

AVIATION FINANCE



Bond House
ESG Financing House
Europe Investment-Grade Corporate Bond House
EMEA Leveraged Finance House
EMEA Structured Finance
Interest Rate Derivatives House
EMEA Loan House
EMEA Structured Equity House



World's Best Bank
World's Best Bank for Sustainable Finance
Western Europe's Best Bank
Western Europe's Best Bank for Sustainable Finance
Western Europe's Best Investment Bank
Latin America's Best Bank for Sustainable Finance
Best Bank in France
And 5 additional awards in multiple categories



APAC Bank of the Year 2023
Global Sustainable Finance Deal of the Year 2023
Global Overall Deal 2023
APAC Bank of the Year 2022
APAC Support Financing of the Year 2022
APAC Lease Deal of the Year 2022
APAC Capital Markets Deal of the Year 2022



BNP PARIBAS

Oct-24

The bank for a changing world

TRACING THE DIFFERENT LIQUIDITY SOURCES DRIVING THE AIRCRAFT FINANCING INDUSTRY

The aviation industry is well-known by financial institutions and various investors.

As such, airlines and aircraft lessors are able to access a wide range and sophisticated sources of funds to support their operations, including:

- PUBLIC INVESTMENTS
- PRIVATE EQUITY
- EQUITY AND DEBT CAPITAL MARKET
- COMMERCIAL BANK LOANS
- ECA FINANCING
- INSURANCE
- LEASING
- TAX INVESTORS

However, the capacity of each player to tap each pocket of liquidity largely depends on its own credit standing. For instance, new entrants or start up airlines may not be able to access all source of funds.

