

Lloyd's List

Plugging the ship finance void

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Shipping industry discuss bank lending capacity and how to address it

THE continuing debate about the size of the gap in bank lending capacity to shipping and how to fill that void left were key themes of last week's Informa Greek Ship Finance Conference in Athens.

Against the backdrop of Greece's own government budget and finance crisis, the conference was presented with a number of different scenarios and options.

Ernst & Young partner Dougald Middleton warned that the historic suppliers of debt to shipping, a group of large European banks, had significant exposure to Greek sovereign debt and were under pressure to reduce their loan books to limit this exposure. Greek banks in the shipping market are also facing liquidity issues.



DVB Bank head of ship finance Dagfinn Lunde pointed out that at an estimated 70% of Greek treasuries are held by European banks. As a result, cash hoarding has resumed and spreads between London Interbank Offered Rate and the actual Interbank Rate have climbed once again.

Shipping is inherently capital intensive and access to debt capital is essential. With capital flow to shipping from traditional bank lenders restricted, deals that are being done feature lower advance rates on lower values, higher margins and more restrictive covenants while pre-delivery finance capacity was "scarce to non-existent".

Mr Lunde said that the main focus for banks was on predictable cash flows and the owner's track record. There is more discrimination between client types, with pricing for top-tier names having softened, but appetite for others is constrained.

"Loan volumes are low and are expected to remain so in 2010," Mr Lunde said. But more deals were being done than were reported, with bilateral and club deals being adopted rather than syndicated loans.

Harris Antoniou of Fortis Bank Nederland outlined the partial drying up of the main traditional source of shipping finance and suggested some alternative sources.

He said that normally at this stage in the ship finance cycle shipping banks would be demanding higher margins for loans but the finance crisis is limiting the lending ability of traditional ship finance banks.

He pointed out that bank loans of varying types traditionally comprise about 75% of shipping's capital finance requirements, with the balance being raised from an assortment of other sources including public capital markets, KG funds and other private equity funds (see graph above) but the severe shortage of bank debt is currently constraining the shipping industry, which is traditionally heavily dependent on the banking market.

Bank lending to shipping fell sharply following the banking crisis in 2008 and is only now slowly recovering, but volumes remain well below earlier levels. Banks have refocused on core clients and quality names. Where they are offering loans they are smaller, with higher prices and tighter covenants. They have a reduced appetite for long-term debt with long-term lending commanding higher premiums. Several leading lenders to shipping have reduced lending activity because of increased credit problems from loans in the boom years, a reduction in balance sheets, sovereign debt concerns and governments pressuring banks to focus on domestic lending.

This is the context in which the ability to meet shipping's finance requirements must be considered. With as much as 50% of lending capacity taken out of the market, based on 70% of the orderbook being delivered, the annual ship lending shortfall is somewhere between \$13bn and \$30bn.

That gap is being partly filled from alternative sources. There has been an increase in shipping capital market activity with a number of bond issues already this year. The equity capital markets have also picked up and there is likely to be further shipping IPOs and follow-on issues this year. Mr Lunde referred to increased activity by Export Credit Agencies in shipbuilding countries.

Mr Antoniou suggested that Asia offered a good opportunity for owners seeking capital to support growth. There is a surplus of liquidity in Asia looking for investment opportunities, while shipping is increasingly Asia-focused. Asian yield requirements are lower than in Europe and the US. Asia offers a "unique opportunity for European shipping companies to take advantage of the liquidity imbalances and use their incumbent position to consolidate and grow", he said. There are a number of private funds in the market aimed at shipping investment.

Ted Petropoulos, managing director of Petrofin Bank Research in Greece, was more optimistic about the size of the perceived gap in bank lending and the ability of banks to meet the requirement.

He suggested that when the expected cancellations and delays are taken into account the funding shortfall reduces to more manageable proportions.

He puts uncommitted newbuilding finance for the orderbook from 2010 to 2013 at \$113.4bn. A further \$23.6bn is likely to be required for secondhand transactions in 2010, but after allowing for buyers' and sellers' finance being retired, this funding requirement reduces to \$5.9bn. Allowing for an expected increase in sale and purchase activity, the four-year finance requirement could be about \$30bn. A further approximately \$25bn could be needed for mergers and acquisitions, while additional newbuilding orders during the period could require another \$50bn in total.

This results in an aggregate new finance requirement during the next four years of some \$218.4bn, just under half the current global lending total. He assumes natural wastage of the global loan book at \$45bn annually. If all of it is made available for new lending, the net additional requirement for new finance is cut to \$38.4bn. Mr Petropoulos said that this was not excessive but he acknowledged that his calculation or the ship lending gap was less than some other estimates, such as Fortis Nederland.

He referred to the gradual global economic recovery and suggested that most banks' losses were gradually reducing, thus improving their capital and liquidity positions. He expected to see a gradual recovery of European banks with competition increasing slowly, though margins will remain close to current levels. Current lending terms, with higher margins and fees and lower loan to value, are attractive for lenders with capacity. What is uncertain is how much business European banks will have lost in the meantime to Asian rivals.

The ability of traditional ship finance banks to rebuild their ship lending capacity is therefore still a matter of some debate. Loan ratios are likely to stay restricted so these estimates only account for the approximately 60% of the funding requirement that the banks should provide. Owners will have to fund the remaining 40% from their own resources or find it elsewhere. That might be no problem for owners that have sound finances but as cash accumulated during the boom starts to drain away, some owners might struggle to fulfil their side of the bargain.

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