

The Private Flyer

Private Jet Industry Whitepaper

Valuable Information For Extremely Valuable People!

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Fractional Ownership—The Third Grade Math!

First things first – there is no ownership involved in fractional ownership. Fractional “owners” are actually tenants in common of an airplane owned by the fractional company (very similar to a lease). OK, I will concede that there is some technical ownership on paper in the form of a deed where the fractional company declares that some fraction (e.g. 1/16) of the plane is owned by the customer (it’s nice to hang on the wall) ... that’s where the rosy ownership story ends.

The reason it is actually a “lease” and not really “ownership” is that the fractional program **forces** a buy back of the airplane after a fixed period of time (2 years, 3 years or 5 years). If you were truly an owner, a voting majority of owners would make the decision when/if the plane needed to be sold. If you were truly an owner, you might actually fly in the plane which you own (many fractional owners never actually step foot in the actual plane with the actual tail number they “own.”) If you were truly an owner, you would never get “shut out” of your own plane like happens to most on busy holidays.

With all of this in mind, the term “Fractional Ownership” (as currently implemented by fractional ownership companies) with respect to private aviation was actually devised to fool the buyer into thinking that they are an owner – after all, it is really cool to say that you are part owner of a jet (see The Private Flier Issue #1). It just wouldn’t have the same effect to say – I am a fractional tenant, or I own part of an aircraft lease – those sound more like financial burdens than something modern and hip.

Private jet travel is not a commoditized product similar to commercial jet travel. There is no competitive search engine to find the best price to charter a plane from any location to any other location – it just doesn’t exist. As such, many private travelers feel that the cheapest way to achieve their travel needs is to actually own the plane itself. Thus, the concept of fractional ownership seems appealing ... on the surface.

Now that we know all of this, the important question still remains - Do Fractional Ownerships offer a strong value proposition when compared to other methods of private aviation? The overwhelming answer is No. The rest of this whitepaper details exactly the reasons why.

There are many different fractional programs in the marketplace – and the sales teams and sales presentations for each of these programs are really, really good (thus steering you towards what they want you to see and away from what they don’t want you to see). In addition, within the fractional companies, there are many different programs and programs within programs. In addition, these programs within programs are often specific to certain types of planes and not applicable on other types of planes. On top of this are the MASSIVE complexities in tax law on whether the plane is eligible for depreciation and which type of depreciation and how personal time is allocated vs. time for business use – and even which type of business use.

By Rick Klev, Private Aviation Expert

When I started writing this whitepaper, I was just going to sit down and type out the various arguments about actual cost per hour of flight time with respect to fractional ownership vs. using a jet charter broker. What I didn't realize was how complex the calculations would need to be given the complexity of the fractional programs. In fact, the calculations and considerations are so complex, that I am absolutely certain that most customers do not in fact actually ever walk through all of the calculations and ramifications. (This leads us to another whitepaper coming soon called "Fractional Decision Factors" where I will explain the thought process which actually goes on when a fractional customer is making the decision.)

For the purposes of this particular issue of The Private Flier, we will focus on the mathematics behind fractional ownership and whether that math proves out a strong value proposition or a weak value proposition.

"Fractional ownership" requires you to pay up front the portion of the asset you are allocating for your own usage. In many fractional programs, the minimum fraction you can purchase is 1/16. Thus, you have to lay out up front all of that money for your share of ownership. Unlike real estate however, this asset is going to depreciate and become old very quickly. Fractional program commitments typically range from 2 years to 5 years. Thus, the ownership outlay you are paying isn't in perpetuity – just for the program duration. The fractional ownership program will then force re-purchase the asset from you at current market value minus remarketing charges. If you want to continue your program, the fractional company will make you sign new agreements and buy back in at the current market rate of whatever the new jet costs. Your particular jet will decrease in value over the period of the commitment significantly, thus you will lose a substantial amount of money on that financial outlay. There's a very big gotcha to this as well. Let's say you own a 1/16 share of the entire plane (about 50 hours a year). If you only flew on the plane for 50 hours a year (250 hours over 5 years) and no one else flew on the plane, that plane would depreciate at a certain relatively reasonable predictable rate. Unfortunately, the plane will actually depreciate at a rate of (250 hours x 16 = 4000 hours) which will yield a MUCH higher amount of depreciation of the asset than your individual share (What I have quoted here is the best case scenario – in most cases, the airplane is flown 2000 hours annually – 10000 hours over 5 years – in this case, the airplane is relatively worthless in comparison with it's original purchase price). Thus, when the fractional program operator "buys your interest back from you", they are buying it back at a massively depreciated value – thus, increasing your per hour average rate significantly.

