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COVID-19 and the Maritime Industry

At the crossroads of trade, transportation, and logistics management, the maritime industry has unquestionably faced the slings and arrows of COVID-19. This article explains the implications of the pandemic—both bad and good—for various segments of the marine market.

By Basil M. Karatzas

Being at the crossroads of trade, transportation, and logistics management, the maritime industry has had a most profound exposure to COVID-19. Both internationally and domestically, the current pandemic has affected many aspects of the industry, from operations to financing to demand shifts. Certain segments of the maritime industry—when selectively viewed by cargo type or by geography—have fared better than others. Those segments may claim they have benefited, at least in the short term.

Still, the long-term impact on the industry is unknown: a novel risk such as COVID-19 entails contemporaneously dealing with and adapting to unprecedented operational and managerial factors.

The fact that the pathology of the coronavirus SARS-CoV-2 is not yet fully understood hinders projections for a vaccine, not to

mention transport of every sort. The implications are significant for lifestyle travel and for business travel; mostly, new lifestyle trends and new business practices materially impact demand in cargoes to support such ensuing changes.

Aside from operational challenges in the short term, maritime leasing and financing faces changes in demand, financing, and technology.

Sectors of the maritime industry that preponderantly depend on the human factor (whether as passengers or seafarers) have been most affected. Aspects of the marine industry and marine sectors that depend less on the human element have managed to scrape by with less damage, possibly benefiting from disruptions in other industries (such as the oil industry for the tanker market).

For both the international and the domestic maritime markets, this article will attempt to assess the

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Most countries—including those considered maritime hubs, like Singapore—have prohibited crew changes at their ports in an effort to contain the spread of the COVID-19 virus in their jurisdictions.

impact of COVID-19 on the major marine market aspects, segments, and businesses, and draw conclusions for the future course.

THE MARITIME INDUSTRY AND THE HUMAN ELEMENT AT THE AGE OF COVID-19

The Human Element as Crewing

Unlike other industries where telecommuting has been an option, for the maritime industry and its worldwide footprint of vessels, there is a constant need for seafarers, longshoremen, and service providers (ship chandlers, surveyors, customs and immigration officers). These professionals need to be able to fully and competently access the vessels at all times, entailing safe and prompt transit to port facilities from one's home (or even from another country).

In the United States, on March 19, 2020, the Cybersecurity and Infrastructure Security Agency, operating under the Department of Homeland Security, identified "transportation and logistics" and "critical manufacturing" workers as essential to continued critical infrastructure viability, therefore exempting seafarers and transport employees from travel restrictions.

In terms of U.S. marine transportation, workforce-related disruptions have stemmed from air travel availability and travel

interconnectivity more so than with seafarers and service providers in the marine industry.

However, internationally, the human element is of much more concern, as most countries—including those considered maritime hubs, like Singapore—have prohibited crew changes at their ports in an effort to contain the spread of the COVID-19 virus in their jurisdictions.

The International Maritime Organization, the United Nations body responsible for the international maritime industry, has called it a "humanitarian crisis," as more than 200,000 seafarers worldwide are currently stranded at sea, several months after COVID-19 was declared a pandemic and several months past the maturity of their original employment contracts. Having crew members away from their families unexpectedly for prolonged periods can take a human toll on both these seafarers and their families back home. This crisis has a potential effect on vessel operations and safety.

The sinking of the 200,000 deadweight Newcastlemac¹ vessel MV Wakashio in Mauritius recently made front-page news for its pollution of a pristine coral reef. It will take a year for the accident report to be finalized, but two of the crewmembers have been onboard the vessel for more than a

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The Port of Miami has run out of docking space for idling cruise ships, even as the Centers for Disease Control and Prevention and the U.S. Coast Guard keep extending their “no sail” orders for cruise ships.

year and unable to take leave. The accident has not been attributed to crew fatigue, at least not yet, but the accident investigation committee must diligently investigate that possibility.

