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Matthew Leigh, an aviation finance partner in our Singapore office, led the Commercial Aviation Banking Panel at the Airline Economics Conference in Seoul at the end of March.

The conference brought together airlines, lessors and financiers from across the Asia-Pacific region to discuss trends and developments in the aviation industry. The panel included Credit Agricole-CIB, The Korea Development Bank, BNP Paribas, Cathay United Bank, DVB Bank SE and Aviation Capital Group; some of the industry's leading financiers.

We summarise here the major themes discussed by the panel.

Competitive financing environment

There has been a huge influx of aircraft into the region in tandem with the associated financing needs. Banks and capital markets are more in demand than ever by airlines and leasing companies in search of funding.

The panel considered that the market was probably now just past its peak in terms of funding liquidity however they did not anticipate any danger of liquidity tightening before aircraft values softened. It was thought that 2019 will continue to see plenty of liquidity readily available in the market.

The aviation finance market remains relatively stable and continues to offer a wide variety of financing options. Funds are available at historically low cost and offered by a range of lenders and investors from around the world together with substantial growth in the aviation capital markets.

Commercial banks are competing with and working alongside a wider and deeper selection of alternative funding sources.

The panel agreed that there was perhaps some risk for the 'new money' market entrants who may have been less disciplined with regard to transaction structuring and pricing.

The panellists also anticipated further growth, competition and consolidation amongst the leasing companies during the course of 2019.

Challenges and changing regulation

The aircraft finance industry enjoys relative stability compared to other asset classes with historically low defaults, limited volatility and a high asset recovery rate. The panel considered however that there had likely been excessive flexibility to the benefit of borrowers in recent years and anticipated an adjustment in the market if riskier credits continued to default.

Inflationary challenges look set to continue with currency fluctuations and the price of jet fuel remaining the greatest threat to airline profitability. Increased political tensions and trade disputes have combined with rising interest rates and slower economies to form headwinds which are impacting on the aviation sector. As the economic environment becomes more challenging, weaker airlines will come under increased pressure - in particular, those airlines with revenues in non-dollar currencies are finding their margins affected.

The panel considered that some liquidity may leave the market as yields have improved in other sectors, which could result in tighter financing terms in the future.

Aviation lenders have been preparing for more restrictive regulations which could lead to a reduced aviation balance sheet as Basel IV may require banks to hold more capital reserves against certain loans that they issue.

JOL and JOLCO market

The amount of equity investment into JOL and JOLCO structures has doubled in the past five years. Aircraft related JOLCOs have been the principal driver of this growth and there has been a substantial rise in the number of airlines able to access the Japanese market as part of their financing solutions.

There were some concerns that, as JOLCOs are tax based investment products, there remains a risk that change in Japanese tax law could have a significant impact on the effectiveness of the product however the panel anticipated this market to remain strong for the immediate future.

Looking to the future

The market is about halfway through the generation change in terms of introducing new aircraft technology and it was noted that next-generation narrow-bodies have proved hugely popular in Asia.

Aircraft production remains at peak levels and the panel did not have significant concerns in relation to the current grounding of the B737 MAX model.

With more airline bankruptcies seen in the past year and the reported lease payment defaults over the past few months, the panel considered whether the aviation super-cycle was finally coming to an end. The general consensus however was that passenger demand remained very strong despite emerging geopolitical headwinds that had the scope to disrupt this positive

momentum.

We would be delighted to discuss any of these matters with you further.

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