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Real Estate Securitization, Aircraft Finance, Ship Finance and Asset Finance

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Q | What is asset finance? What types of transactions are involved in asset finance?

A | Asset finance is a financing method in which a specific asset and the cash flows generated from that asset are the responsible assets. There are various types of asset finance transactions, but typical examples include real estate securitization, aircraft finance, and ship (ship) finance.

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1 What is Asset Finance?

Asset finance is a financing technique in which a specific asset and the cash flows generated from that asset are the responsible assets. Asset finance is a type of **non-recourse financing** that generally makes only specific assets the responsible assets and does not appeal to the originator or sponsor. In asset finance (in the narrow sense), an **SPV** is used as a legal technique to achieve non-recourse financing by transferring specific assets to a SPV, which is also a component of a fund that receives investors' investment capital for the assets.

See also:【Serialization】Fundamentals of Finance Law "**Part 3: What is Structured Finance / Asset Finance?**"

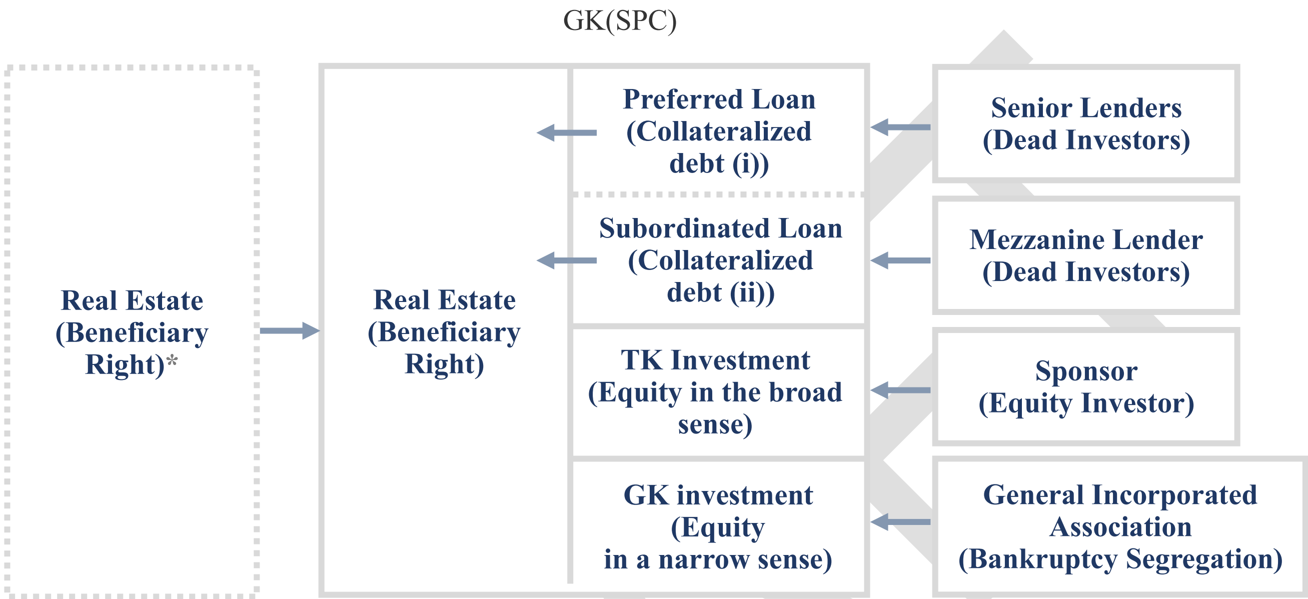
Following are some specific examples of various types of asset finance.

2 Real Estate Securitization

Securitization is a process in which an asset holder (**originator**) establishes another entity (SPV) for the purpose of holding a specific asset, transfers the asset to the SPV, and raises funds from the future cash flow generated by the asset. This article focuses on real estate securitization in the form of a private placement fund as a typical example.

Real estate securitization refers to securitization in which the underlying assets are real estate. There are multiple structures for securitization of real estate, and【Figure 1】shows an example of a structure called the **GK-TK scheme**, with only the cash flow-related part extracted.

