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AIRLEASE LTD  
Form 10-K  
March 26, 2001

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2000

Commission File No. 1-9259

AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

-----  
(Exact name of registrant as specified in its charter)

California

94-3008908

-----  
(State of Organization)

-----  
(I.R.S. Employer Identification No.)

555 California Street, Fourth Floor, San Francisco, CA 94104

-----  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (415) 765-1814

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

|                               |                         |
|-------------------------------|-------------------------|
| TITLE OF EACH CLASS:          | NAME OF EACH EXCHANGE   |
| Depository Units Representing | ON WHICH REGISTERED:    |
| Limited Partnership Interests | New York Stock Exchange |

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: NONE

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES X NO  
--- ---

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Aggregate market value of Depository Units, held by non-affiliates of the registrant as of the close of business at March 19, 2001 was \$42,548,610.00.

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FOR THE FISCAL YEAR ENDED DECEMBER 31, 2000

## PART I

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### ITEM 1. BUSINESS

#### GENERAL

Airlease Ltd., A California Limited Partnership (the "Partnership" or "Airlease"), was formed in 1986. The General Partner of the Partnership (the "General Partner") is Airlease Management Services, Inc., a Delaware corporation. Until October 31, 1996 the General Partner was a wholly owned subsidiary of USL Capital Corporation ("USL Capital"), which in turn was an indirect subsidiary of Ford Motor Company. On October 31, 1996, BA Leasing & Capital Corporation ("BA Leasing & Capital"), a wholly owned indirect subsidiary of BankAmerica Corporation, purchased the stock of the General Partner from USL Capital and the General Partner became a wholly owned subsidiary of BA Leasing & Capital. On September 29, 1999, BA Leasing & Capital merged into Banc of America Leasing and Capital, LLC, a Delaware limited liability company ("BALCAP"). BALCAP is also a wholly owned indirect subsidiary of BankAmerica Corporation. A total of 4,625,000 Depository Units representing limited partnership interests ("Units") in the Partnership are outstanding, of which 3,600,000 are held by the public and 1,025,000 are owned by BALCAP and its subsidiaries.

The Partnership invests in commercial aircraft and leases the aircraft to others, primarily airlines, pursuant to finance (full payout) or operating leases.

#### PRINCIPAL INVESTMENT OBJECTIVES

The business of the Partnership is to acquire and own, either directly or through joint ventures, aircraft and to lease such aircraft primarily to airlines. The Partnership's principal investment objectives are to generate income for quarterly cash distributions to Unitholders and to own a portfolio of leased aircraft. The Partnership's original intent was that until January 1, 2005, it would use a substantial portion of the cash derived from the sale, refinancing or other disposition of aircraft to purchase additional aircraft if attractive investment opportunities were available.

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As previously reported, as part of a plan to mitigate the adverse financial effects of changes in tax law, in 1997 Unitholders authorized the General Partner to decide not to make new aircraft investments, to sell aircraft when attractive opportunities arise, to distribute the proceeds and to liquidate the Partnership when all assets are sold. The General Partner will consider whether it is in the best interest of Unitholders to cease making new aircraft investments as opportunities arise, in light of market conditions and the Partnership's competitive position. Based on its investment experience and its knowledge of the market, the General Partner believes that attractive investment opportunities like those made by the Partnership in the past probably will not be available. In the event that aircraft are sold and appropriate alternative investments are not available, the Partnership will distribute sale proceeds to Unitholders (after repaying debt and establishing appropriate reserves), and

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this would result in a further reduction of the Partnership's portfolio.

In September 30, 2001, the leases with US Airways for five of the seven aircraft in the Partnership's aircraft portfolio expire. Under the leases, US Airways is required, by April 2001, to decide whether to renew the leases or to return the aircraft. If US Airways elects to renew the leases, the leases will continue but perhaps at a lower lease rate. Alternatively, if US Airways decides to return the aircraft, the General Partner will market the aircraft to others for either sale or a new lease.

If the five aircraft on lease to US Airways, which represent approximately 73% of the Partnership's portfolio, are sold, the General Partner would likely seek also to sell the remaining two aircraft in the Partnership's portfolio. The Partnership intends to distribute the net proceeds from the sale of any aircraft to Unitholders.

As the time of lease expirations nears, distributions to Unitholders will depend more on the residual value of the aircraft in the Partnership's portfolio than on the rental payment obligation from existing lessees (the booked residual value per unit is \$9.74.) Although the Partnership has consistently sold aircraft at prices in excess of book value, aircraft values depend on the supply and demand for aircraft, economic conditions, and other factors. Consequently, the General Partner cannot precisely determine the net proceeds available from the sale of aircraft or whether such proceeds will be above or below book value.

### AIRCRAFT PORTFOLIO

The Partnership's aircraft portfolio consists of narrow-body (single-aisle) twin and tri-jet commercial aircraft which were acquired as used aircraft. Although the Partnership is permitted to do so, the Partnership does not own interests in aircraft which were acquired as new aircraft; nor does the Partnership own any wide-body aircraft, such as the Boeing 747 and MD-11, or any turboprop or prop-fan powered aircraft.

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The following table describes the Partnership's aircraft portfolio at December 31, 2000:

| Lessee    | Number &<br>type; year of<br>Delivery | Ownership<br>Interest | Acquired by<br>Partnership | Current<br>lease<br>expiration | Purchase<br>price (in<br>millions) | Type<br>of lease  |
|-----------|---------------------------------------|-----------------------|----------------------------|--------------------------------|------------------------------------|-------------------|
| USAirways | 5 MD-82<br>1981 (2)                   | 100%                  | 1986                       | 2001                           | \$91.0                             | Direct<br>finance |
| FedEx     | 1 727-200FH<br>1979                   | 100%                  | 1987                       | 2006                           | \$18.5 (3)                         | Direct<br>finance |

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|     |                 |      |          |      |            |                   |
|-----|-----------------|------|----------|------|------------|-------------------|
| TWA | 1 MD-82<br>1984 | 100% | 1988 (4) | 2002 | \$15.8 (4) | Direct<br>finance |
|-----|-----------------|------|----------|------|------------|-------------------|

At December 31, 2000, the book value of aircraft by lessee as a percent of total assets was as follows: US Airways, 72.6%; FedEx, 12.8%; and TWA, 14.3%. Revenues by lessee as a percentage of total revenue for 2000 and 1999, respectively, were as follows: US Airways, 76.8% and 77.1%; TWA, 17.4% and 17.2%; and FedEx, 5.9% and 5.7%.

TWA filed for Chapter 11 bankruptcy protection on January 10, 2001 and failed to make its lease payments under its lease with the Partnership on December 22, 2000, January 22, 2001 and February 22, 2001. On March 13, 2001, TWA made its lease payments that were due on December 22, 2000 and January 22, 2001. TWA is expected to file with the U.S. Bankruptcy Court a stipulation, agreement and order pursuant to which TWA agrees to cure the February 22, 2001 lease payment default within certain time limits. On March 12, 2001, the U.S. Bankruptcy Court approved the sale of most assets of TWA to the parent corporation of American Airlines, Inc. ("American Airlines"). Consummation of the sale is subject to federal antitrust regulatory approval and other closing conditions.

On February 27, 2001, the Partnership and American Airlines entered into an assumption and lease agreement (the "Assumption and Lease Agreement") pursuant to which American Airlines, subject to consummation of the sale to American Airlines of the TWA assets and other conditions, has agreed to assume or cause one of its subsidiaries to assume the TWA lease. If assumed by American Airlines, the lease would be amended to reduce the monthly rent from the

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present rent of \$200,000 to a rent of \$90,000 through January 1, 2002 and \$100,000 thereafter, and to extend the lease expiration date from 2002 to 2009. In addition, the Partnership would have the right to exercise a put option requiring American Airlines to purchase the leased aircraft, on any date between October 1, 2001 and March 31, 2002, at a price of \$9 million if purchased in 2001 or \$8.9 million if purchased thereafter.

See "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS" for a further discussion of the Partnership's lessees.

The Partnership's lessees have the following fair market value renewal options: US Airways has the right to renew its lease as to any of the aircraft for up to three additional renewal terms of one year each at a fair market value rental, provided that the number of aircraft to be returned at the end of any renewal term may not be less than two; FedEx has the right to renew its lease for one six-month term at the current rent payable under the lease, and thereafter for four successive one year terms at a fair market value rental; and TWA has the right to renew its lease for one term of one, two, three or four years at fair market value rentals.

COMPETITIVE POSITION OF THE PARTNERSHIP

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The aircraft leasing industry has become increasingly competitive. In making aircraft investments, leasing aircraft to lessees, and seeking purchasers of aircraft, the Partnership competes with large leasing companies, aircraft manufacturers, airlines and other operators, equipment managers, financial institutions and other parties engaged in leasing, managing, marketing or remarketing aircraft. Affiliates of the General Partner are engaged in many of these businesses and may be deemed to be in competition with the Partnership. There are many large leasing companies which have the financial strength to borrow at very low rates and to obtain significant discounts when purchasing large quantities of aircraft. The lower capital and acquisition costs enjoyed by these large leasing companies permit them to offer airlines lower lease rates than smaller leasing companies can offer. The Partnership does not have the resources to purchase newer aircraft or to purchase aircraft at volume discounts and has only a limited ability to use tax deferrals in its pricing.

As previously reported to Unitholders, the Partnership's access to capital is limited. Since all Cash Available from Operations, as defined in the Limited Partnership Agreement, is distributed, there is no build up of equity capital, and acquisitions must be funded from proceeds available when aircraft are sold or from debt. Access to debt is limited because most of the Partnership's aircraft are being used to collateralize existing borrowings. In general, the Partnership's pricing is uncompetitive for new acquisitions because of its limited sources and high cost of capital.

