



JOL & JOLCO

Japanese Tax Driven Operating Leases

17 October 2024

Elliot Milton

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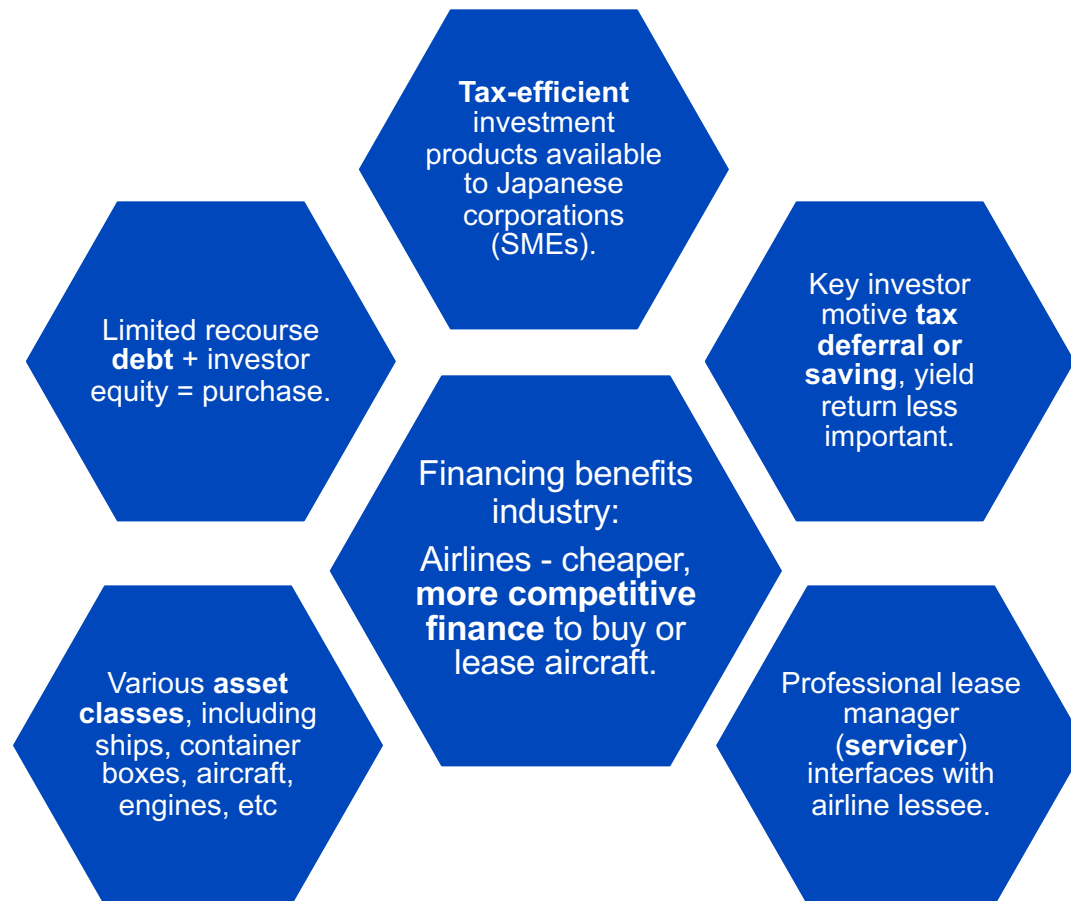
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Intro

JOL: “Dorix” Aviation sells A321 on lease to Wizz to Kondo Corp (SME, non-aviation).

