SPECIAL REPORT: AIRCRAFT ACQUISITION PLANNING AND FINANCING

News / Business aviation, Finance

One of the ultimate attractions of business aviation is the ability to take to the skies on a schedule that fits your company's needs – be it through charter, fractional ownership, aircraft leasing or an outright business aircraft purchase.

If outright ownership isn't right for your company's needs, charter, fractional ownership and, to a lesser degree, aircraft leasing provide scalable options to achieve the benefits of business aircraft use, even if you're flying only 50 hours a year.

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"Business aircraft are becoming something you have to have when you get to a certain level in the business world," said Jeff Wieand, senior vice president of Boston Jet Search, Inc.

All this being said, acquiring a business aircraft requires careful analysis and planning to help you decide which form of ownership fits best and which type of aircraft is right for your needs, and to ensure that the aircraft you ultimately purchase offers the best value.

"One of the things people need to think about starting off is how much they're going to use the airplane in their business," said Wieand. "Federal Aviation Regulations, the Part 91 regulations, are designed for businesses to operate the airplane in the service of the business. Personal use is ancillary, so the more the ownership structure fits that model, the easier it's going to be for someone to comply with FAA regulations."

That's especially true if the user plans to deduct aircraft expenses for tax purposes. But first things first. Deciding on the proper ownership structure depends on the user's needs.

"I tell a potential client that I am here to understand their travel needs," said Lee Rohde, president and CEO of Essex Aviation in Portsmouth, NH, an aviation consultancy that guides clients through the many options of business aircraft ownership. "If you already have [ownership experience], we review that. If you're new to it, we talk to you about what's out there, the options that can meet your needs, and the pros and cons. We look at it from the real-life operational perspective."

Each form of business aviation usage offers certain advantages, based on the user's needs and average total flying hours. What follows is a brief overview of some of the more popular options.

CHARTER AND FRACTIONAL

Air charter is often the easiest way to begin using a business aircraft. Typically it's best for those flying around 50 hours or less per year. The cost of ownership is focused totally on usage. There are no upfront capital costs or maintenance fees. You simply pay for travel time, which makes charter ideal for those who only fly occasionally. Users can fly round-trip, one-way or from one point to another. The main drawbacks to charter are that access and aircraft availability can be limited during high-demand periods, and the tax benefits of aircraft ownership are not available.

Once you reach the 50- to 100-hour per year flying threshold, fractional ownership can start to be a more attractive option. You actually purchase a "share" of an aircraft, which often provides improved aircraft availability and certain tax benefits. However, the upfront costs are higher, since there is a capital expense in purchasing an ownership share of a business aircraft. You also pay a monthly fee for administrative and maintenance costs, plus a per-hour fee for usage. Fractional shares usually are sold for a fixed period of time – usually three to five years. Depending on the contract provisions, ownership shares can then be sold back to the provider at current market value.

"Fractional ownership is a contained cost," said Rohde. "However, at some point you may reach a point where you don't want to share an airplane, or don't want to fly on a different aircraft with a different crew every time."

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Rohde added that the capital cost of fractional ownership has been fairly low since 2009 because many providers stopped buying new aircraft during the Great Recession. “So you were buying an existing aircraft in the fleet, which had already been depreciated in value,” he said.

However, many providers now are updating their fleets with new models, which is driving up share purchase costs. “I have a client who owns two shares, and both of those airplanes are coming out of the fleet,” Rohde said. “[The provider] has sent him proposals to roll over their shares into one of the new planes.”

The cost for a fractional share for new jets can be more than $1 million. Rohde said the companies do need to update their fleets, but the price tag has forced some of his customers to consider other options.

AIRCRAFT LEASING

A popular option for many business aircraft users, leasing is available in two types: wet and dry leases. In wet leasing, the structure is similar to aircraft charter in that the aircraft owner (lessor) provides the aircraft, crew, maintenance, and insurance to the lessee, who pays only for hours operated. In a wet lease scenario, the aircraft lessor is the operator of the flight and maintains control of the aircraft. The lessee pays for fuel, airport fees and any other duties, taxes, etc. Wet lease terms usually run from one to 24 months.

With dry leasing, an aircraft financing or leasing company (lessor) provides only the aircraft, similar to when a company leases a piece of equipment. The lessee pays for insurance, crew, ground staff, supporting equipment, maintenance and other costs. A typical dry lease runs two years or more and the lessee is the operator of flights on the aircraft during that time.

However, for at least some companies, leasing’s popularity has declined recently, due mainly to the negative impact of the market downturn starting in 2008. In fact, many banks have stopped writing leases altogether as planes begin coming off leases with market values well below the projected residual values that were set at the time the leases were written.

“Luckily, we didn’t do leasing,” said Bradford L. von Weise, director and head of global aircraft finance at Citi Private Bank, a unit of Citigroup. “Those [lenders] who did are facing lease returns that are underwater. If they haven’t already had to mark to market those assets, they’re in for some pretty ugly surprises.”

