Financing Aircraft

Two most common methods of acquiring aircraft:

- Direct Purchase with Financing
- Operating Lease

Direct Purchase With Financing

- Airline purchases airplane from manufacturer
- Airplane is financed with loan secured by a mortgage or structured as a finance lease
- Advance rate can range from 70% to 85%
- Fixed or floating interest rates
- Mortgage style amortization – typically up to 12 yrs.

- A number of financial institutions may participate in the loan (syndication)
- The airline gains equity in the airplane as it pays down the loan or lease

Advantages and Disadvantages of Purchase

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Advantages

- Maximum airline control of airplane configuration
- Airline acquires equity in fleet
- Equity can be used as a source of cash in the future
- Significant tax benefits if the airline is profitable (varies by country)
- Benefits to airline from aircraft's residual value
- Possible increase in operational flexibility

Disadvantages

- Large investment and financing requirements
- Residual value risk
- Restrictions included in loan covenants
- Fleet purchase decisions tend to be more permanent than with operating leasing

Leasing an Aircraft

What is a Lease?

- Contract between two parties – lessor and lessee
- Allow lessee to use equipment owned by lessor for a period of time for a rental payment

Characteristics of Operating Lease

- When lessor buys the aircraft from the manufacturer
  - ✓ Lessor makes pre-delivery payments
  - ✓ Lessor funds or arranges financing for the aircraft at delivery
- Airline leases the aircraft from the lessor
- Lease term is usually short for narrowbody aircraft
  - ✓ 3 to 7 years is typical
- Longer lease term is typical for widebody aircraft
- Airline returns airplane to lessor when lease ends
- Airline may have option to renew lease or purchase aircraft at fair market value

Operating Lease Costs Are Categorized Into Three Major Areas

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Leasing

- Typically about 0.8% of new aircraft cost per month
- Actual lease rates are determined by aircraft supply and demand

Maintenance reserves

- Paid to lessor and available for scheduled maintenance
- Typically equal to mature maintenance cost for aircraft but can vary widely

Security deposit

- Typically equal to 2 to 3 months of lease payments
- Returned to airline at end of lease

Advantages and Disadvantages of Leases

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Advantages	Disadvantages
Capital investment requirements reduced	Airline exposed to lease rate fluctuations
Can increase fleet plan flexibility	Airline does not gain equity in the fleet
Lessor assumes aircraft residual value risk	May have smaller tax benefits than purchase or finance lease
Airplane generally available for earlier delivery	Airline must satisfy lease contract requirements (administrative, reporting, maintenance)
Payments can be either fixed or floating depending on Lessee requirements	Lessor may restrict the use of the aircraft
	Lessee may pay withholding or other additional taxes