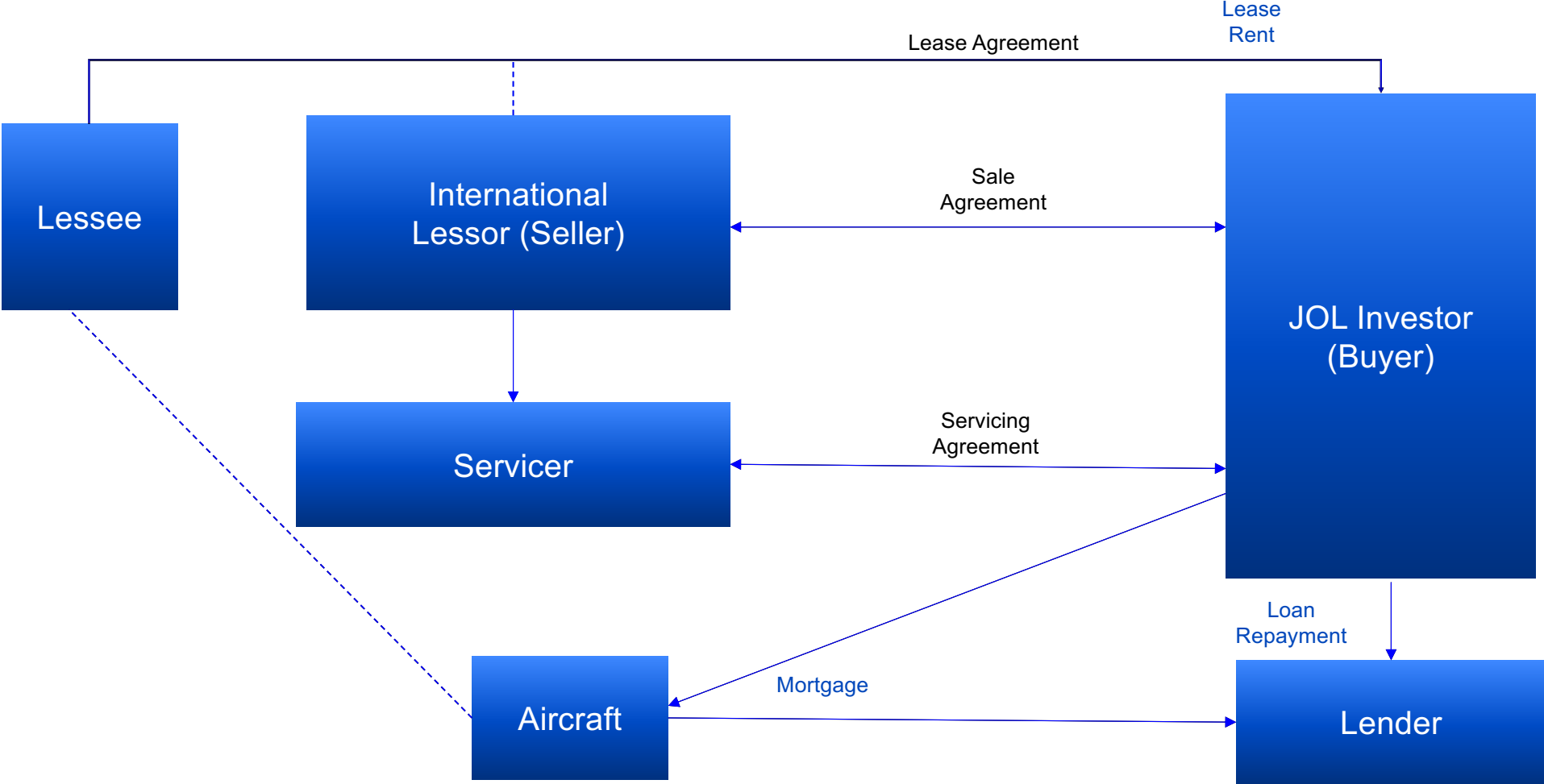
JOLCO: B787-9 airline delivery -> arranger **SPC** acquires -> sells down to multiple equity owners -> ‘op lease’ with future CO.



**Various Asset
Classes:**
Bulk carriers,
container boxes,
engines, aircraft



JOL Structure Overview

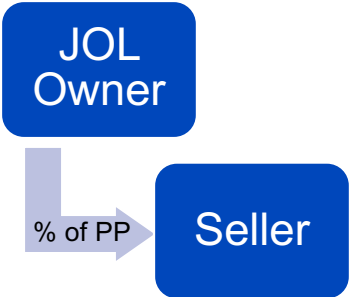


JOL – Japanese Operating Lease

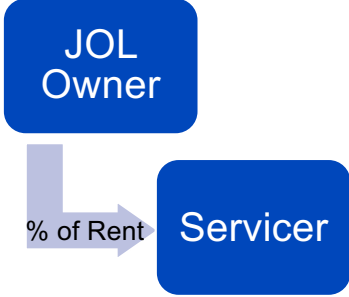
- Depreciating asset offset against profit - defers **income tax**.
- **Depreciation** based on tax rules - aircraft vintage/lease term is relevant -> drives aircraft selection.
- Can save on **inheritance tax** by changing notional stock valuation of company.
- **Rationale** for tax law: supports SME sector, encourages entrepreneurship -> supports economy.
- **Scale** of sector: '00s of Japanese companies are JOL owners, many more consider investment.
- Usually **single-owner** - legal and beneficial ownership, except if held in trust (US, GATS).
- For lessor seller, can be very **lucrative** (PLOC, ongoing fee income):
- Profit & Loss on sale – **strong pricing** in Japan.

