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

**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
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

- **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

**Advantages**
- Capital investment requirements reduced
- Can increase fleet plan flexibility
- Lessor assumes aircraft residual value risk
- Airplane generally available for earlier delivery
- Payments can be either 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 may pay withholding or other additional taxes