Because of these factors, finding new aircraft investments like those made by the Partnership in the past and that offer an appropriate balance of risk and reward has been difficult. During the past seven years the Partnership has made only two aircraft investments, both of

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which were possible because of special circumstances.

In 1996 and 1997, the Partnership sold interests in eight aircraft (a 50% interest in an aircraft on lease to Finnair, a one-third interest in six aircraft on lease to Continental, and a 50% interest in one aircraft leased to Sun Jet International, Inc.) at a profit. See "Disposition of Aircraft" below. However, because of the factors described above, the Partnership was unable to reinvest the proceeds in aircraft at an acceptable return, and the General Partner determined that the best use of the net proceeds was to distribute them to Unitholders. These sales and distributions have reduced the size of the Partnership's portfolio.

### PARTICIPANTS IN LEASES

USL Capital originally participated equally with the Partnership in all aircraft now owned by the Partnership except the aircraft on lease to US Airways (the "US Airways Aircraft"). In April 1993 the Partnership leased two aircraft (held jointly with USL Capital), which were previously off lease, to FedEx. In September 1993 the Partnership exchanged its 50% interest in the two aircraft for a 100% interest in one aircraft and pledged the aircraft and the lease as collateral to obtain funds to upgrade the aircraft from a Stage II passenger aircraft to a Stage III freighter. In January 1997, the Partnership purchased a 50% interest in the TWA Aircraft formerly owned by USL Capital, and now owns a 100% interest in this aircraft.

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### DESCRIPTION OF LEASES

All aircraft now owned by the Partnership are leased to third parties pursuant to full-payout (direct finance) leases. Generally, operating leases are for a shorter term than full-payout leases and, therefore, it is necessary to remarket the aircraft in order to recover the full investment. Full-payout leases are generally for a longer term and hence provide more predictable revenue than operating leases.

All of the Partnership's leases are net leases, which provide that the lessee will bear the direct operating costs and the risk of physical loss of the aircraft; pay sales, use or other similar taxes relating to the lease or use of the aircraft; maintain the aircraft; indemnify the Partnership-lessor against any liability suffered by the Partnership as the result of any act or omission of the lessee or its agents; maintain casualty insurance in an amount equal to the specific amount set forth in the lease (which may be less than the fair value of the aircraft); and maintain liability insurance naming the Partnership as an additional insured with a minimum coverage which the General Partner deems appropriate. In general, substantially all obligations connected with the ownership and operation of the leased aircraft are assumed by the lessee and minimal obligations are imposed upon the Partnership. Default by a lessee may cause the Partnership to incur unanticipated expenses. See "Government Regulation" below.

Certain provisions of the Partnership's leases may not be enforceable upon a default by a

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lessee or in the event of a lessee's bankruptcy. The enforceability of leases will be subject to limitations imposed by Federal, California, or other applicable state law and equitable principles.

In order to encourage equipment financing to certain transportation industries, Federal bankruptcy laws traditionally have afforded special treatment to certain lenders or lessors who have provided such financing. Section 1110 ("Section 1110") of the United States Bankruptcy Code, as amended (the "Bankruptcy Code"), implements this policy by creating a category of aircraft lenders and lessors whose rights to repossession are substantially improved. If a transaction is eligible under Section 1110, the right of the lender or lessor to take possession of the equipment upon default is not affected by the automatic stay provisions of the Bankruptcy Code, unless within 60 days after commencement of a bankruptcy proceeding the trustee agrees to perform all obligations of the debtor under the agreement or lease and all defaults (except those relating to insolvency or insolvency proceedings) are cured within such 60-day period or 30 days after the default. One court has recently held that Section 1110 does not apply after the 60-day period, and thus the automatic stay may apply after such 60-day period.

On October 22, 1994, the President signed the Bankruptcy Reform Act of 1994 (the "Reform Act"). The Reform Act made several changes to Section 1110, such that it now protects all transactions involving qualifying equipment, whether the transaction is a lease, conditional sale, purchase money financing or customary refinancing. For equipment first placed in service on or prior to the date of enactment, the requirement that the lender provide purchase money financing continues to apply, but there is a "safe harbor" definition for

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leases, so that Section 1110 benefits will be available to the lessor without regard to whether or not the lease is ultimately determined to be a "true" lease. This safe harbor is not the exclusive test so that other leases which do not qualify under the safe harbor, but which are true leases, will continue to be covered as leases by Section 1110. The Partnership may not be entitled to the benefits of Section 1110 upon insolvency of a lessee airline under all of its leases.

In the past, the Partnership had interests in aircraft leased to operators based outside the United States. It is possible that the Partnership's aircraft could be leased or subleased to foreign airlines. Aircraft on lease to such foreign operators are not registered in the United States and it is not possible to file liens on such foreign aircraft with the Federal Aviation Administration (the "FAA"). Further, in the event of a lessee default or bankruptcy, repossession and claims would be subject to laws other than those of the United States.

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### AIRCRAFT REMARKETING

On termination of a lease and return of the aircraft to the Partnership, the Partnership must remarket the aircraft to realize its full investment. Under the Amended and Restated Agreement of Limited Partnership, as amended ("Limited Partnership Agreement"), the remarketing of aircraft may be through a lease or sale. The terms and conditions of any such lease would be determined at the time of the re-lease, and it is possible (although not anticipated at this time) that the lease may not be a net lease. The General Partner will evaluate the risks associated with leases which are not net leases prior to entering into any such lease. The General Partner has not established any standards for lessees to which it will lease aircraft and, as a result, there is no investment restriction prohibiting the Partnership from doing business with any lessee, including "start-up" airlines. However, the General Partner will analyze the credit of a potential lessee and evaluate the aircraft's potential value prior to entering into any lease.

### DISPOSITION OF AIRCRAFT

The Partnership's original intent was to dispose of all its aircraft by the year 2011, subject to prevailing market conditions and other factors. However, in 1997 unitholders authorized the General Partner not to make new investments, to sell aircraft when attractive opportunities arise, to distribute the proceeds and to liquidate the Partnership when all assets are sold. See "Principal Investment Objectives" above.

Under the Limited Partnership Agreement, aircraft may be sold at any time whether or not the aircraft are subject to leases if, in the judgment of the General Partner, it is in the best interest of the Partnership to do so.

In March 1996, the Partnership sold its 50% interest in one MD-82 on lease to Finnair to a third party for approximately \$6.9 million, resulting in a net gain of approximately \$556,000. The Partnership had acquired its interest in this aircraft in April 1992, for approximately \$8.5 million. A portion of the sale proceeds were used to pay off the outstanding balance under a non-recourse loan which was collateralized by this aircraft and the balance, after retaining a reserve for liquidity purposes, was distributed to Unitholders. See "Competitive Position of the Partnership" above.



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The Partnership sold its one-third interest in six 737-200 aircraft on lease to Continental at lease expiration on December 31, 1996, at a sale price of approximately \$3.1 million, resulting in a net gain of approximately \$1.9 million. The proceeds were distributed to Unitholders in the first quarter of 1997. See "Competitive Position of the Partnership" above.

On September 29, 1997 the Partnership sold its one-half ownership interest in a DC9-51 aircraft on lease to Sun Jet International, Inc. The sale price was \$1.2 million, resulting in a gain of \$393,000 even though the lessee had filed for bankruptcy in June 1997, and had ceased making the rent payments. The proceeds were distributed to Unitholders in the fourth quarter of

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1997. See "Competitive Position of the Partnership" above. See "Principal Investment Objectives" above for a discussion of the General Partner's present expectations regarding the disposition of the aircraft in the Partnership's portfolio.

The Partnership is permitted to sell aircraft to affiliates of the General Partner at the fair market value of the aircraft at the time of sale as established by an independent appraisal. The General Partner will receive a Disposition or Remarketing Fee for any such sale.

### JOINT VENTURES/GENERAL ARRANGEMENTS

Under the Limited Partnership Agreement, the Partnership may enter into joint ventures with third parties to acquire or own aircraft. No such joint ventures presently exist. Generally, each party to a joint venture is jointly responsible for all debts and obligations incurred by the joint venture, and the joint venture will be treated as a single entity by third parties. If party to a joint venture, the Partnership may become liable to third parties for obligations of the joint venture in excess of those contemplated by the terms of the joint venture agreement. There can be no assurance that the Partnership will be able to obtain control in any joint ventures, or that, even with such control the Partnership will not be adversely affected by the decisions and actions of the co-venturers. The General Partner attempts to ensure that all such agreements will be fair and reasonable to the Partnership, although joint ventures with affiliates of the General Partner may involve potential conflicts of interest.

### BORROWING POLICIES

Under the Limited Partnership Agreement, the Partnership may borrow funds or assume financing in an aggregate amount equal to less than 50% of the higher of the cost or fair market value at the time of the borrowing of all aircraft owned by the Partnership. The Partnership may exceed such 50% limit for short-term borrowing so long as the General Partner uses its best efforts to comply with such 50% limit within 120 days from the date such indebtedness is incurred or if the borrowed funds are necessary to prevent foreclosure on any Partnership asset. There is no limitation on the amount of such short-term indebtedness. The General Partner is authorized to borrow for working capital purposes and to make distributions. See "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS--Liquidity and Capital Resources" and Note 4 of Notes to Financial Statements.

### MANAGEMENT OF AIRCRAFT PORTFOLIO

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Aircraft management services are provided by the General Partner and its affiliates. The fees and expenses for these services are reviewed annually and are subject to approval by the Audit Committee of the Partnership. See Note 6 of Notes to Financial Statements.