WHOLE AIRCRAFT OWNERSHIP

Exactly when is the right time to buy an aircraft? That’s a question many aircraft purchasing consultants and brokers are asked routinely, and for the most part, they say there are a lot of variables to consider. As a general rule of thumb, ownership makes sense once you’re racking up lots of flying hours.

“We find that 150 hours per year is generally the tipping point where whole aircraft ownership is financially more cost-effective than the other options,” said Robin Eissler, president and CEO of Jet Quest, an aircraft brokerage service based in Georgetown, TX. “With the various fractional programs, leases and jet cards available, this sometimes depends on the region.”

But the decision on whether to buy outright or pursue other, less capital-intensive options really comes down to buyer preference and need. For that reason, the experts interviewed for this story said the process starts with careful analysis.

“The whole business ownership experience has certain steps in it,” said Mike Bloom, president and CEO of Bloom Business Jets, an aviation brokerage and consultant service based in Castle Pines, CO. “You don’t want to go out and say, ‘I have $5 million, let’s go shopping.’ Without analyzing, they go out and pick their favorite plane. To the uneducated, that works okay, but for us it really doesn’t. It’s a shot in the dark.”

> *The most important thing in buying an aircraft is that you’ve done your homework and that you’re buying one that is right for your mission – for the use that you need of the aircraft.*

Eissler agrees. “The first step we take with our clients is doing a needs analysis to create an aircraft utilization profile,” she said. “This helps us determine how many hours the client will use the aircraft and also the types of trips and passenger loads that will be required.”

For the potential buyer, especially a first-time purchaser, the process also requires a lot of research. “The most important thing in buying an aircraft, no matter where it is, is that you’ve done your homework and that you’re buying one that is right for your mission – for the use that you need of the aircraft,” said Susan Carriere, partner with Carriere & Little LLP Aviation Business Attorney in Englewood, CO.

Naturally, the process also involves choosing between buying a new or pre-owned aircraft. Given the severity of the downturn starting in 2008, there are many previously owned aircraft on the market that can provide comparable performance at a lower cost compared to factory-new airplanes.

On the other hand, several business jet makers have introduced new, more capable models equipped with the latest avionics and wireless connectivity equipment, which is a big draw for some buyers. However, pricing and availability can vary depending on the market segment.

“In the upper end on the new side, things still are going pretty well,” said Bill Quinn, president and CEO of Aviation Management Systems, Inc., based in Portsmouth, NH. “With the new side, you look at the order backlog and how many years out they are, how many they are delivering and how consistently they are delivering.”

With larger aircraft, in other words, given the demand and longer lead times required from order to delivery, there might be significant wait times, as well.

Buyers moving from a used to a new aircraft often are doing so because of a change in business need, one typically related to company growth or business direction. “Usually, a person wants a new production plane, not because they like new planes…but because it provides a mission fulfillment they couldn’t get buying pre-owned,” said Jay Mesinger of Mesinger Jet Sales in Boulder, CO.

Pre-owned aircraft are much more affordable, especially given that pricing on many models remains near historic lows, especially on older aircraft. Given the slump in new construction between 2009 and 2013, the market for late-model pre-owned business aircraft is fairly limited, the experts say. Those late-model airplanes also are in great demand – when they can be found. “Late models with current avionics technology and WiFi capabilities definitely increases the salability of an airplane,” said Eissler.

For buyers willing to invest in some technology upgrades, older aircraft can be very attractive given their historically low pricing. However, they can be difficult to finance, since many lenders won’t offer loans on planes more than 15 to 20 years old.

For those who do chose to buy pre-owned, perhaps the most critical component of any purchase, once the analysis and aircraft selection process is complete, is the pre-buy or pre-purchase inspection. It typically follows the offering of a letter of intent by the buyer to the seller and precedes the purchase agreement, which spells out the details of the purchase, including price, delivery terms and location, and any other items of importance.

Once the pre-buy is complete and any necessary repairs have been made under terms spelled in out in the purchase agreement, delivery takes place and the plane is put into service. Most existing owners already have an in-house flight department and/or aviation management service provider in place to maintain and staff the aircraft. However, for first-time plane owners it is crucial early on to decide how the plane will be managed.

“When you are a first-time buyer, it is so complicated,” said Mesinger. It’s not out of the question for new owners to decide to self-manage their first airplane, but others might opt for help in the form of a management company.

A good management company handles maintenance, as well as crew staffing and more. “Make sure they understand aircraft like the one you plan on buying,” said Mesinger. “Get references, and get to know them before you hire them.”

Early on in the planning process, additional issues – including financing, aircraft registration and title issues and taxes – also should be carefully evaluated, again with the help of seasoned aviation pros who understand the intricacies of aircraft purchasing and ownership.

When it comes to financing, the experts almost universally say to start the process early. Don’t apply for a loan 30 days from closing and think you’ll be approved in time.

While most buyers these days pay cash for aircraft purchases, roughly 30 percent of buyers finance their airplane. For those who do, the good news is that lenders now are more aggressively pursuing aviation loans. However, lenders also are very choosy these days about who is offered the best rates. First and foremost, they favor borrowers with solid credit histories.