Moreover, on its most recent quarterly earnings report in mid-August, A.P. Moeller Maersk—the world’s largest containership owner—named crewing and the ability to make crew changes as its biggest threat to operations.

The Human Element as Passengers

No marine sector has been so profoundly impacted by COVID-19 as the cruise ship market, where the human element has been the heart of the business in terms of both cargo (passengers) and crewing. (Large cruise ships have several thousand crewmembers, versus 24 crewmembers for a standard cargo vessel.)

Several months after the inception of the pandemic, the pictures of cruise ships on TV still reverberate, as they showed thousands of passengers onboard, stranded on the high seas, some enduring inclement weather, with no port (or country) allowing them to dock.

It is no surprise that the 2020 cruise-ship season has been worse than 2001, after 9/11. The Port of Miami has run out of docking space for idling cruise ships, even as the Centers for Disease Control

and Prevention and the U.S. Coast Guard keep extending their “no sail” orders for cruise ships.

Internationally, a couple of foreign cruise-ship sailings in the summer ended up in disaster as several passengers developed COVID-19 while onboard, despite updated testing and health protocols.

One thing is for certain, though: in 2020 so far, eight cruise ships have demonstrably been sold for scrap, with an average age of 25 years. Almost as many cruise ships were sold for demolition in the three-year period 2016-2019 and having an average age of 36 years at scrap. Two 3000-berth cruise ships, originally under contract to be sold in January 2020 at \$120 million en bloc, presently are again on the market for sale at \$18 million en bloc, since the original buyer walked away from the transaction (and forfeited its deposit). The current asking price is marginally above the vessels’ scrap price.

Although the share prices of the Royal Caribbean Group (RCL), Carnival (CCL), and Norwegian Cruise Line (NCLH) have bounced off the bottom, they are still 50% lower than in early 2020. Cruise-line companies worldwide have stopped making payments on their contractual obligations and have frozen any dry-docking. Some have rushed to raise billions in new capital to buy them enough runway until a market recovery.

COVID-19 obviously brought a collapse in oil and petroleum product demand as people stopped commuting (think of gasoline and diesel fuel, approximately 58% of refinery output) and flying.

Cruising with smaller and boutique pleasure boats, especially in regional markets, has shown signs of an earlier recovery than the megaship cruise-ship market. On a business trip to the Netherlands and France this summer, the author observed that small riverboats and dayboats were busy (and apparently alarmingly overcrowded), while in the United States, steamboat, riverboat, and dayboat companies slowly are coming back online.

However, adhering to local orders is challenging. For example, recently the owners and the captain of a pleasure dayboat in New York City were arrested after concerned local residents called the police to report a seemingly overcrowded day pleasure trip.

MARITIME SECTORS EXPOSED TO THE ENERGY INDUSTRY

The Tanker Market

COVID-19 obviously brought a collapse in oil and petroleum product demand as people stopped commuting (think of gasoline and diesel fuel, approximately 58% of refinery output) and flying (think of jet fuel, approximately 12% of the international petroleum products market).

Logically, tanker demand would decline under such circumstances. However, oil companies, refineries, and traders were found with so much excess inventory on their hands that tanker owners were virtually “printing money” between February and June 2020, just for



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In Better Days, Three Cruise Ships at Georgetown, Grand Cayman

Grand Cayman is the largest island in the Cayman Islands, a British Overseas Territory in the Caribbean. (Photo courtesy of the author.)

As supply chains adjust for lower demand, expectations and excess inventory have worked their way through the system.

using their tankers as floating storage space.

