May 2024

The Impact of Age Limits on the Global Shipping Fleet

Looking at how current age policies may result in a massive structural shortage of capacity, unless policies are loosened

The recent attacks on merchant vessels in the Red Sea, coupled with transit limitations at the Panama Canal, has dramatically increased the ton/mile and placed serious strain on vessel capacity. It is estimated that the re-routing of vessels via the Cape of Good Hope has reduced shipping capacity by as much as 10% with some estimates even higher than that. Like any free market, this has helped to bolster freight rates and, in some cases (ex. container liner services), even provided a much-needed lifeline to an otherwise falling market. For tankers, the market has never been better.

While the situation in Panama seems to be gradually returning to normal, it is anyone's guess when the Red Sea will again be safe for passing merchant ships. It is reasonable to conclude that key supply lines between Europe and Asia and the Middle East will continue to route via the Cape, thus continuing to place strain on the availability of ships.

These extenuating circumstances represent only some of the many challenges the shipping industry faces. For example, regulatory changes governing ship-based emissions requiring vessels to slow down to meet declining CO2 emissions targets are expected to take additional capacity out of the markets. This is particularly impactful to vessels ordered prior to January 1, 2013, which are using older less-efficient engine technologies (~68% of the existing IMO fleet). With potentially fewer ships available in the market, shippers are scrambling to shore up their supply lines at a time when new builds are at an historic high and lead times on building ships are as much as three to four years.

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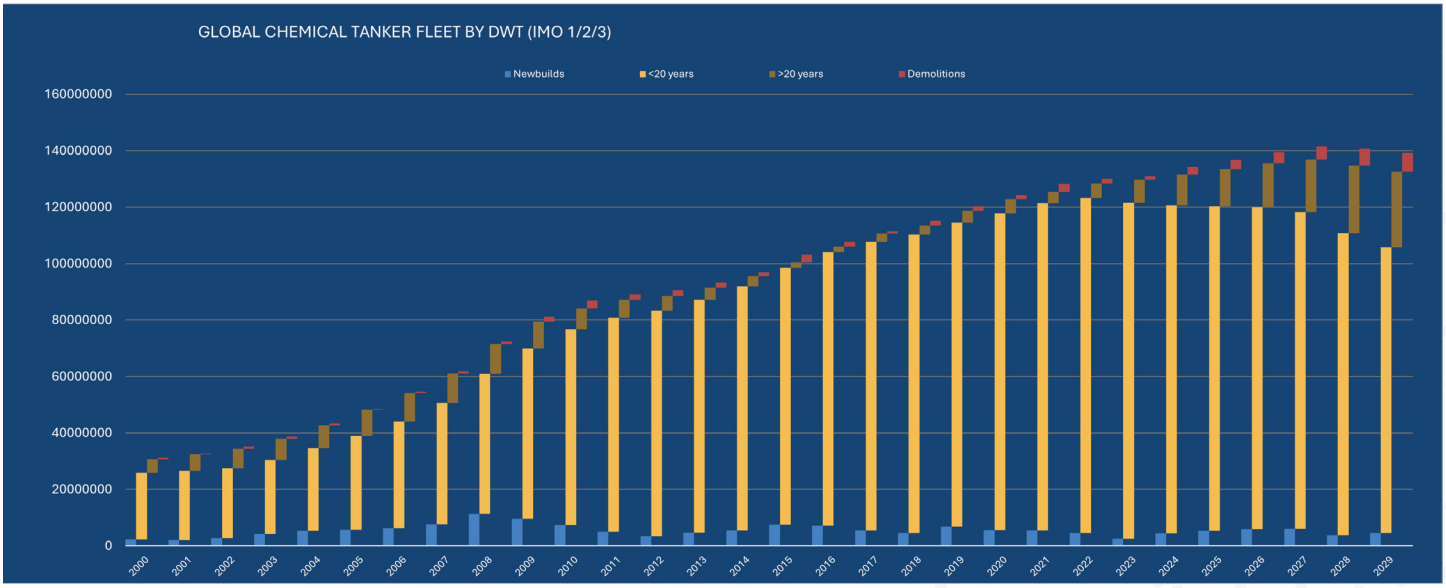
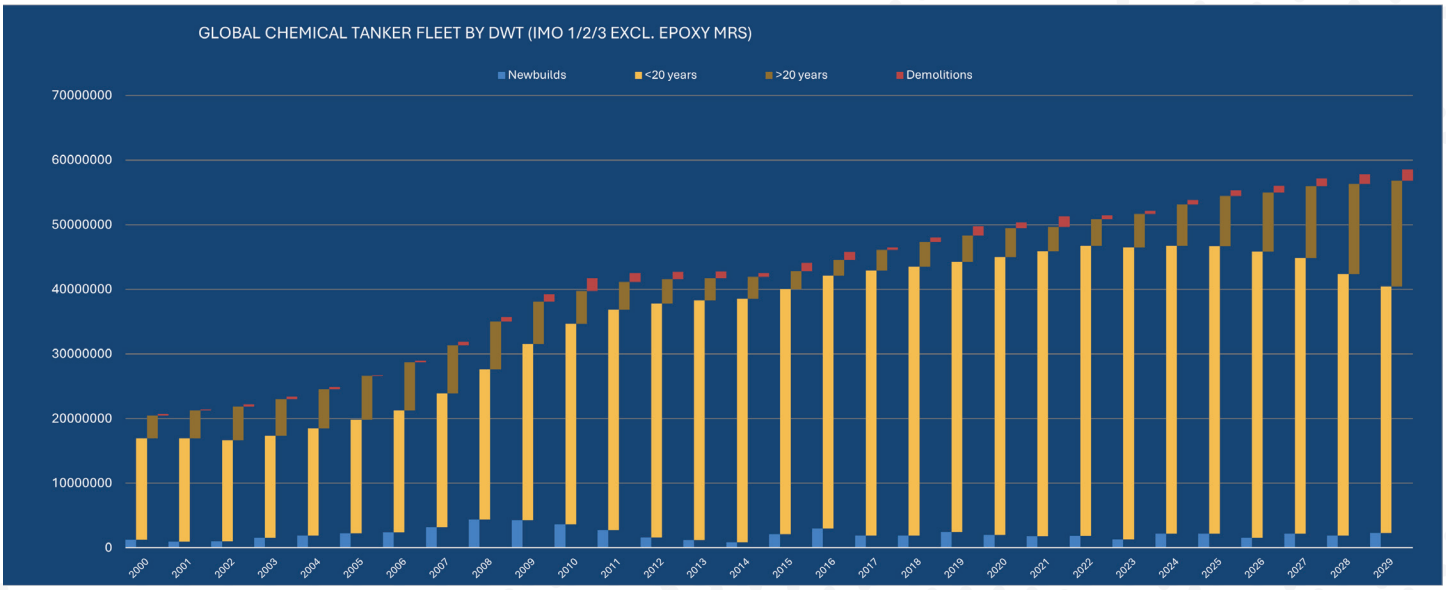
Never Ask a Lady Her Age

