**March 6th 2018**

## Yacht Finance today: Finance vs Optimization

The meaning of yacht finance has evolved over the last 15 years, ever since the booming of the yachting industry during the 2000-2007 period when financing was quite popular and easier to achieve for a wider range of client profiles. Back then, financing a yacht purchase responded to an obvious objective of not having to advance the whole purchase price from the beginning, or to benefit from VAT advantages through leasing schemes.

Today, financing a yacht is part of a wider process of resource allocation. It follows a similar logic as the ownership of corporate assets or property. The main question we address to clients or their family offices today is:

> *"As someone with a global view over net worth and resources, do you have alternative, more performant uses for the funds that you intend to tie up in the yacht purchase."*

As yacht consultants, we provide the necessary input for the client to make an educated decision: our analysis involves structuring the optimal solution:

(i) From a cost perspective (interest payments, fees, legal costs)
(ii) Management of cash flow (when is payment due? how to optimize repayment schedule?)
(iii) Taking into account factors such as Fair Market Value and various types of guarantees and covenants (with time they also involve a cost to be assessed).

## Fair Market Value: now and in the future

Obviously, you will want to know the Fair Market Value when buying, in order not to over-pay. What you should also know is how the FMV will evolve in time. The depreciation in value is as much a cost as the general running cost.

> *Based on several cases that we have studied recently, we estimated that on average, the depreciation over 5 years represents approximately 70% of running costs over the same period of time.*

Owners tend to give their yacht a "subjective value", and don't always assess their book cost. Combining the right financing solution with alternative investment of funds can considerably lower the overall cost by compensating the loss in book value.

But how to forecast the FMV in time? This is one of the most essential questions, as data related to sales prices is not disclosed and only few people are aware of this information.
The lack of data easily available to customers is detrimental to the market, as we all know that a number of buyers regret their purchase when they realize that the cost and money invested do not match their expectations.
There is no Bluebook as for aircrafts or reliable and public data like in real estate.
It is clearly an issue for buyers/sellers and parties involved in this business as the decision to buy and sell is often driven by the current and future FMV, hence the importance to have the right information.

- *Depreciation is specific to each vessel. When assessing it, we take into account factors such as: availability on the market for similar boats, recent similar transactions, market trends, yacht's specifications, discrepancy between asking prices and achieved sales prices, anonymous insider information, etc.*
- *Also, experience and feedback from relevant people on the market is key when assessing the depreciation curve of FMV.*

The FMV is not only key for the new owner, it is also important to the lender. When structuring the financing offer for the lender and the client, at OMYS we always make a thorough analysis of the asset and the FMV by cross-referencing as much reliable information as possible. This makes the case stronger for the client, as the yacht remains the main guarantee for the lender.

Transactions have become much more complex today, with the positive side being that a willing lender is able to structure a solution that is really tailored to the client and asset.

**A few words about compliance and credit process**

It is true that going through credit and compliance is a challenging process. Lenders have learned their lessons from the past and know that yachts are very particular assets. Today, they are more educated in this respect, and careful when assessing risk. Not only do they consider client risk, but for a file to pass compliance, they can apply strict, or sometimes overly-strict, criteria.

- *A lot of discipline is required when organizing the information before presenting it to the lender. Thanks to our unique expertise as top executive bankers specialized in yacht finance within leading*

*European institutions as well as high-end assets consultants introducing such transactions on behalf of clients, we know that a well-documented executive summary is a prerequisite before submitting any application as first impression really counts.*

A key step in the compliance and credit application process is to draft a green light memo of the transaction, providing the lender with a clear view on:

- the client background, potential, and revenue structure: for this, at OMYS we work hand in hand with the client himself, his lawyers and/or family office;
- the indicative fair market value of the asset and potential depreciation in time: this is very important as the yacht is the main security for the lender.
- suggested financing structure: although each lender has its own credit policy they adhere to, we find that when they are presented with a well-documented case, it is possible to suggest alternatives both in the interest of the lender and the client, that will provide the same level of security to the bank, while optimizing the lending structure from the client's perspective.

  - *A typical example is adapting the loan repayment structure to the future cash-flow of the client, while providing an equal level of security to the lender. Here, the notion of FMV comes into consideration.*

  Another example of a tailor-made finance structure is when clients have an existing boat, and they wish to finance the construction of a larger one. Depending on the yachts, we can structure a solution combining equity release and construction finance to enable a reduced cost transition.

Also, one must be able to anticipate all possible questions and have all answers ready. We have seen previously that when a client approaches a bank directly, they will most often send bulk information related to their business, background and revenues. Some parts of information very important in the eyes of the client, but will be irrelevant for the lender, and will in some cases add confusion. It can also happen that clients only provide key documents and information when requested specifically by the lender, when it would have been beneficial to have issued a comprehensive file from the outset. All these "bumps" along the way make one lose precious months in the credit process and jeopardize the chances for success.

