THE PROSPECTS FOR GREEK SHIP FINANCE IN 2010 AND BEYOND

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As the year is coming to a close and the dust has begun to settle, it is an opportune time to examine how Greek ship finance has fared so far during the recent financial, economic and shipping crisis and what lies ahead.

The abruptness and severity of the crisis (which began as a subprime crisis in 2007 and developed into the full blown international crisis we all know about, in 2008) caught out both banks and owners. The adjustment from abundant to no liquidity and from easy to zero credit has been very painful, indeed.

For almost every owner it called for a complete re-evaluation of their strategy. The objective became one of surviving the crisis. For some, one of exploiting the crisis. In general, all uncommitted fresh projects were shelved, newbuilding orders were often cancelled, re-negotiated or delayed, operating costs were curtailed, office staff were often reduced and every cost, expense or cash outflow had to be justified. Moreover, owners reviewed their cash flow, paying particular attention to the performance of charterers, especially those involving high t/c contractual rates. Uncollected / unsettled claims were scrutinized and long forgotten good housekeeping practices were re-applied. Lastly, bank loan repayments were re-examined in the light of the available cash flow and, where possible, restructures / moratoria were negotiated.

Owners, who enjoyed paid-off fleets, and / or large liquidity reserves and / or no newbuilding commitments, began to seek out opportunities to acquire inexpensive tonnage, often for cash, as bank finance had come to a halt.

Banks, too, were caught largely unprepared. With interbank liquidity having dried up, they, too, faced survival issues. Both client and market deposits had to be bid up. In most cases, banks resorted to borrowing from central banks. As the recession hit every industry, including shipping, the bank clientele's ability to repay loans at the high contractual levels of repayment became increasingly difficult. All banks cut down drastically all forms of fresh lending (to all sectors of the economy, including shipping) and sought to boost their liquidity in which ever way possible.

Specifically in shipping, in addition to their own liquidity problems, banks had to tackle the problems of drastically lower asset values. Initially, Dry Bulk and container vessel values fell by 60% - 70% triggering widespread asset cover maintenance defaults. Maintaining capital adequacy ratios in the light of declining loan portfolio quality and / or defaults became increasingly difficult, especially as bank share prices also plummeted denying banks (for a considerable time) the possibility of raising fresh capital via the stock markets.

For banks that proved to be very highly leveraged or heavily involved in sub-prime loans and who were facing huge losses (e.g. RBS, HBoS, HSH etc.), state injection of capital and / or debt was the only choice.

<u>THE CURRENT POSITION</u>

As I write, the financial system has started to recover and there have been no new bank failures for quite some time. Inter-bank borrowing has improved and inter-bank borrowing spreads have drastically declined. Depositor confidence has cautiously returned. Banks have begun not only to recognize increased loan provisions and loses but to build up their capital adequacy. Indeed, some banks have even started to repay state funds, in order to regain fuller control by their managements.

The IMF now estimates that banks worldwide must write off over the period 2007 to 2010 $3.4tr in assets, whilst thus far $1.3tr have been written off. Interestingly, thus far $0.93tr have also been raised by banks in fresh capital. This demonstrates that the banking industry is well on its way to heal its wounds and is expected to reemerge from 2011 onwards in a sufficiently strong position and to resume its role. For the above to occur it is a prerequisite that a) no further major and unreported bad loans are discovered, and b) the world economy shall register a consistent recovery of approximately 3% per annum from 2010 onwards.

Looking at the world economy and international trade, there is no doubt that the situation has stabilised. As the private sector slowed down, massively increased state spending and monetary deficits have provided strong counter balancing factors to the decline of the private economy and the banking problems. China, via massive state spending, re-established an 8% plus per annum economic growth with even higher growth prospects for 2010. India and the rest of the Far East, as well as Brazil, are following suit.

International trade, too, has begun to recover, assisted by the recommencement of letter of credit financing. Whereas the Western economies and West to Far East trade is still depressed, there are early signs of a recovery and the prospects of a mild restocking. The Far East has already restocked and even though there may be a slowdown, positive year on year figures are still expected.

The key ingredients to a further and more robust economic recovery (especially in the West) lies with consumer confidence and private economy investment. These two factors are expected to stage slow recoveries over the next few years. Even though the world economic recovery is expected to remain rather fragile and subject to stop – starts, the IMF is forecasting growth levels of 3% plus over the next 3 – 5 years.

Turning to shipping, the last year has been a year of painful but so far largely bloodless adjustment, as relatively few shipping companies have failed and there have been preciously few bank foreclosures.

Banks have largely traded non-compliance waivers and moratoria / restructures, in exchange for re-pricing of all affected loans. Owners facing financial difficulties were not in a position to successfully resist the demands by banks and banks themselves felt too weak to force the issue and sustain losses. In addition, banks had some sympathy for owners' sudden predicament, especially if they had not over expanded or acted foolishly.

During the year, whereas the container sector remained especially hard hit and the tanker sector weakened, especially the clean, by about 20% between February 2009 and 1st October 2009, dry bulk recovered smoothly to levels that are not far off the sector's long run BDI averages of approx. 2900. The BDI rose from 773 at the beginning of 2009 to a high of 4000 in June 2009 and to approximately 2360 currently.

