PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
STAFF BRIEFING

Item No. 7a

Date of Meeting April 9, 2013

DATE: April 1, 2013

TO: Tay Yoshitani, Chief Executive Officer

FROM: Bari Bookout, Director Seaport Commercial Strategy

SUBJECT: Competitive Situation Update – Container Business

SYNOPSIS:

Shipping lines continue to focus on cost containment, deploying larger vessels as part of this strategy. Ports and terminals around the country will need to make changes to handle these large ships efficiently, and are already in the process of expanding and adding automation. Canada continues to implement an aggressive port and infrastructure development program, with the Harbor Maintenance Tax (HMT), rail rates and customs streamlining initiatives providing added incentives for U.S. cargo to bypass U.S. ports. Shifting trade sourcing patterns could impact Pacific Northwest (PNW) volumes as new regions will see more favorable routing via the Suez Canal to U.S. population centers. The impact of the Panama Canal expansion on West Coast volume remains a debated topic. A shift to "near sourcing" in Latin America could also erode volume growth potential for the PNW. Expansion of containerized exports in the PNW is constrained by available vessel capacity and certain specialized equipment, but would be enhanced by a program to increase and anchor import cargo to the region. Other states have successfully implemented programs to anchor business to their region.

BACKGROUND:

Historically, cargo heading to the Midwest and East Coast found the fastest routing and most efficient gateway to be West Coast ports. Over the last 10 years, there has been a shift in supply chain patterns among importers to a "four corners" strategy of locating distribution centers. Other emerging challenges include new competition from Canadian ports, a project to widen the Panama Canal, the move toward ever larger ships, and a severe global recession affecting the previous consumer powerhouses of North America and Europe. West Coast ports including the Port of Seattle face much more competition for the cargo that moves through our gateway.

The Port of Seattle faces a highly competitive market for container business in a very anemic global economy. Drewry Maritime Research indicates that the near term growth prospects for North American container volumes will probably remain below three percent through 2017 unless the global economy recovers quickly. Shipping lines have

sustained enormous losses in the past five years and continue to place a heavy emphasis on cost containment as they struggle to break even or record an operating profit.

Large Ships and Cost Containment

Part of the focus on cost containment revolves around the deployment of very large container ships in the major trades. Large ships give better economies of scale on a per unit basis, and with new technologies and design, are more fuel efficient. Carriers have large order books for ships carrying 10,000 TEUs (twenty-foot equivalent units) and above. These ships are primarily being phased into the Asia/Europe trade, which used to deploy ships in the 6500-8500 TEU range. The smaller ships are now being cascaded into other trades, including the North American trade. Some carriers with the largest fleets of ultra large container ships have already begun deploying ships larger than 11,000 TEUs in the Transpacific West Coast trade, partly due to the depressed demand in the Asia/Europe trade. One other result of cost containment and the move to deploy large ships is that carriers are pooling assets by forming mega-consortiums like the G6 Alliance, consisting of the carriers from the New World Alliance, APL, MOL and Hyundai, and the carriers from the Grand Alliance, OOCL, Hapag Lloyd and NYK Line.

Large ships have specific operational requirements. Shipping lines will favor terminals that can turn these ships quickly, reducing the amount of time in port and the costs associated with a port stay. Turning the ship faster also allows more time for slow-steaming, another cost-saving method employed by shipping lines. Ports must have enough large cranes (6-7 cranes are standard to work a ship in the 11-13,000 TEU range), a deep enough draft, and terminal and landside infrastructure to handle a much larger flow of containers coming off the ship at one time. Terminal, gate, and rail fluidity are crucial to prevent congestion of a magnitude that would drive the business elsewhere. Automation will be used to handle large vessels more efficiently and cost effectively.

