

Statement of

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Before the

**Subcommittee on Seapower and Expeditionary Forces
Committee on Armed Services
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Mr. Chairman and distinguished Members of the Subcommittee on Seapower and Expeditionary Forces:

U.S.-flag Ship Financing Background

I am Martin Gottlieb, a founder and Managing Director of Argent Group Ltd. Argent is a boutique investment banking firm that specializes in structuring and arranging financing for projects involving large-ticket assets such as ships. Since its inception in 1982, Argent has arranged financing for projects costing in excess of \$25 billion, more than half of which has been in connection with ship financing transactions.

One of the more noteworthy transactions in which Argent has been involved is the \$2.7-billion Maritime Prepositioning Ship and T-5 Tanker program that was completed in the 1980's. That transaction involved a total of 18 commercial ships that were newly-built or converted in U.S. shipyards and chartered by the U.S. Navy. Argent served as financial advisor to the Navy and for our role in that transaction a colleague and I were presented with "Distinguished Public Service" awards.

Over the years, Argent has been involved in many of the commercial ship financing projects for new-build U.S.-flag vessels that have been completed. In fact, since the beginning of 2000, Argent has served as the financial advisor on all but two of the U.S.-flag projects for deep draft, ocean-going vessels. In connection with these 2000-and-beyond projects, Argent has structured and raised financing for 35 vessels costing in excess of \$4.4 billion using both commercial financing and Title XI financing.

Title XI Program Background

My experience with the Title XI program dates back to the early 1970's when the program changed from an "insurance" to a "guarantee" program and I have been involved with the program ever since.

Most recently, Argent served as financial advisor on three of the six projects that have been approved for Title XI loan guarantees by the Maritime Administration since the beginning of Fiscal Year 2003. These projects represent about 2/3 of the \$637 million of Title XI loan guarantee commitments that were approved during that period. Of the six vessels, four were replacement vessels for established operators on existing trade routes and two were of a vessel type that is new to the U.S. market.

I appreciate the opportunity to testify before the Subcommittee about the Title XI program. My testimony will outline some of the benefits that the program affords a shipowner, draw some comparisons between commercial and Title XI financing, and identify some of the issues that I believe need to be addressed in order to revitalize the Title XI program.

Importance of a Robust Title XI Program

The Title XI program has been very successful, having been relied on, by some accounts, to provide assistance in financing over 90% of the new U.S. built ocean-going and Great Lakes fleets from the inception of the program in 1938 through the year 2002.

While commercial financing is readily available for foreign-built vessels, it is more of a challenge for vessels built domestically. The market for U.S.-built vessels is much smaller than that for foreign-built vessels. Consequently, the volume of ships built in the U.S. is too small to create the economies of scale that would lower the cost of these vessels to international levels. Because of their high cost and the small universe of users, commercial financing sources do not view U.S.-built vessels in the same way that they view foreign vessels. Foreign-built vessels are considered to be commodity assets that can be financed largely based on their asset value because they can be readily re-deployed or sold if the shipowner defaults on a loan. By contrast, U.S.-built vessels are viewed as purpose-built assets that cannot be so readily re-deployed or sold at a high enough price to support a significant loan against the vessel. Typically, a commercial lender will consider only the value of the vessel in the foreign market when lending based on asset value.

The Title XI program bridges this financing gap. Like the export finance programs of foreign countries, the Title XI program supports construction financing for ships built in the United States. It also supports permanent financing for U.S.-built vessels that is more closely aligned with the useful lives and values of vessels in the Jones Act market.

Attributes of Title XI Guaranteed Debt Financing

The Title XI program provides four principal benefits to U.S. shipowners:

- The program enables shipowners to obtain construction financing for U.S.-built vessels.
- The program provides financing for up to 87 ½% of vessel cost.
- The program provides for a financing term of up to 25 years from vessel delivery.
- The program provides lower-cost financing.

Construction financing for foreign-built vessels is generally supported by guarantees backed by export credit agencies. Lenders often require similar government support for U.S.-built vessels and the Title XI program, sometimes backed by performance bonds or corporate guarantees from U.S. shipyards, provides that support.

