Ship finance banks become more aggressive, in streamlining their loan portfolios

By Ted Petropoulos
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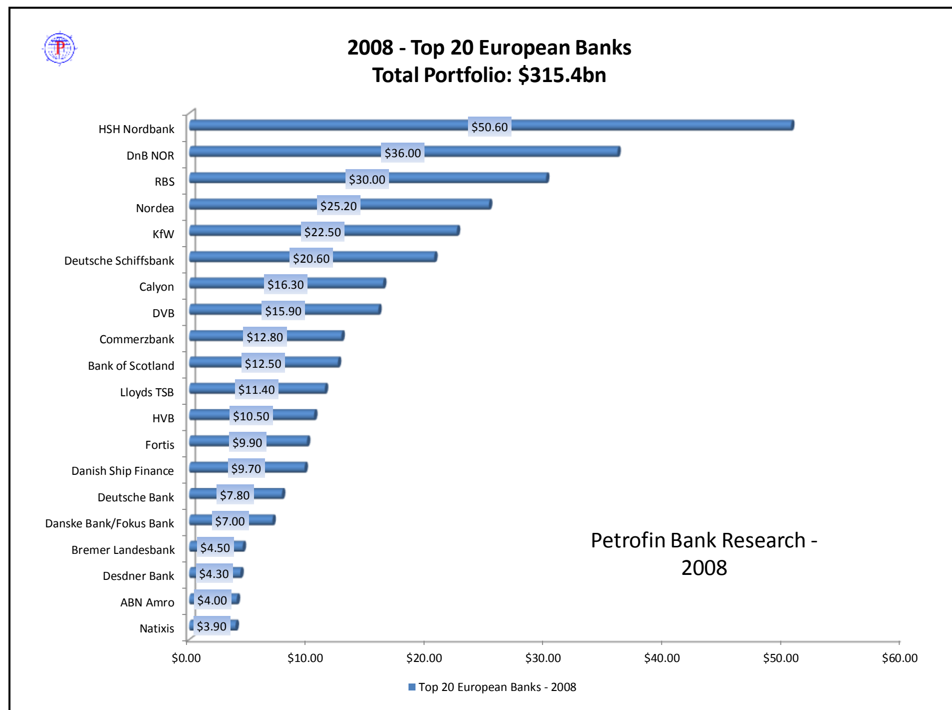
For Nafs – May 2015

The collapse of Lehman Brothers, in 2008, marked the end of the exuberance by commercial banks. The financial crisis that ensued forced banks to deleverage and to rethink their strategies. Shipping was profoundly affected, as it represents an area, where loan portfolios can be allowed to simply reduce, via the repayment of loans. As such, banks could slim their shipping exposures by not lending or part replacing repaid loans with new loans. Over the last 7 years, despite the record newbuilding deliveries, ship finance, especially among western banks, has reduced considerably. Some banks, such as Commertzbank and Bank of Ireland, decided to leave ship finance altogether. Others, such as HSH, RBS, Natixis, Lloyds Bank and many others, decided to substantially reduce their shipping exposures. A few, such as Credit Suisse and ABN grasped the opportunity to expand and take advantage of the much higher yields offered by shipping loans. According to Petrofin Bank research ©, the total European banks' ship finance global portfolios, within the top 40 global banks, fell over the last 7 years from $315bn to $237.7bn i.e. a decline of 24.5%. In the last year alone, the total European banks' global ship finance portfolios dropped from $249bn to $237.7bn i.e. a decline of 4.5% (see graphs 1, 2 and 3).