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### REGISTRATION OF AIRCRAFT; UNITED STATES PERSON

Under the Federal Aviation Act, as amended (the "FAA Act"), the operation of an aircraft not registered with the Federal Aviation Administration (the "FAA") in the United States is generally unlawful. Subject to certain limited exceptions, an aircraft may not be registered under the FAA Act unless it is owned by a "citizen of the United States" or a "resident alien" of the United States. In order to attempt to ensure compliance with the citizenship requirements of the FAA Act, the Limited Partnership Agreement requires that all Unitholders (and all transferees of Units) be United States citizens or resident aliens within the meaning of the FAA Act.

### GOVERNMENT REGULATION

#### GENERAL

The ownership and operation of aircraft in the United States are strictly regulated by the FAA, which imposes certain minimum restrictions and economic burdens upon the use, maintenance and ownership of aircraft. The FAA Act and FAA regulations contain strict provisions governing various aspects of aircraft ownership and operation, including aircraft inspection and certification, maintenance, equipment requirements, general operating and flight rules, noise levels, certification of personnel and record keeping in connection with aircraft maintenance. FAA policy has given high priority to aviation safety, and a primary objective of FAA regulations is that an aircraft be maintained properly during its service life. FAA regulations establish standards for repairs, periodic overhauls and alterations and require that the owner or operator of an aircraft establish an airworthiness inspection program to be carried out by certified mechanics qualified to perform aircraft repairs. Each aircraft in operation is required to have a Standard Airworthiness Certificate issued by the FAA.

#### MAINTENANCE

The Partnership, as the beneficial owner of aircraft, bears the ultimate responsibility for compliance with certain federal regulations. However, under all of the Partnership's aircraft leases, the lessee has the primary obligation to ensure that at all times the use, operation, maintenance and repair of the aircraft are in compliance with all applicable governmental rules and regulations and that the Partnership/lessor is indemnified from loss by the lessee for breach of any of these lessee responsibilities. Changes in government regulations after the Partnership's acquisition of aircraft may increase the cost to, and other burdens on, the Partnership of complying with such regulations.

The General Partner monitors the physical condition of the Partnership's aircraft and periodically inspects them to attempt to ensure that the lessees comply with their maintenance and repair obligations under their respective leases. Maintenance is further regulated by the FAA which also

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monitors compliance. At lease termination, the lessees are required to return the aircraft in airworthy condition. The Partnership may incur unanticipated maintenance expenses

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if a lessee were to default under a lease and the Partnership were to take possession of the leased aircraft without such maintenance having been completed. If the lessee defaulting is in bankruptcy, the General Partner will file a proof of claim for the required maintenance expenses in the lessee's bankruptcy proceedings and attempt to negotiate payment and reimbursement of a portion of these expenses. The bankruptcy of a lessee could adversely impact the Partnership's ability to recover maintenance expense.

From time to time, aircraft manufacturers issue service bulletins and the FAA issues airworthiness directives. These bulletins and directives provide instructions to aircraft operators in the maintenance of aircraft and are intended to prevent the occurrence of accidents arising from flaws discovered during maintenance or as the result of aircraft incidents. Compliance with airworthiness directives is mandatory.

A formal program to control corrosion in all aircraft is included in the FAA mandatory requirements for maintenance for each type of aircraft. These FAA rules and proposed rules evidence the current approach to aircraft maintenance developed by the manufacturers and supported by the FAA in conjunction with an aircraft industry group. The Partnership may be required to pay for these FAA requirements if a lessee defaults or if necessary to re-lease or sell the aircraft.

In January 1999 the FAA issued an airworthiness directive setting payload weight limitations on the Boeing 727 aircraft which were converted from passenger to freight configuration. The directive requires extensive structural modifications to strengthen the aircraft's floor, if the aircraft is to continue to operate under the existing payload limits. If these modifications are not performed, the directive sets substantially reduced payload limits. This airworthiness directive applies to the aircraft on lease to FedEx. Under the lease covering this aircraft, FedEx is required to take the steps necessary to comply with airworthiness directives imposed during the lease term. However, airworthiness directives may affect the residual value of the aircraft or FedEx's decision to exercise fair market value renewal options under the lease.

### AIRCRAFT NOISE

The FAA, through regulations, has categorized certain aircraft types as Stage I, Stage II and Stage III according to the noise level as measured at three designated points. Stage I aircraft create the highest measured noise levels. Stage I and Stage II aircraft are no longer allowed to operate from civil airports in the United States.

See "Aircraft Portfolio" above, for a description of the Partnership's aircraft portfolio. At December 31, 2000, all of the aircraft in the Partnership's portfolio were Stage III aircraft.

ACQUISITION OF ADDITIONAL AIRCRAFT

In 1997 Unitholders authorized the General Partner to decide not to make new aircraft investments, to sell aircraft when attractive opportunities arise, to distribute the proceeds and to liquidate the Partnership when all assets are sold. See "Principal Investment Objectives" above.

Notwithstanding the above, if the Partnership were to acquire additional aircraft, it could do so in many different forms, such as in sale/leaseback transactions, by purchasing interests in existing leases from other lessors, by making loans secured by aircraft or by acquiring or financing leasehold interests in aircraft. The Partnership is permitted to acquire aircraft from affiliates of the General Partner subject to limitations set forth in the Limited Partnership Agreement.

Prior to September 30, 1991, the General Partner and USL Capital ("Related Entities") were required to offer the Partnership a 50% participation interest in certain aircraft leasing investments made by Related Entities. After September 30, 1991 and while the General Partner was an affiliate of USL Capital, the General Partner and USL Capital could, but were not obligated to, offer investment opportunities to the Partnership. The Partnership was required to accept suitable opportunities provided that the General Partner and Related Entities made at least 20% (including their investment through ownership of Units and the General Partner's interest) of the total investment made by Related Entities and the Partnership in such transactions. In the event that the Partnership elected not to make or to make only a portion of an investment offered to it by an affiliate, the remaining investment could be made by affiliates of the General Partner or third parties.

The General Partner believes that since it is no longer affiliated with USL Capital, the limitation as to making investments with Related Entities should no longer apply and that the Partnership should be able to invest in any aircraft leasing transactions deemed suitable by the General Partner. In determining whether an investment is suitable for the Partnership, the General Partner will consider the following factors: the expected cash flow from the investment and whether existing Unitholders' investment will be diluted; the existing portfolio of the Partnership and the effect of the investment on the diversification of the Partnership's assets; the amount of funds available to finance the investment; the ability of the Partnership to obtain additional funds through debt financing, by issuing Units, or otherwise; the cost of such additional funds and the time needed to obtain such funds; the amount of time available to remove contingencies prior to making the investment; projected Federal income tax effect of the investment; projected residual value, if any; any legal or regulatory restrictions; and other factors deemed relevant by the General Partner.

The General Partner and its affiliates are not obligated to make any investment opportunity available to the Partnership, and if any of them are presented with a potential investment opportunity, it may be made by any of them without being offered to the Partnership. In addition, in determining which entity should invest in a particular transaction, it may be

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possible to structure the transaction in various ways to make the acquisition more or less suitable for the Partnership or for the General Partner or its affiliates.

### FEDERAL INCOME TAXATION

The Partnership is considered a publicly traded partnership ("PTP") under the Revenue Act of 1987 with a special tax status, whereby it has not been subject to federal income taxation. This special tax status was scheduled to expire at the beginning of 1998. However, during 1997 federal and California tax laws were amended to provide that PTPs may elect to continue to be publicly traded and retain their Partnership tax status if they pay a federal tax of 3.5% and a California state tax of 1% on their applicable annual gross income beginning in January 1998. The Partnership made an election to pay this tax beginning in 1998.

### EMPLOYEES

The Partnership has no employees. See "DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT - General" below. Employees of the General Partner provide services on behalf of the Partnership.

### ITEM 2. PROPERTIES

The Partnership does not own any real property, and shares office space in the offices of BALCAP and its affiliates.

### ITEM 3. LEGAL PROCEEDINGS

None.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

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## PART II

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### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

#### UNITS OUTSTANDING

The Units are traded on the New York Stock Exchange under the symbol FLY. As of February 2, 2001, there were 941 unitholders of record.

#### MARKET PRICE

The following chart sets forth the high and low closing prices on the New York Stock Exchange and the trading volume for each of the quarters in the years ended December 31, 2000 and 1999.

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| Quarter Ended<br>----- | Trading Volume<br>(in thousands)<br>----- | Unit Prices (high-low)<br>----- |
|------------------------|---|---------------------------------|
| March 31, 2000         | 227                                       | \$12 - \$10 5/8                 |
| June 30, 2000          | 239                                       | \$12 1/4 - \$10 9/16            |
| September 30, 2000     | 230                                       | \$13 1/8 - \$11 9/16            |
| December 31, 2000      | 291                                       | \$12 1/2 - \$11 9/16            |
| March 31, 1999         | 309                                       | \$12 3/4 - \$12 3/16            |
| June 30, 1999          | 293                                       | \$12 3/8 - \$10 13/16           |
| September 30, 1999     | 250                                       | \$12 5/16 - \$11 1/2            |
| December 31, 1999      | 246                                       | \$11 14/16 - \$10 15/16         |

DISTRIBUTIONS TO UNITHOLDERS

CASH DISTRIBUTIONS

The Partnership makes quarterly cash distributions to Unitholders which are based on Cash Available from Operations (as defined in the Limited Partnership Agreement) and are partially tax sheltered. From time to time the Partnership also has made cash distributions from Cash Available from Sale or Refinancing (as defined in the Limited Partnership Agreement.) Information on the tax status of such payments, which is necessary in the preparation of individual tax returns, is prepared and mailed to Unitholders as quickly as practical after the close of each year. The size of the Partnership's portfolio and future aircraft sales will affect distributions.

