



Aircraft Finance

The surprising state of business jet financing

by Jeff Wieand

The current climate for business aviation financing is not what you might expect. In today's market, you may have to wait three or more years for delivery of a brand-new aircraft. Meanwhile, inventories of many pre-owned models are lower than they've been in several years. With so few aircraft for sale, the financing business must be struggling, right?

Wrong. One lender I spoke to described financing airplanes today as "like shooting ducks in a gallery." Travelers are fed up with the airlines and major airports, and those who can afford to consider alternatives are prepared to wait three years or more for a factory-new aircraft. What's more, many of these buyers have no intention of riding the airlines in the meantime.

In fact, the scarcity of new jets has caused quite a few of these people to buy not one aircraft but two, according to aviation lender Mike Gaffney at Banc of America Corporate Aircraft Finance. First, they sign up to purchase a new aircraft that will be delivered years from now; then they purchase a pre-owned model—maybe not one they would have settled for a few

years ago—as interim transportation. In short, lots of airplanes are trading hands and business aviation finance institutions have lots of potential clients.

It follows that it must be a seller's market for the financial institutions, right? Wrong again. Gaffney pointed out that "spreads are lower now than ever before, across the board." Bill Dougherty at Key Equipment Finance, agreed, saying that when it comes to interest rates, "we are in a highly competitive environment." Indeed, some of the lowest financing rates available today are for business jet buyers.

Loss Leader

One reason for the low rates, Dougherty suggested, is that many financial institutions are chasing a finite number of deals. But another may be that many banks are willing to view business aircraft finance as a "loss leader." Business aircraft are usually acquired by very creditworthy buyers, and banks see providing relatively inexpensive financing for those aircraft as a great way to lure attractive clients to the institution.

Some newcomers to business aviation get caught up in the search for the lowest rate and fail to value the expertise a financial institution may have in structuring aircraft leases and loans. GE Capital's Brent Godfred noted that this expertise can often determine whether a buyer gets financing accomplished at all, especially if it involves complex structuring or aviation issues. And borrowers frequently fail to appreciate what the lower rate really means. One lender noted that he lost a deal over four basis points when documentation costs and legal fees from the winning bank might equally exceed the ostensible savings. To put this in perspective, a difference of four basis points on a \$10 million loan equals only \$4,000 a year.

In addition to providing a "loss leader" for other banking services, financial institutions have found financing business aircraft an attractive prospect in its own right. Many such institutions are looking to break into this business or to expand an existing portfolio of aircraft loans. The collateral value of business jets, the ability to advance large amounts of capital on a single

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asset and the ease of monitoring the loan have proved enticing for asset-based lenders, and credit-based lenders have welcomed the opportunity to do business with the high-net-worth individuals and prosperous businesses that acquire jets.

Progress Payments

The long wait for new-aircraft deliveries, meanwhile, has led to another trend: a focus on financing progress payments. Most factory-new aircraft are paid for on a "deposit schedule," with an initial deposit followed by periodic payments throughout the aircraft's production cycle. It's not unusual for most of the purchase price of a new jet to be due well in advance of delivery. Accordingly, most business aviation finance institutions have offered aircraft buyers the opportunity to finance these payments. This has turned into a major revenue source for the banks, often extending a lending relationship from, say, six years to nine.

For asset-based lenders, however, these progress payments can prove challenging, as there is usually no airplane to secure the loan. Under these circumstances, most lenders will require an assignment of the aircraft purchase agreement, enabling the lender to step in and purchase the aircraft itself if the borrower defaults. Moreover, after an aircraft receives its certificate of airworthiness, many manufacturers will permit the purchaser to take title to it or at least allow the lender to secure its progress payments by a lien on the still-to-be-completed jet.

Longer loans have also led buyers to seek more fixed-rate financing. In addition, fixed rates themselves have become more attractive. Key Equipment's

Dougherty said that "the cost of money for floating rates has increased disproportionately compared with fixed," with the result that most of his customers are requesting fixed rates.

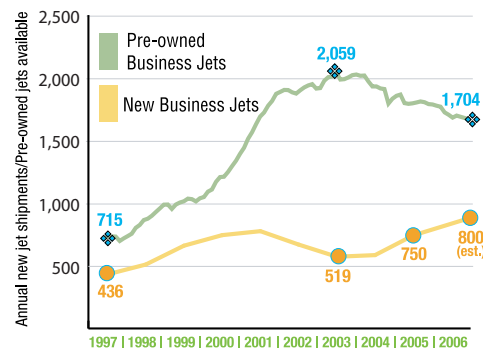
Another trend is the increasing popularity of leases as a means of financing aircraft. Unlike a straightforward loan, where the financial institution simply lends funds against the security of the aircraft, in a standard operating lease the financial institution takes title to the aircraft and leases it to the customer. Because the financial institution owns the jet, the lender (not the lessee) can depreciate it for federal income tax purposes. In theory, the benefit of this tax deduction is passed on to the lessee in the form of lower lease payments. Leases also can offer greater flexibility for structuring payments and, as a result, cash flow is often better under a lease.

