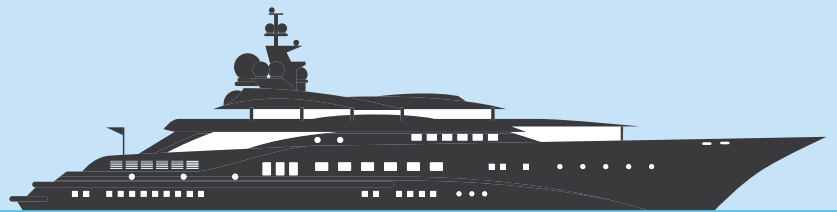


# A GUIDE TO YACHT FINANCE



Those seeking to purchase a yacht or superyacht may often need to borrow the funds in order to buy it. But there are a number of other financially sound reasons to pursue this route, even if you have already amassed enough wealth to buy the asset in the first place. These include both practical and legal arguments ranging from running-cost benefits to tax advantages. In this article, Jonathan Hadley-Piggin provides a definitive guide to yacht finance.

Jonathan Hadley-Piggin  
020 3319 3700  
[jonathan.hp@keystonelaw.co.uk](mailto:jonathan.hp@keystonelaw.co.uk)

**KEYSTONE LAW**  
[www.keystonelaw.co.uk](http://www.keystonelaw.co.uk)

## REGISTRATION AND FLAG PREFERENCE

A flag state is the country under whose laws a yacht is registered. This might be the country in which the owner lives or a ship registry in a country more synonymous with the complexities that surround charters and yacht ownership. Registration also grants the privilege and protection of flying the flag of that particular country. Every maritime nation, and even some land-locked countries such as Switzerland, has a system of ship registration that permits the registration of mortgages and other security interests.

In 1993, a centralised UK registry replaced the system of individual registries in each major port. The centralised registry is divided into four separate parts, of which two are relevant to yachts:

### PART I

This is the main register consisting of merchant ships and yachts alike. It is a full title register and has the facility to register mortgages

### PART III

This is for small ships of under twenty-four metres in length. Known as the Small Ships Registry (abbr. "SSR"), it is not a title register and it can only be used by individuals rather than companies. There is also no means of registering a mortgage on the SSR.

A bank wishing to finance a UK-registered yacht will, for the purposes of registering a mortgage, need to register the yacht on Part 1 of the register.

## REGISTRATION OUTSIDE THE UNITED KINGDOM

For taxation reasons amongst others, the majority of traditional flags have been overtaken in size of fleet by the so-called open registers, often referred to as "the Flags of Convenience". The largest flags of convenience nations are:

- Panama
- Liberia
- Cyprus
- The Bahamas

However, the trend for using flags of convenience has not been extended into the yachting world to the same extent as that of merchant shipping.

To counter the growth of the open registers, a number of European nations have actively encouraged so-called "off-shore" registers. In the case of the United Kingdom, there are, in addition to the mainland register, a number of overseas possessions that offer registers which confer British status to a yacht while at the same time offering fiscal advantages that may not otherwise be available to yacht-owning companies based in mainland UK.

The following British overseas possessions have their own ship registers that are often used for the registration of yachts:

- Anguilla
- Bermuda
- British Virgin Islands
- Cayman Islands
- Gibraltar
- Guernsey
- Isle of Man
- Jersey
- Montserrat
- Turks and Caicos Islands

Of these, Bermuda, the Cayman Islands, Gibraltar and the Isle of Man have Category 1 Registers. This means that their registers can accept any size of vessel. The Cayman Islands register has attracted more "superyachts" than all of the other British registers combined and claims to have more superyachts than any other shipping registry, estimating that it holds more than 20% of the world fleet of such vessels.

## NON-BRITISH FLAGS

It is often the case that banks are asked to finance yachts that are registered in foreign jurisdictions. While this may involve increased legal costs, it is possible to register ship mortgages in most jurisdictions. For example:

- Registers operated in former British colonies generally rely on legislation and procedures derived from earlier Merchant Shipping Acts and therefore, the procedures in these jurisdictions are similar to that of the UK;
- Panama and St Vincent & the Grenadines are occasionally used to register large yachts; and
- The Bahamas, Cyprus and Malta are now amongst the largest open registers and although less well known than the more traditional registers, are now registering an increasing number of yachts – particularly in recent years Malta which can combine this with yachts using the Maltese leasing scheme.

The bulk of the major open registers have either local offices or consular representation in London, making it possible to register yachts and yacht mortgages on these registers in the UK capital.

In any event, correspondent law firms are able to register mortgages and/or provide legal opinions in all the leading open registry countries used by yacht owners.

## SECURITY AND TRANSACTIONAL RISK

As in any secured lending situation, the bank will want as much security as possible to avoid incurring loss in the event of a default by a borrower.

## MORTGAGE

The primary means of securing a loan on a yacht is by means of a legal mortgage. In essence, a mortgage over a yacht works in a similar fashion to a mortgage over a property.