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Distributions declared during 2000 and 1999 were as follows:

| Record Date<br>----- | Payment Date<br>----- | Per Unit<br>----- |
|----------------------|-----------------------|-------------------|
| March 31, 2000       | May 15, 2000          | 45 cents          |
| June 30, 2000        | August 15, 2000       | 45 cents          |
| September 29, 2000   | November 15, 2000     | 45 cents          |
| December 29, 2000    | February 15, 2001     | 45 cents          |
| March 31, 1999       | May 14, 1999          | 41 cents          |
| June 30, 1999        | August 13, 1999       | 41 cents          |
| September 30, 1999   | November 15, 1999     | 41 cents          |
| December 31, 1999    | February 15, 2000     | 41 cents          |

CASH AVAILABLE FROM OPERATIONS

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The Partnership distributes all Cash Available from Operations (as defined in the Limited Partnership Agreement). The Partnership is authorized to make distributions from any source, including reserves and borrowed funds. Distributions of Cash Available from Operations are allocated 99% to Unitholders and 1% to the General Partner. The Partnership makes distributions each year of Cash Available from Operations generally on the fifteenth day of February, May, August and November to Unitholders of record on the last business day of the calendar quarter preceding payment.

### CASH AVAILABLE FROM SALE OR REFINANCING

The Partnership's original intent was that Cash Available From Sale or Refinancing (as defined in the Limited Partnership Agreement) received prior to January 1, 2005 would be retained for use in the Partnership's business, provided that if the General Partner did not believe that attractive investment opportunities exist for the Partnership, the Partnership could distribute Cash Available from Sale or Refinancing. Any Cash Available from Sale or Refinancing received after January 1, 2005 was not to be reinvested but was to be distributed. However, in 1997, Unitholders authorized the General Partner to decide not to make new aircraft investments, to sell aircraft when attractive opportunities arise, to distribute the proceeds and to liquidate the Partnership when all assets are sold. See "BUSINESS--Principal Investment Objectives." For information as to the sales giving rise to distributions from Cash Available from Sales or Refinancing, see "BUSINESS--Disposition of Aircraft."

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### TAX ALLOCATIONS

Allocations for tax purposes of income, gain, loss deduction, credit and tax preference are made on a monthly basis to Unitholders who owned Units on the first day of each month. Thus, for example, if an aircraft were sold at a gain, that gain would be allocated to Unitholders who owned Units on the first day of the month in which the sale occurred. If proceeds from this sale were distributed to Unitholders, such proceeds would be distributed to Unitholders who owned Units on the record date for such distribution, which, because of notice requirements, likely would not occur in the same month as the sale. In addition, a Unitholder who transfers his or her Units after the commencement of a quarter but prior to the record date for that quarter will be allocated a share of tax items for the first two months of that quarter without any corresponding distribution of Cash Available from Operations for, among other things, payment of any resulting tax.

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### ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected financial data and other data concerning the Partnership for each of the last five years:

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| (In thousands except per-unit amounts)  | For years ended December 31, |          |          |          |        |
|---|------------------------------|----------|----------|----------|--------|
|   | 2000                         | 1999     | 1998     | 1997     | 1996   |
| <b>OPERATING RESULTS</b>                |                              |          |          |          |        |
| Lease and other income                  | \$ 6,736                     | \$ 7,614 | \$ 8,400 | \$ 9,210 | \$10,7 |
| Gain on disposition of aircraft         | --                           | --       | --       | 393      | 2,5    |
| Total revenues                          | 6,736                        | 7,614    | 8,400    | 9,603    | 13,2   |
| Interest expense                        | 909                          | 1,270    | 1,704    | 2,028    | 1,8    |
| Depreciation expense                    | --                           | --       | --       | 273      | 1,5    |
| Other expenses                          | 1,082                        | 1,088    | 1,123    | 1,820    | 1,2    |
| Tax on gross income                     | 548                          | 548      | 699      | 0        |        |
| Total expenses                          | 2,539                        | 2,906    | 3,526    | 4,121    | 4,5    |
| Net income                              | \$ 4,197                     | \$ 4,708 | \$ 4,874 | \$ 5,482 | \$ 8,6 |
| Net income per unit(1)                  | \$ 0.90                      | \$ 1.01  | \$ 1.04  | \$ 1.17  | \$ 1.  |
| Cash distributions declared per unit(2) | \$ 1.80                      | \$ 1.64  | \$ 1.64  | \$ 2.02  | \$ 3.  |
| <b>FINANCIAL POSITION</b>               |                              |          |          |          |        |
| Total assets                            | \$61,836                     | \$67,787 | \$75,813 | \$82,859 | \$85,1 |
| Long-term obligations                   | \$ 7,992                     | \$10,092 | \$14,505 | \$19,115 | \$14,0 |
| Total partners' equity                  | \$51,135                     | \$55,347 | \$58,301 | \$61,089 | \$65,0 |
| Limited partners' equity per unit       | \$ 10.95                     | \$ 11.85 | \$ 12.48 | \$ 13.08 | \$ 13. |



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### FORWARD-LOOKING STATEMENTS

The information set forth below and elsewhere in this Annual Report on Form 10-K contains certain forward-looking statements, which reflect the current view of the Partnership with respect to future events and financial performance. The words "expect", "intend", "believe", "anticipate", "likely" and "will" and similar expressions generally identify forward-looking statements. These statements are subject to certain risks and uncertainties, which could cause actual results and events to differ materially from those anticipated in the forward-looking statements.

Factors that could cause the Partnership's actual results to differ from current expectations include, among others, changes in the aircraft or aircraft leasing market, economic downturn in the airline industry, default by lessees under leases causing the Partnership to incur unanticipated expenses or not to receive rental income as and when expected, the Partnership's inability to re-lease or sell, at favorable terms, any aircraft returned at lease expiration or any delays in re-leasing or selling such aircraft, changes in interest rates, consolidation in the airline industry and legislative or regulatory changes that adversely affect the value of aircraft.

### LIQUIDITY AND CAPITAL RESOURCES

The Partnership presently has three long-term debt facilities. At December 31, 2000, the following amounts were outstanding: \$4.0 million on a 7.4% non-recourse note collateralized by one aircraft leased to FedEx; \$2.2 million on a 9.35% non-recourse note collateralized by one aircraft on lease to Trans World Airlines; and \$1.8 million on a long-term variable rate revolving loan facility guaranteed by the Partnership and collateralized by two aircraft on lease to US Airways. At December 31, 2000 and 1999, \$8.0 million and \$10.1 million, respectively, was outstanding under the Partnership's loan facilities. At December 31, 2000 approximately \$3.3 million remained available under the revolving loan facility.

Long-term borrowings at December 31, 2000 represented 6.6% of the original cost of the aircraft presently owned by the Partnership, including capital expenditures for upgrades. The terms of the Partnership Agreement permit debt to be at a level not exceeding 50% of such cost.

Total scheduled debt service (principal and interest) on the fixed loans in 2001 is \$2.7 million, and the principal payment on the floating loan in 2001 is projected to be \$1.8 million (if no purchase or sale of aircraft or any unforeseen business events occur). Debt service will be paid primarily from the rental payments received under aircraft leases.

Net cash provided by operating activities was \$5.3 million for 1998, \$4.1 million for 1999, and \$4.5 million for 2000. Aside from the cash flow activity associated with taxes payable, the net cash flow provided by operating activities showed moderate decreases over the

three-year period. The decrease was due to reduced rentals as a result of a smaller portfolio.

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Total debt service on the fixed loans as a percentage of net cash provided by operating activities was 166%, 78%, and 67% for 1998, 1999 and 2000, respectively. However, cash flow from operating activities does not fully reflect cash receipts from lease payments. When the excess of rental receipts above finance lease income is added to cash flow from operating activities, the ratios become 71%, 26%, and 29%, respectively. The lower 1999 ratio as compared with 1998 reflects a greater rate of debt repayment in 1998, while the cash received from lease rentals remained about the same for each of 1998 and 1999. The 2000 ratio is comparable to the ratio of 1999 as the debt service and the cash flow from operating activities for both years were also comparable.

Cash distributions paid by the Partnership were \$7.8 million (\$1.68 per unit) in 1998, \$7.7 million (\$1.64 per unit) in 1999, and \$8.2 million (\$1.76 per unit) in 2000. There were no special cash distributions paid in 1998, 1999 or 2000.

Partnership net income was \$4.9 million in 1998, \$4.7 million in 1999, and \$4.2 million in 2000. The decline in net income from 1998 to 1999 and from 1999 to 2000 is primarily due to a smaller asset base, as the balances due from the lessees declined. Pursuant to the Limited Partnership Agreement, the Partnership distributed all Cash Available from Operations net of expenses and reserves, as described above. Since such distributions were in excess of earnings, Partnership equity declined from \$55.3 million at December 31, 1999 to \$51.1 million at December 31, 2000, and limited partner equity per unit declined from \$11.85 to \$10.95. From a limited partner perspective, the portion of the distribution in excess of net income constitutes a return of capital. Total cash distributions declared since inception of the Partnership have exceeded total net income by \$7.84 per unit.

### RESULTS OF OPERATIONS

2000 vs. 1999

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The revenue reduction in 2000 as compared with 1999 is primarily due to the scheduled decline in finance lease income as the balances due from the lessees declined.

US Airways, the Partnership's major lessee (73% of total 2000 year-end assets) reported a net loss of \$269 million on revenues of \$9.3 billion for 2000, compared with profits of \$197 million on revenues of \$8.6 billion for 1999.

FedEx (13% of total 2000 year-end assets) reported profits of \$688 million on revenues of \$18.3 billion for 2000 (fiscal year ended May 31, 2000), compared with profits of \$631 million on revenues of \$16.8 billion for 1999.

