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AIN
SPECIAL REPORT

Lenders Loosen the Purse Strings, but Only for the Right Buyer and the Right Airplane

by Curt Epstein

Uncertainty. It's a word that packs a lot of fear and indecision into four syllables, and one that has continued to burden not only the U.S. economy but that of the world as well. Though the most recent recession officially ended in June 2009, according to economists at the National Bureau of Economic Research, more than two years later, most people are still waiting for clear positive signs that the economy is on a strong upward trajectory.

Stock markets remain on a jittery roller-coaster ride, with investors reacting sharply to every morsel of economic news. In September during one particularly volatile week, the markets swung like a pendulum by hundreds of points for four consecutive days. An analysis by *The New York Times* found that these days the stock markets are more likely to experience daily swings on the order of 3 percent or 4 percent than at any other time in recent stock market history. That volatility continues to alarm investors and shake public confidence in the economy.

Last month, the European debt crisis—which U.S. Treasury Secretary Timothy Geithner described previously as the “biggest challenge to growth worldwide”—saw some signs of possible improvement with a change in leadership for financially strapped Greece and Italy. Earlier, news of European banks' agreeing to large write-offs of loans made to Greece, along with the development of a recapitalization program for the European Union's 70 largest banks, gave a brief boost to U.S. markets.

Though many large corporations have largely rebuilt their profits to pre-recession levels, their continued uncertainty and caution is reflected in the amount of cash they are stockpiling rather than making capital investments or increasing the size of their workforces. U.S. corporations currently have a higher share of cash on their balance sheets than at any other time in nearly the last 50 years, according to a recent article in *The Wall Street Journal*. In a Federal Reserve Bank statistical review of the second quarter of this year, non-financial corporations had more than \$2 trillion in cash

and liquid assets on hand over the summer, an increase of \$88 billion since the end of March.

Some analysts speculate the companies are holding capital as a hedge against another possible lending drought or even as insulation in case of further economic shock waves from the European debt crisis, yet critics blame those strategies for the sluggish employment rates that have shown but minor improvement over the past two years. Based on data from the U.S. Department of Labor, aside from a brief dip earlier this year, the national unemployment rate has not been below 9 percent since May 2009, nearly double the pre-recession level.

The notion that companies are sitting on capital rather than augmenting their workforces has contributed to the economic malaise that has fueled the rise of grassroots movements around the country and the world such as Occupy Wall Street. The ragtag protest encampment that was established near the seat of America's financial power base has garnered global media attention and spawned numerous copycat demonstrations in cities around the world.

Complicating the domestic situation was the downgrading of the U.S. sovereign credit by financial ratings analyst Standard and Poor's in August due to America's political infighting over curbing the nation's spiraling debt. In another indication of uncertainty, in September Moody's cut the debt ratings of Bank of America, Wells Fargo and Citigroup, three of the largest U.S. banks, on worries that the U.S. government would be less likely to support a large lender again if it got into trouble.

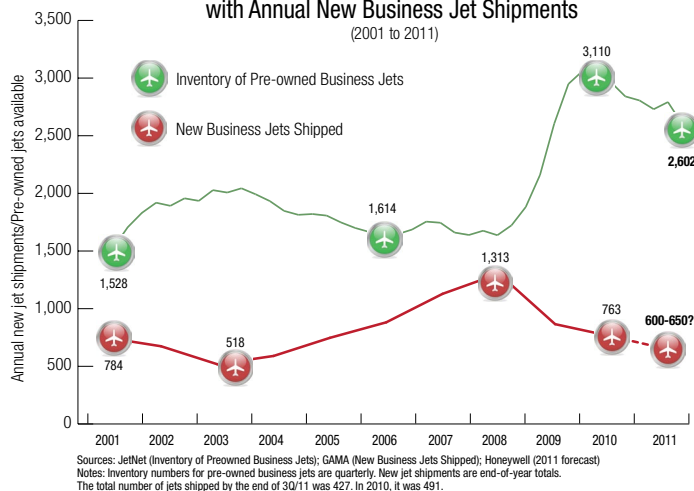
Against this muddled financial backdrop, OEMs prepared for yet another anemic year of sales as the first-half delivery total of 261 business jets reflected the lowest number of business jets handed over since 2004. In his search for an explanation for the continuing slump, Pete Bunce, president of the General Aviation Manufacturers Association (GAMA), blamed the White House, for its recent anti-business aviation rhetoric. “This administration has singled out business aircraft owners with political demagoguery,”

Bunce said. “It is simply astonishing that they cannot connect the dots back to manufacturing jobs and realize they are doing more damage to an industry that has obviously not yet clawed its way out of this recession.”