Traditionally, leases are worth considering for purchasers who don't have taxable income or otherwise can't use the tax depreciation or want the lowest possible payment structure. Moreover, in many leases the aircraft is not an asset that will appear on the lessee's balance sheet, permitting the lessee to walk away from the aircraft at the end of the lease. Thus, within the parameters of the lease documents, the financial institution assumes the risk of diminution of value of the aircraft at the end of the lease term.

Another Incentive

Recent tax-law changes have provided another incentive for aircraft purchasers to use leases. After the 2004 Jobs Act, many business aircraft owners are finding that their depreciation deductions on corporate

Inventory of Pre-owned Business Jets Compared to Annual New Business Jet Shipments



Sources: GAMA, Jetnet LLC

Financing options at a glance

	Financing Type	Pros	Cons
LOANS	Variable-rate Interest rate fluctuates	Low rate now	Rates may go up tomorrow
	Fixed-rate Interest rate is fixed	Offers protection if rates rise	Rates may go down tomorrow
	Nonrecourse No personal guarantee	Borrower's risk is limited to the aircraft	Very expensive
LEASES	Synthetic A lease for accounting purposes, a loan for tax purposes	Lessee has tax depreciation	Aircraft is off balance sheet
	Operating Avoids aircraft ownership	Lessor has residual risk	Lessor has tax depreciation

Aircraft Financial Institutions

Here are some of today's major players in business jet financing. You'll find contact information for dozens of additional financing companies on the Web site of the National Aircraft Finance Association (www.nafa.aero; click on "Member Directory").

Private Banks

Bank of America Corp. Private Banking Group Aviation Division
477 S. Third St., Suite 200
Geneva, Ill. 60134
James F. Dickerson
(630) 262-1439

The Citigroup Private Bank Aircraft Finance
666 Fifth Ave., Fifth Floor
New York, N.Y. 10103
Mary T. Schwartz
(212) 559-0561

First Republic Bank
111 Pine St., 2nd Floor
San Francisco, Calif. 94111
James Simpson
(415) 296-5783

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

SunTrust Bank Private Wealth Management
121 Rolling Hills Road, Suite 225
Mooresville, N.C. 28117
Marcus E. Atkinson
(704) 662-3142

Commercial Banks and Affiliates

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

Chase Equipment Leasing
707 Travis St., Floor 8
Houston, Texas 77002
Douglas Reinartz
(713) 216-7912

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

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

RBS Asset Finance
101 Park Ave., 21st Floor
New York, N.Y. 10178
Beth Guido
(212) 401-3687

Siemens Financial Services
885 Woodstock Road, Suite 430
132 Roswell, Ga. 30075
Steven A. Baker
(770) 518-8899

U.S. Bancorp Equipment Finance Vendor Finance Division—Aviation
12401 Aviator Way
Englewood, Colo. 80112
Greg Babcock
(866) 637-5763

Wachovia Equipment Finance
301 S. College St., 18th Floor
Charlotte, N.C. 28202
Daniel Tyburski
(704) 374-4704

Wells Fargo Bank
333 S. Grand Ave., Third Floor
Los Angeles, Calif. 90071
Craig A. Warden
(213) 253-6169

Other Financial Institutions

Center Capital Corp. General Aviation Finance
14 Clafin Ave.
Hopkinton, Mass. 01748
Greg Renna
(760) 602-9767

Cessna Finance Corp.
220 W. Douglas, Suite 300
Wichita, Kan. 67202-3106
John Newton
(800) 551-5787

CIT Equipment Finance
1540 W. Fountainhead Pkwy.
Tempe, Ariz. 85282
Richard Crofton
(480) 784-1801

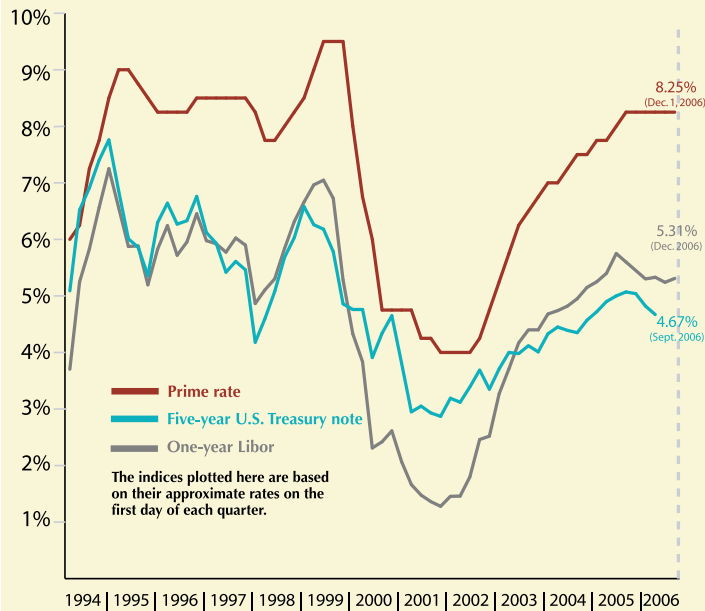
GE Capital Corp. Northeast Corporate Aircraft
44 Old Ridgebury Road
Danbury, Conn. 06810-5105
Brent P. Godfred
(203) 796-1096