TWA (14% of total 2000 year-end assets) reported a net loss of \$115 million on revenues of \$2.7 billion for the first nine months of 2000, compared with a net loss of \$81 million on revenues of \$2.5 billion for the comparable 1999 period. TWA filed for Chapter 11 bankruptcy

protection on January 10, 2001 and failed to make its lease payments under its lease with the Partnership on December 22, 2000, January 22, 2001 and February 22, 2001. As a result of the lease payment defaults, the Partnership has been

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making debt-service payments under its long-term debt secured by the TWA aircraft from other sources of cash. On March 13, 2001, TWA made its lease payments that were due on December 22, 2000 and January 22, 2001. TWA is expected to file with the U.S. Bankruptcy Court a stipulation, agreement and order pursuant to which TWA agrees to cure the February 22, 2001 lease payment default within certain time limits. On March 12, 2001, the U.S. Bankruptcy Court approved the sale of most assets of TWA to American Airlines' parent corporation. Consummation of the sale is subject to federal antitrust regulatory approval and other closing conditions. American Airlines has entered into an agreement with the Partnership, which becomes effective only upon consummation of the sale to American Airlines of the TWA assets, pursuant to which American Airlines would assume the TWA lease subject to a reduced lease rate and an extended lease term. The reduction in cash receipts and the bankruptcy of TWA have led to a reduction in cash distributions to Unitholders, beginning with the cash distribution for the first quarter of 2001.

For information regarding the percentage of total Partnership assets and revenues represented by aircraft owned and leased by the Partnership, see "BUSINESS--Aircraft Portfolio."

The Partnership believes that its revenues and income have not been materially affected by inflation and changing prices because its principal items of revenue (rental payments) and a majority of its expenses (interest) are at fixed long-term rates.

Expenses in 2000 were \$2.5 million or \$367,000 lower than the 1999 expenses of \$2.9 million. The decline in expenses is primarily due to lower interest expense in 2000 as a result of the Partnership's reduced debt balances. Debt balances declined from \$10.1 million at December 31, 1999 to \$8.0 million at December 31, 2000.

1999 vs. 1998

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The revenue reduction in 1999 as compared with 1998 is primarily due to the scheduled decline in finance lease income as the balances due from the lessees declined. At year-end 1999, all of the Partnership's lessees were current under their lease agreements and none was in bankruptcy.

### OUTLOOK

In September 30, 2001, the leases with US Airways for five of the seven aircraft in the Partnership's aircraft portfolio expire. Under the leases, US Airways is required, by April 2001, to decide whether to renew the leases or to return the aircraft. If US Airways elects to renew the leases, the leases will continue but perhaps at a lower lease rate. Alternatively, if US Airways decides to return the aircraft, the General Partner will market the aircraft to others for either sale or a new lease.

If the five aircraft on lease to US Airways, which represent approximately 73% of the Partnership's portfolio, are sold, the General Partner would likely seek also to sell the remaining two aircraft in the Partnership's portfolio. The Partnership intends to distribute the net proceeds from the sale of any aircraft to Unitholders.

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As the time of lease expirations nears, distributions to Unitholders will depend more on the residual value of the aircraft in the Partnership's portfolio than on the rental payment obligation from existing lessees (the booked residual value per unit is \$9.74.) Although the Partnership has consistently sold aircraft at prices in excess of book value, aircraft values depend on the supply and demand for aircraft, economic conditions, and other factors. Consequently, the General Partner cannot precisely determine the net proceeds available from the sale of aircraft or whether such proceeds will be above or below book value.

### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Partnership's assets consist of aircraft subject to leases, accounted for as finance leases, and thus consist of a future stream of fixed rental payments and a residual interest in the aircraft. See Note 2 to Financial Statements for information as to finance lease receivables. At December 31, 2000, the Partnership had long-term fixed-rate notes payable of \$6,227,000 and a revolving variable rate loan facility with \$1,765,000 outstanding and approximately \$3,275,000 of credit available. See Note 4 to Financial Statements for information as to minimum future principal payments due and the interest rates applicable to the notes and revolving credit facility. Since the rental payments under its leases are fixed, but a portion of its liabilities are based on a variable interest rate, the assets and liabilities of the Partnership are not perfectly hedged and the Partnership bears some risk of interest rate fluctuations. Since a portion of its debt under the revolving credit facility is for variable working capital needs, the General Partner believes that the risk of interest fluctuations is appropriate under the circumstances.

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### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements and Notes to Financial Statements described in Item 14(a) are set forth in Appendix A and are filed as part of this report.

### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

## PART III -----

### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

#### GENERAL

The Partnership has no directors or executive officers. Under the Limited Partnership Agreement, the General Partner has full power and authority in the management and control of the business of the Partnership, subject to certain provisions requiring the consent of the Limited Partners.

#### DIRECTORS AND EXECUTIVE OFFICERS

Set forth below is certain information about the directors and executive officers of the General Partner as of February 28, 2001. As used

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below, "BALCAP" refers both to BALCAP and to BA Leasing & Capital prior to its merger into BALCAP in September 1999.

| NAME              | POSITION WITH<br>GENERAL PARTNER   | AGE | PRINCIPAL OCCUPATION<br>EMPLOYMENT FOR LAST 5   |
|-------------------|--|-----|---|
| David B. Gebler   | Chairman of the Board, President, Chief Executive Officer and a Director | 51  | Mr. Gebler is a Managing Director National Association ("Bank of BALCAP. He has been with BALCAP 1996. From 1993 to September 1996 President of the Transportation Financing business unit of USL Capi been President of the General Partner Director since 1990, and has been Cha since September 1996. Mr. Gebler hold in mathematics from Clarkson Universi degrees in Engineering and Management of Michigan.               |
| Richard V. Harris | Director   | 52  | Mr. Harris is Managing Director Leasing of Bank of America, and Chai of BALCAP. He was elected President adding the title of Chairman in 19 Director of the General Partner sin Other assignments at Bank of Ameri responsibilities for Project Finance Finance along with Leasing. Prior present responsibilities, Mr. H transactional and marketing manage BankAmerica Leasing. Mr. Harris degree in Electrical Engineering f |

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| NAME              | POSITION WITH<br>GENERAL PARTNER | AGE | PRINCIPAL OCCUPATION<br>EMPLOYMENT FOR LAST 5   |
|-------------------|----------------------------------|-----|---|
| William A. Hasler | Director                         | 59  | University and a Master of Busine degree also from BYU.<br><br>Mr. Hasler has been the Co-Chief Exe Apton Corporation , a biopharmac since July 1998 and a Director of the since 1995. From August 1991 to Ju Dean of the Haas School of Business of California at Berkeley. From 19 vice chairman and director of KPMG was responsible for its world |

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business. He is a member of the board of directors of The Pacific Stock Exchange and directors of Selectron Corp., TCSI Interactive, and Aphton Corporation. He is a member of a presidential advisory board on critical issues. He is a graduate of Pomona College and received a Ph.D. from Harvard.

|                   |  |    |  |
|-------------------|--|----|--|
| Richard P. Powers | Director                               | 60 | Mr. Powers is a Financial Consultant and Investor. From 1996 to 2000 he was a President of Finance and Administration of Surgical Technologies, Inc., a medical device company, and a Director of the General Partner of Syntex, a pharmaceutical company, serving as President and Chief Financial Officer from 1986 to 1994. From 1994 to 1996 he was a consultant to various companies, including Syntex, and assisting in the sale of Syntex to Roche Corporation in 1994. Mr. Powers holds a Bachelor of Science degree in Accounting from Pomona College and a Masters in Business Administration from the University of Rochester.  |
| K. Thomas Rose    | Director                               | 55 | Mr. Rose has been Managing Director, since 1992. He has been a Director and Partner since October 1996. Prior to his current responsibilities, Mr. Rose was with Leasing Corporation as Executive Vice President of Lease Services since 1973. Mr. Rose holds a Bachelor of Science degree from California State University, Fullerton and a Doctorate degree from Golden Gate University of Law.  |
| Robert A. Keyes   | Chief Financial Officer and a Director | 48 | Mr. Keyes has been Senior Vice President and Finance Manager of BALCAP since December 2000. He has been Chief Financial Officer and a General Partner since March 2001. Prior to his present responsibilities at BALCAP, Mr. Keyes was with Citicorp Bankers Leasing as Vice President of Operations from 1997 to 2000. From 1994 to 1997 he was with USL Capital Corporation (formerly USL Partnership) as Vice President and Chief Controller. While at USL Capital, Mr. Keyes was Chief Financial Officer and as a Director of the Partnership. From 1980 to 1990 Mr. Keyes held various Finance positions with Wells Fargo Leasing, including Senior Vice President and Chief Financial Officer. Mr. Keyes holds a Bachelor of Science in Economics from Bates College and a Masters in Administration and Accounting from Rutgers University. |

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The Partnership does not pay or employ directly any directors or officers. Each of the officers of the General Partner is also an officer or employee of BALCAP and is not separately compensated by the General Partner or the Partnership for services on behalf of the Partnership. Thus, there were no deliberations of the General Partner's Board of Directors with respect to compensation of any officer or employee.

The Partnership reimburses the General Partner for fees paid to Directors of the General Partner who are not otherwise affiliated with the General Partner or its affiliates. In 2000, such unaffiliated directors were paid an annual fee of \$14,500 plus \$500 for each meeting attended.