Lesson Learned

Those buyers who might be returning to the business aviation market after an absence of several years will quickly discover that the lending landscape has changed considerably. “Between 2004 and 2007, the industry was just frothy with capital,” said David Labrozzi, president of GE Commercial Finance’s corporate aircraft division, at the JetNet IQ Summit in June. “If you weren’t a criminal and you had a phone and you were buying an airplane, you got a loan. It was just that simple.” Labrozzi’s sardonic statement was an exaggeration, but not by much. Lenders were drawn to the market by the seemingly ever soaring values of business jets, spurring tight competition. In their eagerness to close deals quickly, financiers began to lose sight of common-sense business practices. “We fell so completely in love with the collateral, we tended not to look at the basics,” explained Labrozzi in an industry mea culpa. “Can they really pay the loan

Inventory of Pre-owned Jets Compared with Annual New Business Jet Shipments
(2001 to 2011)



[Click chart to enlarge](#)

back, can they perform under the lease, can they buy an airplane and maintain it, do they have to charter it out to pay for it? The very basic things.”

When the recession hit in 2008, the pricing bubble burst, leaving many buyers who had borrowed 100 percent of the list price (or more in some cases) underwater on what were suddenly less valuable airplanes. The business jet market became saturated with used aircraft as prices tumbled. Lenders shied away from smaller and older jets, which were the hardest hit. Many simply parked them and walked away. According to statistics from industry data provider Jetnet, between 2008 and 2010 the industry saw 342 business aircraft foreclosures. While the numbers have tapered off, this year has seen 64 repossessions, while many other aircraft operators remain in some form of financial difficulty ([see sidebar on page 4](#)).

During the lowest point of the slump, the portfolios of many lenders were packed with aircraft they were forced to recover or loan agreements they had to rewrite. “While we experienced a flurry of activity during the early months of the financial crisis, we are not experiencing anything outside the norm now,” Labrozzi told AIN.

Many of the lenders who flocked into the market retreated, some having been badly burned by loan portfolios turned



Ex-Im and the ECAs

Export credit agencies, or ECAs as they are commonly known, provide another source of funding for international aircraft customers. In most countries that export goods on a large scale, these agencies serve to facilitate international trade when other sources of funding are not readily available. In the U.S., over the last fiscal year the Export-Import Bank (Ex-Im) handled a record \$32 billion worth of finance authorizations, an amount that has nearly tripled since the start of the credit crisis.

A significant part of the Ex-Im’s portfolio and its strongest-performing business is loans in the aircraft sector. While the agency had traditionally supported the airliner industry, earning itself the sobriquet “the Bank of Boeing,” over the last few years it has increased its involvement in the business aviation arena. “Whereas in the past we might have done less than \$100 million a year in business aircraft and helicopter financing, I think we’ve been doing several hundred million dollars for each of the last several years,” said Robert Morin, vice president of Ex-Im’s transport division. “We’re clearly working at an elevated level.”

Ex-Im’s increased involvement in the industry stems from two convergent factors. The first was the increasing movement of aircraft purchases away from North America, which has led to deliveries in areas beyond the established lenders’ comfort zone. “I think we are probably better positioned to take certain types of cross-border risk,” said Morin. “Whereas some banks are comfortable with lending in the United States, and might be comfortable lending in the UK or Germany, once you get outside their comfort zone, in say India, Turkey or Russia, they might not even really get to looking at the underlying credit because they can’t get past the country risk.” The second factor was the global credit crisis; international sales have still not fully rebounded to pre-2009 levels. “I’m not being critical of the commercial business financing industry but it seems to be an area where the business aircraft financing industry has not kept pace with business aircraft sales.”

In the absence of traditional financing availability, Morin sees his agency’s role as that of a trailblazer, demonstrating how to do deals in that country until commercial lenders feel comfortable conducting business there, thus “graduating” that market from Ex-Im bank support.

The other countries that are home to business aircraft manufacturers have similar facilities known primarily by their acronyms. Coface in France serves Dassault, while BNDES in Brazil can provide financing for Embraer. Bombardier finds itself in a unique situation in that it can take advantage of Export Development Canada (EDC) financing for Challenger and Global sales and can refer customers to Ex-Im for financing inquiries for (Wichita-built) Learjets. So far this year, EDC has financed the sale of three Bombardier jets to Austria and one to South Korea, while Ex-Im handled the financing for a pair of Learjets to Austria, according to David Vandenberg, director of structured finance for Bombardier Business Aircraft. “I think the trend will be to use the ECAs selectively, where there isn’t a lot of [lender] appetite,” Vandenberg told AIN.

Another role for the ECAs at least as far as Morin is concerned is in ensuring fair trade. “If the Brazilian export credit agency was financing the Brazilian-manufactured Phenom 100 or 300 into a third country and Hawker Beechcraft or Cessna was competing to sell its aircraft, it would be appropriate for Ex-Im Bank to offer similar support so that the manufacturers could be competing on a level playing field, not on the basis of the financing that was being provided by their respective governments, but based upon the technical merits of the aircraft and the price that the manufacturers were willing to offer.”