Authors Note: I have been in this industry for quite some time and I always inherently knew that fractional ownership programs didn't offer a strong customer value proposition. It wasn't until I actually sat down and crunched these numbers that I can now prove it. Let's begin.

Conservative Analysis Assumptions:

- For the purposes of this analysis, I am using the published 2008 rates from the largest and most popular fractional program.
- We will only analyze the lowest cost program aircraft as defined within the fractional ownership company referenced above – a Hawker 400XP.
- We will only look at published costs for the 50 hour investment fractional ownership program – a.k.a. 1/16 share.
- The costs as published for the 50 hour program are an initial outlay of \$416,625 with a monthly \$7469 maintenance and an additional hourly charge of \$1,786
- Conservative Interest Rate of Cash In Bank = 5% (very low assumption)
- We will only calculate lost interest value based on the one time purchase outlay cost as it is likely that the corporate flyer would be paying transactional costs anyway.
- We will conservatively compound interest only 1 time annually.
- For the purposes of this study, we will make a ridiculously conservative assumption that the monthly fees and hourly surcharges will not increase over any of the study's time periods (even though most fractional contracts definitely have annual escalations).

“... when the fractional program operator “buys your interest back from you”, they are buying it back at a massively depreciated value – thus, increasing your per hour average rate significantly.”

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- It is difficult to estimate an airplane's depreciation however we will safely and conservatively assume a 50% depreciation of the airplane over 5 years. The 1/16 share is based on an annual flight hour basis of 800 hours. Actually, the plane is more likely to fly 2000 hours – over 5 years, that's 10,000 hours of actual flight time for which the plane will depreciate – 50% is a very generous conservative assumption – it is more likely to depreciate closer to 75% or 80%.

5 Year Analysis

- 5 Years x 12 Months = 60 Months
- 50 Hours x 5 Years = 250 Hours of Usage over 5 Years
- 50% depreciation assumption yields total outlay cost of \$208,312.50
- $\$208,312.50 / 250 \text{ Hours} = \833.25 per hour
- $\$7469 / \text{month} \times 60 \text{ Months} = \$448,140 \rightarrow \$448,140 / 250 = \1792.56 per hour
- \$1786 / Hour (already documented)
- Compound Interest on \$416,625 applied 1 time annually over 5 years at 5% yields \$531,730.81 which represents \$115,105.81 in lost capital $\rightarrow \$115,105.81 / 250 = \460.42 per hour .
- **Therefore (with extremely conservative assumptions), the lowest REAL hourly rate for the most popular Fractional Ownership company on the lowest cost aircraft in the lowest cost program when realizing the cost over 5 years is $\$833.25 + \$1792.56 + \$1786.00 + \$460.42 = \$4872.23 / \text{hour}$**

“The all inclusive hourly price for a fractional ownership program is around \$4800 per hour on the lowest cost jet that they have.”

Reality Check

- The people who read this definitely get more than 5% interest annually on their money.
- Hourly surcharges (especially those relating to fuel) are definitely going to go up significantly.
- Taxes and other fees are definitely going to go up significantly. The monthly maintenance is going to go up.
- Price increases are in the immediate easily predictable future.

What have we learned?

- The all inclusive hourly price for a fractional ownership program is around \$4800 per hour on the smallest cheapest jet that they have.
- Any good reputable fair jet charter broker can get you a cheaper rate on this type of jet (or any other jet) no matter where and when it is flying (RaynAir and other charter companies can easily get that particular plane for around \$3300/hour (usually less) – and you don't need to give RaynAir or other charter companies \$416,625 for the privilege – and RaynAir can get you the plane anytime you need it wherever you need it).
- You are much better off investing your outlay in hyper-conservative financial instruments than a fractional ownership program.

Other VERY Important Factors

- **Strike 1** - There are other “soft” charges which come into play when purchasing a fractional ownership program including the cost of managing the paperwork, interpreting the fractional bills (which are extraordinarily complex) and the significant increase in accounting costs involved in trying to figure out how the aircraft depreciates and how to allocate expenses to corporate vs. personal.

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“Any jet charter broker can easily beat the fractional ownership rates, jet charter brokers will always be able to get customers’ a plane when they want where they want it, the customer doesn’t have to tie up all their money and pay large monthly fees ...”