The Partnership has not established any plans pursuant to which cash or non-cash compensation has been paid or distributed during the last fiscal year or is proposed to be paid or distributed in the future. The Partnership has not issued or established any options or rights relating to the acquisition of its securities or any plans therefor.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

UNIT OWNERSHIP BY CERTAIN BENEFICIAL OWNERS

As of February 28, 2001, the following persons were known to the Partnership to be beneficial owners of more than five percent of the Partnership's equity securities:

| Title of Class   | Name and Address<br>Of Beneficial Owner   | Amount and Nature of<br>Beneficial Ownership |
|------------------|---|--|
| Depository Units | United States Airlease Holding, Inc.<br>555 California Street<br>San Francisco, CA 94104(1) | 231,250(1)                                   |
| Depository Units | BALCAP<br>555 California Street<br>San Francisco, CA 94104(3)                               | 793,750(3)                                   |

UNIT OWNERSHIP BY MANAGEMENT

Set forth below is information regarding interests in the Partnership owned by each director of and all directors and executive officers, as a group, of the General Partner. Unless otherwise noted, each person has sole voting and investment power over all units owned.

| Title of Class | Name of<br>Beneficial Owner | Amount and Nature of<br>Beneficial Ownership |
|----------------|-----------------------------|--|
|----------------|-----------------------------|--|

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|                  |   |         |
|------------------|---|---------|
| Depository Units | David B. Gebler                                 | 700 (1) |
| Depository Units | William A. Hasler                               | 8,700   |
|                  | All directors and executive officers as a group | 9,400   |
|                  |   |         |

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

For a discussion of certain fees, expenses and reimbursements payable and paid to the General Partner and its affiliates by the Partnership, see Note 6 of Notes to Financial Statements. From time to time, the Partnership has borrowed funds from BALCAP or BA Leasing & Capital, including advances for expense payments. All such borrowings were unsecured and bore interest at a floating rate not exceeding the prime rate. At December 31, 2000 Airlease owed BALCAP \$211,542 for such borrowings.

For a discussion of certain terms of the Limited Partnership Agreement regarding the Partnership's participation in aircraft leasing investments made by USL Capital and its Related Entities, see "BUSINESS-Acquisition of Additional Aircraft." For a discussion of aircraft formerly held jointly between the Partnership and USL Capital, see "BUSINESS- Participants in Leases."

PART IV  
-----

ITEM 14. EXHIBITS, FINANCIAL STATEMENTS, SCHEDULES AND REPORTS ON FORM 8-K

|     |  |      |
|-----|--|------|
| (a) | The following financial statements of the Partnership are included in this report as Appendix A: |      |
|     |  | Page |
|     | Management's Responsibility for Financial Statements   | A-1  |
|     | Report of Independent Auditors .....   | A-2  |
|     | Financial Statements:  |      |
|     | Statements of Income for the Years Ended<br>December 31, 2000, 1999 and 1998 .....               | A-3  |
|     | Balance Sheets, as of December 31, 2000 and 1999   | A-4  |
|     | Statements of Cash Flows for the Years Ended<br>December 31, 2000, 1999 and 1998.....            | A-5  |



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Statements of Changes in Partners' Equity for  
the Years Ended December 31, 2000, 1999 and 1998 A-6

Notes to Financial Statements ..... A-6

Financial statement schedules other than those listed above are omitted because the required information is included in the financial statements or the notes thereto or because of the absence of conditions under which they are required.

(b) The Partnership did not file any reports on Form 8-K during the last quarter of the fiscal year ended December 31, 2000.

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(c) Exhibits required by Item 601 of Regulation S-K:

| Exhibit No.<br>----- | Description<br>-----  |
|----------------------|---|
| 3.1(1)               | Amended and Restated Agreement of Limited Partnership of Partnership.   |
| 3.2(1)               | Form of Certificate for Limited Partnership Units of Partnership.   |
| 3.3(1)               | Form of Depositary Agreement among Partnership, Chase-Mellon Shareholder Services (formerly Manufacturers Hanover Trust Company), the General Partner and Limited Partners and Assignees holding Depositary Receipts. |
| 3.4(1)               | Form of Depositary Receipt for Units of Limited Partners' Interest in the Partnership   |
| 3.5(2)               | Amendments to Amended and Restated Partnership Agreement.   |
| 4.1(1)               | Form of Application for Transfer of Depositary Unit.  |
| 4.2(2)               | Loan and Security Agreement dated as of March 20, 1987 between Meridian Trust Company, as Trustee, as Borrower and The World Wing Company Limited, as Lender.   |
| 4.3(2)               | 8.75% Secured Non-recourse Note of Meridian Trust Company dated March 31, 1987 in favor of The World Wing Company Limited.  |
| 4.4(2)               | Instructions and Consent Agreement dated as of March 31, 1987 between the Registrant and The World Wing Company Limited.  |
| 10.1(1)              | Trust Agreement, together with Trust Agreement Supplement No. 1-5, dated as of July 10, 1986, between the Registrant, Meridian Trust Company and the General Partner.   |
| 10.3(1)              | Lease Agreement, together with Lease Supplement Nos. 1-5, dated as of July 10, 1986, between Meridian Trust Company, not in its individual capacity but solely as Trustee, and Pacific                                |

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Southwest Airlines.

- 
- (1) Incorporated by reference to the Partnership's Registration Statement on Form S-1 (File No. 33-7985), as amended.
  - (2) Incorporated by reference to the Partnership's Annual Report on Form 10-K for the year ended December 31, 1995.

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- 10.44 Aircraft Lease Agreement dated as of April 15, 1993 between Taurus Trust Company, Inc. (formerly Trust Company for USL, Inc.) as Owner Trustee, Lessor, and Federal Express Corporation, Lessee with respect to one (1) Boeing 727-2D4 Aircraft, U.S. Registration No. 362PA (manufacture serial no. 21850).
- 10.49(3) Assignment and Assumption Agreement dated as of January 31, 1997 between USL Capital Corporation and the Registrant.
- 10.50(3) Lease, together with Lease Supplement No. 1, dated as of March 15, 1984 between DC-9T-III, Inc., as Lessor, and Trans World Airlines, Inc., as Lessee, with respect to one (1) McDonnell Douglas DC-9-82 Aircraft, as amended by Amendment Agreement dated as of December 15, 1986.
- 10.51(4) Loan agreement secured by two aircraft leased to US Airways dated as of December 22, 1997, amended and restated as of December 15, 1998,6 between Meridian Trust Company, as Trustee, as Borrower and Credit Lyonnais/PK AIRFINANCE, as Lender.

- 
- (3) Incorporated by reference to the Partnership's Annual Report on Form 10-K for the year ended December 31, 1996.
  - (4) Incorporated by reference to the Partnership's Annual Report on Form 10-K for the year ended December 31, 1998.

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### SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on March 26, 2001.

AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP  
(Registrant)

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By: Airlease Management Services, Inc.,  
General Partner

By: /s/ DAVID B. GEBLER

-----  
David B. Gebler  
Chairman, Chief Executive Officer and President

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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant in the capacities and on the dates indicated.

For Airlease Management  
Services, Inc. ("AMSI"), General Partner  
-----

/s/ DAVID B. GEBLER

March 26, 2001

-----  
David B. Gebler  
Chairman, Chief Executive Officer, President  
and Director of AMSI

/s/ ROBERT A. KEYES

March 26, 2001

-----  
Robert A. Keyes  
Chief Financial Officer and Director of AMSI

/s/ RICHARD V. HARRIS

March 26, 2001

-----  
Richard V. Harris  
Director of AMSI

/s/ K. THOMAS ROSE

March 26, 2001

-----  
K. Thomas Rose  
Director of AMSI

The foregoing constitute a majority of the members of the Board of Directors of Airlease Management Services, Inc. (the General Partner).

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

Airlease Management Services, Inc. ("AMSI"), the General Partner of the Partnership is responsible for the preparation of the Partnership's financial statements and the other financial information in this report. This responsibility includes maintaining the integrity and objectivity of the financial records and the presentation of the Partnership's financial statements in accordance with accounting principles generally accepted in the United States.

The General Partner maintains an internal control structure designed to provide, among other things, reasonable assurance that Partnership records include the transactions of its operations in all material respects and to provide protection against significant misuse or loss of Partnership assets. The internal control structure is supported by careful selection and training of financial management personnel, by written procedures that communicate the details of the control structure to the Partnership's activities, and by staff of operating control specialists of Banc of America Leasing and Capital, LLC., which owns 100% of the stock of AMSI, who conduct reviews of adherence to the Partnership's procedures and policies.

The Partnership's financial statements have been audited by Ernst & Young L.L.P., independent auditors for the years ended December 31, 2000, 1999 and 1998. Their audits were conducted in accordance with auditing standards generally accepted in the United States, which included consideration of the General Partner's internal control structure. The Report of Independent Auditors appears on page A-2.

The board of directors of the General Partner, acting through its Audit Committee composed solely of directors who are not employees of the General Partner, is responsible for overseeing the General Partner's fulfillment of its responsibilities in the preparation of the Partnership's financial statements and the financial control of its operations. The independent auditors have full and free access to the Audit Committee and meet with it to discuss their audit work, the Partnership's internal controls, and financial reporting matters.

/s/ DAVID B. GEBLER

-----  
David B. Gebler  
Chairman, Chief Executive Officer and President  
Airlease Management Services, Inc.

/s/ ROBERT A. KEYES

-----  
Robert A. Keyes  
Chief Financial Officer  
Airlease Management Services, Inc.

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REPORT OF INDEPENDENT AUDITORS

To the Partners of Airlease Ltd.,  
A California Limited Partnership:

We have audited the accompanying balance sheets of Airlease Ltd. as of December 31, 2000 and 1999 and the related statements of income, changes in Partners' equity, and cash flows for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Airlease Ltd. at December 31, 2000 and 1999, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States.

/s/ ERNST & Young L.L.P.

