Shipping and ship finance: a symbiotic relationship

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Just like a ship cannot move without a propeller, so shipping cannot function without ship finance. Shipping is a capital intensive industry and the overwhelming majority of owners require ship finance to enable the purchase of vessels.

Even at times when market prospects for ships appear promising, in the absence of finance, neither second hand vessels can be bought nor newbuildings can be delivered. It follows, therefore, that the state of the ship finance industry, not only has a profound effect on the health of the shipping industry, but also on vessel values.

In the absence of ship finance, second hand vessel sales could not be concluded driving down vessel prices and generating an illiquid market. In the absence of newbuilding finance, newbuildings could neither be secured, nor delivered.

Ever since the banking and liquidity crisis of 2008, the ship finance industry has been struggling. Banks were caught in an over-leveraged position, with inadequate capital, facing provisions and losses and having lost the ability to obtain money in the international inter-bank markets due to lack of confidence in each banks' financial condition, they faced liquidity problems. There was an abrupt shift of position by banks, which was felt by all owners. The change from a wildly competitive ship finance market to one where even strong owners had difficulty to secure finance came about in only a few months. A number of owners were caught with newbuilding orders without finance. Others had finance but found that the loan amounts made available at delivery by 'committed' banks had shrunk due to lower vessel values requiring more owner equity. The second hand market was frustrated by an overabundance of willing sellers but very few willing buyers with finance. For a while in 2009, cash was the only way in which vessels were sold.

The recovery of international trade and global GDP started to heal the above extreme difficulties as 2009 progressed, and more so in 2010. However, this recovery was neither steady nor convincing, with the exception of China and the development of the other BRIC countries which kept international trade going.

Despite the economic improvements, over the last couple of years, another serious concern began to affect shipping; that of overcapacity due to over-ordering. The expectation of a market recovery lead to numerous owners placing orders (often without committed finance) that posed (and continue to do) a serious threat of sustained overcapacity market conditions for years to come.

The reduction of vessel values and freight rates, notable collapses of some major charterers and the uncertain market prospects created mounting concerns among ship finance banks. The IMF estimates that over the next two years banks shall require to reduce their loans by 3.6 trillion. This is so that the banks' capital adequacy ratios shall reach the levels required under Basel III and the central bank authorities.

It is not surprising, therefore, that in the current banking climate, the growth of global ship finance reversed in 2009 and only slowly recovered in 2010. According to recently published Petrofin Bank Research © analysis, the top 40 global ship finance banks' loan portfolios (drawn and committed but undrawn) fell by 5.77% at the end of 2009 and rose by 3.56% to $451.75bn at the end of 2010.

Within the above global ship financing scene, Greek ship finance loan totals fell by 8.48% between end 2009 and 2010. In Table 1 you will observe the massive development of Greek ship finance from end 2001 at $16.525bn to a peak of $73.228bn at end 2008.