In February, the member states of the Organization for Economic Cooperation and Development (OECD) approved a new Aircraft Sector Understanding (ASU) that makes several significant changes to how the ECAs can provide financing.

Under past regulations, aircraft were divided into three categories, but this new agreement has eliminated those divisions. As a result, business aircraft are now governed under the same ECA lending policies as commercial aircraft. Under the latest ASU this has resulted in an increase in the cost of rates ECAs will charge, which will make financing from the agencies slightly more expensive. “The big push came from U.S. and European airlines based in countries that don’t have access to export financing due to the home market rule,” said Jens Hennig, vice president of operations for the General Aviation Manufacturers Association. Under the rule, airlines based in the same country as Boeing or Airbus are not eligible for ECA funding for those products and would therefore have to rely solely on commercial financing. Those airlines argued that they were facing unfair competition from airlines that could take advantage of ECA funding, which resulted in the agreed exposure fee increase that now pertains to business aircraft transactions as well.

On the plus side, the agencies can now offer financing terms of up to 12 years, an increase of two years from the previous agreement.

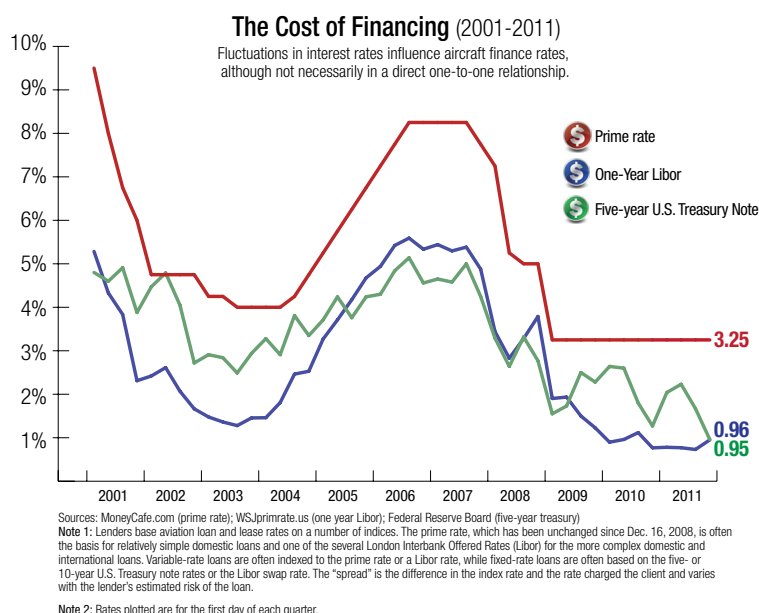
—C.E.

upside down. “We have seen some players leave the market due to losses that they sustained during the industry downturn of the past several years,” said Michael Kahmann, managing director of CIT Aerospace’s corporate aircraft division. “To date, we haven’t seen a lot of movement back into the business aircraft lending arena.”

At the GAMA press conference to announce the 2010 year-end delivery totals in February, John Rosanvallon, the organization’s current chairman and president and CEO of Dassault Falcon Jet, told the audience that 78 percent of U.S. business jet purchases in 2010 were cash transactions as opposed to financed, an increase of 13 percent over the tally for the previous year.

Many factors account for such numbers. “Borrowers are telling us that they have no place to put their money to work with a good return, so they are paying cash for their aircraft,” said Wayne Starling, senior vice president and national sales manager for PNC Aviation Finance. “Also some borrowers found that their current lender was not interested in financing their new purchase, or not at the same terms and structure as in the past.”

GAMA’s statistic evoked numerous opinions within the lending industry. “I would challenge both 2009 and 2010 percentages as too high,” said Richard Ramsden, vice president and territory manager



for Wells Fargo Equipment Finance. “My sense is that it is more of a 50-50 proposition with the knowledge that many aircraft are purchased and then later financed.”

Given the low prices on some aircraft and the increased length of time needed to arrange financing, that strategy might indeed explain the seemingly inflated number of cash transactions. “Due to the more detailed underwriting processes for most lenders, many buyers make the purchase and pay for it and then shop for the best terms,” Ramsden said, adding that such strategies could put borrowers in a strong position to negotiate favorable terms.

However, others such as Peter Bullen, senior vice president and national sales manager at Key Equipment finance, were not surprised by the overall numbers of buyers relying on cash. “The global banking industry was severely impacted during the most recent downturn, and many banks imposed more stringent lending practices,” he said. “The jet buyers who were least affected by the economic downturn were those with exceptional financial strength, and a large percentage of those companies and individuals pay cash for their jets regardless of macro- and microeconomic conditions.”

