

A Few Good Questions to Ask When a Customer Seeks Financing for an Aircraft



The last five years have been a buyer's market for small jets, turboprops and rotorcraft. Cost per seat mile continues to decrease, and fuel-efficiency and range of newer aircraft continue to increase, providing businesses and individuals with added flexibility in their regional travel options.

An eight-seat Pilatus PC-12 turbo-prop or a six-seat Eclipse 500 jet, both of which were manufactured in 2008, can be purchased for less than \$1.5 million. These are just two examples from a fleet of aircraft options available that can quickly reach locations not served by commercial air traffic. The economics of small business aircraft travel are such that independent community banks in Washington will

likely receive a greater number of requests to assist their customers in financing business aircraft purchases.

Financing an aircraft ought to be of mutual benefit for both the bank and the customer. It is generally a straight-forward process: the customer executes a note and security agreement, and the bank records the security agreement with the Aircraft

Registry maintained by the Federal Aviation Administration ("FAA"). If the aircraft can carry eight or more passengers, or has engines with a certain thrust rating, the bank also registers its interest (an "international interest") with the International Registry ("IR") of Mobile Assets, in Dublin, Ireland. Once the loan is paid off, the bank cancels its security agreements with the FAA and IR, and the relationship regarding that particular aircraft successfully concludes.

Yet, there can be pitfalls. Below are five initial questions to ask the customer that will assist the bank in its decision to fund the loan and ensure that its interest in the collateral will be perfected.

What kind of aircraft do you want to buy? The age of an aircraft, and particularly its estimated decline in value over time as it nears the end of its service life, affects the loan term. Suppose a customer wants to finance a \$3 million purchase of a 1998 Cessna Citation jet that has a 20-year estimated service life under the planned hours flown per year. The aircraft still has a quarter of its service life ahead, so it may be a smart purchase for the customer's intended use. In the event of default and repossession, the bank would ideally have a resale value that is as close as possible to the outstanding balance remaining on the loan. In this case, a five-year loan term would be risky. If the customer defaults in year four, it is unlikely that there will be a demand for an aircraft with a one-year service life remaining. So the type and age of the aircraft and the intended hours per use per year, are basic variables that can help form a prudent lending decision.

Which entity or person will own the aircraft? Aircraft that are registered in the United States must be owned either by U.S. citizens or by companies that are predominantly owned by U.S. citizens. If, for example, the customer wants an LLC to own the aircraft but less than 75 percent

Before choosing to rely on its borrower and borrower's counsel, the bank should review the loan documents, its security interest and the nature of the government's "take," to determine whether it needs independent counsel to protect its security and receive the compensation that it is entitled to.



of the LLC's voting interest is held by U.S. citizens, the LLC itself will not be eligible to own the aircraft. This is especially common in the Pacific Northwest where members of a Washington LLC are sometimes Canadian citizens. Either the LLC ownership would need to be restructured or the aircraft would have to be placed in a U.S. citizen-owned trust with the LLC being the beneficiary. Knowing the citizenship of the aircraft owner, and particularly whether the owner is an individual or a business entity, will help the bank to understand who the ultimate obligor will be on the loan and whether there may be a need for an individual guarantor.


How does the customer intend to use the aircraft? The bank should also have an understanding of the type of operation for which the aircraft will be used. Will the aircraft be operated by a flight department? Who will provide the crew? Will the aircraft be used for both business and personal use, or will it be leased to third-parties to help cover costs? The intended use of the aircraft

will help the bank evaluate the risk to the collateral and whether to impose insurance levels in the security agreement.

Who owns the aircraft now? Perhaps the most important — and sometimes convoluted — question to have answered is that of aircraft ownership. Aircraft that are owned and operated by U.S. citizens and businesses are generally registered with the FAA. Thus, the usual assumption is that, as long as the FAA's records show that an aircraft is owned by a certain individual, that record reflects the reality of ownership. That is not always the case. Aircraft are items of personal property; and like any other item of personal property, the question of who actually owns it depends on definitions of ownership under state law. While the FAA's Aircraft Registry generally tracks interests in aircraft (aircraft owners are forbidden by law to operate an aircraft that is owned but not registered with the FAA), there can be unrecorded interests in the aircraft. For example, Washington has an artisan's lien under which an aircraft mechanic who might

have worked on an aircraft but who was not paid can perfect the lien by filing a notice in the county in which the work was performed. The lien notice need not be recorded with the FAA Aircraft Registry. While unrecorded or remotely-recorded liens are unusual, it can happen, and may result in the judicial foreclosure of the aircraft that is serving as collateral to the bank's loan.

How does a bank ensure clear title to the aircraft? The best way to get an understanding of title to the aircraft is to hire a reputable aircraft title search company to investigate the aircraft's title. Most are located near the FAA's records office in Oklahoma City, and often serve as the escrow agents that file the actual registration applications and security interests in the aircraft when the sale closes. Typically the purchaser, and thus the bank's customer, will have hired the escrow agent or title search company to conduct a search of the aircraft in the FAA's Aircraft Registry, and if applicable, the International Registry in Dublin. The title search company or escrow agent might also search UCC filings in various states as well, depending on the aircraft's operating history. A good title search will confirm clear title or find any irregularities in title that need to be corrected prior to the sale.

On a national scale, equipment financing and lending for aircraft continues to be less available than optimal. There are, however, opportunities for banks with good relationships with their local and regional customers to help facilitate their customers' increasing demand for smaller and more cost-effective business aircraft travel options. With answers to a few well-placed questions, the opportunities can be productive for both the bank and the borrower. 



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