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Can a Leaseback Work for You?

There is little doubt that aviation is an expensive and even indulgent hobby. Sure, you might be able to buy block time at the flight school and get a small discount on the hourly rate, or split the rental costs of a \$100 hamburger run with a friend or two.

Conventional wisdom holds that aircraft ownership beats renting at somewhere between 75 and 100 hours per year. For those who are looking to become aircraft owners but are concerned about flying that many hours year in and year out to justify the costs of ownership, a leaseback may seem attractive. If you are contemplating such an arrangement, experience suggests that you should proceed carefully.

The Basics

A leaseback is an arrangement by which an aircraft owner makes an airplane available for rental by pilots, typically under the auspices of a flight school or flying club. Renters pay on a per-hour basis to the flight school or flying club, which keeps a portion as its “management fee” and pays the balance to the airplane owner.

Flight schools and flying clubs like leasebacks because they limit the capital expense necessary to



By **Darrell A. Clay**

acquire aircraft for the flight line. Indeed, many flight schools might not exist if they had to purchase all of the airplanes they have for rent.

Sounds like a dream, right? Unfortunately, for the owner, there are a wide variety of potential “gotchas” that, if not properly addressed when the lease agreement is first negotiated, can turn a leaseback into a nightmare. Plus, the economics may not be as advertised.

Areas Of Concern

One primary concern for owners is having a variety of unknown pilots using “your” airplane. Renters, by definition, are not owners and often do not treat the airplane accordingly. Just looking at how rental cars get treated may convince an owner not to put an airplane on leaseback for fear of ripped

upholstery, dirty carpets, garbage in the cockpit, and the like.

Speaking of renter pilots, the leaseback agreement needs to address the minimum pilot qualifications. It’s one thing to make a Cessna Skyhawk available for rent; it’s far more complicated for a complex, high-performance aircraft such as a Bonanza or Mooney to be placed on leaseback. In large measure, minimum pilot requirements may be dictated by the insurance company (more on that subject, later). But the airplane owner needs to ensure that the flight school or flying club has procedures in place to confirm a renter’s minimum qualifications before the airplane leaves the flight line, and that these procedures are actually followed.

Leasebacks may also cause concern when it comes to decisions related to use and management of the airplane. For example, does the owner retain a priority right to use of the airplane? Who is responsible for decisions with regard to maintenance of the airplane? If maintenance is required, who is responsible for deciding who will perform the maintenance? Must the airplane owner pay the management fee when the owner is personally using the airplane?

Some lease agreements appoint the flight school or flying club as the manager of all aspects of the airplane, including maintenance decisions. This is often the case when the flight school or flying club has an affiliated arm that performs maintenance. However, almost universally, the owner remains liable to pay the costs of all routine maintenance costs. It is not unheard of for owners to be presented with very expensive maintenance bills about which they were consulted very little. If you are considering placing your airplane on leaseback, pay very careful attention to the allocation of responsibilities for maintenance decisions. Importantly, the degree to which the owner actually manages the aircraft also affects the owner's ability under income tax law to deduct any losses.

A primary determinant of the economics of a leaseback is insurance. Obviously, you want your airplane insured when it is on leaseback, and you want coverage for both hull (the value of the aircraft) and liability (payments to others in the event of an accident). If your airplane is sitting outside, tied down on the flight line, you probably will want both in-motion and not-in-motion coverage.

Many times, the flight school or flying club will require that the airplane be placed in its "fleet policy." This is a group policy that applies to multiple aircraft, for which there is usually a per-hour charge levied by the insurance company. Unfortunately, this means that the owner can't "shop" coverage to find the lowest possible rate. And, the owner becomes dependent on the flight school or flying club to make the required payments. In the event that the payments are not made and there is an accident, the owner may be left with a large uninsured loss.

Owners who rely on fleet coverage should ensure that the leaseback agreement requires that they be provided, upon request, with confirmation of payment of the premium. Also, make sure that the premiums are divided according to the type of airplane, not simply by the number of airplanes

in the fleet. The latter results in the owners of airplanes that are more expensive to ensure paying less than their "fair" share.

A final gotcha is that most leasebacks do not guarantee the owner that the airplane will be flown any minimum number of hours per month or per year. Thus, it is possible that the owner will incur all of the costs of placing the airplane on leaseback with no guarantee that the airplane will be flown enough to cover all of the direct and indirect costs associated with a leaseback.

