

Special Report

Financing your next business aircraft

Today's loans offer more creative options and lower interest rates than you could find just a year or two ago, making this a great time to lock in a deal.

by Jeff Wieand



JOHN TLEWIS

Financing a business jet purchase makes more sense now than ever before, because interest rates are low.

This may surprise you. After all, the prime rate has been creeping up. In early 2004, it was 4 percent; now, it's 7 percent. So how can today be a relatively good time to finance an aircraft?

The answer is that competition has caused lenders to decrease the spread they charge on business aircraft loans (which are usually pegged to the London Interbank Offer Rate, or LIBOR). In effect, lenders are making less money on these loans, so borrowers pay less interest even though underlying interest rates have increased.

If you already have a fixed-rate aircraft loan that closed, say, two years ago, the subsequent rise in interest rates may make refinancing unwise. But if you're borrowing to purchase a new aircraft, you may find loans relatively inexpensive. Depending on the return you expect on other investments, you might have no good reason to tie up

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capital in an aircraft when you can finance your purchase so inexpensively by borrowing (or leasing) instead.

How Aircraft Financing Has Changed

The new world of cheap aircraft finance can be traced to an old source: the law of supply and demand. Historically, financial institutions haven't perceived aircraft as

attractive loan collateral. Lenders have often felt unable to evaluate aircraft purchase transactions and feared that airplanes would be subject to damage or loss and wouldn't hold their value as well as other collateral. As a result, a few institutions dominated the aircraft lending field. Aircraft manufacturers created some of these institutions themselves, specifically to finance the models they manufactured and sold.

Loan or Lease?

In a standard operating lease, the financial institution takes title to the aircraft and leases it to you. As the owner, the financial institution will depreciate the aircraft for federal income tax purposes, which results in lease payments that are lower than corresponding loan payments. Consequently, a lease is an attractive alternative if you can't use the tax depreciation or want the lowest possible payment structure. A lease also keeps the aircraft off your balance sheet, and you can walk away from the aircraft at the end of the lease.

But these advantages come at a price. Cash flow can be better under a lease, but it doesn't follow that a lease is a better deal overall. And a lease provides little flexibility; you'll probably have an opportunity to buy out the aircraft on agreed-upon terms prior to the end of the lease on one or two specific dates, but otherwise you'll

be at the mercy of the financial institution if you want to exit the lease early.

In contrast, you can pay off a loan at any time (subject to blackout periods and prepayment penalties in the near term). Instead of owning the aircraft, the financial institution receives a security interest, and any depreciation deductions associated with the aircraft will remain with you. The aircraft will appear as an asset (and the loan as a liability) on your balance sheet.

Except in the case of private banks, which generally aren't in the aircraft leasing business, the fact that an institution doesn't offer leases may indicate that it is relatively new to the aircraft finance market. That can be a plus, as the institution may be making a special effort to build a portfolio of aircraft loans. Still, working with an institution that understands business aircraft offers obvious advantages. —J.W.

Quick READ

- ◆ Despite an increase in the prime rate, financing an aircraft is more attractive now than it was just two years ago.
- ◆ In the past, many lenders viewed aircraft as a dangerous investment.
- ◆ Major banks and traditional aircraft lenders should continue to have a strong presence.
- ◆ Solicit some proposals. Your current lender is a good place to start.

Aircraft Financial Institutions

You'll find some of the more prominent lenders in the aircraft finance business in the list that begins on this page. To locate more lenders, visit the Web site of the nonprofit National Aircraft Finance Association (www.nafa.aero).

There you'll see a Member Directory listing all 50 full NAFA members who, as part of their normal business, provide financing for the purchase of aircraft or make loans secured by aircraft. According to David

Davis, current NAFA president, about 95 percent of the organizations that provide aircraft financing are NAFA members, not including those banks that might make one or two loans a year as a special consideration

to prized customers. Also on NAFA's Web site is its Associate Member Directory, which lists individuals and organizations that are engaged in businesses related to the aircraft financing industry.—*R.R.P.*

In recent years, all this has changed. Manufacturer-sponsored aircraft finance businesses have largely disappeared, mostly because they failed to remain competitive. Meanwhile, as the business aviation field has grown and become accepted, some banks and financial institutions have sought either to create a portfolio of aircraft loans or to enhance an existing portfolio.

Asset-based lenders were attracted by the traditionally good collateral value of business jets, the efficiencies of advancing a large amount of capital on a single asset and the relative ease of monitoring the loan. Credit-based lenders were attracted by the creditworthiness of blue-chip companies and individuals capable of purchasing and operating, say, a \$20 million jet. With so many financial institutions chasing aircraft loans, competitive pressures have increased, which has helped to drive down rates.

Meanwhile, the market for corporate aircraft has heated up. Just a few years ago, the number of airplanes for sale greatly exceeded the number of buyers, and manufacturers were cutting back on production. No more. The recovering economy and availability of bonus depreciation helped to create a seller's market for business jets. Today, you may have to wait three years for delivery of certain new models, and you may find limited opportunities in the pre-owned market as well. This has made it hard for financial institutions to maintain a significant volume of transactions.

