

Babcock & Brown Air LTD
Form 20-F
March 08, 2010

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 20-F**

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) or (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2009

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-33701

BABCOCK & BROWN AIR LIMITED

(Exact name of Registrant as specified in its charter)

Bermuda

(Jurisdiction of incorporation or organization)

West Pier

Dun Laoghaire

County Dublin, Ireland

(Address of principal executive office)

Mina Kim, West Pier, Dun Laoghaire, County Dublin, Ireland

Telephone number: +353 1 231 1900, Facsimile number: +353 1 231 1901

(Name, Telephone, Email and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class

Name of each exchange on which registered

American Depositary Shares

New York Stock Exchange

Common Shares, par value of \$0.001 per share

New York Stock Exchange*

* Not for trading, but only in connection with the registration of American Depositary Shares representing these shares, pursuant to the requirements of the Securities and Exchange Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

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30,279,948 Common Shares, par value of \$0.001 per share.

100 Manager Shares, par value of \$0.001 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

If this report is an annual or transition report, indicate by check mark, if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP

International Financial Reporting
Standards as issued
by the International Accounting
Standards Board

Other

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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PRELIMINARY NOTE

This Annual Report should be read in conjunction with the consolidated financial statements and accompanying notes included in this report.

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP) and are presented in U.S. Dollars. These statements and discussion below contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, objectives, expectations and intentions and other statements contained in this Annual Report that are not historical facts, as well as statements identified by words such as expects, anticipates, intends, plans, believes, seeks, estimates, or words of similar meaning. Such statements address future events and conditions concerning matters such as, but not limited to, our earnings, cash flow, liquidity and capital resources, compliance with debt and other restrictive covenants, interest rates and dividends. These statements are based on current beliefs or expectations and are inherently subject to significant uncertainties and changes in circumstances, many of which are beyond our control. Actual results may differ materially from these expectations due to changes in political, economic, business, competitive, market and regulatory factors. We believe that these factors include, but are not limited to the those described under Item 3 Risk Factors and elsewhere in this Annual Report.

Except to the extent required by applicable law or regulation, we undertake no obligation to update these forward looking statements to reflect events, developments or circumstances after the date of this document, a change in our views or expectations, or to reflect the occurrence of future events.

Unless the context requires otherwise, when used in this Annual Report, (1) the terms B&B Air, Company, we, our and us refer to Babcock & Brown Air Limited and its subsidiaries; (2) the term B&B Air Funding refers to our subsidiary, Babcock & Brown Air Funding I Limited; (3) the term B&B Air Acquisition refers to our subsidiary, Babcock & Brown Air Acquisition I Limited; (4) all references to our shares refer to our common shares held in the form of American Depositary Shares, or ADSs; (5) the terms Predecessor and JET-i refer to JET-i Leasing LLC, the predecessor company of B&B Air; (6) the terms B&B and Babcock & Brown refer to Babcock & Brown Limited, an Australian company, and its subsidiaries; (7) the terms BBAM and the Servicer refer to Babcock & Brown Aircraft Management LLC and Babcock & Brown Aircraft Management (Europe) Limited, collectively; (8) the term Manager refers to Babcock & Brown Air Management Co. Limited, the Company s manager; (9) the term BBIPL refers to Babcock & Brown International Pty Ltd., which is both the main operating and asset-owning entity in the Babcock & Brown group; and (10) the term, Initial Portfolio refers to our initial portfolio of 47 commercial jet aircraft acquired by our subsidiary, B&B Air Funding concurrently with the completion of our initial public offering in October 2007.

Unless indicated otherwise, all percentages and weighted average characteristics of the aircraft in our portfolio have been calculated using net book values as of December 31, 2009.

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

B&B Air is a global lessor of modern, fuel-efficient commercial jet aircraft. Our aircraft are leased under long-term to medium-term contracts to a diverse group of airlines throughout the world. On October 2, 2007, we (i) completed our initial public offering (IPO) and issued 18,695,650 common shares in the form of ADSs; (ii) completed a private placement of 14,907,800 ADSs (Private Placement), and together with the IPO, Offerings) and (iii) issued \$853.0 million of aircraft lease-backed notes (the Notes) at an offering price of 99.71282%, or \$850.6 million, as part of a securitization transaction (the Securitization) through our subsidiary, B&B Air Funding. Using proceeds of the Offerings and the Notes, we acquired our initial portfolio of 47 commercial jet aircraft (Initial Portfolio).

On November 7, 2007, our subsidiary, B&B Air Acquisition, entered into a revolving credit facility (the Aircraft Acquisition Facility) that provided for up to \$1.2 billion of financing for additional aircraft including a \$96.0 million equity tranche from B&B Air. The availability period for the Aircraft Acquisition Facility expired on November 6, 2009 and substantially all available cash flow from aircraft held by B&B Air Acquisition is applied to the repayment of outstanding principal.

As of December 31, 2009, we had acquired 17 additional aircraft using the Aircraft Acquisition Facility and had sold two aircraft from the Initial Portfolio. We owned 62 aircraft as of December 31, 2009.

Our web address is: www.babcockbrownair.com.

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The following selected financial data should be read in conjunction with Item 5 Operating and Financial Review and Prospects and our audited consolidated financial statements and related notes thereto included at Item 18 Financial Statements in this Annual Report. The selected financial data presented below are: (i) our operating results for the years ended December 31, 2009 and 2008; (ii) our operating results for the period from May 3, 2007 (our incorporation date) to December 31, 2007; and (iii) our Predecessor's operating results for the years ended December 31, 2007 and December 31, 2006.

(Dollars in thousands, except share data)

| | Babcock & Brown Air Limited | | | JET-i Leasing LLC (Predecessor Company) | |
|--|---|----------------|---|--|----------------|
| | For the years ended December 31, | | For the period from May 3, 2007 (incorporation date) to December 31, | For the years ended December 31, | |
| | 2009 | 2008 | 2007 | 2007 | 2006 |
| Revenues | | | | | |
| Operating lease revenue | \$ 213,964 | \$ 218,940 | \$ 26,042 | \$ 107,620 | \$ 56,566 |
| Finance lease income | | 2,446 | 2,365 | 7,477 | 1,668 |
| Gain on sale of aircraft | | 11,437 | | | |
| Gain on purchases of notes payable | 82,666 | | | | |
| Lease termination settlement | 8,307 | | | | |
| Interest and other income | 2,598 | 3,315 | 4,927 | 5,940 | 3,115 |
| Total revenues | 307,535 | 236,138 | 33,334 | 121,037 | 61,349 |
| Expenses | | | | | |
| Depreciation | 83,650 | 74,161 | 8,573 | 34,548 | 17,976 |
| Interest expense | 80,925 | 81,689 | 14,628 | 61,541 | 33,840 |
| Interest expense related party | | | | 11,585 | 6,390 |
| Selling, general and administrative | 21,094 | 20,989 | 4,866 | 4,588 | 3,321 |
| Debt purchase option amortization | 6,053 | | | | |
| Maintenance and other costs | 2,353 | 4,307 | 165 | 2,415 | 1,379 |
| Mark-to-market of non-hedge derivatives | | | | (5,898) | 5,898 |
| Debt extinguishment costs | | | | 9,165 | |
| Hedging costs related to interest rate swap option | | | 1,725 | 5,423 | |
| Swap breakage costs | | | | 12,500 | |
| Total expenses | 194,075 | 181,146 | 29,957 | 135,867 | 68,804 |
| | 113,460 | 54,992 | 3,377 | (14,830) | (7,455) |

Net income (loss) before provision for income taxes

| | | | | | |
|----------------------------|------------------|------------------|-----------------|--------------------|-------------------|
| Provision for income taxes | 24,367 | 6,867 | 1,032 | 466 | 17 |
| Net income (loss) | \$ 89,093 | \$ 48,125 | \$ 2,345 | \$ (15,296) | \$ (7,472) |

Earnings per share:

| | | | |
|-------------------|---------|---------|---------|
| Basic and diluted | \$ 2.89 | \$ 1.44 | \$ 0.19 |
| Pro forma | | | \$ 0.07 |

Basic and diluted earnings per share is calculated: (1) for 2009 and 2008, by dividing net income by the weighted average number of shares outstanding for the year and (2) for 2007 by dividing net income for the period from May 3, 2007, the date the Company was incorporated, to December 31, 2007 by the weighted average number of shares outstanding from October 2, 2007 to December 31, 2007. The Company has presented pro forma earnings per share for the period ended December 31, 2007 as if its initial public offering had occurred on May 3, 2007 (incorporation date).

(Dollars in thousands, except shares)

| | Babcock & Brown Air Limited | | | JET-i Leasing LLC | |
|---|--|--------------|--------------|------------------------------|---------------------------|
| | As of December 31, | | | (Predecessor Company) | |
| | 2009 | 2008 | 2007 | As of December 31, | As of December 31, |
| | | | | 2007 | 2006 |
| Balance sheet data: | | | | | |
| Total assets | \$ 2,024,132 | \$ 2,086,174 | \$ 1,589,226 | \$ 5,249 | \$ 1,010,875 |
| Total liabilities | 1,539,608 | 1,696,761 | 1,098,724 | 2,766 | 983,175 |
| Total shareholders' equity/ member's capital | 484,524 | 389,413 | 490,502 | 2,483 | 27,700 |
| Number of shares | 30,279,948 | 32,488,911 | 33,603,450 | | |

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Risk Factors

The risks discussed below could materially and adversely affect our business, prospects, financial condition, results of operations, cash flows, the trading price of our shares and our ability to pay dividends. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially and adversely affect our business, prospects, financial condition, results of operations, cash flows and ability to pay dividends.

Risks Related to Our Relationship with Babcock & Brown

We are wholly dependent on B&B, primarily through BBAM, to manage our business and to service our aircraft portfolio.

B&B manages our business and all of our affairs pursuant to long-term contracts. Therefore, our success or failure wholly depends on the skill and care with which B&B performs its services under our management and servicing agreements. We depend on the diligence, skill and network of business contacts of BBAM. Our Manager manages our company and is responsible for our day-to-day operations. Our Servicer is responsible for arranging the leasing of our fleet, acquiring and disposing our aircraft, marketing our aircraft for lease and re-lease, collecting rents and other payments from the lessees of our aircraft, monitoring maintenance, insurance and other obligations under our leases and enforcing our rights against lessees. Our continued success depends on the continued service of key employees of our Manager and our Servicer. The departure of any key employee of our Manager or our Servicer, or of a significant number of professionals of our Manager or our Servicer, could have a material adverse effect on our performance. As described in the risk factors below, Babcock & Brown Limited was placed into voluntary administration in Australia on March 13, 2009 and is in the process of selling its aviation-related assets.

Even if our board of directors were to become dissatisfied with the performance of Babcock & Brown under these agreements, we may not be able to terminate Babcock & Brown and would have to continue to rely on Babcock & Brown notwithstanding our board's dissatisfaction with the management and aircraft lease services being provided to us.

The proposed sale of Babcock & Brown's aviation related assets could adversely affect our business.

Babcock & Brown was placed into voluntary administration in Australia on March 13, 2009. Although no definitive transaction has been announced, Babcock & Brown has been in the process of selling substantially all of its aviation-related assets, including the assets and servicing agreements associated with BBAM and the common shares of B&B Air owned by them. The successful consummation of a sale and the timing of any eventual sale is dependent on many factors, including the consent of Babcock & Brown Limited's lenders and other third parties.

A sale of BBAM by Babcock & Brown could create uncertainty about our management and servicing arrangements. We cannot assure you that a new owner of BBAM would dedicate comparable resources to BBAM as Babcock & Brown, and the quality of the services that BBAM has provided to us could deteriorate. If Babcock & Brown cannot sell its aviation assets in the near future, there is no assurance that it will continue to dedicate resources to BBAM or continue its operations.

Some of our agreements with Babcock & Brown, as well as the agreements governing the Notes and the Aircraft Acquisition Facility, contain provisions that are linked to the financial performance and ownership of Babcock & Brown and BBAM which could result in a servicer replacement event and an event of default under the Aircraft Acquisition Facility.

These provisions include the following with respect to the Aircraft Acquisition Facility:

Babcock & Brown ceases to hold at least 5% of the issued and outstanding shares of B&B Air;

Babcock & Brown ceases to hold at least 51% of the capital stock of BBAM;

BBAM fails to deliver the audited financial statements of Babcock & Brown Limited to the agent and lenders in the Aircraft Acquisition Facility within 120 days of fiscal year end or the unaudited or audited financial statements for each semi-annual period within 90 days, and in each case such failure to deliver the required financial statements continues for 30 days after written notice from the agent (current default with respect to this provision has been waived to April 30, 2010, as described below);

Any Babcock & Brown Limited annual or quarterly financial statement required to be delivered as described above contains a going-concern or similar qualification in the audit opinion;

The insolvency of BBAM or any significant subsidiary of BBAM; and

BBAM default on recourse debt over \$25 million.

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An event of default under the Aircraft Acquisition Facility would be triggered if Babcock & Brown ceases to hold at least 5% of the issued and outstanding shares of B&B Air and at least 51% of the capital stock of BBAM. If any event of default occurs (other than B&B Air Acquisition or any of its subsidiaries becoming the subject of insolvency proceedings), the agent, on the request of 2/3 of the Tranche A and Tranche B lenders combined, may demand immediate repayment of all outstanding borrowings under the Aircraft Acquisition Facility. After the occurrence of certain bankruptcy and insolvency related events of default, or any acceleration of the amounts due under the Aircraft Acquisition Facility after the occurrence of any event of default, all cash generated by B&B Air Acquisition will be used to repay amounts due under the facility and will not be available to us. Each of these events is beyond our control and could have a materially adverse effect on our business.

In addition, under the servicing agreement related to the Notes, a servicer termination event is triggered if BBIPL ceases to own at least 50.1% of the voting equity or economic interest in BBAM or on the bankruptcy or insolvency of BBIPL or BBAM. Babcock & Brown has announced that the administration proceeding in respect of Babcock & Brown Limited will not impact the solvency of BBIPL, which is the primary operating company in the Babcock & Brown group and the borrower under the restructured corporate debt facilities.

The agent for the lenders has approved an extension of the deadline for delivery of the financial statements of Babcock & Brown Limited for the year ended December 31, 2008. In accordance with the terms of the extension, if BBAM is unable to deliver these financial statements by April 30, 2010, the agent may require compliance within 30 days of written notice to BBAM. If BBAM is still unable to comply within this 30 day period, a servicer replacement event will have occurred.

B&B has conflicts of interest with us and their limited contractual or other duties will not restrict them from favoring their own business interests to our detriment.

Conflicts of interest will arise between us and B&B, as the Manager of our business and the Servicer for our aircraft, with respect to our operations and business opportunities. These conflicts will arise because BBAM acquires, manages and remarkets for lease or sale aircraft for us and for other entities, including entities in which B&B has an economic interest. We may compete directly with such other managed entities for investment opportunities. For example, BBAM performs aircraft acquisition, disposal and management services pursuant to a joint marketing agreement with Nomura Babcock & Brown Co., Ltd, which we refer to as NBB. BBAM has arranged a significant number of aircraft acquisitions and dispositions pursuant to the NBB arrangement. We expect that BBAM will continue to arrange acquisition and disposition opportunities with NBB and that we may compete with NBB for such opportunities. A conflict of interest will arise if BBAM identifies an aircraft acquisition opportunity that would meet our investment objectives as well as those of NBB or any other entity managed by B&B. We do not have any exclusive right to participate in aircraft acquisition opportunities originated or identified by BBAM. Under our agreements with B&B, our Manager has agreed to act in the best interests of our shareholders. However, neither BBAM nor any other B&B affiliate will be restricted from pursuing, or offering to a third party, including NBB or any other party managed by, or otherwise affiliated or associated with, B&B, any investment or disposal opportunity or will be required to establish any investment protocol in relation to prioritization of any investment or disposal opportunity. In addition, we have purchased and can purchase in the future additional aircraft from entities in which B&B has an ownership interest. Although such purchases have been and will continue to be required to be approved by our independent directors, the pricing and other terms of these transactions may be less advantageous to us than if they had been the result of transactions among unaffiliated third parties.

Under our servicing agreements with BBAM, if a conflict of interest arises as to our aircraft and other aircraft managed by BBAM, BBAM must perform the services in good faith, and, to the extent that our aircraft or other aircraft managed by BBAM have substantially similar objectively identifiable characteristics that are relevant for purposes of the particular services to be performed, BBAM has agreed not to discriminate among our aircraft or between any of our aircraft and any other managed aircraft on an unreasonable basis. Nevertheless, despite these contractual undertakings, BBAM as Servicer may favor its own interests and the interests of other managed entities over our interests. Conflicts may arise when our aircraft are leased to entities that also lease other aircraft managed by BBAM and decisions affecting some aircraft may have an adverse impact on others. For example, when a lessee in financial distress seeks to return some of its aircraft, BBAM may be required to decide which aircraft to accept for return and may favor its or another managed entity's interest over ours. Conflicts also may arise, for example, when

our aircraft are being marketed for re-lease or sale at a time when other aircraft managed by BBAM are being similarly marketed.

Under the terms of our servicing agreements, we are not entitled to be informed of all conflicts of interest involving BBAM and are limited in our right to replace BBAM because of conflicts of interest. Any replacement Servicer may not provide the same quality of service or may not afford us terms as favorable as the terms currently offered by BBAM. If BBAM, as the Servicer, makes a decision that is adverse to our interests, our business, financial condition, results of operations and cash flows could suffer. See Even if we are dissatisfied with B&B's performance, there are only limited circumstances under which we are able to terminate our management and servicing agreements and we may not terminate the servicing agreement for our Initial Portfolio without the prior written consent of the policy provider.

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Even if we were to become dissatisfied with B&B's performance, there are only limited circumstances under which we are able to terminate our management and servicing agreements and we may not terminate the servicing agreement for our Initial Portfolio without the prior written consent of the policy provider.

The management agreement provides for a 25-year term and is subject to termination only under the following limited circumstances:

- at least 75% of our independent directors and holders of 75% or more of all of our outstanding common shares (measured by vote) determine by resolution that there has been unsatisfactory performance by our Manager that is materially detrimental to us;
- our Manager materially breaches the management agreement and fails to remedy such breach within 90 days of receiving written notice from us requiring it to do so, or such breach results in liability to us and is attributable to our Manager's gross negligence, fraud or dishonesty, or willful misconduct in respect of the obligation to apply the standard of care;
- any license, permit or authorization held by the Manager which is necessary for it to perform the services and duties under the management agreement is materially breached, suspended or revoked, or otherwise made subject to conditions which, in the reasonable opinion of our board of directors, would prevent the Manager from performing the services and the situation is not remedied within 90 days;
- our Manager becomes subject to bankruptcy or insolvency proceedings that are not discharged within 75 days, unless our Manager is withdrawn and replaced within 90 days of the initiation of such bankruptcy or insolvency proceedings with an affiliate or associate of B&B that is able to make correctly the representations and warranties set out in the management agreement;
- B&B in aggregate ceases to hold (directly or indirectly) more than 50% of the issued share capital of our Manager; or
- an order is made for the winding up of our Manager, unless our Manager is withdrawn and replaced within 15 days with an affiliate or associate of B&B that is able to make correctly the representations and warranties set out in the management agreement.

Even though our shareholders (with the concurrence of 75% of our independent directors) have the right under the management agreement to terminate our Manager, it may not be possible for them to exercise this right in view of the number of common shares held by B&B, its affiliates and funds managed by its affiliates. B&B, its affiliates and such funds own approximately 14.6% of our outstanding common shares, and termination of our management agreement requires the vote of holders of 75% of our outstanding common shares.

We have the right to terminate the servicing agreement for our Initial Portfolio (with the prior written consent of the policy provider) and the policy provider has the independent right to terminate the agreement (without our consent) in the following limited circumstances:

- BBAM ceases to be at least majority-owned directly or indirectly by B&B;
- BBAM fails in any material respect to perform any material services under the servicing agreements in accordance with the standard of care or the conflicts standard in a manner that is materially adverse to us and our applicable subsidiaries taken as a whole;
- specified B&B entities (including BBAM) become subject to bankruptcy or insolvency proceedings;
- with respect to the servicing agreement for our Initial Portfolio, we have insufficient funds for the payment of interest on the notes for a period of at least 60 days;
- at least 15% of the number of aircraft assets in the Initial Portfolio remain off-lease but reasonably available for re-lease for a period of at least three months following specified events set forth in the trust indenture;
- without limiting BBAM's rights under the security trust agreement, BBAM takes any steps for the purpose of processing the appointment of an administrative receiver or the making of any administrative order or for instituting a bankruptcy, reorganization, arrangement, insolvency, winding up, liquidation, composition or any similar proceeding under the laws of any jurisdiction with respect to any jurisdiction with respect to B&B Air Funding, and any of its subsidiaries, or any of the aircraft assets;

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we cease to own all of the aircraft in our Initial Portfolio;
BBAM withdraws from servicing a specified number of our aircraft in the Initial Portfolio for specified periods of time due to conflicts of interest; or

BBAM ceases to be actively involved in the aircraft leasing business.

If the servicing agreement for our Initial Portfolio is terminated by us or the policy provider and another servicer is engaged to service our Initial Portfolio, we will no longer be entitled to a credit against fees due under the management agreement for servicing fees paid with respect to our Initial Portfolio and our expenses would increase substantially. Although this will be a disincentive for us to terminate the servicing agreement for our Initial Portfolio, it is not likely to be a factor in a decision by the policy provider to exercise its independent ability to terminate the agreement.

Our management and servicing agreements limit our remedies against BBAM for unsatisfactory performance and provide certain termination rights to the policy provider.

Under our management and servicing agreements with B&B, in many cases we may not have the right to recover damages from BBAM for unsatisfactory performance. Moreover, we have agreed to indemnify our Manager, BBAM and their affiliates for broad categories of losses arising out of the performance of services, unless they are finally adjudicated to have been caused directly by our Manager's or BBAM's gross negligence, fraud, deceit or willful misconduct in respect of its obligation to apply its standard of care or, in the case of the servicing agreement for our Initial Portfolio, conflicts of interest standard in the performance of its services. In addition, because of our substantial dependence on B&B, our board of directors may be reluctant to initiate litigation against B&B to enforce contractual rights under our management and servicing agreements.

Under certain circumstances the provider of the financial guaranty insurance policy with respect to the Notes has the right to terminate BBAM as the Servicer for our Initial Portfolio without our consent and may terminate BBAM at a time which may be disadvantageous to us.

BBAM may resign as Servicer under our servicing agreements under certain circumstances, which would significantly impair our ability to re-lease or sell aircraft and service our leases.

BBAM may resign under one or more of our servicing agreements under certain circumstances if it reasonably determines that directions given, or services required, would, if carried out, be unlawful under applicable law, be likely to lead to an investigation by any governmental authority of BBAM or its affiliates, expose BBAM to liabilities for which, in BBAM's good faith opinion, adequate bond or indemnity has not been provided or place BBAM in a conflict of interest with respect to which, in BBAM's good faith opinion, BBAM could not continue to perform its obligations under the servicing agreement with respect to all serviced aircraft or any affected aircraft, as the case may be (but with respect to the foregoing circumstance, BBAM may resign only with respect to the affected aircraft).

Whether or not it resigns, BBAM is not required to take any action of the foregoing kind. BBAM may also resign if it becomes subject to taxes for which we do not indemnify it. BBAM's decision to resign would significantly impair our ability to re-lease or sell aircraft and service our leases.

The terms of our agreements with B&B were negotiated without independent assessment on our behalf, and these terms may be less advantageous to us than if they had been the result of transactions among unaffiliated third parties.

We have entered into various agreements with B&B that effect the transactions relating to our formation, our IPO, the Securitization and the application of the proceeds from our IPO and the Securitization to acquire our Initial Portfolio, and our ongoing operations and business. Although the pricing and other terms of these agreements were reviewed by our directors, they were determined by B&B in the overall context of our IPO and the related transactions. As a result, provisions of these agreements may be less favorable to us than they might have been had they been the result of arm's-length transactions among unaffiliated third parties.

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Risks Related to Our Business

Adverse changes in economic conditions affect our business.

Our business and results of operations are significantly affected by general economic, capital markets, credit and industry conditions. The stress experienced by global capital markets that began in the second half of 2007 continues to have an impact into 2010. In particular, the substantial losses experienced by the global banking industry have led to an increase in the cost and deterioration in the availability of capital. Numerous governments sought to establish programs to support the banking industry in order to encourage lending and to mitigate against a sustained recessionary environment. Nevertheless, continued concerns over the availability and cost of credit, declining business and consumer confidence and increased unemployment precipitated an economic recession, which resulted in reduced global economic growth.

The economic downturn and the impairment of credit markets have also resulted in a decline in aircraft values and lease rates. A protracted economic downturn could exacerbate these adverse conditions. The current state of the credit markets may make it difficult for us to refinance our Notes or amounts outstanding under the Aircraft Acquisition Facility on our anticipated schedule or on terms which we find acceptable. In addition, since our IPO in October 2007, the price of our common shares has declined significantly, which could limit our ability to raise additional equity capital.

The recent changes in demand and supply of aircraft have depressed lease rates and have impacted the value of our aircraft portfolio.

The economic downturn and the slowdown in air travel have contributed to a decrease in the demand for aircraft and resulted in capacity cuts by airlines. The financial challenges facing the airlines may result in an increase in the supply of aircraft. In addition, several portfolios of leased aircraft are reported to be available for sale. This shift in supply/demand dynamics may lead to a decrease in aircraft lease rates and values. A decrease in lease rates could adversely affect our lease revenues in future periods as our current leases terminate or to the extent that airlines default on their leases. A decrease in aircraft values would adversely affect the value of the aircraft in our portfolio.

We will need additional capital to finance our growth, and we may not be able to obtain it on acceptable terms, or at all, which may limit our ability to grow and compete in the aviation market.

We will require additional financing to expand our business through the acquisition of additional aircraft and other aviation assets. Our ability to execute our business strategy to acquire additional assets depends to a significant degree on our ability to access debt and equity capital markets. Continuing turmoil in the financial markets has significantly impacted most classes of lending and has caused banks and financial institutions to decrease the amount of capital available for lending and has significantly increased the risk premium of such borrowings.

Our access to capital markets also will depend on a number of other factors, such as our historical and expected performance, compliance with the terms of our debt agreements, industry and market trends and the relative attractiveness of alternative investments. The terms of our Aircraft Acquisition Facility and the Securitization restrict our ability to incur additional debt secured by the aircraft in those portfolios. Our availability period under the Aircraft Acquisition Facility expired on November 6, 2009 and we are no longer able to acquire aircraft through this facility. If we are unable to raise additional funds or obtain capital on acceptable terms, we may have to delay, modify or abandon some or all of our growth strategies.

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Unforeseen difficulties and costs associated with the acquisition of our aircraft portfolio and other aviation assets could reduce or prevent our future growth and profitability.

Future growth through future acquisitions and leasing of additional commercial aircraft and other aviation assets requires the availability of financing for the acquisition. Even if financing were available, the market for commercial aircraft is cyclical, and we may encounter difficulties in acquiring aircraft on favorable terms or at all which could reduce our acquisition opportunities or cause us to pay higher prices. A significant increase in market interest rates would make it more difficult for us to make accretive acquisitions that would increase our distributable cash flows. Any acquisition of aircraft or other aviation assets may not be profitable to us after the acquisition of such asset and may not generate sufficient cash flow to justify our investment. In addition, any acquisition growth strategy exposes us to risks that may harm our business, financial condition, results of operations and cash flows, including risks that we may:

impair our liquidity by using a significant portion of our available cash or borrowing capacity to finance acquisitions;

significantly increase our interest expense and financial leverage to the extent we incur additional debt to finance acquisitions;

incur or assume unanticipated liabilities, losses or costs associated with the aircraft or other aviation assets that we acquire;

incur other significant charges, including asset impairment or restructuring charges; or

be unable to maintain our ability to pay regular dividends to our shareholders.

Unlike new aircraft, existing aircraft typically do not carry warranties as to their condition (although certain manufacturer warranties may still be effective and assignable when the aircraft is purchased). Although we may inspect an existing aircraft and its documented maintenance, usage, lease and other records prior to acquisition, such an inspection normally would not provide us with as much knowledge of an aircraft's condition as we would have if it had been built for us. Repairs and maintenance costs for existing aircraft are difficult to predict and generally increase as aircraft age and may have been adversely affected by prior use. These costs could decrease our cash flow and reduce our liquidity and our ability to pay regular dividends to our shareholders.

We may not be able to pay or maintain dividends on our shares.

Although we have paid a dividend each quarter since our IPO, we reduced our quarterly dividend to \$0.20 per share beginning with the fourth quarter of 2008, compared to \$0.50 per share in prior quarters. There are a number of factors that could affect our ability to pay future dividends including, but not limited to, the following:

lack of availability of cash to pay dividends due to changes in our operating cash flow, capital expenditure requirements, working capital requirements and other cash needs;

restrictions imposed by our financing arrangements, including under the Notes, our Aircraft Acquisition Facility and any indebtedness incurred in the future to refinance our existing debt or to expand our aircraft portfolio;

our inability to make acquisitions of additional aircraft that are accretive to cash flow;

application of funds to make and finance acquisitions of aircraft and other aviation assets;

reduced levels of demand for, or value of, our aircraft;

increased supply of aircraft;

obsolescence of aircraft in our portfolio;

lower lease rates on new aircraft and re-leased aircraft;

delays in re-leasing our aircraft after the expiration or early termination of existing leases;

impaired financial condition and liquidity of our lessees;

deterioration of economic conditions in the commercial aviation industry generally;

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poor performance by our Manager, BBAM and their affiliates and other service providers and our limited rights to terminate them;

unexpected or increased maintenance, operating or other expenses or changes in the timing thereof;

a decision by our board of directors to cease distributing a portion of our cash flow available for distribution;

changes in Irish tax law, the tax treaty between the United States and Ireland (the Irish Treaty) or our ability to claim the benefits of such treaty;

cash reserves which may be established by our board of directors; and

restrictions under Bermuda law on the amount of dividends that we may pay.

Risks Related to Our Indebtedness

We have substantial indebtedness that imposes constraints on our operations and could adversely affect our ability to pay dividends on our common shares.

On November 6, 2009, the availability period under the Aircraft Acquisition Facility expired, and B&B Air Acquisition began to apply substantially all of its available cash flow to repay the principal under its Aircraft Acquisition Facility. As a result, the cash flow from the aircraft held by B&B Air Acquisition is not available to us to pay expenses of B&B Air or to pay dividends on our common shares. In addition, failure by B&B Air Acquisition to maintain a monthly interest coverage ratio of at least 1.1 to 1 and a rolling three month interest coverage ratio of at least 1.25 to 1 would be an event of default under the Aircraft Acquisition Facility. We will seek to refinance some or all of the amounts outstanding under the Aircraft Acquisition Facility prior to its maturity in November 2012. All amounts outstanding on November 6, 2012 must be repaid in four quarterly installments. Depending on market conditions, however, it may not be possible to refinance the Aircraft Acquisition Facility prior to November 2012 on terms we find acceptable.

If B&B Air Funding's debt service coverage ratio (as defined in the indenture for the Securitization) is less than 1.80 on any two consecutive monthly payment dates occurring between July 2010 and July 2012, B&B Air Funding will be required to apply all of its available cash flow to repay the principal of the Notes. Commencing August 2012, B&B Air Funding will be required to apply all of its available cash flow after payment of certain expenses to repay the principal of the Notes. If B&B Air Funding is required to apply all available cash flow to repay the principal amount of the Notes, the cash flow from the aircraft in its portfolio will not be available to us to pay expenses of B&B Air or to pay dividends on our common shares. We may also refinance the amounts outstanding under our Notes prior to August 2012 when substantially all cash flow from aircraft held by B&B Air Funding will be applied to repay the principal on the Notes. Depending on market conditions, however, it may not be possible to refinance the Notes on terms we find acceptable or more advantageous to the current terms of the Notes.

The inability to refinance our indebtedness may require us to seek more costly or dilutive financing for our aircraft or to liquidate assets. If we are unable to refinance our indebtedness before being required to apply all available cash flow from our portfolio to repay principal thereon, then our ability to continue paying dividends to our shareholders will be adversely affected if we have not developed sufficient cash reserves or additional sources of cash flow to replace the cash flows that will be applied to such principal amortization.

We are subject to risks related to our indebtedness that may limit our operational flexibility and our ability to pay dividends on our shares.

The terms of the Notes and the terms of the Aircraft Acquisition Facility subject us to certain risks and operational restrictions, including:

all the aircraft and related leases in our portfolio secure debt obligations, the terms of which restrict our ability to sell aircraft and require us to use proceeds from sales of aircraft, in part, to repay amounts outstanding under those notes;

we are required to dedicate a significant portion of our cash flow from operations to debt service payments, thereby reducing the amount of our cash flow available to pay dividends, fund working capital, make capital expenditures and satisfy other needs;

restrictions on our subsidiaries' ability to distribute excess cash flow to us under certain circumstances;

lessee, geographical and other concentration requirements limit our flexibility in leasing our aircraft;

requirements to obtain the consent of third parties including lenders, the financial guaranty policy provider for the Securitization, whom we refer to as the policy provider, and rating agency confirmations for certain actions; and

restrictions on our subsidiaries' ability to incur additional debt, create liens on assets, sell assets, make freighter conversions and make certain investments or capital expenditures.

The restrictions described above may impair our ability to operate and to compete effectively with our competitors. Similar restrictions may be contained in the terms of future financings that we may enter into to finance our growth.

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We are a holding company and currently rely on our subsidiaries, B&B Air Funding and B&B Air Acquisition, to provide us with funds necessary to meet our financial obligations and pay dividends.

We are a holding company and our principal asset is the equity interest we hold in our subsidiaries, which own, through their subsidiaries, the aircraft in our portfolio. As a result, we depend on dividends and other payments from B&B Air Funding, B&B Air Acquisition and from any other subsidiaries through which we may conduct operations in the future, to generate the funds necessary to meet our financial obligations and to pay dividends on our shares. B&B Air Funding and B&B Air Acquisition are legally distinct from us and are significantly restricted from paying dividends or otherwise making funds available to us pursuant to the agreements governing their financing arrangements. Any other subsidiaries through which we may conduct operations in the future will also be legally distinct from us and may be similarly restricted from paying dividends or otherwise making funds available to us under certain conditions. Our subsidiaries will generally be required to service their debt obligations before making distributions to us, thereby reducing the amount of our cash flow available to pay dividends, fund working capital, make capital expenditures and satisfy other needs. (See above ***The availability period under the Aircraft Acquisition Facility has expired.***)

Our subsidiaries are subject to interest rate risk, which could impair their ability to make distributions to us and our ability to pay dividends to you.

The Notes and the Aircraft Acquisition Facility have floating interest rates, creating the risk of an increase in interest rates and the risk that cash flow may be insufficient to make scheduled interest payments if interest rates were to increase. To limit this risk, our subsidiaries have entered into interest rate swaps with one or more counterparties. If any counterparty were to default on its obligations, then a mismatch in the floating rate interest obligations and fixed rate lease payments may arise, which could impair our subsidiaries' ability to make distributions to us, which would, in turn, adversely affect our ability to meet our financial obligations and pay dividends to our shareholders. If any of our hedging arrangements were terminated early, we could be obligated to make a material payment to our counterparty.

Risks Relating to Our Aircraft Portfolio

The variability of supply and demand for aircraft and other aviation assets could depress lease rates and the value of our leased assets, which would have an adverse effect on our financial results and growth prospects and on our ability to meet our debt obligations and pay dividends.

The aviation leasing and sales industry has experienced periods of aircraft oversupply and undersupply. The oversupply of a specific type of aircraft or other aviation asset in the market is likely to depress lease rates for, and the value of, that type of asset. The supply and demand for aircraft is affected by various cyclical and non-cyclical factors that are not under our control, including:

passenger air travel and air cargo demand;

increased supply due to the sale of assets owned by other aircraft leasing companies;

geopolitical and other events, including war, acts of terrorism, outbreaks of epidemic diseases and natural disasters;

operating costs, availability of jet fuel and general economic conditions affecting our lessees' operations;

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governmental regulation, including new airworthiness directives;

interest rates;

airline restructurings and bankruptcies;

cancellations of orders for aircraft;

delays in delivery by manufacturers;

availability and cost of credit;

manufacturer production levels and technological innovation;

retirement and obsolescence of aircraft models;

manufacturers merging or exiting the industry or ceasing to produce aircraft or engine types;

accuracy of estimates relating to future supply and demand made by manufacturers and lessees;

reintroduction into service of aircraft or engines previously in storage; and

airport and air traffic control infrastructure constraints.

These factors may produce sharp decreases in asset values and achievable lease rates, which would have an impact on the value of our fleet and our cost of acquiring aircraft or other aviation assets, may result in lease defaults and could delay or prevent the aircraft or other aviation assets from being re-leased or re-leased on favorable terms, or, if desired, sold on favorable terms.

Factors that increase the risk of decline in aircraft value and achievable lease rates could have an adverse effect on our financial results and growth prospects and on our ability to meet our debt obligations and to pay dividends.

In addition to factors linked to the aviation industry generally, other factors that may affect the value and achievable lease rates of our aircraft and other aviation assets include:

the particular maintenance, damage and operating history of the airframes and engines;

the number of operators using that type of aircraft or engine;

whether an aircraft or other aviation asset is subject to a lease and, if so, whether the lease terms are favorable to the lessor;

the age of our aircraft and other aviation assets;

airworthiness directives and service bulletins;

aircraft noise and emission standards;

any tax, customs, regulatory and other legal requirements that must be satisfied when an aircraft is purchased, sold or re-leased;

compatibility of our aircraft configurations or specifications with other aircraft owned by operators of that type; and

decreases in the creditworthiness of our lessees.

Any decrease in the values of and achievable lease rates for commercial aircraft or other aviation assets that may result from the above factors or other unanticipated factors may have a material adverse effect on our financial results and growth prospects and our ability to meet our debt obligations and to pay dividends.

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The advent of superior aircraft technology could cause our existing aircraft portfolio to become outdated and therefore less desirable, which could adversely affect our financial results and growth prospects and our ability to compete in the marketplace.

As manufacturers introduce technological innovations and new types of aircraft, including the Boeing 787 and the Airbus A350 and potential replacement types for the Boeing 737 and Airbus A320 families of aircraft, certain aircraft in our existing aircraft portfolio may become less desirable to potential lessees. In addition, although all of the aircraft in our portfolio are Stage 3 noise-compliant, the imposition of more stringent noise or emissions standards may make certain of our aircraft less desirable in the marketplace. Any of these risks could adversely affect our ability to lease or sell our aircraft on favorable terms or at all or our ability to charge rental amounts that we would otherwise seek to charge.

Our operational costs will increase as our aircraft age, which will adversely affect the amounts available to pay dividends.

As of December 31, 2009, the weighted average age of the aircraft in our portfolio was 7.3 years. In general, the cost of delivering an aircraft under a re-lease, including maintenance and modification expenditures, increases with the age of the aircraft. The costs of converting an aging passenger aircraft to a cargo aircraft are also substantial. The incurrence of these greater expenditures as our fleet ages could adversely affect our ability to pay dividends.

The concentration of aircraft types in our portfolio could harm our business and financial results should any difficulties specific to these particular types of aircraft occur.

As of December 31, 2009, our portfolio contains a mix of aircraft types including Airbus A319 aircraft, A320 aircraft, A330 aircraft, Boeing 737 aircraft, Boeing 747 aircraft, Boeing 757 aircraft, Boeing 767 aircraft and Boeing 777 aircraft. 86% of our aircraft are single-aisle, narrow-body aircraft, measured by net book value. If any of these aircraft types (or other types that we acquire in the future) should encounter technical or other difficulties, such affected aircraft types may be subject to grounding or diminution in value and we may be unable to lease such affected aircraft types on favorable terms or at all. The inability to lease the affected aircraft types may reduce our revenues and net income to the extent the affected aircraft types comprise a significant percentage of our aircraft portfolio.

We operate in a highly competitive market for investment opportunities in aircraft and other aviation assets.

The leasing and remarketing of commercial jet aircraft is highly competitive. As the exclusive Servicer of our aircraft, BBAM competes in leasing, re-leasing and selling our aircraft with other aircraft leasing companies, including GE Commercial Aviation Services (GECAS), ILFC, AerCap, Airastle, Aviation Capital Group, AWAS, Boeing Capital, CIT Aerospace, Macquarie Aircraft Leasing, RBS Aviation Capital and BOC Aviation (formerly Singapore Aircraft Leasing Enterprise) among others. We also may encounter competition from other entities that selectively compete with us, including:

airlines;

aircraft manufacturers;

financial institutions (including those seeking to dispose of repossessed aircraft at distressed prices);

aircraft brokers;

special purpose vehicles formed for the purpose of acquiring, leasing and selling aircraft; and

public and private partnerships, investors and funds, including private equity and hedge funds.

Competition for a leasing transaction is based principally upon lease rates, delivery dates, lease terms, reputation, management expertise, aircraft condition, specifications and configuration and the availability of the types of aircraft necessary to meet the needs of the customer. Some of our competitors have significantly greater resources than we have. In addition, some competing aircraft lessors have a lower overall cost of capital and may provide financial services, maintenance services or other inducements to potential lessees that we cannot provide. Given the financial condition of the airline industry, many airlines have reduced their capacity by eliminating select types of aircraft from

their fleets. This has resulted in an increase in available aircraft of these types, a decrease in rental rates for these aircraft and a decrease in market values of these aircraft.

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Competition in the purchase and sale of used aircraft is based principally on the availability of used aircraft, price, the terms of the lease to which an aircraft is subject and the creditworthiness of the lessee. When we decide to dispose of an aircraft, BBAM, as our Servicer, will arrange the disposition pursuant to the terms of the servicing agreement for that aircraft. In doing so, BBAM will compete with the aircraft leasing companies listed above, as well as with the other types of entities described above and other investors.

If demand for leased aircraft does not increase, we may not be able to expand our business.

Over the past 20 years, the world's airlines have leased a growing proportion of their aircraft. Our growth strategy contemplates future acquisitions and leasing of additional commercial aircraft and other aviation assets. If, however, the aggregate demand for leased aircraft does not expand, then we may be unable to implement our growth strategy through aircraft acquisitions. Failure to expand our aircraft portfolio would impair our ability to sustain our revenues or support our expected dividend payments.

Depreciation expenses and impairment charges could have a material adverse effect on our financial condition and results of operations.

Our aircraft have finite economic lives, their values depreciate in the ordinary course over time and their ability to generate earnings and cash flow for our business declines over time. If depreciated aircraft are not replaced with newer aircraft, our ability to generate earnings and cash to pay dividends will be reduced. In addition, we depreciate our aircraft for accounting purposes on a straight-line basis to the aircraft's estimated residual value over its estimated useful life. If we dispose of an aircraft for a price that is less than its depreciated value, then we would be required to recognize a loss that would reduce our net income during the period of the disposition and reduce our total assets and shareholders' equity.

In addition, aircraft in our portfolio and any other aircraft and other aviation assets that we acquire in the future are subject to periodic review for impairment for accounting purposes. We believe the carrying value of the aircraft in our portfolio is currently recoverable through the cash flows expected to result from their use and eventual disposition. However, if these expected cash flows are adversely affected by factors including credit deterioration of a lessee, declines in rental rates, other market conditions and residual values, then we may be required to recognize material impairment charges that would reduce our net earnings or increase our net losses. Under U.S. GAAP, once an impairment results in a reduction to the carrying value of an asset, the carrying value of such asset cannot thereafter be increased.

Aircraft liens could impair our ability to repossess, re-lease or resell the aircraft.

In the normal course of business, liens that secure the payment of airport fees and taxes, custom duties, air navigation charges, landing charges, crew wages, repairers' charges, salvage or other obligations are likely, depending on the laws of the jurisdictions where aircraft operate, to attach to the aircraft (or, if applicable, to the engines separately). The liens may secure substantial sums that may, in certain jurisdictions or for limited types of liens (particularly fleet liens), exceed the value of any particular aircraft to which the liens have attached. Until they are discharged, the liens described above could impair our ability to repossess, re-lease or resell our aircraft.

If our lessees fail to fulfill their financial obligations, liens may attach to our aircraft. In some jurisdictions, aircraft liens or separate engine liens may give the holder thereof the right to detain or, in limited cases, sell or cause the forfeiture of the aircraft (or, if applicable, the engines separately). We cannot assure you that the lessees will comply with their obligations under the leases to discharge liens arising during the terms of the leases. We may, in some cases, find it necessary to pay the claims secured by such liens in order to repossess the aircraft or obtain the aircraft or engines from a creditor thereof. These payments would be a required expense for us and would reduce our net income and our cash flows.

We cannot assure you that all lessees will comply with the registration requirements in the jurisdiction where they operate.

All of our aircraft are required to be registered at all times with appropriate governmental authorities. Generally, in jurisdictions outside the United States, failure by a lessee to maintain the registration of a leased aircraft would be a default under the applicable lease, entitling us to exercise our rights and remedies thereunder. If an aircraft were to be operated without a valid registration, the lessee operator or, in some cases, the owner or lessor might be subject to penalties, which could constitute or result in a lien being placed on such aircraft. Failure to comply with registration

requirements also could have other adverse effects, including inability to operate the aircraft and loss of insurance. We cannot assure you that all lessees will comply with these requirements.

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Risks Relating to Our Leases

We will need to re-lease or sell aircraft as leases expire to continue to generate sufficient funds to meet our debt obligations, finance our growth and operations and pay dividends. We may not be able to re-lease or sell aircraft on favorable terms, or at all.

Our business strategy entails the need to re-lease aircraft as our current leases expire to generate sufficient revenues to meet our debt obligations, finance our growth and operations and pay dividends to our shareholders. The ability to re-lease aircraft depends on general market and competitive conditions. Some of our competitors may have greater access to financial resources and, as a result of restrictions on us contained in the terms of our indebtedness, may have greater operational flexibility. If we are not able to re-lease an aircraft or to do so on favorable terms, we may be required to attempt to sell the aircraft to provide funds for debt service or operating expenses. Our ability to re-lease or sell aircraft on favorable terms or without significant off-lease time could be adversely affected by depressed conditions in the airline and aircraft industries, airline bankruptcies, the effects of terrorism and war, the sale of other aircraft by financial institutions or other factors.

We rely on our lessees' continuing performance of their lease obligations.

We operate as a supplier to airlines and are indirectly impacted by the risks facing airlines today. Our success depends upon the financial strength of our lessees, our ability to assess the credit risk of our lessees and the ability of lessees to perform their contractual obligations to us. The ability of each lessee to perform its obligations under its lease will depend primarily on the lessee's financial condition and cash flow, which may be affected by factors beyond our control, including:

competition;

fare levels;

air cargo rates;

passenger air travel and air cargo demand;

geopolitical and other events, including war, acts of terrorism, outbreaks of epidemic diseases and natural disasters;

operating costs, availability and cost of jet fuel and general economic conditions affecting our lessees' operations;

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labor difficulties;

economic conditions and currency fluctuations in the countries and regions in which the lessee operates; and

governmental regulation of, or affecting, the air transportation business.

