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The Global Corporate Advisor

The Corporate Finance newsletter of Crowe Horwath International



Welcome to the June issue of The Global Corporate Advisor. From Poland, this newsletter has a special focus on investments in renewable energy in Central and Eastern Europe, an area which continues to be important due to implementation of policies dealing with these matters.

From Germany, we have an article on non-performing shipping loans and how crucial differences in the application of law mean that investors cannot consider ships as floating real estate.

Based on my role within Crowe Horwath's International Corporate Finance team I would like to draw your attention to a client segment which is becoming increasingly visible and important in our respective markets, primarily in M&A and for Private Placements (Equity and Debt).

Family Offices or High Net Worth Individuals (HNWI), which traditionally focused their investments and the corresponding

“asset split” on traditional asset classes, are now looking at two major new investment areas – Arts and Direct Investments (Equity or Debt) in companies. This is driven by unsatisfactory interest rates and already relatively high stock markets, along with the fact that investment in properties, regardless of region or currency, have reached an optimum limit.

For these investors, Art and Direct Investments are emerging as promising alternatives aimed at improving rates of return, risk diversification and protection against inflation.

Those assumptions may be correct, but how could such a strategy be implemented? Employees of such Family Offices/HNWIs or their traditional advisors may a) not be qualified to take such decisions and/or b) may not want to take them because of the potential risk of failure and a following loss of their job or advisory position/function. Consequently, they are extremely risk averse. The logical consequence very often is that no investment decisions are being taken.

In fact, this means that FOs/HNWIs look outside for a specialist in art, and for qualified support/advice regarding their investment decisions in companies.

In the case of investments in companies, there are different options. Either the wealth is sufficiently large to employ a

team (like a PE-Fund) or they can team up with other FOs/HNWIs and create a Multi-Family set-up. The third option is to look for external advice in the form of a trustworthy Investment Sparring Partner. This solution may also serve such organizations/clients as an extended work-bench in the execution phase.

Research shows that in general, single family offices serve families with at least \$100m of investable assets. Industry observers are estimating that there are 2,500 to 3,000 single family offices managing more than \$1.2 trillion in the US. They also estimate that there are another 1,000 family offices in Europe and hundreds throughout the rest of the world. ¹⁾



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1) *Generational Equity: Competition for Business Buyers; Carl Doerksen, June 12, 2013*

Inside This Issue:

Welcome	1
Investing in Renewable Energy in Central and Eastern Europe	2
Are Ships Only Floating Real Estate? NPL Investors in Germany Discover a New Asset Class	7

Contact Us

The GCA team is here to respond to your needs relating to M&A transaction support, valuations and advisory services. If there is a topic you would like us to cover in future issues of the GCA newsletter, don't hesitate to contact Peter Varley, Chairman of GCA, at peter.varley@crowecw.co.uk. Alternatively, please contact your local GCA team member to discuss your ideas.

Investing in Renewable Energy in Central and Eastern Europe

By Krzysztof Horodko and Krzysztof Kajetanowicz, Poland

In order to make economic sense, investment in renewable energy relies on government backing quite heavily. This is because the production of energy from renewable sources is generally more expensive than production from fossil fuels such as coal, gas and uranium. In most young democracies of Central and Eastern Europe – those belonging to the European Union and the 11 countries mentioned in this article – long-term policy is not yet taken for granted and the investment that relies on support frameworks is nothing short of doing business with the government. Policy becomes a moving part of the picture and a source of both risk and opportunity, as policymakers learn to shape the renewables market through trial and error, sometimes providing too much support.

Born in Brussels, executed in Budapest

In Europe, renewables have been playing a prominent role for the past few years, not the least due to the commitment made by EU members in January 2007, when the European Commission proposed a binding target that renewables would comprise 20% of the overall EU energy consumption by 2020¹. This commitment led to the adoption of directive 2009/28/EC, which is the cornerstone of today's policies that aim to increase sustainable energy generation in the EU. Through support measures, member states have been made to ensure that they meet their national targets for the ratio of renewable energy production to gross consumption of final energy, which includes electricity, heating and transport. Among more detailed requirements, national action plans have been adopted, specifying interim targets for the production of electricity and predictions on how the total production could be split into various renewable energy sources, which include hydro-electric energy, onshore and offshore wind, combustion and co-combustion of biomass and biogas, among others.

