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The evolution of regional aircraft lease rates

While it is intuitive that lease rates should have increased to account for rising interest rates, they have been slow to adjust to the surge in funding costs of recent years. Angus von Schoenberg, Industry Officer, TrueNoord, explores why this is and how things might be set to change.

It's no surprise that the price of any manufactured item, including aircraft, is primarily driven by supply and demand. The COVID-19 induced oversupply of aircraft exerted unprecedented downward pressure on lease rates and they have not all fully recovered to date. Although demand has largely returned, it has taken time for carriers to restore services not least because of operational staff shortages, including flight crews. Although there continues to be an industry-wide labour shortage, the less attractive pay scales in the regional segment have made this more acute in our sector, as some of the workforce has moved to larger aircraft.

The post-pandemic recovery has been faster than many had anticipated, but the long-term nature of lease agreements means that pricing does not instantly reflect current market conditions. As leases are typically long-term commitments, most have fixed rates that are insulated from short-term interest rate hikes and often lessors have funded such leases with financing also at fixed rates, some of which have still not expired. During the pandemic years, many leases were restructured mainly to provide short-term relief, but, in some cases, lower lease rates became embedded for longer periods. Such rates have unintentionally created expectations that these lower rates are the new normal.

Rising rates

Notwithstanding the above, there is now increasing evidence that lease rates for regional aircraft are heading north. Since 2023, most appraisers, including Cirium, have increased their market lease rental opinions, which in some cases exceed 15 per cent for in-demand types of most mid-life vintages, although less for new examples. This includes ATR 72s and E-Jets, which have emerged as the core of favoured regional aircraft, with some appraisers also including Dash 8-400s as seeing some recovery. New aircraft rates never fell to the same extent, except in isolated cases where either lessors or original equipment manufacturers (OEMs) were left with whitetails.

The reasons for this uptick are various. For airlines, there is now a lack of supply since most airworthy aircraft have been reabsorbed. Many of those that are not flying again require either uneconomic maintenance inputs or the lack of maintenance facility capacity precludes them from entering revenue service when needed. A perfect storm of supply chain issues for spare parts and the current grounding of a number of aircraft exacerbate the inability to return aircraft to operators.

Although short-term interest rates are now starting to trend lower, long-term rates remain elevated, so as lower historical fixed cost funding expires and is replaced with new, higher-cost debt, the weighted average cost of capital increases. Consequently, to generate returns similar to those achieved when interest rates were low, lease rates have to increase over time. Otherwise, capital will migrate to other industries and if this happens, market principles will do their own work and drive up lease rates anyway. So, it really is not a matter of 'if' but 'when' lease rates continue to rise. ■

> *"There is now increasing evidence that lease rates for regional aircraft are heading north"*