AIN BUSINESS JET TRAVELER

Taxes, Laws & Finance

Financing in a changed market

What today's business jet buyers must know

By Jeff Wieand - February 2010

The business jet finance field is unique because business jets are unique. For one thing, they move around–fast. A Gulfstream G550 that's in Zurich this morning could be in Tehran tonight. That poses challenges for naturally risk-adverse bankers concerned about their collateral–challenges that helped facilitate the creation of the burdensome and arguably unnecessary International Registry of Mobile Assets. For another thing, business jets aren't always "all business all the time." Many fly personal trips as well, or are leased to charter companies for use in their businesses. A lender may worry not only about where the aircraft is, but what it's doing there. And whatever the jet is doing, its operation will be subject to a daunting array of some of the most complex safety and economic regulations you'll find anywhere. In part, that's because aircraft have the capacity for causing catastrophic damage when not used properly.

So far, as loan collateral a business jet sounds only slightly more appealing than a mobile dynamite factory driven by a five-year-old. But there are compensating advantages. Jets are expensive, which means that lenders can put out lots of capital on a single asset–a big plus administratively, but less attractive when capital is tight, as it is today. Business jets also offer lenders an entrée to high-net-worth individuals and strong-performing companies. That generally means excellent credit (every lender's dream: borrowers who don't really need the money) and opportunities for the financial institution to cross-sell other services to the client.

Though some lenders lump business jet finance with their general equipment finance products (like financing for cranes and trucks), the uniqueness of business jets has led more and more institutions to employ a dedicated specialist or group to service aviation clients.

After the financial eltdown in 2008, aircraft owners began, with alarming frequency, to default on loans and give back the keys to lessors (instead of buying the aircraft) when financing leases came to term. As a result, some financial institutions found themselves holding a swollen inventory of as many as 50 business jets. Many of these repossessed aircraft won't sell anytime soon, and what's worse, the institution's investment in them can often exceed their current fair market value. Given the large number of available aircraft and the dramatically low prices in the current market, lenders and other jet owners often try to find people willing to lease the airplanes for a couple of years to allow time for values to recover.

Today's lender is thus extraordinarily cautious–probably too cautious–about aircraft values. This caution is exemplified by a marked increase in the amount of due diligence that financial institutions require to make sure the aircraft they finance are worth the prices clients are paying. But taking prudent steps in acquiring a jet, such as retaining a reputable acquisition consultant and conducting a thorough pre-purchase inspection of the aircraft, can help to dispel a lender's anxieties about values.

Concern about values has affected lenders' appetites for certain models and vintages. Unlike wine, business jets don't improve with age. As jet values fell over the last 18 months and a glut of aircraft was listed for sale, the lower end of the market–older business jets and models–took a severe beating.

As I write this, 30 percent of all Challenger 1-As, 21 percent of all Falcon 50s and 25 percent of all Gulfstream IIs are available for purchase. Interested in buying a Learjet 35/35A? You have about 120 to choose from. No wonder many lenders find it hard to regard such aircraft as attractive collateral. As one lender told me, "We really want to stay with aircraft in the five- to 10-year-old range or even newer if possible. Once the aircraft is older than 10 years, the deal really needs to be something special."

This is particularly true when the financial institution is buying the jet to lease it back to the customer. An airplane that's 10 years old today may be 20 years old when the lease ends, and no lender wants to be the owner of an aged and potentially unsellable business jet.

The good news about the decline in business jet prices is that buyers are starting to materialize. Lenders say that many first-time buyers who were on the fence early last year are ready to take the plunge because they now believe that prices have more or less hit bottom.

Unfortunately, the financial position of such customers may have hit bottom as well, and lenders are doing their homework on them. "If all your income comes from buying and selling real estate," said one lender, "we're going to be taking a hard look at you." These days, lenders are also taking a hard look at their own previous experience with the potential borrower. Has the borrower over-extended itself in the past or missed payments on other credit facilities? What changes have occurred in its financial position over the life of the relationship? Lenders are also interested in whether the buyer has another aircraft it will be trying to sell after taking delivery of the new jet–not only with regard to the buyer's ability to bear the financial burden of two aircraft, but also because the lender may already have credit exposure on the first airplane.

