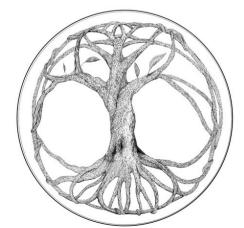
AIRCRAFT FINANCING CONSIDERATIONS FOR FAMILY OFFICES

# WHAT FINANCING OPTION DO I CHOOSE: TRADITIONAL AIRCRAFT DEBT, LEASING, OR SOMETHING ELSE?



WHAT IS RIGHT FOR YOU?

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Many financing options are available for those seeking to finance business aircraft, much of which focuses on the tax and legal requirements for both the user of the aircraft and the financier. The types of financing available can be placed into three categories: traditional term debt, leasing, and something else.

#### Traditional term loans

Traditional term loans supported by an aircraft mortgage (note: A UCC-1 does not guaranty a financier could enforce foreclosure on the aircraft) offer tangible and intangible benefits for the individual financing the aircraft acquisition: It is a way to conserve capital that can be deployed for another investment that could generate a higher rate of rate; it enables an aircraft owner to budget steady cash outflows associated with the repayment of the financing; and potential tax deferral benefits could be obtained when purchasing an aircraft. However, it is important to understand that the risk associated with the declining value of the aircraft is placed on the owner.



## While structure varies by financial institution, the following reflects the commonalities:

- Amount Financed at Inception: Most traditional aircraft financiers structure loans with an original commitment in an amount that is based upon a percentage of purchase price or an appraised Fair Market Value or "FMV" that can range between 20-90%. Note: best practice is to use an accredited aircraft appraiser who will assess the current market issues, rather than solely rely upon industry valuation guides.
- Term of the Financing: The tenor of the facility typically ties to the use of the aircraft and whether it is flown under the FAR Part 91 or Part 135 as that ties to MACRS depreciation schedules. This can range from five (5) to 10 years.
- Amortization to a Balloon at Maturity:
   Payments amortize loan outstandings to a balloon payment that is generally based upon the forecast FMV because the value of the aircraft is expected to decrease over time.
- Loan-to-Value Minimums: True-up payments are included in most structures to ensure that Loan-to-Value requirements are met. During the great recession, the values of certain business jets declined by 8-12% per quarter and resulted in instances where the loan balance temporarily exceeded the FMV of an aircraft.



- Interest Rate and Fees: Loans may be priced at either fixed or floating rates and interest rate swaps can be offered to fix the interest rate during the loan term. Typically the Borrower pays for all legal and perfection costs incurred by the financial institution and may be required to pay an initial loan and appraisal fee to support the upfront due diligence costs.
- Recourse to the Principal or Non-Recourse to the Beneficiary: Although loans are granted to the owner of the aircraft (typically a corporation), loans are structured as recourse or non-recourse. With recourse loans, a higher percentage of the purchase price/FMV is financed if a personal guaranty is provided, and lower interest rates may be offered if a substantial relationship exists between the financier and the guarantor. With non-recourse loans, interest rates may be higher and the Loan-to-Value may be lower compared to a recourse loan. Furthermore, the owner may be limited on tax deductibility due to the at-risk rules and should discuss this issue in detail with their aviation tax advisor to ensure that one is able to deduct any depreciation.

### Leasing

Leasing switches the mindset from the business aircraft user being the owner to one where the financier owns the asset and business aircraft user simply uses the aircraft. The financier/lessor obtains the tax benefits and structures a lease whereby the user/lessee agrees to operate and maintain the aircraft in addition to the periodic lease payments that incorporate the lessor's required rate of return on the asset. For business aircraft users, "Early Termination" clauses and "Lease Buy-Out" dates are generally included that enable a lessee to terminate the lease early for a fee and it is important to ensure that one is fully aware of these milestones. Explicit use, maintenance, and return conditions enforce the lessor's ability to ensure the value of the aircraft upon its return and could result in a significant cash outflow and downtime in the use the of the aircraft to meet the required return provisions. It is also possible for lessors/financiers to use their portfolio to securitize bonds and/or debentures that could result in an assignment of your lease to another party.





### Something Else - two major alternatives

This encompasses other opportunities to finance an aircraft in a nontraditional way with a financier. Depending upon the relationship that one maintains with a financial institution, the following are a few of the other options:

- > Unsecured loans: This implies that a lender would be comfortable providing a line of credit to the principal owner of the aviation entity and would not file an aircraft mortgage with the Federal Aviation Administration that could be used to enforce the financier's rights and remedies.
- Stock secured or margin lines of credit: A financier relies upon the value of the marketable securities that are pledged as collateral and remains indifferent to the use of the funds to finance the aircraft purchase. However, valuation

fluctuations could result in an unforeseen capital call. Additionally, short term floating interest rates can shift quickly and result in unpredictable cash outflows. Interest rate swaps could be used to mitigate this issue, but one must factor the cost to enter into an additional arrangement and the accounting for changes in the valuation of the swap.

Choosing the type of aircraft financing is a complex process and what may work for one person might not work for you. Maintaining an open mind and exploring all financing alternatives with your team of trusted advisors who understand the nuances will benefit you initially and during the term of your aircraft ownership.



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