Muzinich & Co

Lift off: The case for aviation finance in institutional portfolios

As traditional lenders retreat from aviation finance, Alok Wadhawan, Brian Lau and Thomas Light make the case for institutional investors to allocate through a blend of secured debt and leasing.

Alok Wadhawan

Global Head of Aviation Finance

Brian Lau

Portfolio Manager

Thomas Light

Portfolio Manager

As institutional investors navigate a complex market and economic environment, the search for consistent, uncorrelated, risk-adjusted returns is becoming increasingly challenging. Against this backdrop, aviation finance is emerging as a compelling alternative.

In this article, we examine how structural changes in the aviation sector are creating opportunities for investors seeking diversification, potential yield enhancement and capital preservation, focusing on:

- Why the current environment could offer an attractive entry point.
- How the retreat of bank lenders has reshaped the financing market.
- The distinctive characteristics of aviation compared to other asset classes.
- Why a combination of senior-secured loans and aircraft leases can potentially deliver attractive risk-adjusted returns.

Point of differentiation: Blending debt and equity

Many aviation investment strategies focus mainly on operating aircraft leases for their perceived higher return potential compared to senior debt. Due to the cyclical nature of the industry, however, strategies focused solely on leases can experience fluctuating returns depending upon on the timing of investment. For example, an allocation made just before COVID-19 would have seen much lower returns than one made post the pandemic.[1]

We believe the cyclicality of the sector is best navigated through a blended approach that integrates the cash flow stability and downside protection of senior-secured debt with the upside potential of lease exposure. Such an approach is designed for investors seeking a balance between yield, downside protection, and long-term capital appreciation.

In pure lending structures, capital is typically deployed against 75–80% of the aircraft's value,[2] providing a cushion to protect investors from downside risk. Through careful counterparty selection with high-quality airlines operating liquid, in-demand aircraft, we believe loans can achieve ratings in the high triple-B to low single-A range. Meanwhile, leasing transactions introduce a hybrid of equity and bond-style exposure, offering returns from contractual income and potential asset appreciation.

A blended approach can create an attractive risk-adjusted return profile for institutional investors.

1. McKinsey & Company, 'Taking stock of the pandemic's impact on global aviation,' March 31, 2022
2. Muzinich internal analysis, as of May 8, 2025

Industry fundamentals: Solid in the face of headwinds

Despite geopolitical tensions and economic uncertainty, the aviation sector's fundamentals remain robust. Global airline industry revenues are expected to surpass US$1 trillion for the first time in 2025, a 4.4% year-on-year increase, with net profits forecast at US$36.6 billion (up from US$31.5 billion in 2024).[3]

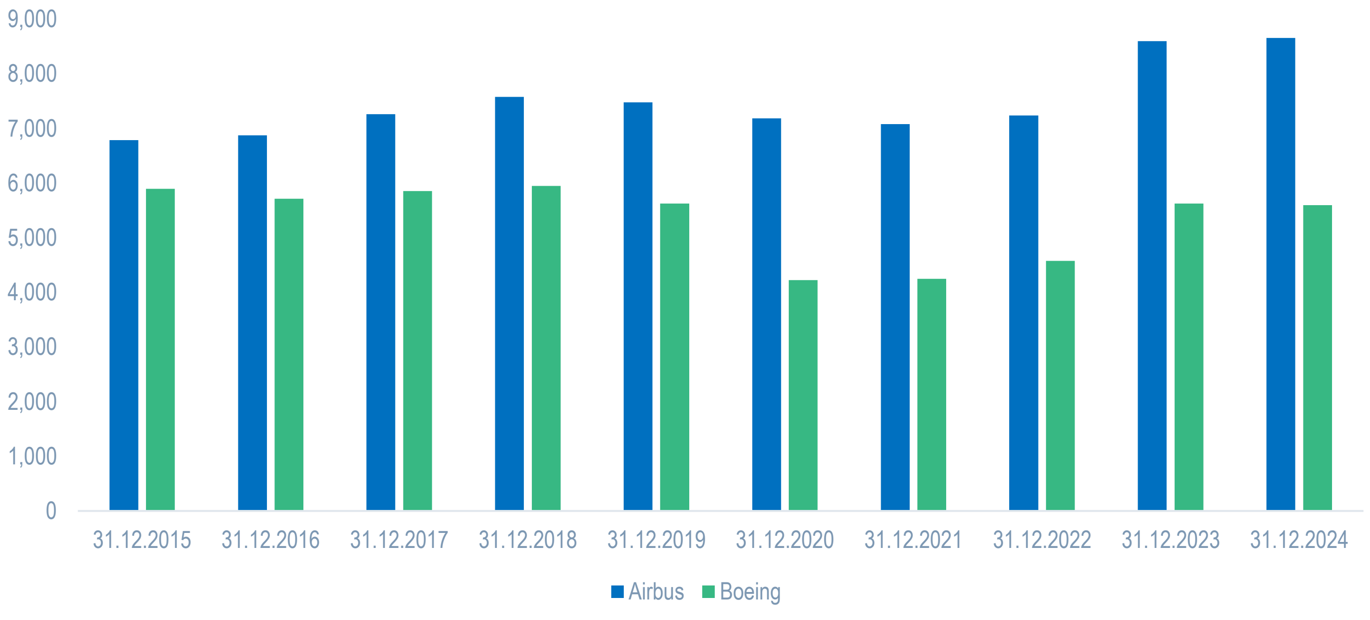
Passenger demand continues to grow, with revenue passenger kilometres increasing 2.6% year-on-year in February 2025. Growth has been particularly strong in Asia Pacific (up 9.5%) and Europe (up 5.7%), with only North America showing moderation.[4]

