

Aircraft Leases

Wednesday 10 May 2017: Module 9

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OVERVIEW

- I. Aircraft Leasing
- II. Terms & Conditions

I. Aircraft Leasing



Why Leasing?

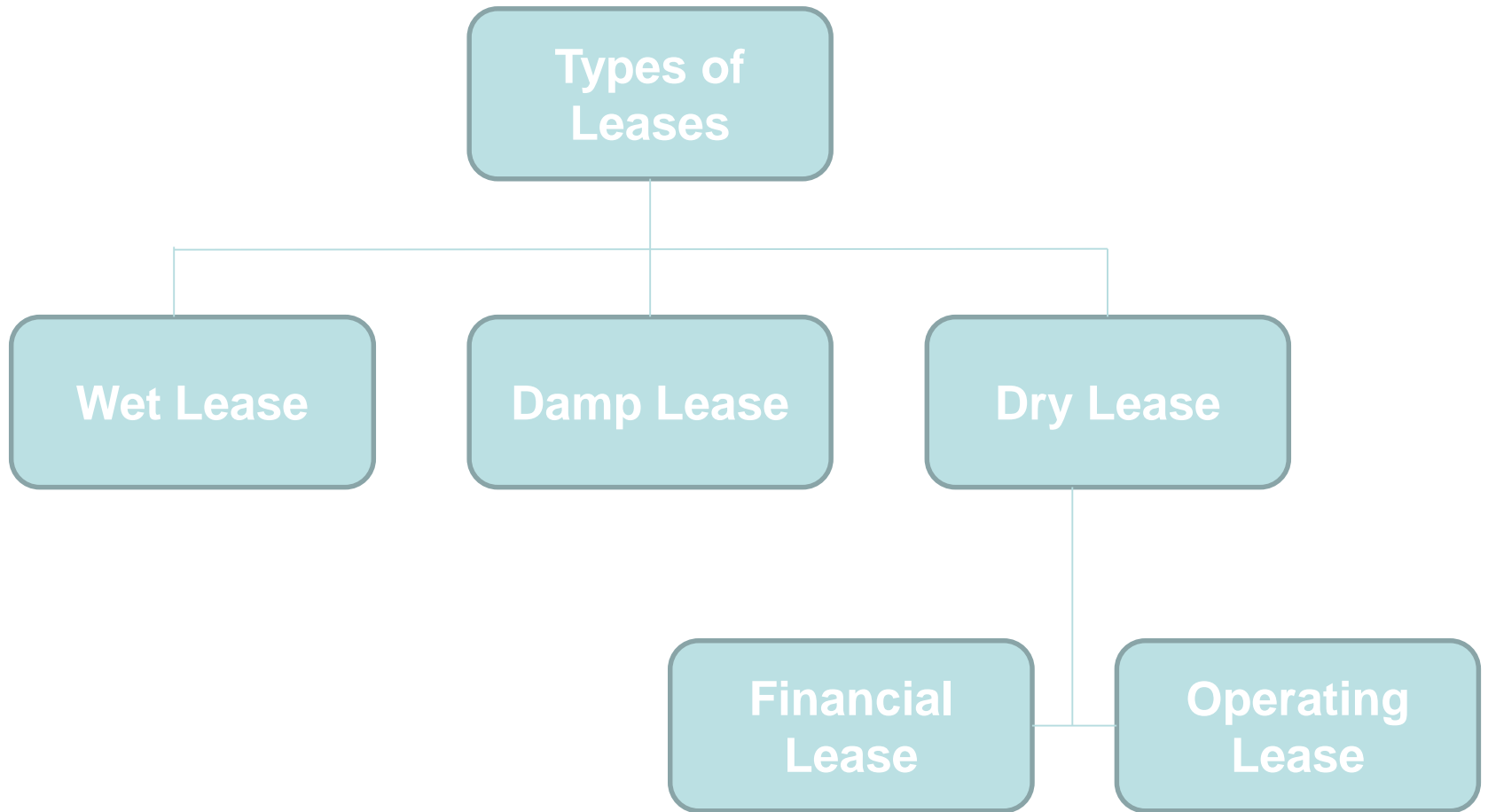
- Cost of aircraft makes acquiring an entire fleet very difficult
- Leasing is flexible (≠ outright ownership):
 - Aircraft can be rotated through the fleet as required to meet the changing demands
 - Eg: Seasonal demand → short-term leasing
- Financial & tax reasons
 - Repayments in currencies of which airline has significant revenue
 - Take advantage of different taxation rules
- Leasing allows airlines to access capital and debt markets to take advantage of attractive interest rates (leaving available cash for other purposes)