“While that stat is accurate, it is old news,” said Michael Amalfitano, managing director and executive head of Bank of America Merrill Lynch Global Corporate Aircraft Finance. “The market has returned to more traditional levels, with cash transactions [relating to both new and pre-owned aircraft] in the first six months of 2011 receding to just over 50 percent in the domestic U.S. This is another sign that capital is in the market and banks and other financial institutions are putting their capital to work.”

According to the Federal Reserve Board’s mid-year survey of senior loan officers, more than 27 percent of domestic banks reported they had eased their standards somewhat for commercial and industrial loans to large and middle market firms (those with annual sales of \$50 million or more), while none of the respondents reported any further tightening of standards. Nearly 70 percent of the survey’s respondents reported that they had “somewhat eased” the spreads of loan rates over their banks’ cost of funds.

A Tale of Two Markets

At the fall meeting of the National Aircraft Resale Association (NARA) the mood this year was one of guarded optimism. Unlike at recent meetings, which were punctuated by those complaining about the lack of available financing, at this year’s gathering attendees noted the gradual thaw. “It’s nice to see some competition; it’s nice to see competing finance proposals, because over the last two or three years you would be lucky to get one proposal,” said Paul Kirby, a partner at aircraft broker Cerretani Aviation and the association’s current chairman. “Now you are getting three or four and a buyer has the ability to choose and get a good deal. There’s pressure on rates, there’s pressure on terms because of that and it’s ultimately good for the airplane buyer.”

But that loosening of credit does not apply across the board, leading to an aircraft market many describe as bifurcated and still facing difficulties. “The older and/or smaller aircraft seem to be having problems recovering value lost in the recent downturn, whereas the newer larger aircraft have recovered,” noted Mary Schwartz, Citibank’s managing director and global head of aircraft finance. “In past downturns the two seemed to recover in tandem, although possibly the smaller and older ones slightly more slowly. This downturn is different; we are seeing little or no recovery with older and smaller aircraft, leaving us to speculate that they might never completely recover.”

For most lenders, the dividing line when it comes to aircraft age is 10 years. Some employ what has become known as the rule of 20. “The rule of 20 is basically the age of the airplane plus the amortization term,” said Kirby. “If it exceeds 20 years, unless there’s a large bank relationship, most banks will pass on it.”

“The supply of 15-plus-year-old aircraft available for sale is at an all-time high, and nobody is forecasting a marked improvement,” Key Equipment Finance’s Bullen told AIN. “From a bank’s perspective, it’s simple risk management. With few exceptions, a two-year-old aircraft is far better collateral than a twenty-year old aircraft.” That uncertainty in the loan-to-value safety equation is one of the primary concerns in the minds of lenders today.

“Across all markets, and business aircraft is no exception, during periods of turmoil and sometimes well into a recovery phase you will see a flight to [perceived] safety,” said CIT’s Kahmann. “In the business aircraft market, right now you’re seeing more money loaned on newer aircraft because that’s where lenders believe there’s more asset value ‘resilience.’”

Providing financing for those newer, larger aircraft is also more desirable from a lender’s perspective because of the perceived level of customer they attract. Those who are most interested in



When Checking the Title Is Not Enough

acquiring large-cabin, long-range aircraft (hence the most expensive types) are those whose economic muscle and financial reserves are best suited to owning them.

“To me bifurcated means ‘a tale of two cities,’” said Doug Reinartz, principle at Independent Aviation Finance Consultants and a former president of the National Aviation Finance Association. “There are the [buyers] that have cash and strength, and they are the ones that are able to qualify relatively easily for financing of pretty much whatever terms they want. If you contrast that with an individual or company that actually needs the money, the filters and requirements go up fairly substantially.”

As a result of this division between the “haves and the have nots” many lenders are choosing to deal mainly with pre-existing “high quality” clients. “To some extent, the market is split between those that can obtain financing because of their deep relationship with their financier, and those who are more challenged by virtue of their lower credit standing who may lack such a relationship,” said GE’s Labrozzi.

Further contributing to the market segmentation is the fact that some financiers today are also eyeing an aircraft price threshold. One lender said his company avoids financing smaller aircraft because it is not worth the associated transactional costs and effort, which remain the same for either a \$5 million deal or a \$45 million transaction. Under that line of thought, a newer, large-cabin aircraft financing deal would simply offer lenders “more bang for the buck.”

Such practices have seen the lending industry “vilified for returning to accepted business practices,” according to economist Brian Beaulieu, CEO of the Institute for Trend Research, and have given rise to the belief expounded in the media and elsewhere that the banks are “hoarding” cash. “Hoarding suggests that they are free to do whatever they want with that money,” Beaulieu told **AIN**. “The regulatory environment that banks find themselves in these days is onerous and therefore their hands are tied in some instances when it comes to making loans or deals.”

