Significant Yacht Issues
Luxury Yacht Market
Purchase & Sale
Maritime Lien Claims
Yacht Insurance

MLA Fall Meeting, October 18, 2018

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How Big Will They Get?

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Lien Enforcement/Arrest

- Changes in lender policy
- Arrest v. Non-Judicial Action
- Class action suit on collateral sale notice and breach of peace
- Bigger Yachts/Bigger claims
- Fraud Issues
- WSJ Article on Natita Aug 10, 2017

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Why Goldman Sachs Seized a Client's 217-Foot Yacht

Wall Street banks' latest gold rush is making loans to wealthy clients; collateral includes Warhol and rare wine collection

By
Liz Hoffman
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158 COMMENTS

Goldman Sachs Group Inc. GS -0.83% owns hundreds of billions of dollars of stocks, bonds and commodities. Add to its portfolio: a 217-foot luxury yacht called Natita.
The story behind the boat begins with a 2014 loan to a prized Goldman client, billionaire Texas oilman William Kallop. It ends with Goldman suing its own client and the U.S. Marshals last month swooping down on a West Palm Beach marina to impound the yacht—which boasts a movie theater, Jacuzzi and helipad.

Goldman's nautical trophy is a strange but inevitable outcome of Wall Street's latest gold rush: lending to wealthy clients, the loans backed by everything from Warhols to wine.

These loans, which are growing quickly at firms such as Goldman, Morgan Stanley and UBS Group AG, are an exotic spin on the most basic thing banks do: lending money to people. They have the added benefit of building loyalty among prized, ultrawealthy clientele.
Like any loans, though, they can go bad and leave banks holding assets that aren't easy to value or sell. Goldman will likely auction Natita, which already has been on the market for almost two years with no takers.

A Goldman spokesman declined to comment on the case. Mr. Kallop didn't respond to requests for comment. A lawyer for Mr. Kallop declined to comment.

"If you do it right, it's a great business and clients will absolutely love you for it," said Bruce Holley, a partner at the Boston Consulting Group who advises private banks on wealth-management strategy. "But there are a lot of ways to mess up."

Banks pushed wealth lending in recent years against a backdrop of increasing deposits and tepid demand for traditional loans. Goldman's private bank has quadrupled its overall lending balances since 2012 to $29 billion. Morgan Stanley wealth-loan balances are up 420% since 2012 to $74 billion.

The largest chunk of wealth loans are mortgages and loans backed by stock portfolios. A smaller but growing segment is secured by valuables such as classic cars, hedge-fund stakes, and even rare violins.

Wealth loans are especially profitable for banks because the revenue they generate is shared less generously with brokers than trading commissions and other fees.

Banks say these loans are safe because they already know the borrowers, their assets, and their ability to repay. And unlike, say, credit cards, these loans have collateral and often a personal guarantee as well. Goldman said in a February filing that the value of collateral in its wealth loans "generally exceed[s]" the loan amount.

Morgan Stanley and Deutsche Bank AG have lent against the art collection of hedge-fund billionaire Steven A. Cohen, who owns works by Andy Warhol and Pablo Picasso, according to Connecticut state filings. Top Blackstone Group LP executives including founder Stephen Schwarzman have borrowed from UBS against their stakes in the private-equity firms' funds, New York filings show.
Goldman lent to natural-gas wildcatter Aubrey McClendon against his wine collection, according to an Oklahoma filing. Executives joked the collateral was "particularly liquid." After Mr. McClendon's death in 2015, the collection—heavy on rare Bordeaux—was auctioned for $8.4 million. Goldman made its money back.

Although not as well-known as those borrowers, Mr. Kallop was the kind of client whom private banks court.

In the 1970s, he joined a family-owned marine-services company called McAllister Towing & Transportation. A legal dispute in 1993 resulted in a split of the company. The tugboat and ferry operations stayed with the family. Mr. Kallop took the offshore oil business, which he built over the next two decades into a portfolio of drilling rights, rig operators and construction arms.

He sold the business for nearly $1 billion in 2009 to a consortium of Colombian and Korean investors. Mr. Kallop then dabbled in investing, taking a 7% stake in energy company Quicksilver Resources and buying a 300-year-old liquor distillery in Peru.

He spent lavishly, acquiring three Gulfstream jets and at least eight residences, including a Peruvian mansion, two homes in the Dominican Republic and a working cattle ranch in Texas, according to property record, lawsuits and people who have worked for him.

And he bought yachts—at least seven of them over the past eight years.

In addition to Natita, which he bought in 2010 and named for his mother-in-law, Mr. Kallop's fleet includes Bad Girl, moored in the Dominican Republic, and Honey Fitz, a 93-footer used by President John F. Kennedy that he bought at Sotheby's Camelot auction in 1998 and restored.

