Beware of buyback provisions

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When it comes to reselling your fractional share, you're at a distinct disadvantage, says the author. Providers need to make some changes.

In the 1990s, a booming economy created fertile ground for fractional flying, a new form of private air travel that providers touted as having predictable costs and being much less expensive than full ownership. Today, though, the fractional concept is being challenged by new business models, including jet cards, openly advertised block charter programs, empty-leg marketing and even per-seat air taxis. All of these have two significant advantages over fractional ownership: they don't require a large up-front investment and they don't put you at risk for substantial losses down the road when you sell your fractional share.

Such losses have become a seemingly intractable problem for fractional programs. No issue is so routinely unseen or glossed over by new fractional owners–yet no issue ultimately has greater effect on the total cost of their investment.

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Part of the "sizzle" of fractional programs that initially attracts many owners is that you "own your own private jet." Aircraft are outfitted to appear privately owned–no provider logos are displayed inside or outside–so you can invite your friends to "fly on my jet," knowing that few will suspect it is part of a fractional fleet. (This marketing tool had the added benefit of satisfying FAA regulations that initially were not well suited to the fractional model.)

The sizzle, however, comes at a high price. The providers use your capital rather than their own to buy the aircraft. Moreover, they buy at discounted prices but do not pass those discounts on to owners; on the contrary, they generally set the purchase price for fractional shares at a premium even to the "retail" price of the aircraft, further sweetening their deal.

Completing the "sell high/buy low" circle of the fractional model, providers generally try to buy back shares at a discount from fair market value. In the early days, many providers were willing to guarantee minimum buy-back prices, but after the severe decline in the private jet market that followed 9/11, those guarantees disappeared. Indeed, many if not most fractional owners who came into the market in the heyday of the late 1990s took a bath on resale values, some losing as much as 75 percent of their investment.

You can do your due diligence and fairly easily ascertain the premium you're paying when you buy a share in a new aircraft, but when it comes to selling back to the provider, you're at a distinct disadvantage. Comparable sales information that helps establish the market value of an aircraft is hard for the layman to come by, and the information offered by the provider, which is difficult for the novice to cipher, may be misleading. It may rely upon bulk or wholesale sales rather than retail sales, may apply an inappropriately large discount for the relatively high time on the airframe and may not accurately account for upgrades and amenities, for example.

Clearly, your provider has a conflict of interest in this zero-sum game and that conflict, coupled with your lack of information and expertise, can leave you flying blind. As one owner put it, "I feel helpless." Frankly, that's what many providers are counting on.

When you run to look at your contract provisions relating to the buyback (provisions you no doubt didn't focus on, much less negotiate, when you signed up), you'll again find that the deck is stacked against you. That's particularly true of recent contracts, as the providers have moved to shore up loopholes that aviation attorneys and consultants have used to achieve higher valuations for their clients.

Take, for example, one major provider's current boilerplate contract. If you and the provider don't agree on fair market value, your only recourse is to hire an appraiser. If the company doesn't agree with your appraiser's valuation, it is entitled to select its own appraiser–with no requirement that that appraiser be "independent." Then that appraiser and yours choose a third appraiser, with the final value determined by majority decision. By the way, *you are required to pay for all three appraisals*, regardless of the outcome. And, this company isn't unique in this type of approach.

Such contract provisions and other valuation games represent a fundamental problem for fractional programs. If the providers don't address it, and provide fairer and more predictable resale prices, they may find that their market shares will decline precipitously as owners head for the exits. ❑

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Check These Resale Provisions

If you are otherwise satisfied with your fractional investment, you may want to stay with fractional when your current contract expires. If you choose to do so, have your attorney look closely at the contract provisions relating to resale. Some points to consider:

- The contract should provide guidance as to what "fair market value" means. Make certain it is based upon arm's length, retail transactions.
- Require that all appraisers are truly independent. Consider limiting the number of appraisals a single appraiser may do for the provider and still be considered independent.
- Insist upon a method that allocates costs in the valuation process to both sides and so gives the provider an incentive to compromise. Each side should bear the cost of its own appraiser. Require that the two appraisers attempt to work out a compromise valuation so a third appraiser isn't necessary. If a third is required, you and the provider should split that cost.

–J.D.B.

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