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CHINESE SHIP FINANCE AND LEASING

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Introduction

- Chinese leasing houses are now major capital providers to the global shipping industry
- According to a survey published on 10 January 2019*, total ship finance drawdowns in 2018 amounted to \$12.6 billion which is around 5% higher than the 2017 figure
- Many of the largest leasing houses are owned by China's banks, e.g. ICBC, BoComm, China Merchants Bank and China Development Bank
- Non-Chinese shipowners have closed a number of deals with Chinese lessors in the last few years
- There is some pressure on the leasing companies to focus their financial support on China's shipbuilding industry at the expense of foreign shipbuilders
- The increase in activity in 2018 was achieved against a backdrop of continuing pressures on the wider Chinese economy and tightening banking regulations

* Smarine Advisors

Introduction

- Some traditional ship finance banks are funding Chinese leasing houses [e.g. China Exim advanced \$1 billion in 2018 and Nord L/B \$300 m]
- Lease financing is now a mature model of financing for global shipping
- Leasing houses can also access capital markets more rapidly than shipping companies
- Growth in 2018 was driven by leasing houses outside the “Big Four”
- As at the end of 2018, total shipping assets held by Chinese leasing firms grew 9% compared to 2017, now exceeding \$50 billion in aggregate

Impact on Greece

- Greek shipping companies have signed many high value deals with Chinese leasing companies
- Chinese financial lessors entered international ship finance market in a significant way in 2013
- Greece (and other prominent shipping hubs) are being actively targeted by Chinese leasing houses

What is lease financing?

- Lease financing involves a lessor (leasing company SPV) leasing an asset, such as a plane or a ship, to the lessee (the borrower/operator) in exchange for the payment of hire (lease payments) throughout the term of the lease
- The lease payments typically cover the entire cost of the asset and provide a return on capital to the lessor. It is not unusual in Chinese lease financing to see a purchase obligation at maturity

What is lease financing?

- Different types of leasing structures:
 - (1) Financing lease
 - (2) Operating lease
 - (3) Sale and leaseback



Differences from traditional bank financing?

Bank Financing

- The borrower retains legal title over the asset.
- The lender receives interest on the loan (plus fees, etc).



Lease Financing

- The lessor (lease finance company SPV) retains legal ownership over the asset during the lease period. Possession and disponent ownership of the asset passes to the lessee (e.g. a traditional shipowner) through a bareboat charter.
- Lessor receives a return in the form of return on capital (plus fees, etc) via the hire payments.

Differences from traditional bank financing?

Bank Financing

- The lender will take security for repayment of the loan by obtaining:
 - a mortgage over the asset
 - an assignment of the earnings, insurances or other proceeds relating to the asset
 - share charges over the borrower
 - a guarantee from the borrower's parent or other group company

Lease Financing

- The lessee has economic ownership of the asset, but not legal ownership
- It has the use and possession of the asset during the main part of its useful economic life
- No ship mortgage (between lessor and lessee), but other security package is similar

Typical Structure – Vessel Lease Financing

- BBC
 - Typical hell or high water BBC
 - Financing provisions (similar to Loan Agreement)
- Typical Security Documents
 - Charterer's Assignment
 - Share Charges
 - Guarantees
 - Account Charges
 - etc



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Opportunities to pursue lease financing

Opportunities to pursue lease financing

Lack of availability of bank financing or other financing options

- There may be a variety of reasons for this including the current unwillingness among traditional providers of ship finance to lend to the industry. The banks have pursued a policy of seeking deals only with the top credits.
- **Strength of Leasing Companies**
 - Leasing companies can typically provide higher leverage than is currently available from the shipping banks.
 - Leasing companies have capacity to advance significant amounts of capital so a single lessor might be able to underwrite a huge deal (which arranger banks would need to syndicate).

Advantages for the lessor

- The lessor retains legal title to the asset. This means the lessor is typically in a better position than a lender as the asset may not be subject to security granted by the lessee in favour of an existing lender (unless the lessor is itself funded by an external lender)
- It should also be easier for the lessor to re-take possession in the event of default by the lessee in making a scheduled payment as compared to the position of a secured lender who tries to enforce its security

Possible disadvantages of lease financing

- Lessee Perspective
 - Tax
 - Flexibility of use of asset

- Lessor Perspective
 - Insolvency of the lessee
 - Legal ownership/liability relating to the asset during the lease period

In Conclusion:

“By 2050, two centuries after the opium wars which plunged the “Middle Kingdom” into a period of hurt and shame, China is set to regain its might and reascend to the top of the world”. Xinhua News Agency, October 2017.

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