

## **Latest major developments in shipping finance**

### **Denizcilik finansmanındaki son gelişmeler**

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#### **Abstract**

The ship finance is no more a fixed science than is any other sort of finance. Financial terms, conditions, banks and shipowners become ever more sophisticated. Because shipping is a highly capital intensive industry, with its 32,000 world- wide companies is one of the three most finance intensive industries in the world, about 80 billion dollars per year for financing new buildings alone. The financing of large ocean-going ships are undertaken by banks all over the world, by no means just for owners in their own country. This is so as banks are willing to finance, during boom periods, shipping loans for new buildings but by this way ‘create’ oversupply and thus depress the freight market by their own actions. Therefore, ship values can change by up to 65 percent in a few months. A five year old Panamax bulk carrier, for example, could be purchased for US\$ 13.5m and achieve freight rates of US\$ 5,500 per day in 1999 while a similar profile vessel was worth US\$ 46m and achieved freight rates in excess of US\$ 46.000 per day in 2005. For this reason, the shipowner can make, or lose millions of dollars and so can his bankers if things go badly wrong. For these reasons, the principle subject of this study is to examine a significant increase in alternative capital sources in recent years. Debt and equity from the public markets, German KG systems and Islamic finance, can all now be regarded as commonplace in the shipping finance market.

**Keywords:** Shipping Finance, liberalisation, kommanditgesellschaft, mergers, acquisitions.

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## **I. Introduction**

The merchant shipping finance is one of the products of the industrial revolution (James, 1929). The ship finance has been facing dramatic changes since Cyril James wrote these words in 1929. While global demand for banking services remains strong, the deregulated market place is forcing individual shipping companies for new and existing customers. As cost pressures and service demands escalate, ship owners and bankers or financiers are collaborating strategically to share resources and information while also realizing economies of scale.

There are many models suited to the financing of ships, and numerous different ways of structuring these models by means of commercial banks, ship mortgage banks, investment and merchant banks, finance houses, brokers, leasing companies and shipbuilding credit schemes.

Ships have made its way up to become an accepted asset class in equity and loan portfolios. The world banks market has realized that ships are considerable value over time and are able to be sold on and remarketed. Therefore, a larger number of banks have entered the market for increasing their earnings and thereby ship financing techniques have become innovative and sophisticated.

The intention of this article was to highlight some aspects of developments in the shipping finance because of becoming an increasingly important market for the banking sector.

## **II. The Importance of Shipping Finance**

The United Nations Conference on Trade and Development (UNCTAD) estimates that the operation of merchant ships contributes about US \$ 380 billion in freight rates within the global economy, equivalent to about 5 % of total world trade.

In addition, the shipping industry, with its 30.000 world-wide companies is one of the three most finance-intensive industries in the world, needing, by rough estimation, about 80 billion dollars per year for financing new buildings alone (Goulielmos *et al.*, 2006).

Today mammoth containerships nudging the 10.000 TEU barrier yet still capable of 25 knot operating speeds; huge oil tankers and bulk carriers that carry vast quantities of fuel, minerals, and grain and other commodities around our planet economically, safely and cleanly; the complex and highly specialized workhorses of the offshore industry; and the wonderful giants of

the passenger ship world are all worthy of our greatest admiration (The IMO Library Services, 2006). For example, container ships and tankers can cost up to \$ 150 million each even some ships can cost \$ 300 million such as big LNG ships.

Capital payments dominate shipping companies cashflow and decisions about financial strategy are among the most important that their executives have to make. For this reason alone ship finance deserves a special place in the study of shipping economics (Stopford, 1997).

More than most other forms of finance, ship finance is international. The financing of large ocean-going ships are undertaken by banks all over the world, by no means just owners in their own country. On the contrary, and certainly for larger ships and larger owners, one is more likely to find, for example, an American bank, acting through its London office, lending to a Greek-controlled owning company and securing itself on a Liberian registered ship. There may be a degree of patriotism but if a foreign bank can offer better terms, then owners, accustomed to international dealings in the everyday operation of their ships, will not be troubled about dealing with foreign lenders (French, 2006).

The shipping finance has mainly two advantages. These are the universal currency of the US dollar and the importance of English Law. Furthermore, "London has a reputation as a centre for innovative ship finance structures and other options such as leasing. In ship finance, foreign commercial banks in London accounts for 17% of the global market (International Financial Services, 2005).

### **III. The Developments of Shipping Finance Methods**

The mainly world bank's range of products and services for shipping companies operating on an international scale includes long-term ship-mortgage loans, finance during construction and structured ship finance. The commercial banks or financial institutions assist its customers both in carrying out projects to build new vessels and in purchasing ships from other sources.

Originally, it is only in the last 20 years that there has been any significant development in alternative sources of capital available to shipping. These sources include both of debt and equity from the public markets, tax-based partnership such as the K/S in Norway and KG in Germany, tax lease finance, equity funds and so on. Some of these financial products only become available periodically depending upon conditions in both the shipping and financial markets. At the time of writing, bank debt finance remains the

dominant source of capital, providing over 70 percent of the industry's external finance needs. This is unlikely to change much in the foreseeable future, especially for bulk shipping, although much will depend upon how the shipping markets perform in the future (Brauner *et al.*, 2006).