Table 1. Production of electricity and overall use of renewables – targets for 2020 versus 2012 statistics

Gigawatt Hours (GWh)/ %	Renewable electricity (gross)		Renewables in gross final consumption of energy	
	Target (non-binding)	2012 actual	Target (binding)	2012 actual
Bulgaria	7,604	6,077	16%	16%
Czech Republic	10,626	8,796	14%	11%
Estonia	1,913	1,477	25%	26%
Croatia	8,388	5,226	20%	17%
Latvia	5,191	4,109	40%	36%
Lithuania	2,958	1,697	23%	22%
Hungary	5,597	2,647	15%	10%
Poland	32,400	17,307	15%	11%
Romania	31,388	15,197	24%	23%
Slovenia	6,126	4,510	25%	20%
Slovakia	8,000	5,810	14%	10%

Source: TPA Horwath compilation based on National Action Plans published by respective national governments and Eurostat data

These goals are met by implementing various support measures, two most ubiquitous of which are feed-in tariffs and “green bonuses”, both proportional to production. A feed-in tariff is a government-mandated price received by a renewable energy producer. This could be any amount, for example, €80 or €100 (\$110 or \$140) per megawatt/hour – in any case, much more than the energy would sell for in the market and theoretically enough to ensure that renewable facilities are built and kept online. More importantly, the price is guaranteed for 15 years or so, contributing to the sector's image as a low-risk area. Feed-in tariffs have been adopted by Bulgaria, Croatia, Slovakia and Hungary.

“Green bonuses” may be awarded either in cash (Czech Republic) or in the form of tradable certificates of origin (in Romania and Poland). The market price of certificates is supported through mandatory quotas imposed on non-renewable producers or sellers of energy to final users.

Trends in the renewable energy mix

At present, the sector in CEE has achieved a role comparable to much of Western Europe. Renewable energy is consumed in the form of electricity, heat and biofuels. In terms of renewables' share in gross production of electricity, Latvia, Croatia and Romania lead the pack, with sustainable sources accounting for over 1/3rd of each electricity market (compared to 24.8% EU-wide), whereas total use of renewables, including heating and transport, is the greatest in the three small Baltic states (Lithuania, Estonia and Latvia – 22% to 36%) as well as former Yugoslav republics Croatia and Slovenia (17% and 20%, respectively, compared to the 14% EU-wide total).

¹Communication from the Commission to the European Council and the European Parliament: An Energy Policy for Europe, Brussels dated 10 January 2007 {SEC (2007) 12}.

Table 2. Gross renewable electricity production in 2012

GWh	Hydro	Solar	Wind	Biogas	Biomass and waste	Total renewable
Bulgaria	3,976	814	1,221	1	65	6,077
Czech Rep.	2,860	2,149	416	1,468	1,903	8,796
Estonia	42	0	434	16	985	1,477
Croatia	4,801	2	329	57	37	5,226
Latvia	3,707	0	114	223	65	4,109
Lithuania	937	2	540	42	176	1,697
Hungary	213	8	771	211	1,444	2,647
Poland	2,465	1	4,747	565	9,529	17,307
Romania	12,337	8	2,640	19	193	15,197
Slovenia	4,080	163	0	153	114	4,510
Slovakia	4,439	424	6	190	751	5,810
CEE	39,857	3,571	11,218	2,945	15,262	72,853

Source: TPA Horwath based on Eurostat data

Importantly, legacy hydropower markets, dominated by facilities built largely pre-1989 (think Latvia) may have little room to grow compared to the newer technologies that have experienced growth in the last decade and/or are poised for further expansion. In many places, including Poland, the Czech Republic and Romania, the renewable mix is changing at a rapid pace, even if some of them seem like laggards with ground to make up. This is the reason for the spotlight on these countries in terms of potential for investment in renewable energy. In recent history, new capacity has mainly related to wind (Poland) and photovoltaic (solar-electric, or PV) systems (Czech Republic). The picture of solid biomass, while in many places accounting for a substantial part of renewables statistics, becomes distorted by so-called co-combustion practices, such as adding biomass to traditional coal-burning furnaces without building new capacity or indeed spending any substantial amount of money on upgrades.