Given the size of our portfolio, we expect that some lessees from time to time, will be slow in making or will fail to make their payments in full under the leases. A delayed, missed or reduced rental payment from a lessee decreases our revenues and cash flow and may adversely affect our ability to make payments on our indebtedness and pay dividends to shareholders. We may experience increased delinquencies, particularly if economic conditions continue to deteriorate. In addition, the demand for aircraft generally diminishes as they age, and the creditworthiness of the lessees of older aircraft is generally lower than the creditworthiness of the lessees of newer aircraft. In addition, many airlines are exposed to currency risk due to the fact that they earn revenues in their local currencies and certain of their liabilities and expenses are denominated in U.S. dollars, including lease payments to us. Some lessees encountering financial difficulties may seek a reduction in their lease rates or other concessions such as a decrease in their contribution toward maintenance obligations. We are typically not in possession of any aircraft while the aircraft are on lease to the lessees. Consequently, our ability to determine the condition of the aircraft or whether the lessees are properly maintaining the aircraft is limited to periodic inspections that we perform or that are performed on our behalf by third-party service providers or aircraft inspectors. A lessee's failure to meet its maintenance obligations under a lease could:

result in a grounding of the aircraft;

cause us to incur costs in restoring the aircraft to an acceptable maintenance condition to re-lease the aircraft;

adversely affect lease terms in the re-lease of the aircraft; and

adversely affect the value of the aircraft.

We cannot assure you that, in the event that a lessee defaults under a lease, any security deposit paid or letter of credit provided by the lessee will be sufficient to cover the lessee's outstanding or unpaid lease obligations and required maintenance expenses or be sufficient to discharge liens that may have attached to our aircraft.

If our lessees encounter financial difficulties and we decide to restructure our leases with those lessees, this could result in less favorable leases, significant reductions in our cash flows and adversely affect our ability to meet our debt obligations and pay dividends on our shares.

We have restructured leases when lessees are late in making payments, fails to make required payments or have otherwise advised us that they expect to default in making required payments. Restructuring can involve anything from a simple rescheduling of payments to the termination of a lease without receiving all or any of the past-due amounts. The terms and conditions of possible lease restructurings could result in significant reductions of rental payments, which would have an adverse impact on our cash flow available for distribution and reduced dividends to shareholders. We may receive more requests for restructuring if current economic conditions continue to deteriorate or do not improve.

Lease defaults could result in significant expenses and loss of revenues.

We repossessed five of our aircraft following lessee defaults in 2008 and may repossess additional aircraft in the future. Repossession, re-registration and flight and export permissions after a lessee default typically result in greater costs than those incurred when an aircraft is returned at the end of a lease. These costs include legal expenses that could be significant, particularly if the lessee is contesting the proceedings or is in bankruptcy. Delays resulting from repossession proceedings also would increase the period of time during which an aircraft or other aviation asset does not generate rental revenue. In addition, we may incur substantial maintenance, refurbishment or repair costs that a defaulting lessee has failed to pay and that are necessary to put the aircraft in a condition suitable for re-lease or sale, and we may need to pay off liens, taxes and governmental charges on the aircraft or other aviation asset to obtain clear possession and to remarket the asset effectively.

If we repossess an aircraft or other aviation asset, we will not necessarily be able to export or deregister and profitably redeploy the asset. For instance, where a lessee or other operator flies only domestic routes in the jurisdiction in which an aircraft is registered, repossession may be more difficult, especially if the jurisdiction permits the lessee or the other operator to resist deregistration. Significant costs may also be incurred in retrieving or recreating aircraft records required for registration of the aircraft and obtaining a certificate of airworthiness for the aircraft or engine.

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Our lessees' failure to fund their maintenance requirements on our aircraft could significantly harm our revenues, cash flows and ability to pay dividends.

The standards of maintenance observed by our lessees and the condition of aircraft at the time of sale or lease may affect the values and rental rates of our aircraft. Under each of our leases, the lessee is primarily responsible for maintaining the aircraft and complying with all governmental requirements applicable to the lessee and to the aircraft, including operational, maintenance, and registration requirements and airworthiness directives. A lessee's failure to perform required maintenance during the term of a lease could result in a diminution in the value of an aircraft, an inability to lease the aircraft at favorable rates or at all, or a potential grounding of the aircraft, and would likely require us to incur maintenance and modification costs upon the expiration or earlier termination of the lease to restore the aircraft to an acceptable condition prior to sale or re-leasing.

Failure to pay certain potential additional operating costs could result in the grounding of our aircraft and prevent the re-lease, sale or other use of our aircraft, which would negatively affect our business, financial condition and results of operations.

As in the case of maintenance costs, we may incur other operational costs upon a lessee default or where the terms of the lease require us to pay a portion of those costs. Such costs, which can be substantial, include:

- the costs of casualty, liability, war and political risk insurance and the liability costs or losses when insurance coverage has not been or cannot be obtained as required or is insufficient in amount or scope;
- the costs of licensing, exporting or importing an aircraft, costs of storing and operating an aircraft, airport taxes, customs duties, air navigation charges, landing fees and similar governmental or quasi-governmental impositions; and
- penalties and costs associated with the failure of lessees to keep the aircraft registered under all appropriate local requirements or obtain required governmental licenses, consents and approvals.

The failure to pay some of these costs can result in liens on the aircraft or a loss of insurance. Any of these events could result in the grounding of the aircraft and prevent the re-lease, sale or other use of the aircraft until the problem is cured.

Our lessees may have inadequate insurance coverage or fail to fulfill their respective indemnity obligations, which could result in us not being covered for claims asserted against us and may negatively affect our business, financial condition and results of operations.

Although we do not expect to control the operation of our leased aircraft, our ownership of the aircraft could give rise, in some jurisdictions, to strict liability for losses resulting from their operation. Our lessees are required to indemnify us for, and insure against, liabilities arising out of the use and operation of the aircraft, including third-party claims for death or injury to persons and damage to property for which we may be deemed liable. Lessees are also required to maintain public liability, property damage and hull all risks and hull war risks insurance on the aircraft at agreed upon levels. However, they are not generally required to maintain political risk insurance. There may be circumstances under which it would be desirable for us to maintain top-up and/or political risk coverage at our expense, which would add to our operating expenses.

Following the terrorist attacks of September 11, 2001, aviation insurers significantly reduced the amount of insurance coverage available to airlines for liability to persons other than employees or passengers for claims resulting from acts of terrorism, war or similar events. At the same time, they significantly increased the premiums for such third-party war risk and terrorism liability insurance and coverage in general. As a result, the amount of such third-party war risk and terrorism liability insurance that is available at any time may be below the amount required under the initial leases and required by the market in general.

We cannot assure you that the insurance maintained by our lessees will be sufficient to cover all types of claims that may be asserted against us. Any inadequate insurance coverage or default by lessees in fulfilling their indemnification or insurance obligations, as well as the lack of available insurance, could reduce the proceeds upon an event of loss and could subject us to uninsured liabilities, either of which could adversely affect our business, financial condition and results of operations.

Failure to obtain certain required licenses, consents and approvals could negatively affect our ability to re-lease or sell aircraft, which would negatively affect our business, financial condition and results of operations.

Aircraft leases often require specific licenses, consents or approvals. These include consents from governmental or regulatory authorities for certain payments under the leases and for the import, re-export or deregistration of the aircraft. Subsequent changes in applicable law or administrative practice may increase or otherwise modify these requirements. In addition, a governmental consent, once given, might be withdrawn. Furthermore, consents needed in connection with future re-leasing or sale of an aircraft may not be forthcoming. Any of these events could adversely affect our ability to re-lease or sell aircraft, which would negatively affect our business, financial condition and results of operations.

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Some of our leases provide the lessees with early termination rights.

As of December 31, 2009, nine of the leases in our portfolio provide the lessees with early termination rights. We also could enter into leases in the future that provide lessees with early termination rights. If any lease is terminated early at a time when we could not re-lease the aircraft at rates at least as favorable to us as the terminated lease, our results of operations and ability to pay dividends could be adversely affected.

Risks associated with the concentration of our lessees in certain geographical regions could harm our business.

In addition to global economic conditions, our business is exposed to local economic and political conditions that can influence the performance of lessees located in a particular region. The effect of these conditions on payments to us will be more or less pronounced, depending on the concentration of lessees in the region with adverse conditions.

European concentration. Revenues from 21 lessees based in Europe accounted for 49% of our total revenues in 2009. Commercial airlines in Europe face, and can be expected to continue to face, increased competitive pressures, in part as a result of the deregulation of the airline industry by the European Union and the development of low-cost carriers. European countries generally have relatively strict environmental regulations and traffic constraints that can restrict operational flexibility and decrease aircraft productivity, which could significantly increase aircraft operating costs.

Asian concentration. Revenues from seven lessees based in Asia (including India) accounted for 22% of our total revenues in 2009, and lease rental revenues from two lessees based in India accounted for 13% of total revenues. There are significant obstacles to the Indian airline industry's development, including poor aviation infrastructure, continuing losses from operations due to overcapacity and other factors, continuing government control and regulation over the industry. If this control and regulation persists or expands, the Indian airline industry likely would experience a significant decrease in growth or restrictions on future growth.

North American concentration. Revenues from five lessees based in North America accounted for 21% of our total revenues in 2009. During the past 15 years a number of North American passenger airlines filed Chapter 11 bankruptcy proceedings and several major U.S. airlines ceased operations altogether. High labor costs, high fuel costs, the strength of labor unions in collective bargaining negotiations, the war and prolonged conflict in Iraq and the September 11, 2001 terrorist attacks in the United States have imposed additional financial burdens on most U.S. airlines.

Mexico, South and Central American concentration. Revenues from three lessees based in Mexico, South and Central America accounted for 8% of our total revenues in 2009. While lessees throughout the world are affected by exchange rate fluctuations as a result of the mismatch of U.S. dollar exposure between their operating expenses and revenues, airlines in Mexico, South and Central America are particularly sensitive to this risk because of the history of currency devaluations in this region. Any strengthening of the U.S. dollar against the local currency could negatively impact the profitability of these airlines and their ability to meet their lease obligations to us. These risks are exacerbated by the potential for Mexico, South and Central American currencies to be devalued by governments as they have been periodically during the last four decades.

The risks associated with the geographical concentration of our lessees may become exacerbated as our aircraft are re-leased to lessees or subleased to sublessees in other regions or as we acquire additional aircraft.

In addition to the geographic concentrations described above, we also have significant exposure to risks associated with conducting business in emerging markets. Emerging markets have developing economies that are vulnerable to business and political disturbances, such as significant economic instability, interest and exchange rate fluctuations, civil unrest, government instability, and the nationalization or expropriation of private assets. The occurrence of any of these events in markets served by our lessees and the resulting instability may adversely affect our ownership interest in aircraft or the ability of lessees which operate in these markets to meet their lease obligations and these lessees may be more likely to default than lessees that operate in developed economies.

Table of Contents**Risks Related to the Aviation Industry**

The passenger aviation industry is historically cyclical and a significant downturn in the industry would adversely impact our lessee's ability to make payments to us, which would adversely affect our financial results and growth prospects.

Our ability to achieve our primary business objectives of growing our lease portfolio and increasing distributable cash flow per share depend on the financial condition and growth of the commercial airline industry, which is inherently cyclical. The years 2001 through 2004 and 2008 and 2009 were characterized by falling demand and rising costs. These industry downturns were exacerbated by global economic conditions, the terrorist attacks on September 11, 2001, prolonged military action in Iraq and Afghanistan, rising fuel prices, SARS, avian influenza and H1N1. As a result, the global airline industry experienced significant financial losses. Many airlines, including some of our lessees, announced or implemented reductions in capacity, service and workforce. Additionally, many airlines sought protection under bankruptcy laws. The airline bankruptcies and the reduction in demand led to the grounding of significant numbers of aircraft and engines and the negotiation of reductions in lease rental rates, which depressed aircraft and engine market values.

The continuing economic uncertainty have adversely impacted the airline industry. Airlines have been reducing capacity, service and workforce. The duration of this downturn and the potential long-term impact of these events on the aviation industry is unclear.

The risks affecting our airline customers are generally beyond our control, but because they have a significant impact on our customers they affect us as well. The risk factors that follow describe risks that affect the commercial airline industry generally and therefore have an impact on our business, financial condition and results of operations. Our ability to succeed depends on the financial strength of our customers and their ability to manage these risks. To the extent that our customers are adversely affected by these risk factors, we may experience:

- downward pressure on demand for the aircraft in our fleet and reduced market lease rates and lease margins;
- a higher incidence of lessee defaults, lease restructurings, repossessions and airline bankruptcies and restructurings, resulting in lower lease margins due to maintenance and legal and other costs associated with the repossession, as well as lost revenue for the time the aircraft are off lease and possibly lower lease rates from the new lessees;
- an inability to lease aircraft on commercially acceptable terms, resulting in lower lease margins due to such aircraft not earning revenue and resulting in storage, insurance and maintenance costs; and
- a loss if our aircraft is damaged or destroyed by an event specifically excluded from an insurance policy, such as dirty bombs, bio-hazardous materials and electromagnetic pulsing.

Airline reorganizations could impair our lessees' ability to comply with their lease payment obligations to us.

In recent years, several U.S. airlines have sought to reorganize (and, in certain instances, have completed reorganization) under Chapter 11, and numerous other airlines have filed for similar protection under their local laws. Bankruptcies have led to the grounding of significant numbers of aircraft, rejections of leases and negotiated reductions in aircraft lease rentals, with the effect of depressing aircraft market values. Additional reorganizations or liquidations by airlines under applicable bankruptcy or reorganization laws or further rejection or abandonment of aircraft by airlines in bankruptcy proceedings may depress aircraft values and aircraft lease rates. Additional grounded aircraft and lower market values would adversely affect our ability to sell certain of our aircraft or re-lease other aircraft at favorable rates.

High fuel prices can adversely affect the profitability of the airline industry and our lessees' ability to meet their lease payment obligations to us.

Fuel costs represent a major expense to companies operating within the airline industry, and fuel prices fluctuate widely depending primarily on international market conditions, geopolitical and environmental events and currency exchange rates. Although fuel prices declined in 2009 from record high fuel prices in 2008, there is continuing volatility and fears of future price increases. Many airlines entered into hedging arrangements which locked in fuel at significant prices. As a consequence, some airlines were not in a position to benefit from a fall in fuel prices during the latter part of 2008, and a number of them will realize significant losses from these hedging positions. Fuel prices will continue to have a significant impact on airline profitability. Due to the competitive nature of the airline industry,

airlines may not be able to pass on increases in fuel prices to their customers by increasing fares. If they pass on the higher costs, it may adversely affect demand for air travel, which would reduce revenues to our customers. In addition, airlines may not be able to manage this risk by appropriately hedging their exposure to fuel price fluctuations. If fuel prices return to historically high levels, they are likely to cause our lessees to incur higher costs or experience reduced revenues. Consequently, increases in fuel prices may:

- affect our lessees' ability to make rental and other lease payments;

- result in lease restructurings and aircraft and engine repossessions;

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increase our costs of servicing and marketing aircraft;

impair our ability to re-lease the aircraft and other aviation assets or re-lease or otherwise dispose of the assets on a timely basis at favorable rates; and

reduce the proceeds received for the aircraft or other aviation assets upon any disposition.

Government regulations could require substantial expenditures, reduce our profitability and limit our growth.

Certain aspects of our business are subject to regulation and require the oversight and regulation by state, federal and foreign governmental authorities. Aircraft are subject to regulations imposed by aviation authorities regarding aircraft maintenance and airworthiness. Laws affecting the airworthiness of aircraft generally are designed to ensure that all aircraft and related equipment are continuously maintained in proper condition to enable safe operation of the aircraft. Aircraft manufacturers also may issue their own recommendations. Airworthiness directives and similar requirements typically set forth particular special maintenance actions or modifications to certain aircraft types or models that the owners or operators of aircraft must implement.

Each lessee generally is responsible for complying with airworthiness directives with respect to its aircraft and is required to maintain the aircraft's airworthiness. To the extent that a lessee fails to comply with airworthiness directives required to maintain its certificate of airworthiness or other manufacturer requirements in respect of an aircraft or if the aircraft is not currently subject to a lease, we may have to bear the cost of such compliance. Under many leases, we have agreed to share with our lessees the cost of obligations under airworthiness directives (or similar requirements). These expenditures can be substantial, and, to the extent we are required to pay them, our cash flow and ability to pay dividends could be substantially adversely affected.

In addition to these expenditures, which may be substantial, significant new requirements with respect to noise standards, emission standards and other aspects of our aircraft or their operation could cause our costs to increase and could cause the value of our aircraft portfolio to decrease. Other governmental regulations relating to noise and emissions levels may be imposed not only by the jurisdictions in which the aircraft are registered, possibly as part of the airworthiness requirements, but also by other jurisdictions where the aircraft operate. In addition, most countries aviation laws require aircraft to be maintained under an approved maintenance program having defined procedures and intervals for inspection, maintenance and repair. To the extent that our aircraft are off-lease or a lessee defaults in effecting such compliance, we are required to comply with such requirements at our expense.

The effects of various environmental regulations may negatively affect the airline industry. This may cause lessees to default on their lease payment obligations to us.

Governmental regulations regarding aircraft and engine noise and emissions levels apply based on where the relevant aircraft is registered and operated. For example, jurisdictions throughout the world have adopted noise regulations which require all aircraft to comply with noise level standards. In addition to the current requirements, the United States and the International Civil Aviation Organization, or ICAO, have adopted a new, more stringent set of standards for noise levels which applies to engines manufactured or certified on or after January 1, 2006. Currently, U.S. regulations would not require any phase-out of aircraft that qualify with the older standards applicable to engines manufactured or certified prior to January 1, 2006, but the European Union has established a framework for the imposition of operating limitations on aircraft that do not comply with the new standards. These regulations could limit the economic life of the aircraft and engines, reduce their value, limit our ability to lease or sell the non-compliant aircraft and engines or, if engine modifications are permitted, require us to make significant additional investments in the aircraft and engines to make them compliant.

In addition to more stringent noise restrictions, the United States and other jurisdictions are beginning to impose more stringent limits on nitrogen oxide, carbon monoxide and carbon dioxide emissions from engines, consistent with current ICAO standards. These limits generally apply only to engines manufactured after 1999. Certain of the aircraft engines owned by us were manufactured after 1999. Because aircraft engines are replaced from time to time in the usual course, it is likely that the number of such engines may increase over time. Concerns over global warming could result in more stringent limitations on the operation of aircraft powered by older, non-compliant engines.

European countries generally have relatively strict environmental regulations that can restrict operational flexibility and decrease aircraft productivity. The European Parliament has confirmed that aviation is to be included in the European Union's Emissions Trading Scheme starting from 2012. This inclusion could possibly distort the European air transport market leading to higher ticket prices and ultimately a reduction in the number of airline passengers. As an answer to these concerns, European airlines have established the Committee for Environmentally Friendly Aviation to promote the positive environmental performance of airlines.

Compliance with current or future regulations, taxes or duties imposed to deal with environmental concerns could cause the lessees to incur higher costs and to generate lower net revenues, resulting in an adverse impact on their financial conditions. Consequently, such compliance may affect the lessees' ability to make rental and other lease payments and reduce the value received for the aircraft upon any disposition, which could have an adverse effect on our ability to pay the interest on and principal of the notes in full or on a timely basis.

The effects of terrorist attacks and geopolitical conditions may negatively affect the airline industry. This may cause our lessees to default on their lease payment obligations to us.

As a result of the September 11, 2001 terrorist attacks in the United States and subsequent terrorist attacks abroad, airports have increased security restrictions, airline costs for aircraft insurance and security measures have increased and airlines have faced increased difficulties in acquiring war risk and other insurance at reasonable costs. Terrorist attacks and geopolitical conditions have harmed the airline industry, and concerns about geopolitical conditions and further terrorist attacks could harm airlines in the future as a result of various factors, including:

- higher costs to airlines because of increased security measures;

- the inconvenience of additional security measures;

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the price and availability of jet fuel and the cost and practicability of obtaining fuel hedges under current market conditions; and significantly higher costs of aircraft insurance coverage for claims caused by acts of war, terrorism, sabotage, hijacking and other similar perils, and the extent to which such insurance has been or will continue to be available.

Future terrorist attacks, war or armed hostilities, or the fear of such events, may further increase airline costs, depress air travel demand, cause certain aviation insurance to become available only at significantly increased premiums or not be available at all and could have a further adverse impact on the airline industry and on the financial condition and liquidity of our lessees, aircraft values and rental rates, all of which could adversely affect our financial results, growth prospects and ability to pay dividends.

The effects of war or armed hostilities may negatively affect the airline industry. This may cause lessees to default on their lease payment obligations to us.

War or armed hostilities in the Middle East, North Korea, or elsewhere, or the fear of such events, could reasonably be expected to further exacerbate many of the problems experienced by the aviation industry as a result of the terrorist attacks on September 11, 2001. Potential problems include increased security restrictions on air travel in the United States and elsewhere, increased airline costs for, and restricted availability of, aircraft insurance and fuel, enhanced security measures, a decline in passenger demand for air travel, increased difficulties in acquiring war risk and other insurance at reasonable costs, and additional lessee restructurings.

The effects of pandemic diseases may negatively affect the airline industry. This may cause our lessees to default on their lease payment obligations to us.

The 2003 outbreak of SARS was linked to air travel early in its development and had a severe adverse impact on the aviation industry, which was evidenced by a sharp reduction in passenger bookings, cancellation of many flights and employee layoffs. In addition, since 2003, there have been several outbreaks of avian influenza, or the bird flu, and more recently, outbreaks of H1N1. Additional outbreaks of these or other pandemic diseases, or the fear of such events, could provoke responses, including government-imposed travel restrictions, which could negatively affect passenger demand for air travel and the financial condition of the aviation industry.

We depend on aircraft and engine manufacturers' success in remaining financially stable and producing aircraft.

The supply of aircraft, which we purchase and lease, is dominated by two airframe manufacturers, Boeing and Airbus, and a limited number of engine manufacturers. We therefore depend on these manufacturers' success in remaining financially stable and producing aircraft and related components which meet airlines' demands and providing customer support. Further, competition between the manufacturers for market share is escalating and may cause instances of deep discounting for certain aircraft types and may have a negative impact on our competitive pricing when we sell or lease aircraft. Should the manufacturers fail to respond appropriately to changes in the market environment or fail to fulfill their contractual obligations, we may experience:

an inability to acquire aircraft and related components on terms that will allow us to lease those aircraft and related components to customers at our anticipated profit levels, resulting in lower growth rates or a contraction in our fleet;

poor customer support from the manufacturers of aircraft and components resulting in reduced demand for a particular manufacturer's product, creating downward pressure on demand for those aircraft and components in our fleet and reduced market lease rates for those aircraft; and

reduction in our competitiveness due to deep discounting by the manufacturers, which may lead to reduced market lease rates and may adversely affect the value of our portfolio and our ability to remarket or sell some of the aircraft in our fleet.

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Risks Related to the Ownership of Our Shares

We have anti-takeover provisions in our bye-laws that may discourage a change of control.

Our bye-laws contain provisions that could make it more difficult for a third party to acquire us without the consent of our board of directors. These include:

- provisions that permit us to require any competitor of BBAM that acquires beneficial ownership of more than 15% of our common shares either to tender for all of our remaining common shares for no less than their fair market value, or sell such number of common shares to us or to third parties as would reduce its beneficial ownership to less than 15%, in either case within 90 days of our request to so tender or sell;
- provisions that reduce the vote of each common share held by a competitor of BBAM that beneficially owns 15% or more, but less than 50%, of our common shares to three-tenths of one vote per share on all matters upon which shareholders may vote;
- provisions that permit our board of directors to determine the powers, preferences and rights of any preference shares we may issue and to issue any such preference shares without shareholder approval;
- advance notice requirements by shareholders for director nominations and actions to be taken at annual meetings;
- and
- no provision for cumulative voting in the election of directors, such that all the directors standing for election may be elected by our shareholders by a plurality of votes cast at a duly convened annual general meeting, the quorum for which is two or more persons present in person or by proxy at the start of the meeting and representing in excess of 25% of all votes attaching to all shares in issue entitling the holder to vote at the meeting.

These provisions may make it difficult and expensive for a third party to pursue a tender offer, change in control or takeover attempt that is opposed by our management and/or our board of directors. Public shareholders who might desire to participate in these types of transactions may not have an opportunity to do so. These anti-takeover provisions could substantially impede the ability of public shareholders to benefit from a change in control of our company or change our board of directors and, as a result, may adversely affect the market price of our shares and your ability to realize any potential change of control premium.

We are a Bermuda company that is managed and controlled in Ireland. It may be difficult for you to enforce judgments against us or against our directors and executive officers.

We were incorporated under the laws of Bermuda and are managed and controlled in Ireland. Our business is based outside the United States and a majority of our directors and officers reside outside the United States and a majority of our assets and some or all of the assets of such persons are located outside the United States. As a result, it may be difficult or impossible to effect service of process within the United States upon us or those persons, or to recover against us or them on judgments of U.S. courts, including judgments predicated upon the civil liability provisions of the U.S. federal securities laws. Further, no claim may be brought in Bermuda or Ireland against us or our directors and officers in the first instance for violation of U.S. federal securities laws because these laws have no extraterritorial application under Bermuda or Irish law and do not have force of law in Bermuda or Ireland. However, a Bermuda or Irish court may impose civil liability, including the possibility of monetary damages, on us or our directors and officers if the facts alleged in a complaint constitute or give rise to a cause of action under Bermuda or Irish law. There is doubt as to whether the courts of Bermuda or Ireland would enforce judgments of U.S. courts obtained in actions against us or our directors and officers, predicated upon the civil liability provisions of the U.S. federal securities laws, or entertain actions brought in Bermuda or Ireland against us or such persons predicated solely upon U.S. federal securities laws. Further, there is no treaty in effect between the United States and Bermuda or Ireland providing for the enforcement of judgments of U.S. courts in civil and commercial matters, and there are grounds upon which Bermuda or Irish courts may decline to enforce the judgments of U.S. courts. Some remedies available under the laws of U.S. jurisdictions, including some remedies available under the U.S. federal securities laws, may not be allowed in Bermuda or Irish courts as contrary to public policy in Bermuda or Ireland. Because judgments of U.S. courts are not automatically enforceable in Bermuda or Ireland, it may be difficult for you to recover against us or our directors and officers based upon such judgments.

Table of Contents***As a shareholder of our company, you may have greater difficulties in protecting your interests than as a shareholder of a U.S. corporation.***

The Companies Act 1981 of Bermuda, as amended, which we refer to as the Companies Act, applies to our company and differs in material respects from laws generally applicable to U.S. corporations and their shareholders. Taken together with the provisions of our bye-laws, some of these differences may result in your having greater difficulties in protecting your interests as a shareholder of our company than you would have as a shareholder of a U.S. corporation. This affects, among other things, the circumstances under which transactions involving an interested director are voidable, whether an interested director can be held accountable for any benefit realized in a transaction with our company, what approvals are required for business combinations by our company with a large shareholder or a wholly-owned subsidiary, what rights you may have as a shareholder to enforce specified provisions of the Companies Act or our bye-laws, and the circumstances under which we may indemnify our directors and officers.

Risks Related to Taxation***If we generate ordinary earnings for U.S. federal income tax purposes, U.S. shareholders may be required to include their pro rata share of these ordinary earnings in their gross income for U.S. federal income tax purposes.***

We expect to be a Passive Foreign Investment Company under U.S. tax laws for the foreseeable future. As a result, U.S. Holders of our shares will be subject to different taxation rules with respect to an investment in our shares depending on whether they elect to treat us as a qualified electing fund, or a QEF, with respect to their investment in our shares. If a U.S. Holder makes a QEF election in the first taxable year in which the U.S. Holder owns our shares (and if we comply with certain reporting requirements, which we have done and intend to do), then such U.S. Holder will be required for each taxable year to include in income a pro rata share of our ordinary earnings as ordinary income and a pro rata share of our net capital gain, [subject to a separate voluntary election to defer payment of taxes, which deferral is subject to an interest charge]. Shareholders that have made a QEF election with respect to our common shares will be required to include in gross income their pro rata share of our ordinary earnings and net capital gain, if any. Such inclusion is required even if the amount exceeds cash distributions, if any, made by us during the year. As a result of our purchase of our Notes in 2009, we generated significant ordinary earnings, and we may continue to generate ordinary earnings for U.S. federal income tax purposes, particularly if we continue to purchase outstanding Notes. (See ITEM 10. ADDITIONAL INFORMATION Taxation U.S. Federal Income Tax Considerations)

We may face increased tax costs.

We and our subsidiaries could face increased tax costs for various reasons, including our failure to qualify for treaty benefits under the Irish Treaty, the maintenance of a permanent establishment within the United States, or the deduction of withholding taxes from rent payments. Any increase in our tax costs, directly or indirectly, would adversely affect our net income and would decrease cash available for distribution to our shareholders.

In addition, because Ireland does not have tax treaties with all jurisdictions, we may find it necessary to establish subsidiaries in other jurisdictions to lease or sublease aircraft to customers in those jurisdictions. Such subsidiaries may be subject to taxation in the jurisdictions in which they are organized, which would reduce our net income and have an adverse impact on our cash flow available for distribution to our shareholders.

The tax rate applicable to us would be higher than we expect if we were considered not to be carrying on a trade in Ireland for the purposes of Irish law.

We are subject to Irish corporation tax on our net trading income at the rate of 12.5%. Under Irish tax law, non-trading income is taxed at the rate of 25% and capital gains are taxed at the rate of 20%. We believe that we carry on sufficient activity in Ireland, directly through our board of directors and indirectly through the services of our Manager, BBAM and our Servicer, so as to be treated as carrying on a trade in Ireland for the purposes of Irish tax law. If we or any of our Irish tax-resident subsidiaries were considered not to be carrying on a trade in Ireland, we or they may be subject to additional Irish tax liabilities. The application of a higher tax rate (25% instead of 12.5%) on taxable income could decrease cash available for distribution to our shareholders. In addition, we cannot assure you that the 12.5% tax rate applicable to trading income, the 20% tax rate applicable to capital gains or the 25% tax rate applicable to non-trading income will not be changed in the future.

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ITEM 4. INFORMATION ON THE COMPANY

We are Babcock & Brown Air Limited, a Bermuda exempted company incorporated on May 3, 2007 under the provisions of Section 14 of the Companies Act 1981 of Bermuda. Our registered office is located at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda. Although we are organized under the laws of Bermuda, we are resident in Ireland for Irish tax purposes and thus are subject to Irish corporation tax on our income in the same way, and to the same extent, as if we were organized under the laws of Ireland. Our principal executive offices are located at West Pier, Dun Laoghaire, County Dublin, Ireland. Our telephone number at that address is +353 1 231-1900. Our agent for service of process in the United States is Puglisi & Associates located at 850 Library Avenue, Suite 204, Newark, Delaware 19711. Our web address is: www.babcockbrownair.com.

We are a global lessor of modern, fuel-efficient commercial jet aircraft. Our aircraft are leased under long-term to medium-term contracts to a diverse group of airlines throughout the world. On October 2, 2007, we (1) completed our IPO and issued 18,695,650 ADSs, (2) issued 14,907,800 ADSs in a private placement, (3) issued \$853.0 million of aircraft lease-backed notes as part of the Securitization, and (4) used the net proceeds of the IPO, the private placement and the Securitization to finance the acquisition of our Initial Portfolio of 47 commercial aircraft. We currently have two significant subsidiaries: B&B Air Funding and B&B Air Acquisition. Both of these subsidiaries are organized under the laws of Bermuda and are tax resident in Ireland. We own 100% of B&B Air Funding's Class A common stock. For purposes of the Securitization, a charitable trust holds the Class B common stock of B&B Air Funding, having limited voting rights and representing less than 0.001% of the economic interest in B&B Air Funding. B&B Air Funding holds interest in 45 of the 47 aircraft in our Initial Portfolio directly or through its wholly-owned subsidiaries. B&B Air Funding sold the remaining two aircraft from the Initial Portfolio in September and October 2008.

On November 7, 2007, our wholly owned subsidiary, B&B Air Acquisition, entered into the Aircraft Acquisition Facility which provided for up to \$1.2 billion of financing for additional aircraft, including a \$96.0 million equity tranche from B&B Air. The availability period under the facility expired on November 6, 2009. As of December 31, 2009, B&B Air Acquisition holds interest in 17 aircraft through its wholly-owned subsidiaries.

As of December 31, 2009, our portfolio consisted of 62 aircraft.

Our Relationship With BBAM

BBAM is a leading commercial jet aircraft servicer. BBAM and its affiliates assist us in acquiring, leasing and re-marketing aircraft, manage our day-to-day operations and affairs and act as Servicer for our portfolio of aircraft and related leases.

We engage BBAM and its affiliates as Manager of our company and Servicer for our aircraft portfolio under long-term management and servicing agreements. Pursuant to these agreements our Manager manages our company under the direction of its chief executive officer and chief financial officer, who are exclusively dedicated to our business. BBAM acts as our Servicer and, in addition to arranging for the leasing of our fleet, assists our Manager in acquiring and disposing of our aircraft, markets our aircraft for lease and release, collects rents and other payments from the lessees of our aircraft, monitors maintenance, insurance and other obligations under our leases and enforces our rights against lessees. BBAM is among the largest aircraft leasing company in the world, as measured by the number of owned and managed aircraft in its portfolio. BBAM has also been a financial advisor to airlines worldwide and has been an active participant in the Asian aircraft leasing market since 1989.

Although we believe BBAM's position in the industry and relationships throughout the world allows us to manage our portfolio effectively, acquire and lease additional aircraft, and remarket our aircraft when leases expire, there is on-going uncertainty related to Babcock & Brown Limited, the ultimate parent of BBAM. Babcock & Brown Limited was placed into voluntary administration in Australia on March 13, 2009. In addition, Babcock & Brown International Pty Ltd. (BBIPL), which is both the main operating and asset-owning entity in the Babcock & Brown group, continues to pursue its business plan to sell all of its assets. Although no definitive transaction has been announced, Babcock & Brown is in the process of selling substantially all of its aviation-related assets, including the assets and servicing agreements associated with BBAM and the common shares of B&B Air owned by them. These sales could result in a servicer replacement event and an event of default under the Aircraft Acquisition Facility.

A sale of BBAM by Babcock & Brown could create uncertainty about our management and servicing arrangements. We cannot assure you that a new owner of BBAM would dedicate comparable resources to BBAM as Babcock & Brown, and the quality of the services that BBAM has provided to us could deteriorate. In addition, if Babcock & Brown cannot sell its aviation assets within a reasonable time frame, there is no assurance that they will continue to dedicate resources to BBAM or continue its operations. The successful consummation of a sale and the timing of any eventual sale is dependent on many factors, including the consent of Babcock & Brown Limited's lenders and other third parties.

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Some of our agreements with Babcock & Brown, as well as the agreements governing the Notes and the Aircraft Acquisition Facility, contain provisions that are linked to the financial performance and ownership of Babcock & Brown and BBAM.

These provisions include the following with respect to the Aircraft Acquisition Facility:

Babcock & Brown ceases to hold at least 5% of the issued and outstanding shares of B&B Air;

Babcock & Brown ceases to hold at least 51% of the capital stock of BBAM;

BBAM fails to deliver the audited financial statements of Babcock & Brown Limited to the agent and lenders in the Aircraft Acquisition Facility within 120 days of fiscal year end or the unaudited or audited financial statements for each semi-annual period within 90 days, and in each case such failure to deliver the required financial statements continues for 30 days after written notice from the agent (current default with respect to this provision has been waived to April 30, 2010, as described below);

Any Babcock & Brown Limited annual or quarterly financial statement required to be delivered as described above contains a going-concern or similar qualification;

The insolvency of BBAM or any significant subsidiary of BBAM; and

A BBAM default on recourse debt over \$25 million.

An event of default under the Aircraft Acquisition Facility would be triggered if Babcock & Brown ceases to hold at least 5% of the issued and outstanding shares of B&B Air and at least 51% of the capital stock of BBAM. As of December 31, 2009, B&B holds 14.6% of our outstanding ADSs. If any event of default occurs (other than B&B Air Acquisition or any of its subsidiaries becoming the subject of insolvency proceedings), the agent, on the request of 2/3 of the Tranche A and Tranche B lenders combined may demand immediate payment of all outstanding borrowings under the Aircraft Acquisition Facility. After the occurrence of certain bankruptcy and insolvency related events of default, or any acceleration of the amounts due under the Aircraft Acquisition Facility after the occurrence of any event of default, all cash generated by B&B Air Acquisition will be used to repay amounts due under the facility and will not be available to us. Each of these events is beyond our control and could have a materially adverse effect on our business.

The agent for the lenders has approved an extension of the deadline for delivery of the financial statements of Babcock & Brown Limited for the year ended December 31, 2008. In accordance with the terms of the extension, if BBAM is unable to deliver these financial statements by April 30, 2010, the agent may require compliance within 30 days of written notice to BBAM. If BBAM is still unable to comply within this 30 day period, a servicer replacement event will have occurred.

In addition, under the servicing agreement related to the Notes, a servicer termination event is triggered if BBIPL ceases to own at least 50.1% of the voting equity or economic interest in BBAM or on the bankruptcy or insolvency of BBIPL or BBAM. Babcock & Brown has announced that an administration proceeding in respect of Babcock & Brown Limited will not impact the solvency of BBIPL, which is the primary operating company in the Babcock & Brown group and the borrower under the restructured corporate debt facilities.

Our Aircraft Portfolio

As of December 31, 2009, our aircraft portfolio consisted of 62 commercial jet aircraft with 58 narrow-body passenger aircraft (including two freighters) and four wide-body passenger aircraft.

As of December 31, 2009, we had 34 Boeing aircraft and 28 Airbus aircraft in our fleet. The aircraft in our portfolio were manufactured between 1989 and 2008 and have a weighted average age of 7.3 years as of December 31, 2009. We estimate that the useful life of our aircraft is generally 25 years from the date of manufacture, except in the case of a converted freighter in which case remaining useful life is determined based on the date of conversion and can extend beyond 25 years.

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The following table presents the aircraft in our portfolio as of December 31, 2009:

| Lessee Name | Aircraft Type | Airframe Type | Date of Manufacture |
|---------------------------|----------------------|----------------------|----------------------------|
| 1 Aeromexico | B737-700 | Narrowbody | 2005 |
| 2 Aeromexico | B737-700 | Narrowbody | 2005 |
| 3 Aigle Azur | A320-200 | Narrowbody | 1998 |
| 4 Air Berlin (1) | B737-800 | Narrowbody | 1999 |
| 5 Air China | B737-800 | Narrowbody | 2006 |
| 6 Atlant-Soyuz | B737-800 | Narrowbody | 2000 |
| 7 CCM | A320-200 | Narrowbody | 1995 |
| 8 CCM | A320-200 | Narrowbody | 1995 |
| 9 Chang An Airlines | B737-800 | Narrowbody | 2006 |
| 10 China Southern | B757-200 | Narrowbody | 1999 |
| 11 China Southern | B757-200 | Narrowbody | 1999 |
| 12 Donavia | B737-500 | Narrowbody | 1992 |
| 13 Donavia | B737-500 | Narrowbody | 1992 |
| 14 Donbassaero | A320-200 | Narrowbody | 1997 |
| 15 Donbassaero | A320-200 | Narrowbody | 1997 |
| 16 easyJet | A319-100 | Narrowbody | 2007 |
| 17 Ethiopian Airlines | B757-200 | Narrowbody | 1997 |
| 18 Ethiopian Airlines | B757-200 | Narrowbody | 1998 |
| 19 Hainan Airlines | A319-100 | Narrowbody | 2006 |
| 20 Icelandair | B757-200 | Narrowbody | 2000 |
| 21 Icelandair | B757-200 | Narrowbody | 2000 |
| 22 Icelandair | B757-200SF (2) | Narrowbody | 1990 |
| 23 Kingfisher Airlines | A320-200 | Narrowbody | 2005 |
| 24 Kingfisher Airlines | A320-200 | Narrowbody | 2006 |
| 25 KLM | B777-200ER | Widebody | 2004 |
| 26 LTU | A330-200 | Widebody | 2001 |
| 27 Mexicana | A320-200 | Narrowbody | 1995 |
| 28 Norwegian Air | B737-800 | Narrowbody | 2001 |
| 29 Omni Air International | B757-200 | Narrowbody | 1989 |
| 30 Sky Airlines | B737-800 | Narrowbody | 2007 |
| 31 SpiceJet Limited | B737-800 | Narrowbody | 2006 |
| 32 SpiceJet Limited | B737-800 | Narrowbody | 2006 |
| 33 SpiceJet Limited | B737-800 | Narrowbody | 2006 |
| 34 SpiceJet Limited | B737-900ER | Narrowbody | 2007 |
| 35 SpiceJet Limited | B737-900ER | Narrowbody | 2008 |
| 36 Sunwing Airlines | B737-800 | Narrowbody | 2006 |
| 37 Swiss International | A320-200 | Narrowbody | 1995 |
| 38 Swiss International | A320-200 | Narrowbody | 1995 |
| 39 Swiss International | A320-200 | Narrowbody | 1995 |
| 40 Thomson Airways Ltd | B757-200 | Narrowbody | 1999 |
| 41 Thomson Airways Ltd | B757-200 | Narrowbody | 1999 |
| 42 Tiger Airways | A320-200 | Narrowbody | 2006 |
| | B737-300QC | Narrowbody | 1991 |
| 43 Titan Airways | (2) | | |
| 44 Transavia Airlines | B737-700 | Narrowbody | 2001 |

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| | | | |
|----------------------------|------------|------------|------|
| 45 Travel Service Airlines | B737-800 | Narrowbody | 1999 |
| 46 TUI | B767-300ER | Widebody | 1997 |
| 47 United Air Lines | B747-400 | Widebody | 1993 |
| 48 US Airways | A319-100 | Narrowbody | 2000 |
| 49 US Airways | A319-100 | Narrowbody | 2000 |
| 50 US Airways | A319-100 | Narrowbody | 2000 |
| 51 US Airways | A319-100 | Narrowbody | 2000 |
| 52 Virgin America | A320-200 | Narrowbody | 2006 |
| 53 Virgin America | A320-200 | Narrowbody | 2006 |

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| Lessee Name | Aircraft Type | Airframe Type | Date of Manufacture |
|---------------------|----------------------|----------------------|----------------------------|
| 54 Virgin America | A320-200 | Narrowbody | 2007 |
| 55 Virgin America | A319-100 | Narrowbody | 2008 |
| 56 Volaris Airlines | A319-100 | Narrowbody | 1999 |
| 57 Volaris Airlines | A319-100 | Narrowbody | 2000 |
| 58 Volaris Airlines | A319-100 | Narrowbody | 2007 |
| 59 Vueling | A320-200 | Narrowbody | 2007 |
| 60 Vueling | A320-200 | Narrowbody | 2007 |
| 61 Yakutia | B757-200 | Narrowbody | 1996 |
| 62 Yakutia | B757-200 | Narrowbody | 1998 |

(1) Aircraft was re-leased to Jeju Air in February 2010.

(2) Freighter.

The following table summarizes the composition of our portfolio by manufacturer and aircraft type as of December 31, 2009:

| Aircraft Manufacturer | Aircraft Type | Number of Aircraft |
|------------------------------|----------------------|---------------------------|
| Airbus | A319-100 | 10 |
| | A320-200 | 17 |
| | A330-200 | 1 |
| | Total | 28 |
| Boeing | B737-300QC | 1 |
| | B737-500 | 2 |
| | B737-700 | 3 |
| | B737-800 | 11 |
| | B737-900ER | 2 |
| | B747-400 | 1 |
| | B757-200 | 11 |
| | B757-200SF | 1 |
| | B767-300ER | 1 |
| | B777-200ER | 1 |
| Total | 34 | |
| Total | 62 | |

Approximately 72.0% of the aircraft in our portfolio based on net book values as of December 31, 2009 are members of the narrow-body Airbus 320 family and next generation Boeing 737 aircraft families, both of which enjoy higher worldwide demand due to their fuel-efficient design, relatively low maintenance costs, and an increase in customer

demand for point-to-point destination service. These aircraft are based on more routes around the world than any other airframe and thus have the largest installed base. As a result, we believe they are easier and more cost-efficient to lease and market than wide-body jets or other specialized types of aircraft.

The following table presents the composition of our portfolio based on airframe type:

| Airframe Type | Number of Aircraft |
|----------------------|---------------------------|
| Narrow-body(1) | 58 |
| Wide-body | 4 |
| Total | 62 |

(1) Includes two freighters.

We have assumed the rights and obligations under a sale agreement entered into by our Predecessor, to sell one of the aircraft in our Initial Portfolio, a Boeing 757-200, upon expiration of the current lease in October 2010.

Table of Contents**Our Markets**

Our aircraft are leased under long-term to medium-term contracts to a diverse group of airlines throughout the world. The following table presents the distribution of our operating lease revenue by geographic region:

| | Year ended December 31, 2009 | | Year ended December 31, 2008 | | Period from May 3, 2007 (Incorporation Date) to December 31, 2007 | |
|--|---------------------------------|-------------|---------------------------------|-------------|--|-------------|
| | (Dollars in thousands) | | | | | |
| Europe, Middle East and Africa: | | | | | | |
| Germany | \$ 17,174 | 8% | \$ 16,353 | 7% | \$ 1,416 | 5% |
| The Netherlands | 16,331 | 8% | 13,990 | 6% | 728 | 3% |
| United Kingdom | 9,624 | 5% | 17,388 | 8% | 3,120 | 12% |
| Switzerland | 8,423 | 4% | 13,296 | 6% | 1,083 | 4% |
| Other | 52,652 | 24% | 42,167 | 20% | 3,078 | 12% |
| Europe, Middle East and Africa Total | 104,204 | 49% | 103,194 | 47% | 9,425 | 36% |
| Asia Pacific: | | | | | | |
| India | 27,451 | 13% | 26,604 | 12% | 2,189 | 8% |
| China | 16,391 | 8% | 17,491 | 8% | 3,827 | 15% |
| Other | 3,017 | 1% | 3,553 | 2% | 939 | 4% |
| Asia Pacific Total | 46,859 | 22% | 47,648 | 22% | 6,955 | 27% |
| North America: | | | | | | |
| United States | 39,600 | 19% | 39,180 | 18% | 3,457 | 13% |
| Other | 5,009 | 2% | 5,007 | 2% | 433 | 2% |
| North America Total | 44,609 | 21% | 44,187 | 20% | 3,890 | 15% |
| Mexico, South and Central America: | | | | | | |
| Mexico | 18,292 | 8% | 19,802 | 9% | 4,086 | 16% |
| Other | | | 4,109 | 2% | 1,686 | 6% |
| Mexico, South and Central America Total | 18,292 | 8% | 23,911 | 11% | 5,772 | 22% |
| Total Operating Lease Revenue | \$ 213,964 | 100% | \$ 218,940 | 100% | \$ 26,042 | 100% |

Our Leases**Lease Terms**

All of our aircraft are subject to leases under which lessees are responsible for most operational and insurance costs, and 54 of the 62 leases in our portfolio are subject to fixed rental rates. Our portfolio is diversified across 36 different airlines in 19 countries, in both developed and emerging markets. Our leases are scheduled to expire between 2010

and 2018 and have a weighted average remaining lease term of 4.8 years as of December 31, 2009. Nine of our aircraft were scheduled to come off-lease in 2010. One lease was extended, one aircraft has been re-leased, one aircraft is subject to a forward sale contract. Our Servicer is in the process of re-marketing the remaining six aircraft. The following table presents the scheduled lease maturity of the aircraft in our portfolio as of December 31, 2009:

| Year of Scheduled Lease Expiration | Airframe Type | | Total |
|---|----------------------|-------------|--------------|
| | Narrow(1) | Wide | |
| 2010 | 9 | | 9 |
| 2011 | 3 | 1 | 4 |
| 2012 | 5 | | 5 |
| 2013 | 5 | 1 | 6 |
| 2014 | 5 | | 5 |
| 2015 | 13 | 1 | 14 |
| 2016 | 8 | 1 | 9 |
| 2017 | 6 | | 6 |
| 2018 | 4 | | 4 |
| Total | 58 | 4 | 62 |

(1) Includes one freighter each in 2014 and 2015.

