

Maximising the lease factor

Operating leases and sale-and-leaseback transactions are valuable financial tools for airlines when they want to acquire new aircraft. Bernie Baldwin reports.

“Oh, that’s such a cliché!” How often is the phrase used in a pejorative fashion to deny a statement applied to a certain situation? Yet the reason that some phrases become clichés is because they are consistently repeated due to a certain core truth contained within them.

In the airline industry, “Low cost wins!” is one such phrase, often muttered by the CEO of a renowned Irish low-fare airline group. Keeping costs down, though, is easier said than done and every tool available needs to be used.

The aircraft that are used for their business, of course, are among the most expensive items for any airline. Keeping the financing of their acquisition as low as possible is a huge challenge, whether it be through obtaining debt finance or through leasing, which can keep the asset off the balance sheet.

Choosing which finance option to take on any aircraft acquisition means considering the state of the money markets and activity

in the aircraft market itself.

As recent orders and commitments at the Dubai Airshow demonstrate, demand in the latter of those markets is strong.

SLOW PROGRESS

Currently, however, new aircraft are still coming off the production lines at rates lower than the OEMs would like, which has an effect on the money markets.

Mark Hughes, CCO at Falko Regional Aircraft, has observed how this has been affecting the market for operating leases and sale-and-leaseback (SLB) deals and how this

may influence the market’s development over the rest of the decade.

He says: “Lower production rates reduce the overall demand in the SLB market. Smaller aircraft are just as affected by this as larger commercial aircraft. For Falko, the impact is a positive one, as airlines are looking to extend leases on existing aircraft or source additional used aircraft on lease to meet gaps in capacity or cover aircraft with engine reliability issues.”

Angus von Schoenberg, Industry Officer for specialist regional aircraft lessor TrueNoord, is of a similar opinion.

He says: “With fewer new aircraft coming off the production lines, there are proportionately fewer SLBs on new aircraft and fewer aircraft coming from any forward order lessors. However, this means the used aircraft lease market is more active than would otherwise be the case.

“Whilst there is a capacity shortage driven by the lack of new deliveries, airlines are extending leases on existing aircraft. Often these are not just short-term stopgap extensions but longer-term

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Mark Hughes, CCO, Falko Regional Aircraft



Air France has invested in major interior upgrades to its leased Embraer E-190s.
Image: Air France

commitments to existing aircraft.

“For example, TrueNoord lessees Air France HOP, Finnair and BA CityFlyer have all invested in major interior upgrades on their Embraer 190s. You don’t do this unless you are committed for at least five to seven years.

“Meanwhile, there continues to be strong demand for additional used aircraft from both existing and new operators. This is keeping lease rates strong for most types, although in the case of regional aircraft there may be further increases as lessors are confronted with increased transition expenses and higher funding costs.”

NO ALTERNATIVE

The current scenario is clearly influencing the level to which operating leases and SLBs are being used by airlines as part of their fleet financing strategy.

“The reasons for choosing operating leases have not materially changed in recent years,” von Schoenberg emphasises.

“The only exception is in circumstances where availability of aircraft drives the buy versus lease decision of an airline, rather than the economics. If aircraft are needed and the only source is a lessor, then there is no alternative.

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“In the current climate, where values are strong, some airlines have turned to the SLB market to sell new or used aircraft for more than their book values, so the transaction can generate a profit the airline can use to grow or develop its network.”

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market to sell new or used aircraft for more than their book values, so the transaction can generate a profit the airline can use to grow or develop its network.

“A number of low-cost carriers in particular have turbo-boosted their growth in this way. In addition, a SLB enables the airline to recover the pre-delivery payments and deploy these funds as working capital, or transfer the money to subsequent delivery positions.”

Falko’s Hughes reports that his company has “seen no major shift in the demand for operating leases from customers”, adding: “The most significant shift recently has been the increase in demand for lease extensions and airlines being willing to commit to extensions even earlier than before.”

Coming back to the question of keeping costs down, the CCO explains how business models using leases judiciously allow airlines to manage costs, maintain fleet flexibility, and address the significant capital expenditure required for fleet renewal.

He says: “Leasing is always a core component to an airline’s sources of capital. For smaller aircraft, where there are fewer in-production alternatives, airlines are increasingly looking to operate aircraft until 25 to 30 years old.

“In these circumstances, with long-term commitment to the type, operating leasing can become economically less efficient if the airline has good access to capital.”

FLEXIBLE FINANCE

TrueNoord’s von Schoenberg also assesses how leasing aids cost management and fleet flexibility.

He says: “If an airline is going through a fleet renewal process, operating leases provide 100% financing for the aircraft it chooses to fund in this way.

“For factory-new aircraft, airlines are also not required to make the pre-delivery payments, some of which are due years before delivery.

“Not only can this enable financially weaker airlines to access new aircraft that they might otherwise struggle to finance, it can also be a very helpful cash-flow management tool for more creditworthy names.

“In addition, for any business, equity is

The availability of aircraft can also be a factor when airlines are making ‘buy versus lease’ decisions.

Image: London City Airport



typically the most expensive funding, so 100% financing can be economically highly efficient, even if a lease might at first glance look expensive compared to on-balance sheet finance. For large airlines seeking to replace big fleets this can have a major impact on managing costs.”

Von Schoenberg adds: “From a fleet flexibility perspective, this is more valuable for airlines that make large orders. If a carrier is inducting a large fleet of aircraft, many of which have different lease lengths, then it gains considerable flexibility to adjust its fleet size throughout the overall lease period.”

Delivery rates for OEMs are currently sub-optimal, driven by a complex web of supply chain and labour constraints.

However, a number of recent high-volume



In placing high-volume aircraft orders, operators are looking past current supply chain disruptions.

Image: Clemens Vasters/Wikimedia

commitments demonstrate that operators are looking past immediate disruptions, banking on there being improved production stability by the time their contracted aircraft roll off the line.

When this pent-up supply is released into

the market, the demand for flexible financing is likely to surge. As a result, operating leases and SLB deals are positioned to be a primary facilitator of this growth, enabling carriers to secure modern fleets without immediate capital depletion. ■

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