

THE YACHT

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report

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I Had a Dream

SUPERYACHT FINANCING IN A RECESSIONARY MARKET



Martin Luther King's speech, whose first words I respectfully paraphrase above, was a true call to arms; though moral not military arms were to be raised. Here Remco Immink of Ciris Capital explains the fundamentals of sound yacht lending and also why lacking these, some loans have failed and players have exited at varying degrees of rapidity or pain over the last 12 months. From that he goes on to propose – amongst other better practices – a more realistic view of yacht values on and after delivery. Finally, he makes an intriguing, radical and bold proposal to the industry; his own call to arms: an invitation to participate in something unique and special that he believes will aid the superyacht market's recovery.

FOR MY ANNUAL VISIT TO THE MONACO YACHT SHOW

I chose not to join the seminar that was held the day before. Usually I love these occasions but I knew that little had changed in the yacht finance sector compared with a year ago and the chances of me or anyone else having much new to report would be as slim as the bank's current yacht portfolios.

Arriving at the show on the opening day, the atmosphere was more than positive. I managed to get through the long list of people I wanted to speak to and enjoyed the evening as Royal Huisman celebrated 125 years in style. As a child I spent many a happy summer on the lakes near the Huisman yard and could never have imagined that one day I'd be among such illustrious company in the glittering playground that is Monaco.

Sleep talk

Talking of dreams... After a great night's sleep, the wake up call in my hotel room came from housekeeping delivering the iron I had ordered. There was a pressing need for me to look smart on this second morning as I was attending a breakfast meeting with the global bankers involved in the yacht finance business.

This is an annual event where we distribute our production for the year ahead to the banks. The breakfast was delicious and all the bankers present were amiable people who thought nothing of sharing their thoughts on yacht finance with the industry. They were also hungry for business and did all they could to convince us to deliver more to them and ensure they meet head office quotas.

As the meeting progressed, I started the so-called 'yearly auction' of yacht finance applications. Who's interested in the US files? Anyone looking for Middle East deals? Who would like to further business in Russia? Can I interest anyone in a straightforward North West European file? To my left, a relatively young banker asked if he could have all the files with a pricing below 1.5%. No one seemed bothered about the loan-to-value ratio – it was the size of the transactions that mattered most!

The pricing of a yacht loan is normally based on three months' Libor plus a margin. The Libor rate can be seen as the funding (the costs for the bank to buy the money). The margin is the margin. A healthy margin in this market should be in the range of 2.0–3.0%. Everything below 2% is too cheap and will not give the bank a good return on investment or give them the possibility to make some reserves for bad times.

Typically the new players that entered the market in the last few years came in with low (too low) pricing (and have already left the market again). Not good for the stability of the yacht finance market at all.

Alarm bells

In less than an hour I'd managed to place all the loans we were requesting and the bankers promised a smooth credit process with turnaround times of four weeks maximum. As we left the room to head for the show, I was sure I could hear bells ringing...

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And then I woke up. The bells were my mobile phone alarm and I was brutally pulled back to reality. This ideal world of cooperative bankers and delighted clients was no more than a dream of how things might have been had the words "recession" and "downturn" not become everyday parlance. A time when questions like 'how are you coping?' would have been unthinkable. Will this fantasy ever come true?

Niche market

Over the past decade a number of finance institutions entered our market, each coming from a different background and – more importantly – having different targets. Entering a new market means you have to add something to the existing products available in order to gain business. As we are talking about finance, the most logical tool available was to increase the 'loan to value' – or, in layman's language, lend more money against the value (or purchase price) of a yacht. Other options are to extend the terms, become more competitive in pricing or offer a flexible credit policy. All are well-known instruments in an industry with high numbers of individual transactions and products that are cash-flow driven.