In our view, one of the main factors supportive of an allocation to aviation finance is the persistent supply-demand imbalance in aircraft production. Total deliveries from Airbus and Boeing fell 10% year-over-year in 2024, with Airbus delivering 766 aircraft and Boeing 333.[5] While aviation analytics firm Cirium estimates combined deliveries will reach approximately 1,500 in 2025, this remains well below demand for new aircraft.

The current backlog stands at 8,720 aircraft for Airbus (representing 10.4 years of production) and 6,319 for Boeing (11.1 years).[6] This substantial order book creates a cushion against potential demand softness and supports aircraft values—a critical consideration for asset-backed lenders and lessors.

Between 2020 and 2024, the sector effectively lost over two years of production—approximately 3,000 aircraft—because manufacturers were producing at significantly reduced capacity.[7] This shortfall cannot be remedied quickly due to persistent supply chain constraints and internal challenges, particularly at Boeing.

Figure 1: Aircraft backlogs, 2015-2024



Source: Airbus, Boeing financial reports, December 31, 2015 – December 31, 2024. For illustrative purposes only.

The situation is further compounded by extended maintenance periods, with engine overhauls now taking six-to-nine months versus the pre-pandemic norm of two-to-three months.[8] These factors collectively contribute to a shortage of available aircraft, supporting valuations and lease rates.

3. IATA, "Strengthened Profitability Expected in 2025 Even as Supply Chain Issues Persist," December 12, 2024
4. IATA, "Passenger Demand Growth Slows Slightly in February," March 31, 2025
5. Cirium, "Shaking out the Airbus and Boeing 2024 delivery numbers," January 29, 2025
6. Forecast International, "Flight Plan, Airbus and Boeing Report March 2025 Commercial Aircraft Orders and Deliveries," April 10, 2025
7. Boeing, Airbus, financial reports, as of April 2025
8. Bain & Company, "Aircraft engine maintenance and repair to peak in 2026, worsening capacity shortage for commercial aviation," July 18, 2024

Mitigating factors against economic volatility

While higher tariffs and a potential economic slowdown are legitimate concerns, we believe several mitigating factors could act as a buffer for the aviation sector:

1. **Oil price decline**: Crude oil has almost halved from its May 2022 peak of US$125.5 per barrel to US$63 in April 2025,[9] significantly reducing airlines' operating costs.

2. **Weaker dollar**: The US Dollar Index, a measure of the strength of the greenback versus other major currencies, has dropped over 10% since mid-January 2025, benefiting airlines whose revenues are in local currencies while their costs (including aircraft purchases and fuel) are mainly in dollars.[10]

3. **Stronger balance sheets**: Unlike previous downturns, many airlines emerged from the pandemic with restructured operations and improved financial positions.[11]

4. **Limited competition**: Despite efforts by China's COMAC and others to challenge the OEMs, regulatory hurdles and production capacity constraints should keep their duopoly intact for the foreseeable future.

