



Aviation Finance: Can Islamic Financing Take Off?

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According to the [Islamic Financial Services Industry Stability Report 2017](#), Indonesia is emerging as an important Islamic finance market. Compared to regional peers such as Malaysia and Brunei, however, there is clearly potential to boost growth.

Expanding the use of Islamic finance in a robust market such as aviation could play an important role in enhancing its use across the Indonesian finance market generally. With this in mind, this article introduces some of the Islamic aircraft financing structures for Indonesia's aviation sector.

A brief history of Indonesia's Islamic finance market

Indonesia first issued Islamic bonds ("sukuk") in 2008, and is now the world's second-largest sovereign sukuk market. Indonesia's first Islamic bank, Bank Muamalat, was established in 1992. Bank Indonesia was first permitted to use Islamic instruments as part of its monetary policy in 1999. In 2015, Garuda Indonesia issued its first Islamic bond, an US\$500m sukuk with a 5-year tenure.

Other than the Garuda Indonesia sukuk, however, Islamic finance is rarely used to finance Indonesia's aviation sector despite increasing passenger numbers, fleets and flights. At the end of 2016, the Islamic finance market share only stood at about 5% of Indonesia's total finance sector.

In order to improve market share, the government continues to assess long-standing plans for a merger of the Islamic finance units of three state-controlled banks – PT Bank Mandiri, PT Bank Rakyat Indonesia and PT Bank Negara Indonesia – into a US\$10b Islamic bank.

The new bank could provide greater critical mass to finance the aviation sector as well as much-needed airport and other transportation infrastructure. It would also offer an alternative to sharia-compliant aviation

funds, which currently provide a potential source of offshore funding for Indonesian airlines.

Islamic Finance Roadmap

On 13 June 2017, the Financial Services Authority of Indonesia ("OJK") launched a road map for the development of Islamic finance in Indonesia for the 2017-2019 period. The road map's aim is to create sustainable Islamic financial services that can compete with conventional financial services in Indonesia. It is expected to address various challenges related to the sharia financial industry, such as small market share, limited variation of products and lack of literacy on sharia finance products.

Each Islamic financial sector — sharia banking, sharia capital market and sharia non-bank financial industry – is expected to organise its own road map during the 2017-2019 period, and these 3 road maps will be used to synchronise the development of the Islamic financial industry to the master plan of the Indonesian financial services.

There is potential for these road maps to be updated in future to include Islamic financing structures that are commonly used in aircraft financing, including those described in this article. In a strong aviation market, the recognition of new structures could help to realise the Indonesian government's vision of expanding Islamic finance market share to 15% of Indonesia's total finance sector.

Islamic aircraft financing structures

Ijarah

An Ijarah is an arrangement where the owner of the aircraft transfers the right to use the aircraft to another person (such as an airline) in return for an agreed

amount of rent. In this respect the Ijarah is similar to a conventional aircraft lease. However, as the ownership of the aircraft is not transferred in a Ijarah, Sharia law expects that the liabilities of the ownership of the aircraft, such as maintenance and repair, and obtaining insurance, remain with the lessor.

Murabahah

A murabahah is a sale where the seller acquires an asset such as an aircraft, and then sells it to a purchaser at a profit, and expressly discloses to the purchaser the cost price that the seller has paid for the asset. In murabahah financings, banks typically buy an aircraft from a borrower (which may be an aircraft lessor or an airline) for a price exceeding the aircraft's cost, and then sell the aircraft back to the borrower in installments. A murabahah is valid only when the exact cost of an asset can be ascertained.

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