Lloyd's List

Shipping finance

A special report

Shipping finance

Shipping finance is grappling with the big question of what is pragmatic and achievable as opposed to idealistic but over-ambitious when it comes to climate goals. Those at the top are struggling to maintain a vision, while the squeezed middle is happy to pay for availability and focus on the immediate markets.

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Many bankers are deeply concerned that they are going to become the greenest bank with the fastest-declining loan book.

Rhetoric vs reality: ship finance approaches an inflection point

Availability of financing is about to become a defining issue of an industry that is already fragmenting into tiered markets defined by scale, efficiency and climate ambition, **Richard Meade** reports

While enough companies are making good money, paying down debt and holding back on orders, the record low point of outstanding shipping debt across the industry is barely noticeable. For now.

However, availability of financing is about to become a defining issue of an industry that is already fragmenting into tiered markets defined by scale, efficiency and climate ambition.

At the most public, visible end of the market, environmental, social and governance criteria is the defining acronym of an era.

ESG-fuelled hesitancy is restricting the orderbook, holding back investment and leading many of the advanced-guard of bankers to become deeply concerned that they are going to become the greenest bank with the fastest-declining loan book.

At this top tier of the industry, the focus is on alignment to the 1.5degC climate goals of the Paris Agreement.

The strategic objectives are about funding the fuels and infrastructure of the future, rather than worrying about the growing concern in some quarters that not enough attention is being paid to funding the transition of the existing fleet.

Debt equity for genuine green finance may be plentiful, but the existing $1.8trn fleet tends not to fall into such colour schemes. Most financing in shipping remains a defiantly unattractive and expensive sludgy hue.

Yet if there is a looming debt equity crisis, then there are no signs of it yet at the other end of the market, where the retrenchment of banks is old news and the more expensive 'alternative' financing options — as they remain quaintly known — have become business as usual for the perennially squeezed middle of shipping's small to medium-sized backbone of owners and operators.

In the Greek market, for example, activity has been at record levels when it comes to shipping finance since the beginning of Covid — and all with barely a mention of ESG at any stage of the transactions.

Greece, of course, has what the rest of the world lacks: a local banking sector that is both focused on lending to shipping and understands the shipping markets.

The Greek banks — and the four key Cypriot banks focused on maritime that largely service the Greek market — are more aggressive than ever, particularly given the reduced margins with which they operate.

The global story of how banking stepped back from shipping in the wake of the financial crisis and Chinese lessors and alternative funding stepped in, is well understood.

The German banks that disappeared from shipping by and large were never replaced and, while everybody still wants to finance the top 10% of the market, the reality is that — historically speaking — banking's commitment to shipping is not what it used to be.

Not so in Piraeus, though, where banks gradually filled the void left by other Western banking exits to dominate the market that serves second- and third-division owners with expensive debt.

Ship finance teams in the major law firms report that they have never been busier and activity has been building for the past two to three years.

Availability is everything and, in the current climate, the more expensive money is being snapped up at margins of 9%-11% in order to take advantage of the market and buy tonnage.

Agile funds are quick to step in where owners are unable to raise the quick cash required, but most are now finding additional alternative funding and re-financing within a year.

At no point are any of the actors in these deals pausing to reflect on the portfolio implications of efficiency — and ESG is not an acronym that tends to trouble completion.

Nor is it much of an issue in China, where the dominant lessors remain conspicuous by their absence in the list of signatories to programmes like the Poseidon Principles.

"We certainly like to finance cleaner ships, but we also need to engage in the less-clean ones," explained one leasing executive recently, neatly summing up the distance between rhetoric and reality in the ship finance sector currently.

The lower tiers of the industry, it seems, are fully focused on the immediate market and happy to leave climate finance questions to the blue-chip owners and their corporate cargo interest partners.

Yet at the top of the industry, there is a very different battle raging when it comes to ship finance. The reality is that for all the best efforts of those committing their portfolios to meeting climate change goals, investors are not looking at shipping as a home for ESG capital right now.

Texbr/Alamy Stock Photo

In the Greek market, activity has been at record levels when it comes to shipping finance.

As one Asia-based chief financial officer of a listed company put it when asked whether they were receiving a lot of ESG questions from equity investors: "Are you joking? Those guys left the table a long time ago.

"They left shipping and they left Asian stock-listed companies. Maybe some are left looking at Europe or North America, but that's not something we get asked."

That needs to change, of course, but the speed at which shipping can manage that change is a major concern for the finance community.

Inside shipping's flagship climate finance programme, the Poseidon Principles, there is a schism emerging between those pushing to accelerate towards more ambitious climate goals and those looking at the reality of their portfolios and arguing for a more pragmatic approach.

Those inside the Poseidon Principles — which provide a framework for integrating climate considerations into lending decisions to promote international shipping's decarbonisation — have been clear for some time that their targets will accelerate to net-zero emissions by 2050, although no official announcement has yet been made.

The implications of this are clear: net-zero commitments by banks and investors mean their capital will ultimately be directed into the net-zero club of shipping businesses.

That means climate change is effectively becoming the filter through which investment is being considered, so there will be increasingly less capital for those industries and assets exposed to carbon risk.

The only question is the pace and the uniformity of the decisions ahead.

Those at the vanguard of climate alignment are understood to be considering adopting the more aggressive 'well-to-wake' measurements (i.e the entire process of fuel production, delivery and use on board ships, and all emissions produced therein) on net zero.

Depending on which interpretation those banks are considering adopting, that could imply a 50% cut in emissions by 2030 across portfolios — a pill that is going to be hard for many banks to swallow immediately.

"We are trying to balance our hopes and dreams here with the reality of our loan books," explained one Poseidon banking insider.

The tension here is that the banks know only too well that the large corporate entities and many of the big brands they deal with are already demanding significantly more progress on climate alignment than is offered by the Poseidon Principles as they stand.

A more aggressive trajectory for the Poseidon banks implies that there will be a significant hit on what the banks are going to be willing to finance.

Then the alignment reports, which place banks' shipping portfolios on one side or the other of the emissions curve, start to matter. This is not a matter of idle speculation from armchair environmentalists. Members of the net-zero banking alliance are going to have to begin to forecast emissions in their portfolios, broadly speaking, by the end of 2024.