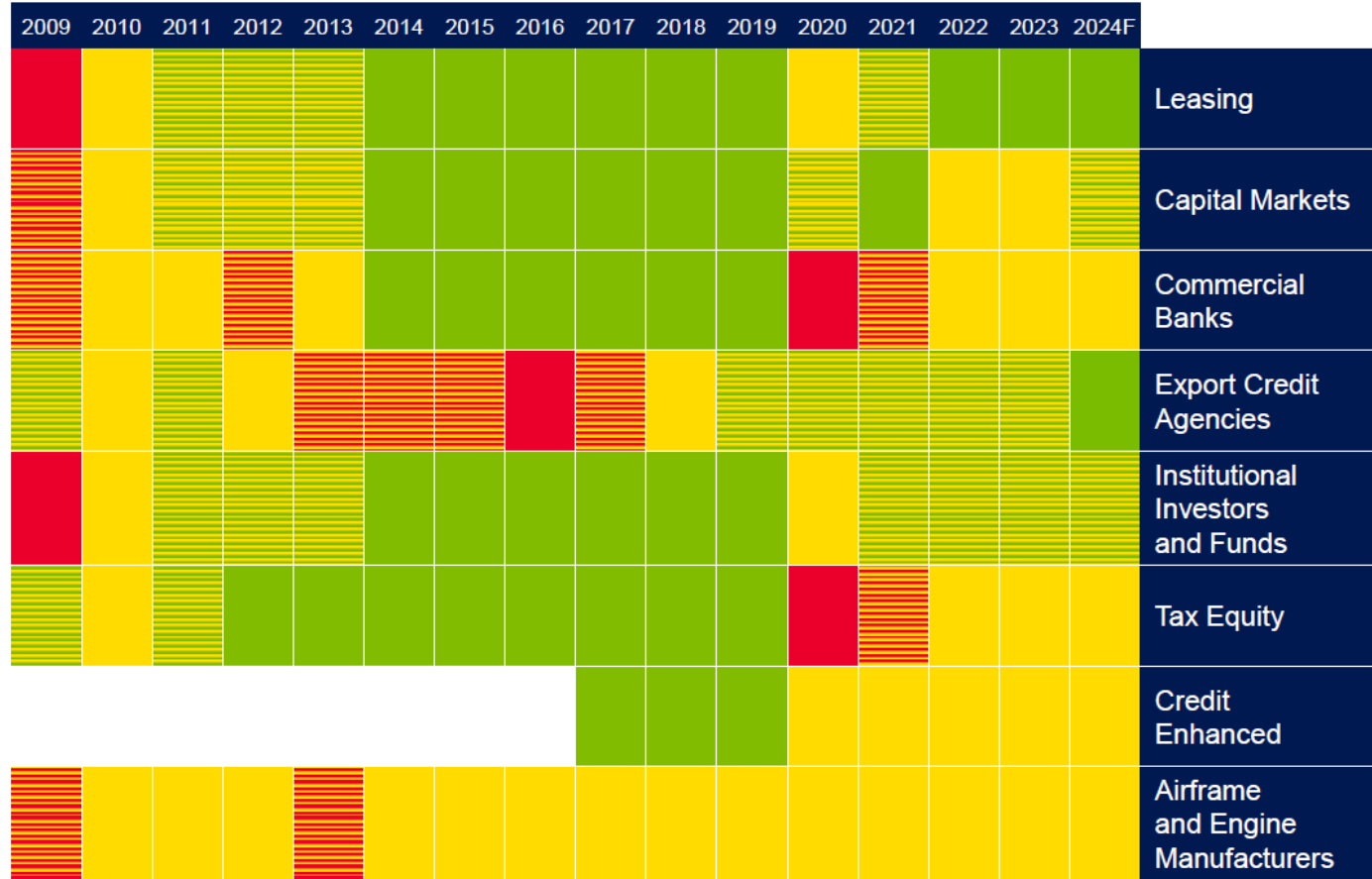
INSTITUTIONAL CLIENTS

CORPORATE CLIENTS



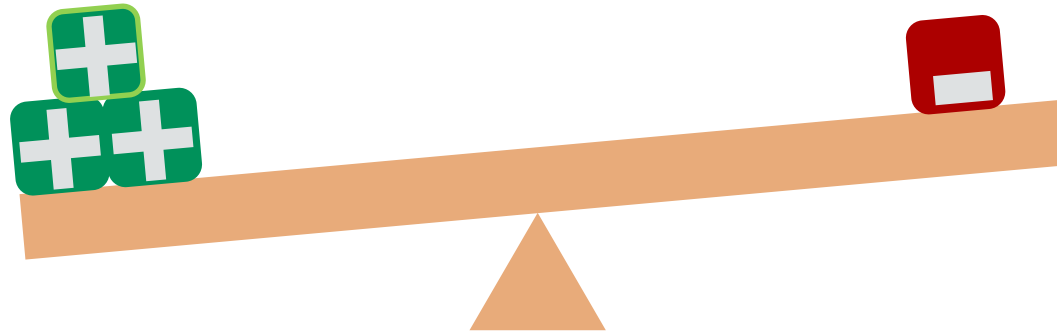
Aircraft Financing Environment

- Satisfactory
- Cautionary
- Major concern



Source: Boeing analysis as of February 2024

WEIGHING THE PROS AND CONS OF COMMERCIAL DEBT FINANCING FOR AIRCRAFT DELIVERIES



ADVANTAGES:

- ✓ A Tailor made financing solution, i.e. LTV, Covenants
- ✓ Flexible. i.e. prepayment, restructure
- ✓ Forward commitment
- ✓ Competitive pricing, cost efficient
- ✓ An evolving and innovative market
- ✓ Private, limited disclosure requirements
- ✓ Rewarding bank relationships