Table 1

	December 2001	**December 2002**	**December 2003**	**December 2004**	**December 2005**	**December 2006**	**December 2007**	**December 2008**	**December 2009**	**December 2010**
Growth percentage		28.66%	20.19%	26.61%	11.62%	28.45%	44.31%	9.39%	-8.478%	**-1.17%**
Total Greek Shipping Portfolio	**$16,525m**	**$21,261m**	**$25,554m**	**32,353m**	**$36,112m**	**$46,387m**	**$66,941m**	**$73,228m**	**$67,020m**	**$66,235**
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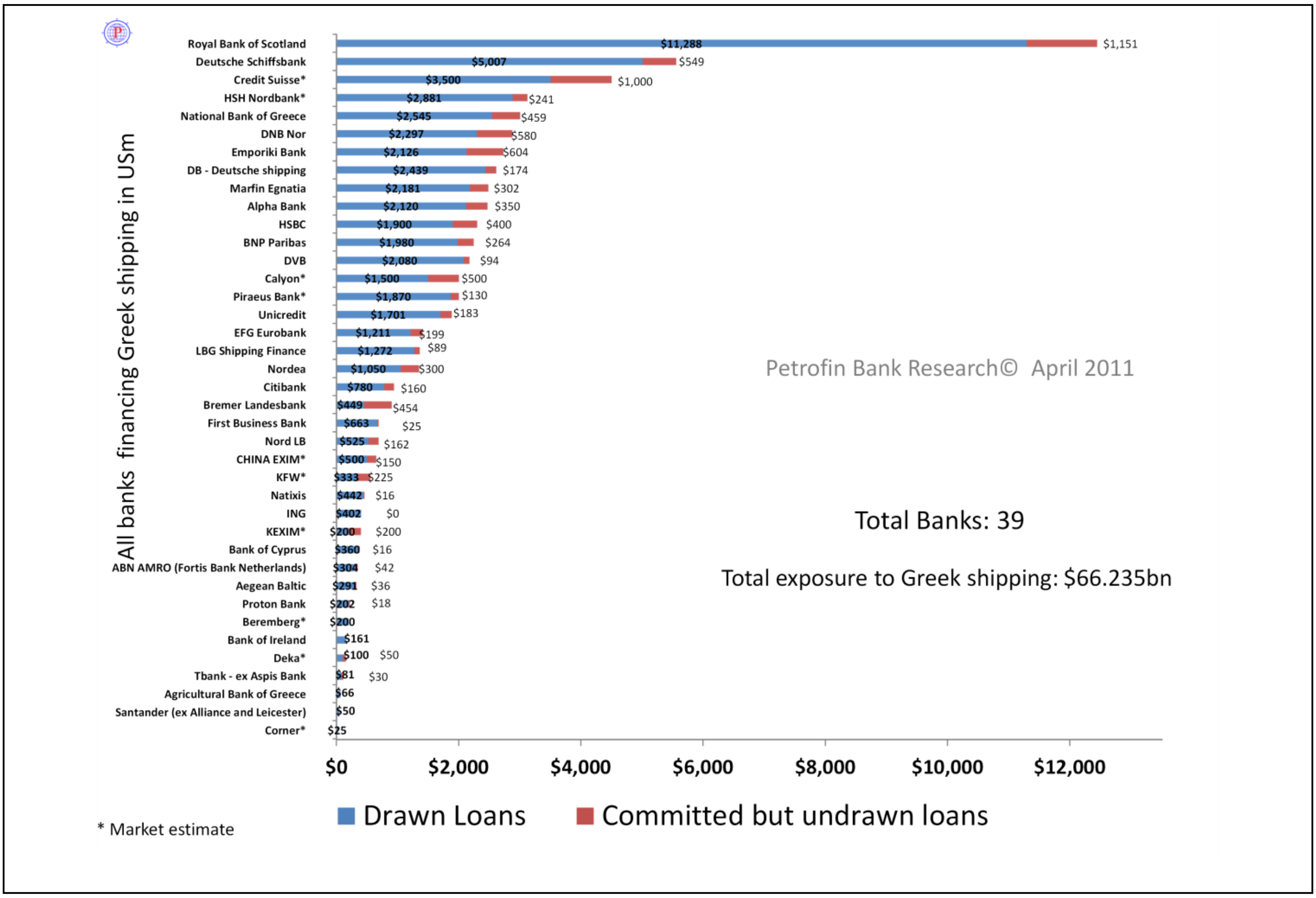
This massive growth in Greek ship finance provided the foundation for the rapid development of the Greek fleet both in size and modernization over the years. However, the banking crisis that affected primarily western banks, hit particularly hard the Greek ship finance sector, as European banks accounted for over 75% of ship finance totals. The continuous fragile position of European banks has been particularly hard felt in the Greek market.

Moreover, three out of the top 6 banks in Greek ship finance (Graph 1) accounting for 47.55% of Greek ship lending in 2010 had for their own financial reasons adopted a policy of reduction in their ship finance exposure, which affected significantly the Greek ship finance sector.