“Banks are sitting on lots of cash but are still gun-shy when it comes to aircraft,” said Joseph Dini, a veteran of the aircraft finance industry and president of Air Credit Alliance. “This has happened three times in the last thirty years.” According to Dini, lenders already concerned with volatile aircraft loan-to-value propositions are still cautious over fears of a “double-dip” recession. “If a bank has maintained cash it will be able to survive without having to recapitalize, have fewer loans outstanding to go bad and maintain a moderate level of profitability.”

Most of the financial industry sources for this year’s report said their institutions are still lending to “good” customers, and some believe there is more than enough funding available to meet present demand from credit-worthy customers.

But defining those who are credit-worthy has now taken on new importance for the lenders who have stayed in the market through the recent downturn, and have learned the important and sometimes painful lesson that collateral is not a substitute for credit. Lenders are now concerned more than ever with the financial ability of their clients to perform over the life of the loan. “A lot of due diligence information is required in today’s marketplace compared with what we used to see two or three years ago,” said Keith Swirsky, president of GKG Law’s aviation and tax groups. “Lenders now go through a comprehensive due diligence process and there are a lot of things that they ask for.” As a result of that increased financial scrutiny, the days of the one-week loan approval have gone the way of the dinosaur.

Industry-wide, loan terms remain varied. One-hundred-percent financing, quite common during the industry peak just a few years ago, is now in most cases reserved for the stratosphere of the wealthiest individuals or top-tier corporations, who have pre-existing

One often overlooked byproduct of distressed aircraft markets could be unpaid bills remaining on the aircraft, because those debts could come back to haunt future owners. Obtaining a title insurance policy could be a way for buyer and lender to buffer themselves against some of those outstanding debts, many of which won’t show up in a standard search of the FAA records.

In the current economic climate, federal as well as state budgets are becoming more strained, and governments are increasingly diligent about collecting taxes and pursuing those who have not satisfied their obligations. Tracey Cheek, vice president of Oklahoma City-based Aircraft Title Insurance Agency, has noted a rise in the number of clients who are concerned that a seller has not paid all of the taxes on an aircraft. “Federal tax liens are not filed at the FAA. They are good for 10 years and renewable for another 10, and can be filed only in the local records of the debtor’s residence or principal place of business, so they can therefore exist without being of record at the FAA,” she said. Further clouding the issue is the fact that the delinquency problem might not even be with the most recent owner, but with an owner before that, Cheek noted.

Personal property tax liens are also becoming an issue. They are controlled by applicable state law and are also not filed at the FAA. In some instances, liens are not “filed” at all. They can arise on January 1 of each year, are assessed in October of that year, and attach based on where the aircraft is “primarily hangared” on January 1 of the applicable year. The hangar address may not be the same as the address of the registered owner on file with the FAA. “The only way to know where the aircraft is hangared is to ask the seller. I don’t think many people are in the habit of doing that,” Cheek told **AIN**.

Though repossessions are not as much of an issue as they were in the last couple of years, they have certainly not disappeared entirely. Since 2008, more than 400 business jets and turboprops have been repossessed, according to statistics from industry data tracker Jetnet, leaving some aircraft with less than “safe” titles.

Many of those previous aircraft owners found themselves in financial distress long before the lenders reclaimed the aircraft. Generally when an aircraft is repossessed, the bank is not the only entity the previous owner had not been paying, so it is not always readily apparent who might claim an interest in the aircraft.

While buyers would undoubtedly prefer a “clear title,” that is not always a possibility. Some liens are released when an aircraft is repossessed or sold, while some might linger along its chain of title, even through multiple previous owners. “Junior lien claimants who feel they are still owed money aren’t always happy to cooperate with anyone and typically refuse to sign a release of their interest,” said Cheek.

Deceased individuals or dissolved entities can also wreak havoc on a title and trying to track down heirs of an estate or officers of defunct corporation can be a challenge.

Title searches, legal opinions, escrow agents and transaction attorneys all remain an accepted part of the closing process, but unfortunately title reports can reveal only what is on record at the FAA. “A title insurance policy is designed to protect a buyer or lender against what is not [on record at the FAA],” said Cheek.

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relationships with the lender. As the borrower's credit level decreases from those peaks, the amount of down payment or "skin in the game" lenders request increases.

Lenders' responses to **AIN** inquiries suggest that down payments now range from 15 to as much as 40 percent, while the amortizations span from seven years to 20 and even 25 at the extreme range of the spectrum. "If financiers are doing it right, they have a clearly defined business jet finance strategy and they're offering tailored financing solutions on a case-by-case basis," Key Equipment Finance's Bullen told **AIN**. The credit spreads associated with the transaction are viewed as a function of perceived credit risk, he noted, with current market pricing ranging from less than 4 percent to more than 10 percent.

