As Shipping Slows, Banks and Carriers Fear Loan Defaults

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LONDON — When Eastwind Maritime, a medium-size carrier company, went bankrupt this summer, few banks in the United States took notice.

But in Europe, where banks hold over $350 billion of increasingly dubious shipping industry loans, the inability of Eastwind, which is based in New York,to handle its debt of more than $300 million set off an anxiety attack on lending desks across the Continent.

The collapse of Eastwind Maritime, analysts say, while small, could well be a harbinger of more carrier failures to come.

And for Europe's struggling banks, already plagued by a toothless economic recovery and continuing losses in real estate, the emergence of yet another questionable category of loans adds to fears that many of them are lagging their counterparts in the United States in overcoming the financial crisis.

In Britain, for example, where the economy shrank a further 0.4 percent for the third quarter, the government had to put an additional £43 billion ($71 billion) into the Royal Bank of Scotland and Lloyds, both essentially under national control, because of continuing trouble with their real estate loans.

And in Spain, where loans to companies working in the real estate sector are estimated to be almost 50 percent of gross domestic product, a consensus is growing that many banks are underreporting the value of their stricken loan portfolios.

Now there is more to worry about. Banks with large shipping industry portfolios — among them Royal Bank of Scotland and Lloyds, and HSH Nordbank and Commerzbank in Germany — could face meaningful write-downs as ship owners confront plummeting charter rates from a 25 percent drop in global trade.

“Peak of defaults is generally one year after the trough of the economy,” said Scott Bugie, a European bank analyst at Standard & Poor's. “In the U.S., the debt workouts have been faster and the economy also bottomed out before Europe.”

HSH Nordbank, a leading lender to the shipping industry, set aside close to $800 million in provisions for its shipping-related loans this spring, and it has already received 13 billion euros ($19.4 billion) in support from its owners, the regional German states of Hamburg and Schleswig-Holstein.

And while global trade appears to be gradually on the mend, a glut of previously ordered ships due in the coming years is expected to limit the extent of a meaningful price recovery.

“The problem is that there will be more bankruptcies and foreclosures if the ship owner can't operate his ship,” said Anthony B. Zolotas, a shipping industry banker at Eurofin in Athens. “At that point he will give the keys to the bank and say, ‘Sorry, mate, I just can't do this anymore.’ ”

Banks in Europe have stubbornly resisted taking write-downs for their shipping industry debts. They concede that the global cargo sector is troubled, but as long as companies continue to pay interest on their loans — which most are still doing — the banks contend that there is no need to write them off.

“Our book is of very high quality, and to date we have not had to make a single provision this year for possible loss,” said Lambros Varnavides, who oversees shipping loans for R.B.S.

“If the market remains low or becomes weaker,” he said, “it is likely that some provisions may be required even for us.” He adds, however, that he would expect to recover those provisions once the markets rebound.

But as competition for business drives cargo revenue well below what it costs to send a ship across the ocean, analysts say that ship owners may soon be the next group of borrowers unable to manage their debts.

Many see parallels to the way banks in the United States and Europe adopted an overly optimistic view of their exposure to subprime mortgages in late 2006 and early 2007.

As with Eastwind, small undercapitalized subprime lenders began to fail when home owners realized that the size of their mortgage had surpassed the value of their house, and stopped making the payments on their loans.

Although the pile of shipping industry debt does not compare to the trillions of dollars in toxic mortgage securities that infected balance sheets worldwide, the essential dynamic of plummeting ship values, burdensome debt and disappearing equity is much the same.

Cato Brahde, a portfolio manager at Tufton Oceanic, a hedge fund that specializes in the shipping industry, says that history shows that the stronger the trade-driven boom, the longer the down cycle that follows, with the slump possibly persisting anywhere from three to 10 years.

The current bust began in the summer of 2008. And after what he called the “biggest order book of all time,” that suggests that most of the pain for the shipping industry is still to come.

“We estimate that there will be a 50 percent oversupply in container ships,” Mr. Brahde said. “And in the next five or six months you will see more banks repossessing ships. It is not life or death, but for those with real exposure there will be problems.”

Like all carriers, Eastwind built its fleet of 55 ships by relying on the generous terms of its eager bankers. At the top of the cycle, when the average five-year-old vessel was valued at about $88 million as of June of 2008, the company seemed a pretty good bet.

But with the 45 percent plunge in freight rates for container ships, the values of the ships that secured the bank loans have dropped, too.

For example, Aozora Bank, a Japanese bank that in addition to being one of Eastwind’s top lenders is a major creditor of Lehman Brothers, found to its dismay that the value of the 12 Eastwind ships it now controlled was considerably lower than its $77 million exposure, according to Eastwind’s bankruptcy filing. Other big lenders include the Bank of Scotland, part of the Lloyd’s Group, and Nordea Bank, based in Sweden.

It is that type of negative equity situation, which was at the heart of the subprime crisis, that could threaten banks if it occurs on a wider scale.

Most vulnerable is HSH Nordbank, which is exposed to the industry’s weakest segment, container ships. It has $50 billion in shipping loans, or about seven times its equity.

The exposures of other major ship lenders include Commerzbank, with $37 billion; R.B.S. with $25 billion; and Lloyds TSB with $23.9 billion, according to estimates made by ING Bank.

With the exception of HSH Nordbank, the shipping industry loans of the other banks represent a small percentage of their overall loan books — not enough, taken on their own, to make a balance sheet buckle.

But the fact that shipping industry debts are concentrated in some of Europe’s weakest banks suggests that the loans may well cause more problems than bankers are now willing to admit.

As a private company, without a Greek billionaire or friendly government to back it, the end came quickly for Eastwind once creditors refused to extend more loans.

So quickly, in fact, that some of the company’s ships, which are a main mover of Chiquita Brands fruits and vegetables, were left stranded in open water.

In one case, a ship belonging to Eastwind lacked the money to pay for fuel, according to the company’s bankruptcy filing. Another even lacked sufficient funds to provide food and water to its crew.

While the ships eventually found their way to port, it may well be their bankers that soon find themselves at sea.

http://www.nytimes.com/2009/11/12/business/global/12shipping.html?_r=4&ref=global-home&pagewanted=print