-----  
Ernst & Young L.L.P.                   .....  
San Francisco, California

January 30, 2001, except for note 10, as to which the date is March 13, 2001

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AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

STATEMENTS OF INCOME

| (In thousands except per unit amount) | For the years ended |                      |         |
|---------------------------------------|---------------------|----------------------|---------|
|                                       | 2000                | December 31,<br>1999 | 1998    |
| REVENUES                              |                     |                      |         |
| Finance lease income                  | \$6,736             | \$7,614              | \$8,400 |

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|   |         |         |         |
|---|---------|---------|---------|
| Total revenues                          | 6,736   | 7,614   | 8,400   |
| -----                                   |         |         |         |
| EXPENSES                                |         |         |         |
| Interest                                | 909     | 1,270   | 1,704   |
| Management fee - general partner        | 603     | 629     | 651     |
| Investor reporting                      | 316     | 339     | 298     |
| General and administrative              | 163     | 120     | 174     |
| Tax on gross income                     | 548     | 548     | 699     |
| -----                                   |         |         |         |
| Total expenses                          | 2,539   | 2,906   | 3,526   |
| -----                                   |         |         |         |
| NET INCOME                              | \$4,197 | \$4,708 | \$4,874 |
| -----                                   |         |         |         |
| NET INCOME ALLOCATED TO:                |         |         |         |
| General partner                         | \$ 42   | \$ 47   | \$ 49   |
| -----                                   |         |         |         |
| Limited partners                        | 4,155   | 4,661   | 4,825   |
| -----                                   |         |         |         |
| NET INCOME PER LIMITED PARTNERSHIP UNIT | \$ 0.90 | \$ 1.01 | \$ 1.04 |
| -----                                   |         |         |         |

See notes to financial statements

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AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

BALANCE SHEETS

|                                   |                    |          |
|-----------------------------------|--------------------|----------|
| (IN THOUSANDS)                    | As of December 31, |          |
|                                   | 2000               | 1999     |
| -----                             |                    |          |
| ASSETS                            |                    |          |
| Cash                              | \$ 17              | \$ 2     |
| Finance leases - net              | 61,657             | 67,509   |
| Prepaid expenses and other assets | 162                | 276      |
| -----                             |                    |          |
| Total assets                      | \$61,836           | \$67,787 |
| -----                             |                    |          |

LIABILITIES AND PARTNERS' EQUITY

LIABILITIES:

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|  |          |          |
|--|----------|----------|
| Distribution payable to partners         | \$ 2,102 | \$ 1,915 |
| Accounts payable and accrued liabilities | 468      | 429      |
| Taxes payable                            | 139      | 4        |
| Long-term notes payable                  | 7,992    | 10,092   |
|  | -----    | -----    |
| Total liabilities                        | 10,701   | 12,440   |
|  | =====    | =====    |

COMMITMENTS AND CONTINGENCIES

PARTNERS' EQUITY:

|  |          |          |
|--|----------|----------|
| Limited partners (4,625,000 units outstanding) | 50,624   | 54,794   |
| General partner                                | 511      | 553      |
| Total partners' equity                         | 51,135   | 55,347   |
| TOTAL LIABILITIES AND PARTNERS' EQUITY         | \$61,836 | \$67,787 |
|  | =====    | =====    |

See notes to financial statements

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AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

STATEMENTS OF CASH FLOWS

| (In thousands)  | For the years |          |
|---|---------------|----------|
|   | 2000          | 1999     |
|   | -----         | -----    |
| CASH FLOWS FROM OPERATING ACTIVITIES  |               |          |
| Net income  | \$ 4,197      | \$ 4,197 |
| Adjustments to reconcile net income to net cash provided by operating activities: |               |          |
| Changes in assets and liabilities:  |               |          |
| Increase/(decrease) in accounts payable and accrued liabilities                   | 39            |          |
| Decrease/(increase) in prepaid expenses and other assets                          | 114           |          |
| Increase/(decrease) in taxes payable  | 135           |          |
|   | -----         | -----    |
| Net cash provided by operating activities   | 4,485         | 4,485    |

CASH FLOWS FROM INVESTING ACTIVITIES

|  |       |   |
|--|-------|---|
| Rental receipts in excess of earned finance lease income | 5,852 | 7 |
| Net cash provided by investing activities                | 5,852 | 7 |

CASH FLOWS FROM FINANCING ACTIVITIES

|  |         |     |
|--|---------|-----|
| Revolving credit borrowing (repayment)-net | (18)    | (2) |
| Repayment of long-term notes payable       | (2,082) | (1) |
| Distributions paid to partners             | (8,222) | (7) |

|                                       |          |      |
|---------------------------------------|----------|------|
| Net cash used in financing activities | (10,322) | (12) |
|---------------------------------------|----------|------|

|                             |    |  |
|-----------------------------|----|--|
| Increase/(decrease) in cash | 15 |  |
| Cash at beginning of year   | 2  |  |

|                     |       |    |
|---------------------|-------|----|
| Cash at end of year | \$ 17 | \$ |
|---------------------|-------|----|

|                         |        |      |
|-------------------------|--------|------|
| Additional information: |        |      |
| Cash paid for interest  | \$ 858 | \$ 1 |

See notes to financial statements

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AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

STATEMENTS OF CHANGES IN PARTNERS' EQUITY

| (In thousands except per unit amounts)                                      | For the years ended December 31, |                 |
|---|----------------------------------|-----------------|
|   | General Partner                  | Limited Partner |
| Balance, December 31, 1997  | 611                              | 60,47           |
| Net Income - 1998   | 49                               | 4,82            |
| Distributions to partners declared<br>(\$1.64 per limited partnership unit) | (77)                             | (7,58)          |



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|   |       |         |
|---|-------|---------|
| Balance, December 31, 1998  | 583   | 57,71   |
| Net Income - 1999   | 47    | 4,66    |
| Distributions to partners declared<br>(\$1.64 per limited partnership unit) | (77)  | (7,58)  |
| -----   |       |         |
| Balance, December 31, 1999  | 553   | 54,79   |
| Net Income - 2000   | 42    | 4,15    |
| Distributions to partners declared<br>(\$1.80 per limited partnership unit) | (84)  | (8,32)  |
| -----   |       |         |
| BALANCE, DECEMBER 31, 2000  | \$511 | \$50,62 |
| =====   |       |         |

See notes to financial statements

NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION - Airlease Ltd., A California Limited Partnership (the "partnership") engages in the business of acquiring, either directly or through joint ventures, commercial jet aircraft, spare or separate engines and related rotatable parts ("aircraft") and leasing such aircraft to domestic and foreign airlines and freight carriers. The general partner is Airlease Management Services, Inc., a wholly owned subsidiary of Banc of America Leasing and Capital, LLC. ("BALCAP"). BALCAP also holds 793,750 limited partnership units and United States Airlease Holding, Inc. ("Holding"), a wholly owned subsidiary of BALCAP, holds 231,250 limited partnership units. An additional 3,600,000 units are publicly held.

BASIS OF PRESENTATION - The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues

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and expenses during the reporting period. Actual results could differ from those estimates.

FINANCE LEASES - Lease agreements, under which the partnership recovers substantially all its investment from the minimum lease payments are accounted for as finance leases. At lease commencement, the partnership records the lease receivable, estimated residual value of the leased aircraft, and unearned lease income. The original unearned income is equal to the receivable plus the residual value less the cost of the aircraft (including the acquisition fee paid

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to an affiliate of the general partner). The remaining unearned income is recognized as revenue over the lease term so as to approximate a level rate of return on the investment.

NET INCOME PER LIMITED PARTNERSHIP UNIT is computed by dividing the net income allocated to the Limited Partners by the weighted average units outstanding (4,625,000).

### 2. FINANCE LEASES

As of December 31, 2000, the partnership owned seven aircraft, which are all leased under finance leases. Five of the aircraft are leased to US Airways, Inc. and the lease is due to expire September 2001. In 2000, 1999, and 1998, leases with US Airways, Inc. resulted in finance lease revenues of \$5,175,000, \$5,873,000, and \$6,498,000, respectively.

The sixth aircraft, wholly owned by the partnership since January 31, 1997 when it purchased USL Capital's 50% interest in this aircraft for \$5.7 million, is leased to Trans World Airlines (TWA) under a finance lease. In 2000, 1999, and 1998 this lease with TWA, resulted in finance lease income of \$1,172,000, \$1,310,000, and \$1,432,000, respectively. TWA filed for chapter 11 bankruptcy protection on January 10, 2001. See note 10.

The seventh aircraft is leased to Federal Express Corporation (FedEx) under a 13-year finance lease which expires in 2006. In 2000, 1999, and 1998 this lease with FedEx resulted in finance lease income of \$389,000, \$431,000, and \$470,000, respectively.

The finance leases at December 31, 2000 and 1999, are summarized as follows (in thousands):

|                            | 2000<br>----      | 1999<br>----      |
|----------------------------|-------------------|-------------------|
| Receivable in installments | \$22,044          | \$34,633          |
| Residual valuation         | 45,500            | 45,500            |
| Unearned lease income      | (5,887)           | (12,624)          |
|                            | -----             | -----             |
| NET INVESTMENT             | \$61,657<br>===== | \$67,509<br>===== |

Residual valuation, which is reviewed annually, represents the estimated amount to be received from the disposition of aircraft after lease termination. If necessary, residual adjustments are made which result in an immediate charge to earnings and/or a reduction in earnings over the remaining term of the lease.

Finance lease receivables at December 31, 2000 are due in installments of \$15,748,000 in 2001, \$1,710,000 in 2002, \$1,310,000 in 2003, \$1,310,000 in 2004, and \$1,966,000 thereafter.

### 3. OPERATING LEASES

At December 31, 2000, the partnership did not own any aircraft subject to an operating lease. The last aircraft that was subject to an operating lease was sold in September 1997.

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### 4. LONG-TERM NOTES PAYABLE

As of December 31, 2000 and 1999 long-term notes payable included the following:

A 7.4% non-recourse loan facility collateralized by the aircraft leased to FedEx, due in semi-annual installments of \$451,000 through April 2006. At December 31, 2000 and 1999, \$4,001,000 and \$4,569,000, were outstanding, respectively.