In the case of a registered yacht, a legal mortgage is created by the registration of a suitable mortgage at the RSS or the equivalent registration authority in other jurisdictions. Once registered, a ship mortgage will rank for priority in order of registration. A first priority mortgage will therefore rank ahead of any subsequent mortgages and most other claimants against a yacht. Certain claimants – for example, unpaid crew – will hold a maritime lien, which will rank ahead of a mortgagee. All other claimants will rank after the interests of the mortgagee.

## ASSIGNMENT

As with any other type of ship mortgage it is essential for the bank to take an assignment of all insurance policies to ensure it is secure in the event of a partial or total loss of the yacht.

## MARGIN AND AMOUNT OF LOAN

It is important for a bank to obtain a professional valuation from a professional with expertise in relation to the yacht in question. This is required in order to allow sufficient margin between the amount of the loan and the likely realisable value in the event that the bank has to enforce its security.

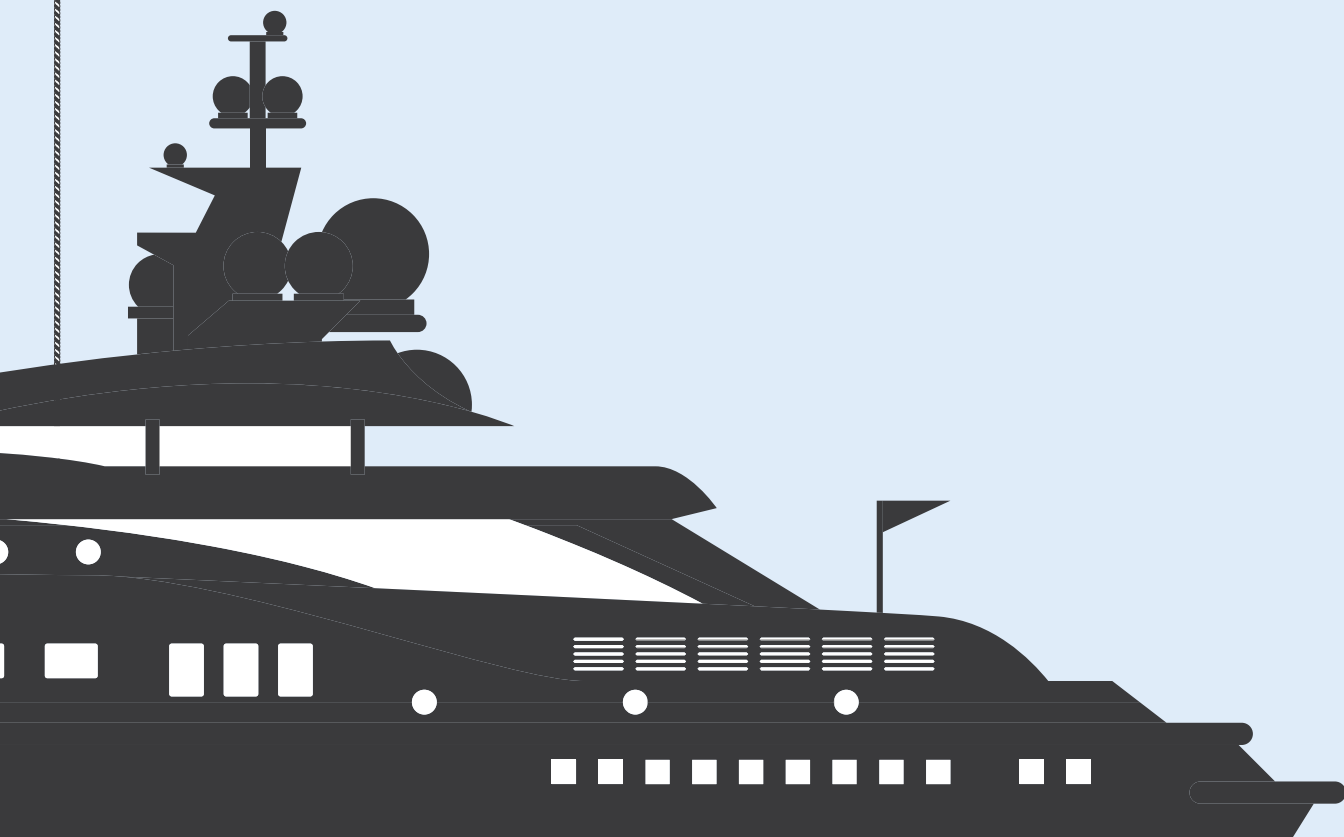
(It should be borne in mind that yachts of unusual specification or construction can often take more time to sell than popular designs from well-known yacht builders.)

The ongoing value of a yacht will depend on its condition and level of maintenance. For that reason, a bank will need to be satisfied as to the experience and competence of a borrower's crew, and the borrower's yacht manager. Most of the larger firms of yacht brokers offer technical and management services, including provision of crew and contact with the yacht's classification society and flag state surveyors. Similarly, the larger firms of yacht brokers provide supervision of maintenance and repairs carried out to the yacht in question.