Another yacht, La Diva, which was once owned by Ivana Trump, was destroyed in a fire.

A few years ago, Goldman came calling. The Wall Street firm's private bank manages some $450 billion in assets for 11,500 ultrarich clients, and was developed in the 1980s to help business owners like Mr. Kallop manage their windfall after a sale.

Mr. Kallop became a client. In 2014, he borrowed $21.2 million from the bank to buy a 12,000-square-foot Tahitian-inspired oceanfront mansion just down the beach from Mar-a-Lago, President Donald Trump's private club in Palm Beach, Fla., county records show.

In 2014, Mr. Kallop borrowed $32 million from Goldman against the Natita and Bad Girl, court records show. The loan, the maritime equivalent of a home-equity loan, carried an interest rate of three percentage points above the London interbank offered rate.

But then Mr. Kallop hit money troubles, according to former employees and acquaintances. He put off upgrades to the boats, which were showing signs of wear—bad enough for a March 2016 charter group to walk off Natita in Nassau, a former crew member said.

Goldman ordered periodic valuations of the yacht after making the loan, according to the crew member.

Mr. Kallop laid off crew members and put Natita up for sale in 2015 for €59.5 million ($67 million at that time), then dropped the price to $57.5 million last year, according to court documents. He sold a second Palm Beach house in April 2015 for $19 million. Goldman alleges he stopped paying back on the loan last November.

Three crew members, including the captain, were recently awarded roughly $90,000 in back pay by a Florida court. A Texas judge last month awarded his former bodyguard more than $500,000 for unpaid services. Mr. Kallop also owes the Florida marina where Natita is docked hundreds of thousands of dollars in fees, employees said.

Eventually, Goldman filed suit in a Miami federal court to seize the boat in a maritime version of a foreclosure. Acting on a judge's orders, U.S. Marshals impounded Natita at a West Palm Beach marina, where it remains.

Goldman's first move as owner-in-waiting: buying $67,000 worth of fuel to keep the yacht's generator running, according to court filings.

Today, the yacht is listed for $39.9 million, according to brokerWorth Avenue Yachts. The outstanding balance of the loan owed to Goldman is roughly $28 million.

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Recreational Marine Finance Report

- US Recreational Boat Loan Update
- Dealer Wholesale Financing (Manufacturer Support)
- Factors Affecting Marine Lending
  - Tax Law Changes
  - Tariffs
  - Economy/Competition/Underwriting
- Delinquency/Charge off
- NMBA Conference schedule

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Recreational Marine Finance Report – Trends & Topics

Maritime Law Association
October 17, 2018 Coral Gables, FL

- **U.S. recreational retail boat loan availability is steady**
  - Recreational boat loan availability has been stable for the past 6 years
  - U.S. boat loans are served by national banks, credit unions, community banks, private originators, on-line lenders, selected fintechs and low-cost home equity loan products
  - Regional U.S. boat lenders have generally expanded their recreational lending programs, since mid-2015 through today
    - Flagstar Bank (MI) re-entered boat lending in early 2018
    - Wells Fargo has implied an interest to enter retail boat lending
    - Similarly, Bank of America has shared with some members of the boat dealership community that it desires a return to retail boat lending
  - Today's leading retail recreational boat lenders, *in part*, are:
    - Aqua Finance
    - BankOZK (formally Bank of the Ozarks)
    - Bank of the West
    - Banterra Bank
    - Branch Banking & Trust Company
    - Community First Bank
    - Georgia's Own Credit Union
    - Huntington Bank
    - Independent Bank Corporation
    - L-H Finance
    - M&T Bank
    - Medallion Bank
    - Merrick Bank
    - Radius Bank
    - Shore Premier Finance
    - SunTrust Bank (Marine & RV Finance)
    - USAlliance Federal Credit Union

- **Dealer floor plan financing availability remains stable**
  - Financing choices remain available for U.S. recreational boat dealer inventory
  - Wells Fargo-CDF continues as the leading marine floor plan lender
  - NextGear Capital, owned by Cox Automotive, exited the marine business line in 2016 to "better focus" on its core automobile business
  - In a surprise move on August 14, 2018, Ally Bank abruptly exited RV retail and floor plan business lines; expectations were previously high that Ally would enter the recreational marine finance arena