A 9.35% non-recourse loan facility collateralized by the aircraft leased to TWA, due in monthly installments of \$150,000 through March 2002. At December 31, 2000 and 1999, \$2,226,000 and \$3,740,000, were outstanding, respectively. During 1998, the partnership renegotiated the terms of the 9.35% loan facility. As part of the re-negotiation, the partnership was able to prepay \$2.0 million in principal and reduce the interest rate 50 basis points from 9.85% to 9.35%.

A \$7.5 million three-year revolving loan facility obtained in February 1998. The facility was initially collateralized by one aircraft on lease to US Airways, Inc., was guaranteed by the partnership, and bore an interest rate of three-month Libor plus 225 basis points. In December 1998, this loan facility was expanded by \$5.0 million and the variable interest rate was lowered to 212.50 basis points over the three-month Libor when another aircraft leased to US Airways was added as additional collateral. At December 31, 2000 \$1,765,000 was outstanding and approximately \$3,275,000 was available under this facility. At December 31, 1999, \$1,783,000 was outstanding.

Based upon amounts outstanding at December 31, 2000, the minimum future principal payments on all outstanding fixed-rate long-term notes payable are due as follows (in thousands):

|                              |         |
|------------------------------|---------|
| 2001                         | \$2,419 |
| 2002                         | 1,078   |
| 2003                         | 710     |
| 2004                         | 763     |
| Thereafter                   | 1,257   |
|                              | -----   |
| Total Fixed Term Debt        | 6,227   |
| <br>Revolving Line of Credit |         |
| Outstanding at 12/31/2000    | 1,765   |
|                              | -----   |
| TOTAL LONG TERM DEBT         | \$7,992 |
|                              | =====   |

### 5. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents carrying amounts and fair values of the partnership's financial

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instruments at December 31, 2000 and 1999. The fair value of a financial instrument is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

| (In thousands)                      | 2000<br>Carrying Amount<br>----- | 2000<br>Fair Value<br>----- | 1999<br>Carrying Amount<br>----- |
|-------------------------------------|----------------------------------|-----------------------------|----------------------------------|
| Long-term notes payable<br>(Note 4) | \$7,992                          | \$7,983                     | \$10,092                         |

The carrying amounts presented in the table are included in the balance sheet under the indicated captions.

Long-term debt is estimated by discounting the future cash flows using rates that are assumed would be charged to the partnership for debt with similar terms and remaining maturities.

### 6. TRANSACTIONS WITH THE GENERAL PARTNER AND AFFILIATES

In accordance with the Agreement of Limited Partnership, the general partner and its affiliates receive expense reimbursement, fees and other compensation for services provided to the partnership.

Amounts earned by the general partner and affiliates for the years ended December 31, 2000, 1999, and 1998, were as follows (in thousands):

|                                  | 2000<br>----   | 1999<br>----   | 1998<br>----   |
|----------------------------------|----------------|----------------|----------------|
| Management fees                  | \$551          | \$577          | \$599          |
| Disposition and remarketing fees | 52             | 52             | 52             |
| Reimbursement of other costs     | 79             | 79             | 79             |
| Reimbursement of interest costs  | 8              | 7              | 7              |
|                                  | ----           | ----           | ----           |
| TOTAL                            | \$690<br>===== | \$715<br>===== | \$737<br>===== |

The general partner was allocated its 1% share of the partnership net income and cash distributions. Holding and BALCAP, each a limited partner and an affiliate of the general partner, were also allocated their share of income and cash distributions.

### 7. FEDERAL INCOME TAX STATUS

The Partnership is considered a publicly traded partnership ("PTP") under the Revenue Act of 1987. Under that Act, the partnership was not subject to federal income tax as a partnership until 1998. Effective January 1, 1998, PTP's were required to choose to retain PTP status and be subjected to federal income tax as a corporation or to delist their units thereby removing themselves from the scope of the PTP rules. Faced with these alternatives, the Partnership initially recommended that its units be delisted.

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In August and October 1997, respectively, federal and California tax laws were amended to provide PTP's a third alternative. Under these amended laws, PTP's are allowed to continue to be publicly traded during 1998 and subsequent years without becoming subject to corporate income tax if they elect to pay a 3.5% federal tax and a 1% California tax on their applicable gross income.

The board of directors of the General Partner unanimously concluded, after authorization from the unitholders and consideration of a number of factors, including the 1997 tax law changes and the benefits of liquidity, that is was in the best interests of the unitholders for the partnership to remain publicly traded at that time. Accordingly, in January 1998 the partnership made an election to pay the annual gross income tax at the partnership level.

8. RECONCILIATION TO INCOME TAX METHOD OF ACCOUNTING (UNAUDITED)

The aircraft on lease to US Airways, Inc. were purchased subject to a tax benefit transfer lease ("TBT") which provided for the transfer of Federal income tax ownership of these aircraft to a tax lessor until 1991. The transfer was accomplished by the sale, for tax purposes only, of the aircraft to the tax lessor for cash and a note and a leaseback of the aircraft for rental payments which equalled the payments on the note. The rental payments resulted in tax deductions and the interest was included in taxable income. In 1991, the TBT lease agreement terminated and the tax attributes transferred under the TBT lease reverted to the partnership.

The difference between the method of accounting for income tax reporting and the method of accounting used in the accompanying financial statements are as follows (in thousands except per unit amounts):

|   | 2000<br>---- | 1999<br>---- |
|---|--------------|--------------|
| Net income per financial statements:  | \$4,197      | \$4,708      |
| Increases (decreases) resulting from:   |              |              |
| 3.5% Gross Income Tax - non deductible  | 544          | 544          |
| Lease rents earned less finance lease income  | 8,810        | 7,934        |
| Depreciation and amortization   | (1,840)      | (2,605)      |
|   | -----        | -----        |
| Income per income tax method  | 11,711       | 10,581       |
| Allocable to general partner  | (117)        | (106)        |
|   | -----        | -----        |
| TAXABLE INCOME ALLOCABLE TO LIMITED PARTNERS  | \$ 11,594    | \$10,475     |
| Taxable income per limited partnership unit after giving effect to taxable income allocable to general partner (amount based on a unit owned from October 10, 1986) | \$ 2.51      | \$ 2.26      |
| Partner's equity per financial statements   | \$ 51,135    | \$ 55,347    |

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|  |          |            |
|--|----------|------------|
| Cumulative increases resulting from:                                       |          |            |
| Lease rents less earned finance lease income                               | 64,211   | 55,401     |
| Deferred underwriting discounts and commissions,<br>and organization costs | 5,361    | 5,361      |
| Accumulated depreciation and amortization                                  | (66,125) | (64,285)   |
| TBT interest income less TBT rental expense                                | (54,030) | (54,030)   |
|  |          |            |
| PARTNERS' EQUITY PER INCOME TAX METHOD                                     | \$ 552   | \$ (2,206) |

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### 9. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following is a summary of the quarterly results of operations for the years ended December 31, 2000 and 1999 (in thousands, except per unit amounts):

| 2000<br>----                            | MARCH 31<br>-----  | JUNE 30<br>-----    |        |
|---|--------------------|---------------------|--------|
| Total Revenues                          | \$1,771            | \$1,712             |        |
| Net Income                              | \$1,097            | \$1,066             |        |
| Net Income Per Limited Partnership Unit | \$ 0.23            | \$ 0.23             |        |
| Unit Trading Data:                      |                    |                     |        |
| Unit Prices (high-low) on NYSE          | \$12-\$10 5/8      | \$12 1/4-\$10 9/16  | 13 1/2 |
| Unit Trading Volumes on NYSE            | 227                | 239                 |        |
| 1999                                    |                    |                     |        |
| ----                                    | MARCH 31<br>-----  | JUNE 30<br>-----    |        |
| Total Revenues                          | \$1,982            | \$1,928             |        |
| Net Income                              | \$1,192            | \$1,157             |        |
| Net Income Per Limited Partnership Unit | \$ 0.26            | \$ 0.25             |        |
| Unit Trading Data:                      |                    |                     |        |
| Unit Prices (high-low) on NYSE          | \$12 3/4-\$12 3/16 | \$12 3/8-\$10 13/16 | 12 5/8 |
| Unit Trading Volumes on NYSE            | 309                | 293                 |        |

### 10. SUBSEQUENT EVENT

On March 12, 2001, the U.S. Bankruptcy Court approved the sale of most assets of Trans World Airlines to American Airlines' parent corporation. Consummation of the sale is subject to federal antitrust regulatory approval and other closing conditions. American Airlines has entered into an agreement with the Partnership, which becomes effective only upon consummation of the sale to American Airlines of the Trans World Airlines assets, pursuant to which American

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Airlines would assume Trans World Airlines' lease with the Partnership subject to a reduced lease rate and an extended lease term.

Additionally, on March 13, 2001, Trans World Airlines made its lease payments that were due on December 22, 2000 and January 22, 2001. Also, the Partnership expects Trans World Airlines to file with the U.S. Bankruptcy Court a stipulation agreement and order pursuant to which Trans World Airlines agrees to cure the February 22, 2001 lease payment within certain time limits.

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### INDEX TO EXHIBITS

| Exhibit No.<br>----- | Description<br>-----   |
|----------------------|--|
| 10.44                | Aircraft Lease Agreement dated as of April 15, 1993 between Taurus Trust Company, Inc. (formerly Trust Company for USL, Inc.) as Owner Trustee, Lessor, and Federal Express Corporation, Lessee with respect to one (1) Boeing 727-2D4 Aircraft, U.S. Registration No. 362PA (manufacture serial no. 21850). |

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