While a country's overall renewables potential has to do with political will – shored up by lobbying, at times – and public acceptance of its costs, geographical features are not entirely without significance. A long coastline will increase the potential of onshore wind (offshore being practically non-existent in the region due to the high cost and complexity), as will sparse population (rural or empty areas being beneficial to the capture of wind energy), whereas a southern location may make solar energy cheaper than elsewhere. Furthermore, solar installations are very quick to react to new incentives, as in the Czech Republic, where attractive feed-in tariffs drew in a tsunami of investments (two gigawatts of photovoltaic power between 2009 and 2011 – enough to supply 300,000 to 500,000 households), committing the government to a costly system that was promptly dismantled and is being partially offset through back taxation². Wind, biomass and other facilities take two to four or more years to develop, if one includes the comprehensive permitting procedures and acquisition of land, among other factors.

Major investors and projects

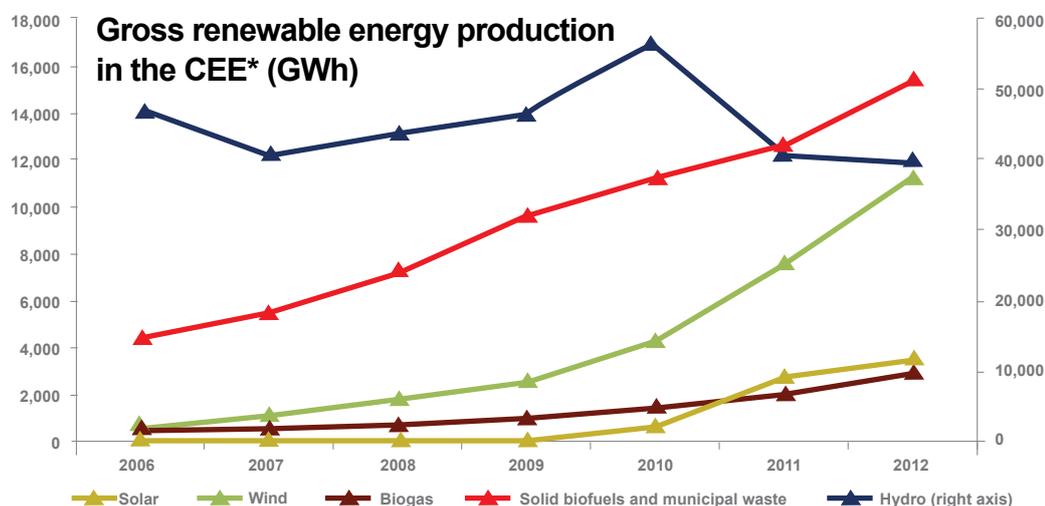
In the Czech Republic, state-controlled energy giant CEZ controls two of the three largest photovoltaic farms (Ralsko and Ševětín). Those may be less acquirable than smaller installations. For example, in January 2014, distributor Prazska Energetika promised to buy the Rajhrad PV farm of 6.3 MW for an enterprise value of €21 million³.

Vertically integrated utilities are also on the offensive in Poland, where they transact with numerous independent developers on a sell-and-build basis. In a notable exception from this modus operandi, Polish Energy Group and the Gdansk-based Energa co-purchased a total of 287 MW in operating wind assets (and a pipeline of nearly 2GW, much of which will have been completed) from Dong and Iberdrola for €440 million in 2012. Western utility majors have shown keen interest in this market as well, especially the French EDF, which we have had the satisfaction of assisting in several wind farm purchases.