Fewer purchases mean fewer financings.

Some industry experts believe that lower profit margins will drive some institutions out of aircraft financing. Other observers, such as Mike Gaffney of Corporate Aircraft Finance at Banc of America, expect a crowded field until the economy experiences a downturn.

If you're concerned about embarking on a financing relationship with an entity that might soon be out of the business and selling your loan to another institution, you might want to consider which lenders seem likely to survive. The major banks and traditional aircraft lenders should continue to have a strong presence in business aviation finance. For example, it is unlikely that an institution such as GE Capital—which holds the country's largest portfolio of business airplane loans—will disappear from this market.

One thing to watch is whether a

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financial institution is "relationship-based" or "transaction-based," according to Greg Babcock at U.S. Bancorp Equipment Finance. "Lenders providing aircraft financing to their existing clients, whether through a private or commercial banking relationship, are compelled to continue in the field," Babcock said. Such lenders focus on maintaining a broader client relationship and to do so, try to bring economies of scale to clients needing corporate aircraft financing. No doubt they will also be trying to discourage clients from developing financing relationships elsewhere. On the other hand, financial institutions that counted on a high volume of stand-alone aircraft loans may have little appetite for the relatively lean times and thin margins of today's aircraft lending environment.

Expect More Creative Terms

Competitive pressures might also cause lenders to be more creative in structuring loans and leases. Longer-term loans have traditionally been cheaper, but in recent times, interest rates on shorter-term loans have come within range of those for longer-term credit. Lenders that demonstrate flexibility in structuring loans and leases to meet customers' needs are more likely to flourish in the current environment.

For Beth Guido at RBS Asset Finance, flexibility has meant synthetic leases. Under such a lease, the lessee treats itself as the aircraft's owner and the financing as a loan for tax purposes. For accounting purposes, meanwhile,

Private Banks

**Bank of America Corp.
Private Banking Group**
James F. Dickerson
Aviation Division
231 S. LaSalle St., 3rd floor
Chicago, IL 60697
(312) 828-4483

The Citigroup Private Bank
Mary T. Schwartz
Aircraft Finance
666 Fifth Ave., 5th floor
New York, NY 10103
(212) 559-0561

J.P. Morgan Chase Private Bank
Jay Owen
227 W. Monroe St., Suite 2700
Chicago, IL 60606
(312) 541-3449

Commercial Banks

Banc of America Leasing
Michael P. Gaffney
Corporate Aircraft Finance
Park 80 West Plaza II, Suite 200
Saddle Brook, NJ 07663
(201) 291-2654

Bank of America
Corporate Aircraft Finance
Michael Amalfitano, Division Executive
5429 LBJ Freeway, Suite 350
Dallas, TX 75240
(972) 385-3383

Chase Equipment Leasing, Inc.
Douglas Reinartz
707 Travis, 8th floor
Houston, TX 77002
(713) 216-7912

Commerce Bank, N.A.
Sean Patrick
950 N. Western Ave., Suite 6C
Lake Forest, IL 60045
(847) 295-4601

Fifth Third Bank Leasing
Matt McNamara
28 State St., Suite 1100
Boston, MA 02109
(617) 573-5191

Key Equipment Finance
William D. Dougherty
Business Aircraft Finance
Two Gatehall Road
Parsippany, NJ 07054
(973) 319-8829

MBNA America Bank, N.A.
Bud Walker
1100 N. King St.
Wilmington, DE 19884
(302) 458-0204

RBS Asset Finance
Karen Pomazal
71 S. Wacker Drive, Suite 1
Chicago, IL 60606
(312) 589-8550

Siemens Financial Services
Steven A. Baker
885 Woodstock Road, Suite 430-132
Roswell, GA 30075
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U.S. Bancorp Equipment Finance, Inc.
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the lessee is regarded as having enough risk with regard to the aircraft's market value that the financing can be treated as a lease. Guido reported that synthetic leases represented about 50 percent of her business aircraft financings last year.

For Ford von Weise at Merrill Lynch Business Aviation Finance, flexibility has meant nonrecourse loans. (Generally speaking, in nonrecourse financing, the borrower's obligation is limited to the asset borrowed against.) Some business aircraft buyers want to avoid any liability on a financing, but many banks and other financial institutions won't provide loans when the only recourse if the borrower defaults is to repossess the airplane. According to von Weise, however, a large percentage of Merrill's financings last year were nonrecourse to the buyer, making Merrill a leader in this area.

If you're interested in nonrecourse financing, keep in mind that it doesn't come free: You should expect to pay higher interest rates and to provide some form of "cushion" for the lender. The lender, for example, may be willing to finance only 80 percent (not 100 percent) of the aircraft's appraised value on a nonrecourse basis. Or the lender may require a pledge of securities to shore up 20 percent of the loan principal.

