

Short Term Aircraft Leasing: An Alternative to Selling Short

by Jay Mesinger

So often in this changing marketplace, as our office prepares a valuation report for a prospective seller, the feedback is the same. "My aircraft is worth less than we owe, we cannot afford to sell it under these economic conditions." Today's prices are well below those of the last 5 years and this represents a buyer's market. Today's sellers are not enjoying the process they are finding themselves faced with. They have no choice but to reduce fleet size or liquidate the department all together. Either due to a debt



constraint or a sheer unwillingness to take today's low prices for their aircraft, sellers are looking for new choices that may provide some relief to this dilemma. The idea of securing a short (one to three year) lease may, in some cases, provide a solution that was not considered only a few months ago. To those of us who can remember back 10 years, this surplus of inventory, with long lead times to sell is not new, as I can recall (and so can others) this happening at least three times in my own career. In periods of high demand and short supply the idea of a Seller becoming a Lessor was not even a consideration. When selling lead-times were, in many cases, only days and sales prices were getting higher, literally by the day, the seller had no incentive to lease. Today all this has changed. Within most categories of aircraft, there will now be some sellers willing to lease. How does this benefit the buyer? Some buyers who have been sitting on the fence, afraid to buy because of their perception of a marketplace continuing to weaken, may be lured off the fence with the prospect of entering the game without having to commit to what they view as a market that has not yet reached the bottom. Also, for those prospective buyers who have been somewhat unclear or unsettled about what plane to buy, this marketplace provides an opportunity to try out what they may have considered to be the most logical choice before they have to commit to ownership. Combining a lease with a purchase option clause can give the reluctant buyer a chance to move forward, as well as a chance to lock into a purchase price based on the weakened market. This allows the buyer some protection against a marketplace rebounding during the term of the lease. Both parties should expect the purchase price to be higher than the market would support today, but lower than what it might be in a quick recovery.

The prospect of leasing also provides a more narrow process of choice. Instead of comparing all aircraft for sale in a category, a prospect will have fewer choices based on a limited number of aircraft available for lease. The inspection process at the inception of the lease is the same as it would be for the pre-buy at the point of sale. The lessor will expect the aircraft to be returned in much the same mechanical condition as when it was taken, less normal wear and tear and reserves being paid for use. The lessee will have to have a clear and accurate assessment of acceptance condition.

Operation of a leased aircraft by a first time operator will have some start up costs that may lead a lessee to contact a management company for assistance. This would help facilitate a very quick start up process.

The process is really the same when buying as with leasing. If you have never owned or operated a corporate aircraft, the procedure can be complex and detailed. Even for an existing flight department, the start up process - including training pilots and putting the aircraft into service - requires monetary as well as time resources. These start-up considerations will (in some cases) make an operational lease of one year seem less attractive. All of these items will need to be weighed against the normal comparative considerations - buying, chartering, fractional and now leasing. Leasing will have an added dimension of enhanced value against fractional if your utilization exceeds 150 to 200 hours per year. This is the typical break point at which fractional begins to be too pricey. Leasing could provide an opportunity to solve the higher utilization needs of some users.

The terms of a short-term lease are fairly straightforward and are subject to many of the same supply and demand pressures as a straight aircraft purchase may be. A value of the aircraft needs to be set and a lease rate established based on that value. Typically the monthly rate for a dry lease will be .6% to 1.2% of the established aircraft value. This means that on top of the lease rate the lessee will also be responsible for all direct and variable expenses. Some other competing factors for terms and rate are the low interest rates available for acquisition financing. Tax considerations for use tax, as well as personal property tax and other applicable taxes also need to be considered. Consulting with a qualified tax attorney who is familiar with aircraft leasing is a must when entering into this process. As the lessor, one may find lending institutions that will essentially buy the paper and fund the lease stream up front. Other benefits to a lessee can include off balance sheet reporting of the transaction as well as less capital or debt tied up in the solution.

As with any business transaction, good legal representation is critical. Formulating the lease, the inspection process, and the return provisions are not simple procedures and should be treated with the foresight placed in all of your day-to-day business decisions.

So out of the ashes of a weak market rises the opportunity for more choices with respect to increasing your existing capacity on entering for the first time the world of corporate aviation.

On November 14, at 2:00 (EST) our monthly *Aviation Leadership Roundtable*, will be talking with several aviation professionals experienced in today's buying, selling and leasing issues. Please join us. To Participate, simply go to www.jetsales.com, click on the *Aviation Leadership Roundtable* section and click "Enter Conference". It's free, and will last about 20 minutes. You will be able to exchange ideas live online. The only thing needed is a download of the software, RealPlayer(TM). It is available free from our site, and takes about twenty minutes to download on a standard dial-up connection, so try to accomplish this in plenty of time before the event. I look forward to seeing you there.

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