GLOBAL JET
CAPITAL

BUSINESS AIRCRAFT:
TO BUY OR TO LEASE?

There is a common misperception in the business aviation industry that high net worth individuals and corporations mostly pay in cash for large business aircraft. Even if the cash resources are at hand, more often than not the preferred approach is to lease or finance assets of this nature. Why? If a new or pre-owned aircraft is acquired for cash – costing tens of millions of dollars –that's a lot of capital tied up in an asset that typically depreciates each and every year (unlike real estate, which may go up in value over time). As such, many business aircraft users prefer to take advantage of available third-party capital to finance or lease their acquisition.

Business aircraft can appreciate. The market has experienced times when aircraft have been sold for higher amounts six months or two years after a purchase. But that has been the exception, not the rule. Typically, business aircraft lose value as they age. Technical obsolescence, wear and tear, operator preferences, new model launches, life limits, and other factors contribute to this steady decline in value.

Funding the acquisition of a new or pre-owned aircraft with cash is 100-percent equity financing – equity capital that the individual or corporation could use to make other investments. Many conclude that the investment in their business is probably a better bet than buying into an asset that will likely lose value each year. The decision that most business aircraft operators reach is that it's most efficient to use third-party capital to fully or partially fund the acquisition of the business aircraft they wish to use.

So how does it work? For an individual or corporation seeking to take advantage of third-party capital to finance a business aircraft, the first question is: lease or buy?

LEASE

In an operating lease the business aircraft (new or pre-owned) is purchased by a third-party financial institution (the lessor) and then leased to the operator (the lessee) for a stated term and rent. The lease is documented as a contract between lessor and lessee with both parties having certain obligations to each other, primarily regarding the operation and care of the aircraft. Title to the aircraft resides with the lessor, and the lessee enjoys the right to use the aircraft without the lessor's interference.

A Global Jet Capital Operating Lease provides an ownership experience without being in the full business of owning an aircraft, which includes the following benefits . . .

Reduced Risk and Predictable Expenses: Offload all future market value to the lessor in exchange for a fixed set of lease payments that will not change over time.

Conserve Capital: Monetize up to 100% of the value of the aircraft, conserving capital for investment in other more profitable ventures.

Disposition Certitude: The GJC "end-of-lease return option" provides a built in "buyer" for your aircraft at lease-end for eventual ease of disposition. This enables a smooth transition into your next aircraft avoiding the cost, time on market delays and hassle typically associated with aircraft sales.

More Efficient Tax Treatment: For many business aviation users, rents under an Operating Lease are an efficient, long term tax-deductible expense.

Flexibility: We take our cue from your operational needs. The lease allows for early termination to upgrade, acquire or dispose of the aircraft should your needs change during the term.

Keep Your Bank for Banking: A GJC Operating Lease provides substantial funding for a depreciating asset that is separate and apart from other primary bank facilities.

Greater Privacy: An Operating Lease reduces visibility to an aircraft's end user, as the public records of the FAA would identify Global Jet Capital as the owner of the aircraft.

The disadvantage to leasing is that the lessor is the owner of the aircraft. This means that any increase in value of the asset is entirely for the lessor's benefit. In addition, as owner of the aircraft, the lessor may enjoy depreciation or tax-related benefits of ownership that the lessee would have been able to use if they had assumed ownership of the asset. It is also important to remember that the owner (lessor) will re-quire the lessee to closely adhere to the terms of the lease. There may be limitations on how many hours an aircraft can be flown, what kind of modifications can be made to the aircraft, and other restrictions such as where the aircraft may be operated, among others.

PURCHASE

The alternative to an operating lease is to retain ownership of the aircraft and use third-party financing for a portion of the acquisition cost. This could be a senior secured mortgage loan or other financing structure, such as a finance lease.

In a typical loan structure, the third-party lender advances between 50 percent and 85 percent of the aircraft value to the borrower by way of a secured loan. The difference in advance rate may be a result of the borrower's credit status, the age or type of the aircraft, or other factors. The security interest is typically a mortgage interest in the aircraft, giving the lender a first-priority security interest in the aircraft. This security interest is designed to offer the lender protection in the event of a default by borrower. Proceeds from liquidating the aircraft after a default are intended to repay the aircraft lender ahead of other creditors. Other loans may be available, particularly for individuals that have a substantial private banking relationship with a lender. In such instances the underwriting of the loan may focus as much on the financial assets held by the individual as the aircraft in determining the nature of the financing.

Title to the aircraft typically remains with the borrower in the secured-loan structure. The loan is usually repaid over a multi-year period to a balloon amount (a lump sum payment at the end of the loan repayment schedule). The loan, including the balloon payment at the end, is usually recourse to the borrower, meaning any deficiency the lender incurs (post default and sale of the aircraft) will still be owed by the borrower. In certain non-recourse or limited-recourse loans, the borrower will have fewer obligations of this nature, but typically at a higher rate of interest.

FINANCE LEASE

An alternative to the senior secured loan is the finance lease. Unlike an operating lease, the lessee does not return the aircraft to the lessor at lease expiry. In a finance lease, the operator makes scheduled lease payments along with a final balloon payment at the end of the multi-year finance lease term. When the final payment is made, title to the aircraft (which had been held by the lessor) will transfer to the borrower. At this point in time the aircraft is fully owned by the lessee and there are no further financial obligations to lessor.

The advantages of buying and then financing a portion of the purchase price are that the operator retains ownership of the aircraft, and all of the depreciation, tax, and residual-value benefits. Additionally, the owner will typically have greater operational control and flexibility over the aircraft. For example, there may be no hourly use limitations on the aircraft or restrictions on modifying the interior, for example. Additionally, subject to certain early prepayment penalties and/or break fees, the owner may elect to sell the aircraft at any time–unlike a typical lease, which would not allow for an early termination.

A major disadvantage to this option is that the operator assumes the complete risk of any drop in the value of the aircraft. This can result in unexpected losses occurring upon disposal of the aircraft if the book value of the aircraft is higher than the actual market value. The diminished sales price can also create unexpected cash flow planning problems.

Buy or Lease: What Happens Next?

In either the buy or lease scenario, the operator will need to work with a third-party financial institution to enter into a lease or loan agreement. This multi-week process will afford the provider of third-party capital a chance to review the aircraft collateral and assess the credit profile of the lessee/borrower. The lease or debt rate offered by the financial institution will reflect the prospects for both the borrower/lessee, as well as the aircraft. Jurisdiction, aircraft age and type, the aircraft manager (if any), and proposed term of the financing or lease will all be considered as the financial institution makes its leasing or lending indication to the client.