracts for shipment as well as operators with large (or strong) balance sheets are getting preference for financing.

financial crisis, which was primarily caused by excessive and loose lending.) We hope that demand will not crater, leading to massive defaults and marine asset arrests.

As spot freight rates have materially declined, operators with long-term contracts for shipment as well as operators with large (or strong) balance sheets are getting preference for financing over smaller players or borrowers too dependent on the spot markets.

It would appear that the current crisis is benefiting the bigger players, while smaller companies are facing harder times. In general, as banks and other regulated lenders are becoming more vigilant with their lending criteria, equipment financiers and lessors seem to get more deal flow, especially with higher quality credit that typically would qualify them as a traditional bank financing.

Clearly, this is a fluid situation. Likely, more changes can be expected. Even in this month-short trajectory, as one banking expert

noted in connection with the early days and weeks of the pandemic,

Banks were concerned with going into recession and reserving capital—thus their higher lending spreads and tightened credit criteria early on. But a few months later, as banks' deposits ballooned, spreads dropped and credit loosened selectively. Banks now are looking more at absolute yields rather than spreads.

To the extent that such financiers are not preoccupied with problematic situations currently, originating new transactions, including in marine, allows for a higher level of client and asset selection. ■

Endnote

1. Newcastlemax is a dry bulk asset class of approximately 200,000 dead-weight tons, with maximum beam (width) of 47 meters (154 feet), capable of docking and loading (coal) at the Newcastle port terminal in New South Wales, Australia. Newcastlemax vessels typically transport coal.



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