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# CHINESE LEASING

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STEPHENSON HARWOOD

# About Stephenson Harwood



**Stephenson Harwood** is a law firm with over **1100** people worldwide, including more than **170** partners and is committed to achieving the goals of clients – listed and private companies, institutions and individuals. Our headquarters are in London, with ten offices across Asia, Europe (including Piraeus) and the Middle East. In addition, the firm has forged close ties with other high quality law firms. This diverse mix of expertise and culture results in a combination of deep local insight and the capability to provide a seamless international service.



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**Strong personal relationship**



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## Recent Awards



"The team is very commercial, will try to be practical and find a solution for all sides. They go out of their way to ensure the transaction is completed within the timeframe."

***Chambers Europe - Greece 2018***

"The team works on such a large volume of transactions, which means they are very aware of everything that is going on in the market."

***Chambers Asia - Pacific 2019***

## Introduction



- **Leasing companies** originate from the major PRC banks
- **Independent entities** from their respective bank affiliates, both commercially and legally
- Share the **same ultimate equity interest holder**, whilst have their own commercial drivers to be profitable and competitive

## Sale and leaseback (1)



- Leasing companies will incorporate **SPV** in tax-neutral jurisdictions to be the lessor
- Lessee will enter into **MOA** with lessor for sale of the vessel
- Lessor will charter the vessel to lessee under **BBC**
- After completion of lease transaction, lessor will enter into conventional **loan facility** with commercial bank(s)

## Sale and leaseback (2)



- Sale and lease back structure applies equally effectively to both **second-hand** vessels and **newbuildings**
- Lessor and lessee will agree **commercial parameters of the charter** which effectively has the economic effect similar to a loan from lessor to lessee
- Majority of the lease deals are **finance leases**; however, leasing companies are now moving towards **operational lease transactions**

## Lessee's perspective (1)



- Leasing transaction is a method of **obtaining funding**
- Lessee will expect to retain **navigational, operational and economic control** of the vessel
- Only counterparty in lease transaction is **lessor**. Thus, lessee often considers its relationship with lessor as a relationship between a borrower and a lender in a **bilateral facility**
- **Practical issues** pertaining to lease structures:

## Lessee's perspective (2)



- What if lessee enters into a sub-charter with a sub-charterer **on a long term basis**?
  1. Lessor may request **step-in rights** that will require a direct agreement with sub-charterer
  2. If sub-charterer is aware of lease transaction, sub-charterer may require a **QE** undertaking from lessor
- How to deal with **residual value risk** during BBC term?
  1. Lessor's **put option** (early termination event)
  2. Lessee's **call option** (voluntary prepayment event)



## Lessor's perspective (1)



- Lessor to conduct **financial and risk analyses** to ensure the transaction is commercially viable
- Lessor to work closely with its legal counsel to ensure documents reflect **agreed commercial terms** and also adequately cover **structural and legal risks**
- Same **security package** from lessee that a lender will expect from borrower under loan facility
- In addition, lessor may grant a **ship mortgage** in favour of its own shareholder as a 'defensive' mechanism

## Lessor's perspective (2)



- Two important aspects
  1. assets / insurance
  2. income / charters / step-in rights
- In refinance deal, lessor would make sure the refinance documents match the lease terms
- **'Onward' assignment** of lessor's 'downstream' security interests

## Debt and Equity



- In addition to **debt finance**, in some recent transactions, lessors also contribute **equity**
- Equity contributed ranks *pari passu* with the equity from the lessee
- Lessor will join lessee to **enjoy benefit** of the market and in the meantime **assume risk** thereof
  1. applies to assets that have a liquidity market
  2. second hand towage with relatively low market value

## Operational Lease



- Lessors may enter into operational leases and take **residual value risk** of assets financed
- Some operational leases are entered into on a **bareboat charter** basis whilst some are on **time charter basis**
- If on time charter basis, **maintenance and operation** of the vessel will be also for lessor's account
- In recent transactions, lessors ordered newbuildings and chartered to top-tier cargo interests on time charter basis, with charterhire linked to relevant index

## Looking Forward



- In general, leasing market becomes **more established** and the stakeholders become **more sophisticated**
- There will be a new **phase of consolidation**
- More innovative or alternative **financing techniques**
- **Debt instruments** or **securitisation** of both existing and new lease portfolios
- And others

## Conclusion



We have the privilege of participating in the rapid development of China's ship finance business as **Chinese financial institutions** play an increasingly significant role in global capital markets.

We see more **operational lease transactions** whereby lenders assume residual value risk of assets as well as **more time charters on an index linked basis**. Players in some niche sectors are considering collaboration via joint venture or merger / acquisition at listed company level.

**Chinese market is exciting.** To catch up with its growth, you are advised to prepare capital (本钱), improve skill (本事) and yourself should be there (本人).

# Speakers



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