"Spreads have continued to compress over the last 18 months as the financial markets have rebounded and corporate balance sheets and earnings have strengthened," said Donald Synborski, managing director of RBS Asset Finance. "The spreads reflect the competitive nature of the current marketplace."

One aspect of the credit crisis, according to some, is that it has flushed the marginal aircraft buyer/operator—those who would normally seek financing for a smaller, older aircraft—out of the market. The declining used aircraft inventory (which recently reached a three-year low) suggests that those aircraft are selling, but the majority of transactions seem to be all-cash purchases.

The View from Abroad

Given the change in aircraft delivery demographics over the past several years, the international market has taken on ever increasing importance. In last year's GAMA aircraft delivery totals just over 42 percent of the business jets delivered went to North America, while more than 56 percent of turboprops were delivered to Europe, Asia, Latin America, the Middle East and Africa. "About three quarters of our new orders this year are coming from international buyers," said Dassault Falcon's Rosanvallon. "The financing involvement in these territories outside the U.S. is a different picture."

While funding for aircraft in North America seems to be loosening somewhat, the international situation remains restricted despite the number of aircraft deliveries. "Outside the U.S. it's getting tougher and tougher," said Kirsten Bartok, vice president of global aircraft finance at Hawker Beechcraft. "I'd say [with] the tightening in Europe we're even going to see a more difficult period. If you are in one of those markets where most of the growth is, it's extremely difficult to find financing in those markets."

The effects of the tentative resolution to the European debt crisis had not been felt as this issue went to press, and those familiar with the European financial market don't expect an immediate turnaround if and when an actual compromise is reached. "My view is that over the last year it's been fairly flat," said Mark Wooler, head of corporate consultancy services at the UK-based International Bureau of Aviation. "I think people are looking a little more cautiously now in as much as the financial environment is going to remain pretty much as it is for the next few years." As a result of the financial belt tightening, lending practices have changed, according

to Wooler. "The pure piece of transactional business that perhaps would have been done five years ago—you just don't see that now," he said. "There is either an existing relationship or a transactional relationship that comes attached with any financing that is being provided."

The Great Wall of Finance

At NBAA's annual meeting and convention in Las Vegas in October, all eyes were focused on the promise of China as the key to an industry turnaround. Among the few major aircraft transactions announced at the show, two were by Minsheng Financial Leasing, which signed two deals for 33 business jets worth more than \$1 billion. The private Chinese bank ordered 13 Embraer Legacy 650s worth approximately \$400 million and signed a memorandum of understanding with Dassault for 10 Falcon 7Xs and 10 Falcon 2000Ss, as a follow on to previous orders for five 7Xs and a Falcon 900LX.

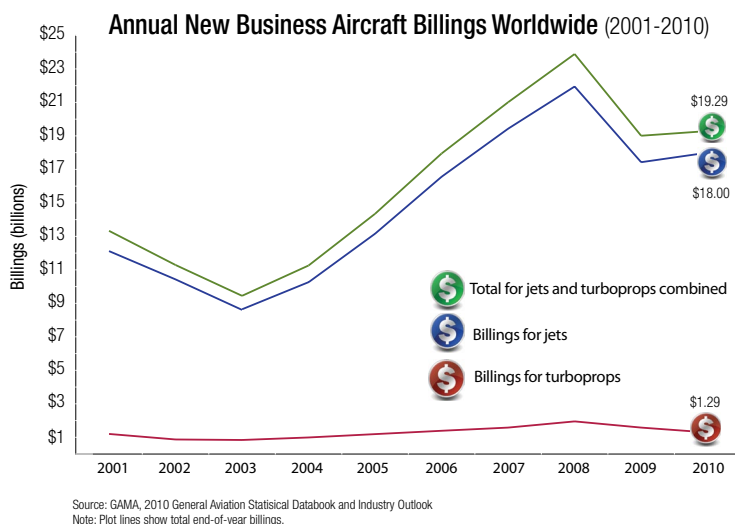
"We have indicated—and I think it's basically the same for other OEMs—that China will be our number-one market this year," said Dassault Falcon's Rosanvallon. "China in itself is another environ-

ment as far as financing goes, and few of the western financial institutions are ready yet to finance a mainland China-registered airplane." Dassault expects to sell 25 bizjets in the country this year and some 10-year industry predictions see a market for approximately 1,000 private jets in China by the end of the decade. Given those prognostications, the demand for financing in the area is a near-certainty and despite the difficulties that remain in dealing with the Chinese regulations, many lenders are eying that market hungrily.

Guggenheim Partners, which

has returned to the aircraft finance sector after several years of restructuring a former joint-venture business, recently named former Gulfstream president Bryan Moss chairman of its business aircraft investment division. The privately held global financial services firm has set its sights firmly on high-end aircraft in the international market and since its return less than a year ago has tallied more than \$300 million in fundings and committed opportunities for its limited recourse financing product. "We are in full-blown exploratory mode with mainland China," said Jim Crowley, Guggenheim's managing director. "It's too early to determine what the ongoing model will be, but I think there will be appropriate transactional opportunity there for the right lender with the right connections."