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Under our leases, the lessees agree to lease the aircraft for a fixed term, although in some cases the lessees have termination or extension rights.

We receive substantially all of our revenue and pay substantially all of our expenses in U.S. dollars. In 2008, we entered into a lease agreement pursuant to which we received part of the lease payments in euros. We have engaged in a foreign currency hedging transaction related to this lease. Most lease rentals are payable monthly in advance, but some lease rentals are payable in arrears or quarterly. Of our leases, 54 have fixed rental rates and eight have floating rental rates based on six-month LIBOR. In addition, because most of our debt bears floating rates of interest, we manage interest rate risk by entering into interest rate swaps pursuant to which we make fixed-rate interest payments on the swap and receive floating-rate payments on our leases. All leases are on a net basis with the lessee generally responsible for all operating expenses, which customarily include maintenance, fuel, crews, airport and navigation charges, taxes, licenses, aircraft registration and insurance premiums.

Most of our leases provide that the lessee's payment obligations are absolute and unconditional under any and all circumstances. Lessees are generally required to make payment without deduction of any amounts that we may owe the lessee or any claims that the lessee may have against us. Most of our leases also require lessees to gross up lease payments where they are subject to withholdings and other taxes, although there are some exceptions to this requirement, including withholdings that arise out of transfers of the aircraft to or by us or due to our corporate structure. In addition, changes in law may result in the imposition of withholding and other taxes and charges that are not reimbursable by the lessee under the lease or that cannot be reimbursed under applicable law. Furthermore, lessees may fail to reimburse us even when obligated under the lease to do so. Our leases also require lessees to indemnify us for certain other tax liabilities relating to the leases and the aircraft, including, in most cases, value added tax and stamp duties.

The cost of an aircraft typically is not fully recovered over the term of the initial lease. We therefore assume the risk that we will not be able to recover our investment in the aircraft upon expiration or early termination of the lease and of the ultimate residual value. Operating leases allow airlines greater fleet and financial flexibility than outright ownership because of the relatively shorter-term nature of operating leases, the relatively small initial capital outlay necessary to obtain use of the aircraft and the significant reduction in aircraft residual value risk.

Security Deposits and Letters of Credit. 53 of our leases provide for cash security deposits and/or letters of credit which may be drawn down in the event that a lessee defaults under any of these leases. These security deposits and/or letters of credit may mitigate losses we may incur while attempting to re-lease the aircraft. Under certain circumstances, the lessee may be required to obtain guarantees or other financial support from an acceptable financial institution or other third parties.

Maintenance Obligations. Under our leases, the lessee is generally responsible for normal maintenance and repairs, airframe and engine overhauls, obtaining consents and approvals and compliance with return conditions of aircraft on lease. In connection with the lease of a used aircraft we sometimes agree to contribute specific additional amounts to the cost of certain major overhauls or modifications, which usually reflect the usage of the aircraft prior to the commencement of the lease. In many cases, we also agree to share with our lessees the cost of compliance with airworthiness directives.

Our portfolio includes leases pursuant to which we collect maintenance reserve payments that are determined based on passage of time or usage of the aircraft measured by hours flown or cycles operated. These payments may be paid in cash or letters of credit which can be drawn if maintenance obligations are not otherwise paid. Under these leases, we are obligated to make reimbursements to the lessee for expenses incurred for certain planned major maintenance, up to a maximum amount that is typically determined based on maintenance reserves paid by the lessee. Certain leases also require us to make maintenance contributions for costs associated with certain major maintenance events in excess of any maintenance reserve payments. Major maintenance includes heavy airframe, off-wing engine, landing gear and auxiliary power unit overhauls and replacements of engine life limited parts. We are not obligated to make maintenance contributions under leases at any time that a lessee default is continuing. We also have leases that provide for a lease-end adjustment payment based on the usage of the aircraft during the lease term and its condition upon return. Most such payments are likely to be made by the lessee to us, although payments may be required to be made by us to the lessee.

Compliance with Laws. The lessee is responsible for compliance with all applicable laws and regulations with respect to the aircraft. We generally require our lessees to comply with the standards of either the U.S. Federal Aviation Administration or its non-U.S. equivalent. We often require a deposit as security for the lessee's performance of obligations under the lease and the condition of the aircraft upon return.

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General. Each aircraft generally must remain in the possession of the applicable lessee and any sublessees of the aircraft generally must be approved by the lessor unless, in some leases, certain conditions are met. Under most of our leases, the lessees may enter into charter or wet lease arrangements in respect of the aircraft (i.e., a lease with crew and services provided by the lessor under the lease), provided the lessee does not part with operational control of the aircraft. Under some of our leases, the lessee is permitted to enter into subleases with specified operators or types of operators without the lessor's consent, provided certain conditions are met. As of December 31, 2009, our lessees have informed us of the following subleases:

| Lessee | Sublessee |
|---------------------|---------------------|
| Icelandair | Air Niugini |
| Thomson Airways Ltd | Skyservice Airlines |
| Thomson Airways Ltd | Skyservice Airlines |

Our leases also generally permit the lessees to subject the equipment or components to removal or replacement and, in certain cases, to pooling arrangements (temporary borrowing of equipment), without the lessor's consent but subject to conditions and criteria set forth in the applicable lease. Under our leases, the lessee may deliver possession of the aircraft, engines and other equipment or components to the relevant manufacturer for testing or similar purposes, or to a third party for service, maintenance, repair or other work required or permitted under the lease.

Some foreign countries have currency and exchange laws regulating the international transfer of currencies. When necessary, we will require as a condition to any foreign transaction, that the lessee or purchaser in a foreign country obtain the necessary approvals of the appropriate government agency, finance ministry or central bank for the remittance of all funds contractually owed in U.S. dollars. We attempt to minimize our currency and exchange risks by negotiating most of our aircraft leases and all of our sales transactions in U.S. dollars. The terms of the Securitization permit B&B Air Funding to have up to 5% of its leases denominated in euros. In 2008, we entered into a lease agreement pursuant to which we received part of the lease payments in euros. We have engaged in a foreign currency hedging transaction related to this lease. As a result, all of our revenues were received in U.S. dollars, and we paid substantially all of our expenses in U.S. dollars.

Lease Restructurings. During the term of a lease, a lessee's business circumstances may change to the point where it is economically sensible for us to consider restructuring the terms of the lease. Restructurings may involve the voluntary termination of leases prior to contracted lease expiration, the arrangement of subleases from the primary lessee to another airline, the rescheduling of lease payments, the forgiveness and/or reduction of lease obligations and the extension of the lease terms.

Aircraft Repossessions. On a lease default, we may seek to terminate the lease and gain possession of the aircraft for remarketing. Although the majority of repossessions are accomplished through negotiation, if we cannot obtain the lessee's cooperation we would have to take legal action in the appropriate jurisdiction. This legal process could delay the ultimate return of the aircraft. In addition, in connection with the repossession of an aircraft, we may be required to pay outstanding mechanic's, airport, navigation and other liens on the repossessed aircraft. These charges could relate to other aircraft that we do not own but were operated by the lessee. In contested repossessions, we likely would incur substantial additional costs for maintenance, refurbishment and remarketing of the aircraft.

Lease Management and Remarketing

We outsource our lease management and aircraft remarketing activities to BBAM. Pursuant to our servicing agreements with BBAM, BBAM provides us with most services related to leasing our fleet, including marketing aircraft for lease and re-lease or sale, collecting rents and other payments from the lessees of our aircraft, monitoring maintenance, insurance and other obligations under our leases and enforcing our rights against lessees. In 2010, we have nine leases scheduled to expire. We may have additional remarketings in 2010 if any leases are terminated prior to their scheduled expiry dates.

From time to time, we may decide to dispose of our leased aircraft at or before the expiration of their leases. In 2008, we sold two aircraft from our Initial Portfolio to an unrelated third-party.

Competition

The leasing and remarketing of commercial jet aircraft is highly competitive. See the risk factor *We operate in a highly competitive market for investment opportunities in aircraft and other aviation assets.*

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Insurance

We require our lessees to carry those types of insurance which are customary in the air transportation industry. These include aircraft all-risk hull covering the aircraft and its engines, spares insurance and hull war and allied perils insurance covering risks such as hijacking, terrorism, confiscation, expropriation, seizure and nationalization to the extent normally available in the international market. Coverage under aircraft hull insurance policies generally is subject to standard deductible levels in respect of partial damage to the aircraft, in some instances and under certain circumstances the lessee has the right to self-insure some or all of the risk. The lessee is required to pay all deductibles, and also would be responsible for payment of amounts self-insured.

We also carry comprehensive liability insurance, including war and allied perils coverage, provisions for bodily injury, property damage, passenger liability, cargo liability and such other provisions reasonably necessary in commercial passenger and cargo airline operations. Coverage under liability policies generally is not subject to deductibles except as to baggage and cargo that are standard in the airline industry.

In general, we are named as an additional insured and loss payee on the hull and hull war policy for the sum of the stipulated loss value or agreed value of the aircraft and our own contingent coverage in place is at least equal to the appraised value of the aircraft. In cases where the Servicer believes that the agreed value stated in the lease is not sufficient, the Servicer will purchase additional total loss only coverage for the deficiency and as additional insurance on the liability policies carried by our lessees.

The Servicer will obtain certificates of insurance from the lessees' insurance brokers to evidence the existence of such insurance. These certificates of insurance generally include, in addition to the information above, (i) a breach of warranty endorsement so that, subject to certain standard exceptions, our interests are not prejudiced by any act or omission of the lessee, (ii) confirmation that the liability insurance is primary and not contributory, (iii) agreement that insurers waive rights of subrogation against us and (iv) in respect to all policies, notice of cancellation or material change 30 days in respect of most policies but war and allied perils insurance policies customarily provide seven days advance written notice for cancellation and may be subject to lesser notice under certain market conditions.

The insurance market imposes a sub limit on each operator's policy for third-party war risk liability, which is currently between \$50 million and \$150 million on the customary war-risk liability endorsement available in the London market. U.S., Canadian and certain other non-European Community-based airlines have government war-risk insurance programs available in which they currently participate.

Although we currently require each lessee to purchase third party war risk liability in amounts greater than such sublimits, or obtain an indemnity from their government, the market or applicable governments may discontinue to make such excess coverage available for premiums that are acceptable to carriers. As a result, it is possible that we may be required to permit lessees to operate with considerably less third-party war risk liability coverage than currently carried, which could have a material adverse effect on the financial condition of our lessees and on us in the event of an uncovered claim.

In late 2005, the international aviation insurance market unilaterally introduced exclusions for physical damage to aircraft hulls caused by dirty bombs, bio-hazardous materials, electromagnetic pulsing and similar causes of loss in addition to the existing exclusion for the detonation of a nuclear device. It is possible that the same exclusions may be introduced into liability policies, but there is no time frame as to implementation.

In addition to the coverage maintained by our lessees, we maintain contingent liability insurance and contingent hull insurance with respect to our aircraft. Such contingent insurance is intended to provide coverage in the event that the insurance maintained by any of our lessees should not be available for our benefit as required pursuant to the terms of the contract. Consistent with industry practice, our insurance policies are subject to commercially reasonable deductibles or self-retention amounts.

We cannot assure you that we have adequately insured against all risks, that lessees will at all times comply with their obligations to maintain insurance, that any particular claim will be paid, or that we will be able to procure adequate insurance coverage at commercially reasonable rates in the future.

Government Regulation

The air transportation industry is highly regulated. Because we do not operate aircraft, we generally are not directly subject to most of these laws. However, our lessees are subject to extensive regulation under the laws of the

jurisdiction in which they are registered or under which they operate. These laws govern, among other things, the registration, operation, maintenance and condition of our aircraft. See the risk factor, We cannot assure you that all lessees will comply with the registration requirements in the jurisdiction where they operate.

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Most of our aircraft are registered in the jurisdictions in which the lessees of our aircraft are certified as air operators. As a result, our aircraft are subject to the airworthiness and other standards imposed by these jurisdictions. See the risk factor, Government regulations could require substantial expenditures, reduce our profitability and limit our growth.

Properties

We have no physical facilities. Our executive offices are located on our Manager's premises in Dublin, Ireland, and we reimburse our Manager for the cost of those facilities pursuant to the management agreement.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this Annual Report. The consolidated financial statements have been prepared in accordance with U.S. GAAP and are presented in U.S. dollars. The discussion below contains forward-looking statements that are based upon our current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from these expectations due to changes in global, regional or local political, economic, business, competitive, market, regulatory and other factors, many of which are beyond our control. See Preliminary note and Item 3 Risk factors.

Overview

B&B Air is a global lessor of modern, fuel-efficient commercial jet aircraft. Our aircraft are leased under long-term to medium-term contracts to a diverse group of airlines throughout the world. We currently have a portfolio of 62 aircraft.

Although we are organized under the laws of Bermuda, we are resident in Ireland for tax purposes and are subject to Irish corporation tax on our income in the same way, and to the same extent, as if we were organized under the laws of Ireland. On October 2, 2007, we completed our IPO and Private Placement and through our subsidiary, B&B Air Funding, completed the issuance of \$853.0 million in Notes at an offering price of \$99.71282%, or \$850.6 million. Using a portion the net proceeds from the IPO, the Private Placement and Notes issuance, we acquired our Initial Portfolio of 47 commercial jet aircraft.

On November 7, 2007, our subsidiary, B&B Air Acquisition, entered into an Aircraft Acquisition Facility that provided for up to \$1.2 billion of financing for additional aircraft including a \$96.0 million equity tranche from B&B Air. The availability period for the Aircraft Acquisition Facility expired on November 6, 2009 and substantially all available cash flow from aircraft held by B&B Air Acquisition is applied to the repayment of outstanding principal. For the year ended December 31, 2009, B&B Air had net income of \$89.1 million or earnings per share of \$2.89. Net cash flows provided by operating activities for 2009 totalled \$138.4 million. Net cash flow used in investing activities was \$7.1 million and net cash used in financing activities was \$92.1 million for 2009. We paid \$24.7 million in dividends during 2009 and repurchased 2,208,963 shares for a total cost of \$9.1 million.

Net income for 2009 included an after-tax gain of \$2.00 per share on the purchase of notes payable. During 2009, a wholly-owned subsidiary purchased a total of \$169.4 million principal amount of Notes issued by B&B Air Funding. These amounts included \$50.0 million principal amount of Notes purchased on exercise of an option as described below. The total purchase price was \$83.0 million including associated expenses. In connection with the purchase of the Notes, we expensed loan issuance costs and an unamortized discount associated with the original issuance of the Notes totalling \$3.4 million and \$0.3 million, respectively, resulting in the recognition of pre-tax gain on purchase of the Notes of \$82.7 million.

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As a result of our purchase of the Notes, we generated significant ordinary earnings for U.S. federal income tax purposes. Accordingly, U.S. shareholders that have made a Qualified Electing Fund (QEF) election with respect to our common shares will be required to include in gross income their pro rata share of our ordinary earnings and net capital gain. Such inclusion is required even if the amount exceeds cash distributions made by us during the year. We intend to publish our Annual Information Statement covering the taxable year ending December 31, 2009 on our website (www.babcockbrownair.com) in late March or April 2010. We may continue to generate ordinary earnings for U.S. federal income tax purposes in future years, particularly if we continue to purchase outstanding Notes.

Through a wholly-owned subsidiary, we entered into agreements to purchase up to \$100.0 million principal amount of the Notes from an unrelated third party. Under the agreements, we had the right to purchase up to \$50.0 million principal amount of the Notes at any time prior to November 17, 2009 for \$24.0 million and another \$50.0 million principal amount of the Notes at any time prior to March 17, 2010 for \$24.0 million. We paid a fee totalling \$7.0 million in connection with these agreements. The fees are amortized on a straight-line basis over the option terms. In 2009, we exercised our option and purchased \$50.0 million principal amount of the Notes for \$24.0 million. In January 2010, we sold to an unrelated third party our right to purchase up to \$35.0 million principal amount of Notes for \$16.8 million. In March 2010, we sold our remaining option to purchase up to \$15.0 million principal amount of Notes for \$7.2 million. In connection with the option sales, we received \$12.5 million in total consideration.

In June 2009, we borrowed \$32.3 million under a new revolving credit facility (the Credit Facility). The Credit Facility is secured by a pledge of our rights, title and interest in \$119.4 million principal amount of Notes purchased by a wholly-owned subsidiary. There are no scheduled principal payments due during the term of the Credit Facility. Interest is payable monthly and equal to the interest proceeds on the pledged Notes. The Credit Facility is scheduled to mature on August 16, 2010 but provides for two 1-year extension options with the payment of a fee at each extension date equal to 2.5% of the then outstanding principal amount.

Market Conditions

The difficulty of obtaining financing and lack of economic growth are having a negative impact on the general financial condition of the airline industry worldwide and on certain lessees' ability to make lease rental and other payments on a timely basis. These trends have resulted in, among other things, significant decreases in aircraft values and lease rates, payment and other defaults under leases and lessee requests for the restructuring of required payments. An increase in airline bankruptcies could result in the return of aircraft to us by lessees prior to the scheduled lease termination. Early termination of a lease or early return of an aircraft may also result in additional maintenance and other associated expenses. Nine of our aircraft were scheduled to come off-lease in 2010. One lease was extended, one aircraft has been re-leased and one aircraft is subject to a forward sale contract. Our Servicer is in the process of re-marketing the remaining six aircraft.

Many other aircraft leasing companies have been adversely impacted by continuing economic uncertainty, either directly or as a result of the impact of the on-going credit crisis on their equity sponsors. It has been widely reported that many aircraft leasing companies or their aircraft portfolios may be for sale, potentially at distressed prices as their equity sponsors seek alternative sources of liquidity. The sale of aircraft at distressed prices could have an adverse impact on existing aircraft values and lease rates, which could adversely affect our financial condition and results of operations.

Critical Accounting Policies and Estimates

B&B Air has prepared its consolidated financial statements in accordance with U.S. GAAP, which requires the use of estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The use of estimates is or could be a significant factor affecting the reported carrying values of flight equipment, investments, deferred assets, accruals and reserves. We utilize third party appraisers and industry valuation professionals, where possible, to support estimates, particularly with respect to flight equipment. Despite our best efforts to accurately estimate such amounts, actual results could differ from those estimates. The following is a discussion of the accounting policies that involve a high degree of judgment and the methods of their application.

Table of Contents***Flight Equipment Held for Operating Leases, Net***

Flight equipment held for operating lease previously owned by our Predecessor and comprising part of our Initial Portfolio is recorded at our Predecessor's cost upon delivery to us, including costs required to transfer the aircraft. Other aircraft are recorded at its acquisition cost. Flight equipment held for operating lease is depreciated on a straight-line basis over its remaining useful life to estimated residual value. Useful life is based on 25 years from the date of manufacture. Estimated residual values are generally estimated to be approximately 15% of original manufacturer's price of aircraft when new. We may make exceptions to this policy on a case by case basis when, in our judgment, the residual value calculated pursuant to this policy does not appear to reflect current expectations of residual values. Examples of such situations would include, but are not limited to:

- flight equipment where original manufacturer's prices are not relevant due to plane modifications and conversions; and

- flight equipment which is out of production and may have a shorter useful life due to obsolescence.

Estimated residual values and useful lives of flight equipment are reviewed and adjusted if appropriate at each reporting period.

Major improvements to be performed by us pursuant to the lease agreement are accounted for as lease incentives and are amortized against revenue over the term of the lease, assuming no lease renewals. Lessee specific modifications to the aircraft are capitalized and also amortized against revenue over the term of the lease. Generally, lessees are required to provide for repairs, scheduled maintenance and overhauls during the lease term and to be compliant with return conditions of flight equipment at lease termination.

Major improvements and modifications incurred by us for an aircraft that is off-lease are capitalized and depreciated over the remaining life of the aircraft. In addition, costs paid by us for scheduled maintenance and overhauls in excess of amounts paid by lessees are capitalized and depreciated over a period to the next scheduled maintenance or overhaul event. Miscellaneous repairs are expensed when incurred.

At the time of an aircraft acquisition, we evaluate whether the lease acquired with the aircraft is at fair market value. A lease premium is recognized when it is determined that the acquired lease's terms are above market value; lease discounts are recognized when it is determined that the acquired lease's terms are below fair market value. Lease discounts are capitalized into other liabilities and amortized as additional rental revenue on straight-line basis over the lease term. Lease premiums are capitalized into other assets and deducted from rental revenue on a straight-line basis over the lease term.

We follow the guidance provided by the Financial Accounting Standards Board (FASB) which addresses financial accounting and reporting for impaired flight equipment and flight equipment that we commit to and commence a plan of sale that is reasonably expected to be completed within one year. In accordance with FASB, flight equipment is evaluated for impairment where circumstances indicate that the carrying amounts of such assets may not be recoverable. The review for recoverability has a level of subjectivity and requires the use of our judgment in the assessment of the estimated future cash flows associated with the use of an asset and its eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, we assess whether the fair values of the flight equipment exceed the carrying value and an impairment loss is required. The impairment loss is measured as the excess of the carrying amount of the impaired asset over its fair value. Fair value reflects the present value of cash expected to be received from the aircraft in the future, including its expected residual value discounted at a rate commensurate with the associated risk. The estimation of these future cash flows is subjective and requires the use of estimates. Future cash flows are assumed to occur under the current market conditions and assume adequate time for a sale between a willing buyer and a willing seller. Expected future lease rates are based on all relevant information available, including the existing lease, current contracted rates for similar aircraft, appraisal data and industry trends. Residual value assumptions generally reflect an aircraft's booked residual, except where more recent industry information indicates a different value is appropriate. The preparation of these impairment analyses requires the use of assumptions and estimates, including the level of future rents, the residual value of the flight equipment to be realized upon sale at some date in the future, estimated downtime between re-leasing events and the amount of re-leasing costs.

Derivative Financial Instruments

We use derivative financial instruments to manage exposure to foreign currency and interest rate risks. Derivatives are accounted for in accordance with pronouncements by FASB. All derivatives are recognized on the balance sheet at their fair value. Current pronouncements provide special hedge accounting provisions, which permit the change in the fair value of the item being hedged to be recognized into earnings in the same period and in the same income statement line as the change in the fair value of the derivative instrument. On the date that we enter into a derivative contract, we formally document all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking each hedge transaction. Derivate instruments designated in a hedge relationship to mitigate exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Cash flow hedges are accounted for by recording the fair value of the derivative instrument on the balance sheet as either a freestanding asset or liability. Changes in the fair value of an effective cash flow hedge are recorded in accumulated other comprehensive income (loss), net of tax until earnings are affected by the variability of cash flows of the hedged transaction.

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Any derivative gains and losses that are not effective in hedging the variability of expected cash flows of the hedged item are recognized directly into income. Changes in the fair value of derivative financial instruments that do not qualify for hedge treatment are recorded in income.

At the hedge's inception and at least quarterly thereafter, a formal assessment is performed to determine whether changes in cash flows of the derivative instrument have been highly effective in offsetting changes in the cash flows of the hedged items and whether they are expected to be highly effective in the future. If it is determined a derivative instrument has not been or will not continue to be highly effective as a hedge, hedge accounting is discontinued. When this occurs, unrecognized gains and losses recorded on hedged assets and liabilities are amortized over the remaining life of the hedged item beginning no later than when hedge accounting ceases.

Security Deposits and Maintenance Payment Liabilities

In the normal course of leasing aircraft to third parties under certain lease agreements, we receive cash or a letter of credit as security for contractual obligations and maintenance payments to be applied against the future maintenance of aircraft.

Our aircraft are typically subject to triple-net leases under which the lessee is responsible for maintenance, insurance and taxes. Amounts collected from lessees for future maintenance of the aircraft are recorded as maintenance payment liabilities. These payments may be paid in cash or letters of credit which can be drawn if maintenance obligations are not otherwise paid. Maintenance payment liabilities are attributable to specific aircraft. Upon occurrence of qualified maintenance events, funds are disbursed and the liability is relieved. In some leases the lessor may be obligated to contribute to maintenance related expenses on an aircraft during the term of the lease. In other instances, the lessee or lessor may be obligated to make a payment to the counterparty at the end of lease based on a computation stipulated in the lease agreement. The calculation is based on the utilization and condition of the airframe, engines and other major life-limited components as determined at lease termination. We may also incur maintenance expenses on off-lease aircraft. Scheduled major maintenance or overhaul activities and costs for certain high-value components that are paid by us will be capitalized and depreciated over the estimated useful life of such maintenance or component. Amounts paid by us for maintenance, repairs and re-leasing of aircraft that do not extend the useful life of flight equipment are expensed as incurred.

Maintenance payment liability balances at the end of a lease or any amount received as part of a redelivery adjustment are recorded as operating lease revenue at lease termination. When flight equipment is sold, maintenance payment liabilities which are not specifically assigned to the buyer are released from the balance sheet as part of the disposition gain or loss.

Revenue Recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to us and the revenue can be reliably measured. Where amounts do not meet these recognition criteria, they are deferred and recognized in the period in which the recognition criteria are met.

Operating lease revenue. We receive lease revenues from flight equipment under operating leases. Rental income from aircraft rents is recognized on a straight-line basis over the respective lease terms. Contingent rents are recognized as revenue when they are earned. Revenue is not recognized when collection is not reasonably assured.

Finance lease income. Revenue from direct finance leases is recognized on the interest method to produce a level yield over the life of the finance lease. Expected unguaranteed residual values of leased assets are based on our assessment of residual values and independent appraisals of the values of leased assets remaining at expiration of a lease term.

Rentals received but unearned under the lease agreements are recorded in Rentals received in advance on the Consolidated Balance Sheet until earned. In certain cases, leases may provide for additional rentals based on usage which is recorded as revenue as it is earned under the terms of the lease. The usage is calculated based on passage of time or on hourly usage or cycles operated, depending on the lease agreement. Usage is typically reported monthly by the lessee. Other leases provide for a lease-end adjustment payment by us or the lessee based on usage of the aircraft and its condition upon return. Lease-end adjustment payments received are included in rental revenue of flight equipment. Lease-end adjustment payments made are capitalized in Flight equipment under operating leases, net when

they relate to planned major maintenance activities or expensed when they relate to minor maintenance activities.

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Rent receivables represent unpaid, current lease obligations of lessees under existing lease contracts. No revenues are recognized, and no receivable is recorded, from a lessee when collectibility is not reasonably assured. Estimating whether collectibility is reasonably assured requires some level of subjectivity and judgment as it is based primarily on the extent to which amounts outstanding exceed the value of security held, the financial strength and condition of the lessee and the current economic conditions of the lessee's operating environment. When collectibility of rental payments is not certain, revenue is recognized when cash payments are received. Collectibility is evaluated based on factors such as the lessee's credit rating, payment performance, financial condition and requests for modifications of lease terms and conditions as well as security received from the lessee in the form of guarantees and/or letters of credit.

There were no allowances for doubtful accounts required at December 31, 2009 or 2008.

New Accounting Pronouncements

Effective January 1, 2009, we fully implemented the guidance provided by the Financial Accounting Standards Board (FASB) for all non-financial assets and liabilities recognized or disclosed at fair value in the financial statements on a non-recurring basis. Non-recurring non-financial assets and liabilities include long-lived assets, such as our flight equipment, that are measured at fair value for purposes of impairment testing. The implementation of the FASB guidance for non-recurring non-financial assets and liabilities recognized or disclosed at fair value in the financial statements did not have any impact on the Company's consolidated financial statements.

We will apply the authoritative pronouncement by FASB which requires an acquiring entity to recognize the assets acquired, the liabilities assumed, and any non-controlling interest in the business acquired at their fair market values as of the acquisition date. The pronouncement also requires the acquirer to measure goodwill as the excess of the consideration transferred plus the fair value of any non-controlling interest in the business acquired at the acquisition date over the fair values of the identifiable net assets acquired. The acquirer should also recognize and record into expense acquisition related transaction costs.

In April 2009, FASB issued additional guidance and required enhanced disclosures regarding certain fair value measurements. The FASB provided guidance for determining fair values when markets become inactive and for identifying distressed transactions. FASB also amended the guidance for determining whether debt securities are other-than-temporarily impaired and required enhanced presentation and disclosure of other-than-temporary impairments on debt and equity securities held as assets in a company's financial statements. FASB also issued a statement of position requiring disclosures by entities about the fair values of their financial instruments in their interim and annual financial statements. This guidance was effective starting with the period ended June 30, 2009 and did not have a material impact on our consolidated financial statements.

In June 2009, FASB issued an authoritative pronouncement which clarifies the criteria for determining whether a transferor has surrendered control when transferring financial assets. The determination must consider the transferor's continuing involvement with the transferred financial asset, including all arrangements or agreements made contemporaneously with, or in contemplation of, the transfer. The pronouncement limits the circumstances in which a financial asset, or portion of a financial asset, should be derecognized when the transferor has not transferred the entire original financial asset to another entity and/or when the transferor has continuing involvement with the transferred asset. A transferor can account for the transfer of an asset as a sale only if the transferor surrenders control over the asset. The pronouncement is effective for financial asset transfers occurring on or after December 31, 2009.

In June 2009, FASB also issued a pronouncement which requires an enterprise to perform analysis and ongoing reassessments to determine whether its variable interest or interests give it a controlling financial interest in a variable interest entity. The pronouncement identifies the characteristics of the primary beneficiary of a variable interest entity and amends the guidance for determining whether an entity is a variable interest entity. Additionally, an enterprise is required to assess whether it has an implicit financial responsibility to ensure that a variable interest entity operates as designed when determining whether it has the power to direct the activities of the variable interest entity that most significantly impact the entity's economic performance. The pronouncement is effective for interim and annual reporting periods after December 31, 2009.

Effective September 30, 2009, the FASB Accounting Standards Codification (Codification) became the authoritative source of generally accepted accounting principles in the United States. The Codification also superseded all

then-existing non-SEC accounting and reporting standards. FASB will no longer issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates which will serve to update the Codification. In addition, the GAAP hierarchy was modified to include only two levels of GAAP: authoritative and non-authoritative.

Table of Contents**Operating Results**

Management's discussion and analysis of operating results presented below pertain to the consolidated statement of operations of B&B Air for the years ended December 31, 2009 and 2008 and for the period from May 3, 2007 (incorporation date) to December 31, 2007.

Consolidated Statement of Income of B&B Air for the years ended December 31, 2009 and 2008

| | Year ended December 31, | | Increase/ Decrease |
|---|--------------------------------|------------------|-------------------------------|
| | 2009 | 2008 | |
| Revenues | | | |
| Operating lease revenue | \$ 213,964 | \$ 218,940 | \$ (4,976) |
| Finance lease income | | 2,446 | (2,446) |
| Gain on purchase of notes payable | 82,666 | | 82,666 |
| Gain on sale of aircraft | | 11,437 | (11,437) |
| Lease termination settlement | 8,307 | | 8,307 |
| Interest and other income | 2,598 | 3,315 | (717) |
| Total revenues | 307,535 | 236,138 | 71,397 |
| Expenses | | | |
| Depreciation | 83,650 | 74,161 | 9,489 |
| Interest expense | 80,925 | 81,689 | (764) |
| Selling, general and administrative | 21,094 | 20,989 | 105 |
| Debt purchase option amortization | 6,053 | | 6,053 |
| Maintenance and other costs | 2,353 | 4,307 | (1,954) |
| Total expenses | 194,075 | 181,146 | 12,929 |
| Net income before provision for income taxes | 113,460 | 54,992 | 58,468 |
| Income tax provision | 24,367 | 6,867 | 17,500 |
| Net income | \$ 89,093 | \$ 48,125 | \$ 40,968 |

As of December 31, 2009 and 2008, we had 62 aircraft in our portfolio. As of December 31, 2009, all of our aircraft were on lease to 36 lessees, compared to December 31, 2008, when 61 of our aircraft were on lease to 36 lessees, with one aircraft off-lease. We sold two aircraft in 2008.

Rental revenues received from operating leases are recognized on a straight-line basis over the respective lease terms. For the year ended December 31, 2009, operating lease revenue totalled \$214.0 million, a decrease of \$5.0 million compared to the year ended December 31, 2008. The decrease was due to (i) recognition of end of lease redelivery and maintenance payment liability relieved at lease termination totalling \$11.7 million in 2008 with no corresponding revenue recognized in 2009; (ii) a decrease in operating lease revenue from aircraft sold in 2008 of \$4.4 million; (iii) a decrease of \$3.7 million in rents on floating-rate leases due to decreases in LIBOR; (iv) an increase in lease incentives amortized as a reduction in operating lease revenue amounting to \$2.0 million; (v) reductions in lease rates due to lease restructurings totalling \$3.0 million; (vi) lower revenue recognition from a lessee that was placed on non-accrual status of \$2.1 million and (vii) other miscellaneous adjustments totalling \$1.7 million. These decreases were partially offset by: (i) a full year of operating lease revenues recognized in 2009 on aircraft purchased in 2008 resulting in an incremental increase of \$16.3 million and (ii) revenue from aircraft re-marketed in 2008 and 2009 resulting in an incremental increase of \$7.3 million.

Net lease discount amortized into lease revenue during the year ended December 31, 2009 and 2008 totalled \$2.0 million and \$2.5 million, respectively.

In 2008, we sold two aircraft to a third-party and recognized a total gain on sale of \$11.4 million.

We purchased in 2009 through a wholly-owned subsidiary, a total of \$169.4 million principal amount of Notes, including \$50.0 million principal amount which was purchased pursuant to an option agreement (see below). The total purchase price was \$83.0 million, including associated expenses. In connection with the Note purchases, we expensed loan issuance costs and an unamortized discount associated with the original issuance of the Notes totalling \$3.8 million. We recognized a pre-tax gain on purchase of Notes of \$82.7 million. The purchased Notes remain outstanding.

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In connection with the early termination of four leases in a prior period, we reached a settlement with the guarantor of these leases in February 2009. Pursuant to the terms of the settlement agreement, we received a lump-sum payment of \$6.3 million at the settlement date, with an additional \$5.9 million to be paid in monthly installments over three years with interest at 8.0% per annum. Payments totalling approximately \$8.3 million were received in 2009. Due to collectibility concerns, future payments will only be recognized as cash is received.

During the years ended December 31, 2009 and 2008, we recorded interest and other income of \$2.6 million and \$3.3 million, respectively, a decrease of \$0.7 million. This decrease is due to lower interest earned on our cash balances as a result of lower interest rates in 2009.

We depreciate our flight equipment under operating leases on a straight-line basis over its remaining estimated useful life to estimated salvage value. Depreciation expense during 2009 was \$83.7 million, compared to \$74.2 million for 2008. The increase of \$9.5 million was primarily due to: (i) full year's depreciation on aircraft purchased in 2008 resulting in additional depreciation of \$5.5 million, (ii) adjustments to salvage value of certain aircraft resulting in additional depreciation of \$2.5 million, (iii) depreciation on major maintenance capitalized totalling \$1.7 million and (iv) depreciation on aircraft previously on direct finance lease of \$1.4 million. These increases were partially offset by depreciation expense on aircraft sold during 2008 totalling \$1.6 million.

Compared to 2008, interest expense decreased by \$0.8 million in the year ended December 31, 2009 to \$80.9 million. The decrease was primarily due to (i) lower interest rates during 2009 resulting in an incremental decrease in interest of \$5.3 million and (ii) purchases of Notes during 2009 and principal repayments during 2008, resulting in net interest savings of \$1.7 million. This decrease was partially offset by increases due to (i) additional borrowings under our Aircraft Acquisition Facility to fund aircraft purchases during 2008 resulting in additional interest of \$5.3 million and (ii) amortization of loan fees associated with the Credit Facility of \$0.9 million during the year ended December 31, 2009.

Selling, general and administrative expenses remained constant totalling \$21.1 million and \$21.0 million for the years ended December 31, 2009 and 2008, respectively.

During 2009, we entered into agreements, through a subsidiary, to purchase up to an additional \$100.0 million principal amount of the Notes from an unrelated third party. Under the agreements, we had the right to purchase up to \$50.0 million principal amount of the Notes at any time prior to November 17, 2009 for \$24.0 million and have the right to purchase another \$50.0 million principal amount at any time prior to March 17, 2010 for \$24.0 million. In connection with these agreements, we paid fees totalling \$7.0 million which are being amortized over the option terms. Subsequent to December 31, 2009, we sold our rights under the option agreement to purchase up to \$50.0 million principal amount of Notes for \$24.0 million and received \$12.5 million as consideration for the sale. During the year ended December 31, 2009, maintenance and other leasing costs decreased \$2.0 million to \$2.3 million from \$4.3 million in the prior year. The decrease is primarily due to re-leasing and repossession costs incurred during the year ended December 31, 2008.

Our provision for income taxes of \$24.4 million and \$6.9 million during the years ended December 31, 2009 and 2008, respectively, consists primarily of Irish income taxes. The increase is primarily due to the recognition of a deferred tax provision on the gain associated with the Notes purchased using the non-trading deferred income tax rate. We are tax-resident in Ireland and expect to pay the corporation tax rate of 12.5% on trading income and 25.0% on non-trading income.

Our consolidated net income for the year ended December 31, 2009 increased \$41.0 million to \$89.1 million from \$48.1 million for the year ended December 31, 2008.

Table of Contents**Consolidated Statement of Income of B&B Air for the year ended December 31, 2008 and for the period from May 3, 2007 (incorporation date) to December 31, 2007**

| | Year ended December 31, 2008 | For the period from May 3, 2007 (incorporation date) to December 31, 2007 | Increase/ (decrease) |
|--|--|---|-------------------------|
| (Dollars in thousands) | | | |
| Revenues | | | |
| Operating lease revenue | \$ 218,940 | \$ 26,042 | \$ 192,898 |
| Finance lease income | 2,446 | 2,365 | 81 |
| Gain on sale of aircraft | 11,437 | | 11,437 |
| Interest and other income | 3,315 | 4,927 | (1,612) |
| Total revenues | 236,138 | 33,334 | 202,804 |
| Expenses | | | |
| Depreciation | 74,161 | 8,573 | 65,588 |
| Interest expense | 81,689 | 14,628 | 67,061 |
| Selling, general and administrative | 20,989 | 4,866 | 16,123 |
| Maintenance and other costs | 4,307 | 165 | 4,142 |
| Hedging costs related to interest rate swap option | | 1,725 | (1,725) |
| Total expenses | 181,146 | 29,957 | 151,189 |
| Net income from continuing operations before provision for income taxes | 54,992 | 3,377 | 51,615 |
| Provision for income taxes | 6,867 | 1,032 | 5,835 |
| Net income | \$ 48,125 | \$ 2,345 | \$ 45,780 |

As of December 31, 2008 and 2007, we had 62 and 52 aircraft in our portfolio, respectively. In addition, as of December 31, 2008, 61 of our aircraft were on lease to 36 lessees, with one aircraft off-lease, compared to December 31, 2007, when all 52 of our aircraft were on lease to 29 lessees. We sold two aircraft in 2008. Rental revenues received from operating leases are recognized on a straight-line basis over the respective lease terms. For 2008, operating lease revenue totalled \$218.9 million, an increase of \$192.9 compared to 2007. The increase was due to: (i) a full year of operating lease revenues being recognized in 2008 on aircraft purchased in 2007 resulting in an incremental increase of \$136.2 million, which includes \$3.2 million of redelivery adjustments earned; and is net of revenue lost from the sale of two aircraft; (ii) operating lease revenue recognized from aircraft purchased in 2008 totalling \$44.4 million; (iii) aircraft which were re-marketed in 2008 generating \$5.1 million of operating lease revenue, including \$4.5 million of maintenance payment liability relieved at lease termination; and (iv) aircraft previously on finance leases which were re-marketed in 2008 generating \$7.2 million of operating lease revenue, including \$4.0 million of maintenance payment liability relieved at lease termination.

Net lease discount amortized into lease revenue during 2008 and 2007 totalled \$2.5 million and \$0.2 million, respectively. In addition, lease incentives amortized as a reduction in operating lease revenue totalled \$2.3 million in 2008.

Finance lease income was \$2.4 million for each of 2008 and 2007. B&B Air's net investment in direct finance lease was attributable to four aircraft repossessed in 2008. As of December 31, 2008, we had no finance leases.

In 2008, we sold two aircraft to a third-party and recognized a total gain on sale of \$11.4 million.

In 2008 and 2007, we recorded interest earned on our cash balances of \$3.3 million and \$4.9 million, respectively, a decrease of \$1.6 million. We had higher cash balances during the Stub Period 2007 as compared to 2008. The higher cash balances for Stub Period 2007 was the result of proceeds received from our Offerings and Securitization on October 2, 2007.

We depreciate our flight equipment under operating leases on a straight-line basis over its remaining estimated useful life to estimated salvage value. Depreciation expense during 2008 was \$74.2 million, compared to \$8.6 million for the Stub Period 2007. The increase of \$65.6 million was due to: (i) full year depreciation recognized in 2008 on aircraft purchased in 2007 resulting in an incremental increase of \$46.6 million, (ii) depreciation expense on aircraft purchased in 2008 totalling \$16.6 million, and (iii) depreciation expense recorded on aircraft transferred from direct finance leases to operating lease amounting to \$2.4 million.

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Compared to 2007, interest expense increased by \$67.1 million in 2008 to \$81.7 million. The increase was primarily due to: (i) a full year of interest incurred on the Notes and borrowings under our Aircraft Acquisition Facility resulting in an incremental increase of \$40.2 million and \$7.0 million, respectively, (ii) additional borrowings under our Aircraft Acquisition Facility to fund aircraft purchases in 2008 resulting in additional interest of \$27.3 million, and (iii) loan issuance costs expensed in connection with the partial repayment of our Notes amounting to \$0.6 million. These increases were partially offset by decreases in interest rates during 2008 resulting in an incremental decrease in interest of \$8.0 million.

Selling, general and administrative expenses totalled \$21.0 million and \$4.9 million for 2008 and Stub Period 2007, respectively, an increase of \$16.1 million. The increase in selling, general and administrative expenses was primarily due to a full year of operations in 2008 and additional aircraft purchased during 2007 and 2008. In addition there was approximately \$0.8 million of repossession expenses recorded in 2008.

Maintenance and other leasing costs totalled \$4.3 million and \$0.2 million for 2008 and Stub Period 2007, respectively. The increase of \$4.1 million was primarily due to: (i) full year operations in 2008 and (ii) re-leasing, repossession, technical consulting and other aircraft related costs incurred to remarket the aircraft repossessed in 2008 which totalled \$2.9 million.

Our provision for income tax consists primarily of Irish income tax incurred amounting to \$6.9 million and \$1.0 million during 2008 and 2007, respectively. We are tax-resident in Ireland and expect to pay the corporation tax rate of 12.5% on trading income and 25% on non-trading income. Certain interest income is not considered trading income and is taxed at the 25% rate. The 2008 provision includes benefits of foreign taxes paid in 2007.

Our consolidated net income for 2008 increased \$45.8 million from \$2.3 million for the Stub Period 2007 to \$48.1 million in 2008.

Liquidity and Capital Resources***Cash Flows of B&B Air for the years ended December 31, 2009 and 2008***

Our sole source of operating cash flows is from distributions made to us by our subsidiaries, B&B Air Funding and B&B Air Acquisition. Distributions of cash to us by our subsidiaries are subject to compliance with covenants contained in the agreements governing their debt financing. The availability period for the Aircraft Acquisition Facility expired on November 6, 2009 and substantially all available cash flow from aircraft held by B&B Air Acquisition was applied to repayment of outstanding principal. Accordingly, our primary source of cash is distributions made to us from B&B Air Funding.

We generated cash from operations of \$138.4 million and \$111.2 million for the years ended December 31, 2009 and 2008, respectively. The increase of \$27.2 million was primarily the result of increased cash flows from (i) settlement proceeds of \$8.3 million received in connection with the early termination of leases, (ii) \$5.4 million of revenue from aircraft that were previously accounted for as direct finance leases in the prior year, and (iii) other changes in working capital balances.

Cash from investing activities relate primarily to the acquisition of aircraft, proceeds from sale of aircraft and lessor maintenance contributions. Cash used in investing activities totalled \$7.1 million and \$470.8 million for the years ended December 31, 2009 and 2008, respectively. During 2009, we paid \$7.1 million for lessor contributions to maintenance. During 2008, we acquired the last two aircraft comprising the Initial Portfolio and ten additional aircraft resulting in cash used in investing activities of \$505.6 million. We did not acquire any aircraft in 2009. Proceeds received from the sale of two aircraft during 2008 totalled \$42.1 million. In addition, cash flow proceeds from direct finance leases were \$2.7 million in 2008. In April 2008, we repossessed all four aircraft comprising our investment in direct finance leases. There were no proceeds from direct finance leases for 2009.

Cash used in financing activities for the year ended December 31, 2009 amounted to \$92.1 million, compared to cash provided by financing activities of \$400.7 million for the year ended December 31, 2008. In 2009, we: (i) made purchases of Notes in the principal amount of \$169.4 million for \$83.0 million, (ii) made additions to our cash collateral account and other restricted cash accounts totalling \$25.6 million, (iii) paid \$7.0 million for options to purchase our Notes and (iv) paid dividends of \$24.7 million. In addition, we received \$30.8 million of proceeds from our Credit Facility. In 2008, we: (i) made borrowings under the Aircraft Acquisition Facility of \$464.9 million, (ii) repaid \$24.9 million of Notes from proceeds received from the sale of two aircraft and (iii) paid dividends of

\$67.1 million. Movements in security deposits and maintenance payment liabilities were consistent in 2009 and 2008.

Table of Contents***Cash Flows of B&B Air for the year ended December 31, 2008 and for the period from May 3, 2007 (incorporation date) to December 31, 2007***

We generated cash flows from operations of \$111.2 million and \$22.2 million for 2008 and 2007, respectively. The increase of \$89.0 million was primarily the result of increased cash flows from leasing activities arising from a full-year impact of aircraft purchased in 2007 and new aircraft additions in 2008. Included in cash flows from operating activities is the proceeds we received from a swap contract terminated in 2008 amounting to \$2.1 million. Compared to 2007, there was a net decrease of \$17.6 million in our net operating assets and liabilities in 2008. Cash used in investing activities totalled \$470.8 million and \$1,366.4 million for 2008 and 2007, respectively. During 2007, we acquired 45 aircraft comprising our Initial Portfolio and seven additional aircraft resulting in cash used in investing activities of \$1,368.4 million. During 2008, our cash used for aircraft acquisitions of the last two aircraft comprising our Initial Portfolio and ten additional aircraft totalled \$505.6 million. In addition, during 2008 we recognized a lessor contribution to maintenance amounting to \$10.0 million. This was partially offset by cash flow proceeds from the sale of two aircraft totalling \$42.1 million. Cash flow proceeds from direct finance leases was approximately \$2.7 in each of 2008 and 2007.

The cash flows provided by financing activities in 2008 amounted to \$400.7 million. The 2007 financing cash flows reflect the capitalization of the Company and include proceeds received in connection with the Securitization and Offerings totalling \$1,318.3 million. In addition, increases and decreases in other items comprising our cash flows from financing activities were movements in: (i) our restricted cash balance amounting to \$111.6 million, (ii) proceeds from and disbursements of security deposits and maintenance payment liabilities amounting to \$4.0 million, (iii) an increase of \$342.0 million in borrowings under the Aircraft Acquisition Facility, (iv) partial repayment of our Notes in 2008 amounting to \$24.9 million, (v) cost of shares repurchased totalling \$6.6 million, and (vi) total dividends paid in 2008 of \$67.1 million.

Our Future Sources and Uses of Liquidity

We operate in a capital-intensive industry. The principal factors affecting our expected cash flows include lease revenues from our aircraft, net proceeds from aircraft dispositions, cash interest payments made on the Notes and our credit facilities, operating expenses, dividend payments and capital expenditures on our aircraft.