² http://www.pv-magazine.com/news/details/beitrag/czech-republic-ends-fit-program--extends-solar-tax-_100012748/#axzz2z9gSXqTH. NB Germany is a more famous example of 'explosive' PV investment incentivised by high feed-in tariffs and a new supply of cheaper solar panels

³ <http://byznys.ihned.cz/c1-61592460-ekonom-prazska-energetika-koupila-velkou-solarni-elektrarnu-za-pul-miliardy>

Graph 1. Winds of change in renewable electricity



*For countries included, see Table 1. Source: TPA Horwath based on Eurostat data

Private equity firms, such as Verdi Capital (three Czech solar parks of 10.8 MW), Impax, and Mid Europa Partners, the acquirer of Energy 21, a company which owns 62 MW of smaller solar installations in the Czech Republic have also shown some interest in the sector. Investors new to the local industry may be deterred by price demands presented by sellers and the degree to which the commercial future of a project is outside the investor's hands. This is the reason behind the activity of wealthy individuals with knowledge of the market in Bulgaria and Poland. The list includes the richest Pole, Jan Kulczyk, whose Kulczyk Investments took control of industry pioneers, Polish Energy Partners, in 2012 through a blockbuster tender offer. Infrastructure funds (Marguerite – 50 MW of wind capacity in Poland purchased in October 2012) are present, as are specialized energy companies (Czech private company Energopro, involved in energy trading and hydroelectric operations, including those based in Bulgaria). In July 2012, a group consisting of First Reserve Corporation, Crescent Capital and ACWA Power bought the 60.4MW Karadzhalovo PV project in Bulgaria from SunEdison.

Strategic foreign investors are moving in varying directions. In June 2013, Italian ERG Renew and Russian Lukoil joined forces to take over two wind farms – Hrabovo in Bulgaria and Gebeleis in Romania, a total of 84 MW – from Vestas, a Danish wind turbine producer. This transaction followed earlier purchases in Bulgaria in 2012.

Biomass combustion – with the exception co-firing of biomass in old coal furnaces – is more of a venue for greenfield activity, especially for domestic and foreign utilities, such as Dalkia in Poland and Hungary, which acquired a co-generation plant with a capacity to generate 70 MW of heat and 35 MW of electricity, commissioned in Pécs in 2011, and GdF Suez in Poland, which in 2012 opened the world's largest biomass-fired plant (205 MW) in Polaniec.

Where to look for investments

Drawing on the experience of the governments of Germany, Czech Republic, Poland, Bulgaria and other countries in which the pace of growth of renewable energy – and the associated public expense – exceeded expectations, authorities are unlikely to fund another investing bonanza where high feed-in tariffs would be maintained while capital costs fall and productivity improves. When seeking above-average returns, investors should take an opportunistic view, looking for situations such as:

- The phasing out of the retroactive Czech compensatory tax on solar installations launched in 2009 and 2010.
- Transitions from one system to another. Poland, for instance, is switching from formerly generous certificate system into an auction-based feed-in tariff and will likely allow projects launched under the existing regulations to switch to the new system at any time, provided they are able to win an auction at the price that meets their investment criteria, or stay in the old system. Given the right strategy, this would, in fact, constitute a free option for a facility launched before the end of 2015.

- Buying immature projects with a view to have them developed and resold to utility companies, whose objectives may differ from those of other investors. For example, in some companies, the need to diversify the portfolio is fulfilled by introducing technologies which others may find unattractive or risky, such as solar.
- Solar panel producers conducting “fire sales” (disposals that need to happen quickly) of renewable assets due to liquidity needs (as panel prices go down, the producers’ operating cash flows suffer and must be replaced, forcing divestments).