The message in all this fuss about values and credit is simple: don't wait until the last minute to seek financing. Unless you're Bill Gates, obtaining financing is no longer simply a question of preparing the paperwork. Lenders need time to assess the aircraft and the customer. As I write this, a business jet purchase just fell apart because, after several weeks, the buyer wanted another month to line up his financing (the seller said no). Another buyer recently forfeited a substantial portion of his deposit on a factory-new aircraft when he couldn't obtain financing and needed the cash back for other purposes. If financing is important, plan ahead.

Probably the biggest challenge in today's aviation finance market is arranging 100 percent financing. It's not impossible to do, and many financial institutions claim to make it available for clients with "strong" credit, but in fact most transactions are being accomplished with 10 percent down or more. One lender told me that he routinely leads off with a request for 15 percent down, which he hopes he can reduce to 10 percent based on the customer's credit position. The down payment may effectively be 100 percent at the outset if you're financing progress payments on a factory-new aircraft. Many lenders want the borrower to have enough of its own money in the deal to cover any damages to which the aircraft manufacturer might be entitled if the borrower defaults.

Interest-rate spreads are also much larger than before the 2008 market crash, but there's a silver lining. Before the crash jet financings were getting done with absurdly low spreads–in some cases as low as 40 basis points over Libor. As of this writing, 30-day Libor itself is well below 40 basis points, so even though the spreads are many times their pre-crash multiples, the overall interest rate remains relatively low. For this reason, said Joe Boles at Siemens Financial Services, "Most aircraft buyers today are choosing fixed rates."

Tom Aiken at RBS Corporate Aircraft Finance agreed: "All the deals we've done in the past few months have been fixed." But most lenders I spoke to expect rates to remain low for the next year at least, so floating rates can look pretty appealing. Wells Fargo's Robert Lebano pointed out that "given that floating rates today are significantly lower than fixed rates, we've seen greater demand for floating rates, and for many clients, they represent a better option."

Similarly, the term of financings these days is often relatively short. "Although amortization schedules today are longer," said Sean Patrick at Commerce Bank's CBI Leasing, "many of our business aircraft customers want shorter-term deals because the rates are lower." He sees most lease financings at CBI in the five- to seven-year range and loan financings in the three- to five-year range.

Where should you look for jet financing today–banks, which common wisdom says are in financial trouble right now, or financial institutions connected to aircraft manufacturers, insurance companies or other businesses?

It's an important question. Some banks shy away from lease financing, but as Beth O'Neill at Bank of America points out, "We are even more aggressive on aircraft leases than loans." Bank of America doesn't require the jet borrower to be a prior customer, but some banks are basically looking to do aircraft financing only for existing or about-to-be significant bank clients.

In any case, being an existing bank customer can speed the credit approval process and encourage the bank to put an attractive deal on the table.

It can also kill the deal. If the bank and its affiliates are already burdened by a layer of relationships with you (such as margin loans, loans against boats or real estate or, in the case of corporate clients, membership in a bank loan syndicate), the bank may conclude that it has enough credit exposure to you already. The non-bank aircraft financial institution, on the other hand, is unlikely to have other credit relationships with the aircraft buyer (except perhaps on an existing aircraft) and certainly won't be requiring deposits or some kind of banking relationship to get the deal done. And some banks, such as Key Equipment Finance, attempt to insulate the aircraft lending business from their other credit exposures. In the end, both kinds of institutions may have something to offer and are worth considering.

Specialized financing needs may narrow the field considerably. Borrowers interested in non-recourse financing, for example, will be turned away at many banks, but not at PNC Aviation Finance, a market leader in this area. PNC's Jeff Hayden said that about 75 percent of their aircraft deals this year involve limited or non-recourse loans. Though you can count on having to make a hefty down payment with non-recourse financing, the actual interest rate can be close enough to recourse rates to make the non-recourse financing appealing.

As financing becomes more challenging to obtain, many jet buyers are turning to aircraft finance consultants for help. "We not only help find the best rates and terms," said Stan Yockey of Strategic Aircraft Solutions, "we can also find financing where none appeared available." Such consultants can help with financings worldwide. Joe DiLallo, former manager of J.P. Morgan Chase's international aviation finance team, is currently arranging financings in Latin America, Asia, Europe and the Middle East for GetJets Aviation Consulting.

Still, these are sobering days for those seeking to finance an aircraft. Lenders aren't giving it away, but with a little effort you should be able to find the financing that's right for you.