




## CORPORATE AVIATION: WEATHERING THE STORM

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March 4, 2009

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## Agenda

- Market Summary
- Aircraft Cost Analysis
- Applicable Limitations
- Options for Restructuring
- Q&A



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## How Bad Is It? Part 1

- Business aircraft activity down by 42.5% in January 2009\*
  - Part 135 midsize jet activity, down by 60.4%
  - Part 91 Large-cabin jet activity, down by 32.3%
- Fractional aircraft, down by 49.6%
  - Fractional small-cabin jets, down by 59.6%
- Part 135 activity, down by 47.1%
- Part 91 activity, down by 38.1%

\* ARGUS

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## How Bad Is It? Part 2

- Used jet inventories rose 70 bps to reach 13.4% in January 2009 \*
  - Heavy (+80 bps)
  - Medium (+70 bps)
  - Light (+60 bps)
- jet inventories increased 138% (over last year) to 1,309 aircraft January 2009
- Average asking price decreased 2.7%\* in Jan
  - Medium down 2.9%
  - Heavy down 2.6%
  - Light down 2.4%
- Cessna production is set to drop 25% in '09
- Gulfstream is cutting midsize production 56% in '09

\* J.P. Morgan Business Jet Monthly – February 2009  
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## Market Outlook

- Continued Falling prices
  - Disconnect between buyers and sellers
  - Negative media attention
  - No premiums for positions
- Increasing inventories
- Reduced Aircraft Usage
- Corporate aircraft lags economic recovery by 6-12 months



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## Market Dynamics

- Industry Factors to Watch:
  - User fees sharply increase cost of aircraft for owners/operators
  - New tax laws and IRS rules governing personal use of corporate aircraft
  - Higher fuel prices may hamper future industry growth
  - Closer scrutiny for public companies

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## Aircraft Cost Analysis


- What does your aircraft operation cost?
  - What are the cost components?
    - Fixed
    - Variable
- What can we do to minimize cost?
- What would be the new going forward aircraft operation cost?
- Does it make sense versus alternatives?



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## Variable Costs

- Costs incurred when the aircraft is flying:
  - Fuel and consumables
  - Maintenance labor
  - Parts expense
  - Miscellaneous
  - Engine costs



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## Variable Cost Example


- Cessna CJ3\*

Fuel/hr.	\$1,054.36
Maintenance Labor/hr.	\$102.35
Parts Expense/hr.	\$78.86
Misc. Trip. Expense/hr.	\$85.44
Engine Cost/hr.	\$204.44
Total Variable Costs/hr.	\$1,525.45
Total Costs for average of 457 hours/yr.	\$697,130.63

\* AMSTAT/Conklin & deDecker fleet data  
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## Fixed Costs

- Costs incurred regardless of whether the aircraft is flying:
  - Hangar Office Lease
  - Crew Salaries
  - Crew Training
  - Insurance
  - Software



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## Fixed Costs Example

- Cessna CJ3\*

Insurance	\$43,600.60
Maintenance Software	\$2,700.00
Miscellaneous Expense	\$4,866.00
Hangar/Office Lease	\$35,800.00
Captain Salary	\$87,500.00
First Officer Salary	\$55,000.00
Flight Crew Training	\$25,600.00
Total Fixed Costs/yr.	\$255,066.59

\* AMSTAT/Conklin & deDecker fleet data  
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## Analyze Continuing Transportation Needs

- Evaluate prior operation
  - CJ3 Example: \$952,197.22 annual costs *Not Including Capital Costs*
- What is your typical flight mission?
- How many hours do you really need?
- How fast do you need access?
- What are your tax, legal, regulatory issues?
- Are there any liability or risk concerns?

