REGULATORY IMPACTS ON HELICOPTER FINANCING

LEASING

By Sharon Desfor, ASA

“One of my great ambitions before I die is to fly in an aircraft that is on an airline’s balance sheet.”

– Sir David Tweedie at the Empire Club of Canada, 25 April 2008

With that statement, Sir David Tweedie changed the world. For nearly a decade, the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) labored to create a new set of accounting standards governing leases. In the first quarter of this year, FASB finally released Topic 842 on leases, and IASB released IFRS 16 on leases. Let’s not rewrite the hundreds of pages that have already been written about the new standards, but do note that you can find some of the best information at www.elfaonline.org/Issues/Accounting/. (Look especially for articles by Bill Bosco, who has very clear explanations.) The major takeaway is that now leases have to appear on corporate balance sheets.

Why Is This Important To Helicopters?

While it’s a truism that the oil industry drives the helicopter industry, it’s seldom mentioned—but just as true—that the availability of capital equally drives the helicopter industry.

Consolidation in the aircraft leasing business affected liquidity by reducing competition. In the past two decades, GE Capital Corporation (GECC) bought either the entire business or the aircraft portfolios of Boeing Capital, Debis Financial, CIT Group, Merrill Lynch, and CitiCapital. To counter that contraction, Bank of America and Wachovia entered the helicopter finance market. Chase/JPMorgan and Royal Bank of Scotland were also consistently vital players in the aircraft finance business for more than a decade.

Then in 2009, GECC got out of helicopters. Royal Bank of Scotland also got out of…well, everything. Wachovia was bought by Wells Fargo, who mostly does trusts in the aviation world, and Chase also reduced their helicopter deals.

So Who Rescued The Helicopter Industry?

The vast majority of money in the helicopter industry over the past five years has come from private investors pooled into operating lessors. Richard T. Santulli cut his teeth in helicopters in the 1980s and figured he knew the business. He watched the major players leaving helicopter finance in 2008-09. In 2010, Santulli left his position at Berkshire Hathaway and decided to create an aircraft operating lease model in the microcosm of the helicopter world by founding Milestone Aviation Group. A number of others then followed his path. Since 2011, almost all real growth in helicopter finance has been in the operating lease market.

Two operating lessors dominate the market at this point: GECAS-owned Milestone with a current portfolio of $3.6 billion and 246 helicopters, and independent Waypoint Leasing with a current and forward-delivery portfolio of $3 billion and 120 helicopters.

Reforming Regulations

- On top of the new accounting standards, over the past 15 years regulators have brought sweeping financial, accounting, and banking reforms:
Sarbanes-Oxley in the U.S. (with similar regulations following rapidly in Canada, Germany, South Africa, France, Australia, India, Japan, Italy, Israel, and Turkey);
- Basel II and III (and the unnamed but still existing IV);
- Regulatory initiatives arising out of the Dodd-Frank Act: risk retention rules, the Volcker Rule, and credit rating agency reform have already appeared, and still more rules remain to be written, like the appraisal rule.

A year ago, American Banker published an article discussing the impact of the new rules on market liquidity.

> **Regulators Worry New Rules May Freeze Markets**
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> American Banker | Jun 12, 2015
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> Nearly five years after the passage of the Dodd-Frank Act, regulators are beginning to question whether the cumulative effect of the rules authorized by the law are hurting market liquidity — and if that could pose a systemic risk.

More regulatory issues will be coming up in the next several years that are likely to impact the availability of capital, and therefore the ability to close a helicopter deal. The Basel Committee is again working on serious revamps to capital requirements, and on something new called Total-Loss-Absorbing-Capacity (TLAC) requirements, which will impact bank lending and leasing. At the end of 2014, American Banker Online started reporting on the Basel Committee’s newest efforts, and not in a good way.