Traditionally, when analyzing the fleets, Quincannon Associates has looked at vessels of twenty years as nearing the end of their service lives. Many of the Majors have had stringent age requirements that precluded them from using ships over twenty years old (or in some cases, fifteen years). To assess the supply-demand relationship for (chemical) tankers, we would compare the orderbook to the vessels set to "age out." In many respects, age restrictions have been a function of the market. It was very easy for shippers to implement age policies in the prolonged down market because there was almost always a newer ship available nearby at little to no additional cost. Today, however, that is no longer the case.

For most of the 2010's, the data indicated that the market was long supply on IMO 2 tonnage. A notable shortage was developing in the "Super-Segregator" stainless steel space where the most sophisticated ships were not being replaced. The ships that were being added to that fleet were much simpler, creating additional challenges for small parcels. Overall, however, the markets stayed in balance with demand. Without a shortage of capacity, age limitations continued to go unchecked. But now, in the past four years we have seen a Global Pandemic, Russia's invasion of Ukraine, transit restrictions in Panama, and Houthi Rebel attacks on merchant shipping in the Red Sea, all of which have served to drive up the freight markets and put a strain on ship availability.

Today, the orderbook sits below replacement level and the ships nearing or exceeding twenty years are the vessels that were built in the last big commodity cycle. With new building prices at all-time highs and a general lack of credible yard space, lead times are, minimum, three to four years to get new capacity on the water. To add an additional layer of complexity, as of today, there is no clear path to ships being carbon neutral and there are no imminent lifelines coming anytime soon. Without a fundamental change in industry policies on the age of ships, a number of Charterers, ports, and port facilities may not have access to sufficient capacity.





The Evolution of the Fleet

The commodity boom of the mid 2000's ignited an expansion of the global fleet at a scale never seen before. Ships, in all segments, were ordered with reckless abandonment because the sentiment at the time was, "this time, it is different." Growth in the developing world was moving at a staggering pace and there was an unquenchable thirst for commodities, and the ships to transport them. This brought in investors from all walks of life and a series of IPOs for shipping companies.

The subprime mortgage crisis of 2008 and subsequent collapse of the global economy brought the freight markets to a screeching halt, but the collateral damage was done. Ships were overbuilt, and while the ordering of new capacity stopped, new builds continued to flood the markets for another two to three years creating additional length in the fleets. It would take more than a decade of endless restructuring and consolidation to resolve the oversupply situation.

Chemical tankers were no exception to this trend and for a segment generally associated with less market volatility, the challenges were arguably greater. These ships are highly specialized, which increases their construction and operational costs, and also means limited market liquidity during periods of excess capacity. Bulkers, product tankers, and other modes of shipping experienced similar prolonged down markets, however there was always a secondhand market, and assets changed hands freely. For the IMO 2 specialty tankers that was very much not the case, requiring owners to hunker down and wait for better times.

By 2014, the freight markets for chemicals started to show signs of life and drew in a new form of investor to the shipping space. Private Equity ("PE") had been involved in shipping for quite some time, but for the first time, they were placing speculative orders on chemical tankers (among other modes) in their unrelenting pursuit of yield. This next wave of new construction was simpler ships that were vastly more efficient in terms of fuel consumption, thus creating a tiered market. Ultimately, PE learned quickly that there was very little in terms of liquidity and so the ships were either sold or farmed out to commercial pools. But again, the damage was done, and the long-anticipated market recovery was pushed out further over the horizon.

A Path Forward

For certain, a strong freight market can justify the life-extension of older vessels. But for established operators, they will need firm commitment from their clients to use ships in excess of twenty years. It is not entirely unreasonable to say that ships of thirty years could be trading outside of protected trades provided they are well-maintained and undergo rigorous screening by the relevant parties. This will be most evident in the specialty tanker space.

At Quincannon Associates, our global team is working closely with both Owners and Charterers to navigate the complex shipping landscape by using data to drive the decision-making process. While this data indicates that there will not be an oversupply situation anytime soon, there are clear opportunities within the existing fleet to optimize how cargoes move as well as additional opportunities to better utilize existing fleet assets to work towards the broader shared goals of reducing ship-based CO2 emissions.

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