Our short-term liquidity needs include working capital for operations associated with our aircraft, interest payments, and cash to pay dividends to our shareholders. We expect that cash on hand and cash flow provided by operations will satisfy our short-term liquidity needs through at least the next 12 months and provide additional funds that may be used to create value for our shareholders.

The current economic recession and resulting slowdown in air travel have contributed to a decrease in the demand for aircraft, resulting in a decrease in aircraft lease rates and values. We expect this trend to continue into 2010. We have completed several restructuring requests and may receive additional requests for lease restructurings from troubled lessees. Nine aircraft are scheduled to come off-lease during 2010. One lease was extended, one aircraft was re-leased in February 2010 and one aircraft is subject to a forward sale contract. Our Servicer is in the process of remarketing the remaining six aircraft. This could result in a reduction in our annual revenues.

We currently do not have any unfunded commitments and have limited capital requirements. We expect to fund our current capital needs from excess cash flow.

The availability period for the Aircraft Acquisition Facility expired on November 6, 2009 and we may not borrow additional amounts. Under this facility, all available cash flow from aircraft held by B&B Air Acquisition are applied to the outstanding principal after payment of interest, certain expenses and a return paid to us on our \$96.0 million equity tranche. All amounts outstanding on November 6, 2012 must be repaid in four quarterly installments. As of December 31, 2009, the Aircraft Acquisition Facility has an outstanding balance of \$594.6 million.

Babcock & Brown has informed us that BBIPL, which is both the main operating and asset-owning entity in the Babcock & Brown group, continues to pursue its revised business plan to sell all of its assets. Although no definitive transaction has been announced, we expect Babcock & Brown to sell substantially all of its aviation-related assets, including the assets and servicing agreements associated with BBAM and the common shares of B&B Air owned by them. These sales could result in a servicer replacement event and an event of default under the Aircraft Acquisition Facility.

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Substantially all cash flow from the aircraft held in B&B Air Acquisition has been applied to repay principal on the loans since the end of the availability period in November 2009. We will seek to refinance some or all of the amounts outstanding under the Aircraft Acquisition Facility prior to its maturity in November 2012. All amounts outstanding on November 6, 2012 must be repaid in four quarterly installments. Depending on market conditions, however, it may not be possible to refinance the Aircraft Acquisition Facility prior to November 2012 on terms we find acceptable. We may also refinance the amounts outstanding under our Notes prior to August 2012 when substantially all cash flow from aircraft held by B&B Air Funding will be applied to repay the principal on the Notes. Depending on market conditions, however, it may not be possible to refinance the Notes on terms we find acceptable or more advantageous to the current terms of the Notes.

Our access to debt and equity financing to refinance amounts outstanding under the Aircraft Acquisition Facility and the Notes or to fund acquisitions will depend on a number of factors, such as our historical and expected performance, compliance with the terms of our debt agreements, industry and market trends, the availability of capital and the relative attractiveness of alternative investments. The current dislocation in credit markets may make it difficult for us to meet our long-term capital needs. In addition, our strategy of growing our aircraft portfolio requires access to the capital markets to secure new debt and equity financings

Dividends and Share Repurchases. The table below shows the quarterly dividends we have paid and the total cash requirement for each dividend payment.

| Dividend payment date | Dividends paid | | Total cash requirement |
|------------------------------|---------------------------|------|-----------------------------------|
| | per share | | |
| 2009: | | | |
| November 20, 2009 | \$ | 0.20 | \$ 6.1 million |
| August 20, 2009 | \$ | 0.20 | \$ 6.1 million |
| May 20, 2009 | \$ | 0.20 | \$ 6.1 million |
| February 20, 2009 | \$ | 0.20 | \$ 6.5 million |
| 2008: | | | |
| November 20, 2008 | \$ | 0.50 | \$ 16.7 million |
| August 20, 2008 | \$ | 0.50 | \$ 16.7 million |
| May 20, 2008 | \$ | 0.50 | \$ 16.8 million |
| February 20, 2008 | \$ | 0.50 | \$ 16.8 million |

The declaration and payment of future dividends to holders of our common shares will be at the discretion of our board of directors and will depend on many factors, including our financial condition, cash flows, market conditions, legal requirements and other factors as our board of directors deems relevant.

Our Board of Directors approved a share repurchase program that authorized the repurchase of up to \$30.0 million of our shares through June 2009. In March 2009, our Board of Directors approved the extension of the program through June 2010. The purchases to be made from time to time will be in the open market or in privately negotiated transactions, and will be funded from available cash. For the year ended December 31, 2009 we repurchased 2,208,963 shares at an average price of \$4.08 per share, for a total of \$9.0 million before expenses. In 2008, we repurchased 1,114,539 shares at an average price of \$5.87 per share, for a total of \$6.5 million before expenses. As of December 31, 2009, we have approximately \$14.4 million available under the share repurchase program.

Note Purchases. During the year ended December 31, 2009, we purchased through a wholly-owned subsidiary \$169.4 million principal amount of the Notes issued by B&B Air Funding for a purchase price of \$83.0 million, including associated expenses. The amounts include \$50.0 million principal amount of Notes purchased on exercise of an option as described below. The Notes are held by a subsidiary and remain outstanding. Notes in the principal amount of \$119.4 million are pledged to the lender in our Credit Facility.

Option Agreements. During the year ended December 31, 2009, we entered into two option agreements for a total cost of \$7.0 million to purchase up to a total of \$100.0 million principal amount of the Notes for 48% of the principal amount or for a total purchase price of \$48.0 million. We exercised the first option agreement in 2009 and purchased a total of \$50.0 million principal amount for \$24.0 million. The second option agreement for another \$50.0 million principal amount expires on March 17, 2010. In January 2010, we sold to an unrelated third party our right to purchase up to \$35.0 million principal amount of Notes for \$16.8 million. In March 2010, we sold our remaining option to purchase up to \$15.0 million principal amount of Notes for \$7.2 million. In connection with the option sales, we received \$12.5 million in total consideration.

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Maintenance Cash Flows. Under our leases, the lessee is generally responsible for maintenance and repairs, airframe and engine overhauls, obtaining consents and approvals and compliance with return conditions of aircraft on lease. In connection with the lease of a used aircraft we may agree to contribute specific additional amounts to the cost of certain major overhauls or modifications, which usually reflect the usage of the aircraft prior to the commencement of the lease. In many cases, we also agree to share with our lessees the cost of compliance with airworthiness directives. Maintenance reserve payments we collect from our lessees are based on passage of time or usage of the aircraft measured by hours flown or cycles operated. Under these leases, we are obligated to make reimbursements to the lessee for expenses incurred for certain planned major maintenance, up to a maximum amount that is typically determined based on maintenance reserves paid by the lessee.

Certain leases also require us to make maintenance contributions for costs associated with certain major overhauls or certain other modifications in excess of any maintenance payments received. Major maintenance includes heavy airframe, off-wing engine, landing gear and auxiliary power unit overhauls and replacements of engine life limited parts. Other leases provide for a lease-end adjustment payment based on the usage of the aircraft during the lease and its condition upon return, with such payments likely to be made by the lessee to us. In some instances, payments may be required to be made by us to the lessee. We are not obligated to make maintenance reimbursements or contributions under leases at any time that a lessee default is continuing.

We expect that the aggregate maintenance reserve and lease-end adjustment payments we will receive from lessees will meet the aggregate maintenance contributions and lease-end adjustment payments that we will be required to make. In 2009, we received \$38.2 million of maintenance payments from lessees, made maintenance payment disbursements of \$8.5 million and also made maintenance contributions of \$7.1 million.

Financing**Securitization**

Our subsidiary, B&B Air Funding, the owner of our Initial Portfolio, completed in October 2007 an aircraft lease-backed securitization (Securitization) that generated net proceeds of approximately \$825.1 million after deducting initial purchasers' discounts and fees. During the year ended December 31, 2009, we repurchased through a wholly-owned subsidiary \$169.4 million principal amount of the Notes issued by B&B Air Funding in the Securitization for a total purchase price of \$83.0 million, including associated expenses. The Notes are held by a subsidiary and remain outstanding.

Interest Rate. The Notes bear interest at an adjustable interest rate equal to the then-current one-month LIBOR plus 0.67%. Interest expense for the Securitization also includes amounts payable to the policy provider and the Note Liquidity Facility provider thereunder. Interest and any principal payments due are payable monthly. We have entered into interest rate swap agreements to mitigate the interest rate fluctuation risk associated with the Notes.

Payment Terms. Up to and until July 2010, there are no scheduled principal payments on the Notes. For each month between July 2010 and August 2012, there are scheduled principal payments in fixed amounts of approximately \$1.0 million per month, in each case subject to satisfying certain debt service coverage ratios and other covenants. Thereafter, cash flow will not be available to us for the payment of dividends since principal payments are not fixed in amount but rather are determined monthly based on revenues collected and costs and other liabilities incurred prior to the relevant payment date. Effectively after July 2012, all revenues collected during each monthly period will be applied to repay the outstanding balance of the Notes, after the payment of certain expenses and other liabilities, including the fees of the service providers, the Note Liquidity Facility provider and the policy provider, interest on the Notes and interest rate swap payments, all in accordance with the priority of payments set forth in the indenture. The final maturity date of the Notes is November 14, 2033.

Available Cash. B&B Air Funding is required to maintain as of each monthly payment date, cash in an amount sufficient to cover its operating expenses for a period of one month or, in the case of maintenance expenditures, six months, following such payment date. All cash flows attributable to the underlying aircraft after the payment of amounts due and owing in respect of, among other things, maintenance and repair expenditures with respect to the aircraft, insurance costs and taxes and all repossession and re-leasing costs, certain amounts due to any credit support providers, swap providers, the policy provider, trustees, directors and various service providers will be distributed in accordance with the priority of payments set forth in the indenture. B&B Air Funding, however, will be required to

use the amount of excess Securitization cash flows to repay principal under the Notes instead of making distributions to us upon the occurrence of certain events, including failure to maintain a specified debt service coverage ratio during specified periods, certain events of bankruptcy or liquidation and any acceleration of the Notes after the occurrence of other events of default.

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Otherwise, we intend to use the excess Securitization cash flow to pay dividends to us, to convert passenger aircraft to freighter aircraft, and to purchase additional aircraft and other aviation assets.

We may refinance the amounts outstanding under our Notes prior to August 2012 when substantially all cash flow from aircraft held by B&B Air Funding will be applied to repay the principal on the Notes. Depending on market conditions, however, it may not be possible to refinance the Notes on terms we find acceptable or more advantageous to the current terms of the Notes.

Redemption. We may, on any payment date, redeem the Notes by giving the required notices and depositing the necessary funds with the trustee. A redemption prior to acceleration of the Notes may be of the whole or any part of the notes. A redemption after acceleration of the Notes upon default may only be for the whole of the notes.

We may, on any payment date, redeem the Notes in whole or from time to time in part, at the following redemption prices, expressed as percentages of principal amount, together with accrued and unpaid interest to, but excluding, the date fixed for redemption, if redeemed on the dates indicated below:

| Redemption Date | Price |
|---|--------------|
| Before April 14, 2010 | 100.36% |
| On or after April 14, 2010, but before October 14, 2010 | 100.27% |
| On or after October 14, 2010, but before April 14, 2011 | 100.17% |
| On or after April 14, 2011, but before October 14, 2011 | 100.09% |
| On or after October 14, 2011 | 100.00% |

Collateral. The Notes are secured by first priority, perfected security interests in and pledges or assignments of equity ownership and beneficial interests in the subsidiaries of B&B Air Funding, their interests in the leases of the aircraft they own, cash held by or for them and by their rights under agreements with BBAM, the initial liquidity facility provider, hedge counterparties and the policy provider. Rentals paid under leases are placed in the collections account and paid out according to a priority of payments set forth in the indenture. The Notes are also secured by a lien or similar interest in any of the aircraft in the Initial Portfolio that are registered in the United States or Ireland. B&B Air Funding may not encumber the aircraft in our Initial Portfolio with any other liens except the leases and liens created or permitted thereunder, under the indenture or under the security trust agreement. B&B Air Funding may not incur any indebtedness, except as permitted under the indenture, other than the Notes, any permitted credit and liquidity enhancement facilities and the obligations related to the policy.

Default and Remedies. Events of default under the transaction documents include, among other things: interest on the Notes is not paid on any payment date (after a grace period of five business days) or principal due on the final maturity date is not paid, certain other covenants are not complied with and such noncompliance materially adversely affects the noteholders, B&B Air Funding or any of its significant subsidiaries becomes the subject of insolvency proceedings or a judgment for the payment of money exceeding five percent of the depreciated base value of the Initial Portfolio is entered and remains unstayed for a period of time. Following any such default and acceleration of the Notes by the controlling party (initially, the policy provider), the security trustee may, at the direction of the controlling party, exercise such remedies in relation to the collateral as may be available to it under applicable law, including the sale of any of the aircraft at public or private sale. After the occurrence of certain bankruptcy and insolvency related events of default, or any acceleration of the Notes after the occurrence of any event of default, all cash generated by B&B Air Funding will be used to prepay the Notes and will not be available to us to make distributions to our shareholders or for any other of our liquidity needs.

Certain Covenants. B&B Air Funding is subject to certain operating covenants relating to the maintenance, registration and insurance of the aircraft as set forth in the indenture. The indenture also contains certain conditions and constraints which relate to the servicing and management of the Initial Portfolio including covenants relating to the disposition of aircraft, lease concentration limits restrictions on the acquisition of additional aircraft and restrictions on the modification of aircraft and capital expenditures as described below.

Aircraft Dispositions. The ability of B&B Air Funding to sell aircraft is limited under the Securitization documentation. B&B Air Funding may sell up to ten aircraft without the consent of the policy provider and additional aircraft with the consent of the policy provider provided that such sales do not violate the

concentration limits discussed below and the price is above 107% of the obligations of the notes allocable to such aircraft. B&B Air Funding may also sell aircraft provided that (1) sales in any one year do not exceed 10% of the initial average base value of all our aircraft as adjusted for depreciation as provided in the indenture, (2) such sales do not violate the concentration limits, (3) Moody's confirms its rating on the notes and (4) the policy provider consents.

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Concentration Limits. B&B Air Funding may only enter into a future lease (other than a renewal, extension or restructuring of any lease) if, after entering into such future lease, B&B Air Funding is in compliance with certain criteria in respect of limits based on, among other things, the proportion of our portfolio leased to any single lessee, the regional concentration of our lessees and the sovereign ratings of the countries in which our lessees are located. B&B Air Funding will be permitted to vary from these limits if B&B Air Funding receives a confirmation from Moody's that it will not lower, qualify or withdraw its ratings on the notes as a result of such lease and the policy provider consents to such lease. These limits may place limits on B&B Air Funding's ability (absent a third-party consent) to re-lease the aircraft in our Initial Portfolio to certain customers at certain times, even if to do so would provide the best risk-adjusted cash flow and would be within our risk policies then in effect.

Debt Service Coverage Ratio. From (and including) the monthly period beginning in July 2010 and continuing through July 2012, B&B Air Funding is required to maintain a debt service coverage ratio of 1.80 to 1. In the event that such debt service coverage ratio is not maintained for two consecutive months, all amounts on deposit in the collections account will be applied towards the outstanding principal balance of the notes after the payment of expenses, senior hedge payments and amounts due and owing to the policy provider and the liquidity facility provider.

Leases. When re-leasing any aircraft, B&B Air Funding must do so in accordance with certain core lease provisions set forth in the Indenture. The core lease provisions include, but are not limited to, maintenance, return conditions in respect of the aircraft, lease termination events and prohibitions on the assignments of the leases. These core lease provisions may not be amended without the consent of the policy provider.

Additional Aircraft. B&B Air Funding is not permitted to acquire any aircraft other than the aircraft in the Initial Portfolio unless certain conditions are satisfied, including that the acquisition does not result in an event of default under the transaction documents and does not result in a default under the applicable concentration limits. We have the right to contribute additional aircraft from time to time to B&B Air Funding. In the event that additional notes are issued to finance the acquisition of additional aircraft, B&B Air Funding must obtain the prior written consent of the policy provider and liquidity facility provider and a confirmation from the rating agencies rating the notes that they will not lower, qualify or withdraw their ratings on the notes as a result of the acquisition. Additional aircraft may include, among other things, aircraft, engines and entities with an ownership or leasehold interest in aircraft or engines. Any additional notes issued will rank pari passu in right of payment of principal and interest with B&B Air Funding's outstanding notes. The acquisition of additional aircraft will also require the approval of the directors of B&B Air Funding.

Modification of Aircraft and Capital Expenditures. B&B Air Funding is generally not permitted to make capital expenditures in respect of any optional improvement or modification of an aircraft in the Initial Portfolio, including aircraft conversions from passenger to cargo aircraft, or for the purpose of purchasing or otherwise acquiring any engines or parts outside of the ordinary course of business. However, B&B Air Funding may make capital expenditures in the ordinary course of business in connection with an existing or new lease or the sale of an aircraft, and capital expenditures where: (1) conversions or modifications are funded by capital contributions from us, (2) modification payments are made and the aggregate net cash cost does not exceed 5% of the aggregate initial average base value of the Initial Portfolio (other than modification payments funded, with capital contributions from us) or (3) modification payments permitted under the servicing agreement that do not require the express prior written approval of B&B Air Funding. Subject to certain conditions set forth in the indenture, B&B Air Funding is also permitted to use funds available to make scheduled principal payments on the Notes and amounts available for distributions to us for the purpose of converting passenger aircraft in the Initial Portfolio to freighter or mixed use configuration.

Other Covenants. The Indenture contains other covenants customary for a securitization, including covenants that restrict the investment and business activities of B&B Air Funding, maintain the special purpose and bankruptcy remoteness characteristics of B&B Air Funding, limit the amount and type of debt, guarantees or other indebtedness that can be assumed by B&B Air Funding entities, restrict B&B Air

Funding's ability to grant liens or other encumbrances, require the maintenance of certain airline hull, liability, war risk and repossession insurance and limit the ability of the members of B&B Air Funding to merge, amalgamate, consolidate or transfer assets.

As of December 31, 2009, B&B Air Funding was not in default under the Notes.

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In conjunction with the completion of the Securitization, B&B Air Funding, the cash manager and BNP Paribas, entered into the Note Liquidity Facility for the benefit of the holders of the Notes. The aggregate amounts available under the Note Liquidity Facility will be at any date of determination, the lesser of (a) \$60.0 million and (b) the greater of (i) the then outstanding aggregate principal amount of notes and (ii) \$35.0 million. Advances may be drawn to cover certain expenses of B&B Air Funding, including maintenance expenses, interest rate swap payments and interest on the notes issued under the indenture. Prior to any drawing on the Note Liquidity Facility, the cash reserve will be drawn in full. Upon each drawing under the Note Liquidity Facility, B&B Air Funding is required to reimburse the provider of the Note Liquidity Facility for the amount of such drawing plus accrued interest on such drawing in accordance with the order of priority specified in the indenture prior to making any dividend payments to us. Upon the occurrence of certain events, including a downgrade of the provider of the Note Liquidity Facility below a certain ratings threshold, the Note Liquidity Facility will be drawn in full and the proceeds will be deposited in an account established under the indenture and will be available for the same purposes as drawings under the Note Liquidity Facility. Drawings under the initial Note Liquidity Facility bear interest at one-month LIBOR plus a spread of 1.2%. B&B Air Funding was also required to pay an upfront fee of \$360,000 at closing and a commitment fee of 40 basis points on each payment date to the provider of the Note Liquidity Facility. Our obligations under the Note Liquidity Facility are secured under the security trust agreement on the same basis as other indebtedness of B&B Air Funding.

Aircraft Acquisition Facility

Our subsidiary, B&B Air Acquisition, has a senior secured revolving credit facility with an affiliate of Credit Suisse Securities (USA) LLC, the agent, and several other lenders. The Aircraft Acquisition Facility provided for loans in an aggregate amount of up to \$1.2 billion, \$96.0 million of which constitutes an equity tranche that we have provided to B&B Air Acquisition. Borrowings under the Aircraft Acquisition Facility were used to finance the acquisition of additional aircraft. All borrowings under the Aircraft Acquisition Facility are subject to the satisfaction of terms and conditions, including the absence of a default and the accuracy of representations and warranties.

Availability. The availability period for the Aircraft Acquisition Facility expired on November 6, 2009 and we may not borrow any additional amounts. Under the terms of the facility, the \$96.0 million tranche of equity was drawn first, a \$184.0 million Tranche B of loans was drawn next and a \$920.0 million Tranche A of loans became available thereafter. The loans under Tranche A and Tranche B are limited such that the outstanding amounts under such tranches may not exceed the borrowing base which is equal to the sum of (i) 85% of the appraised value of the aircraft financed under the Aircraft Acquisition Facility, (ii) 50% of maintenance reserves received with respect to such aircraft, and (iii) 100% of the cash collateral (other than maintenance reserves and security deposits) pledged to secure the loans. If the borrowing base falls below this level, in order to avoid an event of default, we would be required to contribute additional collateral to increase the borrowing base or reduce the outstanding principal balance by the amount of the deficiency. As of December 31, 2009, the \$184.0 million and \$96.0 million of Tranche B and equity tranche, respectively, were fully drawn and \$413.5 million under Tranche A had been drawn.

The servicing agreement associated with the Aircraft Acquisition Facility includes the following servicer replacement events, some of which are also potential events of default (as described below under **Defaults and Remedies**):

Babcock & Brown ceases to hold at least 5% of the issued and outstanding shares of B&B Air;

Babcock & Brown ceases to hold at least 51% of the capital stock of BBAM;

BBAM fails to deliver the audited financial statements of Babcock & Brown Limited to the agent and lenders in the Aircraft Acquisition Facility within 120 days of fiscal year end or the unaudited or audited financial statements for each semi-annual period within 90 days, and in each case such failure to deliver the required financial statements continues for 30 days after written notice from the agent (current default with respect to this provision has been waived to April 30, 2010, as described below);

Any Babcock & Brown Limited annual or semi-annual financial statement required to be delivered as described above contains a going-concern or similar qualification;

The insolvency of BBAM or any significant subsidiary of BBAM; and

A BBAM default on recourse debt over \$25 million.

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On the occurrence of a servicer replacement event, B&B Air Acquisition (with the consent of the agent), or the agent on the direction of two-thirds of the Tranche A and Tranche B lenders combined, may terminate the service agreement.

Babcock & Brown Limited, the Australian company that is the holding company for the Babcock & Brown group and the ultimate parent of BBAM, was placed into voluntary administration in Australia on March 13, 2009. As a result, we do not expect that BBAM will be able to deliver audited financial statements of Babcock & Brown Limited to the agent and lenders as required by the servicing agreement related to the Aircraft Acquisition Facility. The agent has approved an extension of the deadline for delivery of the financial statements of Babcock & Brown Limited for the year ended December 31, 2008. In accordance with the terms of the extension, if BBAM is unable to deliver these financial statements by April 30, 2010, the agent may require compliance within 30 days of written notice to BBAM. If BBAM is still unable to comply within this 30 day period, a servicer replacement event will have occurred.

Commitment Fees. Until November 6, 2009, fees of 0.3% per annum were payable on unutilized commitments under Tranche A.

Principal Payments. Commencing November 7, 2009, substantially all cash flow from the aircraft held by B&B Air Acquisition have been applied to repay principal on the loans. The Aircraft Acquisition Facility provides that all amounts outstanding on November 6, 2012, must be repaid in four quarterly installments. In 2009, we made total principal repayments of \$2.9 million.

B&B Air Acquisition may make additional voluntary prepayments under the Aircraft Acquisition Facility. In addition, B&B Air Acquisition is required to make partial prepayments with the proceeds of sales of aircraft financed under the Aircraft Acquisition Facility and a portion of insurance and other proceeds received with respect to any event of total loss of aircraft financed under the Aircraft Acquisition Facility.

Interest. Borrowings and equity drawings under the Aircraft Acquisition Facility bear interest or earn a return at a rate based on the one-month LIBOR plus an applicable margin. Initially, the applicable margin for Tranche A was 1.25% per annum, for Tranche B was 4.00% per annum and for the tranche of equity, a distribution could be made equal to the percentage determined monthly such that the margin for the entire drawn amount of loans and equity under the facility will be 2.5% per annum. Beginning November 7, 2009, the applicable margin on Tranche A was increased to 1.50%. After November 6, 2012, the applicable margin for Tranche A and Tranche B will increase by 0.25% per quarter, up to a maximum margin of 3.75% for Tranche A and 8.00% for Tranche B. We have entered into interest rate swap agreements to minimize the risks associated with borrowings under the Aircraft Acquisition Facility.

Collateral. Borrowings are secured by our equity interest in B&B Air Acquisition, the equity interest in each subsidiary of B&B Air Acquisition, the aircraft and the leases of the aircraft held by B&B Air Acquisition and its subsidiaries and certain cash collateral, maintenance reserves and other deposits. In order of security interest and priority of payment, Tranche A ranks above Tranche B and the tranche of equity, and both Tranche A and B rank above the tranche of equity.

Certain Covenants. B&B Air Acquisition is subject to certain operating covenants relating to the maintenance, registration and insurance of the aircraft owned by it. The Aircraft Acquisition Facility also contains certain conditions and constraints which relate to the servicing and management of the aircraft acquired by B&B Air Acquisition, including covenants relating to the disposition of aircraft, lease concentration limits restrictions on the acquisition of additional aircraft and restrictions on the modification of aircraft and capital expenditures as further described in the agreement. As of December 31, 2009, B&B Air Acquisition was not in default under the Aircraft Acquisition Facility.

Aircraft Dispositions. The ability of B&B Air Acquisition to sell aircraft is limited by the terms of the Aircraft Acquisition Facility. Any sale after the end of the availability period requires prior written consent of the agent and that B&B Air Acquisition must receive a minimum cash sales price equal to at least the debt allocable to that aircraft plus certain expenses.

Concentration Limits. B&B Air Acquisition may only enter into a future lease if, after entering into such future lease, B&B Air Acquisition is in compliance with certain criteria in respect of limits based on, among other things, the proportion of our portfolio leased to any single lessee, the regional concentration of our lessees and aircraft type and age concentration limits. These limits may place limits on B&B Air Acquisition's ability (absent lender consent) to re-lease their aircraft to certain customers at certain times,

even if to do so would provide the best risk-adjusted cash flow and would be within our risk policies then in effect.

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Interest Coverage Ratio. B&B Air Acquisition is required to maintain a monthly interest coverage ratio of at least 1.1 to 1, and a rolling three-month interest coverage ratio of at least 1.25 to 1.

Leases. When re-leasing any aircraft, B&B Air Acquisition must receive agent consent. Follow-on leases must also be in accordance with certain provisions set forth in the Aircraft Acquisition Facility. The requirements include, but are not limited to, maintenance, insurance and minimum lease rental rates and conditions.

Modification of Aircraft and Capital Expenditures. B&B Air Acquisition is generally not permitted to make capital expenditures in respect of any optional improvement or modification of an aircraft if the aggregate cost of such modifications and improvements exceeds 7.5% of the aircraft value determined as of the date the aircraft was acquired, without the prior written consent of the agent.

Other Covenants. The Aircraft Acquisition Facility contains other customary covenants, including covenants that restrict the investment and business activities of B&B Air Acquisition, maintain the special purpose and bankruptcy remoteness characteristics of B&B Air Acquisition, limit the amount and type of debt, guarantees or other indebtedness that can be assumed by B&B Air Acquisition entities, restrict B&B Air Acquisition's ability to grant liens or other encumbrances, require the maintenance of certain airline hull, liability, war risk and repossession insurance and limit the ability of the members of B&B Air Acquisition to merge, amalgamate, consolidate or transfer assets.

Default and Remedies. Events of default under the Aircraft Acquisition Facility include, among other things: interest or principal is not paid when due,

failure to make certain other payments and such payments are not made within 20 business days of receiving written notice,

failure to maintain required insurance levels,

failure to comply with certain other covenants and such noncompliance continuing for 20 business days after receipt of written notice,

B&B Air Acquisition or any of its subsidiaries becoming the subject of insolvency proceedings,

certain early terminations of B&B Air Acquisition's swap agreements,

failure to meet interest coverage ratios,

Babcock & Brown ceasing to hold at least 5% of the issued and outstanding shares of B&B Air; and

Babcock & Brown ceasing to hold at least 51% of the capital stock of BBAM.

As of December 31, 2009, B&B Air Acquisition was not in default under the Aircraft Acquisition Facility.

Babcock & Brown has informed us that BBIPL, which is both the main operating and asset-owning entity in the Babcock & Brown group, continues to pursue its revised business plan to sell all of its assets. Although no definitive transaction has been announced, we expect Babcock & Brown to sell substantially all of its aviation-related assets, including the assets and servicing agreements associated with BBAM and the common shares of B&B Air owned by them. These sales could result in a servicer replacement event and an event of default under the Aircraft Acquisition Facility.

If any event of default occurs (other than B&B Air Acquisition or any of its subsidiaries becoming the subject of insolvency proceedings), the agent, on the request of 2/3 of the Tranche A and Tranche B lenders combined may demand immediate repayment of all outstanding borrowings under the Aircraft Acquisition Facility. After the

occurrence of certain bankruptcy and insolvency related events of default or any acceleration of the amounts due under the facility after the occurrence of an event of default, all cash generated by B&B Air Acquisition will be used to repay amounts due under the facility and will not be available to us. Each of these events is beyond our control and could have a material adverse effect on our business. In general, the consent of 2/3 of the Tranche A and Tranche B lenders combined is required to amend the Aircraft Acquisition Facility.

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Credit Facility

In June 2009, we entered into the \$32.3 million Credit Facility with an international commercial bank. As of December 31, 2009, we had borrowed \$32.3 million under the agreement. The Credit Facility is secured by a pledge of our rights, title and interest in \$119.4 million principal amount of Notes purchased by a wholly-owned subsidiary of B&B Air.

There are no scheduled principal payments due during the term of the Credit Facility. Interest is payable monthly and equal to the interest proceeds on the pledged Notes. The Credit Facility is scheduled to mature on August 16, 2010 but provides for two 1-year extension options upon the payment of a fee at each extension date equal to 2.5% of the then-outstanding principal amount.

We are subject to certain interest coverage ratios and other financial covenants as specified in the Credit Facility. As of December 31, 2009, we were not in default under the Credit Facility.

Capital Expenditures

We made no aircraft acquisitions during the year ended December 31, 2009.

During the year ended December 31, 2008, we acquired and took delivery of the following aircraft:

One Airbus A320-200 on lease to Vueling (Spain), formerly Clickair;

One Boeing 757-200 on lease to Icelandair (Iceland);

One Boeing 757-200SF on lease to Icelandair (Iceland);

One Boeing 777-200ER on lease to KLM (The Netherlands);

One Airbus A330-200 on lease to LTU (Germany);

One Boeing 737-800 on lease to Sky Airlines (Turkey);

One Boeing 737-900ER on lease to SpiceJet (India);

One Boeing 747-400 on lease to United Air Lines (USA);

One Airbus A319-100 on lease to Virgin America (USA); and

One Airbus A320-200 on lease to Virgin America (USA).

During December 2007, we acquired and took delivery of the following aircraft:

Four Airbus A319-100s on lease to US Airways (USA);

One Airbus A320-200 on lease to Vueling (Spain), formerly Clickair;

One Boeing 737-900ER on lease to SpiceJet (India); and

One Boeing 757-200 on lease to Icelandair (Iceland).

In addition to acquisitions of aircraft and other aviation assets, we expect to make capital expenditures from time to time in connection with improvements to our aircraft. These expenditures include the cost of major overhauls and modifications. As of December 31, 2009, the weighted average age of the aircraft in our portfolio was 7.3 years. In general, the costs of operating an aircraft, including capital expenditures, increase with the age of the aircraft.

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The effects of inflation on our operating expenses have been minimal. We do not consider inflation to be a significant risk to direct expenses in the current economic environment.

Foreign Currency Exchange Risk

We receive a substantial portion of our revenue in U.S. Dollars, and we pay substantially all of our expenses in U.S. Dollars. However, we incur some of our expenses in other currencies, primarily the Euro, and we have entered into a lease under which we receive a portion of the lease payments in Euros. Depreciation in the value of the U.S. Dollar relative to other currencies increases the U.S. Dollar cost to us of paying such expenses. The portion of our business conducted in other currencies could increase in the future, which could expand our exposure to losses arising from currency fluctuations. To mitigate such exposure, we enter into foreign currency hedging transactions. Because we currently receive substantially all of our revenue in U.S. Dollars and pay substantially all of our expenses in U.S. Dollars, a change in foreign exchange rates would not have a material impact on our results of operations.

Research and Development, Patents and Licenses, etc.

Not applicable.

Off-Balance Sheet Arrangements

Not applicable.

Contractual Obligations

Our long-term contractual obligations as of December 31, 2009 consists of the following (in thousand):

| | 2010 | 2011 | 2012 | 2013 | 2014 | Thereafter | Total |
|---|----------|----------|-----------|-----------|-----------|------------|------------|
| Principal payments under the Notes(1) | \$ 9,245 | \$ 9,186 | \$ 37,453 | \$ 80,131 | \$ 85,027 | \$ 437,634 | \$ 658,676 |
| Interest payments under the Notes(2) | 5,958 | 5,830 | 5,692 | 5,093 | 4,344 | 8,889 | 35,806 |
| Principal payments under the Aircraft Acquisition Facility (3) | 30,043 | 31,665 | 155,021 | 377,837 | | | 594,566 |
| Interest payments under the Aircraft Acquisition Facility (4) | 14,853 | 14,330 | 13,557 | 5,068 | | | 47,808 |
| Principal payments under the Credit Facility(5) | 32,290 | | | | | | 32,290 |
| Interest payments under the Credit Facility(5) | 404 | | | | | | 404 |
| Payments to affiliates of B&B under our management agreement(6) | 6,219 | 6,219 | 6,219 | 6,219 | 6,219 | 110,382 | 141,477 |
| Payments to affiliates of B&B under our administrative servicing agreement for our Initial Portfolio(7) | 777 | 777 | 777 | 777 | 777 | 3,111 | 6,996 |
| | 3,055 | 3,017 | 2,992 | 1,848 | | | 10,912 |

| | | | | | | | |
|--|------------|-----------|------------|------------|-----------|------------|--------------|
| Payments to affiliates of B&B under our servicing agreements for additional aircraft(8) | | | | | | | |
| Payments to affiliates of B&B under our servicing agreement for our Initial Portfolio(9) | 3,232 | 2,924 | 2,731 | 2,361 | 2,154 | 5,143 | 18,545 |
| Total | \$ 106,076 | \$ 73,948 | \$ 224,442 | \$ 479,334 | \$ 98,521 | \$ 565,159 | \$ 1,547,480 |

(1) Until July 2010, there are no scheduled principal payments on the Notes. For each month between July 2010 and August 2012, there are scheduled principal payments in fixed amounts of approximately \$1.0 million per month, in each case subject to satisfying certain debt service coverage ratios and other covenants. Thereafter, cash flow will not be available to us for the payment of dividends since principal payments are not fixed in amount but rather are determined monthly based

on revenues
collected and
costs and other
liabilities
incurred prior to
the relevant
payment date.
The final
maturity of the
Notes is
November 14,
2033.

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- (2) Interest payments assume LIBOR remains at the current rate through the term of the Notes and reflect amounts we expect to pay after giving effect to interest swaps and amounts payable to our policy provider.

- (3) Commencing November 7, 2009, B&B Air Acquisition began making principal payments under its Aircraft Acquisition Facility. Subject to an extension by the lenders as provided in the agreement, all amounts outstanding on November 6, 2012 must be repaid in four quarterly installments.

- (4) Interest payments assume LIBOR remains at the current rate through the term of the facility and reflect amounts we expect to pay after giving effect to interest swaps.

- (5) There are no scheduled principal payments due during the term of the Credit Facility. Interest is payable monthly and equal to the interest proceeds on the pledged Notes. The Credit Facility is

scheduled to mature on August 16, 2010 but provides the Company with two 1-year extension options upon the payment of a fee at each extension date equal to 2.5% of the then-outstanding principal amount.

- (6) Our management agreement provides that we pay base and rent fees and a management expense amount of \$6.0 million annually, adjusted for increases in the consumer price index (CPI), to our Manager. Base and rent fees paid to BBAM under our servicing agreements are credited toward (and thereby reduce) such fees payable under our management agreement and the amounts in the table assume that such credit reduces the base and rent fees payable under the management agreement to \$0. See Management Agreement.
- (7) Our management agreement provides that we pay our Manager an administrative agency fee initially equal to \$750,000 per annum, adjusted for CPI increases, for each

aircraft securitization financing we complete.

(8) The servicing agreement between BBAM and B&B Air Acquisition provide that they pay BBAM an administrative agency fee of \$20,000 per month. B&B Air Acquisition will also pay BBAM a rent fee equal to 3.5%, respectively, of the aggregate amount of basic rent actually collected for all or any part of a month. Amounts in the table reflect the rent fee for our aircraft as of December 31, 2009.

(9) Our servicing agreement for our Initial Portfolio provides that we will pay BBAM a base fee of \$150,000 per month, adjusted for CPI increases, which will also increase by 0.01% of the maintenance-adjusted base value (at the time of acquisition) of each additional aircraft acquired into B&B Air Funding that is not an aircraft in our Initial Portfolio. We will also pay BBAM a rent fee equal to 1.0%, of the aggregate amount of basic rent actually collected for all or any part of a month for any of their aircraft plus 1.0% of

the aggregate amount of basic rent due for all or any part of a month for any of our aircraft. Amounts in the table reflect the rent fee for aircraft in B&B Air Funding s portfolio as of December 31, 2009.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

The following table presents information about our directors and executive officers. The business address of each of our directors and executive officers listed below is West Pier, Dun Laoghaire, County Dublin, Ireland. Our telephone number at that address is +353 1 231-1900.

| Name | Age | Position |
|-------------------|------------|--------------------------------------|
| Colm Barrington | 64 | Chief Executive Officer and Director |
| Gary Dales | 54 | Chief Financial Officer |
| Steven Zissis | 50 | Chairman and Director |
| James Fantaci | 63 | Director |
| Erik G. Braathen | 54 | Director |
| Sean Donlon | 70 | Director |
| Joseph M. Donovan | 55 | Director |
| Susan M. Walton | 50 | Director |

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Colm Barrington has been our chief executive officer and a member of our board of directors since May 2007. Mr. Barrington has approximately 40 years of global experience in the aviation industry, having started his aviation career in 1967 at Ireland's national airline, Aer Lingus. In 1979, he joined GPA Group plc where he held various senior positions, including chief operating officer. Upon GECAS's agreement in 1993 to manage GPA's assets, Mr. Barrington oversaw the successful integration of the two companies. In 1994, he joined Babcock & Brown Limited in Ireland where he worked in aircraft and lease management and arranging cross border lease financings of commercial aircraft. Mr. Barrington is the Non-Executive Chairman of the Board of Directors of Aer Lingus plc and a director of IFG Group plc. Mr. Barrington received a BA and an MA in Economics from University College Dublin. He also received a public administration degree from the Institute of Public Administration, also in Dublin.

Gary Dales has been our chief financial officer since March 17, 2008 and has been with Babcock & Brown since August 2007. Mr. Dales' prior position was director of corporate development at PG&E Corporation, an energy based holding company. Prior to assuming that position, Mr. Dales served in various other financial roles at PG&E since 1994, including director of corporate accounting and SEC reporting. Prior to joining PG&E, Mr. Dales was a staff accountant, and later a manager, in the accounting and audit division at Arthur Andersen & Co. for more than 10 years. Mr. Dales graduated from the University of California, Santa Barbara with a BA in Business Economics.

Steven Zissis has been our chairman and a member of our board of directors since June 2007. Mr. Zissis is the President of BBAM. Prior to joining Babcock & Brown in 1990, Mr. Zissis was a vice president of Citibank, where he was also a founder and manager of the Portfolio Acquisition and Divestiture team. Mr. Zissis graduated from Rhodes College with a degree in Finance and International Studies.

James Fantaci has been a member of our board of directors since May 2007. Although now retired from Babcock & Brown, Mr. Fantaci had coordinated all of Babcock & Brown's operating leasing activities worldwide until November 2008. Prior to joining Babcock & Brown in 1982, Mr. Fantaci was senior vice president of the New York office of Matrix Leasing International and prior to that he served as assistant treasurer of the Bank of New York. Mr. Fantaci attended the New School for Social Research and graduated from Brooklyn College with a degree in Economics.

Erik G. Braathen has been a member of our board of directors since June 2007. Mr. Braathen has been the chief executive of Ojada AS, a privately owned investment company, since 1999. Prior to joining Ojada AS, Mr. Braathen was the chief executive officer of Braathens ASA where he gained extensive experience in the airline industry from 1986 to 1999. Mr. Braathen is a member of the boards of directors of Protector Insurance ASA, Sayonara AS and Ojada AS. Mr. Braathen has a Master of International Management from AGSIM, Phoenix Arizona, and a Bachelor of Arts & Economics from the University of Washington.

Sean Donlon has been a member of our board of directors since June 2007. Mr. Donlon has served as the chancellor of the University of Limerick, Ireland from 2002 to 2008. Mr. Donlon has previously worked with the GPA Group plc, as well as with GE Capital Aviation Services. Prior to entering the private sector, he had a long career in the Irish public service, having been Irish Ambassador to the United States of America and Secretary General of the Department of Foreign Affairs. Mr. Donlon is a director of Aviva Life International Ltd., Enba plc, the University of Limerick Foundation Ltd. and chairman of the BIRR Scientific and Heritage Foundation Ltd. Mr. Donlon is a graduate of the University College Dublin and was conferred with an Honorary Doctorate of Civil and Canon Laws by the National University of Ireland in December 2008 and an Honorary Doctorate of Laws by the University of Limerick in January 2009.

Joseph M. Donovan has been a member of our board of directors since June 2007. Prior to his retirement in January 2007, Mr. Donovan was chairman of Credit Suisse's asset-backed securities and debt financing group, which he led for nearly seven years. Prior thereto, Mr. Donovan was a managing director and head of asset finance at Prudential Securities (1998-2000) and Smith Barney (1995-1997). Mr. Donovan began his banking career at The First Boston Corporation in 1983, ultimately becoming a managing director at CS First Boston, where he served as Chief Operating Officer of the Investment Banking Department from 1992 to 1995. Mr. Donovan is a director of Cohen & Company and Homeownership Preservation Foundation. Mr. Donovan received his MBA from The Wharton School and has a degree in Accountancy from the University of Notre Dame.

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Susan M. Walton has been a member of our board of directors since June 2007. Ms. Walton is currently a sub-regional director of the environmental charity Groundwork London. Until February 2008, Ms. Walton was the chief executive of Hampshire & Isle of Wight Wildlife Trust (HWT), a leading wildlife conservation charity in England, where she was responsible for biodiversity projects in two counties and developing partnerships with key stakeholder groups. Prior to joining HWT in 2006, she served as general manager structured finance and export credit, for Rolls-Royce Capital Limited for nine years. Ms. Walton was also a Principal at Babcock & Brown from 1989 to 1997 where she was responsible for producing and implementing Babcock & Brown s annual European marketing plan. Ms. Walton is a trustee for the Sussex Wildlife Trust, a trustee for Buglife The Invertebrate Conservation Trust and a member of the High Weald AONB Sustainable Development Fund Panel. Ms. Walton holds a degree in Environmental Conservation from Birkbeck College, University of London.

Compensation of Directors

Each independent member of our board of directors receives an annual cash retainer of \$100,000 payable in equal quarterly installments. Our lead independent director receives an additional \$25,000 per year. Each independent director who is a chairman of a committee of the board of directors receives an additional \$15,000 per year. We paid to our directors aggregate cash compensation of \$0.6 million for services rendered during 2009. We do not have a retirement plan for our directors.

Executive Compensation

We do not have any employees. Pursuant to the management agreement we have with our Manager, we have the dedicated services of our Manager s chief executive officer and chief financial officer, who serve as our chief executive officer and chief financial officer, respectively, by appointment of our board of directors but who also remain employees of B&B. The services performed by our chief executive officer and chief financial officer are provided at the cost of our Manager or an affiliate of our Manager. Our Manager or an affiliate of our Manager, in consultation with the compensation committee of our board of directors, determines and pays the compensation of our chief executive officer and chief financial officer. We do not provide retirement benefits to any officer or employee.

Board of Directors

Our board of directors currently consists of seven members. Our bye-laws provide that the board of directors is to consist of a minimum of two and a maximum of 15 directors as the board of directors may from time to time determine. Pursuant to our management agreement and our bye-laws, so long as B&B holds any of our manager shares, our Manager has the right to appoint the whole number of directors on our board of directors that is nearest to but not more than 3/7ths of the number of directors on our board of directors at the time. These directors are not required to stand for election by shareholders other than our Manager.

A majority of our directors are independent as defined under the applicable rules of the New York Stock Exchange.

Committees of the Board

The standing committees of our board of directors consist of an audit committee, a compensation committee and a nominating and corporate governance committee. These committees are described below. Our board of directors may also establish various other committees to assist it in its responsibilities.

Audit Committee

Our Audit Committee is concerned primarily with the accuracy and effectiveness of the audits of our financial statements by our independent auditors. Its duties include:

- selecting independent auditors for approval by our shareholders;
- reviewing the scope of the audit to be conducted by our independent auditors, as well as the results of their audit;
- approving audit and non-audit services provided to us by the independent auditors;
- reviewing the organization and scope of our internal system of audit, financial and disclosure controls;

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overseeing internal controls and risk management;
overseeing our financial reporting activities, including our annual report, and the accounting standards and principles followed;
reviewing and approving related-party transactions and preparing reports for the board of directors on such related-party transactions; and
conducting other reviews relating to compliance by our employees with our policies and applicable laws.

Each of the members of the Audit Committee is an independent director as defined under the applicable rules of the New York Stock Exchange. Mr. Donovan, Mr. Donlon and Mr. Braathen have served on the Audit Committee since June 2007, and Mr. Donovan serves as chairperson.

Compensation Committee

Our Compensation Committee will be consulted by our Manager regarding the remuneration of our chief executive and chief financial officers and will be responsible for determining the compensation of our independent directors. Each of the members of the Compensation Committee is an independent director as defined under the applicable rules of the New York Stock Exchange. Mr. Braathen, Mr. Donlon and Ms. Walton have served on the Compensation Committee since June 2007, and Mr. Braathen serves as chairperson.

Nominating and Corporate Governance Committee

Our Nominating and Corporate Governance Committee's responsibilities include the selection of potential candidates for our board of directors and the development and annual review of our governance principles. This committee also makes recommendations to our board of directors concerning the structure and membership of the other board committees. Each of the members of the Nominating and Corporate Governance Committee is an independent director as defined under the applicable rules of the New York Stock Exchange. Mr. Donlon, Ms. Walton and Mr. Braathen have served on the Nominating and Corporate Governance Committee since June 2007, and Mr. Donlon serves as chairperson.

Lead Independent Director

Mr. Donovan serves as the lead independent director on our board of directors.

Our Management

Pursuant to a management agreement, we have appointed Babcock & Brown Air Management Co. Limited, a wholly owned subsidiary of Babcock & Brown, as our Manager to provide management and services to us. In discharging its duties under the management agreement, our Manager uses the resources provided to it by Babcock & Brown. These resources include the dedicated services of Messrs. Colm Barrington and Gary Dales, who serve as our chief executive officer and chief financial officer, respectively, but who also remain employees of Babcock & Brown, the dedicated services of other members of our Manager's core management team, and the non-exclusive services of other personnel employed by Babcock & Brown.