The industry weathered the COVID pandemic—the most severe crisis in its history—and the period of rapidly rising interest rates in 2022 and 2023. This gives us confidence that, even in a period of economic contraction, the structural aircraft shortage should continue to support valuations and protect portfolios.

From bank domination to the rise of institutions

Another key consideration for institutional investors stems from the reshaping of aviation finance in recent years. Traditional bank lenders, who historically dominated the market, have steadily retreated from the sector over the past decade. The exodus has continued this year, with a new German entrant discontinuing its aviation finance business within two years of launch.[12] As a result, only a handful of banks remain significant players.

The retreat of banks has impacted loan pricing. Based on our experience and analysis of the market, spreads on individual loan transactions are now materially wider than historical levels, a premium we believe is now structural rather than cyclical.

This has created a potentially attractive entry point for insurance and institutional capital. High barriers to entry—including the need for asset managers to have specialized origination capabilities and relationships across the aviation ecosystem—have limited new competition, which is helping maintain margins.

Aviation as strategic asset class

For institutional investors, aviation finance offers several compelling characteristics that, combined, differentiate it from other asset classes:

Asset-backed security with high recovery rates: Unlike corporate lending, aviation debt is secured by highly mobile, standardized assets with established global trading markets. This has historically translated into exceptional recovery rates during defaults. For Enhanced Equipment Trust Certificates (EETCs), a common aircraft financing structure, recovery rates from 1994 through November 2023 reached 98.8% for single-A tranches, 92.1% for single-B tranches, and even 89.5% for C-rated securities (Figure 2).[13] By comparison, recovery rates for senior secured and senior unsecured corporate bonds were 58.1% and 44.8%, respectively.[14]

Figure 2: Loss and recovery rates for EETCs in bankruptcy, 1994-2023

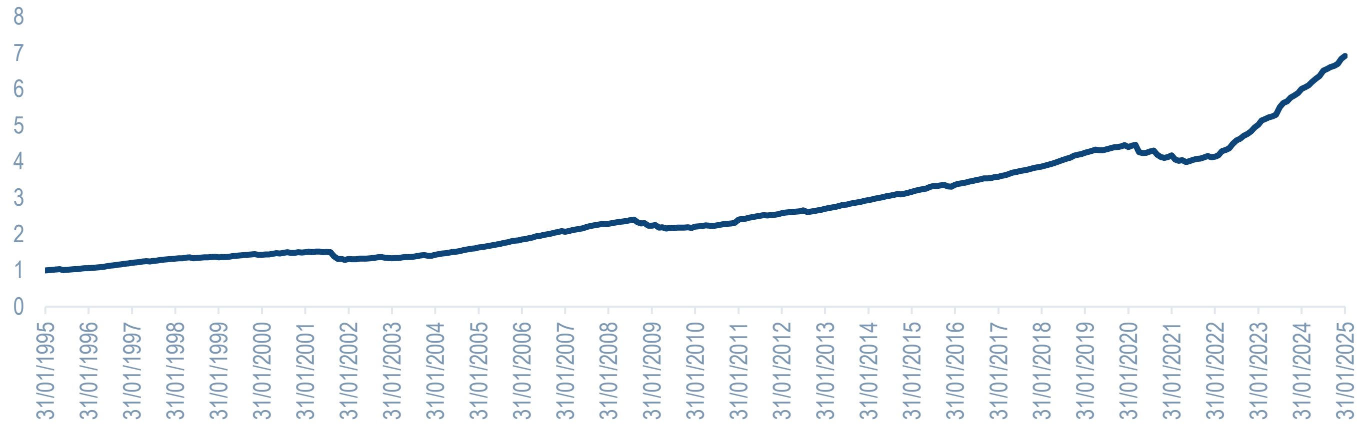
Tranche	Total loss (mn)	Face value (bn)	Loss rate	Recovery rate
A	US$202	US$17.2	1.2%	98.8%
B	US$282	US$3.6	7.9%	92.1%
C	US$277	US$2.6	10.5%	89.5%

Source: Kroll Bond Rating Agency, as of November 29, 2023. Most recently available data used. For illustrative purposes only.