In the case of Minsheng, the private bank—which has already signed for 90 bizjets—is planning to resell or lease the aircraft domestically in a package with financing and other services, including management program registration. While the finance market in China may lack the sophistication of that of North America and Western Europe, the basics are already in place. "Boeing did us all a large favor by going into the market early," said Hawker Beechcraft's Bartok. "Boeing was smart enough to go into China about 10 years ago and start working with all the big banks, trying to teach them how to do aircraft financing, so what you've got now is a group of highly educated commercial financiers." Other Chinese private and state-owned banks are preparing to enter the space as well. □



[Click chart to enlarge](#)



Industry Analysts: Recovery Coming More Slowly than Expected

When the recovery of the business aviation market will occur is the key question facing the industry today. Prompted by continuing worldwide economic volatility, several prominent industry prognosticators recently moved their forecasts for a strong recovery farther into the future. We asked our panel of aviation finance experts how they see the business aviation market developing over the next year, and what factors will affect new and used aircraft sales.

Allen Qualey,
1st Source Bank

"Given the current administration's disdain for general aviation, it's difficult in the U.S. to see reasons for optimism. The trend toward an increasingly vibrant world market will slowly manifest itself, but expecting discernible progress in 2012 with new units might be a little too optimistic. We definitely expect to see meaningful improvement in both the supply and sales of used aircraft. The eventual elimination of the fear of a double-dip [recession] could likely be the catalyst. The potential elimination of bonus depreciation in the U.S. could have a substantial negative impact on new airplanes, which could also help used aircraft sales."

Peter Bullen,
Key Equipment Finance

"I hope to see slow and steady improvement in the marketplace, which will depend on a stabilizing economy and a favorable or neutral political climate."

Donald Synborski,
RBS Asset Finance

"The economy is the primary driver, followed by tax policy, accounting changes and market perception. All have been difficult to read in the last four months, so my view is that 2012 will look a lot like 2011. Economic volatility and the uncertainty on the tax and accounting side seem to be setting us up for another roller coaster year."

Richard Ramsden,
Wells Fargo Equipment Finance

"Aircraft older than 10 years will likely have slow to no recovery in values or trading activity. Newer aircraft will attain the below-10-percent-for-sale benchmark by early 2012. New deliveries will track to the economy and the stock market and will show slow growth through 2012."

Robert Kent,
Scope Aircraft Finance

"I believe the market will improve if the inventory continues to come down. However, I do not think older equipment will recover in value. The overall health of the economy is the only variable that matters."

David Labrozzi,
GE Capital

"A close correlation exists between corporate profits and new aircraft sales. There is an equally close correlation between the Dow Jones Industrial Average and sales of new-production jet aircraft. Assuming that corporations continue to report strong profits, and that the market does not suffer long-term deterioration, one can reasonably assume that new aircraft sales will increase. As most new aircraft clients are existing aircraft operators, they will need to sell their existing aircraft before acquiring their new one, which has a trickle-down effect. Used aircraft transactions have generally been on the rise and values have firmed up. There are numerous domestic and international, political and economic issues that could disrupt the fragile recovery. So while we do not expect a quick fix to the industry's challenges, these recent statistics are encouraging signs for 2012."

Michael Amalfitano,
Bank of America Merrill Lynch

"The market for both [new and pre-owned aircraft] remains in a slow recovery. It will not get ahead of the economy, which remains challenged globally. The factor that needs to be considered is consumer confidence: confidence in the financial markets, confidence in the economy, confidence in political and geopolitical arenas. Once we see confidence return, then the traditional factors related to corporate and personal wealth, GDP and pre-owned inventory will help shape the future of the industry."

Michael Kahmann,
CIT Aerospace

"I read the same statistics that indicate used aircraft values are stabilizing in a way that is consistent with a slowly decreasing level of used inventory. It's been a slow but steady process, and we certainly believe that there's more upside than downside to used aircraft values. On new aircraft, we would likewise think that there's pent-up demand, a normal replacement cycle, and generally positive corporate earnings trends that all have historically resulted in positive orders momentum. So longer term, we are positive on the industry trends for both new and used aircraft."

Joseph Dini,
Air Credit Alliance

"It all comes down to price. If one were to do the math, for example, an up-to-date aircraft that sold in 2001 for \$1 million should be selling today for around \$550,000. The problem was that aircraft got as high as \$1.3 million in the bubble and those sellers who bought at that level are now looking at a significant write down. Those sellers who bought in 2001 would be happy with the current values. Used prices always decline over time; it just depends on when one got on the roller coaster as to how much the decline is. Until the inventory of late-model used aircraft shrinks, new aircraft orders will suffer."