Our chief executive officer and chief financial officer manage our day-to-day operations and affairs on a permanent and wholly dedicated basis. Our board of directors, chief executive officer and chief financial officer have responsibility for overall corporate strategy, acquisitions, financing and investor relations.

Share Ownership

None of our directors or executive officers individually own more than 1% of our outstanding common shares.

Table of Contents**ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**

The table below sets forth certain information regarding the beneficial ownership of our ADSs by each person known by us to be a beneficial owner of more than 5% of our ADSs as of February 28, 2010:

| Name | Shares Beneficially Owned | |
|--|----------------------------------|----------------|
| | Number | Percent |
| Babcock & Brown Limited | 4,422,529 | 14.6% |
| Thornburg Investment Management Inc. (1) | 1,943,500 | 6.4% |
| Neuberger Berman Group LLC (2) | 1,896,125 | 6.3% |

(1) The information above and in this footnote is based on information taken from the Schedule 13G filed by Thornburg Investment Management Inc. with the SEC on January 8, 2010. Thornburg Investment Management Inc. has sole voting power and sole dispositive power over 1,943,500 ADSs.

(2) The information above and in this footnote is based on information taken from the Schedule 13G filed by Neuberger Berman Group LLC with the SEC on June 11, 2009.

Neuberger
Berman Group
LLC and
Neuberger
Berman LLC
have sole voting
power over
1,220,800 ADSs
and shared
dispositive
power over
1,896,125
ADSs.

All ADS holders have the same voting rights.

As of February 26, 2010, 2,800 of our ADSs were held by 5 holders of record in the United States, not including ADSs held of record by Depository Trust Company, or DTC. As of February 26, 2010, DTC was the holder of record of 23,817,728 ADSs. To the best of our knowledge, 7,300 ADSs were beneficially owned by holders with U.S. addresses.

We are not aware of any arrangements, the operation of which may at a subsequent date result in a change of control.

Manager Shares

Our Manager owns 100 manager shares that are entitled to director appointment rights and the right to vote on amendments to the provision of our bye-laws relating to termination of our management agreement with them. Manager shares will not convert into common shares. Upon a termination of our management agreement, the manager shares will cease to have any appointment and voting rights and, to the extent permitted under Section 42 of Companies Act 1981 (Bermuda), will be automatically redeemed for their par value. Manager shares are not entitled to receive any dividends and, other than with respect to director appointment rights, holder of manager shares have no voting rights.

Related Party Transactions

In April 2009, we repurchased a total of 2,208,963 of our ADSs from affiliates of Babcock & Brown who also were investors in JET-i Leasing, for an average price of \$4.08 per ADS pursuant to a stock purchase agreement. The price per share paid was calculated based on 90% of the five-day value weighted average price, as defined in the agreement, preceding the trade day.

| | Date | ADSs Repurchased | Price per share |
|--|----------------|-----------------------------|----------------------------|
| BBGP Aircraft Holdings Ltd | April 1, 2009 | 2,074,528 | \$ 4.05 |
| Babcock & Brown Cayman Ltd | April 9, 2009 | 63,761 | \$ 3.86 |
| Babcock & Brown Direct Investment Fund Ltd | April 30, 2009 | 70,674 | \$ 5.25 |

On December 31, 2008, we repurchased 961,539 of our ADSs from BBGP Aircraft Holdings Ltd. for a price of \$5.20 per ADS pursuant to a stock purchase agreement. The price per share paid was calculated based on 90% of the five-day value weighted average price, as defined in the agreement, preceding the trade day.

We have entered into agreements with BBAM and its affiliates that effect the transactions relating to our ongoing operations and business. Although the pricing and other terms of these agreements were reviewed by our management and the independent directors of our board of directors, they were determined by entities affiliated with Babcock & Brown. As a result, provisions of these agreements may be less favorable to us than they might have been had they been the result of transactions among unaffiliated third parties. See Management Agreement.

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MANAGEMENT AGREEMENT

General

We entered into a management agreement with our Manager, concurrently with the completion of our IPO. In discharging its duties under the management agreement, our Manager uses the resources provided to it by Babcock & Brown. These resources include the dedicated services of Messrs. Colm Barrington and Gary Dales, who serve as our chief executive officer and chief financial officer, respectively, but also remain employees of Babcock & Brown, the dedicated services of other members of our Manager's core management team and the non-exclusive services of other personnel employed by Babcock & Brown.

Our Manager's core management team consists of the Manager's chief executive officer, chief financial officer and that level of dedicated or shared support personnel, such as corporate counsel, company secretary, financial controller and other accounting staff and risk and compliance personnel, as our Manager reasonably determines is necessary to provide the management and administrative services described below.

Services

Our Manager's duties and responsibilities under the management agreement include the provision of the services described below. The management agreement requires our Manager to manage our business and affairs in conformity with the policies and investment guidelines that are approved and monitored by our board of directors. Our Manager may delegate the provision of all or any part of the services to any person affiliated or associated with Babcock & Brown.

Management and Administrative Services. Our Manager provides us with the following management and administrative services:

managing our portfolio of aircraft and other aviation assets and the administration of our cash balances;

if requested by our board, making available a member of the core management team of our Manager as our nominee on the board of directors of any of our subsidiaries (provided that each such member must be agreed between us and our Manager);

assisting with the implementation of our board's decisions;

providing us suitably qualified and experienced persons to perform the management and administrative services for us and our subsidiaries, including persons to be appointed by our board to serve as our dedicated chief executive and chief financial officers (who shall remain employees of, and be remunerated by, our Manager or an affiliate of our Manager while serving in such capacities);

performing or procuring the performance of all reasonable accounting, tax, corporate secretarial, information technology, reporting and compliance services for us and our subsidiaries, including the preparation and maintenance of our accounts and such financial statements and other reports and filings as we are required to make with any governmental agency (including the SEC) or stock exchange;

supervising financial audits of us by an external auditor as required;

managing our relations with our investors and the public, including:

preparing our annual reports and any notices of meeting, papers, reports and agendas relating to meetings of our shareholders; and

assisting in the resolution of any complaints by or disputes with our investors and any litigation involving us (other than litigation in which our interests are adverse to those of our Manager or Babcock & Brown); and using commercially reasonable efforts to cause us to comply with all applicable laws.

Origination and Disposition Services. Our Manager also provides us with the following origination and disposition services:

sourcing opportunities relating to aircraft and other aviation assets, including using its commercially reasonable efforts to notify us of potential aviation asset investment opportunities that come to the attention of our Manager and which our Manager acting reasonably believes may be of interest to us as investments;

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in relation to identified potential opportunities to purchase or sell aircraft and other aviation assets, investigating, researching, evaluating, advising and making recommendations on or facilitating such opportunities;

with respect to prospective purchases and sales of aircraft and other aviation assets, conducting negotiations with sellers and purchasers and their agents, representatives and financial advisors; and

otherwise providing advice and assistance to us in relation to the evaluation or pursuit of aviation asset investment or disposition opportunities as we may reasonably request from time to time.

We are under no obligation to invest in or to otherwise pursue any aviation asset investment or disposal opportunity identified to us by our Manager pursuant to the management agreement. Neither Babcock & Brown nor any of its affiliates or associates are restricted from pursuing, or offering to a third party, including any party managed by, or otherwise affiliated or associated with, Babcock & Brown, or are required to establish any aviation asset investment protocol in relation to prioritization of, any aviation asset investment or disposal opportunity identified to us by our Manager pursuant to the management agreement.

Ancillary Management and Administrative Services. Our Manager also provides us with ancillary management and administrative services upon such terms as may be agreed from time to time between us and our Manager, which may require, among other things if requested by our board of directors:

the expansion of our Manager's core management team with additional personnel as may be required by developments or changes in the commercial aircraft leasing industry (whether regulatory, economic or otherwise) or the compliance or reporting environment for publicly listed companies in the United States (whether as a result of changes to securities laws or regulations, listing requirements or accounting principles or otherwise); and making available individuals (other than members of our Manager's core management team) as our nominees on the boards of directors of any of our subsidiaries.

Servicing

For so long as our Manager's appointment is not terminated, we agree to engage BBAM as the exclusive Servicer for any additional aircraft or other aviation assets that we acquire in the future on terms substantially similar to those set forth in the servicing agreement for our Initial Portfolio or the servicing agreement between B&B Air Acquisition and BBAM or on such other terms as we and BBAM may agree.

Competitors. In the management agreement, we agreed not to sell B&B Air Funding or any of its subsidiaries, or any of our other subsidiaries, receiving services from BBAM pursuant to a servicing agreement to a competitor of BBAM, or to any party that does not agree in a manner reasonably acceptable to BBAM to be bound by the provisions of the applicable servicing agreement, and we agreed not to permit competitively sensitive information obtained from BBAM to be provided to any such competitor even if such competitor is a shareholder or has the right to elect a member of our board of directors. We may also be required to screen certain of our directors and employees from competitively sensitive information provided by BBAM.

Compliance With Our Strategy, Policy and Directions

In performing the services, our Manager is required to comply with our written policies and directions provided to our Manager from time to time by our board of directors unless doing so would contravene any law or the express terms of the management agreement.

Notwithstanding the above, we may not make any decision, take any action or omit to take any action in relation to the acquisition, disposition or management of any aircraft or other aviation assets, unless:

that matter has been the subject of a recommendation by our Manager; or
the failure to make that decision, take that action or omit to take that action would breach the fiduciary duties of our directors or any law.

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In addition, we may not direct our Manager (unless the direction is otherwise permitted under the management agreement) to make any decision, take any action or omit to take any action in relation to the acquisition, disposition or management of any aircraft or other aviation asset, and our Manager is not obliged to comply with any such direction if given by us, unless:

- that matter has been the subject of a recommendation by our Manager; or
- the failure to make that decision, take that action or omit to take that action would breach the fiduciary duties of our directors or any law.

Notwithstanding the foregoing, we may direct our Manager to review a proposed decision, action or omission to take an action in relation to the acquisition, disposition or management of any aircraft or other aviation asset and require that within a reasonable period of time our Manager either make or decline to make a recommendation with respect thereto.

Appointment of Our Chief Executive Officer and Chief Financial Officer

Although our chief executive officer and chief financial officer are employees of our Manager (or an affiliate of our Manager), they serve us in such corporate capacities by appointment by our board of directors. The management agreement acknowledges that our board may terminate our chief executive officer or chief financial officer without our Manager's consent. The management agreement provides that if there is a vacancy in such position for any reason, then our Manager will recommend a candidate to serve as replacement chief executive officer or chief financial officer. If our board of directors does not appoint the initial candidate proposed by our Manager to fill such vacancy, then our Manager will be required to recommend one or more further candidates until our board appoints a candidate recommended by our Manager for such vacancy.

Restrictions and Duties

Our Manager has agreed that it will use reasonable care and diligence and act honestly and in good faith at all times in the performance of the services under the management agreement. We refer to the foregoing standard as the "standard of care" required under the management agreement.

Under the management agreement, our Manager may not, without our board's prior consent:

- (1) carry out any transaction with an affiliate of our Manager on our behalf, it being understood that Babcock & Brown affiliates have been appointed as the exclusive Servicer for our portfolio of aircraft, and that our Manager may delegate the provision of all or any part of the services under the management agreement to any person affiliated or associated with Babcock & Brown;
- (2) carry out any aviation asset investment or disposition transaction, or sequence of related aviation asset investment or disposition transactions with the same person or group of persons under common control, for us if the aggregate purchase price to be paid or the gross proceeds to be received by us in connection therewith would exceed \$200 million;
- (3) carry out any aviation asset investment or disposition transaction if the sum of all the purchase prices to be paid or of all the gross proceeds to be received by us in connection with all such transactions during any quarter would exceed \$500 million;
- (4) appoint or retain any third-party service provider to assist our Manager in providing management and administrative services if:
 - the amount to be paid by our Manager and reimbursed by us or paid by us to the third party with respect to any particular matter, or series of related matters, is reasonably likely to exceed \$1 million; or
 - as a result of the appointment or retention, the amount to be paid by our Manager and reimbursed by us or paid by us to all such third-party service providers appointed or retained in any rolling 12-month period is reasonably likely to exceed \$5 million;
- (5) appoint or retain any third-party service provider to assist our Manager in providing ancillary management and administrative or the origination and disposition services if:
 - the amount to be paid by our Manager and reimbursed by us or paid by us to the third party with respect to any particular matter, or series of related matters, is reasonably likely to exceed \$1 million; or

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as a result of the appointment or retention, the amount to be paid by our Manager and reimbursed by us or paid by us to all such third-party service providers appointed or retained in any rolling 12-month period is reasonably likely to exceed \$7.5 million; or

- (6) hold any cash or other assets of ours, provided that our Manager may cause our cash and other assets to be held in our name or any custodian for us nominated or approved by us.

The thresholds discussed in clauses (4) and (5) above are reviewed regularly by us and our Manager and may be increased by our board of directors (but shall not be decreased) having regard to changes in the value of money, changes in our market capitalization and any other principles agreed between us and our Manager. The thresholds discussed in clauses (2) and (3) may be increased or decreased by our board of directors in its sole discretion at any time by notice to our Manager. Amounts relating to transactions and third-party service providers entered into, appointed or retained by Babcock & Brown on our behalf pursuant to our servicing agreements or administrative agency agreements are not included in determining whether the thresholds discussed under this heading have been met or exceeded. Acquisitions of series of aircraft from nonaffiliated-persons are deemed not to be related matters for purposes of this provision.

Relationship of Management Agreement and Servicing Agreements

To the extent that BBAM is entitled to exercise any authority, enter into any transaction or take any action on our behalf pursuant to any of our servicing agreements or administrative agency agreements, such servicing agreement or administrative agency agreement shall govern such exercise of authority, transaction or authority in the event of a conflict between the management agreement and such servicing agreement or administrative agency agreement.

Board Appointees

Pursuant to the management agreement and our bye-laws, for so long as Babcock & Brown holds any of our manager shares, our Manager has the right to appoint the whole number of directors on our board of directors that is nearest to but not more than 3/7ths of the number of directors on our board of directors at the time. Our Manager's appointees on our board of directors are not required to stand for election by our shareholders other than by our Manager.

Our Manager's board appointees do not receive any compensation from us (other than out-of-pocket expenses) and do not have any special voting rights. The appointees of our Manager shall not participate in discussions regarding, or vote on, any related-party transaction in which any affiliate of our Manager has an interest. Our independent directors are responsible for approving any such related-party transactions.

Fees and Expenses

Pursuant to the management agreement, we pay our Manager the fees and pay or reimburse our Manager for the expenses described below.

Management and Administrative Services

Base and Rent Fees. In respect of the aircraft in our Initial Portfolio and any other aircraft we may acquire that will be held by B&B Air Funding or any of its subsidiaries or any other subsidiary we establish for the purpose of entering into an aircraft securitization financing, we pay our Manager:

a base fee of \$150,000 per month per subsidiary we establish for the purpose of entering into an aircraft securitization financing, which will increase by 0.01% of the maintenance-adjusted base value (at the time of acquisition) of each additional aircraft acquired beyond the Initial Portfolio, in the case of B&B Air Funding, or beyond the initial portfolio of aircraft financed with the proceeds of the applicable aircraft securitization financing (the amount of the base fee will be subject to adjustment as set forth below under Fees and Expenses Adjusting the Base Fees and Administrative Agency Fees); and

a rent fee equal to 1.0% of the aggregate amount of basic rent due for all or any part of a month for any of such aircraft plus 1.0% of the aggregate amount of basic rent actually paid for all or any part of a month for any of such aircraft.

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In 2009 and 2008, the base and rent fees we incurred and payable to the Manager were approximately \$4.6 million and \$4.8 million, respectively. However, this entire amount was offset by servicing fees paid to BBAM pursuant to our servicing agreements. See Fees and Expenses Credit for Servicing Fees Paid.

In respect of any aircraft we acquire that is held by B&B Air Acquisition or any of its subsidiaries, we will pay our Manager a fee equal to 3.5% of the aggregate amount of basic rent actually paid for all or any part of a month for any such aircraft. In 2009 and 2008, the rent fees we incurred and that were payable to the Manager were approximately \$2.8 million and \$2.3 million, respectively.

Incentive Fee. The management agreement includes an incentive for our Manager to increase our distributable cash flow by providing for an incentive fee that is payable to our Manager only if the quarterly dividend on our common shares exceeds specified targets. For the purpose of calculating the amount of the incentive fee payable to our Manager, a notional amount will be utilized. The notional amount for any quarter will be equal to the aggregate dividend paid on all of our common shares for such quarter plus any incentive fee payable to our Manager for such quarter as calculated in the following manner:

100% of the notional amount will be paid as a dividend on our common shares, without the payment of any incentive fee to our Manager, up to a dividend of \$0.575 per common share;

90% of the incremental notional amount in excess of \$0.575 per common share will be paid as a dividend on our common shares and 10% of the incremental notional amount will be paid to our Manager as an incentive fee until each common share receives a dividend of \$0.650;

80% of the incremental notional amount in excess of \$0.650 per common share will be paid as a dividend on our common shares and 20% of the incremental notional amount will be paid to our Manager as an incentive fee until each common share receives a dividend of \$0.800; and

75% of the incremental notional amount in excess of \$0.800 per common share will be paid as a dividend on our common shares and 25% of the incremental notional amount will be paid to our Manager as an incentive fee.

No incentive fee was paid in 2009 or 2008.

Our Manager may elect to receive incentive fee payments in the form of cash or shares or any combination thereof. If our Manager elects to receive an incentive fee payment (or any portion thereof) in the form of shares, the number of shares to be so delivered will be equal to:

the amount of the incentive fee (or applicable portion thereof to be paid in the form of shares), *divided by* the average closing price of one common share for the 15 consecutive trading days following the announcement of the declaration of the applicable dividend on shares (minus the per share amount of the dividend for any trading day before the ex-dividend date for the dividend).

Origination and Disposition Fees and Change of Control Fees. We pay our Manager a fee for each acquisition or sale of aircraft or other aviation assets equal to 1.5% of the gross acquisition cost in respect of acquisitions or the aggregate gross proceeds in respect of dispositions. We also pay our Manager a fee of 1.5% of the aggregate gross consideration received in respect of any change of control of our company, which includes the acquisition of more than 50% of our common shares or the acquisition of all or substantially all of our assets.

Notwithstanding the foregoing, no origination fees were paid in respect of our acquisition of the aircraft in our Initial Portfolio.

In 2008, origination fees of \$7.0 million were incurred in connection with the purchase of ten aircraft by B&B Air Acquisition and its subsidiaries and fees of \$0.6 million were incurred in connection with the sale of two aircraft by B&B Air Funding and its subsidiaries. We did not pay any origination and disposition fee in 2009.

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Administrative Agency Fees. We pay to our Manager an administrative agency fee equal to \$750,000 per annum for each aircraft securitization financing (the amount of the administrative agency fee for each aircraft securitization financing we establish will be subject to adjustment as set forth below under Fees and Expenses Adjusting the Base Fees and Administrative Agency Fees). In 2009 and 2008, we paid the Manager administrative agency fees totalling \$0.8 million in respect of each year, but this amount was credited toward servicing fees paid pursuant to the Servicing Agreement between B&B Air Funding and BBAM.

In addition, our Manager is entitled to an administrative fee from B&B Air Acquisition of \$240,000 per annum commencing on the month that the Aircraft Acquisition Facility became available. In 2009 and 2008, we paid the Manager administrative agency fees totalling \$0.2 million in respect of each year, but this amount was credited toward servicing fees paid pursuant to the Servicing Agreement between B&B Air Acquisition and BBAM.

Adjusting the Base Fees and Administrative Agency Fees. The amount of the base fee payable and the amount of the administrative agency fee payable for each aircraft securitization financing we establish will be increased (but not decreased) annually by the percentage movement (if any) in the CPI index applicable for the previous calendar year.

Ancillary Management and Administrative Services.

We pay to our Manager such additional fees for any ancillary management and administrative services provided by our Manager to us from time to time as we and our Manager agree to before the ancillary management and administrative services are provided. We did not pay any ancillary management and administrative services fee to our Manager in 2009 or 2008.

Credit for Servicing Fees Paid

Base fees and rent fees paid to BBAM under our servicing agreements and administrative services fees paid to our Manager under the administrative services agreements are credited toward (and thereby reduce) the base and rent fees payable to our Manager as described above under Fees and Expenses Management and Administrative Services Base and Fees and Fees and Expenses Administrative Agency Fees. Similarly, sales fees paid to BBAM under our servicing agreements in respect of aircraft dispositions are credited toward (and thereby reduce) the fee payable to our Manager in connection with dispositions as described above under Fees and Expenses Origination and Disposition Services. See Servicing Agreements Servicing Fees.

Break Fees

Our Manager is entitled to one-third of the value of any break, termination or other similar fees received by us (with such value to be reduced by any third-party costs incurred by or on behalf of us or by our Manager on behalf of us in the transaction to which the fee relates) in connection with any investment or proposed investment to be made by us in any aircraft or other aviation assets. We did not pay any break fees to our Manager in 2009 or 2008.

Expenses of the Manager

We pay or reimburse our Manager:

quarterly payments of \$1.5 million, subject to an annual adjustment indexed to the consumer price index applicable to the previous year, to our Manager to defray expenses.

We refer to this foregoing amount as the management expense amount. The management expense amount is subject to adjustment by notice from our Manager and the approval of the independent directors on our board of directors.

for all our costs paid for us by our Manager (other than remuneration and certain expenses in relation to our Manager's core management team and our Manager's corporate overhead), including the following items which are not covered by the management expense amount:

- directors' fees for the directors on our board of directors and our subsidiaries,
- directors' and officers' insurance for our and our subsidiaries' directors and officers,
- travel expenses of the directors (including flights, accommodation, taxis, entertainment and meals while traveling) to attend any meeting of the board of our company,
- fees and expenses relating to any equity or debt financings we enter into in the future,

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fees and expenses of the depository for our ADSs,

costs and expenses related to insuring our aircraft and other aviation assets, including all fees and expenses of insurance advisors and brokers,

costs incurred in connection with organizing and hosting our annual meetings or other general meetings of our company,

costs of production and distribution of any of our security holder communications, including notices of meetings, annual and other reports, press releases, and any prospectus, disclosure statement, offering memorandum or other form of offering document,

website development and maintenance,

travel expenses of the core management team and other personnel of Babcock & Brown (including flights, accommodation, taxis, entertainment and meals while traveling) related to sourcing, negotiating and conducting transactions on our behalf and attending any meeting of the board or our company,

external legal counsel,

fees of third party consultants, accounting firms and other professionals,

external auditor's fees, and

internal auditor's fees.

The above list of items is subject to the addition of further items by notice from our Manager and the approval of our board of directors (which approval shall not be unreasonably withheld or delayed).

for all taxes, costs, charges and expenses properly incurred by our Manager in connection with the provision of ancillary management and administrative services, the engagement of professional advisors, attorneys, appraisers, specialist consultants and other experts as requested by us from time to time; or which our Manager considers reasonably necessary in providing the services and discharging its duties and other functions under the management agreement, including, without limitation, the fees and expenses of professional advisors relating to the purchase and sale of aircraft and other aviation assets.

Term and Termination

The term of the management agreement commenced on October 2, 2007 and continues until the date that is 25 years thereafter, unless terminated earlier. We may terminate our Manager's appointment immediately upon written notice if but only if:

Babcock & Brown in aggregate ceases to hold (directly or indirectly) more than 50% of the issued share capital of our Manager;

our Manager becomes subject to bankruptcy or insolvency proceedings that are not discharged within 75 days, unless our Manager is withdrawn and replaced within 90 days of the initiation of such bankruptcy or insolvency proceedings with an affiliate or associate of Babcock & Brown that is able to make correctly the representations and warranties set out in the management agreement;

at least 75% of our independent directors and holders of 75% or more of all of our outstanding common shares (measured by vote) determine by resolution that there has been unsatisfactory performance by our Manager that is materially detrimental to us;

our Manager materially breaches the management agreement and fails to remedy such breach within 90 days of receiving written notice from us requiring it to do so, or such breach results in liability to us and is attributable to our Manager's gross negligence, fraud or dishonesty, or willful misconduct in respect of the obligation to apply

the standard of care;

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any license, permit or authorization held by our Manager which is necessary for it to perform the services and duties under the management agreement is materially breached, suspended or revoked, or otherwise made subject to conditions which, in the reasonable opinion of our board of directors, would prevent our Manager from performing the services and the situation is not remedied within 90 days; or

an order is made for the winding up of our Manager, unless our Manager is withdrawn and replaced within 15 days with an affiliate or associate of Babcock & Brown that is able to make correctly the representations and warranties set out in the management agreement.

Even though our shareholders (with the concurrence of 75% of our independent directors) have the right under the management agreement to terminate our Manager, it may not be possible for them to exercise this right in view of the number of common shares held by Babcock & Brown, its affiliates and funds managed by its affiliates. Currently, Babcock & Brown, its affiliates and such funds owned approximately 15% of our outstanding common stock and termination of our management agreement requires the vote of holders of 75% of our outstanding common shares. Our Manager may terminate the management agreement immediately upon written notice if;

we are delisted from the NYSE;

we fail to make any payment due under the management agreement to our Manager within 15 days after the same becomes due;

we otherwise materially breach the management agreement and fail to remedy the breach within 90 days of receiving written notice from our Manager requiring us to do so;

we or any of our significant subsidiaries become subject to bankruptcy or other insolvency proceedings;

an order is made for the winding up of our company; or

any person or group (as defined under the Exchange Act) acquires more than 15% of any class of our voting securities.

Upon the termination of the management agreement, we will redeem all of the manager shares for their nominal value and must promptly change our name and all of our subsidiaries' names so that they don't include the words Babcock & Brown, Babcock or Brown.

Conflicts of Interest

Nothing in the management agreement restricts Babcock & Brown or any of its affiliate or associates from:

dealing or conducting business with us, our Manager, any affiliate or associate of Babcock & Brown or any shareholder of ours;

being interested in any contract or transaction with us, our Manager, any affiliate or associate of Babcock & Brown or any shareholder of ours;

acting in the same or similar capacity in relation to any other corporation or enterprise;

holding or dealing in any of our shares or other securities or interests therein; or

co-investing with us.

Acting in Interests of Shareholders

Without limiting the clause set out above, in performing the services under the management agreement, our Manager shall act in the best interests of our shareholders' interests. If there is a conflict between our shareholders' interests and our Manager's interests, our Manager shall give priority to our shareholders' interests.

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Indemnification and Limitation of Liability

We assume liability for, and have agreed to indemnify our Manager and any person to whom our Manager delegates its obligations in compliance with the management agreement, and their respective members, shareholders, managers, directors, officers, employees and agents, on an after-tax basis against, any losses and liabilities (collectively, Losses) that arise out of or in connection with the doing or failing to do anything in connection with the management agreement or on account of any bona fide investment decision made by the indemnified person, except insofar as any such loss is finally adjudicated to have been caused directly by the indemnified person from gross negligence, fraud or dishonesty, or willful misconduct in respect of the obligation to apply the standard of care under the management agreement. Our Manager and each other indemnified person is not liable to us for any Losses suffered or incurred by us arising out of or in connection with the indemnified person doing or failing to do anything in connection with the management agreement or on account of any bona fide investment decision made by the indemnified person, except insofar as any such Loss is finally adjudicated to have been caused directly by the gross negligence, fraud or dishonesty of, or willful misconduct in respect of the obligation to apply the standard of care under the management agreement by the indemnified person.

Independent Advice

For the avoidance of doubt, nothing in the management agreement limits the right of the members of our board of directors to seek independent professional advice (including, but not limited to, legal, accounting and financial advice) at our expense on any matter connected with the discharge of their responsibilities, in accordance with the procedures and subject to the conditions set out in our corporate governance principles from time to time.

SERVICING AGREEMENT BETWEEN B&B AIR FUNDING AND BBAM

B&B Air Funding entered into a servicing agreement with BBAM relating to the Initial Portfolio. The principal services being provided by BBAM relate to:

- lease marketing and remarketing, including lease negotiation;
- collecting rental payments and other amounts due under leases, collecting maintenance payments where applicable, lease compliance and enforcement and delivery and accepting redelivery of aircraft under lease;
- implementing aircraft dispositions;
- monitoring the performance of maintenance obligations of lessees under the leases in a manner consistent with the practices employed from time to time by BBAM with respect to aircraft owned or managed by it;
- using commercially reasonable efforts to maintain compliance with certain of our obligations in our financing agreements;
- procuring legal and other professional services with respect to the lease, sale or financing of the aircraft, any amendment or modification of any lease, the enforcement of our rights under any lease, disputes that arise as to any aircraft or for any other purpose that BBAM reasonably determines is necessary in connection with the performance of its services;
- periodic reporting of operational information relating to the aircraft, including providing certain reports to the policy provider; and
- certain aviation insurance related services.

The servicing agreement provides that BBAM act in accordance with laws applicable to it, in certain cases with directions given by us, a cash manager or an administrative agent on behalf of us, with the specified standard of care described below and with the specified conflicts standard described below. BBAM does not have any fiduciary or other implied duties or obligations to us, our shareholders or any other person. BBAM and their respective subsidiaries cannot be held responsible for any liabilities of ours, including any payment of any dividends to our shareholders or payments due in respect of any financing.

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Term and Termination

The servicing agreement associated with our aircraft comprising our Initial Portfolio expires on the later of (1) the maturity date of the notes issued in the Securitization and (2) the date of repayment of all principal and other amounts due under the Securitization (including any amounts owed to the policy provider).

The Servicing Agreement may be terminated prior to its scheduled termination date in the case of certain events, including Babcock & Brown ceasing to own at least 50.1% of the voting or economic interest in BBAM; or

The bankruptcy or insolvency of BBAM or Babcock & Brown International Pty Ltd.

If either of the above servicer termination events occurs, B&B Air Funding, with the prior consent of the policy provider under the Securitization (or the policy provider alone, if an event of default under the Securitization indenture has occurred and is continuing) may substitute BBAM with a replacement servicer upon receipt of a rating agency confirmation from each rating agency. A servicer termination event under the Servicing Agreement does not give rise to an event of default under the Securitization indenture.

Neither B&B Air Funding or B&B Air Acquisition, nor BBAM may assign their rights and obligations under their respective servicing agreement without the other party's prior consent. The Servicer may, however, delegate some, but not all, of its duties to its affiliates.

Servicing Fees

The servicing agreement provides that we pay to BBAM:

a base fee of \$150,000 per month, which will increase by 0.01% of the maintenance-adjusted base value (at the time of acquisition) of each additional aircraft acquired into B&B Air Funding that is not an aircraft in our Initial Portfolio; and

a rent fee equal to 1.0% of the aggregate amount of basic rent due for all or any part of a month for any of aircraft belonging to our Initial Portfolio, plus 1.0% of the aggregate amount of basic rent actually paid for all or any part of a month for any of such aircraft.

In 2009 and 2008, we paid BBAM servicing fees totalling \$4.6 million and \$4.8 million, respectively.

BBAM is also entitled to additional servicing fees consisting of a sales fee for each sale of an aircraft equal to 1.5% of the aggregate gross proceeds in respect of dispositions of aircraft assets. Fees for additional services will be as mutually agreed. In 2008, we paid additional servicing fees to BBAM totalling \$0.6 million in connection with the sale of two aircraft. We did not pay any additional servicing fees to BBAM in 2009.

SERVICING AGREEMENT BETWEEN B&B AIR ACQUISITION AND BBAM

On November 7, 2007, B&B Air Acquisition entered into a Servicing and Administrative Services Agreement (Servicing Agreement) with BBAM. The principal services being provided by BBAM under the Servicing Agreement are:

lease marketing and remarketing, including lease negotiation;

collecting rental payments and other amounts due under leases, lease compliance and enforcement and accepting delivery of aircraft under lease; and

providing legal and accounting services, including preparing and providing reports as required by the Aircraft Acquisition Facility and providing other services to cause B&B Air Acquisition to comply with the Aircraft Acquisition Facility.

B&B Air Acquisition will pay BBAM a fee for the services of \$20,000 per month plus 3.5% of the monthly rents actually collected. In addition, the Company shall pay a sales fee to BBAM equal to 1.5% of the cash proceeds collected with respect to the sale of any aircraft.

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B&B Air Acquisition may replace BBAM as the Servicer under certain conditions including:

An event of default under the Aircraft Acquisition Facility, including Babcock & Brown ceasing to hold at least 5% of the issued and outstanding shares of B&B Air;

Babcock & Brown ceasing to hold at least 51% of the capital stock of BBAM;

BBAM fails to deliver the audited financial statements of Babcock & Brown Limited to the agent and lenders in the Aircraft Acquisition Facility within 120 days of fiscal year end or the unaudited or audited financial statements for each semi-annual period within 90 days, and in each case such failure to deliver the required financial statements continues for 30 days after written notice from the agent;

Any Babcock & Brown Limited annual or quarterly financial statement required to be delivered as described above contains a going-concern or similar qualification;

The insolvency of BBAM or any significant subsidiary of BBAM; and

A BBAM default on recourse debt over \$25 million.

Babcock & Brown has informed us that BBIPL, which is both the main operating and asset-owning entity in the Babcock & Brown group, continues to pursue its revised business plan to sell all of its assets. Although no definitive transaction has been announced, we expect Babcock & Brown to sell substantially all of its aviation-related assets, including the assets and servicing agreements associated with BBAM and the common shares of B&B Air owned by them. These sales could result in a servicer replacement event and an event of default under the Aircraft Acquisition Facility.

Upon the occurrence of a servicer replacement event, B&B Air Acquisition (with the consent of the agent) or the agent on the direction of 2/3 of the Tranche A and Tranche B lenders combined, may terminate the service agreement. The Servicing Agreement may be amended with the written consent of the agent.

Fees paid to BBAM pursuant to this servicing agreement in 2009 and 2008 amounted to \$3.1 million and \$2.5 million, respectively.

ADMINISTRATIVE SERVICES AGREEMENT

Pursuant to an administrative services agreement, B&B Air Funding has engaged our Manager to act as its administrative agent and to perform various administrative services, including maintaining its books and records, procuring and supervising legal counsel, accounting, tax and other advisers, and informing the board of directors of B&B Air Funding if the administrative agent believes that the net revenues generated by the leases of the aircraft will be insufficient to satisfy the payment obligations under its Securitization. In consideration for such services, B&B Air Funding pays the administrative agent an annual fee of \$750,000, subject to increases tied to a cost of living index, and will reimburse it for its expenses. For each of 2009 and 2008, we incurred administrative services fees totalling \$0.8 million.

REGISTRATION RIGHTS AGREEMENT

We have entered into a registration rights agreement with Babcock & Brown and the other private investors purchasing our shares in the private placement pursuant to which we have agreed that, upon the request of Babcock & Brown or any of the other private investors we will file one or more registration statements to register for resale under the Securities Act the shares that Babcock & Brown and the other private investors have purchased from us. In the registration rights agreement we have also agreed to register the shares that our Manager may receive in payment of the incentive fee under our management agreement. In the registration rights agreement we have agreed to pay expenses in connection with such registration and sales and have indemnified the private investors and Babcock & Brown for material misstatements or omissions in the registration statement.

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See Item 18 below for information regarding our consolidated financial statements and additional information required to be disclosed under this Item.

Legal Proceedings

We have not been involved in any legal proceedings that may have, or have had, a significant effect on our business, financial position, results of operations or liquidity. We are not aware of any proceedings that are pending or threatened that may have a material effect on our business, financial position, results of operations or liquidity. From time to time, we may be subject to legal proceedings and claims in the ordinary course of business, principally claims relating to incidents involving aircraft and claims involving the existence or breach of a lease, sale or purchase contract. We expect the claims related to incidents involving our aircraft would be covered by insurance, subject to customary deductions. However, these claims could result in the expenditure of significant financial and managerial resources, even if they lack merit and if determined adversely to us and not covered by insurance could result in significant uninsured losses.

Dividend

The table below shows the quarterly dividends we have paid and the total cash requirement for each dividend payment.

| Dividend payment date | Dividends paid | | Total cash requirement |
|------------------------------|-----------------------|------|-------------------------------|
| | per share | | |
| 2009: | | | |
| November 20, 2009 | \$ | 0.20 | \$ 6.1 million |
| August 20, 2009 | \$ | 0.20 | \$ 6.1 million |
| May 20, 2009 | \$ | 0.20 | \$ 6.1 million |
| February 20, 2009 | \$ | 0.20 | \$ 6.5 million |
| 2008: | | | |
| November 20, 2008 | \$ | 0.50 | \$ 16.7 million |
| August 20, 2008 | \$ | 0.50 | \$ 16.7 million |
| May 20, 2008 | \$ | 0.50 | \$ 16.8 million |
| February 20, 2008 | \$ | 0.50 | \$ 16.8 million |

We may not be able to pay future dividends at the current level or at all, if, among other things, we do not have sufficient cash to pay the intended dividends or if our financial performance does not achieve expected results. To the extent that we do not have sufficient cash to pay dividends, we do not intend to borrow funds to pay dividends. The declaration and payment of future dividends to holders of our common shares will be at the discretion of our board of directors and will depend on many factors, including our financial condition, cash flows, legal requirements and other factors as our board of directors deems relevant.

As a Bermuda company, our ability to pay dividends is subject to certain restrictions imposed by Bermuda law.

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Our ADSs, each representing one common share, are traded on the New York Stock Exchange under the symbol FLY. The following table sets forth the annual high and low market prices for our ADSs on the New York Stock Exchange since September 26, 2007, the date of listing:

| | High | Low |
|------|-------------|------------|
| 2007 | \$ 23.90 | \$ 16.56 |
| 2008 | 18.85 | 4.70 |
| 2009 | 10.29 | 2.50 |

The following table sets forth the quarterly high and low market prices for our ADSs on the New York Stock Exchange since September 26, 2007, the date of listing:

| | High | Low |
|-----------------------------------|-------------|------------|
| 2008: | | |
| Quarter ending March 31, 2008 | 18.85 | 13.40 |
| Quarter ending June 30, 2008 | 16.94 | 8.73 |
| Quarter ending September 30, 2008 | 14.00 | 8.03 |
| Quarter ending December 31, 2008 | 10.25 | 4.70 |
| 2009: | | |
| Quarter ending March 31, 2009 | 7.79 | 2.50 |
| Quarter ending June 30, 2009 | 8.45 | 4.11 |
| Quarter ending September 30, 2009 | 10.29 | 6.29 |
| Quarter ending December 31, 2009 | 9.90 | 7.95 |

The following table sets forth the monthly high and low market prices for our ADSs on the New York Stock Exchange for the most recent six months:

| | High | Low |
|----------------|-------------|------------|
| 2009: | | |
| September 2009 | \$ 10.29 | \$ 8.01 |
| October 2009 | 9.90 | 8.31 |
| November 2009 | 9.35 | 7.95 |
| December 2009 | 9.40 | 8.70 |
| 2010: | | |
| January 2010 | 10.94 | 9.04 |
| February 2010 | 10.42 | 8.76 |

ITEM 10. ADDITIONAL INFORMATION**Share Capital**

Not applicable.

Memorandum and Articles of Association

Pursuant to the instructions to Form 20-F, the information called for by this Item 10 is contained in our Registration Statement on Form F-1, as filed with the SEC on September 12, 2007, as subsequently amended, under the heading Description of Share Capital, and is hereby incorporated by reference.

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Material Contracts

The following is a list of material contracts, other than contracts entered into in the ordinary course of business, to which we or any of our subsidiaries is a party, preceding the date of this Annual Report:

- 1) Management Agreement, dated as of October 2, 2007, between Babcock & Brown Air Management Co. Limited and Babcock & Brown Air Limited. See Item 7.B Related Party Transactions Management Agreement.
- 2) Servicing Agreement, dated as of October 2, 2007, among Babcock & Brown Aircraft Management LLC, Babcock & Brown Aircraft Management (Europe) Limited, Babcock & Brown Air Funding I Limited and AMBAC Assurance Corporation. See Item 7.B Related Party Transactions Servicing Agreement.
- 3) Administrative Services Agreement, dated as of October 2, 2007, among Deutsche Bank Trust Company Americas, AMBAC Assurance Corporation, Babcock & Brown Air Management Co. Limited and Babcock & Brown Air Funding I Limited. See Item 7 Related Party Transactions Administrative Services Agreements.
- 4) Registration Rights Agreement, dated as of October 2, 2007, among private investors and Babcock & Brown Air Limited. See Item 7 Related Party Transactions Registration Rights Agreement.
- 5) Trust Indenture, dated as of October 2, 2007, among Deutsche Bank Trust Company Americas, BNP Paribas, AMBAC Assurance Corporation and Babcock & Brown Air Funding I Limited. See Item 5 Liquidity and Capital Resources Financing Securitization.
- 6) Security Trust Agreement, dated as of October 2, 2007, between Deutsche Bank Trust Company Americas, and Babcock & Brown Air Funding I Limited. See Item 5 Liquidity and Capital Resources Financing Securitization.
- 7) Aircraft Acquisition Facility, dated as of November 7, 2007 among Babcock & Brown Air Acquisition I Limited, the Lenders from time to time party thereto and Credit Suisse, New York Branch. See Item 5 Liquidity and Capital Resources Financing Aircraft Acquisition Facility.
- 8) Servicing and Administrative Services Agreement, dated as of November 7, 2007 among Babcock & Brown Aircraft Management LLC, Babcock & Brown Aircraft Management (Europe) Limited, Babcock & Brown Air Acquisition I Limited and each Aircraft Subsidiary that becomes a party thereto. See Item 7 Related Party Transactions Servicing Agreement.

Documents On Display

Documents concerning us that are referred to herein may be inspected at our principal executive headquarters at West Pier, Dun Laoghaire, County Dublin, Ireland. You may read and copy these documents, including the related exhibits and schedules, and any documents we file with the SEC without charge at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Copies of these documents are also available at the SEC's website, <http://www.sec.gov>. Copies of the material may be obtained by mail from the public reference branch of the SEC at the address listed above at rates specified by the SEC. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. Our internet address is www.babcockbrownair.com. However, the information on our website is not a part of this Annual Report.

Exchange Controls

We are not aware of any governmental laws, decrees or regulations in Bermuda that restrict the export or import of capital, including foreign exchange controls, or that affect the remittance of dividends, interest or other payments to non-resident holders of our securities.

We are not aware of any limitation of non-resident or foreign owners to hold or vote our securities imposed by the laws of Bermuda of our memorandum of association or bye-laws.

Taxation

Irish Tax Considerations

The following discussion reflects the material Irish tax consequences applicable to both Irish and Non-Irish Holders (as defined below) of the acquisition, ownership and disposition of our shares. This discussion is based on Irish tax law, statutes, treaties, regulations, rulings and decisions all as of the date of this Annual Report. Taxation laws are subject to change, from time to time, and no representation is or can be made as to whether such laws will change, to what impact, if any, such changes will have on the summary contained in this Annual Report. Proposed amendments may not be enacted as proposed, and legislative or judicial changes, as well as changes in administrative practice, may modify or change statements expressed herein.

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This summary is of a general nature only. It does not constitute legal or tax advice nor does it discuss all aspects of Irish taxation that may be relevant to any particular holder of our shares. The Irish tax treatment of a holder of our shares may vary depending upon such holder's particular situation, and holders or prospective purchasers of our shares are advised to consult their own tax advisors as to the Irish or other tax consequences of the purchase, ownership and disposition of our shares.

For the purposes of this summary of Irish tax considerations:

An **Irish Holder** is a holder of our shares that (1) beneficially owns our shares by virtue of holding the related ADSs evidenced by the relevant American Depositary Receipt or ADR; (2) in the case of individual holders, is resident or ordinarily resident in Ireland under Irish taxation laws; and (3) in the case of a holder that is a company, is resident in Ireland under Irish taxation laws and is not also a resident of any other country under any double taxation agreement entered into by Ireland.

A **Non-Irish Holder** is a Holder of our shares that is not an Irish Holder and has never been an Irish Holder.

A **US Holder** is a holder of our shares that: (1) beneficially owns our shares by virtue of holding the related ADSs evidenced by the relevant ADR; (2) is a resident of the United States for the purposes of the Ireland/United States Double Taxation Convention; (3) in the case of an individual holder, is not also resident or ordinarily resident in Ireland for Irish tax purposes; (4) in the case of a corporate holder, is not resident in Ireland for Irish tax purposes and is not ultimately controlled by persons resident in Ireland; and (5) is not engaged in any trade or business and does not perform independent personal services through a permanent establishment or fixed base in Ireland.

Relevant Territory is defined as a country with which Ireland has a double tax treaty, (which includes the United States), or a member state of the European Union other than Ireland.

Irish Dividend Withholding Tax

Dividends that we pay on our shares generally are subject to a 20% dividend withholding tax, or DWT. DWT may not apply where an exemption is permitted by legislation or treaty and where all necessary documentation has been submitted to the ADS depository prior to the payment of the dividend.

Irish Holders. Individual Irish Holders are subject to DWT on any dividend payments that we make. Corporate Irish Holders will generally be entitled to claim an exemption from DWT by delivering a declaration to us in the form prescribed by the Irish Revenue Commissioners.

Non-Irish Holders. Shareholders who are individuals resident in a Relevant Territory and who are not resident or ordinarily resident in Ireland may receive dividends free from DWT where the shareholder has provided the ADS depository with the relevant declaration and residency certificate required by Irish legislation. Corporate shareholders that are not resident in Ireland and

who are ultimately controlled by persons resident in a Relevant Territory and who are not ultimately controlled by persons not resident in a Relevant Territory; or

who are resident in a Relevant Territory and not controlled by Irish residents; or

whose principal class of shares or the principal class of shares of whose 75% or greater parents are substantially and regularly traded on a recognized stock exchange in a Relevant Territory; or which are wholly owned by two or more companies, each of whose principal class of shares are substantially and regularly traded on a recognized stock exchange in a Relevant Territory may receive dividends free from DWT where they provide the ADS depository with the relevant documentation required by Irish law.

Income Tax***Irish and Non-Irish Holders***

Irish Holders. Individual Irish Holders are subject to income tax on the gross amount of any dividend (*i.e.*, the amount of the dividend received plus any DWT withheld), at their marginal rate of tax (currently either 20% or 41% depending on the individual's circumstances). Individual Irish Holders will be able to claim a credit against their resulting income tax liability in respect of any DWT. Individual Irish Holders may, depending on their circumstances, also be subject to the Irish health levy of 4% on the first 75,036 of income and 5% on aggregate income in excess of this amount along with pay related social insurance contributions of up to 4% in respect of dividend income up to the first 75,036 of income. An income levy has been introduced with effect from 1 January 2009. The levy is charged on an individual's income from all sources, including income which is exempt from income tax, with certain exclusions.

The levy is charged at five different rates for the year 2009: 1.67% on the first 75,036; 3% on the next 25,064; 3.33% on the next 74,880; 4.67% on the next 75,140; and 5% on the aggregate income in excess of 250,150. For 2010, the levy will be charged at 2% on the first 75,036, 4% on the next 99,944 and 6% on the aggregate income in excess of 174,980.

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Corporate Irish Holders generally will not be subject to Irish tax in respect of dividends received.

Non-Irish Holders. Non-Irish Holders will not have an Irish income tax liability on dividends from us if the shareholder is neither resident nor ordinarily resident in Ireland and is:

an individual resident in a Relevant Territory; or

a corporation that is ultimately controlled by persons resident in a Relevant Territory; or

a corporation whose principal class of shares (or whose 75% or greater parent's principal class of shares) are substantially and regularly traded on a recognized stock exchange in a Relevant Territory; or

a corporation that is wholly owned by two or more corporations each of whose principal class of shares is substantially and regularly traded on a recognized stock exchange in a Relevant Territory; or

otherwise entitled to an exemption from DWT.

If a Non-Irish Holder is not so exempted, such shareholder will be liable for Irish income tax (currently 20%) on dividends received from us, but will be entitled to a credit for DWT withheld.

