



End of year jolts for owners and lenders

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SHIP FINANCE: REVIEWING 1995

Nineteen-ninety-four was a year of intensified shiplending activity and keener than ever competition among banks. The confidence of owners and banks, however, received a severe jolt in late 1995 as a result of the sharp fall in the BIFFEX index and the uncertain outlook for large bulk carriers.

The year ending 1995 has been an eventful year for the shipfinance market. Supported by a robust OECD economic growth performance and a sound outlook, shipping, across almost all sectors, enjoyed a significant rise in earnings, values and newbuilding orders.

The confidence of owners was equally shared by banks that competed strongly among themselves to meet aggressive budgets. As such, for quality owners, shipfinance became an "owners' market" with many banks prepared to match and improve upon other banks' offers. It is fair to say that aggressive lending was confined largely to the more recently established banks, whereas traditional lenders have shown increased reluctance to follow suit.

Nevertheless, the "market norm" percentage of finance for quality names did rise by approximately 5% i.e. 65% to 70% which represents a further erosion of credit quality. Many banks sought to offset the above either by requesting secured employment or by structuring front-end repayment terms or the provision of minimum cash balances.

In line with the weakening of credit terms and in order to be able to amortize high loan to value transactions, the average loan repayment period of loans

did increase and most banks shifted the maximum age of their loans from 18/20 years to 20/22 years, especially for dry cargo vessels up to handysize, general cargo vessels and container vessels. The latter relaxation, however, was only provided for owners with a demonstrable record of operating efficiently older vessels and when the collateral vessels were of excellent quality (despite their years) and enjoyed an attractive specification and special survey position.

As values rose in 1995, most owners switched their purchase interest to older vessels. This they did, in their search for acquisitions, offering the right risk/reward characteristics and adequate cash flow.

As such, most banks became increasingly involved with older vessels which they mixed with more modern vessels already in their collateral packages. Thus it became common for younger vessels supporting new acquisitions that were in fact older than owners' existing fleets rather than the reverse that has been the case in previous years.

The situation with shiplending Banks





Research by Petrofin, recently published, shows that the number of banks involved in International shiplending rose in 1995 to 154 as compared with 119 in 1994 and only 67 in 1992 when the research first commenced. Whilst the number is still smaller than the over 200 banks active in 1970's, it is still clear evidence of the increased interest in international shipfinance.

The number of banks involved in Greek shipping also rose to 67 of which 34 have a permanent physical presence in the form of a branch or a representative office. In addition to the greater number of foreign banks interested in Greek shipping, a key feature has been the increasing interest shown by the Greek banks themselves.

In addition to the National Bank of Greece, which has been continuously involved in financing Greek shipowners, an increasing role has been played by the Commercial Bank of Greece, Bank Macedonia Thrace, Ionian Bank and Bank of Central Greece. Greater interest has also been shown by the Greek private banks, notably Euromerchant Bank, Dorian Bank, Egnatia Bank and more recently, Alpha Bank. Furthermore, a number of banks have an active operating presence in Piraeus i.e. Bank of Cyprus, Inter-Bank, Bank of Piraeus, Chios Bank and although they have so far limited their direct shipping exposure, entering the shipfinance area does represent a natural evolution to their Piraeus based activities.

Greek banks' interest in shipping has developed as a result of both positive reasons e.g. good performance of the shipping industry, evolution of the Greek banking system, availability of foreign currency via deposits or scraps, greater shipfinance expertise etc., as well as negative reasons e.g. continuous recession in the Greek Economy, limited Greek shore based clientele, etc.

For foreign banks, the main interest in Greek shipfinance business stems from:

-  Considerable availability of funds by banks.
-  Insatiable appetite by Greek clients and high volume of transactions.
-  Positive outlook for shipping in general and Greek shipping in particular.
-  Clarification of Greek shipping loans as "international credits"

i.e. loans without "Greek" political risk.



Few barriers to entry.



The yields of shiplending, which although in decline, still represent a higher return for banks than those offered by other industries and lending opportunities.

Focusing on yields, until the late summer of 1995, shiplending competition has been intense, with many banks willing to reduce their terms in order to retain established Greek clients and/or obtain their fair share of shipfinance business. As such, for quality owners (quality name, operation, liquidity, size and management) spreads of 1% or just over became quite common, with arrangement fees down to 1/4%.

Where banks offered slightly higher loan to value finance and/or an unusually long repayment period and/or non recourse lending, i.e. no personal guarantees, better than the above terms were possible for those banks able to offer such enhanced terms. The better margins offered by Greek shipping began to attract the interest of Scandinavian and other fresh lenders that saw their own home margins approach critically low levels.

It is worthwhile stressing, though, that nowadays spread income is only a part of a bank's yield from shipping business, since banks increasingly have come to rely on ancillary products and services and sophisticated new products, derivatives and other non-risk income. Often such income exceeds spread income and banks use the lending relationships as a platform for selling other services.

A change in sentiment?

The picture changed dramatically in the fall of 1995 as the BIFFEX index began in sharp fall which admittedly caught most bankers and owners by surprise. Suddenly, everyone "held their breath" to see which way the market would go. Ship purchasers became wary and held back awaiting better opportunities, sellers became more accommodative, valuers marked down vessels values, even though this was based on market sentiment and not on actual sales, and charterers held back cargoes hoping for lower fixtures.

The confidence of banks has been undermined by the fall in the level of BIFFEX of over 30% and indeed many have developed "Biffexmania". Although everyone will admit that BIFFEX relates only to the large bulk carriers and so far little or no effect has been observed in the other markets, it seems that in the absence of any other well known index, everyone is mesmerized by BIFFEX. As such, shiplenders (especially their credit departments) have also become wary of new credits and have tightened on the offered terms.

This excessive competition among banks has abated for the time being due to the market sentiment and the Xmas season looming on the one hand and a comfortable position among banks who have met their budgets for this year and are under less pressure at present. The bearish sentiment has not been helped by the Adriatic saga and other problems such as, Lykes, Regency Cruises etc. which have reminded banks of bygone years.

For our part, we have increasingly relied on the Clarksons' sector indices which provide a much more reliable guide as to the performance of each sector and notably presents a much healthier and more resilient picture of actual shipping conditions on a sector by sector basis.

Without doubt, 1996 will represent a year of change for shiplending. Should

the year end market correction develop into a recession and the commencement of a longer term 2-3 year period of cyclical downturn, the expansion of shiplending will come to an abrupt stop. Under the above scenario, the number of shiplending banks will cease to grow, values will stabilize or indeed decline and margins/terms will harden and as such, there will be a "flight to quality".

On the other hand, should the recent decline prove to be a mere correction, bank competition will return in force, especially for sectors such as tankers, containers and multi-purpose vessels which banks consider to be increasingly more attractive collateral.

The "Cassandras" of this world have been given recently their opportunity to shine. However, the majority of analysts still believe in the robustness of market, largely based on the sound economic fundamentals and the overage profile of the world fleet.

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