## TRACING

Yachts are highly mobile assets and, in the event of a default by a borrower, must be physically traced before a bank can take possession or exercise its right of sale. To this end, maritime lawyers have access to Lloyds Marine Intelligence Services and other similar tracing services.

"Superyachts" are also professionally managed and made available for short-term commercial charter by their owners, are well known in the industry and for that reason are easily traced.



## EARNINGS

With a conventional ship mortgage, a bank will attach considerable importance to an income stream derived from a long-term charter, particularly if a vessel is let on time charter to a first-class charterer such as one of the oil majors. In such a situation a bank will take an assignment of earnings and will give a notice of assignment to the charterer.

A bank will sometimes require that a charterer pays charter-hire to a nominated account in the name of the ship owner with the bank to enable the bank to monitor earnings and attach them easily in the event of default. However, as yachts are rarely chartered for more than 18-20 weeks a year and usually for not more than two weeks at a time, a bank cannot place as much reliance on an assignment of earnings as it may in the case of a bulk carrier or tanker vessel.

## PERSONAL GUARANTEE & OVER CHARGE SHARES

To obtain increased security a bank will often take a personal guarantee from the beneficial owner of the yacht and also a charge over the shares in the owning company of the yacht given by the shareholder. The charge over shares will only arise where the yacht-owning company is a single purpose company.

## STANDARD FACILITY STRUCTURES

As discussed earlier, few superyachts are owned by individuals for both personal and tax liability reasons. The usual practice is for the owner to set up a company for the specific purpose of owning the yacht.

In the United Kingdom and its overseas possessions, a ship mortgage consists of a short document in a prescribed standard form. This type of mortgage is known as a statutory mortgage. This must be registered with the RSS or equivalent foreign registry.

A statutory mortgage will be regulated by a separate collateral deed known as a deed of covenant. This deed supports the statutory mortgage and sets out further obligations on the part of the borrower. There is no need for this document to be produced to the RSS. In England and Wales a statutory mortgage and deed of covenant will also need to be registered at Companies House in the same way as other mortgages or charges.

In other jurisdictions a single mortgage document will suffice.

## SECURITY DOCUMENTS

In a typical yacht-finance case involving, for example, a UK or British Virgin Islands borrower, the security documents would probably consist of the following:

1. Loan Agreement;
2. Statutory Ship Mortgage (Body Corporate);
3. Deed of Covenant;
4. General Assignment of Insurances and Earnings (including Notices of Assignment);
5. Charge over Shares of the borrower (with undated share transfers and resignation of directors and company secretary);
6. Personal Guarantee(s) of the beneficial owner(s).

From these security documents, relevant Forms 395 may be registered at Companies House

## STANDARD DOCUMENT CLAUSES

### LOAN AGREEMENT

The loan agreement will expand upon the terms set out in the bank's term sheet and, if required would be configured to the bank's preferred layout and house style as may be used in non-yacht-finance transactions.

### STATUTORY MORTGAGE

The statutory mortgage will recite the names and addresses of the parties, the amount secured by the mortgage and/or the manner in which the amount secured can be ascertained. There are two types of statutory mortgage, principal sum and interest and account current. The account current form is preferred as this will enable the bank to secure not only principal and interest, but also insurance premiums, legal costs and other expenses that might be recoverable by the bank in a default situation.

### DEED OF COVENANT

The deed of covenant will set out the rights and obligations of the bank and the borrower, the most important provisions being:

1. A mortgage and charge over the yacht;
2. An absolute assignment of insurances and requisition compensation;
3. An absolute assignment of earnings including a fixed charge on any earnings account.

In addition to the obligation to repay the loan, the borrower covenants to:

1. Insure the yacht, pay premiums when they fall due and do nothing to imperil such insurances;
2. Inform the bank as to the yacht's trading operation and employment;
3. Not to barefoot charter the yacht (as this would involve parting with possession);
4. Pay earnings into any earnings account designated by the bank;
5. Keep the yacht registered at her existing port of registry and do nothing to imperil such registration;
6. Not to change the yacht's name without the bank's consent;
7. Not to sell, mortgage or create any security interest in the yacht or assign the earnings or insurances;
8. Inform the bank if the yacht is arrested and to secure release from such arrest or lien;
9. Maintain the yacht in good seaworthy condition;
10. Maintain the existing classification society notation free of recommendations;
11. Inform the bank of any casualty or damage to the yacht;
12. Not to put the yacht into the possession of any shipyard for major repair without the consent of the bank;
13. Not to make any alterations to the structure of the yacht without the consent of the bank;
14. Not to change or appoint new managers of the yacht without the bank's prior written consent;
15. Not to operate the yacht in breach of any applicable law or international convention; and
16. Allow the authorised representative of the bank to inspect the yacht at least once a year with prior written notice.

This is a brief summary around the processes involved with yacht finance. Exact necessary procedures will depend on where the yacht is located. It is always worth seeking the advice of an experienced marine lawyer in order to navigate the complexities of a yacht purchase.