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FINANCING LNG CONVERSIONS WITH INTEREST FREE LOANS: MARAD's "CCF" PROGRAM

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MARINE LOG

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INTRODUCTION & MARAD's CCF PROGRAM

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The Merchant Marine Act of 1970 authorized a Capital Construction Fund “CCF” tax deferral program that allows vessel owners to purchase vessels and retire vessel debt with pre-tax dollars.

INTRODUCTION & MARAD's CCF PROGRAM

The CCF Program allows a taxpayer to shelter income from current taxation in exchange for the taxpayer's commitment to purchase or construct a new vessel or reconstruct an existing vessel.

It allows an owner to take "CCF Depreciation" before a vessel is placed in service (rather than only after) and it allows an owner's investment income to be compounded tax sheltered for periods of up to 25 years.

INTRODUCTION & MARAD's CCF PROGRAM

The CCF Program provides an interest free "loan" (a deferral of the tax that would otherwise be paid) which the taxpayer will pay later (because of reduced depreciation deductions) when the taxpayer places a newly purchased vessel in service, or returns a vessel to service after a conversion or reconstruction.

While this CCF Program does not have significant name recognition, the names of CCF Program participants do.

INTRODUCTION & MARAD’s CCF PROGRAM

Crowley Maritime, Matson Navigation, OSG and Saltchuk; BP, ConocoPhillips and EXXON; NASSCO; and GATX and GE Credit Corp – are among the CCF Program’s participants.

Four vessel owner-operators, three petroleum corporation charterers, a General Dynamics West Coast shipbuilder, and two leasing company owner-lessors.

Have we missed a category? It seems that almost everyone can be involved.

INTRODUCTION & MARAD's CCF PROGRAM

This morning we will deal with CCF Program use by only the first of these three classes of potential users – that of vessel owners – and CCF Program use to finance LNG conversions and other Green Ship improvements.

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FINANCING LNG CONVERSIONS WITH MARAD INTEREST FREE LOANS

SHELTERING VESSEL OWNER INCOME

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We'll examine an example of CCF Program use by a vessel owner-operator Alpha Corp. to accumulate funding for the conversion of its three vessel offshore support vessel fleet from diesel to LNG.

For our Alpha Corp. example we will assume a LNG conversion cost in $6 million per vessel.

SHELTERING VESSEL OWNER INCOME

Alpha's planning staff has calculated that Alpha can only afford to put aside $3 million per year in before-tax income from its current service vessel earnings to fund the LNG conversion plan.

If Alpha attempts to accumulate its needed equity with only these $3 million set asides, Alpha will accumulate only $10.76 million over the next 5 years – enough equity for the LNG conversion of one vessel in Alpha's three vessel fleet.

SHELTERING VESSEL OWNER INCOME

Year	Taxable Income [a]	Tax Payable [b]	Non-CCF Account Deposits (Jan 1) [c]	Income on Non-CCF Account Balance (Dec 31) [c][d]	Tax Payable on Non-CCF Account Income [b]	Non-CCF Account Balance (Dec 31)
1	$3,000,000	$1,200,000	$1,800,000	$180,000	$72,000	$1,908,000
2	$3,000,000	$1,200,000	$1,800,000	$370,800	$148,320	$3,930,480
3	$3,000,000	$1,200,000	$1,800,000	$573,048	$229,219	$6,074,309
4	$3,000,000	$1,200,000	$1,800,000	$787,431	$314,972	$8,346,767
5	$3,000,000	$1,200,000	$1,800,000	$1,014,677	$405,871	$10,755,573

Funds available for LNG conversions: $10,755,573 – One LNG conversion

a) Taxable income from prior tax year.
b) Assuming a federal tax at Alpha's highest marginal rate, and a combined federal and state tax rate of 40 percent.
c) Taxable income remains taxable in the absence of CCF account deposits.
d) Assuming a 10.0 percent rate of return on deposited funds.

SHELTERING VESSEL OWNER INCOME

Alpha's tax counsel has suggested the use of MARAD's CCF Program as a means of accumulating the money for these LNG conversions.

Alpha enters a CCF Program contract and deposits $3 million of available earnings in each of the next five years for these LNG conversions.

SHELTERING VESSEL OWNER INCOME

At the end of the five years, this $15 million, together with $5.15 million of investment income, will provide Alpha with $20.15 million; sufficient equity for Alpha's conversion of all three vessels to LNG.

SHELTERING VESSEL OWNER INCOME

Accumulating Capital with CCF: $20,146,830 – three LNG conversions

Year	***Taxable Income [a]***	***CCF Account Deposits (Jan 1)***	***Tax Payable***	***Income on CCF Account Balance (Dec 31) [b]***	***Tax Payable on CCF Account Income***	***CCF Account Balance (Dec 31)***
1	**$3,000,000**	**$3,000,000**	**-0-**	**$300,000**	**-0-**	**$3,300,000**
2	**$3,000,000**	**$3,000,000**	**-0-**	**$630,000**	**-0-**	**$6,930,000**
3	**$3,000,000**	**$3,000,000**	**-0-**	**$993,000**	**-0-**	**$10,923,000**
4	**$3,000,000**	**$3,000,000**	**-0-**	**$1,392,300**	**-0-**	**$15,315,300**
5	**$3,000,000**	**$3,000,000**	**-0-**	**$1,831,530**	**-0-**	**$20,146,830**

Funds available for LNG conversions: $20,146,830 – three LNG conversions

a) Taxable income from prior tax year.
b) Assuming a 10.0 percent rate of return on deposited funds.

SHELTERING VESSEL OWNER INCOME

Without CCF: $10,755,573, one LNG conversion.