Graph 1



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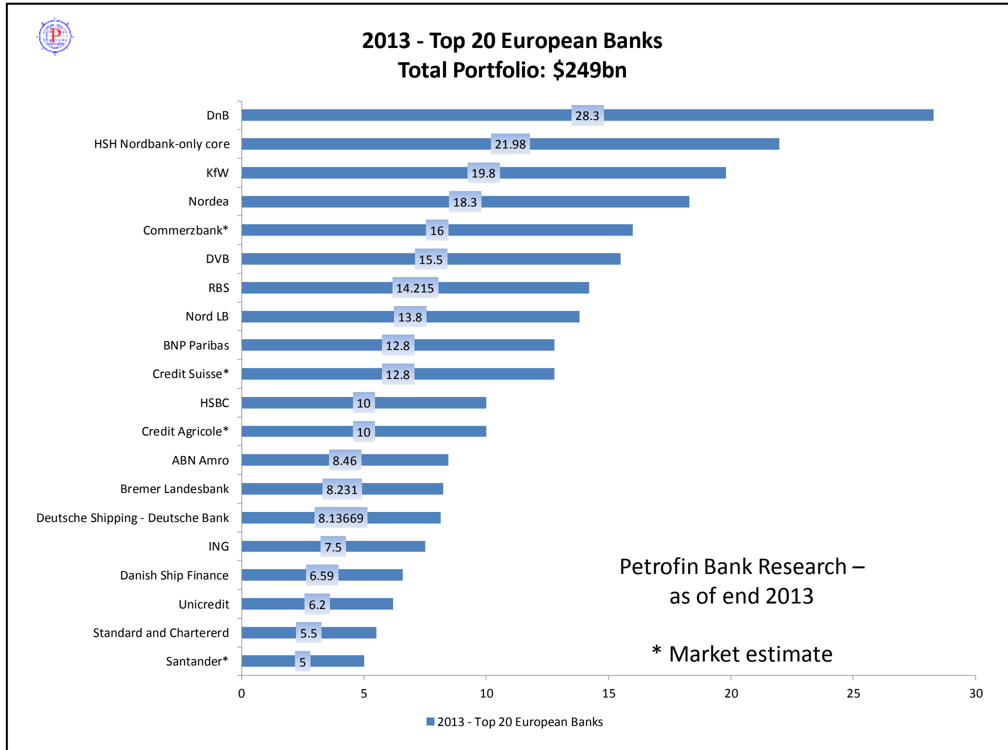
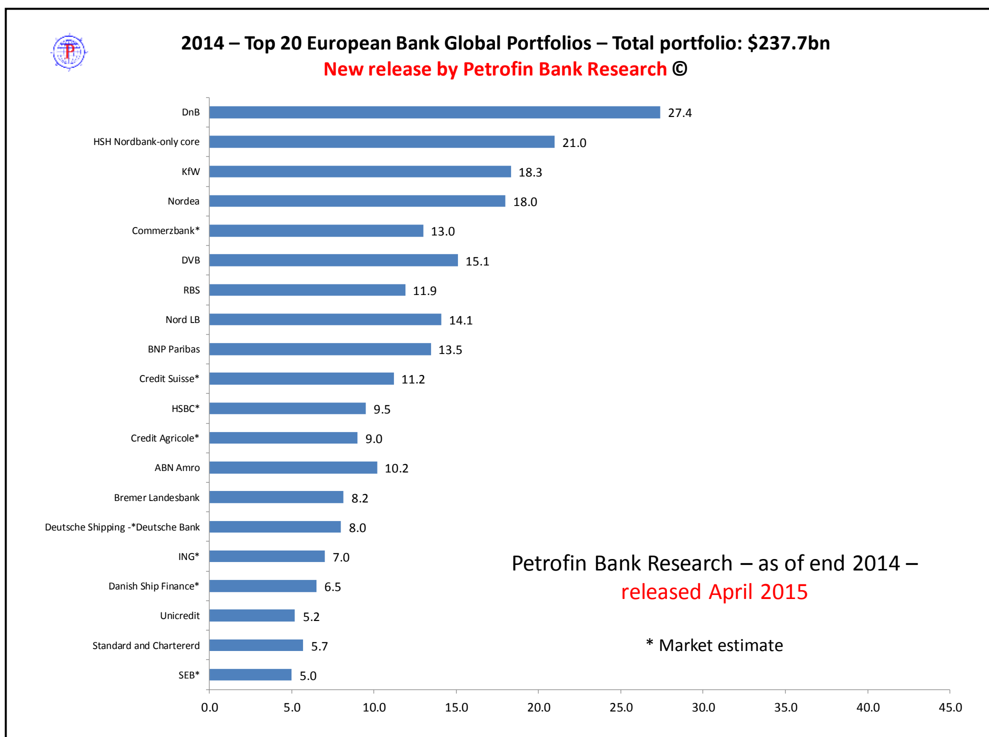
Graph 2



Graph 3



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For some banks, the natural rate of decline was not sufficiently swift, especially among those that wished to leave the industry altogether or to significantly downsize their exposure. Hence, they sought to sell off parts of their loan portfolios at the best price possible.