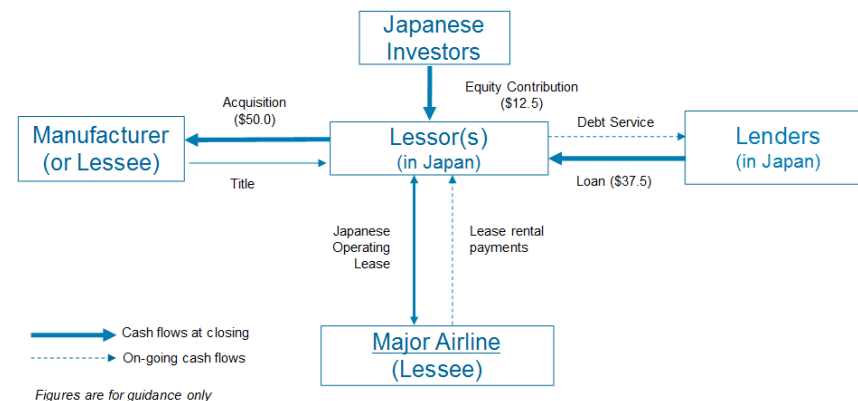
DRAWBACKS:

- Sensitivity to banking crises
- Sensitivity to changes in banking regulation
- Execution can be time consuming

JOL vs. JOLCO

Key Differences:

- ✓ JOL and JOLCO are both Japan-sourced lease transactions that provide 100% financing, but there are important differences.
- ✓ JOL is only an operating lease, whereas JOLCO, while technically an operating lease, is similar to a finance lease with an option to purchase the aircraft at predetermined date and price.
- ✓ While not compulsory, airlines are generally expected to exercise the call option in a JOLCO given the costs associated with putting the aircraft back to full-life return condition.
- ✓ This is a balancing act as an airlines will need to make strategic and economical decisions, including whether the cost of putting the aircraft in redelivery condition outweighs the value of its estimated useful economic life.
- ✓ JOLCO, in most cases, debt has full payout profile with no debt balloon at the end of the debt term (hence no asset risk for the lender unless early terminated). Under JOLCO, the debt is on a limited recourse basis by mainly relying on the airline's credit risk. Transaction will then be either terminated by early buyout option to be exercised by the airline lessee OR carry on until contractual expiry date.
- ✓ Pure JOL is another type of JOL whereby the debt often has balloon at the end of the term (hence with some asset risk to be borne by the lenders) with the aircraft to be returned back to the lessor at the end of the lease.



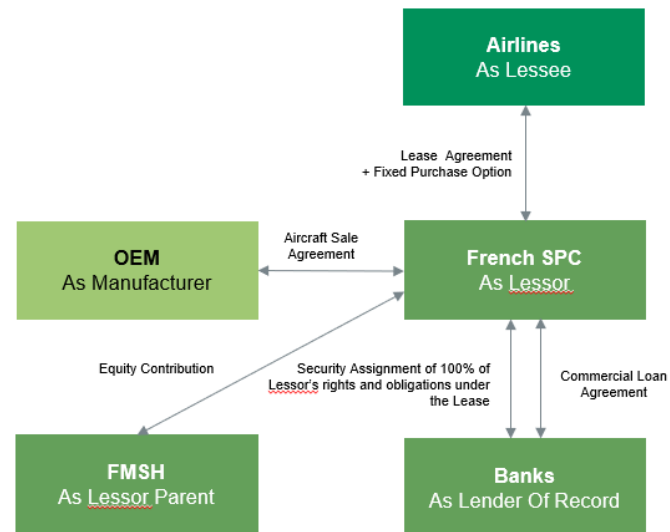
Risks and Rewards:

- JOL and JOLCO products were heavily impacted by COVID 19, as there were instances where JOLCO aircraft were rejected by airlines through bankruptcy proceedings. In addition, some airlines have chosen not to exercise the call options, leaving the Japanese equity investors exposed to residual value risk.
- We have also seen airlines seeking to renegotiate the terms of JOLCO during the pandemic. While JOLCOs can be an attractive form of financing, they are inflexible because it is difficult to amend the terms of a JOLCO during the life of the transaction.
- Any restructures require a lot of waivers and consent from Japanese equity. The tax position of Japanese equity will also be affected due to such restructuring.