Seller/Service Fees

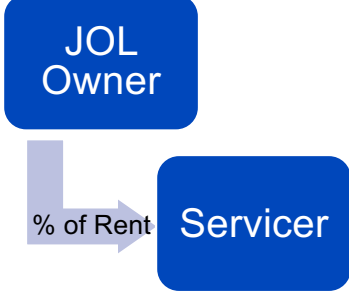
Purchase (Up-Front)



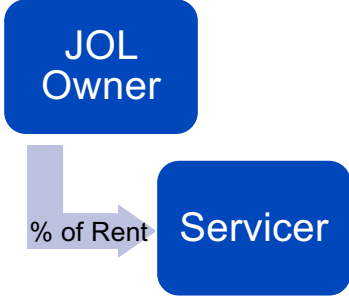
Lease Management



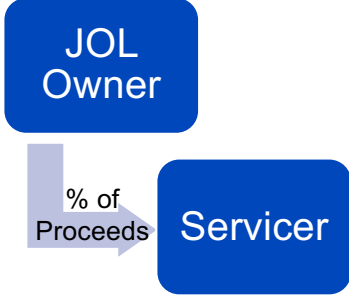
Lease Extension



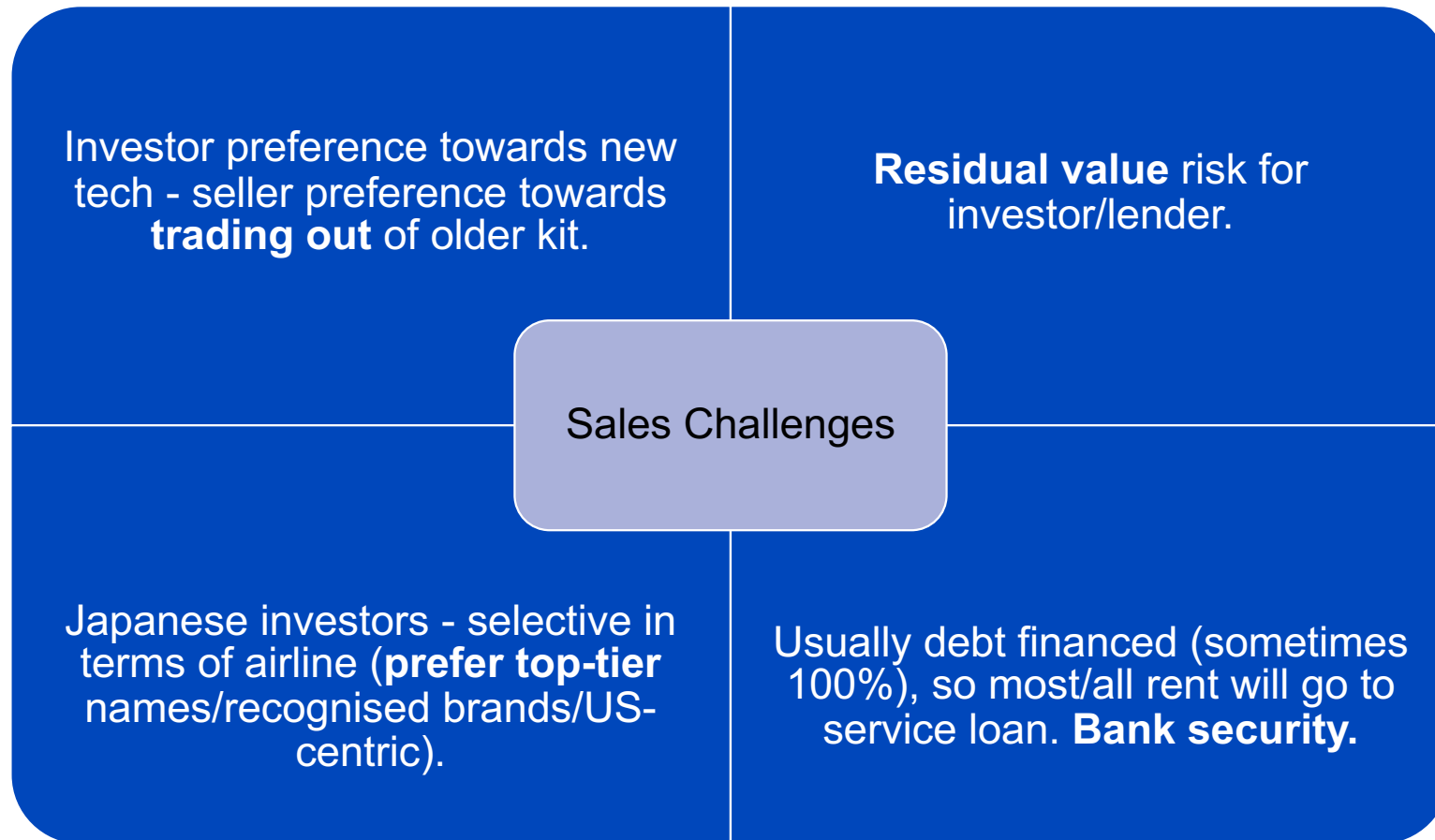
Replacement Lease



Sale Disposal



JOL – Challenges - Market



JOL – Challenges – Airline Relationship

- **Airline buy-in.** Airline will use as leverage to look for concessions on lease or may charge novation fee or increase contractual fee.
- Novation: Japanese owner will engage **own counsel** - non-market positions which slows down novation and 'irritates' airline.
- Post-sale: relationship can be fraught – airline may make **“difficult” requests** of owner/lender (e.g., addition of equipment to plane).