Alternatively, investors may take a more passive stance and be satisfied with returns just commensurate to the level of risk by signing up to the existing support schemes in countries which cannot afford to sit on their hands. This can be easily inferred by the degree to which an EU member state has fulfilled its pledge to reach the target share of renewables in gross energy consumption, as shown in Table 1. This target is often met by shoring up sustainable production of electricity. Poland, Slovakia and Slovenia clearly have room to grow. Effective January 1, 2014, Slovakia introduced a cap of 30 KW on solar, 15 MW on wind and 5 MW on all other installations eligible for subsidies (granted in the form of a supplement to the price of electricity received, which is the difference between the fixed feed-in tariff and the market price of electricity). This leaves wind as the main viable option since biomass-fired plants tend to be much larger and thus outside the scope of overhauled support in Slovakia. Wind farms also grew at a record pace of nearly 1 GW in 2013 in Poland, despite lingering uncertainty as to the exact shape and implementation of the new support scheme. Slovenia has a system where producers with a capacity over 5 MW receive the difference between costs of renewable production and the reference market price and feed-in tariffs for smaller facilities – both based on fixed and variable parts and allowing authorities certain flexibility in reacting to the needs of the market.

Share of energy from renewable sources

GEO/TIME	2007	2008	2009	2010	2011	2012
Austria	27.5	28.3	30.4	30.8	30.8	32.1
Belgium	3.0	3.3	4.6	5.0	5.2	6.8
Bulgaria	9.4	10.7	12.4	14.4	14.6	16.3
Croatia	12.1	12.1	13.1	14.3	15.4	16.8
Cyprus	4.0	5.1	5.6	6.0	6.0	6.8
Czech Republic	7.4	7.6	8.5	9.3	9.3	11.2
Denmark	17.9	18.6	20.4	22.6	24.0	26.0
Estonia	17.1	18.9	23.0	24.6	25.6	25.8
European Union (28 countries)	10.0	10.5	11.9	12.5	12.9	14.1
Finland	29.8	31.3	31.2	32.4	32.7	34.3
France	10.2	11.2	12.2	12.7	11.3	13.4
Germany	9.0	8.5	9.9	10.7	11.6	12.4
Greece	8.2	8.0	8.5	9.8	10.9	13.8
Hungary	5.9	6.5	8.0	8.6	9.1	9.6
Ireland	3.6	4.0	5.2	5.6	6.6	7.2
Italy	6.5	7.4	9.3	10.6	12.3	13.5
Latvia	29.6	29.8	34.3	32.5	33.5	35.8
Lithuania	16.7	18.0	20.0	19.8	20.2	21.7
Luxembourg	2.7	2.8	2.9	2.9	2.9	3.1
Malta	0.4	0.4	0.4	0.4	0.7	1.4
Netherlands	3.1	3.4	4.1	3.7	4.3	4.5
Norway	60.2	61.8	64.8	61.2	64.6	64.5
Poland	7.0	7.8	8.8	9.3	10.4	11.0
Portugal	21.9	22.9	24.5	24.2	24.5	24.6
Romania	18.3	20.4	22.6	23.2	21.2	22.9
Slovakia	7.3	7.5	9.3	9.0	10.3	10.4
Slovenia	15.6	15.0	18.9	19.2	19.4	20.2
Spain	9.7	10.8	13.0	13.8	13.2	14.3
Sweden	44.1	45.2	48.2	47.2	48.8	51.0
United Kingdom	1.8	2.4	3.0	3.3	3.8	4.2

Last update 14.04.14

Extracted on 22.04.14

Source of data Eurostat

UNIT Percentage

Share of renewable energy in gross final energy consumption

Projects are often developed by specialized, private companies of varying sizes. In the wind sector, turbine producers help their sales through dual transactions, which include projects under development plus wind turbines, which can account for up to 75% of overall capital investment. Solar panel producers hedge against falling prices of their product by developing photovoltaic farms themselves, which may allow them to capture the incremental value of the project as capital expenditures fall. Biomass facilities that combine heat and power production (CHP) are becoming a popular subject of public-private partnerships (PPP) between municipalities, construction companies and strategic investors.