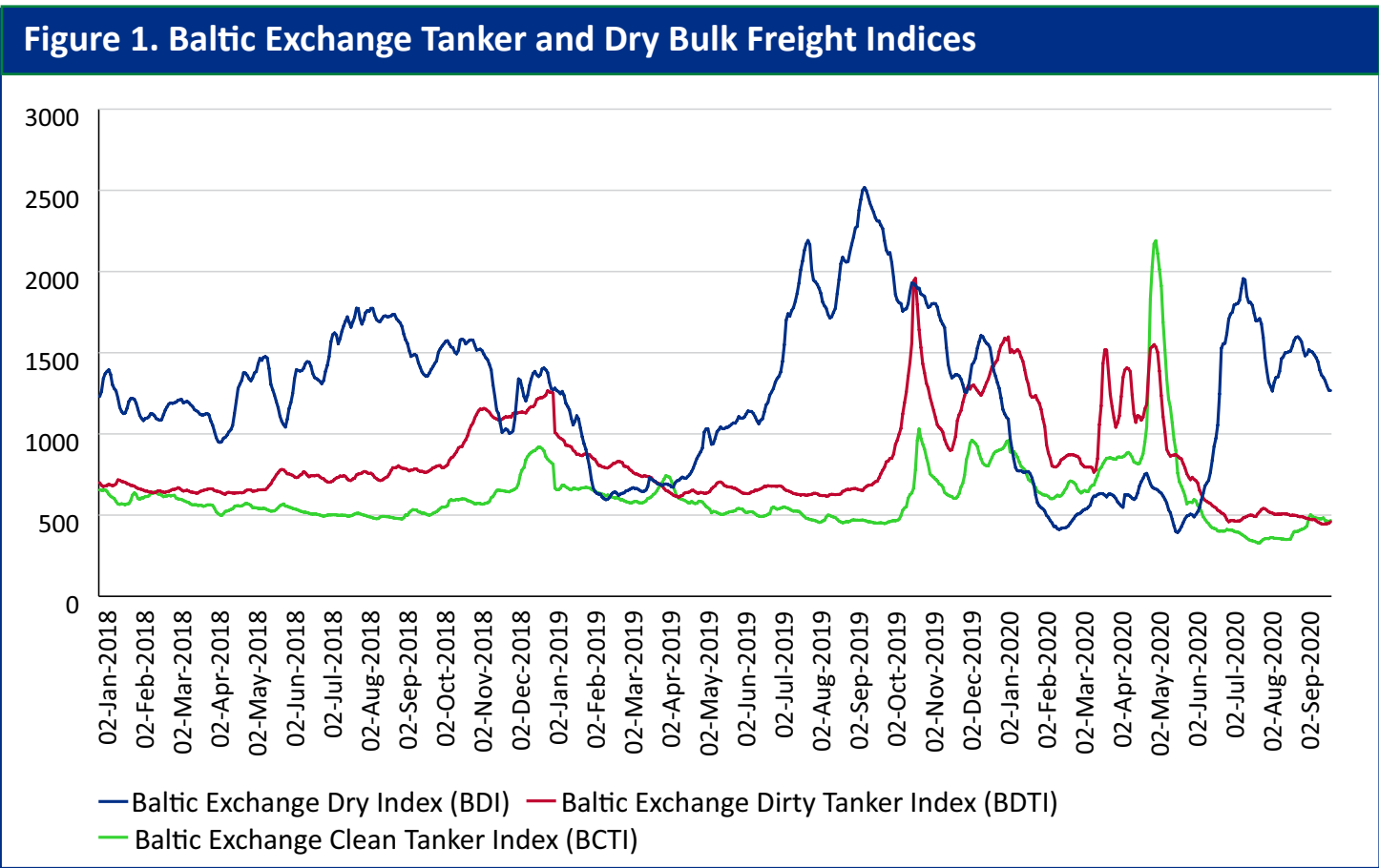
Very large crude oil carriers (VLCCs, tankers capable of holding 2 million barrels of oil) saw their daily rates jump from \$30,000 per diem (pd) at Christmastime to almost \$200,000 pd in March, not on account of transport demand but on account of storage space.

However, as supply chains adjust for lower demand, expectations and excess inventory have worked their way through the system, and tanker rates have finally started reflecting a period of lower demand. VLCCs once again earn approximately \$30,000 pd.

All good things, so to speak, come to an end, and it is hard to be overly optimistic on the tanker sector under the specter of COVID-19.