The Title XI program also provides financing for up to 87 ½% of the cost of a vessel, more than is available with commercial financing. Commercial lenders typically lend a maximum of 70-80% against the cost of a foreign-built ship. When those parameters are applied to higher-cost U.S.-built vessels, lenders will generally not provide more than 40-70% financing against the cost of the vessel. The remainder of the vessel cost must be financed with more expensive junior capital or equity. This overall higher financing cost makes the business case to support the acquisition of a U.S.-built ship very challenging.

By providing a financing term of up to 25 years from vessel delivery, the Title XI program better matches the financing term for U.S.-built vessels to their useful lives. Given their higher cost and purpose-built nature, U.S.-built vessels generally operate for a longer term than foreign-built vessels. The term of commercial financing is typically limited to between 7 and 12 years.

The debt issued under the Title XI program carries a lower interest rate than commercial debt. While the guarantee fees charged for the program can make it more costly for borrowers with high credit ratings, for all but the most creditworthy of borrowers, the Title XI program makes the acquisition of U.S.-built vessels more affordable.

Recent Experiences with the Title XI Program

In order for the Title XI program to be effective in supporting the construction and acquisition of U.S.-built ships, the program must be implemented on an efficient and predictable basis.

Argent's experience in assisting shipowners with the Title XI program spans the "before," "during," and "after" effects of the formation and functioning of the DOT Credit Council that was announced by the Department of Transportation in July 2004.

The Credit Council's formation was the outgrowth of a couple of significant defaults in the Title XI program following the events of September 11, 2001. Those events precipitated a review of the program by both GAO and the Department of Transportation Inspector General, which recommended some changes to the program. While some of these changes were helpful, the overall effect has been to create a program that attempts to be "risk free" – a laudable objective, but one that might also prevent the Title XI program from meeting its policy objectives of supporting shipbuilding in the United States. It is important to note that only one application has been approved since the formation of the Credit Council, perhaps due to the chilling effect on applications from the perceived bureaucratic red tape that is now part of the approval process.

Since the formation of the DOT Credit Council, the Title XI program operates on a less efficient and predictable basis than it has in previous years. The time between Title XI application and approval is longer, and our experience has been that additional conditions and requirements are placed on applicants as the approval process proceeds. It also appears to us that the industry expertise and experience that resides in the Maritime Administration is diluted in the current approval process. This industry expertise and experience, which is comparable to that in the commercial sector, is essential to the effective and efficient evaluation and implementation of appropriate terms and conditions for shipping projects. The appointment of consultants and the oversight of individuals who may not have the necessary depth of industry expertise can harm rather than enhance the program, and certainly slows it down. The industry expertise and experience of the Maritime Administration staff should not be lost in the current process and steps should be taken to take advantage of that expertise and experience.

Suggested Changes to make the Title XI Program more Robust

Having discussed the importance of the Title XI program and our recent experience with it, I'd next like to offer a couple of suggestions to make it operate more efficiently.

First, I suggest that the financial tests set forth in the Title XI regulations be reviewed and updated. As part of any update, I recommend that the Maritime Administration be given some latitude in setting the financial tests as projects are approved. For example, the debt-to-equity test that is currently in the regulations might be less appropriate for a vessel operated by an established carrier on an existing trade route than the debt-to-cash flow test that is commonly used in commercial financings. Similarly, the working capital test that is currently in the Title XI regulations might be replaced with an earnings test or a coverage test to more closely match commercial financing practice.

With regard to the Credit Council and the use of outside consultants to review Title XI applications, I recommend that the evaluation and approval of projects involving vessels for established operators on existing trade routes not require review by the Credit Council and outside consultants, and be put back in the hands of the Maritime Administration. Only those projects involving new technology or an unproven service where additional review and analysis might be warranted, should provide for the possibility of an outside consultant and Credit Council review. Following this approach, all Title XI projects would receive a more expedited review.

Conclusion

In conclusion, I believe that a strong and well-functioning Title XI program is vital to our country, vital to our merchant marine and vital to our domestic industrial base. With proper funding, appropriate revisions to the program and proper oversight, the Title XI program can be revitalized to perform the functions that Congress intended and that are badly needed to help rejuvenate our U.S. Merchant Marine.

Thank you, Mr. Chairman and members of the Committee, for the opportunity to share some of my views and experiences. I would be happy to answer any questions you may have.