【Figure 1: GK-TK scheme】



(*)Due to the relationship with the Real Estate Specified Joint Enterprise Act, trust beneficiary interests in real estate are often used in practice.

In【Figure 1】, a limited liability company (**GK**), an SPC, is established with a neutral general incorporated association or other entity as the parent company (for **bankruptcy isolation**).

SPC raises funds through borrowing (loan) from **lenders** and anonymous association investment (**TK**) by **the sponsor**. After concluding **a real estate (trust beneficiary interest) purchase agreement** with the originator, SPC will acquire **the real estate (beneficiary interest)** using the procured funds, directly or indirectly lease the real estate to tenants (lessees) based on a tenant agreement (**lease agreement**), and secure revenue (**rent**) from the real estate. Furthermore, using the investment income (rent) from the real estate and the proceeds from the sale of the said real estate, etc. as the source of funds, we will repay the loan to the lender and then distribute and redeem the surplus to the sponsor.

One of the reasons for using a limited liability company as an SPC is to avoid the risk of restrictions on the exercise of lenders' rights due to the application of **the Corporate Reorganization Law**. The use of silent partnership investments as equity investments is primarily to eliminate **double taxation** and to ensure **limited liability**. When the amount of funds raised is large, a subordinated loan is often used as mezzanine by setting up **a preferred-subordinated structure** (see: Practical Q&A "**Key Points on Mezzanine (Subordinated) Loans in Mezzanine Financing**"). Equity investors can use the leverage effect by combining debt (loans).

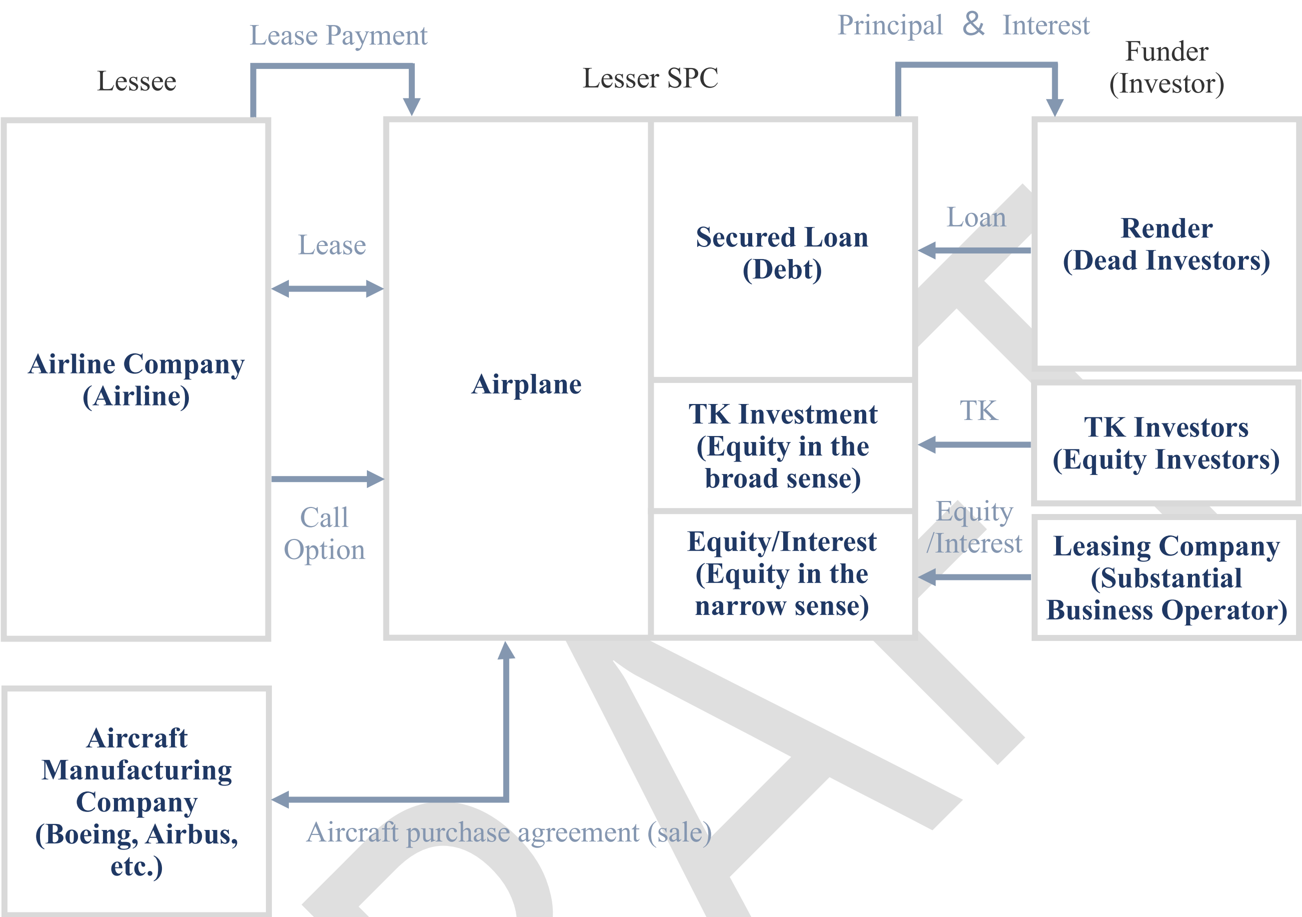
In the actual GK-TK scheme, there are financial institutions that provide various fee businesses to GK. Typical examples include **asset managers** (AMs) that provide investment management services, **trust banks** that are entrusted with real estate **trusts**, and **property managers** (PMs) that physically manage and operate real estate.