Figure 1 shows the Baltic Exchange freight indices for “dirty tankers” (crude oil tankers) and “clean tankers” (petroleum products and chemicals), Baltic Dirty Tanker Index (BDTI) and Baltic Clean Tanker Index (BCTI), along with the better known Baltic Dry Index (BDI) for the dry bulk market. Clearly, after the initial jump on contango, the tanker market has collapsed, while the dry bulk market looks in better shape (but seasonality may partially explain some of the strength).

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Data courtesy of the Baltic Exchange, of which Karatzas Marine Advisors & Co. is a member. www.balticexchange.com/en/index.html

The offshore drilling market had barely been at break-even levels, with 20% to 30% of the world's offshore fleet having been idled.

The Offshore Market

In the last couple of years of low oil prices, high-cost offshore drilling was limited to existing projects, with no new capacity coming to the market and several aging platforms getting dismantled.

The offshore drilling market—whether for drillships and semi-submersibles or the myriad of offshore, crew, platform support vessels, anchor handling tugs, and so on that feed on them—had barely been at break-even levels, with 20% to 30% of the world's offshore fleet having been idled.

Many drilling and offshore companies, both in the United States and internationally, were holding on for dear life, expecting that 2020 would be a year of market recovery. COVID-

19 and the collapse for energy demand just killed any hope for an immediate recovery, so much so that even speculators do not want to buy offshore vessels at scrap price and wait for a recovery (something done in the past with swashbuckling entrepreneurs).

COVID-19 has not killed the offshore market—rates and asset prices were so low that they have little more room to drop—but it clearly has killed any hope for recovery and runway. So far in 2020, several offshore companies have sought some sort of court protection from their creditors (Hornbeck, Noble, Hermitage, Valaris, Diamond Offshore, etc.).

Looking forward, the prospects do not look bright for the offshore



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Six Idled Drillships

These drillships are idled at Las Palmas, Gran Canaria, in the Canary Islands (Spain). (Photo courtesy of the author.)

Although not as bad as in the dry bulk barge market, utilization for inland and coastal tank barges stands overall at mid-80%, much lower than the beginning of the year.

industry, whether in the United States and the Gulf of Mexico or internationally (North Sea, Nigeria, Brazil, etc.) under COVID-19. This fact compounds structural problems in the offshore drilling market and competition from cheaper shale oil and a gradual shift to renewables.

THE JONES ACT AND THE U.S. MARINE MARKET

2020 started with great hopes for the marine industry in the United States. This was premised on greater shale drilling and more movement of crude oil and petroleum products within U.S. waters—especially in a growing economy in a U.S. presidential election year. Internationally, the marine industry anticipated more exports of oil and energy products (shale oil to China, liquefied natural gas and liquefied petroleum products to countries of the Pacific Rim).

Exports would have taken place on foreign-flagged vessels (boosting primarily the international tanker market). However, some spillover was expected for the domestic market, with more active coastal trade and port operations, and the potential need for building modern harbor tugs to accommodate high-risk and expensive vessels and cargoes.

In addition, the Phase I trade agreement between the United States and China provided for more energy exports to China,

and, critically, more than \$80 billion in 2020-2021 of agricultural product exports (primarily grains and soybeans) to China. Again, such exports would have occurred on foreign-flag vessels, but towing grain products from the breadbasket of the Midwest to New Orleans via the Mighty Mississippi was expected to boost the inland barge market, which had a challenging 2019.

So far in 2020, China has only bought approximately 26% of its \$37 billion U.S. agricultural quota for this year, based on data compiled from the U.S. Department of Agriculture, reflecting poorly on the inland barge market. There have been reports that utilization for dry bulk inland barges has dropped to as low as 70% of the fleet, with a tantamount collapse in freight rates and asset prices.

Likewise, for the tank barge market, whether for inland or coastal, once demand for storage subsided, direct demand for shipment of crude and for petroleum products and chemicals brought the market to a standstill. Although not as bad as in the dry bulk barge market, utilization for inland and coastal tank barges stands overall at mid-80%, much lower than the beginning of the year.