French Lease

Key Feature:

- ✓ The aircraft will have to be new.
- ✓ On top of a traditional sale leaseback, the lessor is owned by a French bank which is subject to corporate tax.
- ✓ The lessor will be a tax transparent vehicle, its accounting result will be consolidated at investor level.
- ✓ The aircraft will be depreciated on an accelerated basis. This allow for higher depreciation allowances to be deducted in the early years of use of the asset.
- ✓ The importance is to have a bilateral tax treaty with France agreeing waiver of withholding tax.
- ✓ There is a senior loan and a subordinated loan from the airlines. Tax investors (French Bank) may or may not participate in the term loan.
- ✓ The rental under the lease are set to repay the senior loan only, since the subordinated loan is not repayable until full repayment of the senior loan.
- ✓ The French tax credit earned by the lessor and the investor on the lease payments will create a tax benefit that the lessor will share with the lessee by means of Withholding Tax Refunds paid by the lessor to the lessee.



Limitation:

- The volume of tax can be limited and vary year by year.
- Not all lenders can be lender of record, some lender who does not have French presence has to be a participating lender.
- The Tax ruling may change.

WEIGHING THE PROS AND CONS OF DEBT CAPITAL MARKET FOR AIRCRAFT DELIVERIES

ADVANTAGES:

- ✓ **Diversification of funding**
 1. Reach out to wider investors
 2. Reduce reliance on commercial banks
- ✓ **Capital Market recognition**
- ✓ **Reduce Funding costs**
- ✓ **Standard approach**
- ✓ **Light paperwork**
- ✓ **(for ABS) Lessor can achieve aircraft disposal by selling equity**
 1. Whilst continuing leasing relationship with airline lessee by acting as a servicer
 2. Allow larger portfolio sales / reduce administrative burden
 3. Extend buyers to non-lessor financial investors

What are the DCM Products available for the aviation sector?

1. Senior Unsecured (or Secured) Bonds
2. Future Flow Securitisation
3. Export Credit Agencies (ECA) Guaranteed Bonds
4. Asset Backed Securities (ABS)
5. Enhanced Equipment Trust Certificates (EETC)

DRAWBACKS:

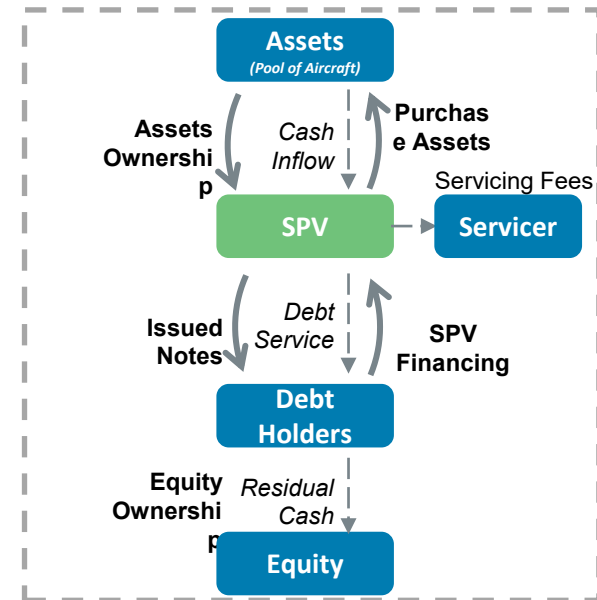
- **Disclosure requirements**
- **Not available to all players**

ASSET BACKED SECURITIES

WHAT IS AVIATION ABS?

Aircraft ABS are notes collateralized by aircraft and their associated leases

- ABS are issued in the private and capital markets and secured by aircraft or lease rental cash flows. The predominant forms of ABS are transactions structured as collateralized obligations. The newly reopened ABS market provides an efficient means for lessors to sell off portions of their portfolios.
- A bankruptcy remote SPV (typically incorporate in Ireland or the Cayman Islands) will purchase a pool of aircraft (directly or indirectly own 100% beneficial interest in a number of aircraft owning SPVs)
- The SPV will fund itself by issuing ABS Notes to Debt (and Equity) Investors
- Ongoing inflows from rent collections as well as maintenance payments from the lessees will be pay for debt servicing and to the Servicer as servicing fee under a cashflow waterfall
- Advance Rate
 - Notes are amortizing with typical WALs of 5 years
 - LTV (value based off the average of 3 third party appraisers):
 - (A) ~65%
 - (BBB) ~75%
 - (BB) ~85%