Taxation of Capital Gains

Irish Holders. Irish Holders that acquire shares will generally be considered, for Irish tax purposes, to have acquired their shares at a base cost equal to the amount paid for shares. On subsequent dispositions, shares acquired at an earlier time will generally be deemed, for Irish tax purposes, to be disposed of on a first in first out basis before shares acquired at a later time. Irish Holders that dispose of their shares will be subject to Irish capital gains tax (CGT) to the extent that the proceeds realized from such disposition exceed the base cost of the common shares or ADSs disposed of and any incidental expenses. The rate of CGT for disposals before 8 April 2009 is 22%. Disposals made on or after 8 April 2009 are subject to CGT at 25%. Unutilized capital losses from other sources generally can be used to reduce gains realized on the disposal of our shares.

An annual exemption allows individuals to realize chargeable gains of up to 1,270 in each tax year without giving rise to CGT. This exemption is specific to the individual and cannot be transferred between spouses. Irish Holders are required, under Ireland's self-assessment system, to file a tax return reporting any chargeable gains arising to them in a particular tax year. When disposal proceeds are received in a currency other than euro they must be translated into euro amounts to calculate the amount of any chargeable gain or loss. Similarly, acquisition costs denominated in a currency other than the euro must be translated at the date of acquisition to euro amounts. Irish Holders that realize a loss on the disposition of our shares generally will be entitled to offset such allowable losses against capital gains realized from other sources in determining their CGT liability in a year. Allowable losses which remain unrelieved in a year generally may be carried forward indefinitely for CGT purposes and applied against capital gains in future years. Transfers between spouses will not give rise to any chargeable gain or loss for CGT purposes.

Non-Irish Holders. A person who is not resident or ordinarily resident in Ireland is not subject to Irish capital gains tax on the disposal of our shares.

Irish Capital Acquisitions Tax

A gift or inheritance of our shares will be within the charge to capital acquisitions tax (CAT) where the donor/deceased or the beneficiary is resident or ordinarily resident in Ireland at the date of the gift/inheritance or to the extent that the property of which the gift or inheritance consists is situated in Ireland at the relevant date. Special rules with regard to residence apply where an individual is not domiciled in Ireland. CAT is charged at a flat rate of 25% for gifts or inheritances taken on or after 8 April 2009. Gifts and inheritances taken before this date are subject to CAT at 22%. Gifts and inheritances between spouses are not subject to capital acquisitions tax.

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The Estate Tax Convention between Ireland and the United States generally provides for Irish CAT paid on inheritances in Ireland to be credited, in whole or in part, against tax payable in the United States, in the case where an inheritance of shares is subject to both Irish CAT and US federal estate tax. The Estate Tax Convention does not apply to Irish CAT paid on gifts.

Irish Stamp Duty

No Irish stamp or capital duty shall apply to the issuance of the common shares. Transfers of the common shares would not ordinarily be subject to Irish stamp duty, unless the transfer was related to Irish property or any matter or thing done or to be done in Ireland. Transfers of ADSs are exempt from Irish stamp duty when the ADSs are dealt in on the New York Stock Exchange, NASDAQ National Market or any recognized stock exchange in the United States or Canada and the transfer does not relate to Irish property or any matter or thing done or to be done in Ireland.

Taxation of the B&B Air Group***Corporation Tax***

In general, Irish-resident companies pay corporation tax at the rate of 12.5% on trading income and 25% on non-trading income. B&B Air and its Irish-tax-resident subsidiaries intend to conduct business so that they carry on a trading business for Irish tax purposes. Non-trading income, including certain categories of interest income, will be subject to corporation tax at the rate of 25%.

U.S. Federal Income Tax Considerations

The following is a general discussion of the U.S. federal income taxation of us and of certain U.S. federal income tax consequences of acquiring, holding or disposing of the shares by U.S. Holders (as defined below) and information reporting and backup withholding rules applicable to both U.S. and Non-U.S. Holders (as defined below). It is based upon the U.S. Internal Revenue Code, the U.S. Treasury regulations (Treasury Regulations) promulgated thereunder, published rulings, court decisions and other applicable authorities, all as in effect on the date hereof and all of which are subject to change or differing interpretations (possibly with retroactive effect). This summary does not purport to address all of the U.S. federal income tax consequences applicable to us or to all categories of investors, some of whom may be subject to special rules including, without limitation, dealers in securities or currencies, financial institutions or financial services entities, life insurance companies, holders of shares held as part of a straddle, hedge, constructive sale or conversion transaction with other investments, U.S. persons whose functional currency is not the U.S. dollar, persons who have elected mark-to-market accounting, persons who have not acquired their shares upon their original issuance, or in exchange for consideration other than cash, persons who hold their shares through a partnership or other entity which is a pass-through entity for U.S. federal income tax purposes, or persons for whom a share is not a capital asset, and persons holding, directly indirectly or constructively, 5% or more of our ADSs or underlying shares. The tax consequences of an investment in our shares will depend not only on the nature of our operations and the then-applicable U.S. federal tax principles, but also on certain factual determinations that cannot be made at this time, and upon a particular investor's individual circumstances. No advance rulings have been or will be sought from the Internal Revenue Service (the IRS) regarding any matter discussed herein.

For purposes of this discussion, a U.S. Holder is (1) a citizen or resident of the United States; (2) a corporation, or other entity treated as a corporation for U.S. federal income tax purposes, created or organized under the laws of the United States or any political subdivision thereof; (3) an estate the income of which is subject to U.S. federal income taxation regardless of its source; or (4) a trust which (a) is subject to the primary supervision of a court within the United States and one or more U.S. persons have the authority to control all substantial decisions of the trust or (b) has a valid election in effect under applicable Treasury Regulations to be treated as a U.S. person. A Non-U.S. Holder is a beneficial owner of our shares that is not a U.S. Holder and who, in addition, is not (1) a partnership or other fiscally transparent entity; (2) an individual present in the United States for 183 days or more in a taxable year who meets certain other conditions; or (3) subject to rules applicable to certain expatriates or former long-term residents of the United States. This summary does not purport to be a comprehensive description of all of the U.S. federal income tax considerations that may be relevant to a decision to purchase the shares. This summary does not describe any tax consequences arising under the laws of any state, locality or taxing jurisdiction other than the United States. For U.S. tax purposes holders of our ADSs are treated as if they hold the underlying common shares represented by the ADSs.

Table of Contents**Taxation of U.S. Holders of Shares**

U.S. Holders of shares are subject to U.S. tax under the passive foreign investment companies (PFIC) rules, as summarized below.

Tax Consequences of Passive Foreign Investment Company (PFIC) Status. We will be deemed a PFIC if 75% or more of our gross income, including our pro rata share of the gross income of any company, U.S. or foreign, in which we are considered to own 25% or more of the shares by value, in a taxable year is passive income. Alternatively, we will be deemed to be a PFIC if at least 50% of our assets in a taxable year, averaged over the year and ordinarily determined based on fair market value and including our pro rata share of the assets of any company in which we are considered to own 25% or more of the shares by value, are held for the production of, or produce, passive income. We believe that we were a PFIC for 2007, 2008 and 2009, and expect to be a PFIC for 2010 and for the foreseeable future. Assuming we are a PFIC, our dividends will not qualify for the reduced rate of U.S. federal income tax that applies to qualified dividends paid to non-corporate U.S. Holders. Thus, dividends (as determined for U.S. federal income tax purposes) will be taxed at the rate applicable to ordinary income of the U.S. Holder.

Assuming we are a PFIC, U.S. Holders of our shares will be subject to different taxation rules with respect to an investment in our shares depending on whether they elect to treat us as a qualified electing fund, or a QEF, with respect to their investment in our shares. If a U.S. Holder makes a QEF election in the first taxable year in which the U.S. Holder owns our shares (and if we comply with certain reporting requirements, which we have done and intend to do), then such U.S. Holder will be required for each taxable year to include in income a pro rata share of our ordinary earnings as ordinary income and a pro rata share of our net capital gain as long-term capital gain, subject to a separate voluntary election to defer payment of taxes, which deferral is subject to an interest charge. If a QEF election is made, U.S. Holders will not be taxed again on our distributions, which will be treated as return of capital for U.S. federal income tax purposes. Instead, distributions will reduce the U.S. Holder's basis in our shares and, to the extent in excess of such basis, will be treated as gain from the sale or exchange of a capital asset.

Because we are a PFIC, if a U.S. Holder does not make a QEF election, then the following special rules will apply:

Excess distributions by us to a U.S. Holder would be taxed in a special way. Excess distributions are amounts received by a U.S. Holder with respect to our shares in any taxable year that exceed 125% of the average distributions received by such U.S. Holder from us in the shorter of either the three previous years or such U.S. Holder's holding period for shares before the present taxable year. Excess distributions must be allocated ratably to each day that a U.S. Holder has held our shares. A U.S. Holder must include amounts allocated to the current taxable year in its gross income as ordinary income for that year. A U.S. Holder must pay tax on amounts allocated to each prior taxable year in which we were a PFIC at the highest rate in effect for that year on ordinary income and the tax is subject to an interest charge at the rate applicable to deficiencies for income tax.

The entire amount of gain realized by a U.S. Holder upon the sale or other disposition of shares will also be treated as an excess distribution and will be subject to tax as described above.

The tax basis in shares that were acquired from a decedent who was a U.S. Holder would not receive a step-up to fair market value as of the date of the decedent's death but would instead be equal to the decedent's basis, if lower than fair market value.

The QEF election is made on a shareholder-by-shareholder basis and can be revoked only with the consent of the IRS. A shareholder makes a QEF election by attaching a completed IRS Form 8621 to a timely filed U.S. federal income tax return or, if not required to file an income tax return, by filing such form with the IRS. Even if a QEF election is not made, a shareholder in a PFIC who is a U.S. Holder must file a completed IRS Form 8621 every year. We have provided and intend to continue to provide U.S. Holders with all necessary information to enable them to make QEF elections as described above. If any subsidiary is not subject to an election to be treated as a disregarded entity or partnership for U.S. tax purposes then a QEF election would have to be made for each such subsidiary. We have made and intend to maintain an election to treat each of our subsidiaries as a disregarded entity for U.S. tax purposes. U.S. Holders may, instead of making a QEF election, elect to mark the shares to market annually, recognizing as ordinary income or loss each year an amount equal to the difference, as of the close of the taxable year, between the fair market value of the shares and the U.S. Holder's adjusted tax basis in the shares. Losses would be allowed only to

the extent of net mark-to-market gain previously included by the U.S. Holder under the election for prior taxable years. If the mark-to-market election were made, then the rules set forth above would not apply for periods covered by the election. A mark-to-market election is only available if our shares meet trading volume requirements on qualifying exchange.

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U.S. Holders who hold shares during a period when we are a PFIC will be subject to the foregoing rules, even if we cease to be a PFIC, subject to certain exceptions for U.S. Holders who made a QEF election.

As a result of our purchase of Notes in 2009, we have generated significant ordinary earnings for U.S. federal income tax purposes. Accordingly, U.S. shareholders that have made a QEF election with respect to our common shares will be required to include in gross income their pro rata share of our ordinary earnings and net capital gain, if any. Such inclusion is required even if the amount exceeds cash distributions made by us during the year.

You should consult your tax advisor about the PFIC rules, including the advisability of making a QEF election or mark-to-market election.

Taxation of the Disposition of Shares. A U.S. Holder that has made a QEF election for the first year of its holding period will recognize capital gain or loss in an amount equal to the difference between such U.S. Holder's basis in the shares, which is usually the cost of such shares (as adjusted to take into account any QEF inclusion, which increases the basis of such shares, and any distribution, which decreases the basis of such shares) and the amount realized on a sale or other taxable disposition of the shares. If, as anticipated, the shares are publicly traded, a disposition of shares will be considered to occur on the trade date, regardless of the holder's method of accounting. If a QEF election has been made, capital gain from the sale, exchange or other disposition of shares held more than one year is long-term capital gain and is eligible for a maximum 15% rate of taxation for non-corporate holders.

Information Reporting and Backup Withholding for U.S. Holders

Dividend payments made within the United States with respect to the shares, and proceeds from the sale, exchange or redemption of shares, may be subject to information reporting to the IRS and possible U.S. backup withholding. Backup withholding will not apply, however, to a U.S. Holder who furnishes a correct taxpayer identification number and makes any other required certification or who is otherwise exempt from backup withholding. Generally, a U.S. Holder will provide such certification on IRS Form W-9 (Request for Taxpayer Identification Number and Certification).

Amounts withheld under the backup withholding rules may be credited against a U.S. Holder's tax liability, and a U.S. Holder may obtain a refund of any excess amount withheld under the backup withholding rules by timely filing the appropriate claim for refund with the IRS.

Information Reporting and Backup Withholding for Non-U. S. Holders

Information reporting to the United States and backup withholding to the IRS generally would not be required for dividends paid on our shares or proceeds received upon the sale, exchange or redemption of our shares to Non-U.S. Holders who hold or sell our shares through the non-U.S. office of a non-U.S. related broker or financial institution. Information reporting and backup withholding may apply if shares are held by a Non-U.S. Holder through a U.S., or U.S.-related, broker or financial institution, or the U.S. office of a non-U.S. broker or financial institution and the Non-U.S. Holder fails to establish an exemption from information reporting and backup withholding by certifying such holder's status on IRS Form W-8BEN, W-8ECI or W-8IMY, as applicable.

The IRS may make information reported to you and the IRS available under the provisions of an applicable income tax treaty to the tax authorities in the country in which you reside. Any amounts withheld under the backup withholding rules will be allowed as a refund or a credit against your U.S. federal income tax liability, if any, provided the required information is timely furnished by you to the IRS. You should consult your own tax advisors regarding the filing of a U.S. tax return for claiming a refund of any such backup withholding. Non-U.S. Holders should consult their tax advisors regarding the application of these rules.

Taxation of B&B Air and Our Subsidiaries

Unless otherwise exempted by an applicable income tax treaty, a non-U.S. corporation that is directly or through agents engaged in a trade or business in the U.S. is generally subject to U.S. federal income taxation, at the graduated tax rates applicable to U.S. corporations, on the portion of such non-U.S. corporation's income that is effectively connected with such trade or business. In addition, such a non-U.S. corporation may be subject to the U.S. federal branch profits tax on the portion of its effectively connected earnings and profits constituting dividend equivalent amounts at a rate of 30%, or at such lower rate as may be specified by an applicable income tax treaty. In addition non-U.S. corporations that earn certain U.S. source income not connected with a U.S. trade or business can be subject to a 30% withholding tax on such gross income unless they are entitled to a reduction or elimination of such tax by an

applicable treaty. Furthermore, even if a non-U.S. corporation is not engaged in a U.S. trade of business, certain U.S. source gross transportation income (which includes rental income from aircraft that fly to and from the United States) is subject to a 4% gross transportation tax in the United States unless a statutory or treaty exemption applies.

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We expect that we and our Irish tax resident subsidiaries will be entitled to claim the benefits of the Irish Treaty. Accordingly, even if we earn income that otherwise would be subject to tax in the United States, such income is expected to be exempt from U.S. tax under the Irish Treaty to the extent that it is: (1) rental income attributable to aircraft used in international traffic; (2) gain from the sale of aircraft used in international traffic; or (3) U.S. source business profits (which includes rental income from, and gains attributable to, aircraft operated in U.S. domestic service) not connected with a U.S. permanent establishment. For this purpose, international traffic means transportation except where flights are solely between places within the United States. We also expect that we will not be treated as having a U.S. permanent establishment. Thus we do not believe that we will be subject to taxation in the United States on any of our aircraft rental income or gains from the sale of aircraft.

No assurances can be given, however, that we will continue to qualify each year for the benefits of the Irish Treaty or that we will not in the future be treated as maintaining a permanent establishment in the U.S. In order for us and our subsidiaries to be eligible for the benefits of the Irish Treaty for a particular fiscal year, we must each satisfy the requirements of Article 23 (Limitation on Benefits) of the Irish Treaty for that fiscal year. We will be eligible for the benefits of the Irish Treaty if the principal class of our shares is substantially and regularly traded on one or more recognized stock exchanges. Our shares will be considered substantially and regularly traded on one or more recognized stock exchanges in a fiscal year if: (1) trades in such shares are effected on such stock exchanges in more than de minimis quantities during every quarter; and (2) the aggregate number of shares traded on such stock exchanges during the previous fiscal year is at least 6% of the average number of shares outstanding during that taxable year. We satisfied this requirement for each of the years since our inception. If our shares cease to be treated as regularly traded, then we may no longer be eligible for the benefits of the Irish Treaty. Our subsidiaries that are Irish tax-resident will be eligible for benefits under the Irish Treaty if we hold, directly or indirectly, 50% or more of the vote and value of the subsidiary and we meet the regularly traded test described above.

If we or any subsidiary were not entitled to the benefits of the Irish Treaty, any income that we or that subsidiary earns that is treated as effectively connected with a trade or business in the U.S., either directly or through agents, would be subject to tax in the U.S. at a rate of 35%. In addition, we or that subsidiary would be subject to the U.S. federal branch profits tax at a rate of 30% on its effectively connected earnings and profits, considered distributed from the U.S. business. In addition, if we did not qualify for Irish Treaty benefits, certain U.S. source rental income not connected with a U.S. trade or business could be subject to withholding tax of 30% and certain U.S. source gross transportation income could be subject to a 4% gross transportation tax if an exemption did not apply.

Bermuda Tax Considerations

We are incorporated under the laws of Bermuda. At the present time, there is no Bermuda income or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax payable by us or by our shareholders in respect of our shares. We have obtained an assurance from the Minister of Finance of Bermuda under the Exempted Undertakings Tax Protection Act 1966 that, in the event that any legislation is enacted in Bermuda imposing any tax computed on profits or income, or computed on any capital asset, gain or appreciation or any tax in the nature of estate duty or inheritance tax, such tax shall not, until March 28, 2016, be applicable to us or to any of our operations or to our shares, debentures or other obligations except insofar as such tax applies to persons ordinarily resident in Bermuda or is payable by us in respect of real property owned or leased by us in Bermuda.

Table of Contents**ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK****Interest Rate Risk**

Interest rate risk is the exposure to loss resulting from changes in the level of interest rates and the spread between different interest rates. Interest rate risk is highly sensitive due to many factors, including U.S. monetary and tax policies, U.S. and international economic factors and other factors beyond our control. We are exposed to changes in the level of interest rates and to changes in the relationship or spread between interest rates. Our primary interest rate exposures relate to our lease agreements and our floating rate debt obligations such as the Notes and borrowings under our Liquidity Facility, if any, our Aircraft Acquisition Facility and the Credit Facility. 54 out of our 62 lease agreements require the payment of a fixed amount of rent during the term of the lease, with rent under the remaining eight leases varying based on LIBOR. Our indebtedness will require payments based on a variable interest rate index such as LIBOR. Therefore, increases in interest rates may reduce our net income by increasing the cost of our debt without any corresponding proportional increase in rents or cash flow from our leases.

We have entered into interest rate swap agreements to mitigate the interest rate fluctuation risk associated with the Notes and to minimize the risks associated with any borrowings under our Aircraft Acquisition Facility. We expect that these interest rate swaps would significantly reduce the additional interest expense that would be caused by an increase in variable interest rates.

Sensitivity Analysis

The following discussion about the potential effects of changes in interest rates is based on a sensitivity analysis, which models the effects of hypothetical interest rate shifts on our financial condition and results of operations. A sensitivity analysis is constrained by several factors, including the necessity to conduct the analysis based on a single point in time and by the inability to include the extraordinarily complex market reactions that normally would arise from the market shifts. Although the following results of a sensitivity analysis for changes in interest rates may have some limited use as a benchmark, they should not be viewed as a forecast. This forward-looking disclosure also is selective in nature and addresses only the potential impacts on our financial instruments and our variable rate leases. It does not include a variety of other potential factors that could affect our business as a result of changes in interest rates.

Assuming we do not hedge our exposure to interest rate fluctuations, a hypothetical 100 basis-point increase or decrease in our variable interest rates would have increased or decreased our interest expense by \$13.9 million and would have increased or decreased our revenues by \$2.0 million on an annualized basis.

The fair market value of our interest rate swaps is affected by changes in interest rates and credit risk of the parties to the swap. As of December 31, 2009, the fair market value of our interest rate swap derivative liabilities was \$65.7 million. A 100 basis-point increase or decrease in interest rate would reduce or increase the fair market value of our derivative liabilities by approximately \$0.5 million. As of December 31, 2009, the fair market value of our credit facility extension options was nominal. A 100 basis-point increase or decrease in interest rates would not be material.

Foreign Currency Exchange Risk

We receive substantially all of our revenue in U.S. dollars and paid substantially all of our expenses in U.S. dollars. We entered into one lease pursuant to which we receive part of the lease payments in Euros. We entered into a foreign currency hedging transaction related to this lease. Although most of our revenues and expenses are in U.S. dollars, we will incur some of our expenses in other currencies, primarily the euro, and we may enter into additional leases under which we receive revenue in other currencies, primarily the euro. Depreciation in the value of the U.S. dollar relative to other currencies increases the U.S. dollar cost to us of paying such expenses. The portion of our business conducted in other currencies could increase in the future, which could expand our exposure to losses arising from currency fluctuations. Because we currently receive most of our revenue in U.S. dollars and pay substantially all of our expenses in U.S. dollars, a change in foreign exchange rates would not have a material impact on our results of operations.

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ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

American Depositary Shares

Fees and Expenses

We pay all fees, charges and expenses of the depositary, Deutsche Bank Trust Company Americas (the Depositary) and any agent of the Depositary pursuant to agreements from time to time between us and the Depositary, except that if a holder elects to withdraw the common shares underlying their American Depositary Receipts, or ADRs, from the Depositary they will be required to pay the Depositary a fee of up to US\$5.00 per 100 ADSs surrendered or any portion thereof, together with expenses incurred by the Depositary and any taxes or charges, such as stamp taxes or stock transfer taxes or fees, in connection with the withdrawal.

We will not receive any portion of the fee payable to the Depositary upon a withdrawal of shares from the Depositary. The Depositary will not make any payments to us, and we will not receive any portion of any fees collected by the Depositary.

Dividends and Other Distributions

The Depositary has agreed to pay holders of ADRs the cash dividends or other distributions it or the custodian receives on common shares or other deposited securities, less any fees for withholding taxes, duties and other governmental charges. Dividends on our shares are subject to deduction of Irish withholding taxes, unless an exemption to withholding is available. U.S. holders of ADSs (including U.S. citizens or residents) are entitled to claim a refund of Irish withholding taxes on dividends. Unless a U.S. holder of ADSs otherwise specifies, a customary fee of \$0.003 per ADS will be deducted from each dividend paid to such holder so that such dividend may be paid gross of Irish withholding taxes.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

None.

ITEM 15. CONTROLS AND PROCEDURES

(a) Disclosure Controls and Procedures

As of December 31, 2009, an evaluation was conducted under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

(b) Management's Annual Report on Internal Control over Financial Reporting

Management of Babcock & Brown Air Limited is responsible for establishing and maintaining adequate internal control over financial reporting for our company. With the participation of our Chief Executive Officer and our Chief Financial Officer, we assessed the effectiveness of our internal control over financial reporting as of December 31, 2009 using the framework and criteria established in Internal Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, our management concluded that our internal control over financial reporting was effective as of December 31, 2009.

Our independent auditor, Ernst & Young LLP, a registered public accounting firm, has issued their report which is included below.

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(c) Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Babcock & Brown Air Limited

We have audited Babcock & Brown Air Limited's internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Babcock & Brown Air Limited's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Babcock & Brown Air Limited maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Babcock & Brown Air Limited as of December 31, 2009 and 2008, and the related consolidated statements of income, stockholders' equity, and cash flows for the years ended December 31, 2009, 2008 and for the period from May 3, 2007 (incorporation date) to December 31, 2007, of Babcock & Brown Air Limited and our report dated March 8, 2010 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Francisco, California

March 8, 2010

(d) Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the year ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

Our board has determined that Joseph M. Donovan, the Chairman of our Audit Committee of the Board of Directors, qualifies as an audit committee financial expert and is independent as defined under the applicable rules of the New York Stock Exchange. See Item 6 Directors, Senior Management and Employees.

ITEM 16B. CODE OF ETHICS

We have adopted our (i) Board Governance Document, (ii) Code of Business Conduct and Ethics and (iii) Supplemental Code of Ethics for the Chief Executive Officer and Senior Financial Officers. These documents, along with the Audit Committee, Compensation Committee and Nominations and Corporate Governance Committee charters are available under Corporate Governance in the About Us section of our website (www.babcockbrownair.com).

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Our principal accountants for the year ended December 31, 2009 were Ernst & Young LLP.

The table below summarizes the fees for professional services rendered by Ernst & Young LLP for the audit of our annual financial statements for the years ended December 31, 2009 and 2008 and fees billed for other services rendered (in thousands):

| | For the year ended December 31, | | | |
|--------------------|---------------------------------|--------|----------|--------|
| | 2009 | | 2008 | |
| | Amount | % | Amount | % |
| Audit fees(1) | \$ 1,036 | 95.0% | \$ 1,159 | 97.2% |
| Audit-related fees | | | | |
| Tax fees | | | | |
| All other fees | 54 | 5.0% | 34 | 2.8% |
| Total | \$ 1,090 | 100.0% | \$ 1,193 | 100.0% |

(1) Audit fees include annual audit fees for B&B Air and its subsidiaries.

The Audit Committee pre-approves all audit and non-audit services provided to the Company by its auditors. The fees incurred in 2009 and 2008 were approved by the Audit Committee.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS**Issuer Purchases of Equity Securities**

Our Board of Directors approved a share repurchase program that authorized the repurchase of up to \$30.0 million of our shares through June 2009. In March 2009, our Board of Directors approved the extension of the program through June 2010. The purchases to be made from time to time will be in the open market or in privately negotiated transactions, and will be funded from available cash. The timing of the share repurchases under the program will depend on a variety of factors, including market conditions, and may be suspended or discontinued at any time.

The following table summarizes our repurchases of our common shares during 2009 under our repurchase program:

| Total Number of | Approximate |
|-----------------|-------------|
| Shares | Dollar |

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Purchased as Part of a Publicly Announced Repurchased Plan | Value of Shares that may yet be Purchased Under the Plans or Programs |
|------------------|---|---|---|--|
| April 1-30, 2009 | 2,208,963 | \$ 4.08 | 2,208,963 | \$14.4 million |

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ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT

Not applicable.

ITEM 16G. CORPORATE GOVERNANCE

The New York Stock Exchange requires companies with listed shares to comply with its corporate governance standards. As a foreign private issuer, we are not required to comply with all of the rules that apply to listed U.S. companies. However, we have generally chosen to comply with the New York Stock Exchange's corporate governance rules as though we were a U.S. company. Accordingly, we do not believe there are any significant differences between our corporate governance practices and those that would typically apply to a U.S. domestic issuer under the New York Stock Exchange corporate governance rules.

PART III

ITEM 17. FINANCIAL STATEMENTS

See Item 18 below for information regarding our financial statements and additional information required to be disclosed under this Item.

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ITEM 18. FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

To the Board of Directors

and Shareholders of Babcock & Brown Air Limited

We have audited the accompanying consolidated balance sheets of Babcock & Brown Air Limited and subsidiaries (the Company) as of December 31, 2009 and 2008, and the related consolidated statements of income, shareholders equity and cash flows for the years ended December 31, 2009, 2008 and for the period from May 3, 2007 (incorporation date) to December 31, 2007. Our audit also included the financial statement schedule listed in the Index at Item 18. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Babcock & Brown Air Limited and subsidiaries at December 31, 2009, 2008 and consolidated results of their operations and their cash flows for the years ended December 31, 2009 and 2008 and for the period from May 3, 2007 (incorporation date) to December 31, 2007, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material aspects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Babcock & Brown Air Limited and subsidiaries' internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 8, 2010 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP
San Francisco, California
March 8, 2010

Table of Contents**Babcock & Brown Air Limited****Consolidated Balance Sheets****AS OF DECEMBER 31, 2009 AND 2008****(Dollar amounts in thousands, except par value data)**

| | December 31, 2009 | December 31, 2008 |
|--|------------------------------|------------------------------|
| Assets | | |
| Cash and cash equivalents | \$ 95,972 | \$ 56,763 |
| Restricted cash and cash equivalents | 139,241 | 113,658 |
| Rent receivables | 3,927 | 4,148 |
| Flight equipment held for operating leases, net | 1,748,988 | 1,830,612 |
| Deferred tax asset, net | 10,465 | 40,734 |
| Fair market value of derivative asset | 30 | 2,368 |
| Other assets, net | 25,509 | 37,891 |
| Total assets | 2,024,132 | 2,086,174 |
| Liabilities | | |
| Accounts payable and accrued liabilities | 5,780 | 13,809 |
| Rentals received in advance | 9,656 | 9,476 |
| Payable to related parties | 8,106 | 2,728 |
| Security deposits | 34,425 | 35,664 |
| Maintenance payment liability | 118,224 | 88,526 |
| Notes payable, net | 657,649 | 826,301 |
| Borrowings under aircraft acquisition facility | 594,566 | 597,471 |
| Credit facility | 32,290 | |
| Fair market value of derivative liabilities | 65,726 | 113,374 |
| Other liabilities | 13,186 | 9,412 |
| Total liabilities | 1,539,608 | 1,696,761 |
| Shareholders equity | | |
| Common shares, \$0.001 par value; 499,999,900 shares authorized; 30,279,948 and 32,488,911 shares issued and outstanding at December 31, 2009 and 2008, respectively | 30 | 32 |
| Manager shares, \$0.001 par value; 100 shares authorized, issued and outstanding | | |
| Additional paid-in capital | 490,818 | 499,882 |
| Retained earnings (deficit) | 47,844 | (16,584) |
| Accumulated other comprehensive loss, net | (54,168) | (93,917) |
| Total shareholders equity | 484,524 | 389,413 |
| Total liabilities and shareholders equity | \$ 2,024,132 | \$ 2,086,174 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**Babcock & Brown Air Limited****Consolidated Statements of Income**

**FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 AND FOR THE PERIOD FROM MAY 3, 2007
(INCORPORATION DATE) TO DECEMBER 31, 2007**

(Dollar amounts in thousands, except per share data)

| | Year ended December 31, 2009 | Year ended December 31, 2008 | Period from May 3, 2007 (Incorporation Date) to December 31, 2007 |
|---|------------------------------------|------------------------------------|--|
| Revenues | | | |
| Operating lease revenue | \$ 213,964 | \$ 218,940 | \$ 26,042 |
| Finance lease income | | 2,446 | 2,365 |
| Gain on sale of aircraft | | 11,437 | |
| Gain on purchases of notes payable | 82,666 | | |
| Lease termination settlement | 8,307 | | |
| Interest and other income | 2,598 | 3,315 | 4,927 |
| Total revenues | 307,535 | 236,138 | 33,334 |
| Expenses | | | |
| Depreciation | 83,650 | 74,161 | 8,573 |
| Interest expense | 80,925 | 81,689 | 14,628 |
| Hedging costs | | | 1,725 |
| Selling, general and administrative | 21,094 | 20,989 | 4,866 |
| Debt purchase option amortization | 6,053 | | |
| Maintenance and other costs | 2,353 | 4,307 | 165 |
| Total expenses | 194,075 | 181,146 | 29,957 |
| Net income before provision for income taxes | 113,460 | 54,992 | 3,377 |
| Provision for income taxes | 24,367 | 6,867 | 1,032 |
| Net income | \$ 89,093 | \$ 48,125 | \$ 2,345 |
| Weighted average number of shares basic and diluted | 30,831,637 | 33,524,074 | 12,584,008 |
| Earnings per share basic and diluted | \$ 2.89 | \$ 1.44 | \$ 0.19 |
| Dividends declared and paid per share | \$ 0.80 | \$ 2.00 | \$ -- |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**Babcock & Brown Air Limited****Consolidated Statements of Shareholders' Equity**

FOR THE PERIOD FROM MAY 3, 2007 (INCORPORATION DATE) TO DECEMBER 31, 2007 AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2009

(Dollar amounts in thousands)

| | Manager Shares | Common Shares | Common Shares | Additional Paid-in Capital | Notes Receivable for Common Shares | Retained Earnings (Deficit) | Accumulated Other Comprehensive Loss, net | Total Shareholder Equity | Total Comprehensive Income (Loss) |
|--|-------------------|------------------|------------------|----------------------------------|--|-----------------------------------|---|--------------------------------|--|
| | Amount | Shares | Amount | | | | | | |
| Balance | | | | | | | | | |
| May 3, 2007 | | | | | | | | | |
| (incorporation date) | \$ | | \$ | \$ | \$ | \$ | \$ | \$ | -- |
| Issuance of common shares | | 1,000,000 | 1 | 9 | | | | | 10 |
| Cancellation of common shares | | (1,000,000) | (1) | (9) | | | | | (10) |
| Issuance of manager and common shares, net of underwriting fees and offering costs of \$26,444 | 100 | 33,603,450 | 34 | 746,402 | (321,354) | | | | 425,082 |
| Collections of notes receivable for common shares and offering costs | | | | | 319,527 | | | | 319,527 |
| Interest received on notes receivable for common shares | | | | 877 | | | | | 877 |
| Deemed distribution to predecessor company, net | | | | (240,940) | | | | | (240,940) |
| Net income | | | | | | 2,345 | | | 2,345 |
| Net change in the fair value of derivatives, net of deferred tax benefit of \$2,342 | | | | | | | (16,389) | (16,389) | (16,389) |

Comprehensive loss, net \$ (14,044)

**Balance
December 31,
2007**

100 \$ 33,603,450 \$ 34 \$ 506,339 \$ (1,827) \$ 2,345 \$ (16,389) \$ 490,502

Collections of notes receivable for common shares 1,827 1,827

Dividends to shareholders (67,054) (67,054)

Other Shares repurchased 140 (6,597) 140 (6,599)

Net income 48,125 48,125 \$ 48,125

Net change in the fair value of derivatives, net of deferred tax benefit of \$11,075 (77,528) (77,528) (77,528)

Comprehensive loss, net \$ (29,403)

**Balance
December 31,
2008**

100 \$ 32,488,911 \$ 32 \$ 499,882 \$ (16,584) \$ (93,917) \$ 389,413

Dividends to shareholders (24,665) (24,665)

Shares repurchased (2,208,963) (9,064) (9,066)

Net income 89,093 89,093 \$ 89,093

Net change in the fair value of derivatives, net of deferred tax liability of \$5,710 39,974 39,974 39,974

Reclassified from other comprehensive income into earnings, net of deferred tax of \$32 (225) (225) (225)

Comprehensive income, net \$ 128,842

Balance

December 31,

2009 **100** **\$** **30,279,948** **\$** **30** **\$** **490,818** **\$** **47,844** **\$** **(54,168)** **\$** **484,524**

The accompanying notes are an integral part of these consolidated financial statements.

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Babcock & Brown Air Limited
Consolidated Statements of Cash Flows
FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 AND FOR THE PERIOD FROM MAY 3, 2007
(INCORPORATION DATE) TO DECEMBER 31, 2007
(Dollar amounts in thousands)

| | Year ended December 31, 2009 | Year ended December 31, 2008 | Period from May 3, 2007 (Incorporation Date) to December 31, 2007 |
|--|---------------------------------------|---------------------------------------|--|
| Cash Flows from Operating Activities | | | |
| Net Income | \$ 89,093 | \$ 48,125 | \$ 2,345 |
| Adjustments to reconcile net income to net cash flows provided by operating activities: | | | |
| Gain on purchases of notes payable | (82,666) | | |
| Gain on sale of aircraft | | (11,437) | |
| Depreciation | 83,650 | 74,161 | 8,573 |
| Amortization of debt issuance and write-off of debt extinguishment costs | 7,251 | 7,532 | 1,467 |
| Amortization of lease incentives | 4,315 | 2,333 | |
| Amortization of debt purchase option | 6,053 | | |
| Amortization of lease discounts/premiums and other items | (1,349) | (1,910) | 189 |
| Direct finance lease income | | (2,446) | (2,365) |
| Maintenance payment liability relieved | | (8,463) | |
| Deferred income taxes | 24,198 | 7,054 | 36 |
| Unrealized gain on derivative instruments | (257) | (156) | |
| Proceeds from termination of swap contract | | 2,065 | |
| Changes in operating assets and liabilities: | | | |
| Rent receivables | (829) | (3,316) | (832) |
| Other assets | 3,499 | (5,600) | (8,934) |
| Payable to related parties | 5,378 | 430 | 1,651 |
| Accounts payable and accrued liabilities | (2,948) | (1,973) | 6,464 |
| Rentals received in advance | 180 | 1,801 | 7,675 |
| Other liabilities | 2,801 | 3,012 | 5,891 |
| Net cash flows provided by operating activities | 138,369 | 111,212 | 22,160 |
| Cash Flows from Investing Activities | | | |
| Acquisition of aircraft comprising the Initial Portfolio | | (54,068) | (1,139,952) |
| Purchase of flight equipment | | (451,579) | (228,423) |
| Deposits on flight equipment purchases | | | (700) |
| Lessor contribution to maintenance | (7,107) | (9,964) | |
| Proceeds from sale of aircraft | | 42,145 | |
| Proceeds from direct finance lease | | 2,700 | 2,635 |
| Net cash flows used in investing activities | (7,107) | (470,766) | (1,366,440) |

Cash Flows from Financing Activities

| | | | |
|---|----------|----------|-----------|
| Restricted cash and cash equivalents | (25,583) | (1,037) | (112,621) |
| Security deposits received | 6,552 | 8,931 | 24,842 |
| Security deposits returned | (6,741) | (5,913) | (1,943) |
| Maintenance payment liability receipts | 38,208 | 39,137 | 7,590 |
| Maintenance payment liability disbursements | (8,510) | (7,687) | |
| Debt issuance costs | (204) | (894) | |
| Option to purchase notes payable | (7,000) | | |
| Proceeds from credit facility | 30,837 | | |
| Proceeds from aircraft acquisition facility | | 464,898 | 122,908 |
| Proceeds from issuance of notes payable, net | | | 825,149 |
| Notes payable purchases | (82,976) | | |
| Repayment of notes payable | | (24,908) | |
| Repayment of aircraft acquisition facility | (2,905) | | |
| Interest received on notes receivable for common shares | | | 877 |

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| | Year ended December 31, 2009 | Year ended December 31, 2008 | Period from May 3, 2007 (Incorporation Date) to December 31, 2007 |
|---|---|---|--|
| Collections of notes receivable for common shares | | 1,827 | 67,556 |
| Proceeds from issuance of IPO shares, net | | | 401,353 |
| Proceeds from private placement shares | | | 24,195 |
| Shares repurchased | (9,066) | (6,599) | (10) |
| Dividends paid | (24,665) | (67,054) | |
| Net cash flows (used in) provided by financing activities | (92,053) | 400,701 | 1,359,896 |
| Net increase in cash | 39,209 | 41,147 | 15,616 |
| Cash at beginning of period | 56,763 | 15,616 | |
| Cash at end of period | \$ 95,972 | \$ 56,763 | \$ 15,616 |
| Supplemental Disclosure: | | | |
| Cash paid during the period for: | | | |
| Interest | \$ 73,420 | \$ 72,936 | \$ 10,168 |
| Taxes | 32 | 659 | 341 |
| Noncash Investing and Financing Activities: | | | |
| Debt issuance costs netted with proceeds from credit facility | 1,453 | | |
| Security deposit applied to rent receivable | 1,050 | | |
| Maintenance liabilities transferred for Initial Portfolio | | | 42,259 |
| Noncash consideration exchanged for aircraft | | | 251,971 |
| Noncash transactions from purchase of flight equipment: | | | |
| Security deposits | | 10,693 | |
| Maintenance payment liability | | 15,689 | |
| Other liabilities | | 2,267 | |
| Noncash transactions from sale of aircraft: | | | |
| Security deposits | | (946) | |
| The accompanying notes are an integral part of these consolidated financial statements. | | | |

Table of Contents**Babcock & Brown Air Limited**

Notes to Consolidated Financial Statements

For the year ended December 31, 2009

1. ORGANIZATION

Babcock & Brown Air Limited (the Company or B&B Air) is a Bermuda exempted company incorporated on May 3, 2007 under the provisions of Section 14 of the Companies Act 1981 of Bermuda. The Company was formed to acquire, finance, lease and sell commercial jet aircraft and other aviation assets directly or indirectly through its subsidiaries.

On October 2, 2007, the Company (i) completed its initial public offering (IPO) and issued 18,695,650 common shares in the form of American Depositary Shares (ADSs); (ii) completed a private placement of 14,907,800 ADSs (Private Placement), and together with the IPO, Offerings) and (iii) issued \$853.0 million of aircraft lease-backed Class G-1 notes (the Notes) at an offering price of 99.71282%, or \$850.6 million, as part of a securitization transaction (the Securitization) through a subsidiary, B&B Air Funding (see Note 6). Using proceeds of the Offerings and the Notes, the Company acquired its initial portfolio of 47 commercial jet aircraft (Initial Portfolio).

On November 7, 2007, a subsidiary of the Company, B&B Air Acquisition, entered into a revolving credit facility (the Aircraft Acquisition Facility) that provided for up to \$1.2 billion of financing for additional aircraft including a \$96.0 million equity tranche from B&B Air. (See Note 7)

Although the Company is organized under the laws of Bermuda, it is a resident of Ireland for tax purposes and is subject to Irish corporation tax on its income in the same way, and to the same extent, as if the Company were organized under the laws of Ireland.

In accordance with the Company's bye-laws, B&B Air issued 100 shares (Manager Shares) with a par value of \$0.001 to Babcock & Brown Air Management Co. Limited (the Manager) for no consideration. Subject to the provisions of the Company's bye-laws, the Manager Shares have the right to appoint the nearest whole number of directors to the Company which is not more than 3/7th of the number of directors comprising the board of directors. The Manager Shares are not entitled to receive any dividends, are not convertible into common shares and, except as provided for in the Company's bye-laws, have no voting rights.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**BASIS OF PREPARATION**

B&B Air is a holding company that conducts its business through its subsidiaries. B&B Air directly or indirectly owns all of the common shares of its subsidiaries. The consolidated financial statements presented are prepared in accordance with U.S. generally accepted accounting principles (GAAP). The consolidated financial statements include the accounts of B&B Air and all of its subsidiaries. In instances where it is the primary beneficiary, B&B Air would consolidate a Variable Interest Entity (VIE). All intercompany transactions and balances have been eliminated. The consolidated financial statements are stated in U.S. Dollars, which is the principal operating currency of the Company. Certain amounts in the consolidated financial statements have been reclassified to conform to the current presentation. Such reclassification had no impact on consolidated net income or shareholders' equity.

USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. For the Company, the use of estimates is or could be a significant factor affecting the reported carrying values of flight equipment, deferred tax assets and accruals and reserves. To the extent available, the Company utilizes industry specific resources, third-party appraisers and other materials to support estimates, particularly with respect to flight equipment. Despite management's best efforts to accurately estimate such amounts, actual results could differ from those estimates.

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Babcock & Brown Air Limited

Notes to Consolidated Financial Statements

For the year ended December 31, 2009

RISKS AND UNCERTAINTIES

The Company encounters several types of risk during the course of its business, including credit and market risks. Credit risk addresses a lessee's or derivative counterparty's inability or unwillingness to make contractually required payments. Market risk reflects the change in the value of derivatives and credit facilities due to changes in interest rate spreads or other market factors, including the value of collateral underlying the Company's credit facilities.

Other types of risk encountered by the Company include the following:

The success of the Company is dependent on the performance of the commercial aviation industry. A downturn in the industry could adversely impact the lessee's ability to make payments, increase the risk of unscheduled lease termination and depress lease rates and the value of the Company's aircraft.

The Company will require access to the capital markets to refinance its current portfolio of aircraft and to grow its business through the acquisition of additional aircraft. The availability period under the Aircraft Acquisition Facility expired on November 6, 2009. (See Note 7) The Company intends to refinance the Aircraft Acquisition Facility, but may not be able to do so on acceptable terms or at all if the current dislocation of the financial markets continues. In addition, the Company is subject to risks associated with movements in interest rates, which may impact the Company's obligations under its debt facilities and its derivative contracts. The Company also bears the credit risks of its counterparties in its derivative contracts. The Company also faces risks associated with its management and servicing arrangements. The Company relies on an external servicer to manage its business and service its aircraft portfolio. Babcock & Brown, the ultimate parent of the Company's servicer, Babcock & Brown Aircraft Management (BBAM) and the Manager, was placed into voluntary administration in Australia on March 13, 2009. Babcock & Brown has informed the Company that Babcock & Brown International Pty Ltd. (BBIPL), which is both the main operating and asset-owning entity in the Babcock & Brown group, continues to pursue its business plan to sell all of its assets. Although no definitive transaction has been announced, the Company expects Babcock & Brown to sell substantially all of its aviation-related assets, including the assets and servicing agreements associated with BBAM. In addition, the departure of any key employee or a significant number of professionals from the manager or servicer could have a material adverse effect on the Company's performance.

Some of the Company's agreements with Babcock & Brown, as well as the agreements governing the Notes and the Aircraft Acquisition Facility, contain provisions that are linked to the financial performance and ownership of Babcock & Brown and BBAM which could result in a servicer replacement event and an event of default under the Aircraft Acquisition Facility (see Note 7).

CASH AND CASH EQUIVALENTS

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

RENT RECEIVABLES

Rent receivables represent unpaid lessee obligations under existing lease contracts. Any allowance for doubtful accounts is established on a specific identification basis and is maintained at a level believed by management to be adequate to absorb probable losses inherent in rent receivables. The assessment of credit risk is primarily based on the extent to which amounts outstanding exceed the value of security held, the financial strength and condition of a debtor and the current economic and regulatory conditions of the debtor's operating environment and geographical areas, including regulatory and general economic conditions. Determination of the allowance is inherently subjective as it requires significant estimates, including the amounts and timing of expected future cash flows and consideration of current factors and economic trends, all of which may be susceptible to significant change. Uncollectible rent receivables are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. A provision for credit losses is recorded based on management's periodic evaluation of the factors previously mentioned, as well as other pertinent factors. As of December 31, 2009 and 2008, the Company had no

allowance for doubtful accounts.

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Babcock & Brown Air Limited

Notes to Consolidated Financial Statements

For the year ended December 31, 2009

RESTRICTED CASH AND CASH EQUIVALENTS

Pursuant to the Company's debt facilities, payments received from lessees serve as collateral to the lenders and are thus subject to withdrawal restrictions. The Company's restricted cash and cash equivalents consist primarily of (i) security deposits and certain maintenance payments received from lessees under the terms of various lease agreements, (ii) a portion of rents collected required to be held as cash collateral and (iii) other cash, all of which are subject to withdrawal restrictions pursuant to the order of priority governed by the Company's credit agreements which are further described in Notes 6 and 7.

All restricted cash is held by major financial institutions in segregated accounts.

FLIGHT EQUIPMENT HELD FOR SALE

In accordance with guidance provided by FASB, flight equipment is classified as held for sale when the Company commits to and commences a plan of sale that is reasonably expected to be completed within one year. Flight equipment held for sale is stated at the lower of carrying value or fair value less estimated cost to sell.

Flight equipment held for sale is not depreciated. Subsequent changes to the asset's fair value, either increases or decreases, are recorded as adjustments to the carrying value of the flight equipment. However, any such adjustment would not exceed the original carrying value of the flight equipment held for sale.

