

# Navigating today's marine market



Ship owners face a perfect storm of falling earnings and values, pressure from banks, possible increased risk and rising insurance premiums. Only careful navigation will see them through this turbulence. By **Sarah Coles**

**W**orld trade has fallen dramatically. According to estimates from the World Trade Organisation, from a peak in the second quarter of 2008 of around \$4.5 trillion, worldwide exports had fallen in the first quarter of this year to \$2.7 trillion. The scale of the drop in trade is massive. Throughput of the port of Long Beach, on the key trans-Pacific route, for example, was down 27 per cent in the first six months of 2009, compared with the same period a year earlier.

## Fleet growth creates risks

To add to the pressure, as demand for vessels continues to fall, so supply is growing, as new buildings ordered in the boom times are delivered. This excess in tonnage inevitably impacts earnings. As Fred Doll, a marine consultant to Jardine Lloyd Thompson, highlights: "A Panamax container vessel of

3500 TEU earning about \$27,000 a day in July 2008, was in August 2009 earning under \$6,000 a day. Similarly earnings of Very Large Crude Carriers (VLCCs) were down from about \$140,000 per day to \$20,000 per day over the same period."

With cash under pressure, risks can escalate. Simon Stonehouse, Chairman of the Joint Hull Committee, says when budgets are tight, maintenance can become an issue: "As earnings drop ship owners have less money to spend on maintenance, which can lead to claims."

It can also persuade owners they need to lay vessels up, which has its own attendant risks. If lay-up is not carried out prudently or the riding crew are less than diligent, it can result in significant deterioration or failure of, for example, the vessels' machinery.

This is one area where working with underwriters and brokers can smooth the way. Underwriters will employ surveyors who will ensure vessels follow correct procedures.

Meanwhile Sean Woollerson, a Partner in Jardine Lloyd Thompson's Marine division, says: "We encourage owners at renewal to negotiate provisions for future possible lay-up, because the premium reduction they get can vary."

## The dangers of collapsing values

Falling earnings have also worked through to ship values. In July 2008, a Capesize vessel no more than five years old was valued on average at around \$150 million, and by August this year it was worth around \$55 million. Equally, the value of a VLCC had fallen from around \$160 million to around \$80 million.

Falling vessel values threaten to breach loan-to-value covenants on ship mortgages. Duncan Bowring, a Partner in Jardine Lloyd Thompson's Marine division says: "A significant fall in value means that the bank may have a shortfall in their collateral security. One way or another this has to be

addressed; banks may demand accelerated repayments or the security of other vessels."

If banks are unable to secure their position, their last resort is to foreclose on the loan and seize the ship. But as Bowring says: "That could result in a forced sale in a severely depressed market, such that there's near certainty that the proceeds will not cover the outstanding loan amount." Instead, Doll says: "There is a degree of compromise going on, to adjust payments to keep the bank secure and the owner in business."

Falling values should have one positive effect: reducing premiums. But this is by no means clear cut. Woollerson points out: "The lower the valuation goes, the less damage it takes to trigger the condemnation clause. This implies owners can claim a constructive total loss on a lesser value, and this leaves underwriters feeling more exposed."

However other considerations come into play if the vessel is financed. Owners may wish to reduce the insured value to reflect current market values, but find they are

unable to do so because of the provisions of the loan agreement. Hull underwriters want the insured value of the vessel to reduce, but the banks want sufficient insurance to cover repayment of the loan. Stonehouse says: "If we underwriters continue to insure for the loan amount rather than the vessel value, it creates a huge moral hazard."

Meanwhile, there are other factors causing the insurance market to harden. Stonehouse says: "On average we are seeing six or seven per cent increases across the board. This is being driven by a flight to quality. More people are looking for cover from the London market or Lloyd's, and in a number of cases banks are insisting on it, so as demand goes up, so do prices."

Owners are under pressure from all sides: falling earnings, rising costs, possible increased risk and a hardening of the insurance market. But negotiation and compromise can mitigate the impact and so help owners weather the storm. **RS**

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## THE TROUBLE WITH YARDS

There was a surge in orders two or three years ago, when the freight market was buoyant. Shipyards generally receive deposits of 5 per cent to 20 per cent of the building costs at the time of contract signing, often as much as four years before projected delivery.

The slump in earnings left ship owners exposed. Bowring says that in many cases they had "no guarantee of financing for subsequent instalments of the building costs. There have been cases where owners have had to walk

away from substantial up-front payments, leaving yards with spare capacity." In many cases yards are willing to renegotiate the number of ships on order and revise schedules.

The fact that repair yards are less busy should be an opportunity to cut costs. Stonehouse points out that some yards bought steel forward when it was much more expensive, so "underwriters need to negotiate hard to make sure we are not subsidising the ship repair industry."