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## Financial Projections

- Conduct continued aircraft ownership and operation financial projections
  - Based on reduced operations
  - Factor in Fixed Costs and reduced Variable Costs
  - Analyze charter offset, if available
- Analyze maintenance expenditures versus JSSI or other MSP plan
- Compare to alternatives (to be discussed)

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## Operational Considerations

- Are you willing to share the aircraft?
- Is your ownership structure set up to accommodate the option you select?
  - Will there be greater risk exposure with the option you select?
  - Affiliates versus third party users
  - Structure to Mitigate Greater Risk Exposure



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## Tax Considerations

- Is aircraft being depreciated?
  - Does restructure affect ability to depreciate?
  - Can only depreciate aircraft if used in a trade or business
- Was aircraft depreciated?
  - Do we have to deal with recapture?
- Does aircraft operation generate ordinary income/losses?
  - Will structure need to be designed to retain ordinary losses
- Does aircraft operation generate passive income/losses?
  - Will structure need to be designed to retain passive losses

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## Legal Limitations

- Is Aircraft Financed?
  - Review loan agreements
  - Limitations on restructuring aircraft operation?
  - Early termination fee?
  - Default provisions
- Is Aircraft Pledged?
  - Security agreement covenants
- Is Aircraft Jointly-Owned?
  - Tenancy-in-common agreement covenants

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## Options for Restructuring

- |  |   |
|--|---|
| <ul style="list-style-type: none"> <li>▪ Cost Sharing           <ul style="list-style-type: none"> <li>◦ Co-Ownership</li> <li>◦ Time Sharing</li> <li>◦ Interchange</li> <li>◦ Trade Up (w/partner)</li> </ul> </li> <li>▪ Cost Shifting           <ul style="list-style-type: none"> <li>◦ Dry Lease</li> <li>◦ Charter</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>▪ Cost Reduction           <ul style="list-style-type: none"> <li>◦ Trade Down</li> <li>◦ Refinance</li> <li>◦ Park</li> </ul> </li> <li>▪ Cost Elimination           <ul style="list-style-type: none"> <li>◦ Sell</li> </ul> </li> </ul> |
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## Co-Ownership

- Aircraft Partnership
  - Unlimited liability for partner's activities
  - Joint Ownership
- Separate Entity Ownership
  - Shield liability from other co-owners
  - No flight department company
    - Aircraft operation must be incidental to other business



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## Structure - Operational Factors

- Primary Aircraft Users?
  - Individual users/ family
  - Corporation
- How Many Users?
  - Single individual or entity
  - Multiple individuals and/or entities
  - Consolidated group of entities (parent/ subsidiaries)
- What Is Relationship of Users to Principal(s)?
  - Affiliate
  - Non-Affiliated

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## Structure - Tax Factors

- Will Aircraft be used in Business?
  - Can only deduct if ordinary and necessary business expense
  - Can only depreciate aircraft if used in a trade or business
- Ultimate Taxpayer has Passive Income
  - Sufficient to bear significant passive losses?
  - Structure must be designed to generate passive losses
- Ultimate Taxpayer has Ordinary Income
  - Sufficient to bear significant losses?
  - Structure must be designed to generate ordinary losses
- Mixed Business/ Personal Use?
  - Personal use of business aircraft problems
  - Seat hours/ disallowance of deductions/ depreciation

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## Structure - Liability Factors

- Analyze Risk Exposure
  - Operation limited to affiliate group/ persons
    - Lesser third party liability
    - Employees covered by workers' comp.
  - Charter Usage
    - Greater third party liability
    - Less control over destiny (reliance on air carrier)
- Structure to Mitigate Greater Risk Exposure
  - Isolate significant liability
  - Insurance to mitigate liability

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## Joint Ownership

- Operational Factors
  - Multiple unrelated business users
  - Users not affiliated or related to principals
- Tax Factors
  - Primary business use
  - Business entity looking for losses against ordinary income
    - Limited personal use
- Liability Factors
  - Several unaffiliated users
  - Sufficient insurance coverage
  - Named insureds
  - Joint owners jointly liable