Another area where lenders are trying to be flexible is the term of the financing. Borrowers and lessees are looking for shorter-term commitments, and it's easy to see why. Most jet purchasers who plan to use the aircraft for business will be eligible for accelerated depreciation for federal tax purposes, and will thus write off most of

the purchase price in the first two years or so—and write it off entirely after four more years. As a result, it isn't uncommon for an aircraft owner to begin looking for a new model after only a few years.

This is especially true of purchasers of light and medium-size jets, who may be thinking about trading up to a bigger cabin or longer-range aircraft. Another consideration is the pace of technological improvements in business aircraft, which gives owners every incentive to trade up to newer, more up-to-date models.

What Borrowers Want Now

Consequently, business jet buyers are increasingly asking for shorter-term financings, and interest rates for the short terms have been relatively attractive lately. If a financing gives you the opportunity to stay in for the long haul—10 or 12 years, say—that's fine, but buyers also want the ability to exit—either by prepaying without penalty or exercising an early buyout in the case of a lease.

In today's market, signing up to purchase a factory-new aircraft poses a different kind of financing challenge: delivery of the airplane may not occur for several years. Many borrowers want to finance the progress payments or deposits due prior to delivery. When you add a 10- or 12-year financing on top of three years of progress payments, however, you have a very long-term credit commitment. Moreover, said Banc of America's Gaffney, many customers also want to lock in interest rates

today for a financing that starts several years from now, when the aircraft is actually delivered.

To test your options, solicit some financing proposals. Your current lender is a good place to start; remember that maintaining relationships is often the key to the best financing opportunities in today's market. But it's unwise to stop there. You should solicit proposals from several leading aircraft financial institutions—all with the same guidelines, so you can make an apples-to-apples comparison.

In this process, you may well

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discover that different institutions have different objectives. Many require a minimum financing amount of \$5 million. (Banks may waive this requirement for existing clients.) And while all institutions will provide loan financing, not all will provide leases.

Happy hunting. ■

Commercial Banks (Cont.)

Wachovia Leasing

Bill Grier
301 S. College St., 18th floor
Charlotte, NC 28202
(704) 383-8420

Wells Fargo Bank

Craig A. Warden
333 S. Grand Ave., 3rd floor
Los Angeles, CA 90071
(213) 253-6169

Finance Companies

Aerius Aviation Capital Partners

John Contas
155 Fleet St.
Portsmouth, NH 03801
(603) 373-6648

Aviation Finance Group

Wayne Starling
4355 Emerald St., Suite 100
Boise, ID 83706
(888) 339-2834

Center Capital Corp.

William Allen
General Aviation Finance
14 Claffin Ave.
Hopkinton, MA 01748
(866) 782-0001

Cessna Finance Corp.

John Newton
220 W. Douglas, Suite 300
Wichita, KS 67202
(800) 551-5787

CFC-Turbine Finance Group

Steve Schaack
8080 E. Central, Suite 340
Wichita, KS 67206
(866) 565-0922

CIT Equipment Finance

Richard Crofton
1540 W. Fountainhead Pkwy.
Tempe, AZ 85282
(480) 784-1801

GE Capital Corp.

Brent P. Godfred
Northeast Corporate Aircraft
44 Old Ridgebury Road
Danbury, CT 06810
(203) 796-1096

GE Corporate Aircraft Finance

David Labrozzi
44 Old Ridgebury Road
Danbury, CT 06810
(203) 205-5415

GMAC Commercial Finance

Charles McGuire
1903 Central Drive, Suite 404
Bedford, TX 76021
(817) 358-1517

Don Gies

Business Aviation Finance
222 N. LaSalle St., 16th Floor
Chicago, IL 60601
(312) 499-3846

National City Corporate Air Capital

Samuel Harris
995 Dalton Ave.
Cincinnati, OH 45203
(513) 455-2618

Especially for Fractional Shares

NetJets Finance Program (CIT)

Gary A. Weiss
750 Ackerman Ave.
Glen Rock, NJ 07452
(201) 689-1107

What About Financing Shares?

It's hard to find banks and other financial institutions that are interested in lending against the purchase of a share in an aircraft, mostly because an undivided fractional interest in an asset is unusual collateral for a lender. Consequently, the share field has been left largely to private banks, said Len Liotta,

who specializes in aircraft finance at Citibank. Liotta added that when a client requests financing for a share, the relationships cultivated by a private bank can make the difference between a generic financing term and a deal structure more conducive to the client's needs.

An exception to the general difficulty of locating financing for shares is the NetJets finance program, which CIT manages. Unlike many financial institutions, CIT "feels its program is well-secured by the shares and structures offered by this type of credit," according to Gary Weiss, who over-

sees the program. Although the program works only with NetJets, it offers customers choices among a wide range of loan and lease options.

Bombardier Flexjet sales director Brandon Mayberry said Flexjet is also helping share buyers arrange for third-party leases. —J.W.