> **Ready or Not, Here Comes Basel IV**
>
> By JOHN HELTMAN
> DEC 3, 2014 1:50pm ET
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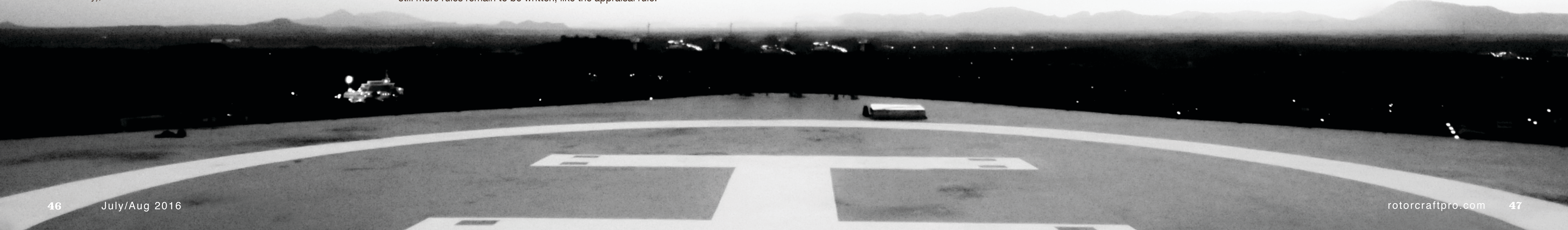
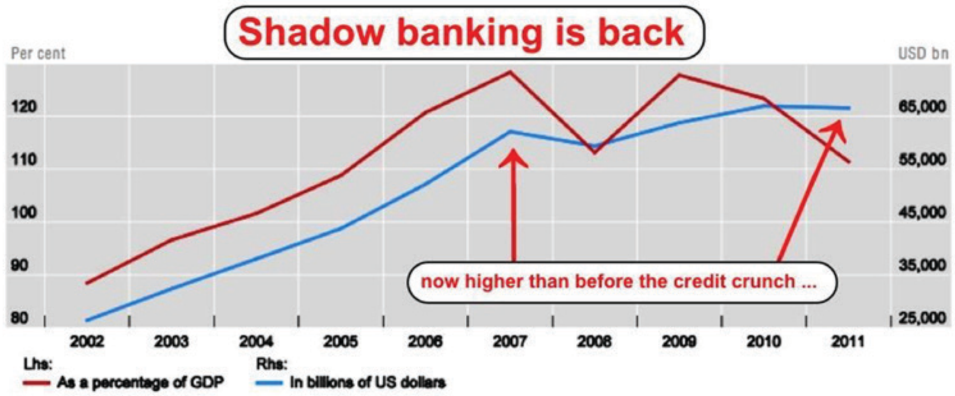
> Over the next three years, regulators are poised to make sweeping alternation to the existing Basel III international accord, including raising the risk-based capital ratio, revising risk weightings, and moving away from model-based assessments as part of a revamp of the capital requirements for operations, market and credit risk.
>
> The stability board said it will issue a plan for total loss-absorbing capacity – a standard that includes capital and convertible debt and is designed to help make it easier for regulators to seize a failing behemoth. Regulators are calling for TLAC to be at least twice the Basel III total risk-based capital of 8%.
>
> -American Banker Online