Although the numbers have been increasing over the last 10 years, we are still talking about a niche market. The banking teams active are generally small divisions within a bank. The knowledge and experience in the field of yacht finance is limited or dependent on one or two people. What is the basis of the credit policy they have in place? What guidance do they have in place to monitor the portfolio? Who will deal with the arrears that might arise and how will they handle workouts? (A workout is when a client is in arrears and is not paying his liabilities to the bank. The bank will repossess and take control of the yacht. The bank will try to solve all outstanding items [it might be on a chain etc] and try to sell the yacht for the best possible price so that the outstanding loan can be repaid). Does the bank have enough knowledge, time and reserves to handle these processes? How long will the yacht finance activities be backed by the board of the bank? These are just some of the questions these bank teams face.

Know how

Regardless of the reasons for financial players to enter the market, one element should be leading. The added value they offer to the industry needs to be genuine internal and external knowledge of the

market. In other words, banks should be clear about what they are lending and to whom, and have a clear (exit) strategy for worse case scenarios. I am the first to admit that this is easier to write than put into practice as we are still talking about a niche market with a myriad of scenarios and cases.

All industries need the long-term support of financial players if their markets are not to slow down. The superyacht world is certainly no exception. Sound financial instruments are required not only in terms of the number of transactions. They also have a profound influence on the complete chain of the yachting industry. We should all focus on establishing and maintaining a long term strategy where things are more in balance.

Securing the deal

In the past, banks have had to deal with two sides of the market. On the one hand there was the industry itself – people in the position of being able to do a transaction subject to finance. On the other side of the equation are the bank's competitors who are looking to lend on the same deal. Under pressure to strike a deal, prices were agreed to close the transactions that do not stand up to scrutiny on reflection.

If the pricing is too low the bank cannot make enough reservations for credit losses and the like. If the loan to value is too high at the starting point, the bank may end up with an unsecured position only shortly after closing the deal. And that was then! The situation would be even worse today!

50% after five years

Let's be honest, was there ever really a time when the value of a yacht after delivery really increased? We always set our internal calculations to a depreciation level after five years of 50% of the yacht's original value. I know there are a few transactions that seem to prove otherwise but from a (bank) risk prospective, our calculation method is a realistic approach. It also ensures owners have less stress should they wish to sell their yacht.

Moreover, such a guideline would make new transactions easier as owners prefer to have their current yacht sold before they purchase a new one. The key to this smooth success story is that the initial transaction was scheduled properly, allowing banks to easily move to the next one with the same client. And vice versa!

Points to ponder

Running costs are also an important point. Yes these costs are low during the first year and yes they increase rapidly after that. Our experience teaches us that average running costs of 10% are pretty close to the mark. Of course there are

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possible revenues from charter to be taken into account but these should never be the basis of a loan or the ownership of a yacht.

Banks and financial institutions should set clear parameters for their credit policy so everyone knows where they stand. It's all very well banks asking for 'full disclosure' from the client but this is so far away from previous banking procedures that it is not surprising people are reluctant. Banks need to be specific in their requests and make clear why they require that information.

Furthermore, we need a proper understanding of how to look at transactions. Is it a cash flow-driven deal? This would be the case for yacht loans with a higher loan to value. The bank must be sure that the client is in a position to repay the loan and maintain the yacht over the long term. Or can we

look at a more asset-based loan? These cases involve a relatively lower end loan to value, where the bank will accept that it has to look more at the value of the asset rather than the serviceability of the client.

A call to action

I started this article speculating about an ideal world. Personally, I have been in the yacht finance world since early 1995 and seen many players come and go. I am convinced that the time is now right for the yachting industry to develop a dedicated yacht finance player for the yachting industry. This will take some time as we are not likely to be in a position to begin with the higher end of the market. But if we can make a start and prove what needs to be done, it need only take a few years for the results to start filtering up to the higher echelons.

I am talking here about building a yacht finance fund in which the yachting industry participates in the equity of that fund by registered certificates. If you are a professional player and would be interested in becoming part of this new venture, please let me know so we can combine our strengths.

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