Prices paid for projects

Prices paid vary widely, depending on the level of support promised and the chances that the promise will be kept. Projects that started to operate when support was exceptionally favorable ("over-support") and before it was fine-tuned, or downright axed, tend to retain that level of support as an acquired right for an extended period. This is evident in the €3 million per megawatt of PV facility prices sometimes observed in the Czech Republic.

For wind facilities, the number of MWh per megawatt-a-year is also critical and weighs heavily on the price, particularly given the fact that the marginal cost of producing each incremental megawatt-hour is zero. A weak project will rotate at full speed for 2200 hours a year or less; a great one may produce 3000 MWh/MW p.a. or more. Additional MWh obtained by acquiring state-of-the-art turbines, higher towers and desirable locations can cost money but that is mostly payable upfront and only contributes to higher project prices. Add this to the differences between subsidy systems supporting projects built in different countries and/or at different times, and the result is prices ranging from €1.1 million to €2 million and more per megawatt.

In both cases, due to the substantial capital cost involved in physical erection of the farm, projects under various stages of development may be traded for 5% to 15% of what an operating project is worth. There is much more to be read on the topic in an engaging piece⁴ by Olivier Grivillers, published in the February 2012 issue of *The Global Corporate Advisor*.

In other technologies, M&A activity has not been spectacular.

Conclusion

Renewable energy in Central and Eastern Europe has only been generated on a grander scale in the last few years. Ignoring co-firing of biomass, two technologies stand out – onshore wind, which is the cheapest way of producing renewable electricity thus far, and photovoltaic, which is the quickest to build, and which historically benefitted from falling solar panel prices as governments were late to restrict support. Nevertheless, dedicated biomass facilities, including CHP, should not be dismissed too quickly, given the caliber of investors who have given a "yes" to the idea of an energy source far more stable and predictable than wind and solar, and one whose economics could vastly improve if the prices of biomass fall.

⁴ *Mergers and Acquisitions in the Renewable Energy Industry: Valuation and Transaction Features* by Olivier Grivillers, *The Global Corporate Advisor Newsletter*, February 2012

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Are Ships Only Floating Real Estate? NPL Investors in Germany Discover a New Asset Class

By Gerald Hespelt and Ralph Krone, Germany

In April 2014, Hapag Lloyd from Germany and CSAV from Chile announced their merger to become the fourth largest global shipping company. In September 2013, shipping company Rickmers Group announced a joint venture with PE investor Apollo Global Management to buy used container ships. The joint venture's budget was stated to be \$500 million.

Due to preferential tax treatment German investors have contributed significantly to the global shipping overcapacity and own approximately one third of the 5,000 container ships which plough the oceans. As a result of this development, German banks dominate the market with ship loans and suffer severely from the continuing crises in the shipping industry. Several had to be rescued with tax payers' money. As banks prepare for the implementation of the Basel III regulatory regime and declare ship financing as non-core business and since an end to the crisis in the shipping industry is not in sight, more M&As and restructurings among shipping companies are expected to take place. Does the German non-performing loans (NPL) market offer opportunities for investors with respect to non-performing ship loans?

The NPL market was established in Germany in 2003 and reached its height with a transaction volume of €14.4 billion in 2006. Despite the high volume of NPLs held by German banks, the market volume of NPLs which are traded has decreased since then, reaching a stable level in the single digit Euro billion range. It is expected that non-performing ship loans will become the biggest segment within the German NPL market and will revive the whole market, overtaking non-performing corporate bonds and real estate loans.

For NPL investors the question is whether ships are only floating real estate or whether getting out of non-performing ship loans is more complicated than getting out of non-performing real estate loans.

Until now, the majority of investors in Germany wanting to invest in distressed assets have decided to buy real estate secured loans. Rising real estate values and recent strategic decisions taken by the banks providing these loans have restricted opportunities in this field. In this situation, distressed ship loans have been a means of filling the gap that has been created. But is it fair to say that ships represent nothing more than floating real estate? The answer to that question can be found, in part, in the collateral structure of the ship collateral scheme and the possibility of compulsory enforcement under German law.