Doug Reinartz,
Independent Aviation Finance Consultants

"I think the usual factors will drive behavior: expanding products and services across longer and longer distances; the economic realities of differing global regions; and the need to get people face to face to drive business forward." —C.E.



Market Turmoil, Zealous Regulations Hamper Economic Recovery

Dr. James West, professor and chairman of the Department of Economics and Business at Moravian College in Bethlehem, Pa., talks with [R. Randall Padfield](#), AIN's editor-in-chief about the global economy and what individual investors can do to ride out the financial uncertainties.

I've read that the housing crisis in 2007 and financial meltdown in 2008 were really symptoms of a much larger problem, namely over-borrowing by individuals, companies, banks and governments in a climate of too much easy credit. This is becoming more evident with the events now happening in Europe. Is this correct?

The increases in globalization and technological innovation in the decades after 1990 have been phenomenal. More recently, the emergence of wealth in the Bric (Brazil, Russia, India and China) and other economies and innovations in computer technology, especially wireless communications, have created optimism, rising expectations and the demand for safety and liquidity for financial assets. Easy credit was the order of the day.

On the one hand, the proliferation of mortgage-generated money creation in the U.S. banking system was in response to the demand for a safe, liquid asset (i.e. the U.S. dollar) by newly rich Brickers and others, who viewed the dollar as "good as gold." It proved not to be.

On the other hand, the motivation for the debt/money creation lies in the desire to fulfill the rising expectations of governments, businesses and households, who were offered easy credit along with the complicit encouragement of government legislation and subsidies.

In the U.S., the credit boom lay in the desire to

own and prosper from an inflating real estate market—until the American Housing Dream bubble burst.

Across the Atlantic, where the "European Dream" is more about government entitlements and cradle-to-grave security, fiscal mismanagement led to widening debt-to-Gross Domestic Product ratios of up to 160 percent. This would be bad enough if these countries were running their own monetary affairs. Sadly, their union is based on a currency—the euro—where their interdependence threatens the continental banking system in much the same way as the mortgage crisis threatened the banking system in the U.S.

Other countries, especially China, while seemingly on a winning streak, face a reckoning of a two-decade profligate and unrealistic lending/borrowing boom.

Easy money and lax credit standards now require the write-down of a huge volume of nonperforming assets, leading to a recapitalization through shrinkage of European banks. This happened to U.S. banks after the crash of the mortgage market. The result is recession.

Economic prosperity has ever been fueled by dreams and underwritten by risk-taking capital. Steve Jobs and Silicon Valley entrepreneurs had bold dreams and equally bold financiers. Many of the dreams of the recent credit boom were more like fantasies, delusions and even frauds. Their underwriting was undertaken not ultimately by the daring financiers,

but by unwitting and now disillusioned taxpayers.

This awakened reality in the U.S., Europe and elsewhere has generated a cautionary business sector, a chastened and diminished banking sector and a zealous regulatory response that will continue to slow economic recovery.

How do you think the global economy will be affected by the austerity measures that must be imposed in some European countries, such as Greece, Italy and Spain? Will the euro survive?

The austerity measures will be seen as an assault on the social contract of post-WWII European states. Yet this is inevitable.

There is a theoretical framework that describes the needed conditions of an "optimal currency area." From the early days of the European Union, the mismatch of the northern economic structure and the behavior of the southern states (Greece, Italy and Spain) along with Ireland and Portugal led many to believe that the EU was not such an optimal area. That would now seem to be the proven fact.

The collapse of the euro and the expulsion of Greece, or other countries, is a minority view among economists and policy makers. It is argued that in the end, the tepid and vacillating northern Europe countries, having faced the precipice of collapse, will seize the moment and do that which members of a federation of states are committed to doing, e.g. rescue their fellows.



Dr. Jim West

Failure to do so will be costly all the way around, but the collapse of the euro as currently construed is, in my opinion, the most likely outcome of a desirable, but overly ambitious, federation that failed from the beginning to monitor the fiscal behavior of its member states.

What should Joe the Investor do now?

The signals driving investor forecasts are less about management competitiveness or the usual monetary, fiscal and trade statistics. The driving forces are instead almost existential jolts that drive frenzied swings in market indices.

Paralysis of governments in the U.S., China and especially Europe, along with the lashing out at the capitalist system by the Wall Street Occupiers, shows that fundamental change is eroding market stability. While careful valuation of individual securities will bring Joe continued success in equity markets, the erratic swings of systemic risk will make for a volatile ride.

Bonds are no safe haven in volatile times, and short of going with the doomsayers' move to guns and gold, I would recommend Joe stay in his diversified equity portfolio, and close his eyes if the ride gets too wild. ■