Part 4 of a Series

In the first three installments of this series, we looked at the various ways to acquire and dispose of a business aircraft, working through both brokers and dealers. We also discussed how to choose and work with brokers and dealers.
Then comes the question: how do you pay for that new aircraft? Most aircraft are financed by either loan or lease funding. Does that mean a trip to your local bank, or is it more complex than that?

Financing aircraft, particularly business aircraft, is a very specialized field with its own unique set of risk elements. As a result, most funding sources either will not touch it, cannot offer competitive rates, or do not have the experience to smoothly complete the process.

The good news is that there are a (relatively small) number of institutions, which specialize in aircraft finance. Many of them are members of the National Aircraft Finance Association in Poolesville, MD, and are listed on the association's website at www.nafa-us.org or are available through (301) 349-2070.

By selecting a specialist aircraft financier, and by handling the financing process effectively, you can expect to be working with a prompt responsive organization that can offer:

- A competitive term sheet proposal and underwriting checklist
- A financing structure that is consistent with your tax planning and budget
- Timely confirmation of commitment
- An efficient documentation and closing process with your selected title company

It is advisable to select your financier early in the transaction to obtain the lowest possible cost of funds and to ensure smooth and timely completion. In addition to having aircraft expertise and experience, you will want to ensure that the financier has both debt and lease capabilities for maximum flexibility. Responsiveness is also critical, because you will need to quickly address issues that inevitably emerge during the purchase process.

Once you have selected your lender, you will need to consider the following:

Interest Rate and Terms.
One issue that will be central to securing good terms is the degree of risk involved. The higher the perceived risk, the higher the interest rate charged, or the higher the likelihood that the bank or other lender won't do the deal at all. Do yourself a favor and help your lender understand the circumstances of the purchase. Make sure you explain the entity that will be making the transaction and provide a complete financial disclosure of its financial circumstances. You should define ownership of the entity and who will receive the tax benefits. If it is an LLC, does it conform to FAA guidelines? Is there recourse to a "deep pocket" such as a parent company, or another guarantor, who will support the loan/lease payments to mitigate the risk? If so, the cost of funds is likely to be lower. Remember, too, that some aircraft are seen as attractive to lenders, while some models pose a higher collateral risk. A lender may require quicker amortization on aircraft older than 15 to 20 years, due to the residual value risk.

Lender Needs.
Equip your lender with information on the purchasing entity's financial strength, access to capital, strength of recurring cash flow, total debt service, and terms of all senior debt. In addition, the lender will want to know specifics on the aircraft, the total time on the engines and airframe, the status of scheduled maintenance, and your plans for a pre-purchase inspection. He will want to see the purchase contract and a spec sheet of the actual serial-numbered aircraft. He will be interested in your plans and budget for improving the aircraft, and your budget for operating it. If you intend to perform a 1031 exchange for tax deferral purposes, he will need to know that too.

Lease Versus Loan.
This is always a complex decision. The key benefit of a loan is tax-related because you own the aircraft and can depreciate it. A loan also offers greater flexibility in terms and pre-payment options in the event you want to sell the aircraft. In the case of a lease, the lender owns the asset and gets the depreciation advantages, but in return you may be able to obtain a lower fixed rate and a longer term with an early buyout option.

The pros and cons of both approaches will depend on your effective tax rate and a variety of other factors. As a first step, ask your lender to help you calculate the internal rate of return (IRR) of the stream of payments of a loan versus a lease on an after-tax basis. This may help you determine which strategy is better for you.

Also ask your lender about the stringent tests imposed by the Financial Accounting Standards Board on the reporting of capital leases. Known as FASB 13, this regulation requires that capital leases be shown as an asset and a related obligation on the balance sheet of the lessee. This may influence your decision.

Closing Procedures.
Remember that a smooth closing results from being thorough. Both you and your lender will want to closely monitor a "closing checklist" which includes the pre-purchase inspection, the appraisal and residual value forecast, the title company and its title search, lien releases and bill of sale, and the legal opinion of title or title insurance policy. Last item? Instructions for wiring funds. Congratulations on a deal well done.

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