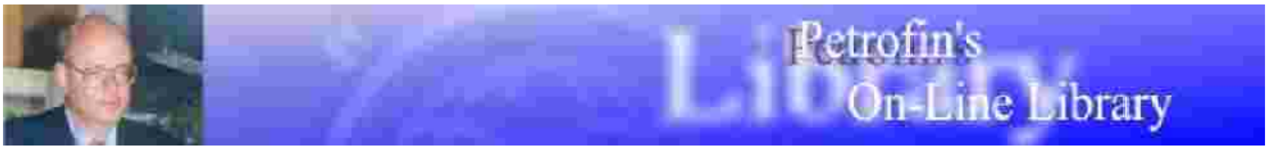
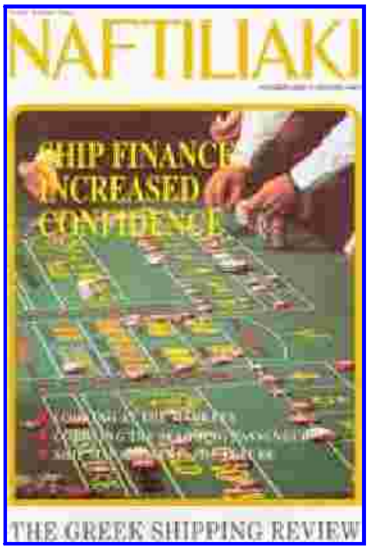


Shipfinance: Reviewing 1994

by Ted Petropoulos

Winter 1994



Nineteen-ninety-four was a year of increased shiplending activity and intensified competition among Banks. Encouraged by the worldwide economic recovery and the positive prospects for shipping, owners and Banks alike, displayed increased confidence, writes Te etropoulos, Managing Director of PETROFIN EPE.

In 1994, as secondhand dry cargo vessel values rose an newbuilding prices remained at competitive levels, there was a ref using by owners towards newbuildings, well supported by Banks looking for high quality, modern assets. In addition, owners sought better opportunities in the wet and specialized sectors that offered better risk/reward opportunities.

Banks moved to support owners' choices enthusiastically for standard type vessels and at least adequately for more specialized t nnage. Supported by a healthy recovery in the capital ratios of International Banks, more and more Banks begun to be attracted by the relatively hig loan yields offered by the shipping sector.

Research by PETROFIN EPE, shows the number of Internat onal shiplending Banks to have risen to 119 in 1994, from 89 in 1993 and 67 in 1992. Moreover, the shipping portfolios of Banks incre substantially in 1994, a year of record shiplending volume.

This put an end to the "credit squeeze" fear of a few years ago and shows that Banks have been quick to notice the enhanced cred risk status of shipping in the 90's and the attractive yields.

In reflection of the increased competition, especially for the "middle" to "top tier" clients, overall shiplending yields have continued to drop. As a rule of thumb, average Bank spreads have fallen by bet an eighth to a quarter for typical transactions in the $5.0m - $20.0m category but arrangement fees have been reduced by between 30% and 50% as a result of the keenness of competition.

Despite the above, shiplending spreads are still very tractive and the number of Banks either entering or positively re-evaluating the shipping sector, is still rising.

Thus far, the increased competition has not seriously affected credit quality and although the percentage of finance has risen by approximately 5% i.e. from 60% to 65% for average transactions, most clients have in compensation, demonstrably higher liquidity and cash f as well as, enhanced ship management operations.

There are another two key features of shiplending in 1994, namely: The average term of loans has increased, and most Banks ha shifted the maximum age of vessels at the end of their loans from an average of 15/18 years to 18/20 years.

The above key features are quite understandable for th following reasons:

- A higher percentage of finance based on a higher vessel value does require a longer period of repayment, if the nece loan to cash flow margins are to be maintained.
- Owners have taken advantage of their relatively stronger position to obtain more comfortable repayment schedule.
- With the increasingly stringent attitude of classification societies, insurances, port authorities and flags, the erage quality of vessels in Banks' portfolio has risen, thus supporting a more elongated repayment policy.
- Banks themselves have paid more attention to the technical side of vessels through their own approval surveys, as well as, insisting on quality insurance coverage, which itself requires better quality vessels. Banks have been asked to finan t least part of these life extension programmes and exte structural surveys as to the vessels' condition. As such, quality older tonnage has maintained full employment status at rates that are not widely different from those obtained by their younger brothers. This trend has encouraged lenders to provide longer term loans for vessels that are approximately 20 years at maturity.

The syndications banking market has been relatively qu with most owners preferring to apportion their business among co peting Banks not only to ensure competitive rates but also to maintain their driver's seat.

Club deals have gained in popularity but in most cases Banks remain "asset hungry" and would not give up well-performed assets unless they would keep the majority of the fees and a "wrap around" portion of the spread. Many prefer a "do it alone" policy.

A key feature of the market is that club deals rarely involve UK Banks, although they are more common among Northern European-based Banks. In most cases, the number of participating Banks is st only two to three with the lead Bank lending up to two thirds of the loan amount.

Another trend has been for Banks to cautiously open th minds to more specialized vessels i.e. ferries, chemical tankers, reefers, ro-ro vessels etc. Provided the clients in their sector could demonstrate their expertise and established shipping market position, Banks would consider lending but at lower percentages and high margins than “main stream” shiplending.

With the Banks meeting thus far all the capital requirements of the industry, it is quite understandable that in terms of public issues and private placements, 1994 was a rather quiet year. Neve theless, attention was focused to the Greek and Oslo stock exchanges, where the first participants have paved the way for other to follow.

In order to maximize risk free profits, shipping Banks have also stressed their private banking products, as well as, auxiliary services. An additional feature has been the encouragement of Joint Ventures among clients of different nationalities and/or those offering differen skills and contributions to each venture, thereby creating synerg ic profits. In these cases, Banks enjoy good fees at the right of first ref sal to finance such ventures.

In addition to financial muscle, shipping Banks have b un to invest more hastily in human capital by tapping into the new abundant supply of academically well qualified and experienced shipping executives that have selected shipping and ship fiance as their chosen indu ry careers. These highly numerative officers have made increasing use of cialized computer shipping software to analyse markets and pres t finance decisions in a modern and sophisticated manner.

Lastly, the development of on-line information systems and abundance of shipping statistics, trends and forecasts have given e banker an outstanding ability to have all the necessary market information “right at his fingertip”. The information revolution has truly rendered the ship g industry an open one without information barriers.

Looking to the future, ship mortgage finance will remain the mainstay of shiplending. The number of active shipping Banks will further increase but the trend towards lower Bank loan yields will slow down as Banks resist the pressure from owners and competition. Further increases in 1995 in dry cargo vessel values and interest rates, will begin to ndermine the financial base of the shipping industry, since the higher loans, interest rates and vessel operating costs will also increase the necessar daily breakeven rates to unsustainably high levels.

Most owners and Banks have built their cushions for th and as usual, it is the aggressive ones that will pay the price.

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