“Five years ago, lending standards were tighter and the borrowers didn’t look as strong, since we were reviewing their financial results from 2007 to 2009, which of course were weak years,” said Scott Schaidle, CIT Business Aircraft Finance vice president of sales. “When evaluating a potential client, we’re interested in the strength of the borrower and their ability to repay the loan. This is accomplished by evaluating their cash flow, liquidity and leverage. Based on the borrower’s financial results, we will structure the aircraft loan to meet their unique requirements.”

Given the financial regulatory environment today, lenders are asking for more information than in years past. “It is important to have current financial information prepared and available, and have a good understanding of how the aircraft will be operated,” Schaidle said.

Also, thanks to banking regulations passed since the financial crisis, lenders are required to hold more capital against loans. As result, they tend to offer preferable terms and interest rates to borrowers they know well – typically those who do business with them in other areas, since studies show they're lower-risk borrowers, according to von Weise.

"If you want a financing-only relationship, it's going to cost you a lot more money," said von Weise. "Therefore, go to your existing [financing] relationships, discuss this early with them, and if they don't do aircraft financing, consider establishing a relationship with a bank that does, and consider establishing a broad relationship, because you're going to end up paying a lot more money if you don't."

INSURANCE, TAX AND LEGAL ISSUES

Another important part of the loan-approval purchase process is securing title insurance. "Title insurance is becoming more prevalent as banks are starting to require it, as they have with land purchases," said Clay Healey, owner of AIC Title in Oklahoma City, OK.

Available to both the aircraft owner and lender, title insurance protects all parties in a purchase against forgeries, fraud and FAA filing or recording errors. "You want to make sure that if anything ever comes up, [the title company] is going to fight on your behalf," said Healey.

Another invaluable professional any aircraft purchaser will want to have on his/her team is a good aviation attorney, who can guide you through the maze of legal and tax issues involved in a purchase. Without proper guidance, buyers can fall into costly traps that can rack up significant unanticipated costs.

> *It pays to plan, use professional assistance, and take your time when evaluating any form of usage.*

State tax issues are a particularly complicated area to navigate without proper advice. "In an aircraft purchase, a buyer should be looking at the state taxes," said Nel Stubbs, vice president and co-owner of Conklin & de Decker in Prescott, AZ.

These include:

- Sales tax – due in the state in which the aircraft is delivered.
- Use tax – due in the state in which the aircraft will primarily be domiciled.
- Aircraft registration fees – due in the state in which the aircraft is domiciled.
- Ad valorem/personal property taxes – due in the state in which the aircraft is domiciled.

"Sales tax is often easy to plan for by taking delivery in a sales-tax-friendly state," said Stubbs. "That is a state in which there is either no sales tax, or the state does not impose their sales tax on aircraft, or the state has a fly-away exemption."

A flyaway exemption is where a non-resident buyer in a state where delivery is taking place can remove the aircraft from that state within a specific period of time and not pay sales tax. "However, once a buyer has avoided the sales tax, it is the use tax that the buyer now needs to be concerned with," Stubbs added.

Some states also assess personal property taxes on aircraft.

"In some cases, the personal property taxes can be reduced if the state apportions these taxes among the states a particular aircraft operates in," said Stubbs. "However, if an aircraft is primarily hangared in a state with a personal property tax, in most cases the tax is due in the county where the airport is located. In some states, individual counties have special rates for aircraft, and it might be beneficial to an owner to look at the different counties in which they could hangar their aircraft."

There also are a number of legal pitfalls potential aircraft buyers need to be aware of. One concerns the so-called "Flight Department Dilemma." Very often, aircraft buyers set up a limited liability company (special purpose entity, or SPE) to purchase and operate the plane because they believe it may protect the owner(s) from potential liability issues. However, if the company is not set up properly, users can face penalties.

"If the only thing that SPE does is own an aircraft, if it also operates the aircraft, it is in violation of FAA regulations unless it has a 135 charter certificate, or some sort of special certification or exception from the FAA," Carriere said.

The reason: According to the FAA, an SPE established solely to own and operate an aircraft, without any other legitimate business purpose, qualifies as a commercial air carrier and must have a commercial air carrier or charter operating certificate. Otherwise the owner is operating an illegal charter service and could be subject to fines of as much as $11,000 per illegal flight leg, according to Carriere.

In addition, if there is an accident or incident, the aircraft's insurance and financing could be invalidated because the use isn't permitted under provisions of the aircraft insurance policy and/or financing documents.

"It's a big deal," said Carriere. "I would say a high percentage of our clients who come in and haven't consulted a professional aviation specialist have a risk of unknowingly violating that regulation."

So it pays to plan, use professional assistance and most of all – take your time and scrutinize the details when evaluating any form of business aircraft ownership or usage. Those who do, say the experts, will generate the best return on their investment and the most satisfaction from the experience.

12 OCTOBER 2015

SOURCE: NBAA
ARTICLE LINK:
https://to.50skyshades.com/news/business-aviation/special-report-aircraft-acquisition-planning-and-financing