For those banks exposed to liquefied natural gas fleets — which are going to have an interesting discussion when it comes to well-to-wake measurements — the decisions that follow are going to be difficult when it comes to their annual ESG reports.

The question of what is pragmatic and achievable as opposed to idealistic but over-ambitious then becomes a live debate not just for the banks, but the entire supply chain.

Vladimir Zuev/Alamy Stock Photo

An examination of recent sustainability-linked financing and so-called 'green bonds' in shipping shows modest progress.

Green goes mainstream in shipping finance

Sustainability-linked loans are on the rise, amid criticism over greenwashing, a lack of detail about targets to be met and the size of discounts, **Michelle Wiese Bockmann** reports

Shipping finance is increasingly linked to maritime decarbonisation targets — although whether the terms 'green' or 'sustainable' should be attached to loan conditions is up for debate.

"There's a lot of greenwashing going on," one New York-based financier told Lloyd's List during a recent visit.

The alignment of sustainability targets with financial performance is enshrined in the Poseidon Principles, to which 31 banks with more than $185bn in maritime debt are now signatories.

Those principles are further aligned with the International Maritime Organization's greenhouse gas-reduction targets, already subject to criticism for their lack of ambition.

Yet an examination of recent sustainability-linked financing and so-called 'green bonds' in shipping shows modest progress, if not an acknowledgement that at least a baseline has been established.

Copenhagen-based Torm chief executive Jacob Melgaard, who also chairs the board of Danish Shipping, said more loans reflected looming decarbonisation goals.

"There's more to be done between financial institutions and the [shipping] industry," he said.

"We're in the early phase... and, over time, there will be more and more linkage."

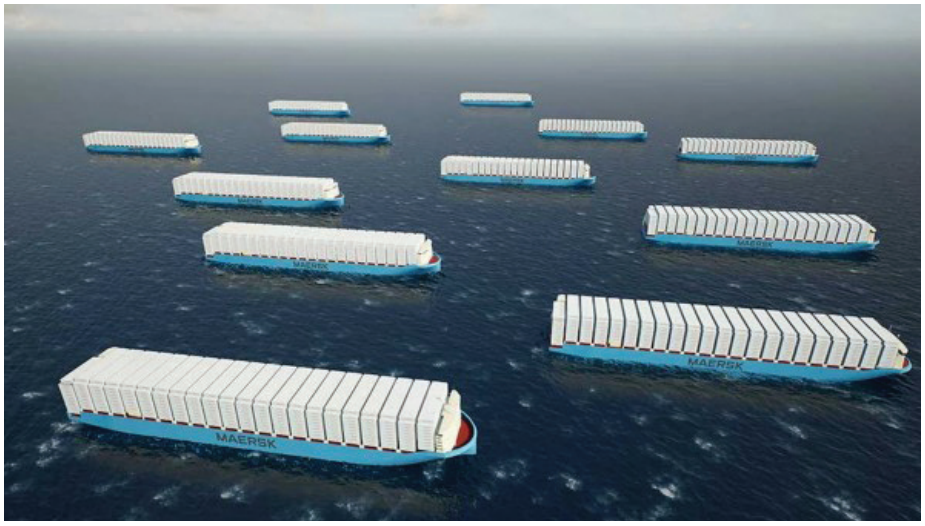
Torm signed its first sustainable loan in November 2020.

London law firm Watson, Farley & Williams — which most recently advised ING Bank on a sustainability-linked Japanese leasing deal for Stolt-Nielsen — said deals were driven by regulatory targets and a desire by participants "to be seen to be green".

"Banks are very supportive for green/sustainable financing, but they also have an obligation to be commercially sensible and reasonable," said WFW maritime group partner Simon Petch.

"They're not innovative venture capitalists; they're relatively conservative financial institutions.

"As a shipowner, there's a lot to be said for being ahead of the curve because you don't know exactly what the regulation is going to look like when it comes in or how rapidly it is going to evolve."



A.P. Moller-Maersk

Maersk launched a €500m ($496.3m) green bond in November 2021 to partially finance its $3.7bn order for methanol-fuelled newbuildings, now at 12 ships.

Banks to 'reconsider' covenants

Another WFW partner, Maren Brandes, who advises international banks on ship finance, said banks will not wait until a shipping company is in difficulties for non-compliance with environmental regulations.

"You have to ask the question about where we're headed," Ms Brandes said.

"With all the regulations coming into force, banks will want to reconsider their covenants in the next couple of years.

"At some point, when the pressure becomes higher — when there are repercussions that are meaningful if you're not compliant — then covenants dealing with environmental compliance might become quite as important as financial covenants."

There have been four high-profile boxship green finance or bond deals in the past two years, viewed as signs of increased consumer pressure for cleaner, more efficient transport.

They include the world's second-largest container line, Maersk, Seaspan Corp — a division of Atlas Corp, which leases vessels to container lines — as well as Hapag-Lloyd, a container line that owns and operates 230 ships.

MSC, the largest line, also announced a $1.3bn refinancing with a revolving credit facility linked to green targets in November 2020.

Maersk launched a €500m ($496.3m) green bond in November 2021 to partially finance its $3.7bn order for methanol-fuelled newbuildings, now at 12 ships.

The transaction priced at a coupon of 0.75%, which Maersk said was the lowest ever annual interest for the container line.

> *There's more to be done between financial institutions and the [shipping] industry. We're in the early phase... and, over time, there will be more and more linkage*

Jacob Melgaard
Chief executive
Torm

> *The tanker market has only just ended an 18-month period of pandemic-induced loss-making spot rates, while orders for LNG carriers have surged in the past 12 months*

Hapag-Lloyd's €300m green bond, launched in March 2021, as well as Seaspan's private placements exceeding $300m, funded the latest-generation engines for their liquefied natural gas, dual-fuelled newbuilding orders. Each chose technology with the lowest level of methane slip.

These second-generation engines are being installed on 12 ultra large containerships, of 23,500 teu, for Hapag-Lloyd, with the first due to be delivered in the first quarter of 2023.

Technical studies show these engines offer the lowest levels of unburnt emissions of methane, an increasingly polemic greenhouse gas for shipping amid the transition to LNG-fuelled propulsion.

The fine print in US Securities Exchange Commission filings shows collateral Seaspan vessels must annually fall below IMO targets for their average efficiency ratio, which measures the ratio of a ship's carbon emissions per capacity-carrying distance. (The AER is expressed as dwt per nautical mile sailed.)