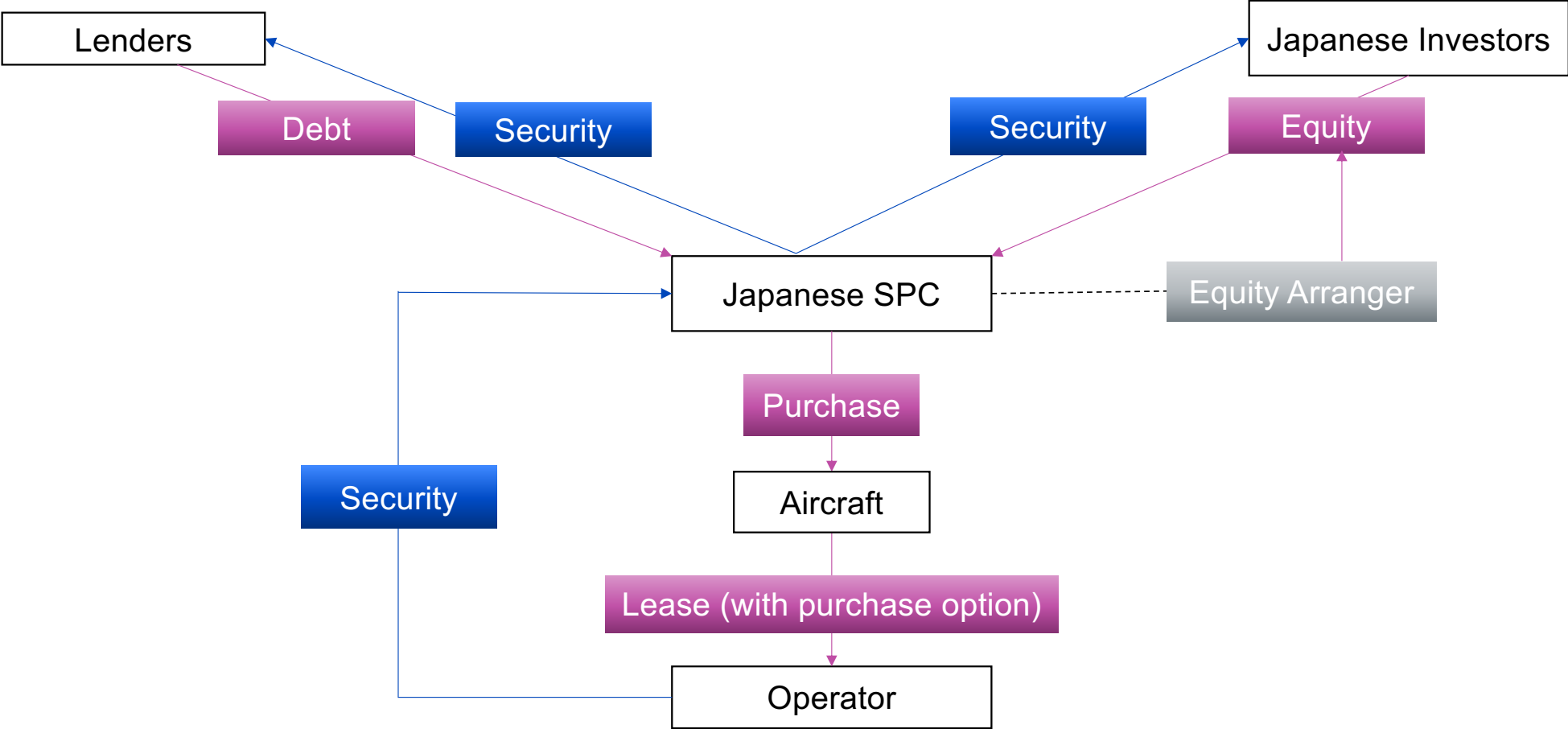


JOL – Challenges – Airline Relationship

- **Dilemma** for lessor: airline is key customer - squeezed on both sides (internal tension between trading and marketing teams).
- Other JOL risks:
 - - **rent deferral** request; **lessee insolvency** (maintenance exposure); **transition** to new lessee.
- Following sale, investor usually needs a **replacement aircraft** to defer a large tax bill. Investor is **'hooked'** on JOL!



JOLCO Structure Overview



JOLCO – Japanese Operating Lease with Call Option (I)

- Leveraged operating lease with Japanese **equity** owners seeking tax deferral (yield less important).
- Distinct from JOL:
 - - almost always **multiple owners** (structures are called (in Japanese) “TK” or “NK”, TK being more typical).
 - - aircraft is owned via a **Japan-incorporated SPV lessor** which holds legal title throughout lease term.
 - - equity ownership in aircraft is **sold “down”** to a number of smaller ticket (than JOL) investors, as low as c.USD500k.
 - - airline is strongly **expected to exercise CO** to buy aircraft at pre-determined price on/before expiry.
 - - **structured** to ensure aircraft does not stay in de-facto ownership of equity investors.
 - - due to high expectation of airline exercising call option, much **less residual value** asset risk for owners than with JOL.
- **Benefits for airline:**
 - type of long (c12YR) sale and leaseback with early buy-out option.
 - 100% debt financing; **on-balance sheet financing**
 - attractive - cheaper than straight debt financing, more stable, less subject to market flux.

