Aircraft Lessor Considerations | Short Insights to Aircraft Liquidity

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The content contained herein is based on my own professional experience and may contain personal opinions. Additional references are herein under "List of References" section.

Aircraft Liquidity

As an owner of aircraft, the lessor holds the residual value risk. Moreover, this identifies one reason why aircraft operators often choose to lease vs. own. Lessors are responsible for identifying unsystematic risk. Consideration of aircraft liquidity are not taken lightly. How fast would the lessor be able to remarket the aircraft to another lessee in the event of a lease return, bankruptcy, or default? Risk mitigation is extremely important in this business, as owning aircraft which are afoul to remarket can significantly hurt financial performance. Lessors want the ability to easily transfer the aircraft from one operator to the next. The notion of aircraft liquidity is prominent, whether you lease small flight training aircraft, mid-sized business aircraft, or large commercial aircraft. Aircraft liquidity is assessed by how fast an asset can be released or sold at fair market value (FMV). Reductions to the lease rate or sale price may indicate softness in the market, or the lessor's immediate need to generate revenue. Revenue is often the best indicator of overall demand, as it is a function of volume consumed at a specific price.

Risk Mitigation

How can the risk of liquidity be mitigated, the answer is straightforward, by investing in a diversified portfolio of aircraft types. Lessors must balance their investments between higher yielding vs. lower yielding aircraft. Less common, unique, or specialized aircraft types and variants often yield greater returns, while commonly operated aircraft offer a source of stability in exchange for lower yields. When dealing with less common, unique, or specialized aircraft the lessor may charge a risk premium to the lessee to offset their ownership risk. Certain aircraft types may be afoul to remarket, due to reduced or uncommon presence amongst operators. Many lessors, particularly commercial aircraft lessors, often find great monetary value in offering niche aircraft to their customers, who operate in unique business segments of the airline industry. For example, regional and large widebody aircraft. Inversely, the Boeing 737 family and Airbus A320 series aircraft offer the highest level of liquidity, due to their large operator base. Airlines who operate these aircraft include Southwest, Delta, United, Allegiant, Sun Country, Avelo, and many other domestic and flag carriers around the globe. As to flight training aircraft, the high liquidity equivalent would consist of the Cessna 172 and Piper Archer variants. While Light-Sport Aircraft (LSA) or larger multi-engine flight training aircraft would be considered less common, unique, or a specialized aircraft type by a lessor.

Upon analysis, if we observe part 61 and 141 flight schools across the United States, you will conclude that a large portion of schools operate variants within the Cessna 172 or Piper Archer

family. There are approximately 2,226 flight schools in the United States. While knowing many of those operate the Cessna 172 or Piper Archer, we could reasonably find another lessee in the event of remarketing the aircraft. However, considerations such as poor current economic conditions and demand for flight training, may trickle down and have an adverse effect on the lessor's ability to successfully remarket the aircraft. The last situation the lessor wants to incur would be to be forced to take possession of many aircraft which may prove difficult to remarket. The lessor would now bear the cost of storage, insurance, and likely be forced take a hit on the assets value whether the aircraft is released or sold to another operator. How can lessors pro-actively mitigate portfolio risk, and ensure aircraft liquidity? The answer is to effectively measure the aircraft's liquidity. Lessors shall be concerned with an aircraft's market penetration, operator base, production run, and availability of financing.

Aircraft rule of thumb: Basic is good, unique is bad.

<u>Market Penetration</u>

- What is the quantity of the aircraft produced by the OEM?
- What jurisdictions can you find the aircraft in?
- Who's purchasing the aircraft?
- Does the OEM have an orderbook, if so, how large?

<u>Operator Base</u>

- Who's actively operating the aircraft?
- How many aircraft remain in service vs. retired?
- What is the current economic environment of the operator's business in aggregate?
- Is demand for the aircraft type increasing or decreasing?

<u>Production Run</u>

- Is the aircraft still being produced?
- Does the aircraft easily conform to current FAA regulations?
- How many aircraft are currently available for lease or sale in the market?
- Does the OEM or a third-party maintenance provider extend a position to support the aircraft in the aftermarket?

<u>Availability of Financing</u>

- Are lenders willing to lend against the specific asset type?
- What LTV is likely to be received by a borrower?

In short, the risk of aircraft liquidity shall be carefully analyzed and taken into consideration of the lessor, while simultaneously aiming to maximizing returns.

List of References:

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