Principles of Aircraft Leasing

- Access vs. Ownership
 - Leasing gives the customer access to new equipment by way of renting it for a contracted period, without owning the asset
- Parties
 - *Lessor*: party that owns the asset
 - *Lessee*: party that takes lease of the asset from lessor
- 2 Main types of lease
 - A. Finance Lease
 - B. Operating Lease

Types of Leases

- **Wet leases**
 - ACMI (aircraft, crew, maintenance & insurance)
- **Dry leases**
 - Aircraft only
- **Damp leases**
 - Between Wet & Dry Leases: only AMI and in some cases also technical crew, but not cabin crew
- **Charters vs. Wet Lease**
 - Traditionally charter is for limited number of missions, while wet lease for fixed period



A. Finance lease

- Value of the asset appears on the lessee's balance sheet and the rental payments pass through the profit and loss account
- The full value of the asset is repaid to the lessor, plus interest, over the lease period
- Not much flexibility and given the transaction costs, it's very unusual for short-term issues
- Sources: banks, bond & debt markets and sometimes even export credit agencies

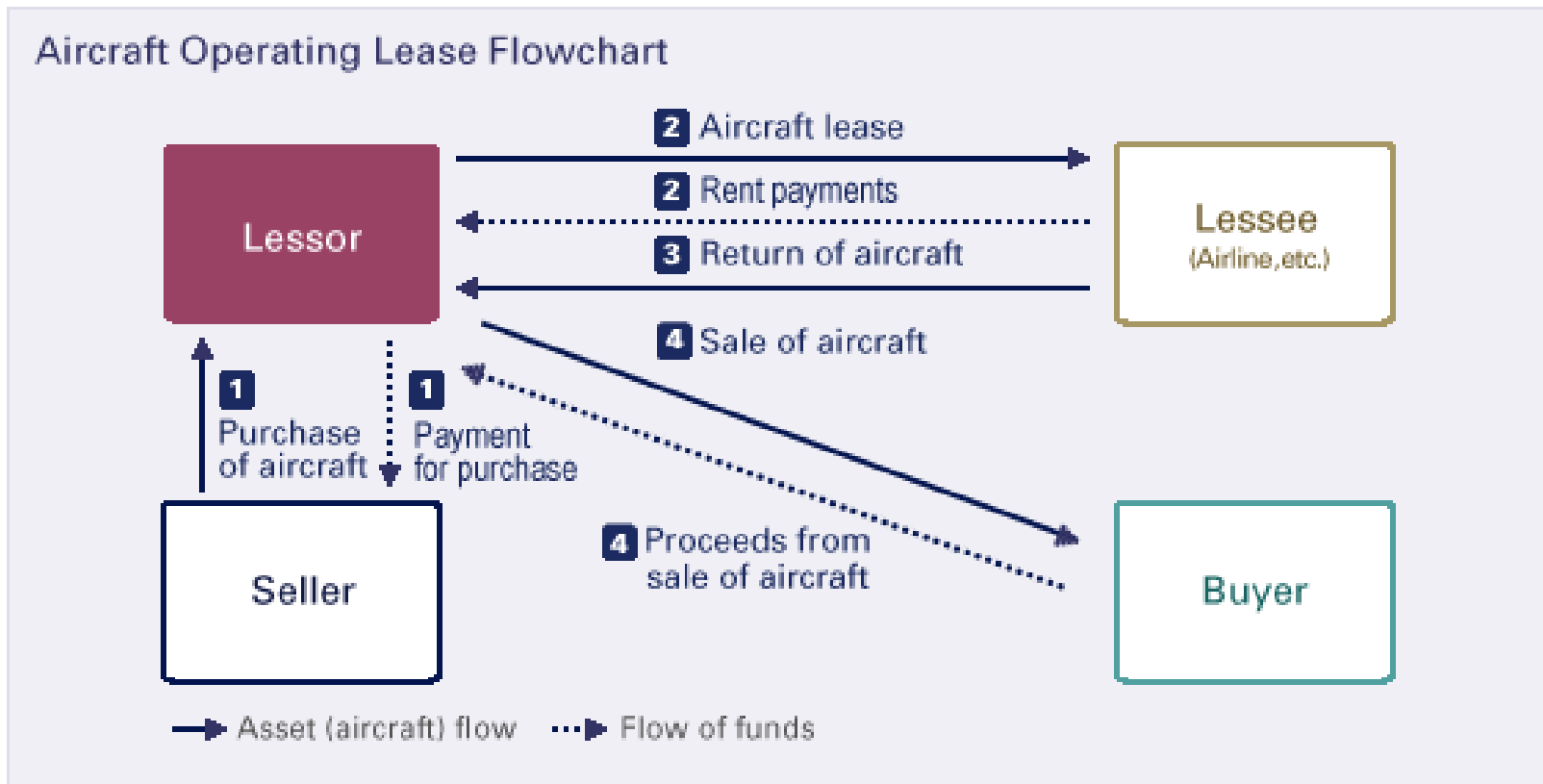
B. Operating lease

Principles:

- Appropriate when lessee does not need the asset for its entire working life
- Payments are made to the lessor for the use of the asset while it is needed
- The asset is not shown on the lessee's balance sheet, instead it appears there as a (rental) cost
- The lessor may retain responsibility for maintenance and often takes the asset back at the end of the lease period

In an operating lease of an aircraft:

- Lessor retains risks and rewards of ownership of aircraft
- Lessee receives usage of the aircraft over a finite period (usually <10 years)



Loan to value ratio

→ The lower, the better

Maturity:

→ The shorter, the better:

Aircraft with an economic life span of 20 or more years typically need 10 to 15 years of financing

Payout:

