Financing Fishing Vessels

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The size of fishing fleets in the various ports of New England has changed considerably over the last decade. In some ports the number of vessels has dwindled; in others about the same numbers have been maintained, but with increased average size and horsepower; and in others there may have been a small increase in the number of producing units. In some ports new vessels have entered the fleet each year; in others several years have gone by without a single new addition. To a large extent the cause of these different trends has been the different impact of foreign pressure on different stocks, but that is not the whole story.

Growth of a fleet is determined by the rate of return to capital, which depends on the price of fish, the flexibility of vessels, the cost of inputs, like vessels, gear, insurance and supplies, and the lay system. All these factors differ among New England ports. For some ports the picture looks bleak, for others it looks rosy; in the latter the fishermen, despite complaints about foreign pressure, might not want to return to the situation of ten years ago with plenty of fish and low prices. Personally I do not think this will happen.

A 200-mile limit would increase domestic landings, but a large part of these would be substitutions for imports, so supplies might not be affected to the same extent, particularly of domestic food fish species. Nevertheless, the current New England fleet would hardly be able to harvest the MSY (maximum sustainable yield) within area 5, and significant amounts of funds to rebuild units and add new ones to the fleet would be required. Financing of new construction or purchase of a vessel by fishermen who do not already own one has become increasingly difficult. For example, two familiar sources of finance have become "inoperative." The Construction Cost Equilization Payments Program, commonly referred to as the "subsidy program," has been discontinued. It was a poor program anyway. The Fisheries Loan Fund operated by the National Marine Fisheries Service (NMFS) has been put in abeyance, and it is doubtful that the program will be revitalized in the form we were used to.

At the present time funds for financing the purchase of new or used vessels or for reconstructing them can be obtained through either commercial banks, the Farm Credit Administration, or the Capital Construction Fund. Let me describe briefly these sources of funds and the terms at the current time, plus some other mortgage guarantee programs.

Commercial Banks

Many Rhode Island banks do not handle vessel loans, but some are willing to give small loans up to $10,000. The few willing to finance vessels offer the loans through their installment credit department. The terms vary somewhat from one bank to the next and shopping around might be desirable. In Rhode Island the down payment required for a vessel loan is currently 10 to 30 percent on a new vessel and 40 to 50 percent on the appraised value of a used vessel. The true interest rate seems to be 11 to 12 percent on a new vessel and 13 to 14 percent on a used one. The length of loan periods is generally seven to ten years on a new vessel and five to seven years on a used one. If a new vessel is ordered or bought, banks might request that the Coast Guard inspect the drawings or the vessel before the bank will consider the prospects for a loan.

The length of time required to close a loan depends on the size of the loan. A loan for less than $100,000 might take about two weeks to close, while a loan larger than that figure might take an additional week or two. A bank normally requires that the owner has full insurance for the appraised value of the vessel and normally also requires Protection and Indemnity and other insurance to cover all contingencies. Monthly payments are normal, but possibilities exist for seasonal payments. Personally, I believe that for certain kinds of vessels ten monthly payments might be desirable without payments in January and February.

The more that is written in the newspapers about the foreign fleet and gear losses, the more reluctant banks are to provide loans to fishermen. From the newspapers at least, it sounds as if the fishing industry were very high risk.

SBA and the Banks

When the Fisheries Loan Fund was in operation, a fisherman's loan application had to be turned down by the National Marine Fisheries Service before he could apply for a loan from the Small Business Administration (SBA). Now, of course, this is only an academic matter, which can be settled by a telephone call. Some years ago fishermen could borrow directly from the SBA, but currently the SBA only guarantees fisheries loans through commercial banks. The terms are negotiated through a bank, and the SBA guarantees 90 percent of the loan for a one percent fee. I understand the maximum interest rate the bank can charge and get an SBA guarantee is 11 percent; moreover, SBA will only guarantee 90 percent of a maximum loan of $350,000. Thus the terms are basically set by the banks. The time required for the SBA to determine whether or not it will guarantee a loan is about two weeks.

Farm Credit Administration and the PCA

The Farm Credit Administration, which started operating in the 1930s, was by its charter limited to lending to farmers and to farmers' cooperatives. Later aquaculture was included, basically for oystermen, and finally, fishermen and fisheries cooperatives. The Farm Credit Administration consists of the Federal Land Banks, the Bank for Cooperatives and the Production Credit Associations (PCA). The PCA covering Rhode Island and eastern Connecticut is in Dayville, Connecticut, and the one for southern Massachusetts is in Taunton.

Fishermen can borrow funds for vessels, gear, house, car and personal needs through the PCAs. The interest charged might differ from Association to Association because it depends on how well the local Association is doing. Many losses within a local Association area will increase its interest rate. At the current time the stated interest in the Rhode Island-eastern Connecticut PCA is 7 1/2 to 9 percent. PCAs offer four classes of loans, basically determined by the degree of risk. The class and stated interest in percent are I - 7 1/2, II - 8, III - 8 1/2 and IV - 9. With a 25 percent down payment class IV applies, but if a fisherman has no debt on his vessel, has a fair amount of assets in real estate, and wants to finance some gear or a job on the vessel, class I applies. Let me hasten to add here that when a fisherman borrows funds from a PCA he becomes a member and ten percent of the borrowed amount is received in stocks or certificates. If a fisherman borrows $100,000, he will receive $90,000 in cash and $10,000 worth of stocks. He pays interest on the $100,000, but pays back the $90,000 plus the stocks.