9. Macrotrends, "Crude Oil Prices – 70 year historical chart," as of April 28, 2025
10. ICE Index Platform, "US dollar index," as of April 28, 2025
11. McKinsey & Company, 'Aviation value chain: Strong recovery brings profitability into view,' November 1, 2024
12. Airfinance Global, "HCOB pulls out of aviation," April 8, 2025
13. Kroll Bond Rating Agency, "EETC Resilience, Updated Historical Recoveries Through Pandemic and Beyond," November 29, 2023. Most recently available data used
14. S&P Global, "U.S. Recovery Study: Loan Recoveries Persist Below Their Trend," as of December 15, 2023. Most recent available data used

A growing leasing market: The aircraft leasing market was valued at US$192.45 billion in 2024 and is forecast to experience annual compound growth of 11.5% through 2034, reaching US$551.5 billion.[15] Leased aircraft currently represent 51.3% of the global fleet, a proportion that has more than doubled since the start of the millennium.[16] At a broad market level, this has been reflected in consistent long-term investment returns.

Figure 3: Aircraft leasing index returns (rebased to January 1, 1995)



Past performance is not a reliable indicator of current or future results.

Source: Ascend, as of January 31, 2025. Ascend Aircraft Leasing Return Index: Estimates risk-adjusted returns derived from historical trading of the commercial aircraft operating lease portfolio. Index selected represents best proxy for aircraft leasing market. Index performance is for illustrative purposes only. You cannot invest directly in the index. For illustrative purposes only.

Diversification benefits: Aviation finance has historically demonstrated low correlation with other asset classes (Figure 4). While correlation can rise during severe economic shocks, we believe the sector's distinct drivers—including robust passenger and cargo demand and a shortage of aircraft—provide meaningful diversification benefits. In periods where traditional credit or equity markets face stress, aviation-backed debt, especially senior-secured loans, can offer stable, amortizing income and principal protection.

Risk: Diversification and asset allocation may not fully protect you from market risk.

Figure 4: Correlation matrix: Aircraft leasing versus other asset classes, 2007-present

	ALRI	S&P Airlines	S&P Global REITs	Baltic Exchange Dry Index	MSCI World Transport	S&P 500	US IG	US HY
ALRI	1.00							
S&P Airlines	-0.08	1.00						
S&P Global REITs	0.00	0.54	1.00					
Baltic Exchange Dry Index	0.02	-0.03	-0.01	1.00				
MSCI World Transport	-0.04	0.61	0.80	0.04	1.00			
S&P 500	-0.03	0.57	0.81	0.03	0.89	1.00		
US investment grade	-0.06	0.19	0.62	0.06	0.51	0.49	1.00	
US high yield	-0.03	0.44	0.79	0.10	0.67	0.75	0.69	1.00

Key
- Perfect positive correlation
- Strong positive correlation
- Weak positive correlation
- Very weak positive correlation
- Weak negative correlation

Source: Muzinich analysis, as of May 8, 2025. Ascend Aircraft Leasing Return Index, S&P Airlines Index, S&P Global REITs Index, Baltic Exchange Dry Index, MSCI World Transport Index, S&P 500, ICE Index Platform - ICE BofA ML US Cash Pay High Yield Index (J0A0), ICE BofA US Corporate Index (C0A0). Indices represent best proxies for respective asset classes. For illustrative purposes only.

15. Polaris, "Aircraft Leasing Market Overview," March 2025
16. IATA, “More aircraft are leased than owned by airlines globally,” April 12, 2024

Inflation hedge: As physical assets with replacement costs linked to inflation, aircraft can offer protection against inflationary environments—particularly newer, fuel-efficient models that become more valuable when fuel prices rise. Moreover, aircraft leases can be structured to include inflation-adjusted rent payments, while the ability of lessors to renegotiate terms periodically offers additional protection.

Flexibility: Insurers and pension funds typically view aviation as an asset class alongside infrastructure and real estate. But we believe aviation offers greater flexibility because aircraft are transferable across jurisdictions, unlike fixed infrastructure or property assets.

The case for a blended approach

While aviation finance offers a variety of opportunities, the optimal approach for institutional investors may not be a pure leasing or lending strategy, but rather a thoughtful blend of both.