FLIGHT EQUIPMENT HELD FOR OPERATING LEASES

Flight equipment held for operating lease are recorded at cost and depreciated to estimated residual values on a straight-line basis over their estimated remaining useful lives. Aircraft transferred from the Company's predecessor, JET-i Leasing LLC (JET-i) in conjunction with the Offerings were recorded by the Company at the predecessor's net book value as of the delivery date. Useful life is generally 25 years from the date of manufacture, except in the case of a converted freighter whose remaining useful life is determined based on the date of conversion. In such a case, the total useful life of the aircraft may extend beyond 25 years from the date of manufacture. Residual values are generally estimated to be 15% of original manufacturer's estimated realized price for the flight equipment when new. Management may, at its discretion, make exceptions to this policy on a case by case basis when, in its judgment, the residual value calculated pursuant to this policy does not appear to reflect current expectations of residual values.

Examples of such situations include, but are not limited to:

Flight equipment where original manufacturer's prices are not relevant due to plane modifications and conversions.

Flight equipment which is out of production and may have a shorter useful life or lower residual value due to obsolescence.

Estimated residual values and useful lives of flight equipment are reviewed and adjusted, if appropriate, at each reporting period. As of December 31, 2009 and 2008, management's estimates of residual values for flight equipment held for operating leases averaged 13.3% and 14.4%, respectively, of the original manufacturer's estimated realized price.

Major improvements to be performed by the Company pursuant to the lease agreement are accounted for as lease incentives and are amortized against revenue over the term of the lease, assuming no lease renewals. Lessee specific modifications to the aircraft are capitalized and also amortized against revenue over the term of the lease. Generally, lessees are required to provide for repairs, scheduled maintenance and overhauls during the lease term and to be compliant with return conditions of flight equipment at lease termination.

Major improvements and modifications incurred for an aircraft that is off-lease are capitalized and depreciated over the remaining life of the flight equipment. In addition, costs paid by us for scheduled maintenance and overhauls are also capitalized and depreciated over a period to the next scheduled maintenance or overhaul event. Miscellaneous repairs are expensed when incurred.

At the time of an aircraft acquisition, the Company evaluates whether the lease acquired with the aircraft is at fair market value by comparing the contractual lease rates to the range of current lease rates of like aircraft. A lease premium is recognized when it is determined that the acquired lease's terms are above market value; lease discounts

are recognized when it is determined that the acquired lease's terms are below fair market value. Lease discounts are capitalized into other liabilities and amortized as additional rental revenue on straight-line basis over the lease term. Lease premiums are capitalized into other assets and deducted from rental revenue on a straight-line basis over the lease term.

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IMPAIRMENT OF FLIGHT EQUIPMENT

The Company evaluates flight equipment for impairment at least annually and where circumstances indicate that the carrying amounts of such assets may not be recoverable. Our evaluation of impairment indicators include, but are not limited to, recent transactions for similar aircraft, adverse changes in market conditions for specific aircraft types, third party appraisals of specific aircraft, published values for similar aircraft, any occurrences of adverse changes in the aviation industry and the overall market conditions that could impact the fair value of our aircraft. The review for recoverability includes an assessment of the estimated future cash flows associated with the use of an asset and its eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, the Company will assess whether the carrying values of the flight equipment exceed the fair values and an impairment loss is required. The impairment loss is measured as the excess of the carrying amount of the impaired asset over its fair value. Fair value reflects the present value of cash expected to be received from the aircraft in the future, including its expected residual value discounted at a rate commensurate with the associated risk. Future cash flows are assumed to occur under current market conditions and assume adequate time for a sale between a willing and able buyer and a willing seller. Expected future lease rates are based on all relevant information available, including the existing lease, current contracted rates for similar aircraft, appraisal data and industry trends. Residual value assumptions generally reflect an aircraft's salvage value, except where more recent industry information indicates a different value is appropriate.

The preparation of these impairment analyses requires the use of assumptions and estimates, including the level of future rents, the residual value of the flight equipment to be realized upon sale at some date in the future, estimated downtime between re-leasing events and the amount of re-leasing costs. There were no impairment losses recognized for the years ended December 31, 2009 and 2008 and for the period from May 3, 2007 (incorporation date) to December 31, 2007.

INVESTMENT IN DIRECT FINANCE LEASES

The Company had recorded certain leases as an Investment in Direct Finance Leases which consisted of lease receivables, plus the estimated residual value of the equipment on lease termination date less unearned income. Lease receivables represented the total rent to be received over the term of the lease reduced by rent already collected. Initial unearned income represented the amount by which the original sum of the lease receivable and the estimated residual value exceeded the original cost of the leased equipment. Unearned income was amortized to finance lease income over the lease term in a manner that produced a constant rate of return on the net investment in the lease.

At December 31, 2009 and 2008, there were no aircraft accounted for as direct finance leases.

DERIVATIVE FINANCIAL INSTRUMENTS

The Company uses derivative financial instruments to manage its exposure to interest rate and foreign currency risks. Derivatives are accounted for in accordance with applicable FASB guidelines. All derivatives are recognized on the balance sheet at their fair values. Pursuant to hedge accounting provisions, changes in the fair value of the item being hedged can be recognized into earnings in the same period and in the same income statement line as the change in the fair value of the derivative instrument. On the date that the Company enters into a derivative contract, the Company formally documents all relationships between the hedging instruments and the hedged items, as well as its risk management objective and strategy for undertaking each hedge transaction.

Derivative instruments designated in a hedge relationship to mitigate exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Cash flow hedges are accounted for by recording the fair value of the derivative instrument on the balance sheet as either a freestanding asset or liability. Changes in the fair value of a derivative that is designated and qualifies as an effective cash flow hedge are recorded in accumulated other comprehensive income (loss), net of tax, until earnings are affected by the variability of cash flows of the hedged transaction.

Any derivative gains and losses that are not effective in hedging the variability of expected cash flows of the hedged item are recognized directly into income. Changes in the fair value of derivative financial instruments that do not

qualify for hedge treatment are recorded in income.

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At the hedge's inception and at least quarterly thereafter, a formal assessment is performed to determine whether changes in cash flows of the derivative instrument have been highly effective in offsetting changes in the cash flows of the hedged items and whether they are expected to be highly effective in the future. If it is determined that a derivative instrument has not been or will not continue to be highly effective as a hedge, hedge accounting is discontinued. When this occurs, unrecognized gains and losses recorded on hedged assets and liabilities are amortized into income over the remaining life of the hedged item beginning no later than when hedge accounting ceases.

OTHER ASSETS

Other assets consist primarily of debt issuance costs, unamortized lease premiums, initial direct lease costs and other receivables. The Company capitalizes costs incurred in arranging financing as debt issuance costs. Debt issuance costs are amortized to interest expense using the effective interest method over the terms of the credit facilities. Lease premiums are amortized into lease income over the lease term.

SECURITY DEPOSITS

In the normal course of leasing aircraft to third parties under its lease agreements, the Company receives cash or letters of credit as security for certain contractual obligations. At December 31, 2009 and 2008, security deposits represent cash received from the lessee that is held on deposit until termination of the lease.

MAINTENANCE PAYMENT LIABILITY

The Company's flight equipment is typically subject to triple-net leases under which the lessee is responsible for maintenance, insurance and taxes. B&B Air's operating leases also obligate the lessees to comply with all governmental requirements applicable to the flight equipment, including without limitation, operational, maintenance, registration requirements and airworthiness directives.

Under the terms of the lease agreements, cash collected from lessees for future maintenance of the aircraft is recorded on the Consolidated Balance Sheet as maintenance payment liabilities. The Company does not recognize such maintenance payments as revenue during the lease. Maintenance payment liabilities are attributable to specific aircraft and are typically based on hours or cycles of utilization, depending upon the component. Upon occurrence of qualified maintenance events, the lessee submits a request for reimbursement and upon disbursement of the funds, the liability is relieved.

In some leases, the lessor may be obligated to contribute to maintenance related expenses on an aircraft during the term of the lease. In other instances, the lessee or lessor may be obligated to make a payment to the other party at the end of lease based on a computation stipulated in the lease agreement. The calculation is based on the utilization and condition of the airframe, engines and other major life-limited components as determined at lease termination.

The Company may also incur maintenance expenses on off-lease aircraft. Scheduled major maintenance or overhaul activities and costs for certain high-value components that are paid by the Company are capitalized and depreciated over the period until the next overhaul is required. Amounts paid by the Company for minor maintenance, repairs and re-leasing of aircraft are expensed as incurred.

Maintenance payment liability balances at the end of a lease or any amount received as part of a redelivery adjustment are recorded as lease revenue at lease termination, including early termination upon a default. When flight equipment is sold, the maintenance payment liability amounts are generally remitted to the buyer in accordance with the terms of the related agreements and are released from the balance sheet as part of the disposition gain or loss.

REVENUE RECOGNITION

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be reliably measured. Where revenue amounts do not meet these recognition criteria, they are deferred and recognized in the period in which the recognition criteria are met.

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Notes to Consolidated Financial Statements

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OPERATING LEASE REVENUE

The Company receives operating lease revenue from flight equipment held for operating leases. Rental income from aircraft is recognized on a straight-line basis over the initial term of the respective lease. The operating lease agreements generally do not provide for purchase options, however, the leases may allow the lessee the option to extend the lease for an additional term. Contingent rents are recognized as revenue when the contingency is resolved. Revenue is not recognized when collection is not reasonably assured and revenue is recognized when cash payments are received

FINANCE LEASE INCOME

Revenue from direct finance leases is recognized on the interest method to produce a level yield over the life of the finance lease. Expected unguaranteed residual values of leased assets are based on the Company's assessment of residual values and independent appraisals of the values of leased assets remaining at expiration of the lease terms.

TAXES

The Company provides for income taxes by tax jurisdiction (see Note 10). Deferred income tax assets and liabilities are recognized for the future tax consequences of temporary differences between the financial statement and tax basis of existing assets and liabilities at the enacted tax rates of the Company's tax jurisdiction expected to apply when the assets are recovered or liabilities are settled. A valuation allowance is used to reduce deferred tax assets to the amount which management ultimately expects to be more-likely-than-not realized.

The Company applies a recognition threshold of more-likely-than-not to be sustained in the examination of tax uncertainty in income taxes. Measurement of the tax uncertainty occurs if the recognition threshold has been met. FASB also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company has elected to classify any interest on unpaid income taxes and penalties as a component of the provision for income taxes.

NEW ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2009, the Company fully implemented the guidance provided by FASB for all non-financial assets and liabilities recognized or disclosed at fair value in the financial statements on a non-recurring basis. Non-recurring non-financial assets and liabilities include long-lived assets, such as our flight equipment, that are measured at fair value for purposes of impairment testing. The implementation of the FASB guidance for non-recurring non-financial assets and liabilities recognized or disclosed at fair value in the financial statements did not have any impact on the Company's consolidated financial statements.

The Company will apply the authoritative pronouncement by FASB which requires an acquiring entity to recognize the assets acquired, the liabilities assumed, and any non-controlling interest in the business acquired at their fair market values as of the acquisition date. The pronouncement also requires the acquirer to measure goodwill as the excess of the consideration transferred plus the fair value of any non-controlling interest in the business acquired at the acquisition date over the fair values of the identifiable net assets acquired. The acquirer should also recognize and record into expense acquisition related transaction costs.

In April 2009, FASB issued additional guidance and required enhanced disclosures regarding certain fair value measurements. The FASB provided guidance for determining fair values when markets become inactive and for identifying distressed transactions. FASB also amended the guidance for determining whether debt securities are other-than-temporarily impaired and required enhanced presentation and disclosure of other-than-temporary impairments on debt and equity securities held as assets in a company's financial statements. The FASB also issued a statement of position requiring disclosures by entities about the fair values of their financial instruments in their interim and annual financial statements. This guidance was effective starting with the period ended June 30, 2009 and did not have a material impact on the Company's consolidated financial statements.

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In June 2009, FASB issued an authoritative pronouncement which clarifies the criteria for determining whether a transferor has surrendered control when transferring financial assets. The determination must consider the transferor's continuing involvement with the transferred financial asset, including all arrangements or agreements made contemporaneously with, or in contemplation of, the transfer. The pronouncement limits the circumstances in which a financial asset, or portion of a financial asset, should be derecognized when the transferor has not transferred the entire original financial asset to another entity and/or when the transferor has continuing involvement with the transferred asset. A transferor can account for the transfer of an asset as a sale only if the transferor surrenders control over the asset. The pronouncement is effective for financial asset transfers occurring on or after December 31, 2009.

In June 2009, FASB also issued a pronouncement which requires an enterprise to perform analysis and ongoing reassessments to determine whether its variable interest or interests give it a controlling financial interest in a variable interest entity. The pronouncement identifies the characteristics of the primary beneficiary of a variable interest entity and amends the guidance for determining whether an entity is a variable interest entity. Additionally, an enterprise is required to assess whether it has an implicit financial responsibility to ensure that a variable interest entity operates as designed when determining whether it has the power to direct the activities of the variable interest entity that most significantly impact the entity's economic performance. The pronouncement is effective for interim and annual reporting periods after December 31, 2009.

Effective September 30, 2009, the FASB Accounting Standards Codification (Codification) became the authoritative source of generally accepted accounting principles in the United States. The Codification also superseded all then-existing non-SEC accounting and reporting standards. FASB will no longer issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates which will serve to update the Codification. In addition, the GAAP hierarchy was modified to include only two levels of GAAP: authoritative and non-authoritative.

3. FLIGHT EQUIPMENT HELD FOR OPERATING LEASES

As of December 31, 2009 and 2008, the Company had 62 aircraft held for operating leases. No aircraft were purchased or sold during the year ended December 31, 2009.

Flight equipment held for operating leases consist of the following:

| | December 31, 2009 | December 31, 2008 |
|--|-------------------------------|--------------------------|
| | (Dollars in thousands) | |
| Cost | \$ 1,912,825 | \$ 1,910,798 |
| Accumulated depreciation | (163,837) | (80,186) |
| Net Flight Equipment Held for Operating Lease | \$ 1,748,988 | \$ 1,830,612 |

The Company capitalized \$2.0 million and \$17.8 million of major maintenance expenditures for the years ended December 31, 2009 and 2008, respectively. These amounts have been included in Flight Equipment Held for Operating Leases.

The classification of the net book value of flight equipment held for operating leases and operating lease revenues by geographic region in the tables and discussion below is based on the principal operating location of the aircraft lessee. The distribution of the net book value of flight equipment held for operating leases by geographic region is as follows:

| | December 31, 2009 | | December 31, 2008 | |
|--|-------------------------------|----|--------------------------|----|
| | (Dollars in thousands) | | | |
| Europe, Middle East and Africa: | | | | |
| Germany | \$ 130,674 | 8% | \$ 136,712 | 8% |

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| | | | | |
|---|----------------|------------|----------------|------------|
| The Netherlands | 126,636 | 7% | 132,116 | 7% |
| United Kingdom | 72,569 | 4% | 76,120 | 4% |
| Switzerland | 39,290 | 2% | 42,394 | 2% |
| Other | 455,406 | 26% | 461,949 | 25% |
| Europe, Middle East and Africa Total | 824,575 | 47% | 849,291 | 46% |
| Asia Pacific: | | | | |
| India | 254,141 | 15% | 263,450 | 15% |
| China | 142,925 | 8% | 148,731 | 8% |
| Other | 36,302 | 2% | 37,689 | 2% |
| Asia Pacific Total | 433,368 | 25% | 449,870 | 25% |

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| | December 31, 2009 | | December 31, 2008 | |
|--|-------------------------------|-------------|--------------------------|-------------|
| | (Dollars in thousands) | | | |
| North America: | | | | |
| United States | 302,756 | 17% | 315,972 | 17% |
| Other | 39,115 | 3% | 40,603 | 2% |
| North America Total | 341,871 | 20% | 356,575 | 19% |
| Mexico, South and Central America: | | | | |
| Mexico | 149,174 | 8% | 155,710 | 9% |
| Mexico, South and Central America Total | 149,174 | 8% | 155,710 | 9% |
| Off-lease Total | | | 19,166 | 1% |
| Total Flight Equipment | \$ 1,748,988 | 100% | \$ 1,830,612 | 100% |

As of December 31, 2009 and 2008, the Company had 62 aircraft held for operating lease. At December 31, 2009, all of the 62 aircraft held for operating leases were on lease to 36 lessees in 19 countries. At December 31, 2008, 61 of the aircraft held for operating leases were on lease to 36 lessees in 19 countries. One aircraft was off-lease as of December 31, 2008.

The distribution of operating lease revenue by geographic region is as follows:

| | Year ended December 31, 2009 | | Year ended December 31, 2008 | | Period from May 3, 2007 (Incorporation Date) to December 31, 2007 | |
|---|---|------------|---|------------|--|------------|
| | (Dollars in thousands) | | | | | |
| Europe, Middle East and Africa: | | | | | | |
| Germany | \$ 17,174 | 8% | \$ 16,353 | 7% | \$ 1,416 | 5% |
| The Netherlands | 16,331 | 8% | 13,990 | 6% | 728 | 3% |
| United Kingdom | 9,624 | 5% | 17,388 | 8% | 3,120 | 12% |
| Switzerland | 8,423 | 4% | 13,296 | 6% | 1,083 | 4% |
| Other | 52,652 | 24% | 42,167 | 20% | 3,078 | 12% |
| Europe, Middle East and Africa Total | 104,204 | 49% | 103,194 | 47% | 9,425 | 36% |
| Asia Pacific: | | | | | | |
| India | 27,451 | 13% | 26,604 | 12% | 2,189 | 8% |
| China | 16,391 | 8% | 17,491 | 8% | 3,827 | 15% |
| Other | 3,017 | 1% | 3,553 | 2% | 939 | 4% |
| Asia Pacific Total | 46,859 | 22% | 47,648 | 22% | 6,955 | 27% |
| North America: | | | | | | |

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| | | | | | | |
|--|-------------------|-------------|-------------------|-------------|------------------|-------------|
| United States | 39,600 | 19% | 39,180 | 18% | 3,457 | 13% |
| Other | 5,009 | 2% | 5,007 | 2% | 433 | 2% |
| North America Total | 44,609 | 21% | 44,187 | 20% | 3,890 | 15% |
| Mexico, South and Central America: | | | | | | |
| Mexico | 18,292 | 8% | 19,802 | 9% | 4,086 | 16% |
| Other | | | 4,109 | 2% | 1,686 | 6% |
| Mexico, South and Central America Total | 18,292 | 8% | 23,911 | 11% | 5,772 | 22% |
| Total Operating Lease Revenue | \$ 213,964 | 100% | \$ 218,940 | 100% | \$ 26,042 | 100% |

The Company had no customer that accounted for 10% or more of total operating lease revenue for the years ended December 31, 2009 and 2008 or for the period from May 3, 2007 (incorporation date) to December 31, 2007. During the year ended December 31, 2009, the Company stopped accruing rent from one lessee due to concerns about the lessee's financial condition and only recognizes revenue as cash is received from the lessee. The Company recognized revenue of \$2.9 million from this lessee during the year ended December 31, 2009.

For the year ended December 31, 2008, the Company recognized redelivery income on three expired leases totalling \$3.2 million. These amounts have been included in operating lease revenue. In addition, for the year ended December 31, 2008, the Company recognized \$8.5 million in operating lease revenue for maintenance payment liabilities retained at the end of the lease. There were no aircraft redelivery income or maintenance payment liabilities retained at the end of lease in the year ended December 31, 2009 or for the period from May 3, 2007 (incorporation date) to December 31, 2007.

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The amortization of lease discounts, net of lease premiums which have been included as a component of operating lease revenue was \$2.0 million, \$2.5 million and \$0.2 million for the years ended December 31, 2009 and 2008, and for the period from May 3, 2007 (incorporation date) to December 31, 2007, respectively.

As of December 31, 2009 and 2008, the weighted average remaining lease term of the Company's aircraft portfolio was 4.8 years and 5.5 years, respectively.

Presented below are the contracted future minimum rental payments due under non-cancellable operating leases, as of December 31, 2009. For leases that have floating rental rates based on the six-month LIBOR, the future minimum rental payments due assume that the rental payment due as of December 31, 2009 would be held constant for the duration of the lease.

| Year ending December 31, | (Dollars in thousands) | |
|--|-------------------------------|------------------|
| 2010 | \$ | 203,176 |
| 2011 | | 186,655 |
| 2012 | | 176,336 |
| 2013 | | 151,506 |
| 2014 | | 132,653 |
| Thereafter | | 178,690 |
| Future Minimum Rental Payments under Operating Leases | \$ | 1,029,016 |

For the years ended December 31, 2009 and 2008, amortization of lease incentives recorded as a reduction of operating lease revenue totalled \$4.3 million and \$2.3 million, respectively. There were no lease incentives amortized during the period from May 3, 2007 (incorporation date) to December 31, 2007. At December 31, 2009, lease incentive amortization for the next five years and thereafter is as follows:

| Year ending December 31, | (Dollars in thousands) | |
|--|-------------------------------|---------------|
| 2010 | \$ | 5,164 |
| 2011 | | 5,164 |
| 2012 | | 5,164 |
| 2013 | | 3,393 |
| 2014 | | 1,063 |
| Thereafter | | 313 |
| Future amortization of lease incentives | \$ | 20,261 |

In connection with the early termination of four leases in a prior period, the Company reached a settlement with the guarantor of these leases in February 2009. Pursuant to the terms of the settlement agreement, the Company received a lump-sum payment of \$6.3 million at the settlement date, with an additional \$5.9 million to be paid in monthly installments over three years with interest at 8.0% per annum. Payments totalling approximately \$8.3 million were received during the year ended December 31, 2009. Due to collectability concerns, future payments will only be recognized as cash is received.

4. INVESTMENT IN DIRECT FINANCE LEASES

On April 2, 2008, the lessee of all four of the Company's direct finance leases filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code and ceased all operations. In connection with its filing, the lessee made a first day motion to reject these aircraft leases. This motion was granted on April 8, 2008 and the leases were terminated as of that date. The lessee has been current on its rent payments through March 31, 2008.

With the termination of the direct finance leases, the aircraft are now accounted for as flight equipment held for operating lease. For both the year ended December 31, 2008 and for the for the period from May 3, 2007 (incorporation date) to December 31, 2007, the Company recognized \$2.4 million of finance lease income. The implicit interest rates in the finance leases ranged from 13% to 15%.

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For the year ended December 31, 2009

5. OTHER ASSETS

The principal components of the Company's other assets are as follows:

| | December 31, 2009 | December 31, 2008 |
|---------------------------|-------------------------------|--------------------------|
| | (Dollars in thousands) | |
| Loan issuance costs, net | \$ 17,983 | \$ 27,018 |
| Lease premiums | 3,519 | 4,120 |
| Other assets | 4,007 | 6,753 |
| Total Other Assets | \$ 25,509 | \$ 37,891 |

For the years ended December 31, 2009 and 2008 and for the period from May 3, 2007 (incorporation date) to December 31, 2007, the Company amortized \$7.3 million, \$6.9 million and \$1.5 million, respectively, of loan issuance cost into interest expense.

As of December 31, 2009 and 2008, the accumulated amortization associated with the loan issuance costs was \$15.6 million and \$8.3 million, respectively.

For the years ended December 31, 2009 and 2008, amortization of lease premiums recorded against operating lease revenue totalled \$0.6 million in each respective year. For the period from May 3, 2007 (incorporation date) to December 31, 2007, amortization of lease premiums totalled \$37,000.

The amortization into operating lease revenue of unamortized lease premiums at December 31, 2009 for the next five years and thereafter is as follows:

| Year ending December 31, | (Dollars in thousands) | |
|--|-------------------------------|--------------|
| 2010 | \$ | 601 |
| 2011 | | 601 |
| 2012 | | 601 |
| 2013 | | 601 |
| 2014 | | 601 |
| Thereafter | | 514 |
| Total future amortization of lease premiums | \$ | 3,519 |

6. NOTES PAYABLE

On October 2, 2007, B&B Air Funding issued \$853.0 million of Notes at an offering price of 99.71282%. The Notes generated net proceeds of approximately \$850.6 million after deducting initial purchaser's discounts, which were used to partially finance the acquisition of aircraft. The Notes are direct obligations of B&B Air Funding and are not obligations of, or guaranteed by B&B Air.

The Notes are secured by: (i) first priority, perfected security interests in and pledges or assignments of equity ownership and beneficial interests in the subsidiaries of B&B Air Funding; (ii) interests in the leases of the aircraft they own; (iii) cash held by or for them; and (iv) rights under agreements with BBAM, the initial liquidity facility provider, hedge counterparties and the insurance policy provider. Rentals paid under leases and proceeds from the sale of aircraft are placed in the collections account and paid out according to the priority of payments set forth in the indenture. The Notes are also secured by a lien or similar interest in any of the aircraft B&B Air Funding currently owns that are registered in the United States or Ireland. B&B Air Funding may not encumber the aircraft it currently owns or incur additional indebtedness except as permitted under the securitization related documents. Interest is

payable monthly based on the current one-month London Interbank Offered Rate (LIBOR) plus a spread of 0.67%, which includes an amount payable to Ambac Assurance Corporation, the provider of a financial guaranty insurance policy (the Policy Provider) that supports payment of interest and in certain circumstances, principal on the Notes. The financial guaranty insurance policy (the Policy) issued by the Policy Provider supports the payment of interest due on the Notes and the payment of the outstanding principal balance of the Notes on the final maturity date and, under certain circumstances, prior thereto. A downgrade of the Policy Provider 's credit rating or its failure to meet its obligations under the Policy will not have a direct impact on B&B Air Funding 's obligations or rights under the Notes.

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During the year ended December 31, 2009, the Company, through a wholly-owned subsidiary, purchased a total of \$169.4 million principal amount of the Notes, for a total purchase price of \$83.0 million, including associated expenses. These amounts include \$50.0 million principal amount of Notes purchased on exercise of an option as described below. In connection with the purchase of the Notes, the Company expensed loan issuance costs and the unamortized discount associated with the original issuance of the Notes totalling \$3.8 million. The Company recognized a pre-tax gain of \$82.7 million on the purchases of Notes. The purchased Notes remain outstanding, although Notes with a principal amount totalling \$119.4 million are pledged under the Credit Facility as described in Note 7 below.

The Company, through a wholly-owned subsidiary, entered into agreements to purchase up to an additional \$100.0 million principal amount of the Notes from an unrelated third party. Under the agreements, the Company had a right to purchase up to \$50.0 million principal amount of the Notes at any time prior to November 17, 2009, for \$24.0 million and another \$50.0 million principal amount of the Notes at any time prior to March 17, 2010 for \$24.0 million. The Company paid fees totalling \$7.0 million in connection with these agreements. The fees are being amortized on a straight-line basis over the option terms. In 2009, the Company exercised its option and purchased \$50.0 million principal amount of the Notes for \$24.0 million. In connection with the purchases, the Company recognized a pre-tax gain of \$25.0 million including expensed loan issuance costs and the unamortized discount associated with the original issuance of the Notes totalling \$1.0 million.

In January 2010, the Company sold to an unrelated third party its right to purchase up to \$35.0 million principal amount of Notes and received \$8.7 million as consideration. The Company retains an option to purchase up to \$15.0 million principal amount of Notes for \$7.2 million which expires on March 17, 2010.

As of December 31, 2009 and 2008, the Notes had a balance of \$658.7 million and \$828.1 million, respectively, net of the purchased Notes. The unamortized discount associated with the Notes totalled \$1.0 million and \$1.8 million as of December 31, 2009 and 2008, respectively. Accrued interest totalled \$0.3 million and \$0.7 million at December 31, 2009 and 2008, respectively. The interest rate on the Notes at December 31, 2009 and 2008, including the premium payable under the Policy, was 0.90% and 1.87% per annum, respectively. For the year ended December 31, 2009 and 2008, the effective average interest rate of the Notes Payable including the interest rate swap payments made was 5.57% and 5.69%, respectively. (See Note 9)

Until July 2010, there are no scheduled principal payments on the Notes and for each month between July 2010 and August 2012, there will be scheduled minimum principal payments of approximately \$1.0 million per month, in each case subject to satisfying certain debt service coverage ratios and other covenants. Effective after July 2012, all revenues collected during each monthly period will be applied to repay the outstanding balance of the Notes, after the payment of certain expenses and other costs, including the fees to the Policy Provider, interest and interest rate swap payments in accordance with those agreements. The final maturity date of the Notes is November 14, 2033.

Presented below are the anticipated future minimum principal payments due for the Notes as of December 31, 2009.

| Year ending December 31, | (Dollars in thousands) |
|--|-------------------------------|
| 2010 | \$ 9,245 |
| 2011 | 9,186 |
| 2012 | 37,453 |
| 2013 | 80,131 |
| 2014 | 85,027 |
| Thereafter | 437,634 |
| Future Minimum Principal Payments Due | \$ 658,676 |

The Company may, on a payment date, redeem the Notes in whole or from time to time in part, at the following redemption prices, expressed as percentages of principal amount, together with accrued and unpaid interest to, but excluding, the date fixed for redemption, if redeemed on the dates indicated below:

| Redemption Date | Price |
|---|--------------|
| Before April 14, 2010 | 100.36% |
| On or after April 14, 2010, but before October 14, 2010 | 100.27% |
| On or after October 14, 2010, but before April 14, 2011 | 100.17% |
| On or after April 14, 2011, but before October 14, 2011 | 100.09% |
| On or after October 14, 2011 | 100.00% |

B&B Air Funding is subject to financial and operating covenants which relate to, among other things, its operations, disposition of aircraft, lease concentration limits, restrictions on the acquisition of additional aircraft, and restrictions on the modification of aircraft and capital expenditures. A breach of the covenants could result in the acceleration of the Notes and exercise of remedies available in relation to the collateral, including the sale of aircraft at public or private sale. As of December 31, 2009, B&B Air Funding was not in default under the Notes.

In connection with the issuance of the Notes, B&B Air Funding also entered into a revolving credit facility (Note Liquidity Facility) that provides additional liquidity of up to \$60.0 million. Subject to the terms and conditions of the Note Liquidity Facility, advances may be drawn for the benefit of the Note holders to cover certain expenses of B&B Air Funding, including maintenance expenses, interest rate swap payments and interest on the Notes. Advances shall bear interest at one-month LIBOR plus a spread of 1.20%. A commitment fee of 0.40% per annum is due and payable on each payment date based on the unused portion of the Note Liquidity Facility. As of December 31, 2009 and 2008, B&B Air Funding had not drawn on the Note Liquidity Facility.

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The servicing agreement between the B&B Air Funding and BBAM may be terminated prior to its scheduled termination date in the case of certain events, including:

Babcock & Brown ceasing to own at least 50.1% of the voting or economic interest in BBAM; or

The bankruptcy or insolvency of BBAM or Babcock & Brown International Pty Ltd.

If either of the above servicer termination events occurs, B&B Air Funding, with the prior consent of the Policy Provider under the securitization transaction (or the Policy Provider alone, if an event of default under the indenture has occurred and is continuing) may substitute BBAM with a replacement servicer upon receipt of a rating agency confirmation from each rating agency. A servicer termination event under the servicing agreement does not give rise to an event of default under the indenture for the Notes.

7. AIRCRAFT ACQUISITION FACILITY

| Aircraft Acquisition Facility: | Balance as of December 31, 2009 | Balance as of December 31, 2008 |
|---|--|--|
| | (Dollars in thousands) | |
| Principal Tranche A | \$ 410,566 | \$ 413,471 |
| Principal Tranche B | 184,000 | 184,000 |
| Borrowings under aircraft acquisition facility | 594,566 | 597,471 |
| Equity Tranche | 96,000 | 96,000 |
| Total Aircraft Acquisition Facility | \$ 690,566 | \$ 693,471 |

On November 7, 2007, B&B Air Acquisition entered into a revolving credit facility (the Aircraft Acquisition Facility) that provided for up to \$1.2 billion of additional aircraft financing consisting of a \$920.0 million Tranche A, \$184.0 million Tranche B and a \$96.0 million equity tranche from B&B Air. Tranches A and B are provided by a consortium of third party lenders and are subject to customary terms and conditions. The availability period for the Aircraft Acquisition Facility expired on November 6, 2009, and the Company may not borrow any additional amounts. B&B Air Acquisition periodically funds, in accordance with the facility agreement, a cash collateral account that was established for the benefit of the lenders. As of December 31, 2009 and 2008, the cash collateral account had a balance of \$30.4 million and \$22.3 million, respectively.

The Aircraft Acquisition Facility provides that borrowings under Tranches A and B be limited such that the outstanding combined amounts under such tranches may not exceed the sum of: (i) 85% of the sum of the appraised value of the aircraft funded through the Aircraft Acquisition Facility, (ii) 50% of the maintenance reserve balance and (iii) 100% of the cash collateral account. Commencing November 6, 2009, all available cash flow from the aircraft held by B&B Air Acquisition was required to be applied to the outstanding principal after payment of interest, certain expenses and a return paid to B&B Air on its \$96.0 million equity tranche. The equity tranche accrue interest at a rate such that the aggregate monthly interest of the entire facility reflect an interest rate of one-month LIBOR plus 2.5%. During the year ended December 31, 2009, principal paydowns made by Company on the Aircraft Acquisition Facility totalled \$2.9 million.

Subject to an extension by the lenders as provided in the agreement, all amounts outstanding at November 6, 2012 must be repaid in four quarterly installments.

Based on estimates, the available net cash flows from the aircraft held by B&B Air Acquisition that are anticipated to be applied to the outstanding principal balance of the Aircraft Acquisition Facility as of December 31, 2009, are as

follows:

| Year ending December 31, | (Dollars in thousands) |
|--|-------------------------------|
| 2010 | \$ 30,043 |
| 2011 | 31,665 |
| 2012 | 155,021 |
| 2013 | 377,837 |
| 2014 | — |
| Thereafter | — |
| Future Minimum Principal Payments Due | \$ 594,566 |

Borrowings under the Aircraft Acquisition Facility are secured by (i) the equity ownership and beneficial interests in B&B Air Acquisition and its subsidiaries, and (ii) a security interest in the underlying aircraft and related leases. In addition, the lenders are granted a first priority, perfected security interest in derivative agreements entered into by B&B Air Acquisition.

Tranche A borrowings accrued interest at a one-month LIBOR-based rate plus a margin of 1.25%. Beginning November 7, 2009, Tranche A borrowings accrue interest at a one-month LIBOR-based rate plus a margin of 1.50%. Tranche B borrowings accrue interest at a one-month LIBOR-based rate plus 4.00%. The first quarterly installment of principal is due on November 6, 2012, and after that date the applicable margin for Tranche A and Tranche B increases by 0.25% per quarter up to a maximum margin of 3.75% and 8.00% for Tranche A and B borrowings, respectively. For the years ended December 31, 2009 and 2008, the effective average interest rate of the Aircraft Acquisition Facility including the payments made on interest rate swap hedge contracts entered into on borrowings made under the facility, was 6.35% and 6.73%, respectively. (See Note 9)

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Until November 6, 2009, fees of 0.3% per annum were payable on unutilized commitments under Tranche A. In order of security interest, Tranche A ranks above Tranche B, and both Tranche A and B rank above the equity tranche. The servicing agreement for the Aircraft Acquisition Facility includes the following servicer replacement events, some of which also constitute events of default under the Aircraft Acquisition Facility:

Babcock & Brown ceases to hold at least 5% of the issued and outstanding shares of B&B Air;

Babcock & Brown ceases to hold at least 51% of the capital stock of BBAM;

BBAM fails to deliver the audited financial statements of Babcock & Brown Limited to the agent and lenders in the Aircraft Acquisition Facility within 120 days of fiscal year end or the unaudited or audited financial statements for each semi-annual period within 90 days, and in each case such failure to deliver the required financial statements continues for 30 days after written notice from the agent;

Any Babcock & Brown Limited annual or semi-annual financial statement required to be delivered as described above contains a going-concern or similar qualification;

The insolvency of BBAM or any significant subsidiary of BBAM; and

A BBAM default on recourse debt over \$25 million.

On the occurrence of a servicer replacement event, B&B Air Acquisition (with the consent of the agent), or the agent on the direction of two-thirds of the Tranche A and Tranche B lenders combined, may terminate the servicing agreement.

An event of default under the Aircraft Acquisition Facility would be triggered if Babcock & Brown ceases to hold at least 5% of the issued and outstanding shares of B&B Air and at least 51% of the capital stock of BBAM. As of December 31, 2009, B&B holds 14.6% of B&B Air's outstanding shares.

Babcock & Brown Limited, the Australian company that is the holding company for the Babcock & Brown group and the ultimate parent of BBAM, was placed into voluntary administration in Australia on March 13, 2009. As a result, BBAM was not able to deliver the audited financial statements of Babcock & Brown Limited to the agent and lenders as required by the servicing agreement related to the Aircraft Acquisition Facility. The agent has approved an extension of the deadline for delivery of the financial statements of Babcock & Brown Limited for the year ended December 31, 2008. In accordance with the terms of the extension, if BBAM is unable to deliver these financial statements by April 30, 2010, the agent may require compliance within 30 days of written notice to BBAM. If BBAM is still unable to comply within this 30 day period, a servicer replacement event will have occurred.

Babcock & Brown has informed the Company that BBIPL, which is both the main operating and asset-owning entity in the Babcock & Brown group, continues to pursue its revised business plan to sell all of its assets. Although no definitive transaction has been announced, the Company expects Babcock & Brown to sell substantially all of its aviation-related assets, including the assets and servicing agreements associated with BBAM and the common shares of B&B Air owned by them. These sales could result in a servicer replacement event and an event of default under the Aircraft Acquisition Facility.

The Aircraft Acquisition Facility also contains affirmative covenants customary for secured aircraft financings.

Further, B&B Air Acquisition must maintain certain interest coverage ratios and the aircraft in B&B Air Acquisition's portfolio must comply with certain concentration limits. A breach of these requirements would result in an event of default under the Aircraft Acquisition Facility.

If any event of default occurs (other than B&B Air Acquisition or any of its subsidiaries becoming the subject of insolvency proceedings), the agent, on the request of two-thirds of the Tranche A and Tranche B lenders combined, may demand immediate repayment of all outstanding borrowings under the Aircraft Acquisition Facility. If the lenders accelerate all amounts due upon the occurrence of any other event of default, all cash generated by B&B Air Acquisition will be used to repay amounts due under the facility and will not be available to B&B Air. In addition, immediately after the occurrence of certain bankruptcy and insolvency related events of default, all cash generated by B&B Air Acquisition will be used to repay amounts due under the facility and will not be available to B&B Air. As of December 31, 2009, B&B Air Acquisition was not in default under the Aircraft Acquisition Facility.

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8. CREDIT FACILITY

In June 2009, the Company entered into a \$32.3 million credit facility agreement (Credit Facility) with an international commercial bank. As of December 31, 2009, the Company had borrowed \$32.3 million under the agreement. The Credit Facility is secured by a pledge of the Company's rights, title and interest in \$119.4 million principal amount of Notes purchased by a wholly-owned subsidiary of the Company. (See Note 6)

There are no scheduled principal payments due during the term of the Credit Facility. Interest is payable monthly and equal to the interest proceeds on the pledged Notes. The Credit Facility is scheduled to mature on August 16, 2010 but provides the Company with two 1-year extension options upon the payment of a fee at each extension date equal to 2.5% of the then-outstanding principal amount. In accordance with GAAP, the extension options are accounted for as derivative instruments. As of December 31, 2009, the extension options had nominal value.

The Company is subject to certain interest coverage ratios and other financial covenants as specified in the Credit Facility. As of December 31, 2009, the Company was not in default under the Credit Facility.

9. DERIVATIVES

The Company uses interest rate swap contracts to hedge variable interest payments due on (i) the Notes and (ii) borrowings under the Aircraft Acquisition Facility, associated with aircraft under fixed rate rentals. The swap contracts allow the Company to pay fixed interest rates and receive variable interest rates with the swap counterparty based on the one-month LIBOR on the notional amounts over the life of the contracts. The notional amounts decrease over time. As of December 31, 2009 and 2008, the Company had interest rate swap contracts with notional amounts aggregating \$1,175.8 million and \$1,260.3 million, respectively. The unrealized fair market value loss on the interest rate swap contracts, reflected as derivative liabilities, was \$65.7 million and \$113.4 million as of December 31, 2009 and 2008, respectively.

To mitigate its exposure to foreign currency exchange fluctuations, the Company has entered into a cross currency coupon swap contract in conjunction with a lease in which a portion of the lease rentals are denominated in Euros. Pursuant to the cross currency swap, the Company receives \$1.7 million quarterly based on a fixed Euro to U.S. Dollar conversion rate of 1.4452 per Euro until January 15, 2016, the maturity date of the swap contract. As of December 31, 2009 and 2008, the unrealized fair market value gain on the cross currency swap contract, reflected as a derivative asset, was \$30,000 and \$2.4 million, respectively.

During 2008, the Company terminated a cross currency swap contract and received settlement proceeds totalling \$2.1 million which is being amortized into operating lease revenue through April 15, 2016, the original contract maturity date.

The Company's interest rate and foreign currency derivatives are accounted for as cash flow hedges. The changes in fair value of the derivatives are recorded as a component of accumulated other comprehensive income, net of a provision for income taxes. For the period ended December 31, 2009, the Company recorded a net unrealized gain of \$40.0 million, after the applicable net tax provision of \$5.7 million, as a component of accumulated other comprehensive income. For the period ended December 31, 2008, the Company recorded a net unrealized loss of \$77.5 million, after the applicable net tax asset of \$11.1 million, as a component of accumulated other comprehensive income. For the period ended December 31, 2007, the Company recorded a net unrealized loss of \$16.4 million, after the applicable net tax asset of \$2.3 million, as a component of accumulated other comprehensive income. (See Note 13)

The Company determines the fair value of derivative instruments using a discounted cash flow model. The model incorporates an assessment of the risk of non-performance by the swap counterparty in valuing derivative assets and an evaluation of B&B Air's credit risk in valuing derivative liabilities. The Company considers in its assessment of non-performance risk, if applicable, netting arrangements under master netting agreements, any collateral requirement, and the derivative payment priority in the Company's debt agreements. The valuation model uses various inputs including contractual terms, interest rate curves, credit spreads and measures of volatility.

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As of December 31, 2009, the Company had the following derivative liabilities (dollar amounts in thousands):

| Maturity Date | Interest Rate | Swap Contract | Fair Market Value of Derivative Liability | Credit Risk Adjustment | Adjusted Fair Market Value of Derivative Liability | Deferred Tax Benefit | Loss Recognized in Accumulated Other Comprehensive Loss | Gain Reclassified from Accumulated Other Comprehensive Loss into Income |
|-------------------------------------|---------------|---------------------|---|------------------------|--|----------------------|---|---|
| | | | | | | | | |
| 10/14/2015 | 4.93% | \$ 266,272 | \$ (21,240) | \$ 1,004 | \$ (20,236) | \$ 2,530 | \$ (17,706) | \$ |
| 10/14/2015 | 4.93% | 266,272 | (21,240) | 1,004 | (20,236) | 2,530 | (17,706) | |
| 11/15/2015 | 4.36% | 27,665 | (1,755) | 57 | (1,698) | 212 | (1,486) | |
| 12/15/2015 | 4.37% | 27,669 | (1,756) | 56 | (1,700) | 212 | (1,488) | |
| 9/15/2015 | 4.36% | 28,155 | (1,807) | 62 | (1,745) | 218 | (1,527) | |
| 11/15/2015 | 4.37% | 27,918 | (1,791) | 59 | (1,732) | 216 | (1,516) | |
| 1/14/2015 | 3.40% | 63,581 | (2,184) | 19 | (2,165) | 271 | (1,894) | |
| 3/15/2018 | 3.31% | 195,087 | (3,206) | (533) | (3,739) | 467 | (3,272) | |
| 8/15/2015 | 3.85% | 31,771 | (1,352) | 26 | (1,326) | 167 | (1,159) | |
| 5/15/2016 | 4.49% | 46,877 | (3,144) | 111 | (3,033) | 379 | (2,654) | |
| 3/15/2015 | 4.22% | 27,773 | (1,662) | 56 | (1,606) | 201 | (1,405) | |
| 4/15/2015 | 4.07% | 29,857 | (1,586) | 41 | (1,545) | 193 | (1,352) | |
| 10/15/2016 | 4.25% | 27,773 | (1,491) | 16 | (1,475) | 184 | (1,291) | |
| 10/15/2012 | 2.30% | 109,170 | (1,326) | (27) | (1,353) | 169 | (1,184) | |
| Accrued interest | | | (2,137) | | (2,137) | | | |
| Total derivative liabilities | | \$ 1,175,840 | \$ (67,677) | \$ 1,951 | \$ (65,726) | \$ 7,949 | \$ (55,640) | \$ |

As of December 31, 2009, the Company had the following derivative asset which is included in other assets (dollar amounts in thousands):

| EURO to US Dollar Conversion | Swap Contract | Fair Market Value of Derivative | Credit Risk | Adjusted Fair Market Value of Derivative | Deferred Tax | Gain Recognized in Accumulated Other Comprehensive Loss | Gain Reclassified from Accumulated Other Comprehensive Loss into Income |
|------------------------------|---------------|---------------------------------|-------------|--|--------------|---|---|
| | | | | | | | |

| Maturity Date | Rate | Amount | Instrument | Adjustment | Instrument Liability | Loss | Income |
|---|-------------------------|-----------------|-------------------|-------------------|-----------------------------|-----------------|-----------------|
| Cross currency coupon swap contract: | | | | | | | |
| 1/15/2016 | 1EURO to US1.4452 | 1,650 | 24 | 6 | 30 | (4) | 26 |
| Terminated Contract | | | | | | (207) | 1,446 |
| Total derivative asset | | \$ 1,650 | \$ 24 | \$ 6 | \$ 30 | \$ (211) | \$ 1,472 |
| | | | | | | | \$ 225 |

The amount amortized into operating lease revenue for the proceeds received from the terminated cross currency coupon swap contract, for the next five years and thereafter is as follows:

| Year ending December 31, | (Dollars in thousands) |
|--|-------------------------------|
| 2010 | \$ 295 |
| 2011 | 296 |
| 2012 | 279 |
| 2013 | 264 |
| 2014 | 263 |
| Thereafter | 256 |
| Total future amortization of terminated cross currency coupon swap contract | \$ 1,653 |

To protect against rising interest rates in connection with the Company's IPO and Securitization, JET-i entered into two interest rate swap options in 2007 for the benefit of B&B Air. The interest rate swap options provided the Company with an option to enter into interest rate swap agreements for a portion of the Notes at a fixed rate of 5.43%. In September 2007, the Company agreed to share a portion of the cost of the interest rate swap option with JET-i and recorded into expense its share of the hedging costs amounting to \$1.7 million.

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10. INCOME TAXES

B&B Air is a tax-resident of Ireland and has wholly-owned subsidiaries in Ireland, France and the Cayman Islands that are tax residents in those jurisdictions. In calculating net trading income, B&B Air and its Irish-tax-resident subsidiaries are entitled to a deduction for trading expenses and tax depreciation on its aircraft. In general, Irish-resident companies pay corporation tax at the rate of 12.5% on trading income and 25.0% on non-trading income. In addition, repatriated earnings from the Company's Cayman subsidiary, including the gain associated with the purchase of notes payable, will be taxed at the 25.0% tax rate. B&B Air's French-resident subsidiaries pay a corporation tax of 30.38% on their net trading income. Subject to limitations under current Irish tax regulations, U.S. withholding taxes paid may be credited against the Company's Irish tax liability.