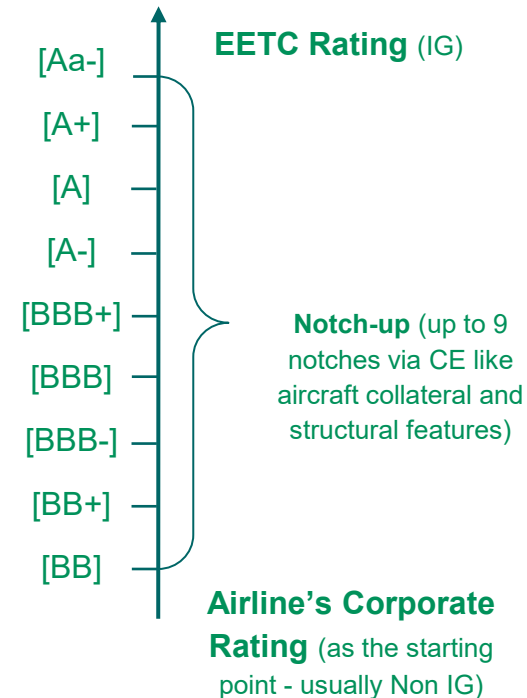


ENHANCED EQUIPMENT TRUST CERTIFICATE (EETC)

What is EETC?

- **Enhanced Equipment Trust Certificate (“EETC”) is a hybrid corporate bond secured by aircraft where the corporate rating of the airline is enhanced by the collateral**
 - The rating of an EETC is linked to the senior unsecured corporate rating of the underlying airline.
 - EETC is a publicly issued rated security that relies on the credit of a single issuers and is secured by aircraft. While EETCs have traditionally been issued by US airlines, because of the availability of section 1110 of the US Bankruptcy Code, the product is now increasingly available to airlines in countries that have adopted the Cape Town ‘Alternative A’ insolvency regime. E.g. Air Canada, British Airways and Virgin Australia.
 - However, the rating of an EETC can be much higher than that of the airline’s unsecured corporate rating thanks to the credit enhancement facilitated by the quality of the collateral and legal and structural features of the transaction
 - Permits a sub-investment grade borrower to issue investment grade debt.
 - EETCs are well suited to repeat issuances, and carriers with established histories in the market can achieve very competitive rates. One of the key development of recent years has been a growing cadre of non US investors.
- **U.S. airlines lead EETC issuance**
 - First issuance in 1993
 - Over USD100 billion total issuance since inception

Rating Scale



KEY FACTS:

- ✓ ECA-guaranteed loan products covered only about 4 per cent of new aircraft financings in 2019, substantially down from previous years, principally as a result of the restriction of the operations of UX EX-IM Bank and the European ECAs for several years. By the end of 2021, ECA support had increased to 9 per cent of funding for the industry and nearly 5 per cent of Boeing deliveries
- ✓ ECA financings are currently regulated by the Organisation for Economic Co-operation and Development (OECD) Aircraft Sector Understanding (ASU) arrangements; however, not all aircraft manufacturing countries are subject to the ASU rules (eg, China and Japan), which will be of increasing significance as these countries develop new aircraft types and products.
- ✓ Having been of critical importance when filling the funding gap during the downturn in the availability of traditional debt finance during the liquidity crisis and associated recession.
- ✓ ECA financing is likely to reduce over time in the light of the ASU's requirements to impose market-level fees and rates. The 2011 ASU requires each ECA to classify its borrowers into one of eight risk categories, based on these senior unsecured credit ratings. The new ASU thereby raises the export credit premium for all buyers and borrowers.
- ✓ Both Airbus and Boeing lacked access to their domestic ECAs for a lengthy period since 2017 .
- ✓ ECAs remain an integral part of the financing ecosystem, injecting critical support in the event of market distress and covering situations where commercial financing is not available.
- ✓ ECAs accounted for 2.6 per cent of Boeing deliveries in 2020, up from a low watermark of 0.4 per cent in 2019. By 2021, this had increased further to 4.9 per cent. The year 2020 saw the first deal supported by US EX-IM close since the bank had its charter reinstated for Turkish Airlines. Overall, ECA pipelines grew notably during the second half of 2020 and throughout 2021, with continued growth for export credit volumes in 2022 and 2023. However, no one anticipates ECA financing levels getting back to anywhere near those seen in the financial crisis in 2008.



