PRACTICAL INFORMATION

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HERMES COVER SPECIAL

Basic elements of ship finance

EXPORT CREDIT GUARANTEES OF THE
FEDERAL REPUBLIC OF GERMANY

Hermes Cover

► Basic elements of ship finance

I. COVER FOR SHIP FINANCE

The shipbuilding industry has been facing challenging market conditions for a number of years now, forcing many shipyards to specialise and realign their production range.

Given these market conditions, it is of crucial importance for German shipyards to acquire and execute export orders successfully. Reliable and custom-fit ship finance is an important element in this respect. The Export Credit Guarantees of the Federal Republic of Germany offer assistance for the German shipping industry in line with market requirements.

WHAT COVER IS AVAILABLE FOR SHIP FINANCE?

In addition to the generation of cash flow mirroring the percentage of completion, long-term finance must frequently also be provided for competitive reasons. Generally speaking, export credit guarantees provide cover for post-delivery finance, i.e. the purchase price less any prepayments. This covers both political risk and the risk of non-payment for economic reasons.

Due to its "domestic" nature, predelivery finance is covered by the German federal state concerned in the form of a "state guarantee" (Landesbürgschaft). However, the Federal Government can also cover domestic performance risks to a limited extent via its Counter-Guarantee. A Counter-Guarantee can normally be granted for the 20% downpayment. If absolutely necessary, a Counter-Guarantee can also be issued for further contract bonds subject to careful examination. There is a standard maximum per shipyard of EUR 80 million, although this may be exceeded in justified exceptions.

WHAT UNDERLYING CONDITIONS APPLY WITH RESPECT TO COVER FOR LONG-TERM SHIP FINANCE?

The customary national and international rules applicable to other export transactions must also be observed in the case of long-term ship finance covered by the Federal Government. The framework for this is provided by the Ship Sector Understanding (SSU) within the OECD Consensus, which particularly applies to

- new sea-going vessels of 100 gt and above used for the transportation of goods or persons, or for the performance of a specialised service, for example, specialised ships for installing and servicing wind farms or for use in the oil and gas industry,
- the conversion of sea-going ships entailing radical alterations to the cargo plan, the hull or the propulsion system.

Ships used for military purposes, floating docks and mobile offshore units are expressly excluded from the SSU.

In addition to full-scale ships, cover under export credit guarantees is also available for individual components for new and converted ships.

The SSU provides a framework for the conditions for ship finance:

- downpayment: at least 20% of the building costs until delivery subject to
- a credit period (regardless of the buyer's domicile) of no more than 12 years from delivery (the minimum downpayment is reduced to 15% for credit periods of 10 years or less)
- repayment profile: equal instalments at regular intervals (normally quarterly or semi-annual instalments/ repayment on an annuity basis is also possible in the case of lease structures)

Finance is fundamentally possible at the CIRR interest rate (cover for interest rate to be clarified with KfW).

ARE THERE ANY SPECIAL DISBURSEMENT RULES FOR SHIP FINANCE?

The customary disbursement rules for buyer credit cover apply. Under post-delivery finance, 80% of the ship price plus any financing costs are financed a under loan covered by the Federal Government. The 20% downpayment and/or interim payment is remitted in advance or during the construction phase. The buyer credit is normally paid out in a lump sum upon delivery of the ship. A reimbursement procedure may also be used (i.e. the buyer initially pays, upon which the bank "reimburses" the buyer for this amount).

II. REVIEW PROCEDURE FOR SHIP FINANCE

Ship transactions frequently entail large-scale contracts that are exposed to the following risk, which must therefore be duly examined:

- **Credit risks** on the part of the debtor and/or guarantor
- **Market risks**, particularly with respect to single-ship entities (SPVs) with no recourse to an existing entity that has solid annual financial statements (corporate backing):
  – volatile freight and charter rates,
  – insecure market environment, particularly special ship building for offshore
  – ship values difficult to forecast, resulting in risks with respect to liquidation proceeds (loan-to-value) in the event of a loss.

Given these various economic risks, the examination of the **justifiability of the risk** involved in the transaction plays a vital role for the granting of an export credit guarantee.

The experts of Euler Hermes conduct an examination of the planned project on the basis of the details provided in the application and additional information obtained from the bank/exporter and submit a recommendation to the Interministerial Committee, which then makes its decision on the basis of the results of the analysis.