Green bonds, such as those used by Seaspan, will not finance ships that carry fossil fuel — yet the tanker and gas carrier sectors are most in need of capital.

The tanker market has only just ended an 18-month period of pandemic-induced loss-making spot rates, while orders for LNG carriers have surged in the past 12 months.

Listed tanker owners — including Hafnia, Ardmore Shipping Corp, International Seaways, d'Amico International Shipping and Euronav — have all announced sustainability-linked deals this year.

Margins on loans

D'Amico chief executive Paulo d'Amico described the discount applied to his company's $82m sustainable loan, announced in June, as "very limited".

Ardmore paid slightly less for its three sustainable loans, used to refinance 12 vessels in June and July, than the original facilities it paid off.

The three loans, totalling $308m, included six tankers under lease arrangements.

Some $185m was with Nordea Bank and Skandinaviska Endkilda Banken via a revolving credit facility.

The second was a term loan with ABN AMRO Bank and Credit Agricole Corporate and Investment Bank.

Both were at the Libor equivalent, plus a margin of 2.25%. They replaced facilities with a 2.4% margin.

Euronav's $713m sustainability-linked senior secured credit facility had a rate of Libor plus a margin of 2.35%.

That rate was higher than prior terms, which showed Libor plus a margin of 2.25% on the 2014 facility that the new loan paid off, SEC filings show.

If greenhouse gas-reduction targets are met, there is a reduced interest coupon of five basis points, lowering the loan to Libor plus 2.3% — still higher than the 2014 loan, according to filings.

In June, Euronav entered into another sustainability-linked $150m loan when it bought out International Seaway's 50% stake in two floating offshore storage vessels.

The interest rate is lowered when Euronav reaches two sustainability-linked key performance indicators, the company said, without disclosing those terms.

Hafnia's seven-year, $374m loan, signed in March 2021 with a 10-bank syndicate and backed by 29 tankers, had a similar adjustment mechanism that discounted loan terms if undisclosed targets were met.

> *With all the regulations coming into force, banks will want to reconsider their covenants... Everybody wants new technology, but not many people want to pay for the development*
>
> **Maren Brandes**
> Assets and structured finance partner
> Watson, Farley & Williams

> *Banks are very supportive for green/sustainable financing, but they also have an obligation to be commercially sensible and reasonable. They're not innovative venture capitalists*
>
> **Simon Petch**
> Maritime group partner
> Watson, Farley & Williams

Even so, Hafnia's 2021 annual report showed that the weighted average effective interest rate on its borrowings was unchanged from the previous year, at 1.8%, suggesting a negligible impact on the bottom line.

LNG-fuelled vessels eligible for loans

The lack of transparency of KPIs and the IMO-linked targets are at the forefront of criticism over green maritime finance.

LNG-fuelled vessels classify to be eligible for a green loan in the EU, even though the alternative fuel has been criticised by the World Bank, which recommended against funding a related natural gas maritime infrastructure.

WFW partner Ms Brandes highlighted the work that New York-based Entrust Global was undertaking via Purus Marine and its Blue Ocean 4Impact fund.

"Everybody wants new technology, but not many people want to pay for the development," she said.

Figures from signatories to the Poseidon Principles suggest there is some way to go before all credit is aligned with even the most basic of targets.

The IMO has committed to a 40% reduction in carbon intensity in international shipping by 2030 and a 50% cut in greenhouse gas emissions by 2050.

In all, 11 out of 23 ship finance portfolios of Poseidon Principles signatories were aligned with this target, according to the latest annual report. Some of the biggest European banks, including Credit Suisse and ING, reported negative scores.

However, with all signatories now measuring loans against these targets, going green has become mainstream.

Zoonar GmbH/Alamy Stock Photo

It is envisaged that total shipping-related bank loans for all banks as of the end of 2021 amounted to an estimated $340bn.

Banks make a cautious comeback

Ted Petropoulos reviews the state of global ship finance and finds that a long-awaited recovery in bank lending to the industry in 2021 is already showing signs of stalling in 2022

Following the 'annus horribilis' of 2020, when the global economy shrank due to the coronavirus pandemic, 2021 came as a huge relief to the shipping industry, as well as to its bankers.

The world economy and seaborne trade expanded again, while fleet growth was limited. Charter rates shot up for most sectors except tankers — and vessel values followed suit.

Against the background of this remarkable turnaround, banks faced an increased demand for loans, as well as competition from other non-banking lenders.

Based on the latest Petrofin Research, the Top 40 ship financing banks' portfolios collectively reached $290bn at the end of 2021 — a year-on-year increase of 1.12%. This growth may appear small but it represents the first rise since 2011.

The Petrofin Global Index shows the development of ship finance against the growth of the global fleet from 2008 to 2021.

The long decline in ship finance loans was mainly due to the departure of many large European ship financing banks over the period.

This withdrawal process seems to have run its course and bank lending in 2021 marks a long-awaited recovery.

However, comparison with the growth of the global fleet makes it evident that fleet growth was not financed by banks alone but by non-banking funding, including fleet cashflows and owners' liquidity.

Delving into the bank lending market in 2021, new business was robust, especially towards the second half of the year.

However, although most banks were active in looking for lending opportunities, this was offset in their overall end-year portfolios by a number of factors, including significant loan runoffs and loan prepayments as a result of vessels sales or refinancings from other banks or leasing providers.

There was also a decline in loan syndications, which, according to Dealogic, was in the order of 25%.

As the year progressed, owners got the upper hand over lenders and competition increased, mainly from Far Eastern leasing companies. There was also increased bond issuance in 2021.

Another factor impacting on lending volumes was a slowdown in the newbuilding orderbook, which fell from 200m dwt at the end of 2020 to 177m dwt at the end of 2021, according to Clarksons, before recovering to 219m dwt again by mid-2022.

Petrofin's research shows that out of the top 40 banks, 15 showed an increase, 12 a fall and nine remained unchanged. Four banks entered the ranks of the top 40 for the first time.

BNP Paribas remains the leader, even though its total portfolio reduced primarily, as we understand, due to reclassification reasons.