The number of banks interested in financing ships and the appetite for greater risk and underwriting capacity for such assets has grown substantially. Shipping finance now attracts a diverse group of financial institutions that range from shipping banks and project finance houses to export credit agencies and newer sources of finance such as *Kommanditgesellschaft* ('KG') funds, Initial Public Offering ('IPO'). Banks are willing to stretch loan maturities, reduce pricing, relax loan covenants and take higher project and country risks.

With plenty of cash in hand, shipowners are looking at other ways of raising finance, and the banks have been keen to respond. For this reason this article also deals with two newer sources of developments in the shipping finance;

### ***III. I. Kommanditgesellschaft ('KG')***

According to basic principals, a KG consists of two different kinds of shareholders. One is the so called "Komplementar" (general partner), who bears unlimited liability for the actions of the KG. The other one's assumes the management's duties, whereas the "Kommanditist" (limited partner) is only an investor and his liability is limited to the amount of his share. No minimum capital is required (Ownership). The KG purchases vessels and charters them to shipping companies. The purchase of the vessel is financed by equity provided by the investors (usually 35-50 per cent) and a bank loan (usually 50-65 per cent) secured by a first ranking mortgage over the vessel (Ownership, 2004).

The 2006 figure for KG funding of shipping would be similar to that in 2005, but more diversified from containerships. The biggest impact on the KG market are changes in German tax law rather than changes in the shipping market, but it is important to stick to high quality transactions to ensure good dividends act to retain investors for the future and reduce the risks of non-performance in a market downturn. The current lack of growth in the KG market is due to a lack of good products not a shortage of liquidity. The outlook for KG is good, but there could be changes in time charter arrangements, with shorter first charters and perhaps more spot market activity. KGs have a good future as investors have made good returns. Now investors are much smarter than when KGs were largely tax driven and are

more interested in the underlying asset and markets, rather than just the tax deductibles. For big liner companies it is a matter of capital costs and which structure is cheaper for them (Matthews, 2006).

While containerships have been the traditional home for KG funds, these funds are now looking into other areas, for example, tankers and bulkers. Another development has been the emergence of a secondary market. Whereas before, KG shares carried only limited opportunities to be sold on, these shares can now be traded. There are, at present, a number of platforms where an investor can opt to trade KG shares (Macqueen, 2006).

### ***III. II. Initial Public Offerings***

Fleet operators have seen unprecedented earnings over the past five years. Rising Chinese demand for oil and related products, commodities like iron ore, plus the shifting trade balance between China and the United States, was matched by a jump in maritime IPOs. While globally, there were just four maritime IPOs totaling \$393 million in 2001, the number jumped to 27, worth \$6.07 billion in 2005, with \$3.05 billion in U.S. listings. The total slid to 14 IPOs worth \$2.8 billion in 2006, with \$1.4 billion in U.S. listings, as uncertainty over shipping rates on the spot market. (Carey, 2007).

What is more, in 2000, publicly traded tanker firms had a market capitalisation of just \$2.5bn; today the figure is in excess of \$21bn. The stock market value of firms operating bulk carriers has soared from almost nothing to about \$6bn (McGroarty, 2006). Shipping companies listed at the Nasdaq raised about \$1.7bn via IPOs and \$328m in secondary offerings within the last year. According to lloyd's shipping economist's statistics, Asia had the highest number of listed shipping companies, 77, compared with 52 in Europe and 37 in the US. Aggregate market capitalisation in Asia was about \$60bn, slightly less than Europe's \$66bn, but well above the \$25bn in the US (Matthews, 2006).

In 2005 was a record-breaker for initial public offerings of equity securities of shipping and shipping services companies in the US. The uses of proceeds of a large part of the offerings were to finance or refinance the purchase price of vessels prior to repay indebtedness incurred in connection with the acquisition of vessels. Moreover, New York Stock Exchange and size are traded on the Nasdaq National Market. Historically, reasons to choose the NYSE have included perceptions by issuers of greater prestige and a determination that the open outcry auction market conducted by the NYSE is a superior model. Reasons to choose the Nasdaq have historically included a desire by issuers to

associate with technology and high growth companies and a determination that an electronic order matching system is a superior model. (Jensen, 2005).

