

Sailing on Halal Waters

By Bote de Vries

For many years, by far the largest segment of the Islamic financial sector's assets were real estate-related. However, the Ijarah operating lease concept, which facilitates Islamic finance for real estate, can also be used for other assets such as aircraft, vessels and even container boxes. Moving into new asset classes enables the Islamic investor to diversify his portfolio. Today it is not uncommon for 90% of a portfolio to consist of real estate-related transactions, so some diversification is welcomed!

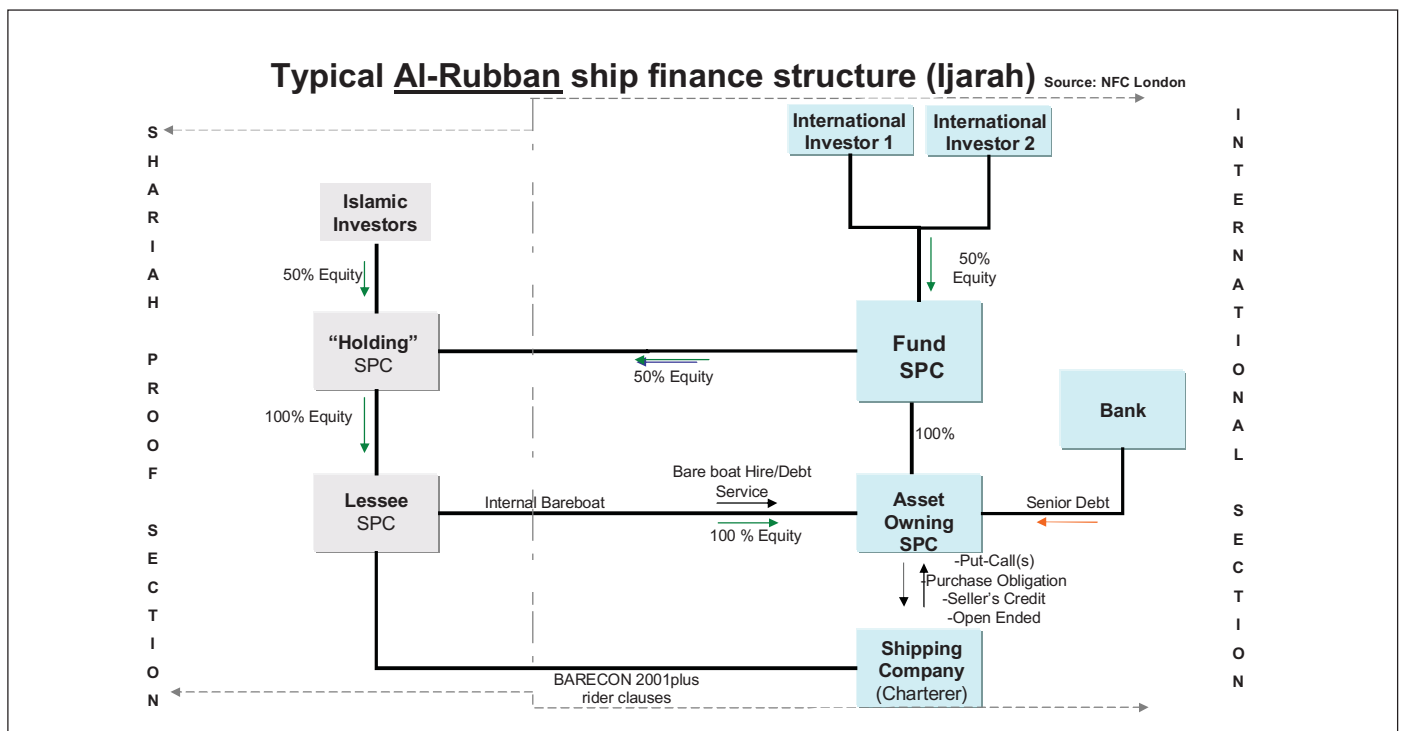
The real estate market has been booming in many countries, resulting in upwards of 15% returns for investors. This is, for new asset classes, a challenging benchmark. In 2004 two funds with a focus on the shipping industry were created: the Allslami Fund from shipping boutique Tufton Oceanic, and the Al Rubban NFC Shipping Fund IV from DVB Bank. The Allslami fund was structured jointly with Dubai Islamic Bank and was a fund fully dedicated to Islamic investors. The Al Rubban Fund was the first Islamic fund in a range of four shipping funds and combined both Islamic and other investors. The fund was established with an equity base of US\$80 million; 50% thereof was provided by Kuwait Finance House (the Islamic part) and 50% by DVB and its partners (see the chart below showing the fund structure developed by KFH and DVB).