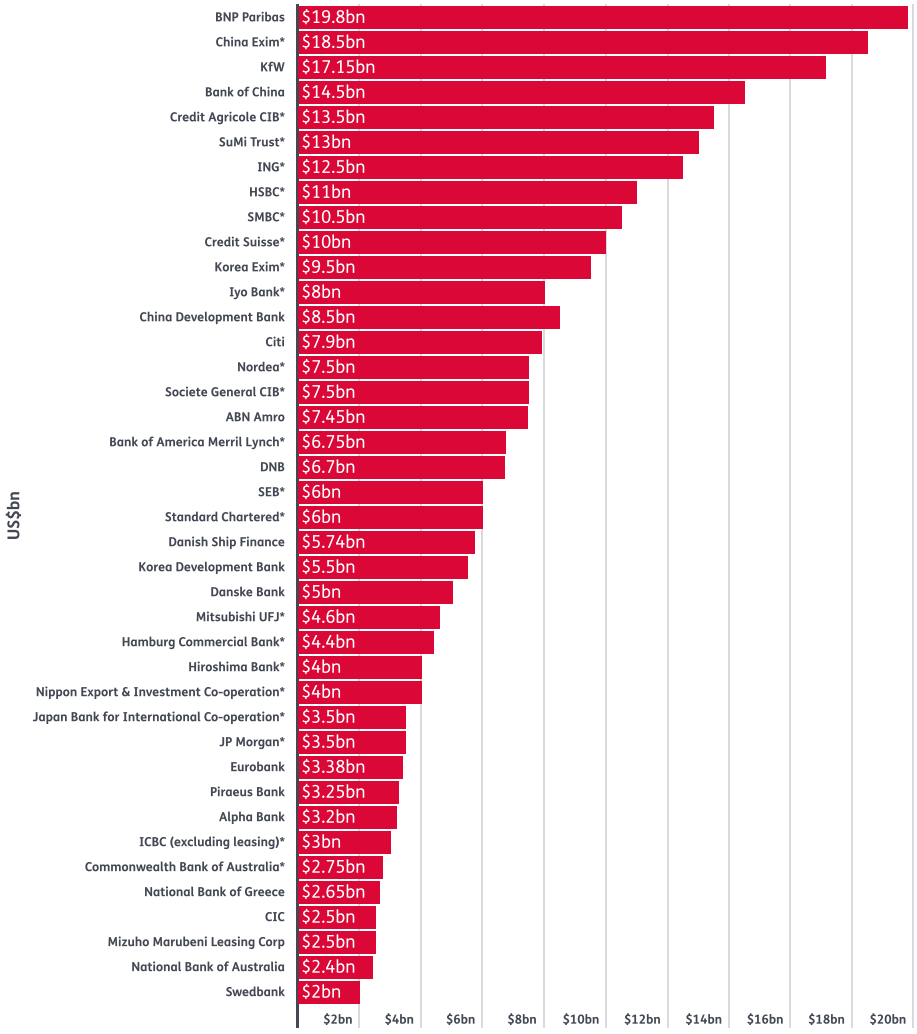
It should be noted that not all banks adopt the same criteria as to what sectors are covered within their reported/estimated totals, in terms of inclusion of cargo vessels, offshore, cruise vessels and other sectors. The majority of banks are unwilling to disclose breakdowns of their portfolio but a few have begun to do so.

Within the Top 40, 21 banks are European-based, 16 are Asian/Australia-based, and three are based in North America. European banks still hold the lion's share, with an aggregate of $157.2bn.

There was a trend among relative newcomers and smaller banks — such as Bank of Cyprus, Hellenic, Pareto, M&M Bank and others in this category — to grow during 2021, providing plurality to the available sources of bank finance.

It is envisaged that total shipping-related bank loans for all banks — including numerous domestic banks across the globe that are outside the scope of this research — amounted to an estimated $340bn as of the end of 2021.

Top 40 banks in global ship finance as of end 2021



**market estimate*

Source: Petrofin Research, August 2022

> *Based on the latest Petrofin Research, the Top 40 ship financing banks' portfolios collectively reached $290bn at the end of 2021 — a year-on-year increase of 1.12%*

Ted Petropoulos
Founder and head of research
Petrofin

Additionally, although banks may still command the majority of ship finance, leasing by Chinese, Japanese and other nationalities has grown dramatically in recent years.

During 2021, however, there was a slowdown. Chinese leasing stood at $66.5bn in 2020, but no reliable figures are available for 2021.

Worldwide, 12 leasing companies during 2021 represented collectively a total portfolio of $59.1bn (source: Marine Money and Petrofin Research).

It has been increasingly difficult to obtain leasing and loan portfolio figures from Asian banks and lending entities. However, we are of the view that the total global leasing portfolios are substantially higher.

Funds, too, have focused on ship lending and have provided higher loan-to-asset ratios at reasonable costs — something that was useful in the buoyant market conditions experienced in 2021.

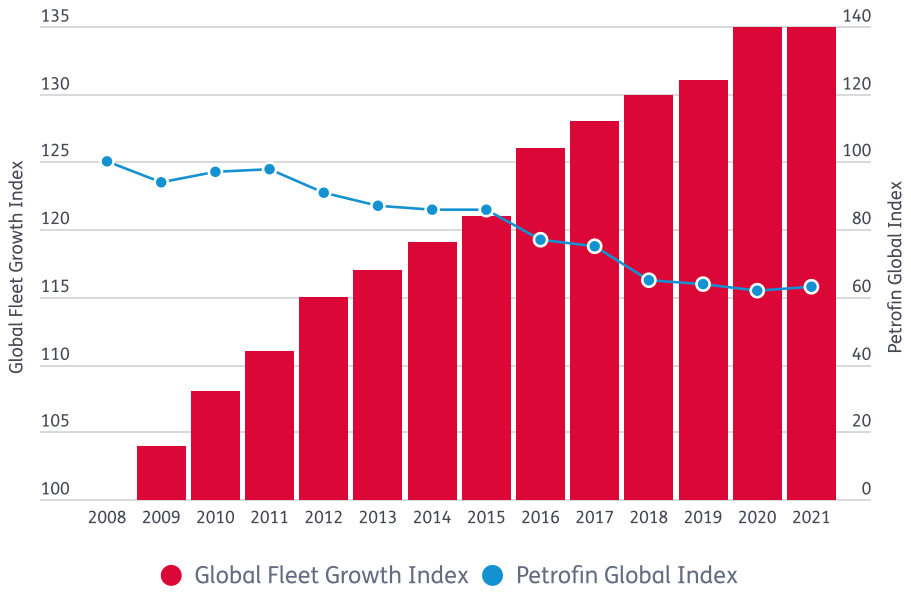
Further export finance was provided mainly for European newbuildings, supported by Export Credit agencies such as Hermes, Coface, Atradius, Eksfin and others, largely for offshore and smaller specialist vessels.