Examples of such sales are Commerzbank, Lloyd's Banking Group, HSH Nordbank and Royal Bank of Scotland. Initially, the sale terms were quite favourable to banks, especially where loan portfolios were both performing and strong, with a number of interested banks, PE (private equity) funds, concluding deals, such as Oaktree, Carlisle. As time passed and with the initial sales already concluded, it became harder to sell more loans, especially as the shipping market declined in all the 3 main sectors i.e. dry bulk, tankers and container vessels. The market decline affected an increasing number of loans, which went through one or more restructures, in an attempt to provide more time to repay customers and in the hope of a shipping recovery.

Although there was a widespread expectation that the rate of loan sales would increase in 2013 - 2014, it became harder for banks to find buyers at acceptable terms and the spread between buyers' offer and sellers' willingness to accept became wider. Bank appetite to buy other bank loan portfolios began to wane, as the market fundamentals were weak and as shipping friendly banks could pick and choose from the best new loans amongst their clients at attractive terms. Consequently, distress situation PE funds became the only potential buyers of shipping loan portfolios and their IIR (internal rate of return) requirements were much higher than those of banks. In addition, for distressed loans, such funds were looking to obtain them with heavy discounts.

For a long time and until the second half of 2014, loan portfolio sales slowed down. However, funds became interested in picking up individual loans that met their criteria, on a case by case basis.

During 2014 and increasingly in 2015, the pressure on many banks to reduce their loan exposures intensified. The main reasons for this, were:

1) Poor performance by the dry bulk market, with most vessels earning less than their operating costs, by the end of the first quarter of 2015.

2) An increase in nonperforming loans in the dry bulk, as well as container sector.

3) Many loans after initial restructures could not be restructured any further, as the age of the underlying vessels would not permit it.

4) The new Supervising authority for EU banks i.e. ECB, became harder in its assessment of nonperforming loans, resulting in a substantial increase of loan loss provisions.

5) Increasingly, banks felt that the only way to reduce further their loan portfolios, and especially the nonperforming ones, would be by accepting significant discounts. Such discounts reflected the loan loss provision already taken by the banks.

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6) Banks preferred to sell loans or seek their prepayment, often with discounts, preferring to avoid conflict situations, which would tie up considerable resources for banks and their managements and which would also carry significant risks.

7) Increasingly, banks lost heart that an imminent asset value (and cash flow) recovery would take place. This was mostly felt for dry bulk vessels, whose values tumbled and showed few prospects of a recovery in the foreseeable future.

As a result of all the above general factors and on the basis of additional ad hoc factors, banks became more realistic sellers. Deeper loan discounts were now on offer and these grew as the market continued to be poor, especially in the dry bulk and container sectors.

Some banks sought to find selected clients to whom to sell whole fleets e.g. HSH and Navios, recently announced.

As there is considerable secrecy, involving most banks and many loan sales are not reported, it has become difficult to assess the numbers involved. However, in our own Petrofin Bank Research ©, just recently published, RBS reduced its shipping portfolio from \$14.215bn to \$11.9bn, Commertzbank* from \$16bn to \$13bn, Unicredit from \$6.2bn to \$5.2bn and HSH from \$21.9bn to \$20.9bn.

On the demand side, we find that buying interest by mostly US PE funds remains strong. The explosive growth in the size of such funds has helped in shipping being considered as an attractive area for growth and profits, especially given the more realistic sale prices offered by banks.

Buying interest, though, is not limited to such funds. It has, also, appeared among the banks' clients as well.

For a very long time, selling a loan at a discount to a bank's client was taboo. It appeared to be a reward to nonperforming clients. This, however, changed over the last year, as banks became more concerned with reducing their loan exposures than with the origin of the offers. Consequently, an increasing number of loans have been acquired at a discount by nonperforming clients, who raised fresh finance to do so either using their own resources or those of other investors or PE funds or a combination of all three.

Performing clients, too, were able to prepay their loans at a discount and a number of banks made this a priority. Such sales, too, that used to go against the grain for banks, became acceptable ways of reducing bank exposure. One argument used to justify such discounts was that the new finance raised by a client would be more expensive than the retiring loan or would require fresh equity and this was reflected in the loan discount.

As long as shipping market conditions continue to be adverse and banks wish to reduce their shipping exposures, loan discounted sales are expected to continue. This process is actually beneficial to banks, as it clears up their loan portfolios, reduces them to more acceptable levels and allows banks to a) start growing again over time, utilising their good client base, b) it clears their loan portfolio and c) involves loans with more attractive lending terms and conditions.