Aircraft Non-Payment Insurance (“ANPI”)

The ANPI product is a similar concept to export credit support that provides an insurance policy (rather than a guarantee) to lenders, who rely on the credit of the insurers underlying the ANPI products.

At its core, the ANPI product protects investors from payment defaults by obligors (namely, customers predominantly made up of airlines and lessors)

AFIC

- AFIC offers an insurance-based aircraft finance product accessed through and managed by Marsh LLC (who acts as exclusive broker). While not expressly designated as a product for Boeing aircraft, this has been the norm (other than a handful of more recent transactions involving new Embraer aircraft).
- The three direct AFIC insurer counterparties that typically participate on a several basis are: (1) Allianz (rated AA by Standard & Poors (“S&P”)); (2) AXIS (rated A+ by S&P); and (3) Sompo International (rated A+ by S&P). Typically, one insurer takes 50% exposure and the other two each take 25%. The insurer who takes 50% will lay 25% of the risk to Fidelis. The insurer counterparties may sometimes vary in order to satisfy insurance licencing requirements of the particular jurisdictions in the transaction.
- Lenders take a mixture of single-A or double-A risk of a group of insurance companies. This is one of the key differences between AFIC and ECA deals, whereby the lenders effectively take sovereign risk. While the ratings are slightly lower than ECA deals, such insurer ratings are substantially higher than any airline credit.
- Since each insurer counterparty is liable for their own portion, the lenders will have to assess the risk of default by one or more of the insurers. However, the lenders are focused on the credit assessment of the insurer counterparties, and therefore do not need to be specialized aircraft lenders.
- As for the claims process, the following simple steps should be followed:
 - 1) Customer fails to make a scheduled payment (of principal and/or interest)
 - 2) Lender submits notice to AFIC of the missed payment in order for their claim to be processed under the ANPI policy
 - 3) Insurers will pay 100% of the missed payment (with accrued interest) within a specified time frame
- Once the insurer counterparties make the payments to the lenders, the insurer counterparties will be subrogated to the rights of the lenders in respect of those payments, and the insurer counterparties become entitled to claim from the customer.

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Balthazar

- Balthazar is the Airbus equivalent of AFIC and was also developed with Marsh but through a different entity Marsh S.A.S. The Balthazar ANPI product was established as an alternative source of financing for new Airbus aircraft in response to the lack of available financings of Airbus aircraft supported by the export credit agencies.
- Lenders take risk of a group of insurance companies who have a credit rating of at least A- (S&P)(each with a separate exposure as the Balthazar insurer counterparties participate on a several basis). This is one of the key differences between Balthazar and ECA deals, whereby the lenders effectively take sovereign risk. Similar to AFIC, Balthazar deals are similar to investment grade loans, although with three credits to analyze.
- The Balthazar ANPI product allows parties to use their own transaction documentation granting some flexibility given the lack of the requirement for a harmonised approach. The documentation process is done by way of two streams (running on track): the first track is just the financing parties (and related financing documents), and the second track is the lenders and the insurer counterparties (and the related insurance policy). Typically, lenders’ counsel will draft the documentation (save for the insurance policy) and coordinates with the relevant parties on both tracks of the deal.