With CCF: $20,146,830, three LNG conversions; and an interest free working capital loan of $9,391,257.

FINANCING LNG CONVERSIONS WITH MARAD INTEREST FREE LOANS

SHELTERING OWNER PAYMENTS OF VESSEL DEBT

SHELTERING PAYMENTS OF VESSEL DEBT

Alpha's existing vessels have been financed, on a vessel by vessel basis, with long-term vessel-associated debt.

SHELTERING PAYMENTS OF VESSEL DEBT

Rather than making its debt service payments from general funds, Alpha deposits sufficient current vessel operating income in its CCF Program account to make these debt payments with funds taken from its Program account in qualified withdrawals.

SHELTERING PAYMENTS OF VESSEL DEBT

In this fashion, Alpha's debt service can be made with before-tax dollars, the measure of funds otherwise required for debt service will be reduced, and funds for LNG conversions and other working capital needs will be increased.

SHELTERING PAYMENTS OF VESSEL DEBT

Assume that Alpha has annual debt service (principal payment) obligations that total $3 million per year. In order to make these $3 million payments with after-tax income (Alpha's income is taxed at 40 percent) Alpha must earn $5 million before-tax.

Over a five-year period, Alpha will require $25 million in before-tax dollars to service its $15 million in debt payments.

SHELTERING PAYMENTS OF VESSEL DEBT

Retiring Debt without CCF - Additional funds for LNG conversions $ 0

Year	Taxable Income[a]	CCF Account Deposits (Jan 1)[b]	Tax Payable[c]	Debt Payments (Jan 1)	CCF Account Balance (Jan 1)	Income on CCF Account Balance (Dec 31)	CCF Account Balance (Dec 31)
1	$5,000,000	-0-	$2,000,000	$3,000,000	-0-	-0-	-0-
2	$5,000,000	-0-	$2,000,000	$3,000,000	-0-	-0-	-0-
3	$5,000,000	-0-	$2,000,000	$3,000,000	-0-	-0-	-0-
4	$5,000,000	-0-	$2,000,000	$3,000,000	-0-	-0-	-0-
5	$5,000,000	-0-	$2,000,000	$3,000,000	-0-	-0-	-0-

Additional funds available for LNG conversions: $ 0

(a) Taxable income from prior tax year.

(b) Taxable income remains taxable in the absence of CCF account deposits, thus eliminating funds available for fleet expansion.

(c) Assuming a federal tax at Alpha's highest marginal rate, and a combined federal and state tax rate of 40 percent.

SHELTERING PAYMENTS OF VESSEL DEBT

Making use of the CCF Program, Alpha will need only $15 million in before-tax dollars to service its existing vessel debt during the same five-year period.

If this savings is deposited and invested in Alpha's CCF Program accounts, Alpha will have an additional $13.4 million for use as equity for the purchase of new Vessels at the end of five years.

SHELTERING PAYMENTS OF VESSEL DEBT

Retiring Debt with CCF - Additional funds for vessel additions: $13,431,220

Year	Taxable Income[a]	CCF Account Deposits (Jan 1)	Tax Payable	Debt Payments (Jan 1)	CCF Account Balance (Jan 1)	Income on CCF Account Balance (Dec 31)[b]	CCF Account Balance (Dec 31)
1	$5,000,000	$5,000,000	-0-	$3,000,000	$2,000,000	$200,000	$2,200,000
2	$5,000,000	$5,000,000	-0-	$3,000,000	$4,200,000	$420,000	$4,620,000
3	$5,000,000	$5,000,000	-0-	$3,000,000	$6,620,000	$662,000	$7,282,000
4	$5,000,000	$5,000,000	-0-	$3,000,000	$9,282,000	$928,200	$10,210,200
5	$5,000,000	$5,000,000	-0-	$3,000,000	$12,210,200	$1,221,020	$13,431,220

Additional funds for vessel additions: $13,431,220

a) Taxable income from prior tax year.
b) Assuming a 10.0 percent rate of return on deposited funds.

SHELTERING PAYMENTS OF VESSEL DEBT

By using the CCF Program, Alpha will have "borrowed" an extra $22.8 billion for LNG conversions or other working capital uses, or a total of $33.6 million as combined with Alpha's base case earnings.(a)

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a) $9.39 million of this "extra" money has been achieved by deferring tax on money set aside from current vessel earnings, and $13.43 million by deferring tax on money used to pay existing service vessel debt, which when these two figures are combined with Alpha's base case income of $10.76 produces a total of $33.6 million.

FINANCING LNG CONVERSIONS WITH MARAD INTEREST FREE LOANS

CONCLUSIONS

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In our CCF Program examples, Alpha Corp's tax payments deferred through CCF use were: (i) $9.39 million from sheltering current vessel and investment portfolio earnings; and (ii) $13.43 million from sheltering earnings used to retire existing vessel debt; and (iii) $22.82 million in total.

FINANCING LNG CONVERSIONS WITH MARAD INTEREST FREE LOANS

The MARAD and MARAD/IRS regulations governing the CCF Program are set out in Part 390 and Part 391 of volume 46 of the Code of Federal Regulations. Part 390, Appendix I, contains the form of Application and instructions for its completion, and Appendix II, contains a sample form of Agreement.

Both texts can be accessed on line at the US Department of Transportation website under MARAD “shipbuilding programs.” The CCF Program has no MARAD application or participation fees.

FINANCING WITH INTERST FREE LOANS: MARAD's CAPITAL CONSTRUCTION FUND "CCF" PROGRAM

THANK YOU

ADDITIONAL INFORMATION: For background and follow-on reading you may wish to refer to Mr. Cook's Marine Money article "Financing With the Maritime Administration's Capital Construction Fund," MARINE MONEY International, October 2007.