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## Special Purpose Entity

- Operational Factors
  - Single or multiple business primary users
  - Large number of users/ charter customers\*
  - Users not affiliated or related to principal(s)
- Tax Factors
  - Primary business use
  - Business entity looking for losses against passive income
    - Limited personal use
- Liability Factors
  - Multiple unaffiliated users
  - Sufficient insurance coverage/ named insureds
  - \*If charters are conducted, optimal structure



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## Joint Ownership or SPE

Consideration	Joint Ownership	SPE Ownership
Financing	<b>CON:</b> Having each joint owner as a direct borrower can make an owner in default of the loan if the other owner defaults in any loan covenant	<b>PRO:</b> Having the LLC as borrower can insulate the loan from economic activity of a member (subject to compliance with their guarantee obligations)
Transferability	<b>CON:</b> Each time a new owner is added or removed will involve a new registration with the FAA	<b>PRO:</b> Members can be added or removed without the need to file a new registration with the FAA
Liability	<b>CON:</b> Each owner is fully responsible for the other owner's liability	<b>PRO:</b> The members are not liable for the other member's actions. Only liability is for one's own operation as a dry lessee
Tax Consequences	<b>PRO:</b> Depreciation is at the owner level and offsets active income	<b>CON:</b> Depreciation will only result in passive losses at the LLC level

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## Co-Ownership Challenges

- How to locate co-owner
  - Brokers
  - Management companies
- Conducting due diligence on co-owner
- How to structure co-ownership
  - Operating rules
  - Cost allocation
- Tax consequences
  - Contribution to entity can be a sale (if financed)
- How to terminate

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## Co-Ownership Example

- CJ3 w/2 co-owners in LLC, no financing
  - Owner contributes CJ3 to new LLC in exchange for 100% of membership – not a sale
  - New co-owner makes capital contribution at agreed 50% of fmv of CJ3
    - Contributing owner can reduce capital account to equalize with new co-owner by making withdrawal
    - BOE may consider a sale of ½ of CJ3
  - Split fixed costs per capita
    - Each co-owner contributes \$127,533 per year to LLC
  - Split variable costs pro rata based on use
    - Dry lease to each co-owner to avoid flight department issue
    - Each co-owner pays LLC \$1,260 per hour

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## Insurance

- Mitigates Risk Associated with Aviation
  - Should be written to correspond to structure/ operations (e.g. personal business use, commercial use, etc.)
  - Hull insurance
    - Equal to agreed value of aircraft
  - Liability insurance
    - limits correspond to liability exposure
    - Charters should mean highest liability limits
  - War risks insurance
  - Guest voluntary settlement endorsement
- Adequate named insured coverage
  - Principal users/ Lessor and all lessees of the aircraft

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## Joint Ownership

- an arrangement whereby one of the registered joint owners of an airplane employs and furnishes the flight crew for that airplane and each of the registered joint owners pays a share of the charge specified in the agreement.
  - Managing owner can retain operational control
- FAR 91.501
  - Limited to large airplanes (>12,500)
  - turbojet-powered multiengine airplanes
- NBAA exemption

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## Time Sharing

- an arrangement whereby a person leases his airplane with flight crew to another person, and no charge is made for the flights conducted under that arrangement other than:
  - 2x Fuel, oil, lubricants, and other additives.
  - Travel expenses of the crew, including food, lodging, and ground transportation.
  - Hangar and tie-down costs away from the aircraft's base of operation.
  - Insurance obtained for the specific flight.
  - Landing fees, airport taxes, and similar assessments.
  - Customs, foreign permit, and similar fees directly related to the flight.
  - In flight food and beverages.
  - Passenger ground transportation.
  - Flight planning and weather contract services
- FAR 91.501
  - Limited to large airplanes (>12,500)
  - turbojet-powered multiengine airplanes
- NBAA exemption

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## Time Sharing Agreement

- Time sharing lessee uses 3 hours on a time shared King Air 350
- Limited reimbursement of 2x fuel (\$1,667.36) plus listed 1 for 1 incidental cost reimbursement
- Net to owner is the extra 100% of fuel cost
- FET
- Useful for empty legs
- Owner cannot hold out

