



Article

Alternative Financing in the Shipping Industry

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In the decade since the global financial crisis, ship financing has undergone considerable change. Traditionally, debt financing with banks and equity financing were the most common methods used by shipping companies to raise money. However these forms of traditional financing have been increasingly replaced by alternative sources of funding such as convertible debt, private equity and sale-and-leaseback arrangements. This trend has increased over the past year caused by, in part, the volatility in the sector as a result of the COVID-19 pandemic, and certain banks, most notably many European banks, exiting the sector and selling their shipping portfolios or not taking on new business while existing loans are paid off.

Sale-and-leaseback arrangements have increased in popularity recently. Under a sale-and-leaseback arrangement the original ship owning company sells a vessel to another company, and then leases it back from them. The original ship owner then becomes a lessee and the new buyer a lessor. Sometimes the transactions will also include a purchase option, pursuant to which the lessee has the right of first refusal to repurchase the vessel at the end of the lease. Due to the increased popularity of sale-and-leaseback arrangements in 2020, BIMCO introduced SHIPLEASE, which is a standardized term sheet for use in sale and leaseback transactions.

Benefits of Sale-and-leaseback Arrangements

Sale-and-leaseback arrangements have benefits for both the lessor and lessee. They allow the original ship owner (the lessee) to raise cash and free up capital, thereby improving liquidity when they receive funds from selling their ships. Funds raised by the lessee can be used to invest in other activities or to fund operating expenses. For new builds or second-hand vessel purchases, such arrangements may be used by shipping companies to facilitate the delivery of the vessel without the shipping company (lessee) having to increase the company's debt or dilute its equity. The benefits for the lessor include increased security over the asset, as they will become the owner. Under traditional bank financing, in the event of non-payment or default the secured party would typically be required to commence enforcement proceedings to recover the asset, which may be both time consuming and costly. As the owner of the vessel, in the event of a default the lessor is able to terminate the lease or charter and take back possession of the vessel, which will be quicker than attempting to enforce a mortgage.

Chinese-leasing houses in particular are responsible for a significant proportion of the growth in sale-and lease-back transactions, which have seemingly grown exponentially in recent years. Whilst leasing houses were once primarily focused on the new- build market, they are also increasingly entering the second-hand market. The trends point toward further growth in sale-and-leaseback transactions throughout 2021.

JOLCO Transactions

Additionally, we have seen a rise in recent years of Japanese Operating Leases with Call Option (JOLCO) transactions. Whilst JOLCOs have historically been prevalent in financing arrangements in the aviation sector we have seen them being used increasingly in the shipping sector. These operating lease arrangements are funded by an equity investment from Japanese investors and senior debt financing provided by financial institutions to a special purpose vehicle (SPV) which finances the vessel acquisition costs by the SPV. The SPV and the shipping company simultaneously enter into a bareboat charter. Such arrangements provide shipping companies access to competitive lease rates and off balance sheet financing, and are popular in Japan due to specific provisions in Japanese tax law. JOLCOs represent a move towards alternative sources of financing in the shipping industry.

At Conyers, our Shipping Team has significant experience advising on matters of Bermuda law related to such sale and leaseback and JOLCO transactions. Some of these transactions have also included the registration of vessels on the Demise Register at the Bermuda

Shipping and Maritime Authority. The BSMA accepts both demise 'out' (where the underlying registry is in Bermuda and the ship flies the flag of another state) and demise 'in' (where the underlying registry is outside of Bermuda and the ship flies the Bermuda flag), thereby assisting both lessors and lessees.

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