Merrill Lynch Capital Business Aviation Finance
222 N. LaSalle St.
Chicago, Ill. 60601
Donald Geis
(312) 499-3846

PNC Aviation Finance
4355 Emerald St., Suite 100
Boise, Idaho 83706
Kenneth Wilson
(888) 339-2834

The Cost of Financing

Fluctuations in interest rates influence aircraft finance rates, although not necessarily in a direct one-to-one relationship.



Note: Lenders base aviation loan and lease rates on a number of indices. The prime rate is often the basis for relatively simple domestic loans and one of the several London Interbank Offered Rates (Libor) for the more complex domestic and international loans. Variable-rate loans are often indexed to the prime rate or a Libor rate, while fixed-rate loans are often based on the five- or 10-year U.S. Treasury note rates or the Libor swap rate. The "spread" is the difference in the index rate and the rate charged the client and varies with the lender's estimated risk of the loan.

Source: Federal Reserve Board, British Bankers Association

aircraft may be disallowed for tax purposes to the extent that they use the jet for personal or "entertainment" purposes. A lease provides an easy way to avoid some of this disallowance; the financial institution depreciates the aircraft as an asset and, as noted earlier, passes this tax advantage on to the lessee.

There are, however, disadvantages to an aircraft lease as compared with a loan. Although some loans have prepayment prohibitions or penalties in the early years, you can generally pay them off at any time without penalty. This is especially important if you want to sell the aircraft. Leases, on the other hand, provide little prepayment flexibility. The lessee may have the opportunity to buy out the aircraft from the financial institution at an agreed-upon price prior to the end of the lease term on one or two occasions (called "early buyouts"), but at other times the lessee will usually find early termination extremely expensive. However, even if it's cheaper in the short run, the lease may be more expensive in the long run when assumptions about the future value of the aircraft come into play.

Not everyone has been doing more financing with operating leases. One lender I spoke with said most of his lease financings recently have been synthetic leases. A synthetic lease offers some advantages of both loan and lease financing. For tax purposes, the "lessee" owns the aircraft and is eligible to depreciate it; the "lessee" thus treats the financing as a loan. On the other hand, for accounting purposes the "lessee" is treated as merely leasing the aircraft.

The Patriot Act has also had an increasing impact on aircraft lenders. Lenders are required to verify the sources of payments and repayments and that their borrower is not a "straw" for a third party. As a result, lenders are subject to "know your customer" policies requiring greater scrutiny and due diligence for potential

long history of providing business aircraft finance; others are relative newcomers seeking to cash in on what they view as a desirable market. A lender's track record with aircraft finance can play a big role in its

Longer loans have led buyers to seek more fixed-rate financing.

ability to structure loans and leases that will meet customer objectives.

Second, not all lenders offer the same facilities. Most private banks and some commercial ones, for example, will not provide lease financing, and some financial institutions have a "sweet spot" (say, loans below \$5 million) that they will rarely exceed. And then there are asset-based and credit-based lenders. The financial in-

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borrowers. Several lenders reported that they lost potential deals in the past year either because the customer was unwilling to provide the requisite information or because the information provided was unsatisfactory.

Know Your Lender

If "know your customer" is the motto of today's lender, "know your lender" should be the motto for today's borrower. Different financial institutions have different specialties, and knowing what a given institution can and cannot do can save you a lot of time and effort.

For starters, some lenders have a relatively

stitutions on our list (see page 27) for the most part consider themselves credit-based

lenders and will have little if any appetite for, say, non-recourse financing of a business jet.

But you can usually find nonrecourse financing if you look for it. Beth Guido at RBS Asset Finance said she has seen lots of interest in nonrecourse financing lately, but pointed out that it doesn't come cheap; the lender will want a significant "cushion" to limit its own exposure. In addition, said Guido, know-your-customer policies have removed one attraction of nonrecourse financing: the borrower will be required to make financial disclosures even though the loan is theoretically not based on his credit.

Various forms of "limited" recourse financing are also available. The borrower may be obligated to repay the loan only up to a certain amount, or the loan may be nonrecourse on financial terms (like paying interest) but recourse on contractual obligations (like insurance, liens and tax indemnities).

A good way to test your aircraft finance options is to solicit some proposals, preferably on an apples-to-apples basis. You should target institutions that can address the issues that matter to you, like low rates and fees, nonrecourse financing, availability of operating leases and the ability to close on the deal within your time frame. Aircraft buyers often overlook this last point; as a rule, aircraft sellers are not receptive to delaying a closing because the buyer hasn't finished arranging financing.

There are few better financing deals out there right now than those available for business jets, and it pays to examine your options carefully. □

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