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## Interchange

- an arrangement whereby a person leases his airplane to another person in exchange for equal time, when needed, on the other person's airplane, and no charge, assessment, or fee is made, except that a charge may be made not to exceed the difference between the cost of owning, operating, and maintaining the two airplanes
- Use right aircraft for mission
- FAR 91.501
  - Limited to large airplanes (>12,500)
  - turbojet-powered multiengine airplane
  - Hour for hour only
- NBAA exemption



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## Interchange Example

- GIV to GIV
  - No cost differential
  - Incidentals can be reimbursed
- GIV to Citation CJ3
  - GIV Variable Cost - \$4,300.23
  - CJ3 Variable Cost - \$1,525.45
    - CJ3 owner uses 3 hours on the GIV (\$12,900.69)
    - GIV owner uses 3 hours on the CJ3 (\$4,576.35)
    - CJ3 owner will owe GIV owner the difference plus incidentals
- FET

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## Trade Up (w/Partner)

- Trade-in with OEM
- Warranty coverage for new aircraft
- Lower variable costs
  - More efficiency
  - More appropriate for mission
- Downside – Low trade-in



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## Dry Lease

- Granting lessee with legal possession and custody of aircraft
- No pilot can be provided directly or indirectly by lessor
  - Wet lease
    - FAR violation
    - Insurance risk
- Lessee will have operational control of aircraft

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## Dry Lease Examples

- Partial cost-shifting
  - Part-time lease on as needed basis
    - Hourly rate
    - Formula for allocating fixed costs
      - Pro-rata based on hours
      - Lessee responsible for damage
- Full time cost-shifting
  - Full-time lease on as needed basis
    - Monthly rate should cover all fixed costs

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## Charter

- Charter revenues shared between owner and air carrier
- Tax benefits
  - depreciation
  - sales tax exemption if new aircraft
- Can result in further savings on hangar, storage and maintenance costs.
- Insurance costs can be reduced in aircraft is placed on fleet policy



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## Charter Examples


	Small Jet	Medium Jet	Large Jet
Aircraft Type	Citation CJ1	Hawker 800	Gulfstream IV
Fixed Costs	\$334,906	\$415,697	\$767,395
Variable Costs	\$353,996	\$685,573	\$1,138,690
Total Annual Operating Costs	\$688,901	\$1,101,270	\$1,906,085
Charter Revenue	\$516,750	\$841,500	\$1,530,000
Net Annual Operating Costs	\$172,151	\$259,770	\$376,085
Hourly Cost	\$1,722	\$2,598	\$3,760
Passengers	6	8	14

No Capital Costs Included  
All Annual Operating Costs - Fixed and Variable  
100 Hours Owner Flight  
300 Hours Charter with 30 Hours Dead-Head  
Net of Potential Property Taxes  
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- ## Charter Challenges
- Compliance Costs
  - Lack of charters in down economy
  - Additional risk exposure to third party users
  - Wear and tear on aircraft / increased cycles
  - Loss of control over operations
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- ## Trade Down
- Trade-in with OEM
  - Warranty coverage for new aircraft
  - Lower variable costs
    - More efficiency
    - More appropriate for mission
  - Downside – Low trade-in
    - Run financial projection to analyze
- 
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- ## Refinance
- Interest rates are at a record low
  - Lenders looking for low LTV using FMV
  - Existing lender may be willing to restructure to avoid taking back aircraft
  - Additional collateral exposure
  - Speak with lender now
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- ## Park
- Eliminate most variable costs
  - Eliminate some fixed costs
    - Pilots
    - Insurance limited to ground risk
  - Defer most maintenance
    - Still do calendar maintenance
    - Continued airworthiness
- 
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- ## Sell
- Find best value for equipment
    - Work with experienced broker
    - Willingness to lower price for quicker sale
      - Continued carrying costs versus quick sale
      - Opportunity cost
    - Take loss / stop bleeding
  - Lose use of aircraft
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## Q&A

Thank you for attending!



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