In a weak market with many idling barges, asset pricing has come down, as potential buyers prefer cash preservation in an uncertain market, unless they see highly

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Lower structural demand leads to decreased demand for trade and shipment, which eventually leads to lower freight rates.

opportunistic transactions at distressed pricing.

A SILVER LINING

Once the “noise” of higher demand from disrupted supply chains is removed from the market and there is an adjustment to lower demand, it is hard to see how COVID-19 can be beneficial for the maritime industry. Lower structural demand leads to decreased demand for trade and shipment, which eventually leads to lower freight rates. The trend has been clear in May to July this year, despite the fact that the market has anemically bounced from the absolute bottom.

However, the news is not as abysmal as it would appear. The U.S. Federal Reserve and central banks worldwide have kept interest rates extremely low, thereby allowing for cheap access to capital, at least for the well-capitalized shipowners, and for competitively-priced rental payments for qualified lessees. With low inflation and soft marine asset prices, COVID-19 offers a great opportunity for fleet renewal and growth for the companies that see beyond the current crisis.

Furthermore, as a result of limitations imposed due to COVID-19, there has been a renewed effort to adopt technology faster in the marine industry, in areas ranging from compliance to operations to commercial aspects of the industry.

More importantly, COVID-19, as a novel risk, has given people a pause to think deeper than business as usual. If a pandemic on this order can wreak havoc on our lives and business, how much more might an even bigger crisis affect our lives—or even human life on earth? We do not want to get too speculative or philosophical, but it would appear that COVID-19 is accelerating in-the-bud environment, society, and governance (ESG) initiatives.

At least for the U.S. maritime market, new licenses, new contracts, and a multibillion offshore wind market have taken off, a development that will be cataclysmic for decades to come.

SUMMARY — COVID-19 AND MARITIME LEASING AND FINANCING

Clearly, the COVID-19 pandemic has slashed demand for raw materials and end products, and as a result, demand for transport. As freight rates have softened, both internationally and domestically, borrowers in the marine industry have had difficulty making prompt payments to their banks.

Equipment financiers and lessors and lenders have been on alert since April with their marine, as with their clients in other industries. However, recognizing that COVID-19 is a novel risk and no one’s fault, financiers so far seem accommodating and patient. (Contrast this situation with the

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As spot freight rates have materially declined, operators with long-term contracts for shipment as well as operators with large (or strong) balance sheets are getting preference for financing.

financial crisis, which was primarily caused by excessive and loose lending.) We hope that demand will not crater, leading to massive defaults and marine asset arrests.

As spot freight rates have materially declined, operators with long-term contracts for shipment as well as operators with large (or strong) balance sheets are getting preference for financing over smaller players or borrowers too dependent on the spot markets.

It would appear that the current crisis is benefiting the bigger players, while smaller companies are facing harder times. In general, as banks and other regulated lenders are becoming more vigilant with their lending criteria, equipment financiers and lessors seem to get more deal flow, especially with higher quality credit that typically would qualify them as a traditional bank financing.

Clearly, this is a fluid situation. Likely, more changes can be expected. Even in this month-short trajectory, as one banking expert

noted in connection with the early days and weeks of the pandemic,

Banks were concerned with going into recession and reserving capital—thus their higher lending spreads and tightened credit criteria early on. But a few months later, as banks' deposits ballooned, spreads dropped and credit loosened selectively. Banks now are looking more at absolute yields rather than spreads.

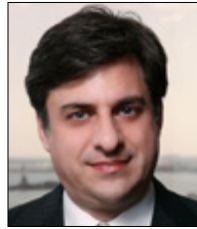
To the extent that such financiers are not preoccupied with problematic situations currently, originating new transactions, including in marine, allows for a higher level of client and asset selection. ■

Endnote

1. Newcastlemax is a dry bulk asset class of approximately 200,000 dead-weight tons, with maximum beam (width) of 47 meters (154 feet), capable of docking and loading (coal) at the Newcastle port terminal in New South Wales, Australia. Newcastlemax vessels typically transport coal.

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