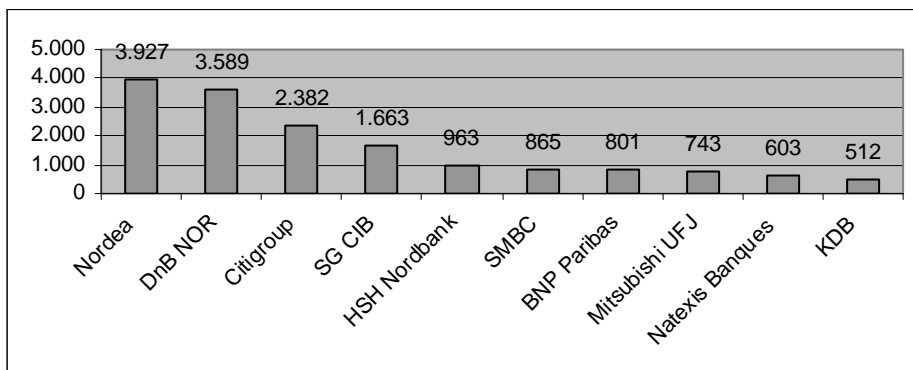
In conclusion, many US institutional investors and fund managers are expressing interest in shipping. Foreign shipowners should not forego those investors. The US capital markets are open to anyone who can make a good case and who has nothing material to hide (Wolfe, 2006). Initial public offerings from maritime shipping firms may be thin on the ground in 2007, not for a lack of investor interest but because many operators are flush with cash.

### V. Ranking of Banks

The most important financiers of the shipping industry are commercial banks, consisting of mainly European banks such as Nordea, Fortis, ABN Amro, Royal Bank of Scotland, Deutsche Schiffsbank, Citigroup and Den norske Bank.

Generally, these banks offer term loans for periods between 2-10 years. The financing amount is usually based on a certain percentage of the market value of the financed ship, unless credit enhancement is used (such as time charter, mortgages on sister-ships in the fleet, sponsor guarantee), in which case debt/equity ratio can move up to 70-80 %, possibly with mezzanine financing (The European Bank, 2001).

**Table 1.** Top 10 Shipping Bookrunners (BNP Paribas, 2007).



In 2006 demonstrate the high level of activity in this funding category by the two Norwegian shipping banks, Nordea and DnB NOR: They occupied first

second places respectively in the rankings of shipping portfolio sizes. At the same time between them the two Norwegian banks accounted for a market share of 42.7% for bookrunning of syndicated shipping loans and 42.4% for the role of mandated arranger. In both cases, they were well ahead of the third placed banks, Citigroup as bookrunner and French bank Calyon for mandated arranger. The concentration of syndicated shipping loans among the leading banks is illustrated by the fact that the top 10 banks were responsible for 81.3% as bookrunners.

These international banks have some disadvantages that one of the most important is lack of skilled personal. The shipping finance involves the exercise of a number of important skills which are based upon expertise and knowledge of the various shipping markets, particularly knowledge of recent transactions which form the basis of the market at any given time; it should also be stressed that delivering such services to clients requires a good sense of timing of transactions as well as integrity and discretion.

## **VII. Conclusion**

Shipping finance has play important role in the maritime sector. However, the combination of increased competition within the banking sector and increased asset prices means the current phase in the shipping cycle is a dangerous one for banks involved in traditional ship finance. With the inevitable market downturn that will occur, both freight rates and asset prices will fall. Banks that have made loans based on overly generous margins during the peak of the cycle will likely experience a rash of defaults and see their capital base eroded during the market downturn. Banks that have adopted a more conservative approach through the market peak are better positioned to maintain and grow their portfolio during the market downturn (Lunde, 2005).

Consequently, shipping finance continues to grow, and the world shipping industry has responded to demand for its services. But, shipping markets are cyclical and notoriously volatile, and today's unprecedented markets are unlikely to continue for ever. Charter rates are expected to fall across the board through 2009-10 due to the increasing rate of new building deliveries. A recession in the US or China, or a political shock may exacerbate this trend further by reducing demand growth. Nevermore, the financial and economic integration forces are leading to the emergence of larger multinational financial institutions because virtually all sectors of the industry have benefited from the recent global shipping boom. The another reason is that all banks financed shipping projects should comply with IMO standards for safety and protection of the environment and ships should be operated in open

and commercial markets because of the tanker market is healthy with 70% of remaining single hulls likely to be scrapped by 2010.

## **Özet**

Denizcilik finansmanı; diğer finans türlerinden farklı bir yapıya sahip değildir. Ancak finansal terimler, koşullar, bankalar ve hatta armatörler her geçen gün daha da denizcilik alanında kendilerini geliştirmektedirler. Çünkü denizcilik sektörü, Dünya da 32.000 denizcilik şirketi ile en yoğun hareketli piyasaları oluşturmaktadır. Son yıllarda gemi inşa sanayisine yıllık olan talep miktarı 80 milyar dolardır. Ve bu gemilerin almında finansman kaynağının büyük bir bölümünü bankalar oluşturmaktadır. Bankaların verecekleri kredi miktarlarına göre de denizcilik sektöründe arz talep dengesi harekete geçer. 1999 yılında 5 yaşında olan Panamax kuru yük gemisi 13 milyon dolar'a alıcı bulurken, 2005 yılında bu rakam 46.000 dolar'a çıkmıştır. Bu yüzden armatörler bankalar aracılığıyla milyonlarca dolar kaybedebilir veya kazanabilir. Bu çalışmanın amacı da denizcilik sektöründe yeni finansman modellerini incelemektir. Ayrıca şirketler arası birleşmelere de değinilmiştir.

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