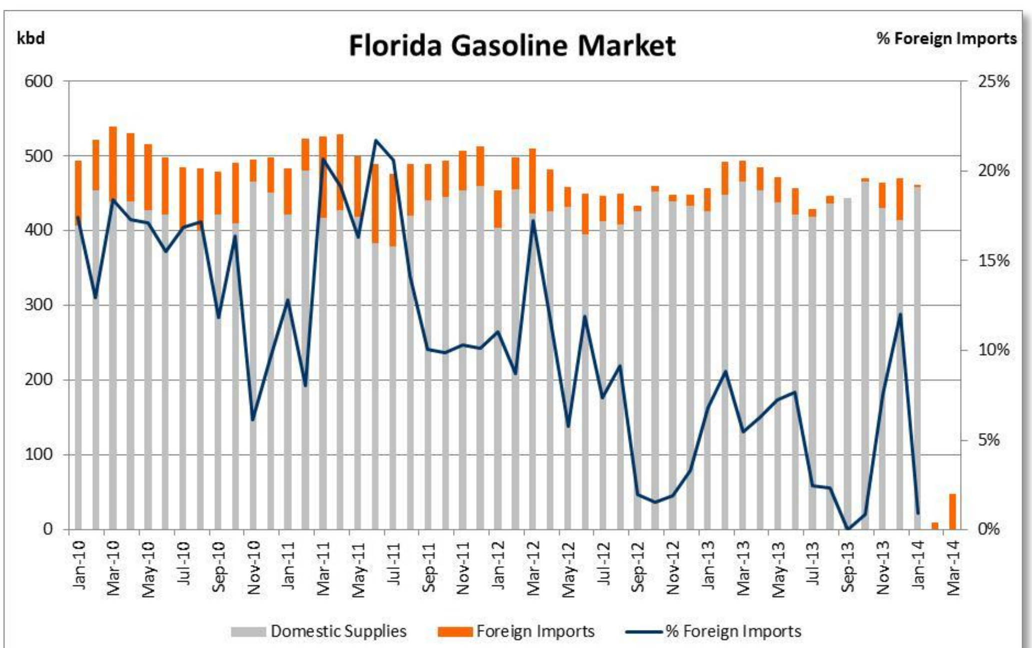
Moonlighting in the Sunshine State

A recent, *This Week In Petroleum*, published by the US Department of Energy's Energy Information Agency (EIA) suggested that a shift in Florida's gasoline supplies could be underway. Florida is essentially entirely dependent on gasoline imports from neighboring states or other countries, the majority of which require marine transportation. The EIA suggested that due to a shortage in Jones Act tonnage and high transportation costs, incremental gasoline cargoes would likely be increasingly sourced from foreign markets. Although it is true that spot market freight rates for tankers under the Jones Act are at all-time highs, the cost of transportation for units moving gasoline from places like Houston, Pascagoula, Mississippi and Convent, Louisiana to Florida has been well-established through term charters for quite some time. Additionally, the volatility in foreign-flag freight rates breaks any semblance of sustained arbitrage. Nestled between the trading and storage hubs of Houston and New York, Florida serves as a balancing point for foreign and domestic freight rates, driving seemingly disparate markets toward parity.

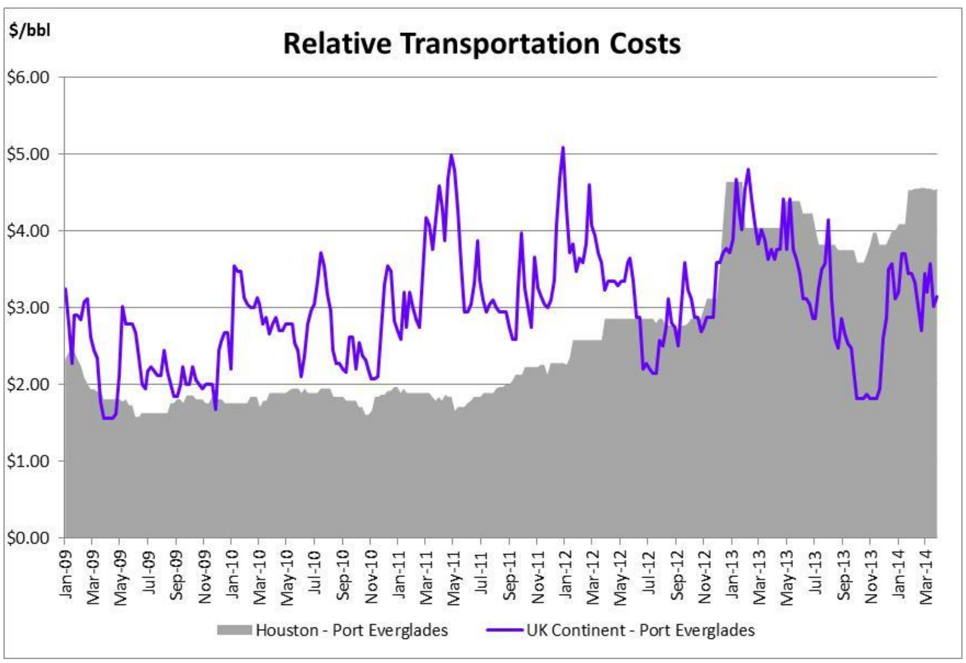
In contrast to the swings in freight rates, one thing in Florida is remarkably steady: demand. The chart below shows total Florida gasoline sales by prime supplier by source, as provided by the EIA.



Source: EIA, Poten

While the spring months bring a slight uptick in demand, the standard deviation on a monthly basis over the past five years is a limited 26,000 barrels per day. The volume of gasoline cargoes imported from foreign sources as an overall percentage of the market has generally been on the decline. On average in 2010, 15% of total demand was met by foreign imports. Last year, that proportion dwindled to 5%. EIA monthly data is only available through January 2014, but foreign import volumes are consistent with recent months.

Consistent with recent media scrutiny, the EIA raises concerns of transportation cost premiums associated with the Jones Act. The chart below shows the dollar per barrel costs for domestic and foreign Medium-Range (MR) product tankers trading into Florida. At present, freight on a Jones Act MR carrying 330,000 barrels is in the $4.50 per barrel range, compared to the cost of importing gasoline from Europe which would cost about $3.15 per barrel. However, historically foreign imports have been more costly on average. The five-year average of weekly assessed rates for foreign imports is $3.00 per barrel, compared to the cross-gulf Jones Act rate is $2.60 per barrel. Cheaper still are the longer-term time chartered MR and Articulated Tug Barge (ATB) units that deliver barrels at a discount to the spot market.



Source: Poten

With US refineries cranking out refined products with all-time fervor, the US Gulf is awash with gasoline. Although these products will directionally move to markets where they can achieve the highest price, Florida will continue to provide a baseline level of demand due to its proximity. Since a high percentage of the Florida market is supplied through term sales contracts on term-chartered ships, freight rate risk is minimized. Unless a significant amount of Jones Act vessels transition out of clean product service in the US Gulf for crude oil movements to the Northeast, domestic transportation will remain generally competitive with foreign freight. As such, Florida will continue to be a unique example of how the Jones Act can in fact keep a lid on rates charged under foreign flags.