JOHN T. LEWIS

Sometimes, ‘fair market value’ isn’t so fair

Quick READ

- Sometimes the promises made at the purchase of a share don’t pan out.
- Despite a rebound in preowned aircraft prices, share values have yet to follow the trend.
- The hours a fractional airplane flies make it a different animal on the used jet market.
- Sometimes, but not always, an appraisal or two is the answer, though it can cost a lot.

Over the past couple of years, my consulting firm has heard from and helped many fractional aircraft owners. They’re troubled. And they’re wondering, “Can my share have gone down in value as much as my provider claims?” Along the same lines, we’ve heard comments like:

- “The salesman promised me the share would be worth at least 75 percent of what I paid for it.” (But when we asked whether his contract spells out that promise, the owner grumbled, “No.”)
- “I told them I’d buy the whole plane based on the value they’re offering me for my share, but they wouldn’t let me.”
- “They’re offering the same share on their Web site for much more than they’re offering me. How can they do that?”

Owners consistently bemoan the losses they face–in some cases, as much as 60 percent. Although the market in pre-owned aircraft certainly took a tumble from 2001 through 2003, increasingly it has stabilized and, in some areas, it has even begun to rebound. Yet for many fractional owners, the repurchase prices offered by fractional providers still reflect a substantial loss in value.

Faced with this loss, every owner wants to know the same thing: “What can I do?”

The answer is, “Plenty.”

First things first. Look at your purchase agreement. It gives you the right to sell your share back to the provider, both during and at the end of the contract. The amount you receive is supposed to equal the “fair market value” of your aircraft divided by the size of your share, less a “remarketing” fee that may range from 5 to 12 percent.

Sounds simple enough. But how do you figure out what “fair market value” means and how do you apply that to your particular case? Again, look to your purchase agreement for guidance. However, unless you negotiated some specifics on this point, you’re stuck with the standard boilerplate, which probably doesn’t include a definition of “fair market value.”

In law school, they told us fair market value is “the amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having knowledge of the relevant facts.”

If that’s the rule, how does it apply to your share? You might think it is enough to look at comparable sales. Indeed, you’ll find that, just as with automobiles, there’s a “blue book” for aircraft, which your provider will tell you it has used as the basis for determining the value of your share.

But simply looking at sale prices for the same model aircraft probably won’t tell you the whole story. For example, these numbers won’t reveal how long the other aircraft were on the market, how many hours were on their airframes, whether they had the latest avionics or whether their interiors had been refurbished recently. In short, they won’t tell you whether these sales are in fact comparable, or whether other recent sales may be more indicative of your aircraft’s fair market value.

Beyond unpacking these sales to see whether they’re truly comparable, there are many aspects of your share investment that impact its value and that may not be taken into account in the provider’s calculation. Here are a few:

- You bought your share at a premium over the actual proportionate selling price of the aircraft paid by the fractional provider because it probably received a discount by buying several aircraft.
- Your airplane has been maintained to the highest industry standards and your management fee covers a maintenance program that will fund overhaul of the aircraft’s engines.

James D. Butler is an attorney and chief executive officer of Shaircraft Solutions LLC (www.shaircraft.com), an air-travel consulting firm based in Bethesda, Md.

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- While an aircraft like yours that's not in a fractional program typically may be flown 400 hours per year, yours may have been flown as much as 1,200 hours annually. With the advent of so-called jet cards, the provider may have been paid for many of these flights outside the fractional program, but hasn't shared that compensation with you, despite putting more hours on your aircraft.
- The fractional company may own so many aircraft of your model that it can have a defining impact on the resale market. For example, if 50 Beechjet 400A aircraft will be sold this year and your provider will sell 25 of them, it has an unusual ability to affect the market price for that aircraft. (Indeed, if it is selling the aircraft in bulk, that likely will lower the price of each aircraft).

So, what can you do if you're concerned that the provider's valuation doesn't take into account all the relevant factors and that its offer therefore may be too low? Again, it's back to your purchase agreement. It most likely states that if you don't agree with the provider's assessment, you have the right to have the aircraft appraised by an independent third party mutually agreed upon by you and the provider.

The provider will be happy to suggest appraisers, but you weren't born yesterday, so you won't want to use an appraiser chosen by the provider. Chances are, your provider won't want to use an appraiser you find, either.

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In that case, your purchase agreement probably says that you and the provider should both select appraisers and that they should try to agree on the fair market value. If the two appraisers can't come to terms, which is often the case, they are directed to appoint a third appraiser; the three of them then work it out. With appraisals costing $2,000 to $5,000 each, this can get expensive.

Owners often ask us, "Is it worth it for me to go through this process?" We approach that question by considering the size of both your share and the aircraft. The larger the share and the bigger the aircraft, the more likely it is that it will be worth your while to contest the provider's valuation. Next, without doing a full appraisal, we attempt to ascertain a ballpark value for the aircraft, again to get a rough sense of whether it's likely that we can add sufficient value through this process.

On more than a few occasions, we've told owners that the potential reward may not be worth the cost. In other cases, we've achieved significantly higher valuations by making the most of the owner's contractual rights and by using appraisers who understand all the aspects that make fractional aircraft unique. ❑

Get It In Writing

The best way to avoid resale problems down the road is to anticipate them in your contract. If you're buying or renewing a fractional share, have your attorney look closely at the contract provisions relating to resale. Some points to consider:

- To make sure the valuation process doesn't drag on, the contract should specify deadlines for completing each part of the process, including appointing of appraisers, completing of appraisals and funding the sale after the purchase price is determined.
- The contract should require that all appraisers be truly independent. Consider limiting the number of appraisals a single appraiser may do for the provider and still be considered independent.
- The contract should provide guidance as to what "fair market value" means.
- The contract should require that the provider supply you with documentation justifying its valuation.

Fractional providers may balk at some of these suggestions, but they shouldn't. As more and more private air travelers look to investments like jet-card programs in order to avoid back-end valuation surprises, fairer and more predictable resale prices will become essential to the long-term viability of the fractional industry.

Remember, while management fees and hourly rates are relatively easy to project, the only way to truly estimate the cost of a fractional investment is to include the difference between what you pay for your share and what you receive when you resell it. While this cost comes to you at the end of your investment, it's something you should seriously think about at the beginning. ■