Therefore, the true interest on the loan will be about ten percent higher: that is, interest quoted at nine percent will be 9.9 percent or instead of eight, 8.8. The maximum time period for a PCA loan is seven years.

The length of time it takes to process a loan depends on several factors. Since outside appraisers are used, the time it takes to get an appraiser is a key factor and sometimes can take up to four weeks. However, if a recent appraisal of the vessel has been made, if there are no liens against assets put up as collateral, or if there are no other complications, a loan can be processed in two weeks.

Obligation Guarantee Program

The old mortgage and loan insurance program operated by the NMFS has been amended and is now entitled the Obligation Guarantee Program. The state of this program is somewhat confusing because even though it is in operation, final rules and regulations have not yet been established and the program is working under proposed rules. Under it, a fisherman can obtain a loan for 75 percent of the cost of building a vessel, including gear permanently attached to the vessel, or for reconstruction of a vessel.

The loan has to be secured through a commercial bank, which the NMFS hopes will reduce the interest rate considerably. The bank will pay a fee to the NMFS for the guarantee, possibly one percent of the amount of the loan, which, of course, will be added to the borrower's interest rate. If a vessel owner wants to build or reconstruct a vessel, three bids on the job have to be obtained, and normally the lowest bid will be accepted. If the owner insists on having the work done in another yard he might have to put up the funds for the difference in cost between the low bid and the one chosen. When applying for a loan, the applicant must submit a fee of one-half percent of the amount applied for, plus $50. The one-half percent is refunded if the application is withdrawn or turned down. To qualify as reconstruction, the work performed has to cost at least 20 percent of the replacement value after reconstruction, or at least $40,000.

A loan under the Obligation Guarantee Program cannot exceed seven years for a reconstruction or 15 years for new construction, but due to the possibility of refinancing, the time period of payment can be pushed to 25 years for a new vessel.

To the best of my knowledge, no loan has been processed under this program in the northeast. Many loans have been processed in the south. The question immediately raised is: What is the interest rate? The answer is that it is determined by the bank. Someone interested in borrowing funds under this program will either have to shop around and find a bank that is willing to give a satisfactory interest rate on a 100 percent-guaranteed loan, or contact the Financial Assistance Division in Gloucester and ask them for names of cooperative banks.

Capital Construction Fund

The Capital Construction Fund was established three years ago. (Sec. 607, Merchant Marine Act of 1936, as amended.) Its main feature is that a vessel owner can use pre-tax dollars rather than after-tax dollars to construct a new vessel, buy a used vessel or reconstruct one. To qualify as reconstruction, the cost has to be at least 30 percent of the replacement value of the vessel, and the reconstruction must include work on the hull. Let me point out that there are no federal funds involved and that the program only applies to vessel owners and fishermen who operate a vessel under charter.

The vessel owner sets up a contract with the Secretary of Commerce to establish a fund into which he can deposit earnings from his current vessel, labor income as a fisherman, capital gains from sale of a vessel, or insurance settlements for his vessel. On money deposited in the fund, he pays no income tax. The agreement states how the money will be invested in the fund and the depository. The depository can be a local bank. The vessel owner decides whether the money should be put in a savings account or invested in stocks or bonds (a maximum of 60 percent can be put into stocks). The money is deposited into three accounts in the fund depending on the source of the money: the Capital Account, the Capital Gains Account, or the Ordinary Income Account. The latter two are of primary interest. Earnings on which the vessel owner normally would pay income tax would be deposited in the Ordinary Income Account and earnings on which capital gains tax normally would be paid are deposited in the Capital Gains Account.

The funds used for construction, reconstruction or purchase of a vessel are tax exempt. If the vessel owner should withdraw the funds for other purposes, he has to pay taxes on the funds in the year of withdrawal, plus interest--currently eight percent--on the money owed in taxes.

When the money is spent according to the rules for a qualified withdrawal, the depreciation basis for the new or reconstructed vessel is affected according to the account from which the funds are withdrawn. For example, a vessel owner has $50,000 in the Capital Construction Fund, $30,000 of which is in the Capital Gains Account and $20,000 in the Ordinary Income Account. If he buys a vessel worth $80,000 he will either have to have $30,000 or borrow that amount from somewhere. The depreciation basis or book value of the $80,000 vessel purchased can be calculated as follows:

Purchase Price		$80,000
Personal fund or borrowed (no effect)	$30,000	
$30,000 from Capital Gains Account (may affect)	$15,000	
$20,000 from Ordinary Income Account (full affect)	$20,000	

Reduction in depreciation basis	$35,000
Book value	$45,000

The $45,000 would be the basis for depreciation of this vessel. Earnings from a vessel acquired under the Capital Construction Fund can be used for further payment of the principal or money owed on the vessel.

This then is a brief outline of what I consider to be some of the more important current sources of funds for vessel finance.

For Further Reading

Napoli, J. J. 1972. Fisheries cooperatives: their formation and operation. University of Rhode Island, Marine Memorandum 32, Kingston, RI.

Prochaska, F. J. 1973. The fisherman and the Farm Credit System. Florida Cooperative Extension Service Publication SUSF-SG-73-004, Gainesville, FL.