SEEKING SHIP FINANCE? THINK AGAIN

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Owners, who have contracted newbuilding related ship finance, are praising themselves for having acted so prudently. According to the latest Petrofin Bank Research ©, there is a total of approx. $10.5bn in committed but undrawn ship finance facilities for Greek shipping related to newbuildings. Although owners should have been feeling protected by such committed loan facilities, they are instead having sleepless nights. The reason is that the ship finance market has changed and is now a “bankers’ market”. Consequently, as will be analysed later in this article, banks are trying to seek and take advantage of each and every opportunity to re-negotiate the loan terms.

Banks, able to lend now to clients with high margins (in excess of 3% and with high fees), resent being locked into low yielding loans. In many cases, the banks also have high funding costs. The result is that banks often end up losing money on these loans, something which they seek to redress.

Loan agreements contain numerous clauses. Often, these are determined “at the sole discretion of the bank”. There are also many rather loosely defined clauses about “adverse financial changes” affecting the borrowers and / or the guarantors, which are again determined by the bank. Conceivably, the recent economic recession and banking crisis could be interpreted as having triggered such clauses. However, more importantly, the key determinant is the value of the underlying asset, in relation to the facility amount. As vessel values plummeted, the value of newbuildings fell substantially below their contract price. Of course, what matters most is the value of the vessel at delivery. However, banks could not be blamed for being concerned about the fallen values, especially, as they are often called to finance the pre-delivery installments.

The answer often involves either a) non draw down of the pre-delivery installments and / or b) reducing the overall amount of finance and / or c) asking for additional security. Moreover, should the client have other loans, which may have triggered their asset cover covenants, a decision to continue with the newbuilding finance becomes a wider matter of re-negotiation between banks and their clients, taking into account the whole fleet mortgaged to the bank.

Once a client has a need to obtain the bank’s consent to waive a breach of a term of a loan agreement, negotiations begin.

Banks point out to the terms of the loan agreement, giving them the right to call the loan in default. Owners challenge this approach by claiming that banks are seeking to take advantage of their position to obtain unfair and punitive increases in loan margins. They argue hardest when they have managed to keep the loan serviced both in terms of interest and principal.

Banks have a "duty of care" towards their clients and a need to be consistent and non discriminatory. As there has not been a legal decision given the absence of a legal dispute, what arguments shall prevail will remain a matter of conjecture. Banks are also aware that in cases of technical breaches, when loans are being serviced properly, their position weakens.

After all, liquidating collateral is a bank's last resort and a reduction of the loan, as per the loan agreement, provides a safety net around the loan. Hence, a reduced need to turn a performing loan into a workout.

Banks are also aware of their reputation and how this might be affected if they adopt a harsh and legalistic strategy to prise monies from hard pressed but performing clients.

The main reason that such cases do not reach the courts is that, in the end, both the bank and the client invariably agree on a compromise.

I should hasten to add that during the recent banking – economic – shipping crisis, most banks adopted a commercial and fair approach to addressing technical defaults. Some banks though, especially those with problems of their own, have adopted an aggressive approach, which has estranged their relationships with their clients.

For those clients able to avoid a technical default, they would continue to enjoy low margins and good terms, which are very favourable when compared with other owners seeking fresh finance today.

Let us now move to owners who are seeking fresh finance in these troubled times. Presumably, this finance would be sought to purchase a vessel and enjoy current relatively low ship values. It might involve either a second hand vessel or a newbuilding.

The first thing that loan aspirants will discover is the lack of appetite by commercial banks, including their own well-trusted and long-term bankers. In most cases, banks are wary of the economic backdrop, as well as the prospects of shipping and are not seeking to expand at this point of time. In addition, a number of banks have severe problems of their own, depriving them of the necessary liquidity / ability to provide new loans.

There are, of course, some banks that are still open for business. However, these banks are aware that they hold a rare asset (i.e. ability to provide a loan) and they have become very selective. Many banks also do not lend outside their client base.

Consequently, banks tend to seek to maximize their margins and fees as much as the clients and / or the project can bear. This raises the cost of capital to owners to considerably higher levels than those prevailing up to 2 years ago. The high cost of finance and more importantly its scarcity, tends to sway owners away from new purchases / orders.

For those committed to bear the higher costs, it should be pointed out that the percentage of finance available is often only approximately 50% - 55% of the real value of the vessels, In addition, the vessels must be young and in a shipping sector, which finds favour with the bank. The clients' financial strength and liquidity must also be supportive of this expansion.

Lastly, the legal clauses within the loan agreement, including financial covenants and events of default would be expected to be very strict. Once again, the banks are less willing to discuss these terms, knowing that these are many potential deals round the corner.

The fairness of loan documentation concluded under prevailing market conditions will only be discovered later in the shipping cycle and especially if the shipping market shall weaken.

To conclude, therefore, ship finance has become an "obstacle race". To succeed, owners must be determined and try to obtain terms from all available sources. Armed with patience and offering full transparency, as well as, willingness to be flexible and adjust the required finance, should enhance owners' chances.

Under no circumstances should owners be swayed by investment considerations to contract vessel purchases without committed finance. Indeed, lately, a number of sale and purchase transactions have failed, due to buyers' inability to obtain finance.

For banks, the current difficult times do provide an opportunity to build up quality business with targeted clients on excellent terms. Moreover, how clients are treated will affect the banks' reputation in ship finance for many years to come.

Just like shipping, ship finance is a cyclical business and the balance between banks and their clients is an ever-changing one. Steering the vessel smoothly and clear of rocks with good communication should work both for existing, as well as, new ship finance.