**Are AUM (Assets Under Management) a must, and should they always be seen as a constraint by the client?**

For many clients, whether they have to open a private banking relation with the lender and bring Assets Under Management as a prerequisite to the financing, is one of the questions that come first when discussing yacht finance.

Many have the idea that asset-based finance would be a preferable option. But is that still the case today?

Asset-based solutions come with their advantages and disadvantages. Of course, it allows the client to keep it simple, and not have any discussion related to transferring and managing funds. Usually, that's where the advantage stops.

In return, they will not benefit from some features that come with transferring a portfolio, such as:

(i) They have the choice to structure the loan in a manner that maintains the portfolio as a pledge or as free assets; pledging part of the portfolio allows the negotiation of a balloon payment at the loan terms, thus postponing up to 30% to 50% of capital repayment for 5 to 7 years; where as an asset-based lender is likely to require full amortization or to allow only a much-reduced level of balloon payment;

(ii) They have access to lower rates: there is a 1,5% to 3% margin premium with asset-based lenders;

(iii) Private Banking Lenders are more flexible on the repayment structure, and on such things as penalties, fees etc;

(iv) The latter usually have more appetite for construction finance than assets-based lenders;

(v) In some cases, on selected high-quality projects and profiles, we are able to negotiate for the borrower to leverage part of the AUM and thus increase the available drawdown;

(vi) In the end, based on the usual LTVs applied by both type of lenders, the funds available for the borrower are more or less the same.

- *So, the smart question is not "how can I avoid private banking finance?", but rather "how can I optimize the balance between what I bring to the lender, what I get in return, and at what cost?"*

**Are there many banks active in the yacht finance market right now? And how can one differentiate them?**

There are several banks active in the yacht finance market, each with their own credit policy and targeted clientele. Some of them are long terms players but there are also other banks that provide yacht finance services to their clients or valuable prospects on a more confidential basis. Often these terms are very interesting and they have proven their ability to structure tailored products when presented with a motivating yacht project and prospective client.

The main point of consideration for the discerning client is to know how lenders comprehend the transaction and how business friendly they are.

**How is client profile important? How can OMYS, as yacht finance consultant, be of valuable assistance in this respect?**

Most banks will finance a yacht project based on the interest they have to develop a wider banking relation. We've known all lenders for many years now, and we are well aware of their preferences in terms of risk and future development. These are subtle nuances, but they can make the difference when there is need for out of the box solutions during the credit process and / or obtaining better terms. In short, it is good to know what will motivate a lender to start a relationship through the yacht finance channel.

> *To take an example, we have made a successful match between a client active in the commodity transportation business, and a lender that had an important desk looking for development in the same sector, and the geographical location of the client's business. They were able to start the relation through the yacht finance channel.*

**How long does the credit approval process take?**

Usually you have to pass through two to three different decision committees, each of them having their own purposes. The first one is the compliance committee, that checks if the client matches their customer acceptance policy. The second level of acceptance is the private banking committee, to ascertain if the profile complies with targeted level of clients and required amount of assets under management. The third and final decision level is the credit risk committee, that decides if the criteria of the credit application are in compliance with their credit risk policy.

It has to be noted that the due diligence process is sometimes the most challenging and lengthy phase.

Depending on the facility amount and risk profile of the transaction, we reasonably consider that the whole process can take from 10 to 12 weeks from the moment all documents and information are received from the client.

**How can we facilitate the procedure for the client?**

- we speed-up the decision-making process thanks to our knowledge of banking process and close relationship with key people within credit committees;
- we minimize lending costs and obtain better options in terms of loan structuring and guarantees;
- on behalf of the client, we draft the credit package (credit application, compliance issues, asset analysis, finance structuring) and negotiate with the lenders credit and compliance committees until a final decision is reached;
- we have the right tools and arguments to find efficient solutions:
- we work with key providers in all strategic and geographic locations to access competitive financing programs tailored to the client's situation.

➢ *More than pricing, what makes the difference today is discussing the right finance structure along with the fair level of guarantees.*

**Our background**

Olivier MILLIEX: Head of Yacht Finance at ING Bank (2005-2011). Head of SMEF (subsidiary of CMB Bank), specialized in Yacht Finance (1999-2005). Director at BNP Group France (1988-1999).

Adina SUCIU: 11 years banking experience as project manager, expertise in legal, fiscal and financial aspects of marine finance.

Together OMYS partners and consultants:

- Have established risk and commercial policies related to yacht finance for several major European lenders
- Have arranged and structured the financing of more than 300 super yachts.

Recent transactions: Lurssen 85m+, Lurssen 75m, CRN 60m, Admiral 40m, Heesen 47m, 40m+ Perini Navi.