→ Full payout (amortization to zero) required for longer maturities

→ “Balloon” payments possible for shorter maturities

	Finance Lease	Operating Lease
Meaning	Commercial arrangement in which lessor allows lessee to use the asset for the max. part of its economic life against payment	Commercial arrangement in which lessor allows lessee to use the asset for a time shorter than economic life of the asset against payment
Nature	Loan Agreement	Rental Agreement
Lease Period	Longer	Short
Risk bearing for obsolescence	With lessee	With lessor
Transferability of risk & rewards	From lessor to lessee, with transfer of asset	No transfer
Lease Cancellation	Only on happening of specified event	Possible
Tax benefit	Depreciation & finance charges allowable as deduction to lessee	Lease rent allowable as deduction to lessee
Maintenance	Cost for lessee	Cost for lessor
Purchase option	Yes, at price > Fair Market Value	No

II. Terms & Conditions

PRE-AGREED LEASE RETURN CONDITIONS

Having clear and pre-agreed lease return conditions is essential in order to enable the smooth asset hand over from Lessee back to Lessor...

In the same vein, when looking at lease contracts, the most likely time for an issue to occur is not at aircraft delivery or whilst the aircraft is being operated, but at the point that the asset is returned to the Lessor...



The lease document is a *contract*

- Contains **essential elements** of all contracts:
 - Offer
 - Acceptance of the offer
 - Consideration
 - Intention to create legal relations
 - Certainty of contractual terms
 - Capacity of the parties to contract
- Contains **terms of varying importance**:
 - Terms (express and implied)
 - Conditions
 - Warranties
 - Exclusions

General Lease Provisions

- Operation
 - Restrictions on operations in certain circumstances
- Maintenance
 - Maintenance Reserve
- Prohibition on subleasing and reregistration
- Possession
- Replacement on Events of Loss
- Insurance (cf. next slide)
- Return Conditions

