ASIAN FINANCING FOR GLOBAL SHIPPING – ECA FINANCE, CHINESE AND JAPANESE LEASING

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In the '80s and '90s, Asian shipping finance was mainly dominated by traditional shipping finance banks extending pure asset finance facilities[1] to Asian owners and operators. Fast forward to the Millennium: the maritime finance space has changed. Different breeds of financers are in our midst, and financial products are varied and lend (excuse the pun) themselves to permutations. Chinese leasing houses, Japanese leasing houses, and private equity funds join the group of financiers, while the same leasing companies and funds may also be seeking funding themselves for their maritime investments and projects. Asian financing has also globalised. Today, the reach of these financiers extends to European and US entities. The Asian maritime financing platform has become more diverse and colourful.

The cyclical nature of maritime, the resultant financial difficulties faced by some big shipping names, and the pressure levied on many international banks following stricter capital adequacy controls have all contributed to the growth of the funding gap in the maritime market. It is in this environment that the Chinese lessors, Japanese lessors and private equity funds have, very timely, emerged to offer alternative financing options. Unlike European leasing houses, which have established market characteristics demarcating the distinction between finance leases[2] from operating leases[3], Chinese leasing houses take a more pragmatic and commercial approach to their leases. Whilst Chinese lessors offer both financial and operating leases to their clients, the typical characteristics which traditionally distinguish financial leases from operating leases are often blurred, and the nature of the leases are driven by the commercial needs of the parties. These bespoke arrangements invariably require careful consideration and skilful drafting so that the parties' intention is clearly reflected to avoid any ambiguity, especially if challenging times come to roost. Chinese leasing may not necessarily be the cheapest option currently available; however, their relatively longer tenure, higher leverage, flexible and practical approach make them attractive and much sought after by the Asian and international owners and operators.

Japanese leasing houses also have financial and operating leases as part of their offerings, but these transactions are fewer in number, as these lessors are sometimes less competitive or may prefer to limit their activities to the Japanese market. A more popular Japanese product is the Japanese operating lease (particularly, the Japanese operating leases with call option (JOLCO)). The JOLCO is a tax-driven leasing structure funded by equity investment from a Japanese entity with non-recourse senior debt provided by an on-shore bank. The structure provides 100% financing at relatively attractive rates over a relatively long term. The 100% funding feature makes this a favourable product despite the lessee having to bear any change of law that may put the structure and its benefits at risk. Historically, JOLCOs were adopted mainly in the aviation sector before appearing in the intermodal space. It is only in recent years that JOLCOs have found some popularity in the maritime sector. This may be because the asset value of ships is more volatile in nature, making their residual values less stable and reliable. As there are not many Japanese equity providers, the arrangers and financiers advocating JOLCOs need to be selective with this product and their choice of lessee counterparties. We have, however, seen several financially strong and reputable owners and operators avail themselves of the Japanese operating lease structures, and believe that there is — and will continue to be — demand for such product for the right companies.

The impetus for the influx of more diverse financiers has also been driven by financiers' increased interest in the LNG, LPG and offshore sectors. Before the recent fall in oil prices, ships operating in this arena usually commanded better employment rates with contracts entered into with strong or government-linked counterparties. This piqued the interest of non-traditional shipping banks, including merchant banks that have been seen competing for the financing of high profile offshore and LNG projects. These banks have also been actively operating out of, not only their transportation teams, but also their project finance, structured finance, and export credit agency (ECA) teams. The expansion of maritime financing to various other banking groups demonstrates that bankers from different disciplines have a growing interest in energy-related floating assets. The classes of ships being financed are more sophisticated and complex, with the likes of floating regasification storage units (FSRUs) and floating LNG carriers (FLNGs) coming on line. These ships require specialised knowledge and experience in recognising the risks and issues associated with the contracts that employ them. They are not fungible in nature like containerships and bulkers, and seeking employment for them can be competitive and aggressive. Banks will find them hard to deploy if they are compelled to take them over as part of a "work-out." To mitigate the banks' risks and exposure in these financing projects, ECAs play a crucial and notable role. ECAs operate as a tool of economic policy and have a mandate to support domestic exports. Asian ECAs such as, CEXIM, SINOSURE, KEXIM, KSURE, JBIC and/or NEXI have played an invaluable role in Asian financing in recent years. Their increased activity within the maritime sector has grown hand-in-hand with the banks' appetite in the maritime sector, as well as the banks' enthusiasm to reduce their risk profile. As Korea and, in particular, China have stepped up efforts to forge formidable shipbuilding industries, the ECAs' support for maritime financing has become important and often necessary. The combination of uncertainty in the maritime market and changes in the financial sector means that ECAs are now viewed by many banks as an indispensable funding prerequisite in the shipping industry.

The modern banks' approach to ship finance has become more "all encompassing" and holistic, as banks are generally savvy about the various ways to mitigate risks[4] and to avoid dreaded calls from their restructuring teams. It is no wonder that the banks are adopting such approach. The maritime market is and has always been a cyclical one, with its intrinsically linked relationship with oil prices, demand/supply of goods and trade policies (not to mention Trump's!) always subject to economic vicissitudes.

Chinese leasing houses are not only significant financiers, but are also significant borrowers in the market. Many of the Chinese leasing houses are affiliated to Chinese state-owned banks or policy banks, state-owned enterprises or shipyards, but the origins of their US dollars funding are not limited to on-shore financiers (often from each other) but are also derived from offshore banks, private equity funds and foreign investment (via securities or bonds listed on foreign stock exchanges including Hong Kong and the US). Some of these Chinese lessors are viewed by certain banks as the new wave of "favoured" or "credit-worthy" borrowers in the market. Although many banks were initially cautious to lend to these lessors, over the last couple of years, possibly due to the lack of arguably "safer" borrowers, they have relaxed their attitude with several banks actively competing with each other to fund some of these lessors.

The Hong Kong government has also recently announced that it is considering developing a Hong Kong sovereign rated financial institution (substantially similar to an ECA), which may offer insurance services akin to SINOSURE and KSURE and may co-finance shipping loans. Watch this space. Hong Kong is keen to leverage off the Belt and Road initiative and compete for a share of the maritime financing activities that the Asian ECAs presently support.

Finally, let's also not forget the latest buzzword – blockchain. Blockchain-backed initiatives in shipping are gaining interest. No doubt Blockchain will also affect the Asian ship finance scene in the coming years, as this decentralized ledger technology will attempt to revolutionize financing transactions and impact the financial products in this market.

Interesting and exciting times are ahead – there is no such thing as "vanilla" financing in shipping today!

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1 Asset finance typically involves a security package essentially focused on the ship, its insurances, earnings, requisition compensation, shares over the shipowner, charge over the earnings account, and perhaps a corporate guarantee from the holding company.

2 Finance leases in their purest form commonly have the following characteristics: full pay-out termination sum, obligation on lessor to sell the ship, rebate or all but nominal portion of sale proceeds by lessor, parent support for lessor's obligations, control over sale of lessor outside lessor group, etc.

3 Operating leases do not usually have the characteristics of finance leases and, further, there is no obligation to purchase the ship on termination or natural expiration.

4 Banks now are moving towards a combination of project finance (ships need to be on medium to long term good charters) and ECA finance when funding in the maritime sector (on top of relying on the usual asset finance security).