ANPI products also have a number of other positives for both Customers and lenders, including but not limited to:

1. helping Customers attract funding at competitive rates due to reduced risk;
2. fairly simple transaction structuring (while it functions in a similar way to an export credit supported guarantee, there are no non-commercial constraints on pricing or deal structure (not subject to ECA’s dictating terms, for example) which can accommodate a variety of transaction structures (finance lease, operating lease, JOLCO etc.) ;
3. ANPI comes at no additional cost to lenders; and
4. helps secure regulatory capital relief for lenders



Cape Town is the generic reference to the international treaty adopted on 16 November 2001

Convention on International Interests in Mobile Equipment (the “Convention”) and an associated Protocol to the Convention on Matters Specific to Aircraft Equipment (the “Protocol”).

- The Cape Town Convention is intended to give parties involved in such transactions greater confidence and predictability, principally through the establishment of a uniform set of rules guiding the constitution, protection, prioritization and enforcement of certain rights in Aircraft and Engines.
- At a very high level, the Cape Town Convention has two primary areas of coverage.
 - a) The first relates to the establishment of an International Registry that serves as a central database to record, among others, mortgage and lease interest in airframe and engines constituting Aircraft Objects. This central database allows parties to fairly easily record on the public record, and perfect, their interests in aircraft assets and allows interested persons to review what encumbrances may be on these assets.
 - b) The second area of coverage is to provide a body of law that will govern the exercise of remedies in respect of Aircraft Objects by a creditor in the face of a default by a debtor, including the deregistration of an Aircraft by a creditor from an offending debtor’s jurisdiction.
- An aircraft financier contemplating a financing in a particular jurisdiction, might first be interested to know whether that jurisdiction is a party to the Cape Town Convention as it assesses the legal risks associated with that jurisdiction.
- As to matters relating to the International Registry “perfection” regime, the financier will want to understand whether there are local procedures for the perfection of International Interests in aircraft assets that go beyond the simple matter of recording interests on the International Registry. In United States, filing must also be made with FAA.

Examining the impact of regulation on the market

Basel IV will reduce availability for secured aircraft lending

**350% -
600%**

Increase in Tier 1 capital requirements on secured aircraft loans

**\$17Bn -
\$34Bn**

Amount required for banking industry to raise to support existing aircraft loan banking books

1

Disadvantages lower risk loans

- A reduction in the size of low-risk aircraft loan portfolio on banking books via possible asset sales.
- An overall increase in bank portfolio risk through re-allocating capital away from secured lending towards riskier unsecured lending and riskier collaterals.

2

Increased pressure on banks

- Banks will face pressure to do more cross-selling in capital markets and pursue advisory/fee businesses.
- Continue to see more structured and heavily syndicated deals that have become the norm for commercial banks since the financial crisis.

Key Takeaways

- 1) Regulation **is unlikely to affect the overall volume of bank debt** in the sector because of demand in the Chinese market (31% of global demand), where bank debt is the most popular form of financing.
- 2) The Basel rules exemption for ECA financing is welcome, expect to see a **growing share of ECA aircraft financing** in coming years.