Due to the debtor friendly provisions of German civil law and court decisions, real estate NPL investors generally prefer to take action against the real estate property (*actio in rem*) rather than against the debtor (*actio in personam*). Foreclosure exit strategies, such as public auction and administrative receivership, allow the NPL investor to shift control over the asset away from the (uncooperative) debtor to a court appointed third party administrator. However, in order to achieve this result, the investor as a creditor needs to enforce its rights in rem presented by a mortgage.

Leading merchant fleet by nationality of ship owner

Merchant ships > 1,000 GT

Fleet size				
Country of domicile	Ships	Gross tons	Age	Gross tons-share of total
Japan	3,979	151.9	7	14.70%
Greece	3,283	135.9	10	13.20%
Germany	3,827	94.1	9	9.10%
China	3,224	83.5	13	8.10%
USA	1,076	43.1	15	4.20%
Others	24,643	521.3	11	50.70%
Total	40,032	1,029.80	11	100.00%

Source: IHS Fairplay, Status 31.12.2012

Container ships by nationality of ship owner

Merchant ships > 1,000 GT

Fleet size				
Country of domicile	Ships	1,000 k€	Million dead weight tons (MDWT)	k€-share of total
Germany	1,759	5,148	66.1	31.60%
Denmark	256	1,308	16.7	8.00%
Japan	318	1,295	16.0	7.90%
Greece	259	1,041	13.3	6.40%
China	345	964	12.5	5.90%
Others	2,162	6,547	83.0	40.20%
Total	5,099	16.303	207.6	100.00%

Source: IHS Fairplay, Status 31.12.2012

As with real estate, the main collateral in a ship financing scheme is mortgage. Ship mortgages are listed in a public register known as the “Schiffsregister”. However, this register does not disclose all debt on any particular ship. Claims for services rendered to, or injuries caused by the ship, called maritime liens, take precedence over the mortgage but are not visible in the register. They also allow their claimant an *actio in rem* and therefore have the potential to interfere with the interests of creditor.

In order to realize the ship’s value, under German law, the owner of the mortgage can call for a public auction, known as “Zwangsversteigerung”. During these proceedings, however, the ship usually gets arrested and is put in chains. This means it cannot be operated. While the ship is hooked up, it still needs to be maintained and therefore generates costs. In Germany, the public auction procedure means that it will take at least six months until the date of the first auction.

Unlike a real estate mortgage, a ship mortgage under German law does not allow the creditor to collect ongoing cash-flows, such as charters, by operating the vessel. A court ordered administrative receivership (comparable to real estate) known as “Zwangsverwaltung”, is not an option. A creditor may only request that the court appoint an administrator in connection with a public auction, “Treuhänderische Nutzung”. This procedure is at the sole discretion of the judge in charge and cannot be insisted upon. Furthermore, all other creditors that participate in the auction must give consent. The proceedings can only be ordered in the event of a preliminary discontinuation of the auction, “Einstweilige Einstellung”.

As with a public auction, or administrative receivership, court ordered bankruptcy proceedings also prevent the debtor from operating the vessel. According to German insolvency law, however, a charter is not part of the insolvency estate and therefore cannot be recovered by the creditor in insolvency proceedings.

As demonstrated above, there are structural differences between a real estate mortgage and a ship mortgage and differences in their enforcement under the German law. The fact that a ship needs to sail to operate and to generate revenue reduces the options for creditors when determining an exit strategy from an NPL engagement. Getting out of a ship NPL will generally require a higher degree of cooperation from the creditor and borrower in terms of the going concern. In this respect, ships should not be seen as a straightforward asset class and certainly not as floating real estate.

Due to the high and even increasing number of non-performing ship loans in Germany, new opportunities for investors are developing accordingly. However, the complexity of the shipping business itself combined with the loan and collateral structure of a common ship financing scheme place a challenge for NPL investors compared with real estate. This may indicate the need for specialist support.

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