DETAILS AND DOCUMENTS REQUIRED TO PROCESS AN APPLICATION:

- For orders worth over EUR 15.0 million, a brief memorandum setting out the main elements of the project (description of project, importance of the order for the buyer (buyer's country) and exporter, finance, market and competition conditions etc.)
- Most recent audited annual financial statements of the foreign buyer/borrower or guarantor including semi-annual financial statements where available in English
- Details of the terms and conditions of the loan (conditions for disbursement, repayment arrangements, collateral, borrower's duties, e.g. financial covenants etc.)
- Details of the collateral: for all ship finance, a security package typical of the sector as a whole but doing justice to the requirements of the individual case must generally be agreed. In addition to the customary insurance, this includes, for example, ship and predelivery mortgages, the assignment of proceeds under charters or the issue of a guarantee of the parent company of a single-ship entity.
- Details of the market (description of competitive situation, analysis and forecast of demand)

In the case of structured finance or project finance (see below for explanation of the difference), a financial model allowing the economic viability of the transaction to be gauged must also be submitted. The scope of the financial model may vary depending on the individual case. However, the following aspects must normally be included:

- Description of the assumptions underlying the income and cost forecast, any tax burdens, capital spending requirements and debt service
- Plausibility check of the main cost factors and assumptions
- Description of the entire period of the loan for which cover is being sought.

The viability of the transaction is assessed on the basis of the financial model. In the case of a large-scale investment, this data must normally be provided for the entire company.

As a rule, two scenarios are evaluated – the banking case and the stress case.

The Federal Government is primarily concerned with determining whether the cash flow that is generated is sufficient to cover operating costs and debt service. The decisive indicator in this question is the debt service cover ratio (DSCR). In individual cases, additional documents and information may also be necessary and will be requested as the application is being processed.

If the Federal Government is additionally asked to issue a Counter-Guarantee, a performance review of the shipyard is also required. This primarily focuses on the shipyard's technical experience and liquidity situation during the construction phase. The specific requirements are set out in the application form.

WHAT TYPES OF SHIP FINANCE ARE DISTINGUISHED FOR THE PURPOSES OF THE RISK REVIEW?

Corporate Finance
Financing of an export transaction in cases in which the buyer or borrower has a sufficiently documented credit rating, where applicable, also backed by additional bank or other collateral (payment guarantee, mortgage)

Main focus of analysis: annual financial statements of the borrower and/or guarantor and, where applicable, details of market trends

Structured Finance

Financing of an export transaction in cases in which additional elements must be included in the collateral package and a finance model must be submitted due to shortcomings in the credit rating of the foreign borrower/guarantor.

Main focus of analysis: annual financial statements of the borrower and/or guarantor, financial model and details of market trends

Project Finance

If the finance is not underpinned by any existing corporate as the entity concerned has been newly established (SPC, single-ship company), the project must generate sufficient cash flow on its own to cover the operating costs and debt service. In this case, the standards applied to project finance are used. A separate information page is available on project finance setting out further details.

These projects are examined in far greater detail. As a rule, an external expert's opinion is required due to the complexity of the project.

Main focus of the analysis (non-exhaustive list): financial model, completion and technical risks, market trends, security package

It is advisable to contact Euler Hermes as early as possible to determine which of the three classes the planned ship financing should be allocated to.

WHAT DO YOU NEED TO KNOW ABOUT THE PREMIUM?

Under international rules, a market test must be performed in the case of ship finance to ensure that the premium structure is appropriate. In this connection, the applicant (bank) is asked to provide details of certain aspects of the planned financing scheme. It is advisable to keep in as close contact as possible with the experts at Euler Hermes.

TIME FRAME AND APPROACH:

It should be noted that it may take some time to review an application in the case of complex contractual and financing structures. Moreover, a decision on credit transactions can only be communicated after the customary consultation and notification period as defined in the OECD guidelines (seven to ten calendar days after a decision has been made).

In view of the frequently difficult structures, it is generally a good deal to consult with the Euler Hermes experts at an early stage of the negotiations. If necessary, a legally non-binding letter of interest can generally be issued at short notice to support your negotiations with the foreign customer. The Federal Government can review the transaction before any contracts are signed and issue an offer of cover.

POINT OF CONTACT

The Maritime, Rail and Special Business Unit will be pleased to answer any further questions.

www.exportkreditgarantien.de/en

Export Credit Guarantees and Untied Loan Guarantees: instruments to promote foreign trade and investment provided by the

Federal Ministry for Economic Affairs and Climate Action

Commissioned to implement the federal funding instruments Export Credit Guarantees and Untied Loan Guarantees:

EULER HERMES

Cover from the Federal Republic of Germany for foreign business

Export Credit Guarantees and Untied Loan Guarantees have been established and effective foreign trade promotion instruments of the Federal Government for decades. Export Credit Guarantees (so-called Hermes Cover) protect German exporters and banks financing exports against political and commercial risks. Untied Loan Guarantees are to support raw material projects abroad regarded as eligible for promotion by the Federal Government. Both promotion instruments play an important role in fostering economic growth as well as in protecting and creating jobs. Federal Government commissioned Euler Hermes Aktiengesellschaft to manage the federal funding instruments Export Credit Guarantees and Untied Loan Guarantees.

Information on other foreign trade promotion instruments of the Federal Government can be found at www.bmwk.de/en under the heading Promotion of Foreign Trade and Investment.

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