Leasing strategies typically generate contracted cash flows representing anywhere between 50-80% of invested capital, with the return of principal dependent on aircraft sales at the end of the lease period.[17] This can expose investors to residual value risk and potential market timing challenges.

Conversely, senior lending strategies offer greater capital preservation but may not meet the higher hurdle rates of pension funds and other investors.

As such, investors may consider an approach that combines senior-secured lending with selective leasing exposures, which we believe has the following potential benefits:

1. **Enhanced cash flow profile:** By incorporating fully amortizing loans into a portfolio, contracted cash flows can cover approximately 130% of invested capital before considering potential asset sale proceeds.[18]

2. **Customizable risk/return profile**: A blended strategy can be tailored to investor preferences, with the flexibility to adjust the debt/leasing mix depending on risk appetite and market conditions.

3. **Capital preservation**: The senior debt component (typically 75-80% LTV) can provide downside protection to a portfolio, while leasing exposure offers the potential for enhanced returns.

4. **Mitigation of market timing risk**: Unlike pure leasing strategies that need to deploy capital regardless of market conditions, a blended strategy gives managers the flexibility to increase the debt allocation during uncertain periods and leasing exposure when conditions improve.

The leasing component requires selectivity, however. The leasing market has become commoditized, with major players pursuing scale over margins. This environment has led some investors to suffer disappointing outcomes from overly aggressive leasing strategies.

Success lies in patience and discipline—identifying niche opportunities where yields remain attractive, and downside protection is intact. That means focusing on popular, liquid aircraft types, limiting lease duration risk, and avoiding overheated sub-markets.

We believe blending leasing exposure with senior-secured debt allows for upside potential without exposing the entire portfolio to equity-like risk. The combination provides a more stable return profile, while allowing for possible capital appreciation.

In our view, institutional investors should view aviation as core allocation within their private credit or real assets portfolios, combining the resilient cash yields and inflation protection of infrastructure with the standardization and mobility of transport finance.

For insurers, the long-dated nature of aircraft debt and leases can align with their own long-term liability profiles and meet their investment objectives of capital preservation, investment-grade ratings, and stable income.

Given higher return hurdles, pension schemes have historically been less active in senior aviation debt. However, as return expectations moderate and demand for low-volatility alternatives increases, blended aviation strategies could offer attractive potential returns without sacrificing risk discipline.

17. Muzinich analysis, as of April 2025
18. Muzinich analysis, as of April 2025

Navigating current challenges

Global trade tensions and shifting tariff policies have introduced additional uncertainty to the aviation sector. Higher tariffs on materials like steel and aluminum are increasing aircraft costs, while airlines face supply chain delays and potential route adjustments.[19]

Meanwhile, in Europe, environmental regulations such as the "Fit for 55" package are increasing compliance costs through carbon taxes and sustainable fuel mandates.[20]

For institutional investors considering an allocation to aviation finance, we believe these challenges underscore the importance of:

1. Diversification across geographies and airline credits.

2. A focus on fuel-efficient, modern aircraft in lease agreements and as collateral for secured debt.

3. Conservative underwriting assumptions.

4. The flexibility to adjust between lending and leasing based on market conditions.

Even in a slowdown, the fundamental shortage of aircraft should provide a buffer that did not exist in previous cycles. For asset-backed lenders at conservative LTVs, we believe the capital preservation thesis should hold even if we enter a prolonged period of economic uncertainty.

In summary

For institutional investors seeking consistent risk-adjusted returns with meaningful diversification, we believe a blended aviation finance strategy warrants serious consideration. Structural changes in the competitive landscape and favourable supply-demand dynamics have created an opportunity set that could align well with the investment objectives of insurance companies and pension funds.

Combining the capital preservation characteristics of senior debt with the return potential of aircraft leases can create a compelling alternative to traditional aviation investment strategies. Moreover, the flexibility to adjust the debt/leasing mix could provide a valuable portfolio construction tool as market conditions evolve.

Although the latest bout of economic uncertainty will provide challenges, we believe the sector's proven resilience through severe shocks should offer confidence in its long-term stability and growth potential.

19. S&P Global, "Global Airlines Brace For Tariff Uncertainty," April 22, 2025
20. European Council, “Fit for 55 Explainer,” April 25, 2023

Important information