To the above sources of finance, we also need to add shipping bonds and capital markets-related funding.

Any estimate of global ship finance exposure, including all forms of direct or indirect finance, is an exercise that needs to be approached with caution, as there is a scarcity of information, especially from Asian lenders and from lending funds on a bilateral basis.

As an indication only, however, Petrofin Research estimates that total global ship finance exposure, including leasing and all other forms of finance, at the end of 2021 amounted to about $500bn, with bank loans accounting for about two-thirds of the total.

Petrofin Global Index vs Global Fleet Growth Index



Source: Petrofin Research, August 2022

Prospects for 2022

The global situation changed abruptly with the Russian invasion of Ukraine on February 24, 2022.

It led to geopolitical sanctions, high energy and commodity prices, a dislocation of trade, higher inflation and interest rates, a slowdown of global growth and a decelerating demand for shipping.

Tankers benefited enormously in the post-invasion rush to meet demand, primarily in Europe. China experienced near-zero growth as a result of pandemic-related lockdowns and Chinese loan demand has remained low, despite record state spending.

The Chinese slowdown resulted in reduced port congestion and a much weaker dry bulk market.

Inevitably, the new geopolitical circumstances and the poor economic outlook have made owners and banks more cautious.

Owners have preferred to build up their liquidity, as well as repay loans or refinance them at a lower cost.

With dry bulk weakening, the front-loaded amortisation of loans preferred by banks is being replaced by longer and flatter repayment periods.

The higher interest rates have adversely affected cashflows and have resulted in higher loan breakevens.

At the time of writing, banks are still keen on new business to maintain their lending portfolios but viable new loan generation is reducing.

For the buoyant tanker sector, there remains apprehension as to how long geopolitically-derived demand will last.

Bank loan margins are being squeezed as owners have access to alternative sources of finance and often opt for higher leverage as opposed to lower margins.

All in all, the ship finance outlook is now uncertain and this has begun to affect new loan production.

A bright development has been the increased popularity of sustainability-linked loans provided by lenders participating in the Poseidon Principles.

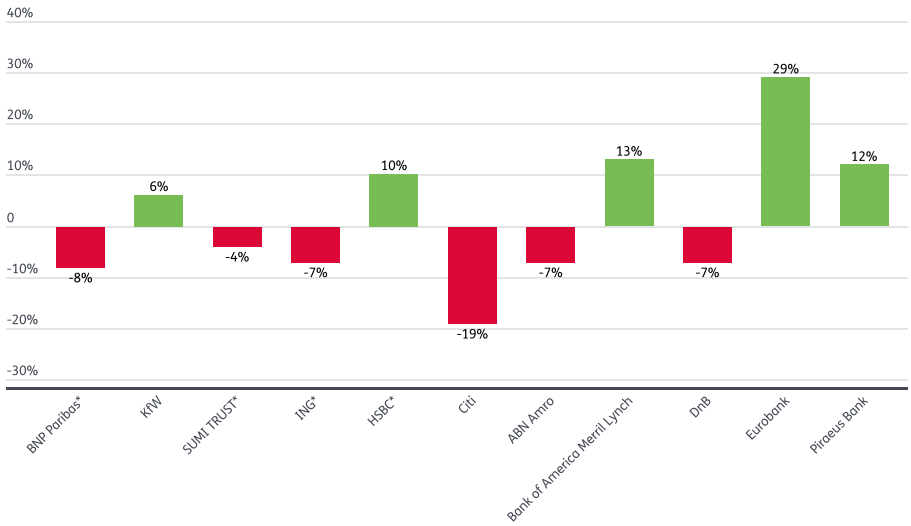
Banks have targeted such loans and provided some incentives to owners in terms of pricing, although in themselves, the incentives are not significant in swaying owners towards green technology.

With regard to new technology to address stricter post-2030 requirements, banks are waiting to see the new technology, cost implications, as well as the support to be provided by the market towards such vessels.

For the time being, the emphasis of both owners and banks lie with tier-3 newbuildings, which seem to represent an intermediate choice compared to more advanced technologies.

The outlook for shipping and ship finance for the next couple of years will partly depend on whether recent geopolitical events represent a transient or a permanent change.

Selected bank portfolio changes (2020-2021)



**market estimate*

Source: Petrofin Research, August 2022

Sustainable financing propels MISC's ESG ambitions

The global focus on environmental, social and governance (ESG) principles has led to the worldwide expansion of sustainability-focused investments

Six very large ethane carriers were purchased by MISC with a sustainability-linked loan.

Focus on the ESG principles delivered a pivotal year in 2021, with a record $649bn channeled towards ESG-related funds compared to $542bn in 2020, based on Refinitiv Lipper data. ESG funds now account for 10% of worldwide fund assets.

In maritime, ESG's integration into the long-term decision-making and strategic planning process continues to gain momentum and is key towards shaping a sustainable future for the industry.

High on the agenda is the push for rapid decarbonisation to achieve the International Maritime Organization's (IMO's) goals for its greenhouse gas (GHG) strategy.

The maritime industry is expected to require investments in the order of at least $1trn to meet the IMO's GHG emissions reduction targets by 2050.

Given the substantial capital expenditure required, financial institutions play a critical role in supporting the maritime industry's transformation and sustainability agenda.

The launch of the Poseidon Principles in 2019 marked a significant milestone in establishing the framework for responsible maritime shipping finance that is aligned with the IMO's climate targets.

That has led to growth in the adoption of green and sustainability-linked financing for the maritime industry.

It makes good sense for industry players looking to invest in their future growth to consider the adoption of a sustainable financing framework as part of efforts to holistically embed ESG into their business strategy.

At MISC, the experience in structuring its first sustainability-linked loan (SLL) financing was both meticulous and introspective. The company worked with Standard Chartered to raise a syndicated $527m, 11-year SLL to finance six very large ethane carriers — among the largest of their kind in the world — purchased in July 2020.