- **Strike 2** - Getting into a fractional program will require a significant investment by the buyer to retain a law firm or lawyer who is knowledgeable in aircraft transactions. Reviewing the legal language for fractional ownership contracts is extremely important and it is equally important to retain a legal expert who is well versed in these types of contracts.
- **Strike 3** - “Fractional Ownership” is a balance sheet item which forces depreciation calculations over multiple years (most companies I know would rather take the complete write-off in the first year). Jet chartering on a transactional basis is a P&L item which hits the books as the expense is incurred – which instantly makes the complete expense a write-off as it happens.
- **Strike 4** - There is a 1/10 hour loss factor for taxi time and fuel burn which is always incremented into the hourly burn rate – Thus a 5 hour flight will yield a 5.2 hour burn off. The analysis listed above does NOT include this significant factor (so the numbers are even worse!)
- **Strike 5** - Many fractional programs don’t calculate flight time by the minute – but they round up – thus a 40 minute flight is 1 hour. Depending on the typical flight utilized, these losses can be very significant. Some articles I have read outline that the total flight hour loss caused by round up can exceed 20% - thus losing about 10 hours off of that 50 hours actually yields 40 hours. The analysis listed above does NOT include this significant factor either (so the numbers continue to get worse!)
- **Strike 6, 7, 8, 9,10,11,12 and 13** - This analysis does not include outside Primary Service Area (PSA) charges, international ferry charges, fees for mandatory custom stops, relief crew positioning costs, mandatory sales commission incurred at contract termination (sometimes as high as 7%), additional fuel surcharges or wait charges.

Wrap-Up

Without any of the easily predictable price increases, **the numbers as laid out today just don’t tell a story where there is any compelling reason whatsoever to lay out such an exorbitant sum of money.** Any jet charter broker can easily beat the fractional ownership rates, jet charter brokers will always be able to get customers’ a plane when they want where they want it, the customer doesn’t have to tie up all their money and pay large monthly fees (even when not flying) and the corporate write-offs happen transactionally as they occur rather than requiring complex accounting. If you are still compelled to get a fractional program, I only have two pieces of advice: 1) Bring your private aviation knowledgeable lawyer with you – ALL OF THE CONTRACT ELEMENTS ARE FULLY NEGOTIABLE – NEGOTIATE WISELY! 2) Manage your hours wisely. If you see a mistake on your statement, fight back – it is in the fractional company’s advantage to burn your hours as quickly as possible – and they will do everything they can to burn them.

Fractional Ownership Direct Feedback – You have spoken

This is a really fun part of the whitepaper where I am sharing consolidated views of many fractional customers. I am a jet charter broker. As such, I speak with thousands of people who are operators, customers, fractional owners, jet manufacturers, etc. etc. Because I speak with so many different people involved in various aspects of private aviation including suppliers, customers and manufacturers, I act as a consolidation point for a lot of different information. This is the type of information which others just wouldn’t know as they don’t talk to as many people as I do. With respect to fractional ownership, here is what **HUNDREDS** of current fractional owners have told me.

- Fractional invoices and statements are so complex, you need accountants and lawyers to review each bill to verify legality with respect to the original contract, overall fairness and overall value (basically, you feel like you are being taken advantage of).

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“At least 1 out of every 10 people ... will absolutely not renew their fractional ownership program.”

- There are different fractional owner bands – Primary and Secondary. Primary owners get their jets when they want. Secondary owners (those with small ownership quantities) are second class citizens and only get the leftovers. I can't tell you how many people have told me that they just can't get a plane on Presidents Day. Many of the secondary owners actually have to go out and charter a plan on Presidents Day (hmmm, when I look back at my own records, I do book a lot of trips on Presidents Day now I know why!)
- At least 1 out of every 10 people I have spoken to says that they will absolutely not renew their fractional ownership program. 5 out of every 10 people say they will aggressively renegotiate terms if they renew and the other 4 out of 10 just pay the bill and don't care.

Conclusion

The hardcore truth is this: *when it comes to fractional ownership programs, the third grade math just doesn't add up.*

About RaynAir Private Jets

We are a small jet charter brokerage, headquartered in New York, serving clients all-over the world. We strive to educate our customers on their options for private jet charter. We hope to earn your trust and serve you by consistently finding you the very best value in private jet service. While there are many good and reputable brokers out there, we hope you will choose us. We offer friendly customer service, reasonable quote turn-around times and reasonable brokerage fees. We believe we are the answer for most private flyers. Please allow us the opportunity to meet your private flying needs; we will work hard to save you valuable time and money.

If you have feedback or questions regarding any of the content contained within this document or any document within the RaynAir Educational Series, please contact rick.klev@raynairjets.com

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