Score the best aircraft financing deal

Here's are your options, along with expert advice on how to proceed.

by Jeff Wieand

The past couple of years have been tough for business jet manufacturers. Sinking prices for preowned aircraft have turned buyers away from costlier factory-new models. This in turn has caused the manufacturers to lower prices; even Gulfstream, which for a time stood firm on its "fixed prices" for newly introduced models beginning with the G650, has started negotiating purchase prices. Attractive valuations have caused some preowned markets to be picked over, a trend that should eventually help send jet buyers back to the airframers.

Falling prices have also proved challenging for business jet financiers, who would prefer to see values hold up (generally, a vain hope), or at least decline at slower rates. For lenders, jets are collateral, and for leasing companies, they're assets on the balance sheet that must eventually be sold. At banks and finance companies with underwater business jet portfolios, appetites for swallowing more jet financings have abated, which in some cases has led to a renewed focus on financing aircraft for existing clients rather than for all comers, a position encouraged by the new Basel III banking requirements.

Other lenders, such as GE Capital and CIT, have sold off their jet financing portfolios to new entrants in the market like Global Jet Capital and Stonebriar Commercial Finance, which are looking for an easy way to jump-start their business in this field, and other financial institutions may do the same. As always, however, there are plenty of new entrants to the business jet finance world, including more regional banks in recent years. You can still get financing at JP Morgan Chase, Citibank, and Bank of America, but you can also try First Interstate Bank (formerly Bank of Cascades), UMB Bank, Ally Bank, Seacoast Bank, Enterprise Bank, Bank of the Ozarks, and others, especially if your aircraft is relatively small and inexpensive. For lenders like these, jet financing is a high-profile opportunity to attract or keep prestigious individual and business clients with excellent credit by offering low rates based on a low cost of funds. It can also be an opportunity to help diversify the bank's asset finance portfolio.

Jet finance, however, also offers the chance to make ill-informed value and residual assumptions in what amounts to a specialized field. But experienced help is available, though personnel changes at many institutions mean that the veteran jet finance professional you worked with a few years ago may not be the same one you meet with today.

The decline in jet values has contributed to an uptick in lease rate factors—the percentage of the "lessor's cost" for the aircraft that the lessee pays every month. It also reflects a growing wariness among financiers, especially banks, to write aircraft leases at all. One bank lender told me recently that it would write a lease these days only to move an aircraft in its own inventory.

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Loan rates, on the other hand, seem to be holding steady, and the experts I've spoken with lately don't see any dramatic future increases in their crystal balls. It's possible for borrowers with the right credit at the right banks to finance an aircraft loan at around 2.5 percent per annum (floating) or 3.5 percent per annum (fixed). Loan-to-value ratios continue their conservative trend, with some lenders quoting 75 to 80 percent for recourse financings—though 90 percent is still typical and 100 percent financing remains available for borrowers with outstanding credit from the right lender. Amortization schedules have likewise been declining; some lenders are now asking for 10 to 12 years on older aircraft, and 15 years is starting to sound like a good deal, though 18 years or more can be achieved depending on the financial institution, age of the aircraft, and projected usage.

There are five basic business jet financing options: operating lease; synthetic lease; recourse loan; non-recourse loan; and cash. What's the right choice? In recent years, cash has been the most common way to buy a business jet, ostensibly because there is too much cash available for good investment opportunities. However, jet buyers who have better things to do with their money than tie it up in an aircraft should seriously consider financing. Even if you already own a jet, you can always borrow against it or do a leaseback with a financier (unless it's too old or has unusual or worrisome problems).

Recourse loans remain a popular strategy. Subject to prepayment penalties in the early years, they're relatively easy to get out of if you decide you want to upgrade, downgrade, or give up owning an aircraft altogether. However, the loans are called recourse because the bank has recourse—and not just your aircraft, but your credit. This will often require a personal guarantee of the credit obligation from the principal of the borrower. Further, in a recourse loan, though the borrower owns the aircraft and gets the advantages like tax depreciation that go with it, it also accepts all the perils (like the possibility of plummeting residual value). Recourse loans are arguably not for the risk-averse.