- **Boat loan business**
  - Approximately 88% of surveyed lenders reported the same or increased loan bookings during 2017 (compared to 2016)
  - Pre-owned boats accounted for 66% of marine (bank) lender originations in 2017
  - According to national industry sources, new boat sales in units will increase an estimated 6% during 2018; 10% in dollars
  - Profitability issues such as margin/spread management and credit risk persist as a leading concern by boat lending (bank) management
    - Interest rates have increased and are projected by leading economists to head north two more times in 2018, and three to four more times during 2019, at this writing
  - Tax Cuts and Jobs Act
    - Tax reform's interest deductibility for consumer boaters is expected to have little effect on the recreational boating sales market
    - Interest deduction on HELOCs are no longer available (includes boats)
    - Itemized interest deductions (for qualified boats/boaters) remain allowed up to $750,000 (down from $1,000,000); limit applies on a combined basis
  - Tariffs and the recreational boat business
    - Recent U.S. policy changes have added significant challenges and risks to the boating industry, many other domestic industries and their work-forces
    - Most U.S. boat manufacturers are less optimistic about the future as the current trade-war would negate the positive effects of tax reform, hamper exports, drive-up prices, cause wholesale order cancellations, decrease consumer sales and cost jobs
    - Boat manufacturers and industry stakeholders are urging the current administration to recognize dangerous impacts to the industry and swiftly seek a restructure of agreements that benefit global trade and all Americans

    NMLA Annual Statistical Report/Quarterly Snapshot, SSI and Coburn & Associates, LLC

- **Boat types being financed**
  - Bank and credit union lenders reported increased finance originations in most boat-type categories with the exception of houseboats
    - The largest origination gains in 2017 vs 2016 were for all outboard boats, all stern-drive boats and inboard ski/wakeboard boats
  - For documentable boats, 44% of the lenders reported increased originations for power boats in 2017; 28% reported increased originations for sailboats

    NMLA Annual Statistical Report

- **Recreational boat loan underwriting**
  - 26% of bank and finance broker lenders surveyed in Q2-2018 indicated that boat loan credit criteria are less stringent than previous quarters
    - Trending (upward) since Q3-2017, this is the highest percentage response given prior to 2011
  - Only 13% of surveyed lenders (bank/finance brokers) reported their 2Q-2018 credit application quality had improved – also a trend (downward) since Q3-2017
  - Bank lending programs in 2018 continue to reveal easy down payment requirements and slight moderation toward collateral valuation procedures and LTV guidelines
    - Further analysis of historical and current programs in 2018 continue to reveal most lenders have gradually regressed to underwriting practices that existed prior to 2008
    - Some recently surveyed lenders specifically noted "irrational pricing" of competitors and experiencing "unwise lending practices" such as low-doc loans, no-doc loans and lower down payments

NMLA Quarterly Snapshot and Coburn & Associates, LLC

- **Credit scores**
  - During 2017, all lenders (banks & credit unions) reported they originate and hold boat loans with scores from 700 to 850
  - 57% originate loans with scores from 650 to 699 (up from 50% the prior year)
  - 19% originate loans with scores from 600 to 649 (up from 18% the prior year)
  - 14% originate loans with scores from 500 to 599 (up slightly over the prior year)
  - 4.8% reported originating loans with scores below 500 (up slightly over the prior year)

NMLA Annual Statistical Report

- **Average boat loan delinquencies are performing well**
  - 2017 delinquencies improved again. Delinquency is at a *record low* for the business line and has consistently performed below the 1.0% level since the end of the Great Recession. Performance is expected to remain stable for prime loans throughout 2018
    - 2003: 0.85%
    - 2004: 0.69%
    - 2005: 0.83%
    - 2006: 0.63%
    - 2007: 0.85%
    - 2008: 1.18%
    - 2009: 2.26%
    - 2010: 1.69%
    - 2011: 1.48%
    - 2012: 0.82%
    - 2013: 0.80%
    - 2014: 0.87%
    - 2015: 0.69%
    - 2016: 0.84%
    - 2017: 0.45%

      NMLA Annual Statistical Report

- **Boat loan charge-offs have also been consistent**
  - 2017 total charge-offs also improved. Charge-off performance has improved steadily every year since the end of the Great Recession
    - 2003: 0.35%
    - 2004: 0.30%
    - 2005: 0.52%
    - 2006: 0.27%
    - 2007: 0.77%
    - 2008: 0.93%
    - 2009: 1.43%
    - 2010: 0.89%
    - 2011: 1.14%
    - 2012: 0.77%
    - 2013: 0.57%
    - 2014: 0.44%
    - 2015: 0.48%
    - 2016: 0.31%
    - 2017: 0.26%

      (NMLA Annual Statistical Report)

National Marine Lenders Association Events

- **The 2018 NMLA Annual Statistical Report**
  Is available now at www.marinelenders.org/annual-report
  Next release is scheduled for Summer, 2019

- **2019 NMLA 40th Annual Conference**
  Ocean Reef Club, Key Largo, FL
  Early Fall, 2019

- **2019 Marine Lending & Recreational Finance Workshop**
  Early Spring, 2019 (Venue, exact dates TBD)

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Michigan Boating Industries Association – Secretary-Treasurer & Director/Immediate Past Chairman
Recreational Boating Industries Educational Foundation – President

Open Discussion/Q&A

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