Standard Chartered, as structuring bank, worked with other lenders to develop the SLL structure that included two key performance indicators (KPIs) related to environmental and governance targets.

Setting up the KPIs required careful consideration to ensure targets are ambitious yet achievable and aligned with MISC's long-term business strategy.

A unique feature of the SLL is that it motivates the borrower to achieve ambitious, predetermined ESG performance targets. For MISC, this would mean the annual adjustment of the interest rate benchmarked against the agreed KPIs.

For the duration of the loan, the average efficiency ratio of MISC's Gas Assets & Solutions (GAS) fleet and its anti-bribery and corruption systems will be monitored annually.

Both KPIs are benchmarked above leading market standards, including the IMO 2050 decarbonisation trajectory, and aligned with the calculation methodology of the Poseidon Principles and the ISO 37001 Anti Bribery Management System, with progressively tighter levels aligned with MISC's net-zero GHG emissions reduction aspirations.

The results will be independently verified by a third party over the loan period.

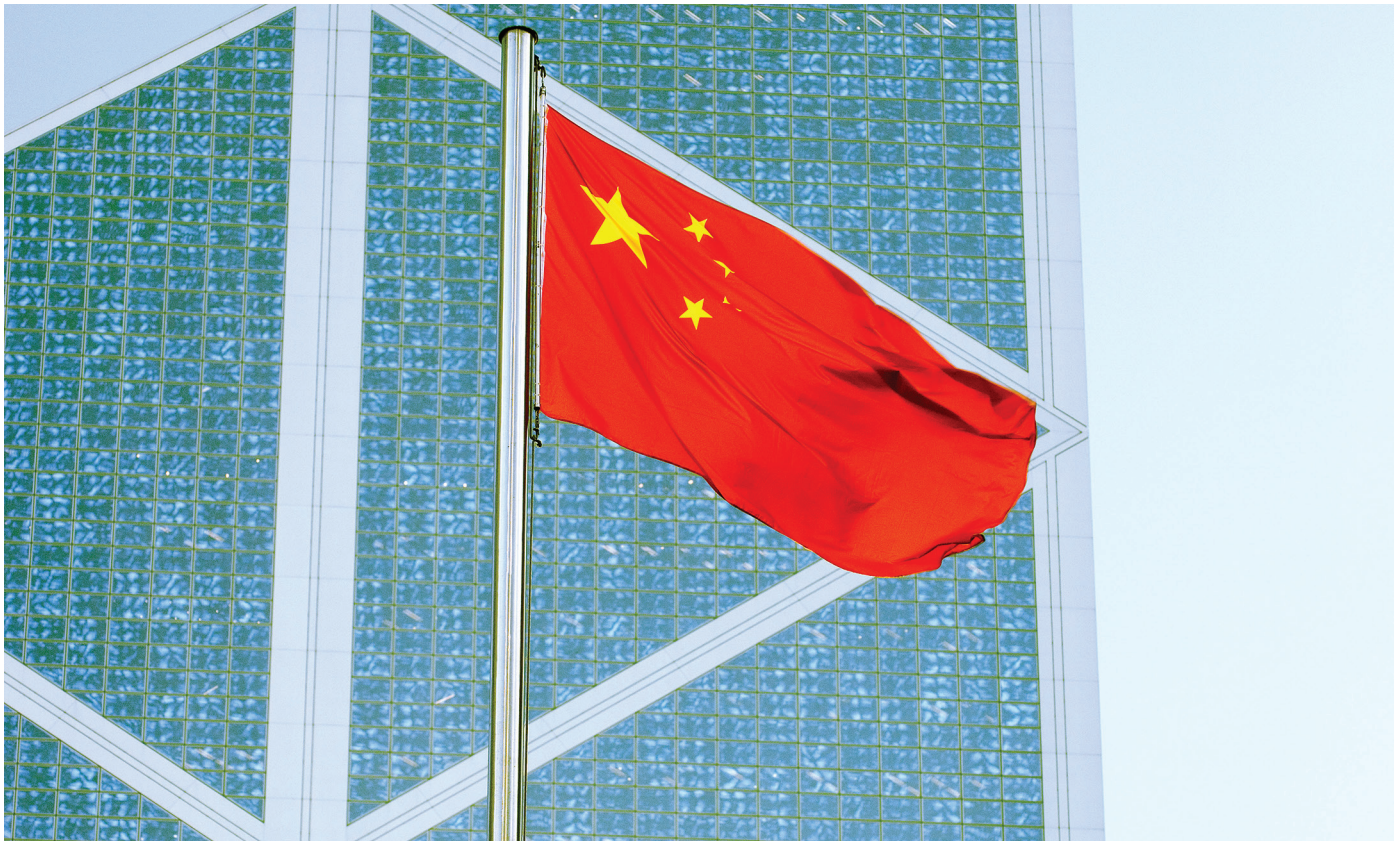
Having a like-minded financial partner is critical in ensuring accountability in setting and meeting ESG goals and alignment with overall strategic priorities.

MISC was able to leverage Standard Chartered's knowledge of sustainable financing and, through its robust engagement with the bankers, the company was able to build a deeper understanding in identifying potential sustainable financing solutions.

MISC has committed itself to achieving net-zero GHG emissions by 2050 and has set transitional short- to medium-term strategic initiatives that are vital to enable it to reach its targets.

These include a medium-term target of reducing 50% GHG intensity from its shipping operations by 2030, benchmarked against the baseline year of 2008.

Building on the experience from its first SLL, MISC will continue to explore potential SLL and green financing solutions to propel its ESG ambitions to drive positive change across the maritime landscape and accomplish a shared, sustainable future ahead.



David Lyons/Alamy Stock Photo

China's corruption crackdown on the financial sector has stoked concerns over compliance pressure on leasing lenders.

Chinese ship leasing struggles to weather anti-graft storm

Heaped compliance pressure, restrictions on using shipbrokers and concerns over further regulatory scrutiny could all slow business — but lessors are said to remain active and keen to change the perception of them being out of the game, **Cichen Shen** reports

Ship lessors embroiled in Beijing's recent anti-graft efforts leave behind a key question: are they still a global solutions provider — or is the lustre wearing off?

Thriving on the exodus of Western shipping banks, Chinese leasing houses have grown at a blistering pace, with some seeing their vessel portfolio expand tenfold over the past decade, led by US dollar-denominated lending to overseas owners and charterers.