A carefully-drafted leaseback agreement may help avoid some of these pitfalls. When reviewing such an agreement, be sure that it addresses other important items, such as: term of the leaseback; options to withdraw from or renew the agreement; time period for the owner to receive payment; limits on use of the airplane, such as no grass strips, no aerobatics, etc.; ability to designate a new home base for the airplane when the flight school or flying club has multiple locations; and the owner's right to review or inspect rental records, and fuel and maintenance bills.

A Hard Look At The Economics

An example may help shed light on the economics of a leaseback. Suppose that you own a Cessna 172 that you purchased for \$75,000. You put down 20% when you bought the Skyhawk, so your loan was for \$60,000. Your loan is for 15 years at 6%, so your monthly loan payment is about \$506.00. There are 500 hours on the engine and propeller when you decide to place it on leaseback.

The local flight school rents Skyhawks for \$100 per hour, wet, based on Hobbs time. (Using tach time is less favorable to the owner and renting organization, because the Hobbs meter measures time without regard to engine speed.) Fuel at the home airport is \$4.25 per hour, and your trusty Skyhawk is going to burn about 10 gallons per hour. There is a 20% premium paid to the flight school as a management fee. A tiedown at the



airport is \$50 per month. You are hopeful that the airplane will fly 200 hours per year. This means that, in addition to the annual, you have to budget for a 100-hour inspection as well.

So, here's how the economics break down:

country consist largely of airplanes on leaseback, so there certainly are many owners who are willing to enter into such agreements.

The overall economics may be improved to the extent that the owner is able to depreciate the airplane. However, losses sustained in a leaseback may be limited by a variety of IRS rules and regulations, such as the "passive activity" rule. Stripped to its essence, if the leaseback is declared a passive activity, then any losses may only be used to offset passive income. Thus, if you have no passive income, you may not deduct the loss; instead, it is "suspended" until the aircraft is sold. If you are seriously considering a leaseback, it would be wise to consult a seasoned tax professional with experience in this area for further information.

Typical Leaseback By The Numbers	
Gross revenue – 200 hours per year @ \$100 per hour	\$20,000
Less management fee – 20% (\$20 per hour)	\$4,000
Net revenue before expenses	\$16,000
Less Estimated Expenses	
Fuel – 10 gallons per hour, \$4.25 per gallon, 200 hours per year	\$8,500
Oil changes – every 50 hours, \$100 each	\$400
Engine overhaul reserve – \$20,000 cost, 1500 hours until TBO = \$13.33 per hour * 200 hours	\$2,667
Propeller overhaul reserve – \$3,000 cost, 1500 hours until TBO = \$2.00 per hour * 200 hours	\$400
Tiedown - \$50 per month * 12	\$600
Insurance – assume \$12 per hour flown	\$2,400
TOTAL ANNUAL PROFIT	\$1,033

So, even at this point, the leaseback starts to look only marginally profitable. When you layer on other routine costs – oil consumed between oil changes; the annual inspection and any 100 hour inspections; pitot-static, altimeter, and transponder checks; the cost of any necessary GPS or MFD database subscriptions; etc. – the profit is quickly erased. Plus, of course, this scenario omits one additional cost: The \$506 monthly loan payment! (Of course, you were going to be obligated for that payment anyway, so perhaps that's an even wash.)

Making It Work?

This example isn't to say that leasebacks can't be made to work. Flying more hours obviously generates more income, although it also means some additional expenses and a shorter period before engine and propeller overhauls become necessary. Some of the largest rental fleets in the

Likewise, it pays to consider talking to other airplane owners who have entered into a leaseback with the same flight school or flying club. Find out what those owners' experiences have been. Look at the condition of their airplanes. The information that they provide may be equally as important as the dollars-and-cents analysis.

In the final analysis, there is no simple answer whether a leaseback is right or wrong. Instead, study all aspects of the proposed arrangement, ask pointed questions, get professional help on the tax and legal issues, and try to set expectations realistically.

Darrell A. Clay is a partner with the Cleveland, Ohio law firm of Walter & Haverfield LLP, where he counsels and represents aircraft owners, pilots, and others in aviation-related legal matters. He is an instrument-rated private pilot, and owns and flies a Socata Trinidad, N62TB. Contact him at dclay@walterhav.com.