



# MARINE FINANCE

## BANKING HANDY GUIDE

## An introduction

Marine finance is a form of asset finance used in the maritime industry, particularly to finance the construction or purchase of ships. Funding can be provided for a single ship, for multiple ships and/or for ships under construction or already operational. The purpose will impact on the optimal structure of the transaction and any potential security package to be taken by a funder.

This guide looks at the key features of a marine finance transaction for both a 'new-build' and a second hand ship before setting out some of the key finance documents and specific terminology you can expect to encounter on this type of deal.

- Funding can be provided for a **single ship**, or for **multiple ships** and for **ships under construction or already operational**.

## Key features

- Marine finance is a form of asset finance used to (a) finance the construction and/or acquisition of a new ship; (b) finance the purchase of an existing ship or fleet of ships; or (c) refinance indebtedness secured on a ship and related equipment and assets.
- Where the borrower is part of a corporate group, a typical structure will involve a parent company borrowing funds with a separate subsidiary special purpose vehicle (SPV) ultimately owning and operating the ship(s).
- The particular security package taken by a funder will reflect the transaction:
  - financing a new-build under construction will normally include an assignment of a borrower's rights under any refund guarantee issued on behalf of the shipyard and the underlying shipbuilding contract (effectively providing that a funder may 'step-in' in the event of a breach by the borrower); and
  - financing an already operational ship will involve taking a mortgage over the ship, and an assignment over relevant insurances, together with a deed of covenant as described below.

- Instruction of foreign legal counsel to deal with any foreign law aspects (e.g. diligence and identifying appropriate security) and completion/delivery of the ship (if applicable, depending on the location of the shipyard undertaking the construction of the new-build and/or the location of the delivery of the ship on completion).
- The flag state of the ship will govern the law of the ship mortgage. This will be important when determining that any security entered into is valid, enforceable and has been granted in accordance with the requirements of the relevant flag state.

## Key finance documents

### Assignment/assignment in security

An assignment or assignment in security is used to create fixed security over certain moveable assets (e.g. contractual rights). Depending on the transaction the assignment can be used to create security over insurances, the shipbuilding contract and/or refund guarantees. In each case, the relevant counterparty will receive notice that the borrower's (or grantor's) interest has been secured in favour of a funder. Assets assigned in security cannot be sold or otherwise dealt with without the consent of the secured creditor.



## Debenture

A debenture is used to grant security in favour of the funder over the whole of the borrower's (or grantor's) assets, property and undertaking, by way of combination of fixed and floating charges. A debenture granted by a Scottish company will only create a floating charge, with any required fixed charges documented separately in accordance with Scots law by way of an assignation in security or ship or other mortgage.

## Deed of covenant

A deed of covenant is supplemental to a ship mortgage and contains all of the legal and commercial terms and conditions of the security which are not capable of being contained in the prescribed form of ship mortgage itself. It is also likely to contain a separate assignation of a ship's earnings, insurances and requisition compensation and, depending on the transaction, may also include fishing licences and quota.

A deed of covenant will likely impose further funder imposed ship maintenance and operational undertakings (e.g. a geographical restriction in which a ship may operate/work) in respect of the ship and the chargor.

## Facility agreement

As with any type of lending, a facility agreement will be entered into by the parties to document the terms and conditions of the finance provided. The particular terms of this will be dependent on a number of factors, including the type and purpose of the facility being provided and the asset involved.

## Floating charge

A floating charge is a common form of security not specific to marine finance. The floating charge will secure to the funder all of the assets, property and undertaking of the borrower or grantor, including any relevant ship(s).

## Ship mortgage

A ship mortgage constitutes fixed security over the ship itself. A ship mortgage is registered in the flag state of the ship. In the UK, the ship mortgage takes a statutory form and is registrable at the UK Ship Register and at Companies House. The ranking or priority of a creditor's ship mortgage is decided by the date/time of registration at the UK Ship Register.

- Assets assigned in security cannot be sold or otherwise dealt with, **without the consent of the secured creditor.**

### Did you know?

We have undertaken a large number of deals across a range of sectors - oil and gas, general cargo, passenger ferries, tugs, the fishing fleet and workboats supporting the aquaculture industry in particular.





## Key terminology and non finance documentation

### Bill of sale

A bill of sale is an important legal step in a vessel sale process. It is the document that transfers the ownership of a ship from the seller to the buyer and confirms that the relevant transaction has taken place.

### Delivery

Delivery of a ship occurs when the title to the ship is transferred. Most commonly delivery involves a meeting between the buyer and the seller where all outstanding documents detailed within the relevant memorandum of agreement are exchanged, including the bill of sale.

### Flag state

The flag state of a ship is the country under whose laws the ship is registered. This does not necessarily need to be in the same jurisdiction as the owner of the ship is registered and/or incorporated (as the case may be). The flag state is relevant in marine finance transactions to (1) funders, as it determines the formalities required in order to create the ship mortgage and also where any ship mortgage requires to be registered; and (2) owners, as the ship is then subject to the laws of that country (which has an effect on matters such as licensing, safety of design and operation).

### Memorandum of agreement

The memorandum of agreement sets out the terms and conditions and process of the sale of the ship as between a buyer and seller, including the timing of the relevant transfer of title.

### Refund guarantee

A refund guarantee is obtained in circumstances where there is a new-build ship under construction and the buyer pays the shipbuilder in instalments as construction progresses. A refund guarantee is provided by a third party, usually a bank, to the buyer on behalf of the shipyard, guaranteeing that the shipbuilder will pay back the instalments in certain circumstances or the occurrence of particular events e.g. if the ship is not completed or delivered.

### Requisition compensation

Funds due as a result of requisition for title or compulsory acquisition of a ship by a governmental, state or other competent authority. The borrower (or owner's) interest in those funds is generally secured to a funder under a deed of covenant.



## Shipbuilding contract

In the case of a new-build ship under construction, a shipbuilding contract between the shipbuilder and the buyer of the ship will be entered into. This contract will include the agreed terms for construction of the ship and, key from a funding perspective, specify when payments are to be made and when the ownership of the ship will pass to the borrower or buyer. Ownership most commonly passes when the shipbuilder has completed the construction of the ship (as approved by classification society) and the buyer has paid to the shipbuilder the full purchase/construction price.

## How can Brodies help you?

Brodies' marine finance practice draws a wealth of experience from legal service areas including finance, shipping, insurance, licensing and general corporate law. The marine finance team is able to assist with all types of marine finance including re-banking; acquisition funding; construction funding; fleet funding and 'quota' loans across the world.

## Key contacts



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