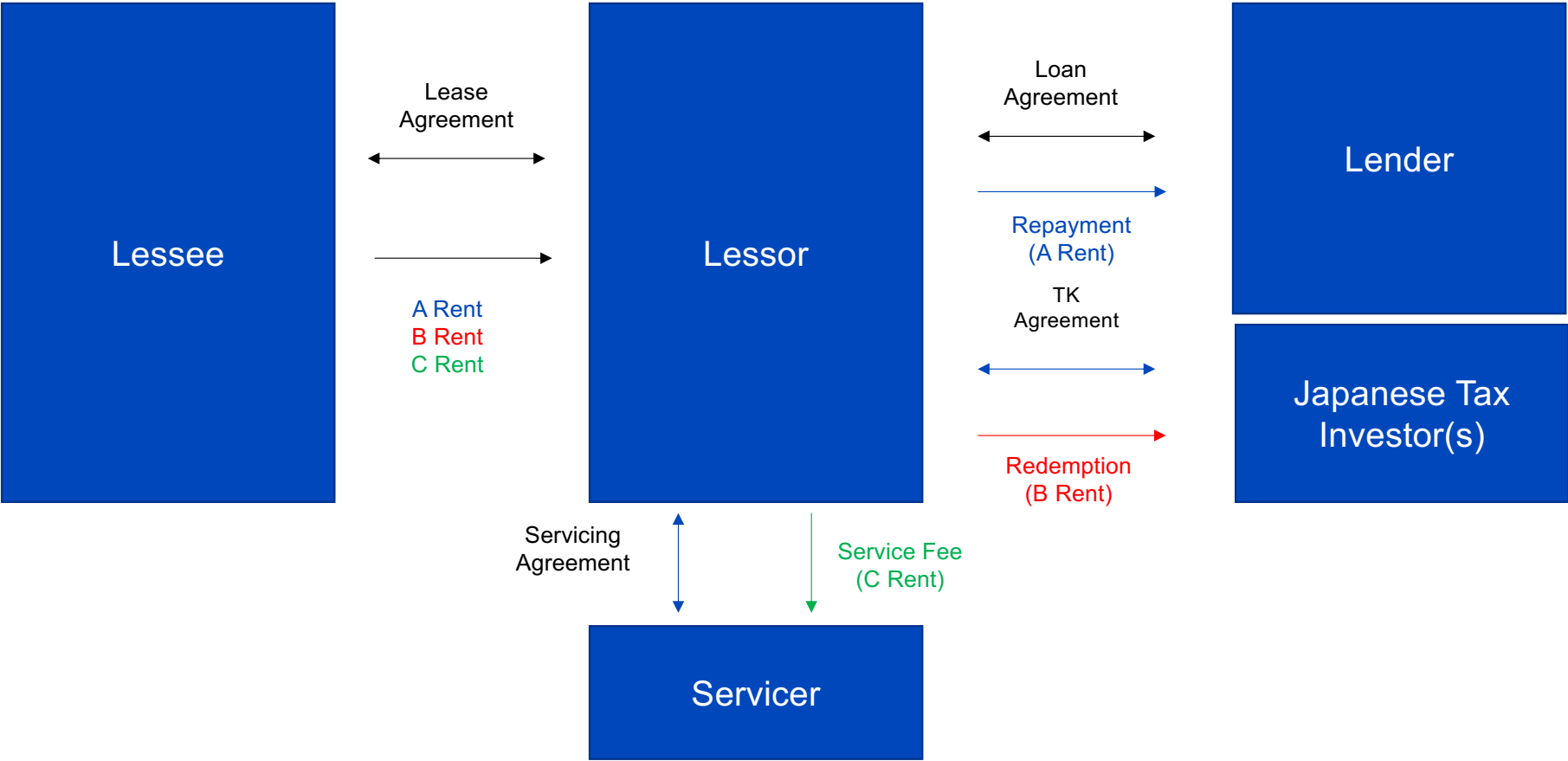
JOLCO – Japanese Operating Lease with Call Option (II)

- Most airlines will **court JOLCO** market – way to diversify sources of finance.
- Often stems from airline **order book** - way for it to finance aircraft ‘coming at them’, like SLB.
- Airlines will go out to market via RFP. Competitive bidding process between lessors.
- Post-COVID (chilling effect) -> **tendency towards better credits**. Difficult for non top-tier airlines ->
- Investors wary of **weaker airline credits unable to exercise** call option.

JOLCO – Japanese Operating Lease with Call Option (III)

- **FX issue:** weak JPY - difficult to sell down USD equity - JPY equity better for investors->
- But this will rule out most airlines as unable to pay **JPY rent** under structure unless they earn JPY revenue.
- Start date of **lease term** as well as PO timing will be important for investors, to align with tax objectives.
- **Underwriting risk for arranger** - before sold down to equity investors – esp., WB aircraft.
- If arranger cannot sell down (as happened during COVID) - significant **liability on its balance sheet**.

JOLCO - (TK (Tokumei Kumiai) example)



JOLCO – Japanese Operating Lease with Call Option (IV)

- Exercise of **Purchase Option** -> airline pays down outstanding debt.
- Loan structured – not fully amortised – balloon payment due at maturity. Balance -> equity investor
- PO is at **pre-determined** date and price which is supported by day-1 appraisals.
- Lessee purchases aircraft on **as-is basis**.
- Except for specific **termination events**, JOLCOs cannot be terminated during the agreed lease term.

Conclusion

- JOL & JOLCO: established financing tool.
- Significant deployment of Japanese capital to industry.
- Airlines and lessors are fully bought into it, despite challenges.
- Existed for a number of decades so likely to continue, notwithstanding any changes to tax law.



Questions?

Elliot Milton

Of Counsel, Dublin

T +353 86 014 3044

E Elliot.milton@walkersglobal.com

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