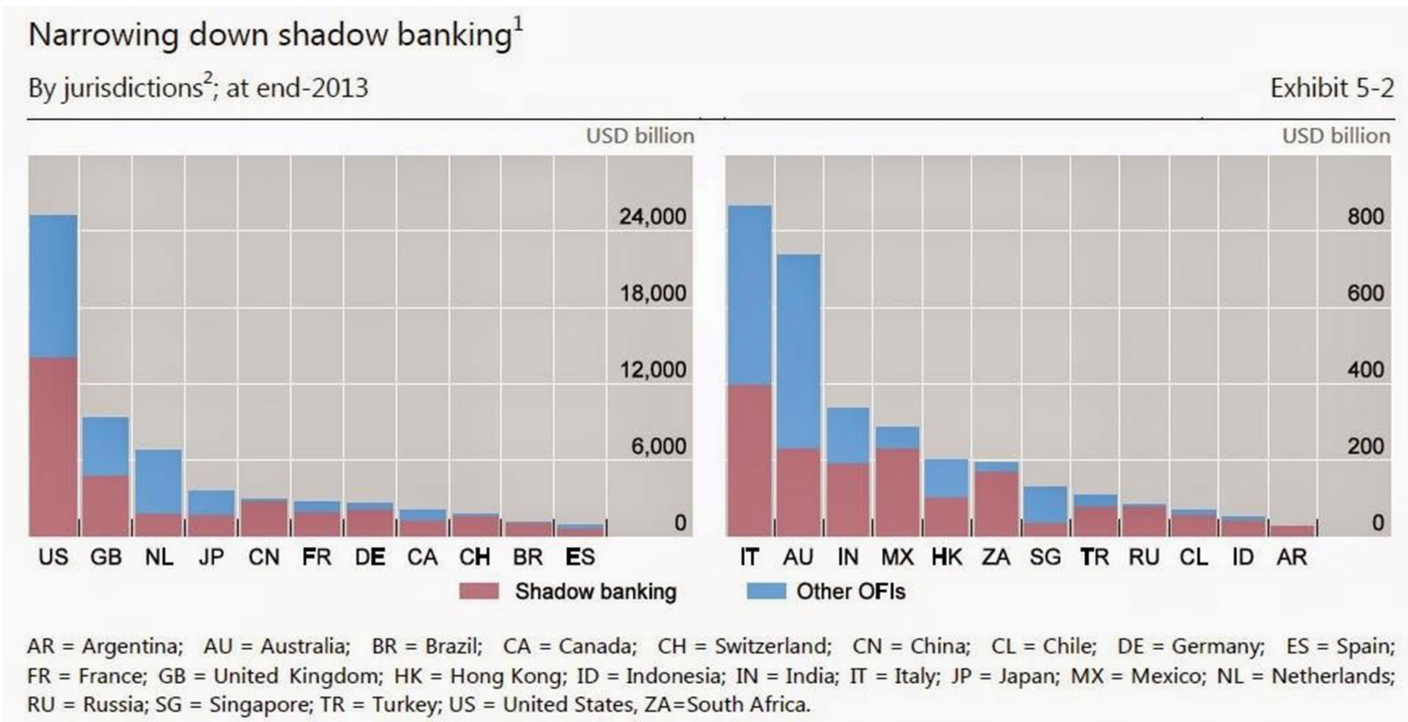
By August, *Financial Times* was reporting the same thing, saying “This is not a minor tweak. It is the birth of Basel IV.” Then by November, the paper began a series about the dismal future of banking. They wondered whether the banking industry’s decline “is just a blip induced by excessive regulation … a return to normal after an exceptional pre-crisis boom … (or) the slow death of banking.”



Shadow Banking

In addition, the Basel Committee, the European Commission, the Financial Stability Board, and the G20 (Shall we play "You Name the Financial Body?") are pondering new rules on shadow banking, which is just banking activities by non-banks. It's a pretty big deal, increasing from $25 billion in 2002 to $60 billion in 2010. And it's still rising.





It's not just a U.S. issue. The top three regions affected by shadow banking are Europe, the U.S., and China. Furthermore, Japan, Canada, and Brazil also have notable shadow banking economies relative to their traditional banking economies.

The European Commission has written a "green paper" tentative government report and consultation document of policy proposals on the topic, and it has some scary things in it.

> As stated in its Green Paper of 20 October 2010,[18] the Commission will also undertake further work on the resolution of other financial institutions. This will examine the nature of the risks for financial stability posed by various non-bank entities and explore the need for any appropriate resolution arrangements. In this context, a number of the shadow bank entities referred to in this Green Paper will be considered.

The terms "undertake further work on the resolution of," and "explore the need for any appropriate resolution arrangements" are pretty ominous verbiage for a regulatory authority, indicating an urge toward sweeping regulation.

The rotorcraft leasing industry is a classic example of shadow banking. The potential for regulatory involvement that could create a new liquidity crisis should be frightening to anyone involved in the financing of the helicopter industry. The 2008 liquidity crisis did as much to drive the helicopter market to a standstill as the global economic collapse. We might be facing worse in short order.

Sharon Desfor, ASA, is president of HeliValue$, Inc., the world's most trusted helicopter appraisal firm, and publisher of ***The Official Helicopter Blue Book®,*** the accepted standard for helicopter resale pricing information.

Desfor is an Accredited Senior Appraiser of the ASA, currently serving as ASA's international vice president. She is past chair of the Helicopter Foundation International and of the HAI's Finance & Leasing Committee, and served as editor of HAI's finance handbook, "Helicopter Funding: Assembling the Pieces of the Puzzle."