- **Security:**
 - Ownership of the asset is the best security
- **Maintenance:**
 - Aircraft maintenance key to safety, asset value, etc.
 - Lenders require proper maintenance on a regular schedule, and may levy maintenance reserves for upcoming costs
- **Instalments:**
 - The more frequent, the better: semi-annual or quarterly
 - Monthly instalments allow monitoring of weaker credits
- **Payment denomination:**
 - USD, in line with second hand aircraft market
 - Only most creditworthy airlines (where collateral asset value is less important) may finance in other currencies matching their revenues

- **Fixed or floating rates:**
 - Unless underwritten by export credit agencies, fixed rate financing for 10 to 15 years available only to most creditworthy airlines, due to potential funding breakage costs
- **Risks:**
 - All operating risks and costs associated with aircraft (operation, maintenance, insurance, etc.) borne by airline
- **Yield:**
 - The interest paid on the loan (junior lenders typically receive a higher rate than senior lenders)

Aviation Insurance:

a. Provisions

- ✓ Hull
- ✓ Liability and Third Party
- ✓ War and Allied Perils
- ✓ Political Risk
- ✓ Breach of Warranty

b. Standard form

- ✓ AVN67C
 - Standard to be required as security for financing

AVN67C Form

file:///C:/Users/saras/Downloads/AVN67C.pdf

AIRLINE FINANCE/LEASE CONTRACT ENDORSEMENT

It is noted that the Contract Party(ies) have an interest or interests in respect of the Equipment under the Contract(s). Accordingly, with respect to losses occurring during the period from the Effective Date until (i) the date and time at which the Insurance expires or, if earlier, (ii) the date and time at which the Insured has no further obligation to insure the Equipment under the Contract(s), as notified in writing by the Designated Contract Party to the Insurers (via the Appointed Broker, if any) (such notification to be given promptly and in any event within 30 days after such date), and in consideration of the Additional Premium, it is confirmed in respect of the said interest(s) of the Contract Party(ies) that the Insurance afforded by the Policy is in full force and effect, and it is further agreed that the following provisions are specifically endorsed to the Policy:-

1. Under the Hull and Aircraft Spares Insurances

- 1.1 In respect of any claim on Equipment that becomes payable on the basis of a Total Loss, settlement (net of any relevant Policy Deductible) shall be made to, or to the order of the Contract Party(ies). In respect of any other claim, settlement (net of any relevant Policy Deductible) shall be made with such party(ies) as may be necessary to repair the Equipment unless otherwise agreed after consultation between the Insurers and the Insured and, where necessary under the terms of the Contract(s), the Contract Party(ies).

Such payments shall only be made provided they are in compliance with all applicable laws and regulations.

- 1.2 Insurers shall be entitled to the benefit of salvage in respect of any property for which a claims settlement has been made.

2. Under the Legal Liability Insurance

- 2.1 Subject to the provisions of this Endorsement, the Insurance shall operate in all respects as if a separate Policy had been issued covering each party insured hereunder, but this provision shall not operate to include any claim howsoever arising in respect of loss or damage to the Equipment insured under the Hull or Spares Insurance of the Insured. Notwithstanding the foregoing the total liability of Insurers in respect of any and all Insureds shall not exceed the limits of liability stated in the Policy.

- 2.2 The Insurance provided hereunder shall be primary and without right of contribution from any other insurance which may be available to the Contract Party(ies).

- 2.3 This Endorsement does not provide coverage for any Contract Party with respect to claims arising out of its legal liability as manufacturer of, or performer of maintenance, repairs or other operational activities on, the Equipment.

- 2.4 The coverage afforded by the Policy is amended by this Endorsement to provide coverage in respect of the liability of the Contract Party(ies) to the pilots and crew of the Equipment (excluding liability to those pilots and crew employed by the Contract Party(ies)), on the basis that for the purposes of providing such coverage under this Endorsement, such pilots and crew shall be deemed to be passengers.

3. Under the Hull and Aircraft Spares Insurances and the Legal Liability Insurances

- 3.1 The Contract Party(ies) are included as Additional Insured(s).