Financing Menu For Airlines

Financing type	Export Credit*		Insurance	Commercial				Tax optimization		
Financing format	Loan	Bond	AFIC/Balthazar	PDP Financing	Secured RCF	Senior Term Loan	Junior / Mezz Loan	EETC	JOLCO	French Lease
Financing need	Permanent LT		Permanent LT	Liquidity	Growth / Liquidity	Permanent LT	Permanent MT/LT	Permanent MT/LT	Permanent LT	Permanent LT
Aircraft life cycle	Brand New		Brand New	Pre-delivery	Can accommodate older aircraft (up to 12 years)	Can accommodate older aircraft (up to 12 years)	Can accommodate mid-life aircraft (up to 7-8 years)	Can accommodate mid-life aircraft (up to 7-8 years)	Can accommodate mid-life aircraft (up to 4-5 years)	Brand New
Rating	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	Structured	N.A.	N.A.
Aircraft type	All	Airbus, Boeing, ATR only	All	Narrowbodies	All	All	All	Narrowbodies	Narrowbodies	All
LTV	Up to 85% + ECA premium		Up to 85%	Up to 80%	Up to 80%	Up to 80%	Up to 90%	Up to 90%	100% (with PO)	80% (with PO)
Size (in USD m)	Up to 500-700		Up to 200	up to 50-60	up to 150	large (subject to each bank limit)	up to 50-60	up to 400-500	2-3 NB at a time	2-3 NB at a time
Maturity	up to 12 years		Up to 12 years	2 years	2-3 years	up to 12 years	up to 8 years	5-7 years	PO date up to 10 years	up to 13 years
Max aircraft age at maturity	up to 13 years		Up to 12 years	0	up to 12 years	up to 15 years	up to 12 years	up to 12 years	up to 13 years	up to 13 years
Balloon at maturity	No		No	Yes	Yes	Possible	Possible	Possible	Purchase Option	Purchase Option (small)
Pricing	L + 50-110 bps + premium		L+90-120bps +premium	L + 150-250bps	L + 100-300bps	L + 100 - 300 bps	L + 400 - 800 bps	L + 200 - 500 bps	L + 100 - 300 bps	L + 100 - 300 bps
Flexibility	Low		Low	Low	High	High	Medium	Low	Low	Medium
Execution certainty	High	Medium	Medium	Medium	Medium	High	Medium	Medium	High	High
Execution time	up to 9 months		3-4 months	3-4 months	2-3 months	1-2 months	1-2 months	3-4 months	3 months	3 months
Source of financing	Banks	Capital Market	Banks	Banks	Banks	Banks	Banks / Private investors	Capital Market	Banks & Japanese lessors	Banks
Market depth	Deep		Limited to certain banks	Limited to certain banks	Limited to certain banks	Relatively deep	Limited	Institutional buyers	~10 active investors	4 banks

* Boeing & Airbus ECAs are not available.

** the ECAs usually don't like to finance more than 30-40% of deliveries



Financing Menu For Lessors

Financing Need	Growth / Liquidity		Permanent Financing			
Format	Warehouse Facility	ABS Warehouse	Bank Loans	Unsecured Bonds	Secured Notes	Asset-Backed Securities (ABS)
Secured / Unsecured	Secured / Unsecured	Secured	Can be either	Unsecured	Secured	Secured
Type	Recourse	Non-Recourse	If unsecured = Recourse, otherwise Non-recourse	Recourse	Recourse	Non-recourse
Aircraft	Relatively new	Can accommodate older aircraft	Typically brand new or up to 5 years old	NA	Brand new or mid-age	Can accommodate older aircraft
Advance Rate	60-70% range	Up to 70% (mix of appraisers)	Up to 70% senior and 85% junior (Ascend)	NA	Up to 65%	Up to 80% (mix of appraisers)
Size (\$MM)	750	750	Up to 700	Unlimited	unlimited	unlimited
Pricing	L+180-300 bps	L+150-300 bps	L+100-300 bps subject to certain restrictions (Senior)	L+300-400 bps	L+200-300 bps	4.40% area for A rated issuance
Loan Amortization Profile/Tenor	3-5 years / Bullet	2-5 years	Senior 7 year amortization with small balloon, Junior full payout within 7 years	Up to 10 years	Up to 7 years	Up to 25 years; full amortization
Rating	Investment grade for unsecured	Unrated	Typically None	Corporate limited to up to 2 notches above corporate	2 notches above corporate limited to up to 2 notches above corporate	BBB- to A+ Required for ABS; but not for sponsor
Execution Certainty	High	High	High	Medium	Medium	High
Execution Time	2-3 months	2-3 months	1-2 months	2-3 months	2-3 months	2-3 months
Depth of the market	Relatively deep	Limited to certain banks	~15-20 active banks, limited junior appetite	Deep investor base	Deep investor base	Deep - Institutional buyers



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