

Two most common methods of acquiring aircraft:

- Direct Purchase with Financing
- Operating Lease

Direct Purchase With Financing

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- 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

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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- 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

- 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