Income tax expense by jurisdiction is shown below:

| | Year ended December 31, 2009 | Year ended December 31, 2008 | Period from May 3, 2007 (Incorporation Date) to December 31, 2007 |
|---|---|---|--|
| | (Dollars in thousands) | | |
| Deferred tax expense: | | | |
| Ireland | \$ 24,212 | \$ 7,054 | \$ 36 |
| France | (14) | | |
| Deferred tax expense total | 24,198 | 7,054 | 36 |
| Current tax expense: | | | |
| Ireland: | | | |
| Current | 156 | 286 | 996 |
| Adjustment for prior period's tax provision | | (868) | |
| France | 13 | 52 | |
| United States | | 343 | |
| Current tax expense (benefit) total | 169 | (187) | 996 |
| Total Income Tax Expense | \$ 24,367 | \$ 6,867 | \$ 1,032 |

For the period from May 3, 2007 (incorporation date) to December 31, 2007, the Company had accounted for certain interest income it had earned as non-trading income, taxed at the 25% tax rate. In 2008, the Irish Revenue Commissioners allowed this interest to be treated as trading income, taxable at the 12.5% rate.

Subject to limitations under current Irish tax regulation, U.S. withholding taxes paid by the Company may be deducted as additional expense or credited against its Irish tax liability.

The principal components of the Company's net deferred tax asset are as follows:

| | |
|------------------------------|--------------------------|
| December 31, 2009 | December 31, 2008 |
|------------------------------|--------------------------|

| | (Dollars in thousands) | |
|--|-------------------------------|------------------|
| Ireland: | | |
| Excess of tax depreciation over book depreciation | \$ (19,162) | \$ 4,196 |
| Net operating loss carryforwards | 41,604 | 23,121 |
| Net unrealized losses on derivative instruments | 7,738 | 13,417 |
| Net earnings of non-European Union member subsidiary | (19,715) | |
| Deferred Tax Asset, Net | \$ 10,465 | \$ 40,734 |

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The Company has determined that no valuation allowance against its deferred tax asset was necessary as of December 31, 2009 and 2008.

The table below is a reconciliation of the Irish statutory corporation tax rate of 12.5% on trading income to the Company's recorded income tax expense (benefit):

| | Year ended December 31, 2009 | Year ended December 31, 2008 (Percentage) | Period from May 3, 2007 (Incorporation Date) to December 31, 2007 |
|---|--|---|---|
| Irish statutory corporate tax rate on trading income | 12.5% | 12.5% | 12.5% |
| Incremental effect of higher tax rate on non-trading income | | 0.5% | 18.3% |
| Gain on purchases of Notes | 9.1% | | |
| Amortization of debt purchase options | 0.7% | | |
| Adjustment for prior period's tax provision | | (1.6%) | |
| Other | (0.8%) | 1.1% | (0.2%) |
| Income tax expense | 21.5% | 12.5% | 30.6% |

The Company had no unrecognized tax benefits as of December 31, 2009.

11. OTHER LIABILITIES

The following table describes the principal components of the Company's other liabilities:

| | December 31, 2009 | December 31, 2008 |
|--------------------------------|------------------------|-------------------|
| | (Dollars in thousands) | |
| Unamortized lease discounts | \$ 2,313 | \$ 4,887 |
| Lease incentive obligation | 6,523 | 2,333 |
| Other | 4,350 | 2,192 |
| Total Other Liabilities | \$ 13,186 | \$ 9,412 |

For the years ended December 31, 2009 and 2008, amortization of lease discounts recorded into rental revenue totalled \$2.6 million and \$3.1 million, respectively.

The amortization into lease income of unamortized lease discounts at December 31, 2009 for the next five years and thereafter is as follows:

| Year ending December 31, | (Dollars in thousands) |
|--------------------------|------------------------|
| 2010 | \$ 867 |
| 2011 | 338 |
| 2012 | 338 |
| 2013 | 338 |
| 2014 | 338 |

| | | |
|---|-----------|--------------|
| Thereafter | | 94 |
| Total future amortization of lease discounts | \$ | 2,313 |

12. SHAREHOLDERS EQUITY

On October 2, 2007, the Company completed its IPO and issued 33,603,450 common shares at an offering price of \$23.00 per share. The Company received approximately \$430.0 million in cash and approximately \$318.7 million in the form of interest-bearing notes before offering costs. The notes receivable for common shares accrued interest at 4.00%. As of December 31, 2007, the notes receivable for common shares had an aggregate outstanding principal balance of approximately \$1.8 million and was fully collected in January 2008. In connection with the Offerings, B&B Air incurred costs including underwriting, legal and other professional fees aggregating \$26.3 million. In connection with the transfer of aircraft from JET-i to the Company, B&B Air recorded a deemed distribution to the predecessor company of \$240.9 million representing the excess of the acquisition costs, including related liabilities assumed by the Company, over the aircraft's recorded value as of the delivery date. The deemed distribution was recorded into additional paid-in capital.

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During the years ended December 31, 2009 and 2008, the Company declared and paid dividends of \$0.80 per share and \$2.00 per share or \$24.7 million and \$67.1 million, respectively. Subsequent to December 31, 2009, the Company declared a dividend of \$0.20 per share or approximately \$6.1 million. The dividend was paid on February 19, 2010 to shareholders of record at January 29, 2010.

In June 2008, the Company's Board of Directors approved a share repurchase program. The program authorizes the Company to repurchase up to \$30.0 million of its shares through June 21, 2009. The Board of Directors subsequently approved an extension of the share repurchase program through June 2010. As of December 31, 2009, the Company had repurchased 3,323,502 shares at an average price of \$4.68 per share, or \$15.6 million.

13. ACCUMULATED COMPREHENSIVE LOSS

The components of comprehensive loss for the years ended December 31, 2009 and 2008 and for the period from May 3, 2007 (incorporation date) to December 31, 2007 are presented below:

| | Year ended December 31, 2009 | Year ended December 31, 2008 | Period from May 3, 2007 (Incorporation Date) to December 31, 2007 |
|--|---|---|--|
| | (Dollars in thousands) | | |
| Net income | \$ 89,093 | \$ 48,125 | \$ 2,345 |
| Net change in unrealized gain (loss) on fair value of derivative instruments, net of tax benefit | 39,749 | (77,528) | (16,389) |
| Total comprehensive income (loss) | \$ 128,842 | \$ (29,403) | \$ (14,044) |

As of December 31, 2009, 2008 and 2007, the accumulated other comprehensive loss, net of tax benefits, totalled \$54.2 million, \$93.9 million and \$16.4 million, respectively.

14. EARNINGS PER SHARE

Basic and diluted earnings per share are calculated by dividing net income by the weighted average number of shares outstanding for the years ended December 31, 2009 and 2008 and for the period from May 3, 2007 (incorporation date) to December 31, 2007. The Company has presented pro forma earnings per share for the period ended December 31, 2007 as if the IPO had occurred on May 3, 2007 (incorporation date).

| | Year ended December 31, 2009 Basic and diluted | Year ended December 31, 2008 Basic and diluted | Period from May 3, 2007 (Incorporation Date) to December 31, 2007 Basic and diluted Pro forma | |
|--------------------|---|---|--|------------|
| | (Dollars in thousands, except share and per share data) | | | |
| Numerator | | | | |
| Net income | \$ 89,093 | \$ 48,125 | \$ 2,345 | \$ 2,345 |
| Denominator | | | | |
| | 30,831,637 | 33,524,074 | 12,584,008 | 33,603,450 |

Weighted average number of shares
outstanding for the period

| | | | | | | | | |
|---------------------------|----|-------------|----|-------------|----|-------------|----|-------------|
| Earnings per share | \$ | 2.89 | \$ | 1.44 | \$ | 0.19 | \$ | 0.07 |
|---------------------------|----|-------------|----|-------------|----|-------------|----|-------------|

The Manager may elect to receive incentive fee payments under the management agreement in the form of shares. The Company does not have any other outstanding contracts or securities that could result in the issuance of common shares and potentially dilute net income per share. No incentive fee was earned by the Manager during the years ended December 31, 2009 and 2008 or for the period from May 3, 2007 (incorporation date) to December 31, 2007.

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Table of Contents**Babcock & Brown Air Limited**

Notes to Consolidated Financial Statements

For the year ended December 31, 2009

15. COMMITMENTS AND CONTINGENCIES

The Company has an agreement to sell one of the aircraft from the Initial Portfolio for a base purchase price of approximately \$11.8 million upon expiration of the current underlying operating lease in October 2010.

From time to time, the Company contracts with third-party service providers to perform maintenance or overhaul activities on its off-lease aircraft.

16. RELATED PARTY TRANSACTIONS

B&B Air has no employees and has outsourced the daily operations of the Company by entering into management, servicing and administrative agreements (the Agreements) with subsidiaries of Babcock & Brown. Services to be rendered under these agreements include acquiring and disposing of aircraft; marketing of aircraft for lease and re-lease; collecting rent and other payments from the lessees; monitoring maintenance, insurance and other obligations under the leases; enforcing the Company's rights under the lease terms; and maintaining the books and records of the Company and its subsidiaries. The Manager manages the Company under the direction of its chief executive officer and chief financial officer. Pursuant to the terms of the Agreements, certain fees and expenses that may be payable to the Manager may be reduced for any like payments made to other Babcock & Brown affiliates.

Pursuant to the Agreements, Babcock & Brown is entitled to receive servicing fees. With respect to the Company's Initial Portfolio, Babcock & Brown is entitled to receive a base fee of \$150,000 per month, subject to certain adjustments, and a rent fee equal to 1.0% and 1.0%, respectively, of the aggregate amount of aircraft rent due and rent actually collected. With respect to aircraft acquired that are held by B&B Air Acquisition, Babcock & Brown is entitled to receive a fee equal to 3.5% of the aggregate amount of rent actually received for such aircraft. For the years ended December 31, 2009 and 2008 and for the period from May 3, 2007 (incorporation date) to December 31, 2007, total base and rent fees incurred amounted to \$7.4 million, \$7.1 million and \$1.2 million, respectively.

Babcock & Brown is entitled to an administrative agency fee from B&B Air Funding equal to \$750,000 per annum, subject to adjustments based on the Consumer Price Index. In addition, Babcock & Brown is entitled to an administrative fee from B&B Air Acquisition of \$240,000 per annum. For the years ended December 31, 2009 and 2008 and for the period from May 3, 2007 (incorporation date) to December 31, 2007, \$1.0 million, \$1.0 million and \$0.2 million of administrative fees were paid to Babcock & Brown.

For its role as exclusive arranger, Babcock & Brown receives a fee equal to 1.5% of the purchase price of aircraft acquired, excluding aircraft in the Initial Portfolio. Babcock & Brown also receives 1.5% of the sales proceeds of all disposed aircraft. For the year ended December 31, 2008 and for the period from May 3, 2007 (incorporation date) to December 31, 2007, \$7.0 million and \$3.4 million of fees were incurred for aircraft purchased by B&B Air Acquisition, respectively. During the year ended December 31, 2009, the Company did not acquire any aircraft. For the year ended December 31, 2008, aircraft disposition fees totalling \$0.6 million were incurred by the Company. The Company did not dispose of any aircraft during the year ended December 31, 2009 and for the period from May 3, 2007 (incorporation date) to December 31, 2007.

Babcock & Brown is also eligible for an incentive fee. The incentive fee is payable if the Company's quarterly dividends exceed certain specified targets. No incentive fee was earned by Babcock & Brown during the years ended December 31, 2009 and 2008 or for the period from May 3, 2007 (incorporation date) to December 31, 2007.

The Company makes quarterly payments to the Manager as compensation for providing the chief executive officer, the chief financial officer and other personnel, and certain corporate overhead costs related to B&B Air (Management Expenses), subject to adjustments tied to the Consumer Price Index. For the years ended December 31, 2009 and 2008 and for the period from May 3, 2007 (incorporation date) to December 31, 2007, the Company incurred \$6.1 million, \$6.0 million and \$1.5 million of Management Expenses, respectively.

In connection with its services, Babcock & Brown may incur expenses such as insurance, as well as legal and professional advisory fees on behalf of the Company. As of December 31, 2009 and 2008, \$0.2 million and \$0.8 million of reimbursable expenses were due to Babcock & Brown, respectively.

Table of Contents**Babcock & Brown Air Limited**

Notes to Consolidated Financial Statements

For the year ended December 31, 2009

The Company's management agreement with the Manager has a term that expires on October 2, 2032. However, the Company may terminate the Manager's appointment immediately upon written notice if certain events occur, including if Babcock & Brown ceases to hold more than 50% of the issued share capital of the Manager.

Under the Agreements, the Company's minimum long-term contractual obligations with Babcock & Brown as of December 31, 2009, excluding rent fees, consisted of the following:

| | 2010 | 2011 | 2012 | 2013 | 2014 | Thereafter | Total |
|--|------------------------|-----------------|-----------------|-----------------|-----------------|-------------------|-------------------|
| | (Dollars in thousands) | | | | | | |
| Fixed base fee payments (1) | \$ 1,866 | \$ 1,866 | \$ 1,866 | \$ 1,866 | \$ 1,866 | \$ 7,461 | \$ 16,791 |
| Fixed administrative agency fee payments due from B&B Air Funding (1) | 777 | 777 | 777 | 777 | 777 | 3,111 | 6,996 |
| Fixed administrative agency fee payments due from B&B Air Acquisition | 240 | 240 | 240 | 160 | | | 880 |
| Fixed payments for Management Expenses (1) | 6,219 | 6,219 | 6,219 | 6,219 | 6,219 | 110,382 | 141,477 |
| Total | \$ 9,102 | \$ 9,102 | \$ 9,102 | \$ 9,022 | \$ 8,862 | \$ 120,954 | \$ 166,144 |

(1) Amounts in the table assume CPI rates in effect for 2010 remain constant in future periods.

17. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company's financial instruments consist principally of cash and cash equivalents, restricted cash and cash equivalents, accounts receivable, derivative instruments, accounts payable, credit facilities and notes payable. The Company's notes payable and borrowings under the Aircraft Acquisition Facility bear floating rates of interest which reset monthly to a market benchmark rate plus a credit spread.

Fair value is defined as the price at which an asset could be exchanged in a current transaction between knowledgeable, willing and able parties. A liability's fair value is defined as the amount that would be paid to transfer the liability to a new obligor, not the amount that would be paid to settle the liability with the creditor.

The fair value of the Company's cash and cash equivalents, restricted cash and cash equivalents, accounts receivable, and accounts payable approximate their carrying value. Where available, the fair value of the Company's notes payable and credit facilities is based on observable market prices or parameters or derived from such prices or parameters. Where observable prices or inputs are not available, valuation models are applied, using the net present value of cash flow streams over the term using estimated market rates for similar instruments and remaining terms. These valuation techniques involve some level of management estimation and judgment, the degree of which is

Table of Contents**Babcock & Brown Air Limited**

Notes to Consolidated Financial Statements

For the year ended December 31, 2009

Level 3 Inputs reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model.

As of December 31, 2009 and 2008, the categorized asset and liabilities of the Company measured at fair value on a recurring basis, based upon the lowest level of significant inputs to the valuations are as follows:

| | Level 1 | Level 2 (Dollars in thousands) | Level 3 | Total |
|---------------------------|---------|-----------------------------------|---------|---------|
| December 31, 2009: | | | | |
| Derivative asset | | 30 | | 30 |
| Derivative liabilities | | 65,726 | | 65,726 |
| December 31, 2008: | | | | |
| Derivative asset | | 2,368 | | 2,368 |
| Derivative liabilities | | 113,374 | | 113,374 |

18. UNAUDITED QUARTERLY CONDENSED CONSOLIDATED FINANCIAL INFORMATION

The unaudited quarterly financial statements for the year ended December 31, 2009 are presented below:

| (Dollars in thousands, except per share data) | March 31, 2009 | June 30, 2009 | September 30, 2009 | December 31, 2009 |
|---|-------------------|------------------|--------------------------|-------------------------|
| Total revenues | \$ 109,080 | \$ 64,519 | \$ 67,795 | \$ 66,141 |
| Net income | \$ 46,951 | \$ 13,994 | \$ 14,449 | \$ 13,699 |
| Earnings per share | \$ 1.45 | \$ 0.46 | \$ 0.48 | \$ 0.45 |

The unaudited quarterly financial statements for the year ended December 31, 2008 are presented below:

| (Dollars in thousands, except per share data) | March 31, 2008 | June 30, 2008 | September 30, 2008 | December 31, 2008 |
|---|-------------------|------------------|--------------------------|-------------------------|
| Total revenues | \$ 51,945 | \$ 57,199 | \$ 66,310 | \$ 60,684 |
| Net income | \$ 11,684 | \$ 11,062 | \$ 16,029 | \$ 9,350 |
| Earnings per share | \$ 0.35 | \$ 0.33 | \$ 0.48 | \$ 0.28 |

19. SUBSEQUENT EVENTS

On January 15, 2010, the Company declared a dividend of \$0.20 per share or approximately \$6.1 million. The dividend was payable on February 19, 2010 to shareholders of record at January 29, 2010.

On January 15, 2010, the Company sold to an unrelated third party its right to purchase up to \$35.0 million principal amount of Notes for \$16.8 million. On March 4, 2010, the Company sold its remaining option to purchase up to \$15.0 million principal amount of Notes for \$7.2 million. In connection with the option sales, the Company received \$12.5 million as total consideration. (See Note 6)

Table of Contents**Schedule I Condensed financial information of parent****Babcock & Brown Air Limited****Condensed Balance Sheets****AS OF DECEMBER 31, 2009 AND 2008****(DOLLARS IN THOUSANDS)**

| | December 31, 2009 | December 31, 2008 |
|--|------------------------------|------------------------------|
| Assets | | |
| Cash and cash equivalents | \$ 95,797 | \$ 56,684 |
| Restricted cash and cash equivalents | | |
| Receivable from subsidiaries | | 96 |
| Notes receivable from subsidiaries | 90,219 | |
| Investments in subsidiaries | 356,453 | 332,265 |
| Deferred tax asset, net | | 422 |
| Other assets, net | 427 | 2,005 |
| Total assets | 542,896 | 391,472 |
| Liabilities | | |
| Payable to related parties | 5,778 | 441 |
| Payable to subsidiaries | 32,643 | |
| Deferred tax liability, net | 18,982 | |
| Accrued and other liabilities | 969 | 1,618 |
| Total liabilities | 58,372 | 2,059 |
| Shareholders equity | 484,524 | 389,413 |
| Total liabilities and shareholders equity | \$ 542,896 | \$ 391,472 |

Table of Contents**Schedule I Condensed financial information of parent****Babcock & Brown Air Limited****Condensed Statements of Income****FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 AND FOR THE PERIOD FROM MAY 3, 2007
(INCORPORATION DATE) TO DECEMBER 31, 2007****(DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)**

| | Year ended December 31, 2009 | Year ended December 31, 2008 | Period from May 3, 2007 (Incorporation Date) to December 31, 2007 |
|--|------------------------------------|------------------------------------|--|
| Revenues | | | |
| Equity in earnings of subsidiaries | \$ 113,051 | \$ 51,622 | \$ 2,981 |
| Intercompany management fee income | 5,100 | 5,100 | 1,275 |
| Interest and other income | 98 | 548 | 1,298 |
| Total revenues | 118,249 | 57,270 | 5,554 |
| Expense | | | |
| Selling, general and administrative | 10,038 | 9,567 | 3,115 |
| Net income from continuing operations before provision for income taxes | 108,211 | 47,703 | 2,439 |
| Income tax provision (benefit) | 19,118 | (422) | 94 |
| Net income | \$ 89,093 | \$ 48,125 | \$ 2,345 |
| Weighted average number of shares | 30,831,637 | 33,524,074 | 12,584,008 |
| Basic and diluted earnings per share | \$ 2.89 | \$ 1.44 | \$ 0.19 |

Table of Contents**Schedule I Condensed financial information of parent****Babcock & Brown Air Limited
Condensed Statements of Cash Flows**

**FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 AND FOR THE PERIOD FROM MAY 3, 2007
(INCORPORATION DATE) TO DECEMBER 31, 2007
(DOLLARS IN THOUSANDS)**

| | Year ended December 31, 2009 | Year ended December 31, 2008 | Period from May 3, 2007 (Incorporation Date) to December 31, 2007 |
|---|---------------------------------------|---------------------------------------|--|
| Cash Flows from Operating Activities | | | |
| Net Income | \$ 89,093 | \$ 48,125 | \$ 2,345 |
| Adjustments to reconcile net income to net cash flow provided by operating activities: | | | |
| Equity in earnings of subsidiaries | (113,051) | (51,622) | (2,981) |
| Income tax benefit | 19,118 | (422) | |
| Changes in operating assets and liabilities: | | | |
| Payable to subsidiaries | 32,739 | 34,203 | (34,299) |
| Other assets | 1,578 | (1,217) | (788) |
| Payable to related parties | 5,337 | 345 | 96 |
| Accrued and other liabilities | (363) | 426 | 876 |
| Net cash flows provided by (used in) operating activities | 34,451 | 29,838 | (34,751) |
| Cash Flows from Investing Activities | | | |
| Capital contributions to subsidiaries | (176) | (20,114) | (444,588) |
| Distributions received from subsidiaries | 128,788 | 83,397 | 20,757 |
| Notes receivable from subsidiaries | (90,219) | | |
| Net cash flows provided by (used in) investing activities | 38,393 | 63,283 | (423,831) |
| Cash Flows from Financing Activities | | | |
| Movement in restricted cash and cash equivalents | | 19,816 | (19,816) |
| Dividends paid | (24,665) | (67,054) | |
| Proceeds from issuance of shares, net | | | 401,353 |
| Proceeds from private placement | | | 24,195 |
| Repurchase of common shares | | | (10) |
| Interest received on notes receivable for common shares | | | 877 |
| Collections received on notes receivable for common shares | | | 67,556 |
| Collections made on subscription notes receivable | | 1,827 | |
| Shares repurchased | (9,066) | (6,599) | |
| Net cash flows (used in) provided by financing activities | (33,731) | (52,010) | 474,155 |

| | | | | | | |
|---|-----------|---------------|-----------|---------------|-----------|---------------|
| Net increase in cash | | 39,113 | | 41,111 | | 15,573 |
| Cash at beginning of period | | 56,684 | | 15,573 | | |
| Cash at end of period | \$ | 95,797 | \$ | 56,684 | \$ | 15,573 |
| Supplemental Disclosure of Non Cash Activities: | | | | | | |
| Taxes paid | \$ | | \$ | | \$ | 341 |
| Noncash financing activities: | | | | | | |
| Issuance of other receivables to JET-i for transfer of aircraft | | | | | | (251,971) |
| Proceeds from notes receivable for common shares | | | | | | 251,971 |

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Report of Independent Registered Public Accounting Firm

To the Member of JET-i Leasing LLC
and Board of Directors of Babcock & Brown Air Limited

We have audited the accompanying consolidated balance sheet of JET-i Leasing LLC and subsidiaries (the Predecessor Company), the predecessor to Babcock & Brown Air Limited, as of December 31, 2007 and the related consolidated statement of income, member's capital and cash flow for the year ended December 31, 2007. These financial statements are the responsibility of the Predecessor Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Predecessor Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Predecessor Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Predecessor Company at December 31, 2007 and the consolidated result of their operations and their cash flow for each of the year ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 of the consolidated financial statements, on January 1, 2007, the Predecessor Company adopted the provisions of SFASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* and *Interpretation of FASB Statement No. 109*.

/s/ Ernst & Young LLP
San Francisco, California
March 18, 2008

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JET-i Leasing LLC
Predecessor Consolidated Balance Sheet
AS OF DECEMBER 31, 2007
(in thousands)

| | | |
|---|----|--------------|
| Assets | | |
| Cash and cash equivalents | \$ | 5,181 |
| Other assets, net | | 68 |
| Total assets | | 5,249 |
| Liabilities | | |
| Accounts payable and accrued liabilities | | 1,135 |
| Payable to related parties | | 316 |
| Other liabilities | | 1,315 |
| Total liabilities | | 2,766 |
| Member s capital | | |
| Member s contributions | | 328,304 |
| Distributions to Member | | (302,261) |
| Accumulated deficit | | (23,560) |
| Total member s capital | | 2,483 |
| Total liabilities and member s capital | \$ | 5,249 |

The accompanying notes are an integral part of the predecessor consolidated financial statements.

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JET-i Leasing LLC
Predecessor Consolidated Statement of Income
FOR THE YEAR ENDED DECEMBER 31, 2007
(in thousands)

| | |
|--|--------------------|
| Revenues | |
| Operating lease revenue | \$ 107,620 |
| Finance lease income | 7,477 |
| Interest income | 5,190 |
| Mark-to-market of non-hedge derivatives | 5,898 |
| Other revenues | 750 |
| Total revenues | 126,935 |
| Expenses | |
| Depreciation | 34,548 |
| Interest expense | 61,541 |
| Interest expense related party | 11,585 |
| Debt extinguishment costs | 9,165 |
| Selling, general and administrative | 4,588 |
| Maintenance and other costs | 2,415 |
| Hedging costs related to interest rate swap option | 5,423 |
| Swap breakage costs | 12,500 |
| Total expenses | 141,765 |
| Net loss before provision for income taxes | (14,830) |
| Provision for income taxes | 466 |
| Net loss | \$ (15,296) |

The accompanying notes are an integral part of the predecessor consolidated financial statements.

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JET-i Leasing LLC
Consolidated Statement of Member s Capital
FOR THE YEAR ENDED DECEMBER 31, 2007
(in thousands)

| | Member s Contributions | Distributions to Member | Accumulated Deficit | Total Member s Capital |
|--|-----------------------------------|------------------------------------|--------------------------------|---------------------------------------|
| Balance December 31, 2006 | \$ 35,964 | | \$ (8,264) | \$ 27,700 |
| Capital contributions | 19,165 | | | 19,165 |
| Capital contributions in excess of net book value of assets transferred | 273,175 | | | 273,175 |
| Distributions to Member | | (302,261) | | (302,261) |
| Net loss | | | (15,296) | (15,296) |
| Balance December 31, 2007 | \$ 328,304 | \$ (302,261) | \$ (23,560) | \$ 2,483 |

The accompanying notes are an integral part of the predecessor consolidated financial statements.

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JET-i Leasing LLC
Consolidated Statement of Cash Flow
FOR THE YEAR ENDED DECEMBER 31, 2007
(in thousands)

| | |
|--|--------------------|
| Cash Flows from Operating Activities | |
| Net loss | \$ (15,296) |
| Adjustments to reconcile net loss to net cash flow provided by operating activities: | |
| Depreciation | 34,548 |
| Amortization of debt issuance costs | 1,627 |
| Debt extinguishment costs | 9,165 |
| Amortization of lease discounts and other items | (1,730) |
| Mark-to-market of non-hedge derivatives | (5,898) |
| Direct finance lease income | (7,477) |
| Changes in operating assets and liabilities: | |
| Rent receivables | 740 |
| Other assets | (2,223) |
| Accounts payable and accrued liabilities | (5,454) |
| Rentals received in advance | (4,261) |
| Security deposits and maintenance payment liabilities retained | (3,929) |
| Accrued interest payable | (3,143) |
| Other liabilities | 97 |
| Net cash flows provided by (used in) operating activities | (3,234) |
| Cash Flows from Investing Activities | |
| Purchase of flight equipment | (263,350) |
| Lessor contributions to maintenance | (4,856) |
| Proceeds from transfer of flight equipment at historical cost | 1,014,752 |
| Deposits on flight equipment purchases | 300 |
| Proceeds from transfer of investment in direct finance leases at historical cost | 71,965 |
| Proceeds from finance leases | 8,165 |
| Net cash flows provided by (used in) investing activities | 826,976 |
| Cash Flows from Financing Activities | |
| Movement in restricted cash and cash equivalents | 101,194 |
| Proceeds from security deposits and maintenance payment liabilities | 31,156 |
| Security deposits and maintenance payment liabilities paid | (14,675) |
| Security deposits transferred | (22,572) |
| Proceeds from warehouse credit facility | 260,173 |
| Proceeds from warehouse credit facility related party | |
| Repayments of warehouse credit facility | (1,078,175) |
| Repayments of warehouse credit facility related party | (80,000) |
| Loan issuance costs | (638) |
| Financing from related parties, net | 14,043 |
| Capital contributions | |
| Contributions received in excess of net book value of assets transferred | 21,203 |
| Distributions paid to Member | (50,290) |

| | |
|---|------------------|
| Net cash flows provided by (used for) financing activities | (818,581) |
| Net increase in cash | 5,161 |
| Cash at beginning of period | 20 |
| Cash at end of period | \$ 5,181 |
| Supplemental Disclosure of Non Cash Activities: | |
| Cash paid during the period for: | |
| Interest | \$ 74,691 |
| Taxes | \$ 6 |
| Noncash investing and financing activities: | |
| Conversion of payable to related party to capital contribution | \$ 19,165 |
| Contribution of other receivable for transfer of aircraft and related assets and liabilities | \$ 251,971 |
| Distribution of other receivable to Member | \$ (251,971) |
| The accompanying notes are an integral part of the predecessor consolidated financial statements. | |

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Table of Contents**JET-i Leasing LLC****Notes to the Predecessor Consolidated Financial Statements
For the Year Ended December 31, 2007****1. ORGANIZATION****ORGANIZATION**

JET-i Leasing LLC (JET-i or Predecessor) was formed in Delaware on September 14, 2005 for the purpose, directly and indirectly through its subsidiaries, of engaging in the business of financing, acquiring, leasing and selling commercial jet aircraft to airlines throughout the world. JET-i commenced operations on November 22, 2005 with the finalization of its warehouse credit facility as described in Note 5. JET-i is operated and managed as a single operating segment and is primarily engaged in the acquisition and leasing of commercial jet aircraft to airlines throughout the world.

JET-i is a wholly-owned subsidiary of JET-i Holdings LLC (Holdings). Holdings serves as the Manager of JET-i (the Manager). Through various contracts, JET-i has contracted with subsidiaries of Babcock & Brown Limited (collectively B&B or Babcock & Brown), a company listed on the Australian Stock Exchange, to: (i) arrange debt; (ii) arrange aircraft acquisitions and dispositions; and (iii) perform lease servicing, remarketing, debt compliance and other administrative functions. B&B owned directly and indirectly, 25.9% and 6.5% of Holdings.

Subject to the provisions of the limited liability company agreement, Holdings is not bound, or personally responsible for JET-i s expenses, liabilities or its obligations. The liability of Holdings is limited solely to the amount of Holding s capital contributions into JET-i.

JET-i is the predecessor to Babcock & Brown Air Limited (B&B Air). B&B Air was incorporated in Bermuda on May 3, 2007 for the purpose of acquiring 44 commercial jet aircraft from JET-i and three aircraft from three companies in which B&B has an ownership interest (the Initial Portfolio). B&B Air funded the purchase price of its Initial Portfolio with: (i) the net proceeds of an initial offering of B&B Air s common shares (IPO) in the form of American Depository Shares (common shares); (ii) a concurrent private placement of its common shares to existing equity holders of JET-i, including B&B, and certain funds managed by a company in which Babcock & Brown has an interest (together with the IPO, the Offerings); and (iii) issuance of aircraft lease-backed class G-1 notes (the Notes). On October 2, 2007, Holding s investors instructed JET-i to transfer their interests in certain aviation assets and related liabilities of JET-i to B&B Air. As of December 31, 2007, JET-i had transferred all 44 aircraft owned by JET-i to B&B Air for aggregate consideration of approximately \$1,360.0 million in consideration. The excess of the proceeds received for each aircraft over the aircraft s net book value and the related maintenance payment liability assumed by B&B Air, net of legal and related transfer costs, was recognized as a contribution from Holdings. A portion of the cash proceeds were used to pay off the aircraft related debt balances. After settlement of these liabilities, approximately \$50.3 million in cash and \$252.0 million of other receivable from B&B Air was distributed to Holdings.

The transfer of aircraft to B&B Air by JET-i pursuant to an Asset Purchase Agreement did not result or require the dissolution of JET-i or other changes to its corporate structure. JET-i has maintained and will continue to maintain a separate legal existence from B&B Air.

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JET-i Leasing LLC

Notes to the Predecessor Consolidated Financial Statements

For the Year Ended December 31, 2007

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PREPARATION AND PRINCIPLES OF CONSOLIDATION

JET-i is a holding company that conducts its business through wholly-owned subsidiaries. The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), and all intercompany transactions and balances have been eliminated. The consolidated financial statements include the accounts of JET-i and all of its subsidiaries. In instances where JET-i is the primary beneficiary, JET-i would consolidate a Variable Interest Entity (VIE) in accordance with GAAP. The predecessor consolidated financial statements are stated in United States Dollars, which is the principal operating currency of JET-i.

Certain amounts in the predecessor consolidated financial statements have been reclassified to conform to the current presentation.

RISKS AND UNCERTAINTIES

Prior to the acquisition by B&B Air of all its aircraft, JET-i encountered two significant types of economic risk in the normal course of business: credit and market. Credit risk is the risk of a lessee s inability or unwillingness to make contractually required payments. Market risk reflects the change in the value of derivatives and credit facilities due to changes in interest rate spreads or other market factors, including the value of collateral underlying the credit facilities. The Company believes that the carrying values of its investments and obligations are reasonable taking into consideration these risks along with estimated collateral values, payment histories and other relevant financial information.

USE OF ESTIMATES

The preparation of predecessor consolidated financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the amounts reported in the predecessor consolidated financial statements and accompanying notes. For JET-i, the use of estimates is or could be a significant factor affecting the reported carrying values of flight equipment, deferred tax assets, accruals and reserves. To the extent available, JET-i utilizes industry specific resources and other materials to support estimates, particularly with respect to flight equipment. Despite management s best efforts to accurately estimate such amounts, actual results could differ from those estimates.

CASH AND CASH EQUIVALENTS

JET-i considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

REVENUE RECOGNITION

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be reliably measured. Where revenue amounts do not meet these recognition criteria, they are deferred and recognized in the period in which the recognition criteria are met.

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JET-i Leasing LLC

Notes to the Predecessor Consolidated Financial Statements

For the Year Ended December 31, 2007

Operating Lease Revenue

JET-i received operating lease revenues from flight equipment under operating leases. Rental income from aircraft rents is recognized on a straight-line basis over the initial term of the respective lease, which generally ranged from 13 months to 15 years. The operating lease agreements generally do not provide for purchase options, however, the leases may allow the lessee the option to extend the lease for an additional term. Contingent rents are recognized as revenue when they are earned. Revenue is not recognized when collection is not reasonably assured.

Finance Lease Income

Revenue from direct finance leases is recognized on the interest method to produce a level yield over the life of the finance lease. Expected unguaranteed residual values of leased assets at the expiration of the lease terms are based on JET-i's assessment of residual values using industry specific resources and other materials.

TAXES

JET-i provided for income taxes by tax jurisdiction (see Note 6). Deferred income tax assets and liabilities are recognized for the future tax consequences of temporary differences between the financial statement and tax basis of existing assets and liabilities at the enacted tax rates expected to apply when the assets are recovered or liabilities are settled. A valuation allowance is used to reduce deferred tax assets to the amounts ultimately expected to be more-likely-than-not realized.

3. FLIGHT EQUIPMENT UNDER OPERATING LEASES

During the year ended December 31, 2007, JET-i transferred its 40 aircraft under operating leases to B&B Air. Proceeds of \$1,269.9 million were received as consideration.

JET-i leased aircraft to airlines throughout the world. For the year ended December 31, 2007, JET-i had one customer that accounted for 11% of operating lease revenue. No other customer was responsible for lease revenue in excess of 10%.

Table of Contents**JET-i Leasing LLC****Notes to the Predecessor Consolidated Financial Statements****For the Year Ended December 31, 2007**

The distribution of operating lease revenue by geographic region is as follows (in thousands):

| | | |
|--------------------------------------|-------------------|-------------|
| Europe Developed: | | |
| United Kingdom | \$ 8,991 | 8% |
| Sweden | | |
| France | 6,601 | 6% |
| Other | 25,291 | 24% |
| Europe Developed | 40,883 | 38% |
| Asia Pacific: | | |
| India | 19,134 | 18% |
| China | 10,801 | 10% |
| Other | 1,620 | 1% |
| Asia Pacific | 31,555 | 29% |
| North America: | | |
| United States | 8,120 | 8% |
| Other | 4,605 | 4% |
| North America | 12,725 | 12% |
| South and Central America: | | |
| Mexico | 16,918 | 16% |
| Other | 5,539 | 5% |
| South and Central America | 22,457 | 21% |
| Total Operating Lease Revenue | \$ 107,620 | 100% |

The amortization of acquired lease discounts included as a component of operating lease revenue was \$2.2 million for the year ended December 31, 2007.

The classification of operating lease revenues a by geographic region in the table and discussion above is based on the principal operating location of the aircraft lessee.

4. INVESTMENT IN DIRECT FINANCE LEASES

JET-i's net investment in direct finance leases was attributable to four planes leased to a single North American lessee for terms of 15 years. JET-i recognized \$7.5 million of finance lease income during the year ended December 31, 2007. The implicit interest rates in the finance leases ranged from 13% to 15%.

In October 2007, these four aircraft and their associated leases were transferred to B&B Air for an aggregate price of \$90.0 million.

Table of Contents**JET-i Leasing LLC****Notes to the Predecessor Consolidated Financial Statements
For the Year Ended December 31, 2007****5. AIRCRAFT WAREHOUSE CREDIT FACILITY**

In November 2005, JET-i entered into a warehouse loan agreement (the Facility) to finance up to \$1.2 billion of aircraft assets, and provided no default has occurred, and subject to lenders' consent, the Facility amount could have been increased to \$1.5 billion. Tranches A and B were provided by a consortium of third party lenders; Tranche C was provided solely by Holdings. One of the investors in Holdings was also a member of the Tranches A and B consortium of third party lenders. Borrowings were collateralized by the assets of JET-i and its special purpose subsidiaries established to own the aircraft. Under the Facility, the Funds were available for draw on a revolving basis for a period of two years after closing (the Availability Period). The Availability Period expired in November 2007, and the Facility was fully repaid as of December 31, 2007. As a result of the extinguishment of the Facility, unamortized deferred debt issuance costs totalling approximately \$9.2 million were expensed and classified as debt extinguishment costs.

Borrowings were advanced in three separate tranches—Tranches A, B and C. Fundings were made in reverse order such that the Facility amount related to Tranche C was fully utilized first, then Tranche B and then Tranche A. Tranche A borrowings accrued interest at one-month London Interbank Offered Rate (LIBOR) plus a margin of 1.25%. Tranche B borrowings accrued interest at one-month LIBOR plus 4.5%. Tranche C borrowings accrued interest at a rate such that the aggregate monthly interest of the entire Facility reflected an interest rate of one-month LIBOR plus 2.5%. Monthly payments of principal and interest were made based on available cash after certain expenses, in accordance with the order of priority governed by the Facility. Any unpaid amounts were carried forward and accrued interest at applicable interest rates for each tranche. Unutilized amounts under Tranche A and B accrued commitment fees of 0.3% per annum of the daily average unutilized balance; however, Tranche B commitment fee started to accrue six months after the inception of the Facility. In order of security interest, Tranche A ranked above Tranche B, and both Tranche A and B ranked above Tranche C.

JET-i capitalizes costs incurred in arranging financing as debt issuance costs. Debt issuance costs are amortized to interest expense using the effective interest method for amortizing loans and on a straight-line basis for revolving credit facilities over the lives of the related debt. Amortization of debt issuance costs was \$1.6 million during the year ended December 31, 2007. These amounts are included as components of interest expense.

JET-i used interest rate swaps to manage exposure to interest rate risk. The derivatives allowed JET-i to pay fixed interest rates and receive variable interest rates with the swap counterparty over life of the contracts. The fixed interest rates under contract ranged from 5.11% to 5.71% per annum and had maturity dates through December 2014. The changes in fair value of the derivatives were recorded into income from continuing operations before provision for income taxes. JET-i recorded \$5.9 million as an income with respect to these derivatives for the year ended December 31, 2007.

In October 2007, JET-i terminated its interest rate swap agreements and paid breakage costs of \$12.5 million to the swap counterparty.

To protect the owners of Holdings against rising interest rates in connection with B&B Air's initial public offering and Securitization, JET-i entered into two interest rate hedge options for the benefit of B&B Air. The interest rate swap options provided B&B Air with an option to enter into interest rate swap agreements for a portion of its Notes at a fixed rate of 5.43%. In September 2007, JET-i settled the options in cash and recorded into expense its share of the hedging costs amounting to \$5.4 million, net of \$1.7 million reimbursed by B&B Air.

Table of Contents**JET-i Leasing LLC****Notes to the Predecessor Consolidated Financial Statements****For the Year Ended December 31, 2007****6. INCOME TAXES**

JET-i has subsidiaries in a number of tax jurisdictions, principally, Ireland, Luxembourg and the United States of America. JET-i is treated as a flow-through entity for U.S. federal and state income tax purposes. JET-i's member, Holdings, is also a flow-through entity. Accordingly, Holdings' members report their allocable share of the taxable income in their respective income tax returns.

Income tax expense by tax jurisdiction is summarized below for the year ended December 31, 2007.

| | (Dollars in thousands) | |
|-----------------------------------|-------------------------------|-------------|
| Deferred Tax Expense | | |
| Ireland | \$ | (14) |
| Luxembourg | | (4) |
| | | (18) |
| Less valuation allowance | | 4 |
| Total Deferred Tax Expense | | (14) |
| | | |
| Current Tax Expense | | |
| Ireland | | 446 |
| Luxembourg | | 34 |
| Total Current Tax Expense | | 480 |
| | | |
| Total Income Tax Expense | \$ | 466 |

Table of Contents**JET-i Leasing LLC****Notes to the Predecessor Consolidated Financial Statements
For the Year Ended December 31, 2007****7. OTHER LIABILITIES**

The following table describes the principal components of JET-i's other liabilities at December 31, 2007 (in thousands):

| | | |
|--|-----------|--------------|
| Income taxes payable | \$ | 415 |
| Accrual for major maintenance activities and costs | | 900 |
| Total Other Liabilities | \$ | 1,315 |

8. RELATED PARTY TRANSACTIONS

JET-i has no employees and has outsourced to B&B the daily operations of JET-i through various agreements. JET-i entered into a broker agreement with B&B to engage B&B to act as the exclusive arranger of JET-i's acquisitions and dispositions of aircraft. In consideration for these services, B&B receives a fee equal to 1% of the purchase price of the aircraft on acquisition and 1% of the sales proceeds on aircraft disposition. During the year ended December 31, 2007, JET-i incurred and paid \$2.6 million, for acquisition services rendered by B&B under this agreement. The amounts paid were capitalized into the cost of the flight equipment. No fees for disposition of aircraft have been paid to B&B under this contract.

JET-i also entered into a servicing agreement with B&B which authorizes B&B to perform lease servicing, remarketing, debt compliance and other administrative functions for JET-i. In consideration for these services, B&B receives a fee equal to 3.5% of lease revenues. During the year ended December 31, 2007, JET-i incurred expenses of \$3.5 million under this agreement.

The debt under Tranche C of the Facility is provided by Holdings. For the year ended December 31, 2007, JET-i has incurred interest expense of \$11.6 million on this debt. Additionally, Holdings, for its role as Manager of JET-i earns fees of \$10,000 per month. For the year ended December 31, 2007, JET-i incurred \$0.1 million for this service. This cost is recorded in selling, general and administrative expense. One of the investors in Holdings is also a member of the Tranches A and B consortium of third party lenders.

In the normal course of business, Holdings has financed expenses on behalf of JET-i. During the year ended December 31, 2007, Holdings authorized the conversion of \$19.1 million of its financing receivables from JET-i to a capital contribution. At December 31, 2007, JET-i had no outstanding liabilities to Holdings.

JET-i is the predecessor to B&B Air. An aircraft transferred from JET-i is recorded by B&B Air at JET-i's net book value as of the transfer date. JET-i has made payments to Holdings aggregating \$273.2 million for: (i) the excess of each aircraft's adjusted purchase price over its net book value as of the delivery date to B&B Air and (ii) relief of JET-i's maintenance payment liability which were assumed by B&B Air. The amount owed and paid was reduced by legal and other transfer costs incurred. The resulting gain on the transfer of aircraft to B&B Air will be recognized by Holdings. Certain costs related to this transfer were also shared with B&B Air.

As of December 31, 2007, JET-i has recorded a payable to B&B Air totalling \$1.2 million for (i) maintenance payment liabilities collected by JET-i on behalf of B&B Air and (ii) professional fees to be paid by B&B Air on behalf of JET-i.

Table of Contents**JET-i Leasing LLC****Notes to the Predecessor Consolidated Financial Statements****For the Year Ended December 31, 2007****9. UNAUDITED QUARTERLY CONDENSED CONSOLIDATED FINANCIAL INFORMATION**

The unaudited quarterly financial statements for the year ended December 31, 2007 are presented below:

| | Three months ended | | | |
|------------------------|---------------------------|--------------------------|-----------------------------------|----------------------------------|
| | March 31, 2007 | June 30, 2007 | September 30, 2007 | December 31, 2007 |
| (Dollars in thousands) | | | | |
| Total revenues | \$ 30,962 | \$ 39,185 | \$ 37,418 | \$ 19,370 |
| Net income (loss) | (708) | 10,640 | (17,443) | (7,785) |

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ITEM 19. EXHIBITS

We have filed the following documents as exhibits to this Annual Report.

| Exhibit Number | Description of Exhibit |
|---------------------------|---|
| 1.1 | Memorandum of Association* |
| 1.2 | Bye-laws* |
| 2.1 | Deposit Agreement between Deutsche Bank Trust Company Americas and Babcock & Brown Air Limited.* |
| 4.1 | Management Agreement, dated as of October 2, 2007, between Babcock & Brown Air Management Co. Limited and Babcock & Brown Air Limited.* |
| 4.2 | Servicing Agreement, dated as of October 2, 2007, among Babcock & Brown Aircraft Management LLC, Babcock & Brown Aircraft Management (Europe) Limited, Babcock & Brown Air Funding I Limited and AMBAC Assurance Corporation.* |
| 4.3 | Administrative Services Agreement, dated as of October 2, 2007, among Deutsche Bank Trust Company Americas, AMBAC Assurance Corporation, Babcock & Brown Air Management Co. Limited and Babcock & Brown Air Funding I Limited.* |
| 4.4 | Registration Rights Agreement, dated as of October 2, 2007, among private investors and Babcock & Brown Air Limited.* |
| 4.5 | Trust Indenture, dated as of October 2, 2007, among Deutsche Bank Trust Company Americas, BNP Paribas, AMBAC Assurance Corporation and Babcock & Brown Air Funding I Limited.* |
| 4.6 | Security Trust Agreement, dated as of October 2, 2007, between Deutsche Bank Trust Company Americas, and Babcock & Brown Air Funding I Limited.* |
| 4.7 | Cash Management Agreement between Deutsche Bank Trust Company Americas and Babcock & Brown Air Funding I Limited.* |
| 4.8 | Director Service Agreement between Babcock & Brown Air Limited and each director thereof.* |
| 4.9 | Aircraft Acquisition Facility, dated as of November 7, 2007 among Babcock & Brown Air Acquisition I Limited, the Lenders from time to time party thereto and Credit Suisse, New York Branch.** |
| 4.10 | Servicing and Administrative Services Agreement, dated as of November 7, 2007 among Babcock & Brown Aircraft Management LLC, Babcock & Brown Aircraft Management (Europe) Limited, Babcock & Brown Air Acquisition I Limited and each Aircraft Subsidiary that becomes a party thereto.** |
| 8.1 | List of subsidiaries of the Company. |

- 12.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002.
- 12.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002.
- 13.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002.

* Previously filed with the Registration Statement on Form F-1, File No. 333-145994.

** Previously filed with the Annual Report on Form 20-F for the year ended December 31, 2007.

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SIGNATURE

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this Annual Report on its behalf.

Babcock & Brown Air Limited

By: /s/ Colm Barrington
Colm Barrington
Chief Executive Officer and Director

Dated: March 8, 2010