Further sustained growth by China, the stabilisation of the world economy and the banking system, as well as, prospects of a gradual recovery have helped overall shipping sentiment. A recent Moore Stephens survey noted an improved market sentiment in the shipping industry over the last three months. It is true that both banks and owners are concerned with the large order book and the increasing rate with which new vessels are being delivered. However, for dry bulk shipping at least, the combined effects of scrapping, newbuilding cancelations, delivery delays and congestion have resulted in a near flat fleet growth in 2009 and a tentative but still fragile recovery of sorts. Although the prospects for shipping remain uncertain and the remaining newbuilding order book remains daunting, nevertheless, both banks and owners now find themselves in a more stable position. Even though for the dry sector the position has now improved somewhat, the tanker and container sectors have yet to show any demonstrable recovery. These two sectors can only recover once the western economies start to recover and there is increasing east – west international trade and a rise in oil related energy demand.

In conclusion, although demand for shipping across all sectors is expected to show a robust recovery, the supply of tonnage outlook remains still in doubt. For a sustained shipping recovery, the rate of newbuilding cancellations must be substantially increased, shipyard newbuilding capacity contained, newbuilding delays maximized as well as, scrapping increased. Only then can a market equilibrium be maintained for an across the board shipping recovery.

SHIP FINANCE – THE WAY FORWARD

The past year has been well utilised by banks to gauge the quality of their loan portfolios, focus on specific problem clients and agree more attractive spreads and fees for loan restructures, moratoria and / or financial covenant default waivers.

Having addressed to the best of their ability, both the quality and profitability of their loan portfolios, and having developed specific strategies for specific “watch” clients, banks are now expecting the revised terms to be honoured by their clients. It is expected that non performing clients from now on will be treated more firmly, as banks cannot afford to keep on delaying being repaid.

In addition, as banks are finding their feet and as they are re-building their capital bases, they will feel increasingly more confident to accept loan losses, where these cannot be avoided.

It has been widely anticipated that banks will “turn the screws” on problem clients from 2010. To an extent, this is a realistic expectation, as banks are often compelled to take write offs for non-performing loans and will not wish to see such write offs increase. On the other hand, for credits involving young vessels, good managements and good client relationships, banks will have no benefit in realizing losses and switching the assets to other management or owners.

The only reason such a switch may be merited if a new owner would be prepared to enhance the bank's security or to inject fresh funds, rendering him a better risk.

No doubt, the strength or weakness of the market, its prospects and the ability of clients to cover interest and at least part of the principal shall impact on the willingness of banks to provide further support to non-performing clients.

Banks are very keen to also increase the rate of natural reduction of their loan portfolios, via loan repayment and pre-payment of loans. At the same time, banks have been much tougher in their treatment of newbuilding finance, where compliance to lower asset values has resulted in a massive reduction in commitments and drawdowns. Banks wish to use the above reductions to reduce the size of their overall shipping loan portfolios and / or make available fresh funds for lending to high quality, core clients on excellent (for the bank) terms. Thus far, lending for new businesses has been almost zero. The exception has been for cases where existing clients acquire new vessels and are willing to cross collateralise them with existing vessels. Such finance is useful in achieving a better asset to loan ratio for the bank and enables a clients to acquire a new vessel using today's relatively low prices.

WHEN WILL SHIP FINANCE RESTART

As banks' liquidity and capital position improves, so will their willingness to provide ship finance. However, ship finance is competing with other forms of finance for bank allocation of resources and banks' appetite will be adjusted to reflect the above. In addition, should the shipping market remain poor, banks will be unwilling to increase their shipping loan portfolios at the time of further stresses in the shipping industry.

Surviving ship finance banks are quick to announce massive ship financing needs with ranges varying from $500bn (Clarkson's) to $733bn (FORTIS BANK, Netherland). However, the considerable newbuilding cancellations and delays, the use of alternative finance, newbuilding lower valuations, as well as, owners' additional equity resources, is likely to reduce the above amount considerably. A further reduction will be achieved from the natural wastage of banks' existing portfolios releasing liquidity. It is difficult to provide accurate estimates of the sums involved, but for the Greek ship finance scene should the industry be willing to maintain current levels, the additional funds involved, based on a global and shipping recovery in due course, do not cause undue concern. The only exception lies with the departure for new shipfinance of the largest lenders, e.g. RBS, HSH and others in the short term before new banks shall enter the ship financing field.

Interestingly enough, Asian banks in general and Chinese banks in particular, are stepping in to provide fresh ship finance. This is available to their local (regional) clients. However, in order to assist fresh newbuilding orders at Chinese shipyards and for re-sales, Chinese banks (EXIM and others) have been offering competitive finance. The high spreads (3% plus) commanded by banks for new ship finance coupled by the lower funding cost and improving market prospects will, no doubt, attract newcomers into ship finance over time. After all, such attractive rates are usually locked in for a number of years, with heavy prepayment fees, which is not encountered in many other industries.

Greek owners are concerned that non-Greek banks will become "regional" in their focus category for their domestic clients at the expense of their international assets. This is a worrying trend (also identified by the IBRD bank) as 75% of

Greek shipping is financed by non-Greek based banks. This is, however, a short term approach by banks to appease their domestic central banks and states. As banks shall regain their decision flexibility, this trend should reduce.

One thing is certain, for vessel values to rise, in addition to all the usual market factors, the bank appetite to lend must return, as not many aspiring vessel buyers are willing to finance their purchases in cash.

I expect that ship finance will recommence in 2010 and gather pace, provided the shipping market shall not be disastrous. New ship finance loan production will need a good 3 – 5 years to return to the 2008 record levels. Such period of relatively tight finance should assist shipping in keeping newbuilding orders low and should provide ship financing banks with additional profit opportunities. Maintaining a tight ship finance policy by banks is on the whole beneficial to the shipping industry in order to curve the effects of previous over ordering and to assist the industry to reach a much needed equilibrium earlier.