Financing Aircraft

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Two most common methods of financing the purchase of aircraft:

- Direct Purchase with Bank Financing
- Operating Lease

Direct Purchase With Bank 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 90%
- Fixed or floating interest rates
- Mortgage style amortization – typically up to 12 yrs.

- Frequently a number of financial institutions participate in the loan
- The airline gains equity in the airplane as it pays down the loan or lease

Advantages and Disadvantages of Purchase

Advantages

- Maximum airline control of airplane configuration
- Airline acquires equity in fleet
- Equity can be used as a source of cash
- Significant tax benefits (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
- Less fleet plan flexibility than operating lease

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

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- Lessor acquires the aircraft from a manufacturer
  - ✓ Lessor pays the advance 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, but can range from 1 day to 80% of aircraft useful life
- 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 approximately 1.0% 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

- Capital investment requirements reduced
- Can increase fleet plan flexibility
- Lessor assumes aircraft residual value risk
- Airplane may be available for earlier delivery
- Financial statement impact minimized
- Payments can either be fixed or floating depending on Lessee requirements

Disadvantages

- Airline exposed to lease rate fluctuations
- Airline does not gain equity in the fleet
- May have smaller tax benefits than purchase or finance lease
- Airline must satisfy lease contract requirements (administrative, reporting, maintenance)
- Lessor may restrict the use of the aircraft
- Lessee pays withholding or other additional taxes