- 3.2 The cover afforded to each Contract Party by the Policy in accordance with this Endorsement shall not be invalidated by any act or omission (including misrepresentation and non-disclosure) of any other person or party which results in a breach of any term, condition or warranty of the Policy PROVIDED THAT the Contract Party so protected has not caused, contributed to or knowingly condoned the said act or omission.

- 3.3 Nevertheless, no Contract Party shall be entitled to claim a loss by theft or alleged theft of the Equipment under the hull insurances by reason of the actual or alleged dispossession or refusal or failure to redeliver the Equipment by the Insured or any other Contract Party, but this shall not exclude any claim by a Contract Party by reason of loss of or damage to the Equipment (other than loss by such theft) during the period of this Endorsement.

- 3.4 The provisions of this Endorsement apply to each Contract Party solely in its capacity as financier, lessor or lease servicer or manager under the Contract(s) and not in any other capacity. Knowledge that any Contract Party may have or acquire or actions that it may take or fail to take in that other capacity (pursuant to any other contract or otherwise) shall not be considered as invalidating the cover afforded by this Endorsement. For this purpose "lease servicer or manager" means a Contract Party who is appointed by one or more other Contract Party(ies) to provide services relating to the Equipment in connection with the Contract(s) (other than services of a kind specified in paragraph 2.3 above).

- 3.5 The Contract Party(ies) shall have no responsibility for premium, and Insurers shall waive any right of set-off or counterclaim against the Contract Party(ies) except in respect of outstanding premium in respect of the Equipment.

- 3.6 Upon payment of any loss or claim to or on behalf of any Contract Party(ies), Insurers shall to the extent and in respect of such payment be thereupon subrogated to all legal and equitable rights of the Contract Party(ies) indemnified hereby (but not against any Contract Party). Insurers shall not exercise such rights without the consent of those indemnified, such consent not to be unreasonably withheld. At the expense of Insurers such Contract Party(ies) shall do all things reasonably necessary to assist the Insurers to exercise said rights.

- 3.7 Except in respect of any provision for Cancellation or Automatic Termination specified in the Policy or any endorsement thereof, cover provided by this Endorsement may only be cancelled or materially altered in a manner adverse to the Contract Party(ies) by the Insurers giving not less than 30 days' notice in writing to the Contract Party(ies) (via the Appointed Broker, if any). Notice shall be deemed to commence from the date such notice is given by the Insurers. Such notice will NOT, however, be given at normal expiry date of the Policy or any endorsement.

EXCEPT AS SPECIFICALLY VARIED OR PROVIDED BY THE TERMS OF THIS ENDORSEMENT:-

1. THE CONTRACT PARTY(IES) ARE COVERED BY THE POLICY SUBJECT TO ALL TERMS, CONDITIONS, LIMITATIONS, WARRANTIES, EXCLUSIONS AND CANCELLATION PROVISIONS THEREOF.
2. THE POLICY SHALL NOT BE VARIED BY ANY PROVISIONS CONTAINED IN THE CONTRACT(S) WHICH PURPORT TO SERVE AS AN ENDORSEMENT OR AMENDMENT TO THE POLICY.

SCHEDULE IDENTIFYING TERMS USED IN THIS ENDORSEMENT

1. **Equipment¹:**
2. **Policy Deductible** applicable to physical damage to the Equipment²;
3. **(a) Contract Party(ies):**

AND (b), in addition, in respect of Legal Liability Insurances:

4. **Contract(s):**

and references in this Endorsement to "the Contract(s)" mean the contract(s) listed above, as amended or supplemented from time to time.

5. **Designated Contract Party:**
6. **Effective Date³:**
7. **Additional Premium:**
8. **Appointed Broker:**

AVN 67C

2 August 2007

In common with all AICG produced AVN Clauses, this Clause is published by AICG, but it is expressly non-binding and AICG makes no recommendation as to its use in particular policies. Insurers are of course free to offer different policy wordings and clauses to their policy holders.

¹ Specify details of any aircraft, engines or spares to be covered.

² Insert all applicable Policy deductibles.

³ Insert the date when the Contract Party(ies) acquire their interests in the Equipment, or the policy renewal date, as applicable.

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