Graph 1



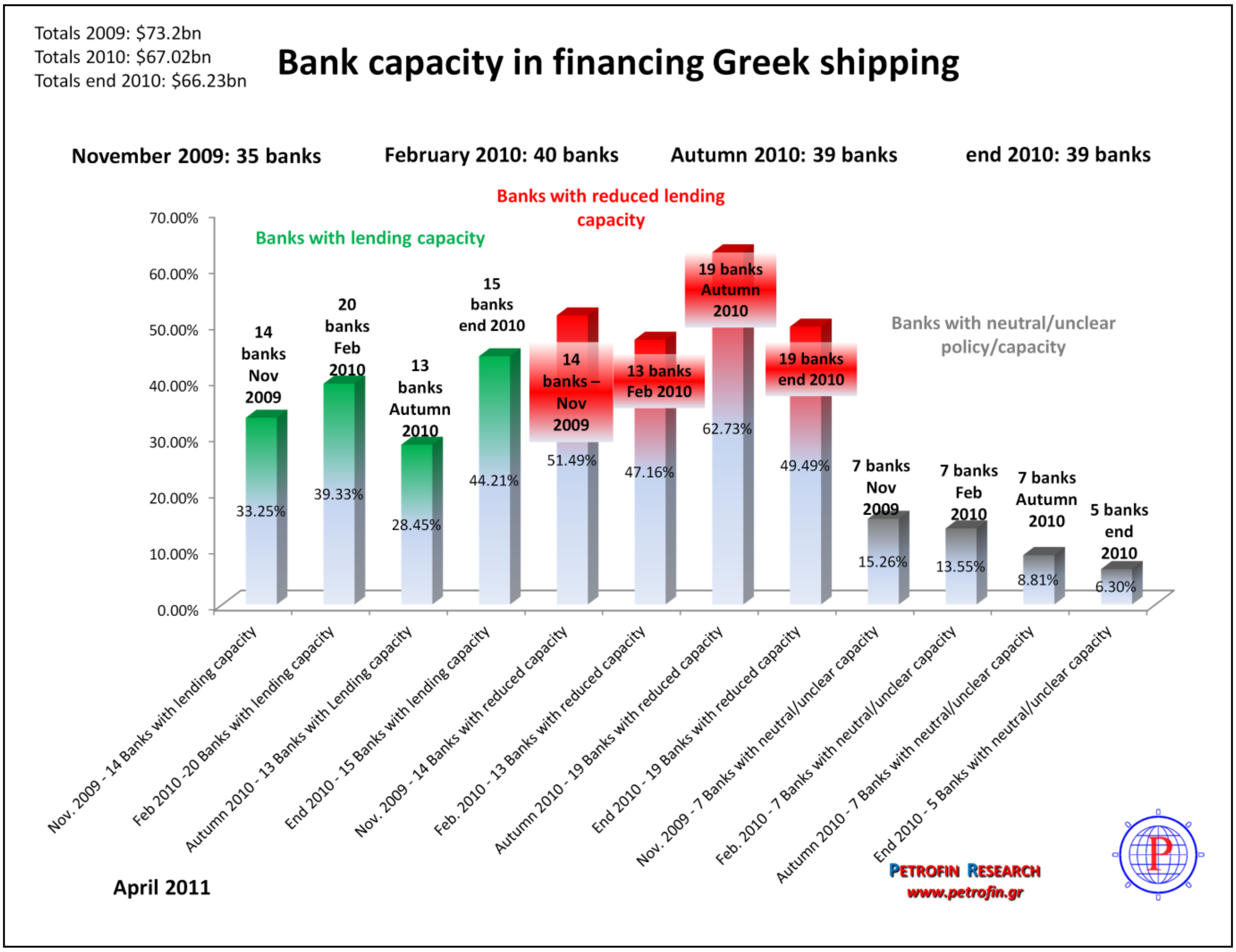
The Greek economic crisis from 2009 onwards also had a profound effect on the ability of Greek banks to finance Greek owners as Greek banks account for 23.98% of the total exposure to Greek shipping.

Consequently, the ability by Greek owners to finance their newbuildings and second-hand acquisitions became particularly difficult in 2009 and 2010 with conditions changing only slowly in 2011. During these tight conditions, it has been the biggest public and private owners that managed to secure ship finance, whereas other owners found it next to impossible to do so, as ship finance loan margins have more than doubled and financing terms have become much stricter even when finance is available.

Despite the difficulties and uncertainties over shipping market prospects, Greek shipping has performed well with hardly any owner failures and displaying an exuberance and over-confidence in the future of shipping by placing a stream of orders that kept Greece in the top position among ordering nations. In order, though, for these vessels to be built and delivered over the next couple of years, ship finance shall continue to be required. This raises the question; will there be finance for all? Will Greek owners be able to obtain finance for the over 660 newbuildings they have currently on order and for their second-hand vessel purchases?

Seeking useful indicators as to prospects of the Greek ship finance sector, Petrofin has been monitoring the attitudes towards ship lending in Greece by all 39 banks that are engaged in this sector. In Table 2, you will observe the results of research carried over between 2009 (2008 data) and end 2010 (2010 data) of the ship lending policies of banks in the Greek sector.

Graph 2



As you will observe, 49.49% of the total (in loan portfolio weighted terms) have a policy of reduced commitment towards Greek shipping compared with 44.21% with an expanding policy and a 6.3%% with a neutral policy.

Owners are increasingly looking to Chinese banks, Scandinavian banks and some financially strong European banks to finance their newbuildings. The absence of finance combined with market uncertainties, have resulted in a drop of fresh Greek newbuilding orders and efforts at delaying vessel deliveries and / or cancelling or converting such orders. It is the need to secure fresh newbuilding orders that has lead Chinese banks to focus on the Greek market and offer finance on competitive terms.

The attractive yields and loan terms currently being enjoyed by lenders is expected over time to attract fresh banks seeking to exploit the Greek sector.

As the demand for loans is expected to slow down, the ability of banks and their willingness to finance the Greek sector should slowly improve. This process should accelerate if the shipping market were to recover and current lenders' loan portfolios be deemed safer. Consequently, we foresee that in the next 2-3 years, competition among banks for Greek shipping business shall resume. This shall be supportive of Greek shipping going forward. It is, thus, expected that the demand for finance for newbuildings especially shall be accommodated by non-Greek banks in an orderly manner. We anticipate overall Greek ship finance totals to stabilize in 2011 and resume their growth from 2012 onwards.

A key and unpredictable factor is the contribution to Greek ship finance by Greek banks which remains in doubt as the Greek economic crisis continues.

Unexpected factors may, also, alter the appetite of banks. These include the risk of much weaker dry and wet markets, geopolitical factors, as well as changes in the world economic growth and international trade. Consequently, the Greek ship finance industry is still bound with many uncertainties, at this time. However, it is expected that the foundations towards a gradual recovery and growth are being laid both by banks and Greek owners.