DVB Investment Management – a core business unit of DVB, established at the beginning of 2002 – arranges equity for transport clients and provides fund management services to investors in the transport sector. The NFC Shipping Funds (NFC) provide equity, preferred equity and mezzanine loans to the shipping industry. The

amount of equity raised in the eight NFC funds is close to US\$500 million. In 2006, NFC concluded 32 transactions, of which 10 were exits and 22 were new investments. The exits involved 16 vessels with a combined value of close to US\$300 million. The realized returns are well above the 15% return on equity (ROE) benchmark of NFC. The new investments involved over 60 vessels with a combined value of US\$900 million. In 2006 a new shipping fund was established (NFC VI) with an available equity of US\$150 million, enabling it to buy assets up to US\$600 million. The five investors in NFC VI are based in the USA, Japan, Hong Kong and Germany.

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The international investors created an asset-owning company which owns the vessel via a fund special purpose company (SPC). This asset-owning company purchases the vessel and pays the purchase price with a bank loan and the “equity.” The asset-owning company leases the vessel based on a bare boat agreement to the lessee SPC. To obtain this lease, the lessee company pays up front an amount equal to the “equity” to the asset-owning company. In this way 100% of the capital for the vessel is available. The monthly lease terms are set



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by the asset-owning company at such a level that the asset-owning company can service the bank loan, but no more than that (always approximately zero result).

The lessee company is a 50/50 joint venture between the Islamic and international investors and must comply with Shariah law. The lessee company obtains the equity of the partners and transfers it based on the lease (bare boat agreement) to the asset-owning company. The lessee company part sub-leases the vessel to a third party with a lease rate above the original lease. The difference between the sub-lease rate and the lease rate based on the bare boat agreement is the return on the equity from the partners.

At the end of the sub-lease the vessel will be sold. The asset-owning company sells the vessel and uses the proceeds to repay the bank loan. Thereafter the lessee company has the right to acquire the debt-free and now Shariah compliant asset-owning company for US\$1. All proceeds above the bank loan also end up in the lessee company and can be distributed to the investors.

The Al Rubban fund acquired, in a period of 15 years, 14 vessels with a total asset value of close to US\$400 million. The fleet included various types of vessels such as product tankers, offshore vessels, LPG vessels, etc. In 2006, the portfolio was sold and the return generated for the Islamic investors was 40% per year on the amount invested.

Last March, DVB Bank, the Frankfurt-based specialist in transport finance, announced that DVB Investment Management activities outperformed in the 12 months ending December 2006, contributing approximately 25% of the bank's result from operating activities. High levels of activity in the aviation and shipping fund management activities have collectively generated a substantial deal flow above benchmark returns.

This performance has stimulated a new Islamic shipping fund. The shipping capital market has, however, changed over the last two years. Booming values and charter rates have attracted new equity capital to the industry from various sources. The new equity capital fuels the increase of values and charter rates and puts pressure on the expected returns. Lower return expectations and higher volatility indicate that the timing is not yet right for a new Islamic shipping Fund, but it will come. ☺



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Main-based DVB Bank. NFC, a joint venture between DVB Bank and Northern Navigation Group, acts as investment manager for shipping funds. The bank operates out of offices in Frankfurt/Main, Hamburg, London, New York, Rotterdam, Hong Kong, Singapore, Tokyo, Bergen/Oslo, Piraeus and Curaçao. DVB Bank is listed on the Frankfurt Stock Exchange. For further information, please contact Professor Dr Borislav Bjelicic by email: borislav.bjelicic@dvbbank.com or by telephone at: +49 69 9750 4390.

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