Some of these dangers can be mitigated by a non-recourse loan. The recognized industry leader here is PNC Bank, which offers a variety of "asset-based" aircraft finance products keyed off the borrower's loan-to-value ratio choice. For example, if you're willing to borrow only 50 percent of a jet's value, you can get a loan with no amortization, no personal guarantees, and no financial disclosure…but with a lien on the aircraft. On the other hand, if you borrow 80 percent of the jet's value, you can still eliminate the financial disclosure, and recourse is limited to 20 percent. Needless to say, interest rates are higher for these asset-based programs, but not as much higher as you'd expect.

The best way to dodge the risk of falling jet values is to choose an operating lease. The popularity of aircraft operating leases is on the wane with banks for the same reason they are popular with many jet buyers: the lessor bears the brunt of residual risk. Given changes to lease accounting rules that compromise off-balance treatment of leases, minimizing residual risk is an ever more important reason aircraft buyers choose leases. Leases also remain popular with buyers who cannot enjoy the tax advantages of aircraft ownership.

Of course, a lessee is still required to maintain the aircraft, fly it no more than a certain number of hours per year, and deliver it back to the lender in good condition (which usually involves specific maintenance requirements) when the lease is over. Potential jet lessees should also keep in mind the loss in flexibility compared with loan financing—in particular, the difficulty in getting out of the lease whenever you want to. [*See "Exit Strategies," August/September 2017, available at bjtonline.com.—Ed.*] In addition, lessees must think twice about paying for expensive (and often needed) upgrades to the aircraft for which they may receive no financial credit from the lessor.

As banks lost interest in financing traditional aircraft operating leases, they resurrected the synthetic lease. Traditionally, this was a strategy to allow the lessee to write off the aircraft for tax purposes (and treat the lease payments as debt payments) while retaining off-balance-sheet treatment for accounting purposes by flunking accounting rules that would make the lessee the aircraft owner. Accounting rules changed and synthetic leases fell out of fashion, but they currently provide an opportunity for banks to write a lease with the lessee taking on the risk of declining jet values.

Loan rates seem to be holding steady and experts don't see any dramatic increases coming soon.

When looking for the best loan terms, high-net-worth individuals should start with their private bank. It likely already has a security interest in physical assets (the house, the boat, more houses) and investment accounts, so adding the jet can be relatively easy. Some private banks are so comfortable with the collateral already in place that they forgo putting a lien on the aircraft altogether. The drawback of private bank financings is cross-collateralization, which may allow the institution to foreclose on your aircraft because of defaults elsewhere in the portfolio—or on your other assets in the case of aircraft loan defaults.

If a private bank isn't an option, to get the lowest possible rate, you may still be better off with a commercial bank. A bank lending deposits has a lower cost of funds than a finance company obtaining money from investors or commercial paper. But the finance company is more likely to be flexible in structuring the loan to achieve objectives such as 100 percent financing, a lengthy amortization schedule, ability to prepay without penalty, and the like—not to mention leasing the aircraft. Further, while a private banking relationship works to an individual jet buyer's advantage, a commercial banking relationship with a company can work to the company's disadvantage if the bank already thinks it has too much exposure to the business from existing credit facilities.

Finance companies are often a good place to look for lease financing. I've seen aircraft leases from private banks, but they're extremely rare, and are becoming rarer from commercial banks as well, so finance companies are picking up the slack. Since the financial institution will own the aircraft, it will be picky about the terms. Obtaining a lease of less than five years will be difficult and securing one for less than three years will be almost impossible (unless you're leasing the aircraft from a bank that just took it back from a lease and wants to postpone recognizing a loss on a sale). Though interest rates often inch upward the longer the term of the facility, lease financing rates often go down, so pricing may be more attractive on a 10-year lease than on a five-year one. Early buy-out options (EBOs) offer an opportunity to get out of the lease, but they can also drive up the lease rate. To find out how much, ask for proposals both with and without EBOs.

Speaking of proposals, if you're undecided between loan and lease financing, request proposals for both. Even if you've made up your mind, and even if you have a relationship with a bank, it's worth getting several financing alternatives to validate your intended choice. BJT

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