However, the business shuddered off a convulsion after Li Li, a former senior executive at Export-Import Bank of China, was placed under formal investigation by Beijing's top anti-corruption agency at the beginning of 2022.

Since then, a string of well-known ship finance figures in the county — including several who led the shipping division of leading leasing companies — have become the target of state investigators and even removed from their offices.

This has stoked concerns that the probes, as part of China's latest corruption crackdown on the financial sector, will heap compliance pressure on leasing lenders, hence dwindling the appetite for shipping assets.

Leasing sources in China and those close to them said their expansion has slowed this year. And there are reasons related to both regulations and markets.

Owing to the latest market boom, the affluent dry bulker and containership owners are in no rush to borrow, while the current high asset prices amid declining freight rates are not seen as the right entry timing. Many Chinese leasing firms are still biding their time, they said.

Meanwhile, a higher dose of circumspection is now required for the use of shipbrokers, which regulators often consider as a hotbed for misconduct involving bribery in ship finance transactions.

BonkersAboutPictures/Alamy Stock Photo

China still needs leasing houses to support newbuild demand at its shipyards.

The side-effect of the requirement is that it gets more difficult to deal with foreign customers who are the main source for lessors to grow assets in US dollars.

"Most deals with foreign ship operators will need to involve brokers," said one manager from a large Chinese leasing house.

"Direct contact with familiar overseas clients is more effective via travelling, but we can't do this at the moment because of China's Covid-led travel restrictions."

A bigger concern is whether the corruption probes will lead regulators to put the sector "under the magnifying glass", said a Hong Kong-based shipping executive who also engages in leasing deals.

Most Chinese leasing houses — especially the major ones in shipping — are subsidiaries of large banks in the country. They are required to keep a minimum of 8.5% tier-1 capital adequacy ratio, which indicates roughly a leverage ratio of up to 12 times.

At the same time, bank-backed lessors also have access to cheap, short-term inter-bank lending — even though projects financed are mostly long-term, lasting for at least several years.

"This borrow-short-and-lend-long model with high leverage is allowed assuming the credit or asset risk is low," said the shipping executive.

> *"Ship finance is part of the banking system that involves global trade. You cannot simplistically say that for geopolitical reasons, Chinese leasing is not safe"*

"But does a highly cyclical industry like shipping fall into that category?"

Bank loan-like financial leasing is safer. Yet in recent years, lessors have increasingly favoured the other model — operate leasing — under which they become the de facto shipowner, entitled to the upside or downside potential of the vessel's asset value, depending on the market direction.

The latter type of arrangement could also be more vulnerable to the volatility of freight rates in the absence of a fixed-rate, long-term charter contact.

"Chinese leasing companies made inroads into global ship finance after 2012 when asset prices were relatively cheap, so their returns so far have been quite handsome and they have not encountered any significant industry recessions like 2009," the shipping executive said.

"But that doesn't mean they will never meet one. If the regulators see this as a problem, they might take action to curb the business."

For now, at least, there is absolutely no reason to be overly worried about the situation, according to Christoforos Bisbikos, a partner at law firm Watson Farley & Williams, who advises Chinese lessors on ship finance projects.

There are changes, he admitted. For example, leasing houses with executives directly implicated in dishonesty charges could experience changes in personnel and internal approval procedures that may delay transactions.

And, while brokers remain instrumental in facilitating ship leases, more deals are likely to be done directly between lessors and ship operators in the future.

Yet overall, the flow of transactions has not been affected and lessors' lending appetite remains "intact", he said. "They want to do business."

Market conditions have shifted as owners are no longer flocking to shipyards for vessels across the board. However, lessors are still bustling in certain market sectors, such as liquefied natural gas carriers, where orders abound.

"Even for those that have been directly affected, I hear in the markets that they want to do deals and are actually offering more aggressive terms, because they want to eradicate this perception that we're out of business," said Mr Bisbikos.

He also shrugged off concerns that geopolitical uncertainties, highlighted by the escalating US-China discord, are overshadowing the prospects of Chinese leasing.

"Ship finance is part of the banking system that involves global trade. You cannot simplistically say that for geopolitical reasons, Chinese leasing is not safe."

One Singapore-based shipping executive close to Chinese lessors said they are unlikely to fall victim of the heavy-handedness of policymakers in Beijing, who struck a big blow to the country's property developers and tech giants, among other sectors.

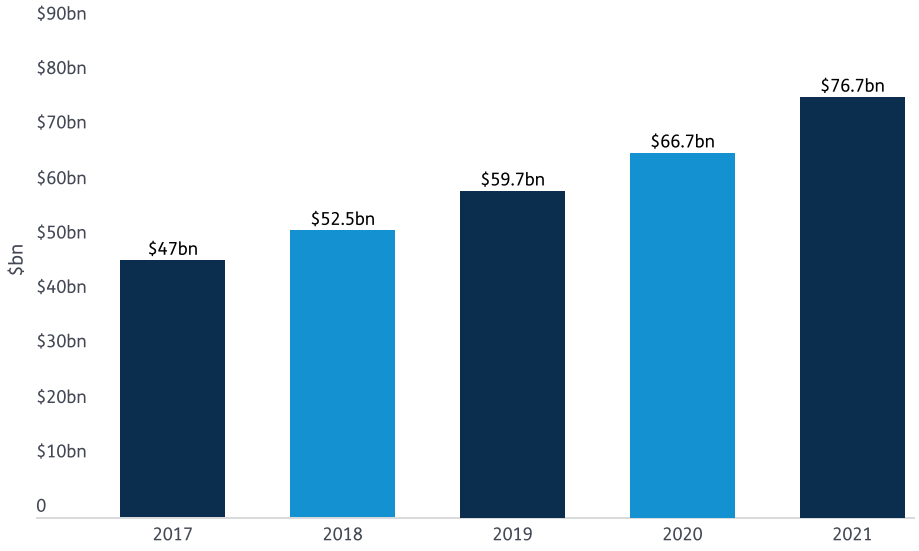
The investigations and detentions will just be an "interlude" for Chinese ship leasing, which remains a profitable business, he argued.

And China still needs the leasing houses as an important tool to support ordering demand at its shipyards. A sufficient flow of merchant newbuilding projects will not only keep the builders afloat commercially, but also sharpen their skills and technological edge when building naval ships, he said.

