IF YOU DON’T KNOW WHAT A JOLCO IS, LEARN!
LEASING DEAL OF THE YEAR

WEST
Transaction: Gram Car Carriers $52 Million JOLCO of a 6,700 CEU PCC
Winners: Credit Agricole, Mizuho Securities, SBI Group

EAST
Transaction: Orient Overseas Container Line $76 Million JOLCO Financing of a Containership
Winners: Citi, Financial Products Group Co.

If it flies or floats, lease it.
These are words to live by.
For many, ownership of assets has little appeal, particularly when tax benefits are available to lower the cost, residual risk is shifted to a third party, favorable accounting treatment is achieved and the cost is competitive. It is particularly useful when long-term access to cargo space at the lowest possible cost is what matters most. For these purposes control of the asset is sufficient.

While Chinese leasing is all the rage, the leasing axis has taken a slight detour eastward to Japan if the magnitude of nominations for the leasing deal of the year are any indication. But before we proceed, an explanation is in order.
A Japanese Operating Lease (“JOL”) is an operating lease funded with an equity investment from a Japanese entity, usually institutions or Japanese corporates that have tax capacity, and non-recourse senior debt provided onshore in Japan. The investor, puts up a minority portion of the equity funding in exchange for the tax benefits associated with the asset. In order to claim the tax benefits, the lessor must assume residual risk. The main requirement for any JOL is the “90% test” which means that the overall lease rentals payable over the life of the transaction cannot exceed 90% of the acquisition cost of the asset.

There are two types of JOLs: an open-ended JOL, where the investor takes asset risk, and JOLCO (Japanese Operating Lease with Call Option), which incorporates a fixed purchase option. In addition to offering competitive long-term financing, the JOLCO has the further benefit of asymmetrical tax treatment. For the owner/lessee, the transaction is an operating lease and is not capitalized on its balance sheet.

However, for the lessee it is a finance lease and is treated like a loan.

From an historical perspective, JOLs were mainly used in aircraft financing as investors were very comfortable with residual risk on these assets. Ships are an esoteric asset class. Different types of ships are built in different shipyards in different countries to different specifications. This creates a real residual risk which needs to be mitigated, making the transference to shipping difficult, but not impossible. In the beginning, it had been done as single investor sale-leasebacks, but strictly with local Japanese Shikoku owners in Imabari.

The yard was well known as were the owners, easing the lessors’ concerns.

To expand the market, the
focus moved to foreign ships and foreign owners. It was a long education process to grow and scale the business for non-Japanese owners. Heavily structured, the JOLCO included an Early Buyout (“EBO”) provision but investors needed to get comfortable that the lessees, who they did not know, would exercise it.

Fearnleys successfully concluded two sale-leaseback transactions with Hafnia and Concordia. In the case of the former, Hafnia sold a 2010 built LR1 to a large private shipowning company and leased it back over eight years with a four-year renewal option and annual purchase options, beginning at the end of year four. Hafnia achieved a 100% loan-to-value while maintaining a highly competitive breakeven. In the second transaction, Concordia entered into a nine-year sale leaseback with a Japanese leasing company for a 2015 built IMOIIImax tanker. Fully levered (100% LTV), the transaction had a competitive cost of capital of less than 5% with the long repayment profile contributing to a sound cash-breakeven and refinancing options to add flexibility.

In this year’s winning transaction in the West, Crédit Agricole CIB (CACIB) successfully structured, arranged and closed a $52M Sale and Leaseback Facility for the post-delivery financing of a 6,700 CEU Pure Car Carrier for Gram Car Carriers Holdings Pte Ltd. Structured as a JOLCO, the sale and leaseback raised funds for Gram equal to 93% of the market value of the vessel. Funding for the JOLCO consisted of a 75% senior-secured term loan facility and a 18% junior-secured “tax equity” facility fully underwritten by a wholly owned subsidiary of the SBI Group of Japan, who subsequently syndicated it to its Japanese investor base. The SBI affiliate also acted as legal owner/lessor of the vessel.

Close collaboration between CACIB, Gram and the shipyard (CSC Jinling, China) was essential to facilitate the successful implementation of the JOLCO since it was necessary to confirm that the specification of the vessel qualified for specialized (or accelerated) tax depreciation in Japan. Despite the uncommon and unusual nature of the request, the Chinese shipyard was supportive of the Japanese tax requirements and the vessel was certified for specialized tax depreciation for the benefit of the Japanese tax investors. This benefit, which allows the tax owners to depreciate 40% of the vessel’s cost in the first year, was factored into the rentals payable by Gram over the term of the JOLCO, resulting in a highly competitive (tax-enhanced) bareboat rate for Gram.

The JOLCO has a term of 11 years from delivery of the vessel with an early buy-out option, exercisable at the discretion of Gram, on the 7th anniversary of delivery. The vessel is employed under time charter with Siem Car Carriers and ultimately serves commercial contracts to move cars for the VW group.

This JOLCO is particularly unique, as it does not involve a single element of Japanese content. The vessel was built in China for a Norwegian owner, who chartered it to a Norwegian operator, with financing arranged by a French bank. In this way, it is a pioneering transaction which will open the door for other international owners to benefit from the provision of Japanese tax equity.

P.D. Gram Group started car carrier ownership and operations more than 30 years ago and remains today amongst the most reputable tonnage-suppliers to the top car carrier companies. The company has a fleet of 19 vessels, making it the third largest tonnage provider in the PCTC segment.

In the winning transaction from the East, Citi, as mandated lead arranger, assisted Orient Overseas Container Line (“OOCL”) in converting an existing bilateral loan into a JOLCO structure. The transaction involved the sale and leaseback of the vessel with the Financial Products Group, Japan (“FPG”), arranging the tax equity and Citi providing the necessary top-off secured credit facility. The transaction is structured as a Bareboat Charter Hire Purchase with a Japanese SPV owned by FPG as the owner/borrower and a guaranteed subsidiary of OOCL as the bareboat charterer. Citi’s $76 million term loan has an initial tenor of eight-years, which can be extended by 1.5 years in the event the charter period is extended. The financing’s security package includes a first mortgage over the vessel, assignment of the BBCHP, charter payment and performance guarantees from OOCL and insurances. The terms of the loan permit the owner to enter into an installment sales agreement with a subsidiary of FPG, the registered owner.

The transaction highlights include:

• Improved liquidity through the sale and leaseback
• Competitive loan pricing considering the cost of equity and cost of debt in a JOLCO structure
• Extension of loan tenor through the refinancing of the existing loan.

As you can see, the JOLCO is not for everyone. The tax capacity is limited and investors reticent reflecting concerns with residual and counterparties. It may be hard to break into the club, but it is worth the effort.