3 Aircraft Finance

Aircraft financing means financing for the procurement of aircraft or investment in such aircraft.

Aircraft finance includes (i) a method in which an airline company itself procures funds through a loan to purchase an aircraft (**corporate finance**), but in practice, (ii) an airline company often procures an aircraft through a lease from an SPC, and the latter is generally organized as **asset finance**. In practice, finance leases often have a strong **corporate finance** nature to the airline company.【Figure 2】shows an example of a structure called **JOLCO** (Japanese Operating Lease with Call Option).

【Figure 2: JOLCO (Japanese Operating Lease with Call Option)】



In【Figure 2】, **the leasing company** establishes an SPC (joint stock company or limited liability company) and becomes a limited liability investor in the SPC.

The SPC raises funds by borrowing from lenders (loans) and equity investors (equity and silent partnership investments), enters into **an aircraft purchase agreement** with the aircraft manufacturer, and uses the funds raised to acquire **the aircraft**.

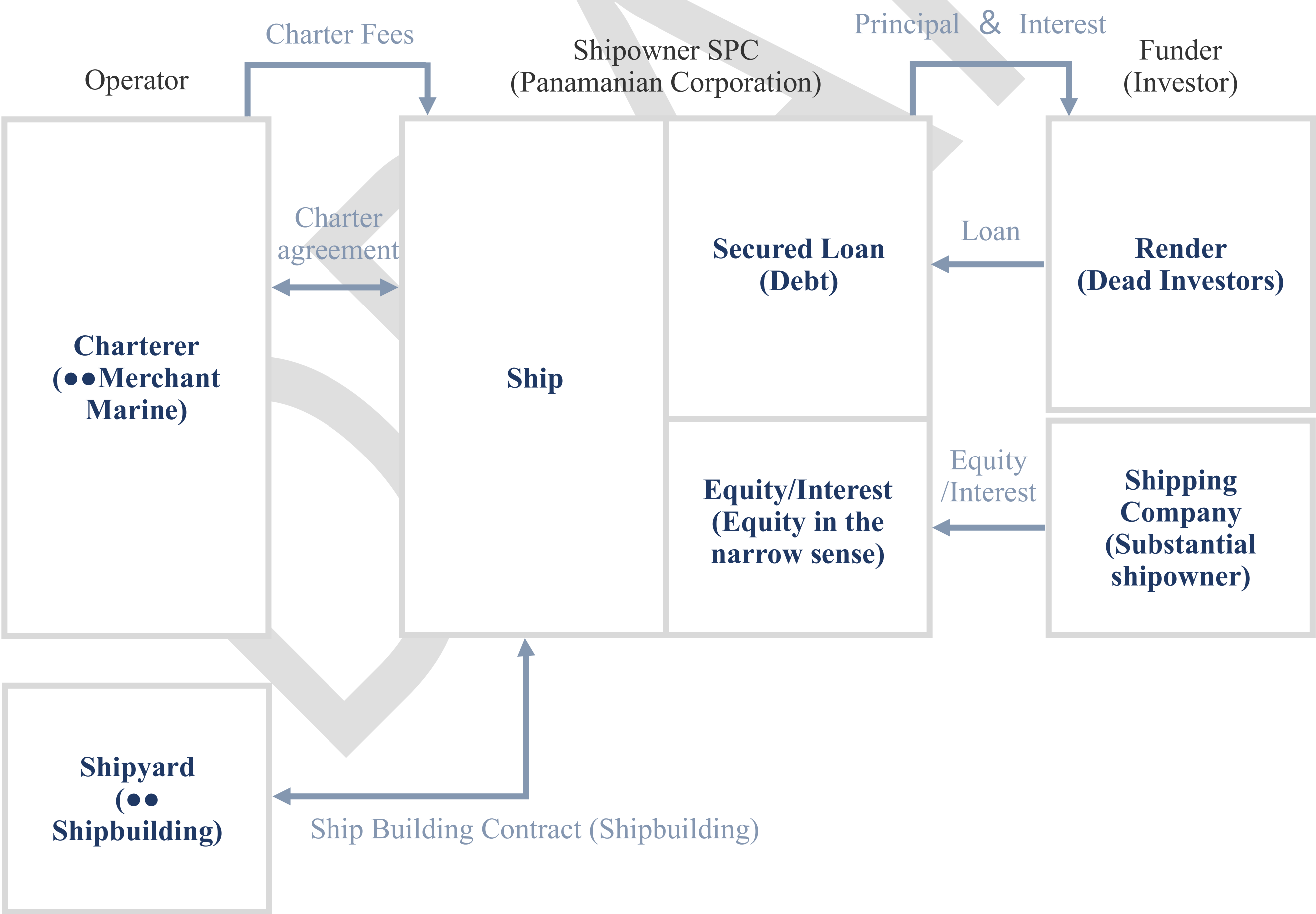
The SPC (**lessor**) leases the aircraft to **the airline (lessee)** that actually operates the aircraft based on **the lease agreement** and secures the revenue (**lease payments**) from the aircraft. The SPC then repays the loan to the lender, using the revenue (lease payments) from the aircraft and the proceeds from the sale of the aircraft (**call option** or **third-party sale**), and then distributes and reimburses the surplus to equity investors.

4 Ship Finance