"Shipbuilding is still a strategic industry for China, particularly now amid the tensions in the Taiwan Strait," said the executive.

"So of course there is increased compliance pressure on the lessors in short term, but the long-term impact will be minor."

Ship assets of Chinese lessors based on outstanding balances



Source: Smarine

Fintech aims to reboot lending to shipowners

Chin Leong Teoh/Alamy Stock Photo

Fintech platforms can offer bespoke opportunities to invest in low-risk, secured maritime loans with attractive yields.

Platforms that work on the same principle as dating apps are starting to have an impact on ship finance, **David Osler** reports

Dating apps have had a big impact on the world of personal relationships — and now platforms that work on the same principle are starting to have an impact on ship finance.

Two cases in point are eShipfinance.com — the pioneer in the field — and more recent arrival, Oceanis.

Both of them work on the basis of would-be borrowers seeking to finance vessels entering their requirements, with potential lenders — ranging from banks to private equity and family offices — able to show an interest if the profile looks enticing.

The idea is obviously sensible. Nobody in the industry will need to be reminded of the huge reduction in bank appetite for plain vanilla mortgages and straightforward loans since the shipping downturn that followed the global financial crisis from 2009.

The problems have been especially acute for the smaller entities that still constitute the sizeable majority of all shipping companies.

In particular, those with 12 vessels or fewer are far less likely to have bankers return their calls than they did two decades ago.

From the investor's point of view, the attractions of fintech platforms will include the potential bespoke opportunities to invest in low-risk, secured maritime loans with attractive yields, served up in an easy, fast and secure manner.

On a risk/reward basis, lending to shipping can compare favourably to other debt products such as mortgage-backed securities, investment grade corporate bonds, municipal bonds and direct investments.

For the borrowers, the touted benefits are speed and cost efficiency, and the ability to reach a wider lender base than might otherwise be available. Term sheets for viable projects can sometimes be ready in as little as three days.

By standardising the loan application process, clients with borrowing requirements should find it easier to optimise financing terms by dint of being able to check out the global lending market.

Fintech platforms may obviously be more suitable for some shipowners than others. The household names can still go straight to the banks, and larger tickets will usually find cheaper money through listing or the over-the-counter market. Yet smaller players are quite used to paying more for loans.

EShipfinance.com, founded in 2018, is the brainchild of industry veteran Dagfinn Lunde, well known for his stints at DVB, Det Norske Bank and Intertanko, and his business and life partner Marina Tzoutzouraki, also a ship finance professional with Credit Lyonnais and EFG Eurobank.

Legally speaking, it is a seven-member partnership domiciled in Cyprus — but in reality, it is the epitome of an internet company, with partners dotted around the globe.

Its website even proclaims that its corporate goal remains to disrupt and transform ship finance, utilising what it presents as a completely new way of doing business.

Base costs are correspondingly held back, making the platform profitable from the get-go.

Mr Lunde commented: "We don't believe old-fashioned ship finance can continue in the long run. We saw the banks pulling back and tried to find something new and different.

"At the time, it was a low interest rate environment and investors were interested in trying to get different deals, and we combine that with our expertise."

The reputation of Mr Lunde and his colleagues was certainly helpful to begin with, and the company was often approached by smaller shipowners looking for advice, including on restructurings and even on selling their companies.

Clients so far number in the dozens, with a business volume to date of around $55m.

Asked about the scale of his ambitions, Mr Lunde answered: "There is no limit, honestly. The shipping market is a global market, and that is an advantage when you are on the internet.

"If you have an office, you will be in Greece or Scandinavia, or in a certain place. With an internet platform, we can work everywhere. The Middle East, the Far East. That's the advantage."

However, he accepts that shipping is a conservative industry and will take time to adapt to a new way of doing things.

EShipfinance.com is aimed squarely at the two- to 10-ship guys, and is able to accept single-ship projects in the dry bulk and tanker sectors, providing financing of up to 50%. The target deal size will range from $3m to $20m.

> *We don't believe old-fashioned ship finance can continue in the long run. We saw the banks pulling back and tried to find something new and different*

Dagfinn Lunde
Co-founder
EShipfinance.com

Fixed interest rates do away with base rate risk, which will be a happy circumstance for those who have borrowed up until now, given the current inflation climate.

On the other hand, the low leverage involved should make the deals all but bombproof from asset value volatility.

To some extent, eShipfinance.com plays the role of an old style bank's credit committee. By the time a loan is presented to an investor, it is a very safe investment.

If the investor does not have the capacity to undertake analysis itself, it can — according to Mr Lunde — rely on the firm's analysis.

Oceanis was established a year later in 2019, and is led by joint managing directors Maximilian Otto and Erlend Sommerfelt Hauge.

As of June this year, it had built a base of more than 45 lenders, including traditional shipping banks, Asian leasing houses and alternative debt providers.

The Hamburg-based company claimed to have closed more than $200m in transactions for some 100 shipowners, and to have seen over $2bn in indicative terms.

"Ship finance got more complex with the exodus of many of the traditional banks. However, this has spawned a lot of innovation and new, very competent capital providers have covered the gap," said Mr Hauge.

"There is capital available, but in many cases this requires some structuring and fine-tuning to arrive at a solution acceptable to borrowers and creditors. Some guidance by industry finance specialists, early in the process, is very valuable to many shipowners in order to make the most out of the loan request and get the best terms possible.

"In particular, the maximum attainable leverage and expected repayment profile vary greatly between lenders and by segment, which makes up-to-the-minute market insight invaluable."

Small and medium-sized shipowners do not have the luxury of attracting the largest banks with the occasional capital markets mandates, which act as a magnet to banks with in-house capital markets desks, he points out.

Shipowners with fleet sizes below this level, or those that choose to remain private, attract a different set of lenders that tend to be more industry-focused, retaining a deep knowledge and appreciation of the shipping industry.

Variation of terms is high and the appetite and capabilities of the lenders wide-ranging. Consequently, there is a lot to be gained from structuring projects correctly and finding the right lender for your specific project's needs, he counsels.

> *There is capital available, but in many cases this requires some structuring and fine-tuning to arrive at a solution acceptable to borrowers and creditors*

Erlend Sommerfelt Hauge
Joint managing director
Oceanis