Ship financing refers to financing for the procurement of or investment in ships.

Ship finance theoretically includes (i) a method in which shipping companies raise funds themselves to purchase ships (**corporate finance**), but in practice there are many methods in which (ii) shipping companies purchase ships through SPCs, and the latter is generally organized as **asset finance**. The latter is generally organized as asset finance. Practically speaking, it is often in the nature of **corporate finance** for shipping companies through **guarantees** by the **shipping companies**. Figure 3 shows an example of a ship finance structure using a flag-of-convenience ship.

【Figure 3: Flag-of-convenience ship scheme】



In【Figure 3】, the shipping company establishes an SPC (**Panamanian corporation**) and becomes a limited liability investor in the SPC.

The SPC raises funds through borrowing from lenders (loans) and equity investments (equity or equity contributions) by shipping companies as equity investors, enters into **shipbuilding contracts** with shipyards, and then uses the funds raised to acquire **the ship**.

The shipowner SPC charters the ship to the **charterer (operator)** who actually operates the vessel based on **the charter agreement**, and secures revenue (**charter fees**) from the vessel. The shipowner SPC also repays the loan to the lender, using the revenue (charter fee) from the ship and the proceeds from the sale of the ship as the source of funds, and then distributes and reimburses the surplus to the shipping company, which is the equity investor.

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