Port and Terminal Developments

In the North American port and terminal business, we continue to see planned investments in terminal expansion or new terminals, automation, and landside infrastructure. Southern California terminals have aggressive expansion and automation plans. Projects include the Port of Long Beach's Middle Harbor Terminal development that will be fully automated and handle 3 million TEUs at full capacity. The first phase will be completed by 2014. TRAPAC, Yusen, Pier S, and APL are other expansions that will include automation, increased rail capacity and expanded footprints in the Los Angeles/Long Beach (LA/LB) ports. Canada's Port of Prince Rupert is set to expand from 500,000 TEU capacity to 1.5 million TEUs. Environmental review and design are completed. Port Metro Vancouver is in the environmental impact statement (EIS) and public outreach phase of a second terminal complex at Delta Port, which will add 2.4 million TEUs of capacity and will most likely be automated. The Port of New York/New Jersey (NY/NJ) has multiple terminal expansions going on and will be raising

the Bayonne Bridge to accommodate larger vessels. Global Terminals, already outside of the bridge, is expanding and introducing automation by 2014. The Port of Norfolk already has a fully automated terminal, deep draft, and an aggressive program to anchor first port of call rotations to serve the Midwest intermodal market. Both eastern railroads have completed significant investments to provide double-stack access to the Ohio Valley and Chicago. Canadian interests and Maher Terminals have a Prince Rupert-style terminal development planned in Melford, Nova Scotia. This terminal will also be fully automated. The significance of these developments is two-fold: all of these ports will compete aggressively to secure a port call by large ships, and there could potentially be overcapacity of terminals in North America, adding to rate pressures that we are already experiencing in the PNW.

Canadian Encroachment

Canada continues an aggressive, coordinated Gateways and Corridors initiative to develop infrastructure and increase container business through their ports. Growth is targeted to come in part from growth in the Canadian economy, but for the most part from the U.S. Heartland, the core market for the Port of Seattle. HMT continues to provide an incentive to importers to use a Canadian gateway port. A new "Beyond the Border" initiative aimed at easing the flow of North American Free Trade Agreement (NAFTA) cargo through streamlined customs processes is also piloting easier customs clearance for international origin cargo moving to the U.S. via the Port of Prince Rupert. Both Canadian railroads continue to price aggressively and the combination of their rates plus their lower fuel surcharges amount to $200-400/container savings for shipping lines. The railroads, especially the Canadian National, are making improvements in the Chicago/Ohio Valley area to better serve the U.S. market. U.S. railroads have shown reluctance to compete on a rate basis, and the Canadian market share of intermodal cargo into the Midwest continues to increase.

One local manifestation of the price differential has been the switch in port rotations for two services that used to have Seattle as first port of call. These two services now call at Prince Rupert first and Seattle second or third. This increases the likelihood that the import customers on those services will want their cargo to be routed via Prince Rupert – calling at Prince Rupert first and Seattle third after Vancouver gives a 3-4 day advantage in transit time for cargo bound to Chicago via Prince Rupert.

Shifting Trade Patterns

The headline news for a few years has been the Panama Canal expansion, which will allow ships up to 13,500 TEUs to transit the canal. While the trade continues to debate the effect this expansion will have on cargo flows, another threat is developing for the PNW: a shift in manufacturing trade patterns potentially away from North Asia to Southeast Asia or even to Mexico, Central and South America as the cost increases and labor shortages in China are weighed against benefits of manufacturing in other regions.

Because large populations in the U.S. are located in the East and Midwest, from Southeast Asia, a Suez Canal routing is faster and more cost effective even into our core market of the Midwest. Cargo manufactured in Mexico would be trucked, and the natural gateway for South American cargo trying to reach the majority of the U.S. population is the Gulf of Mexico and East Coast ports.

Local Export Capacity and Trends

The Port of Seattle and the United States are focused on increasing exports. Because the higher volume commodities of containerized exports are comprised of very heavy cargo (especially the agricultural, forest and seafood products from the PNW), we see an additional constraint of container vessel capacity due to ships maxing out at "Dead Weight" capacity before reaching full "TEU" capacity on the outbound voyage. Currently the PNW ships are enjoying good utilization on the export leg, without much additional capacity available for an increase in exports. To deploy more vessel capacity for exports, shipping lines must have their round trip cost covered and this means an increase in import volumes will be needed. Import rates cover most of the cost of a voyage, while exports have long enjoyed very low rates as backhaul cargo. For low margin exports, these rates are a necessity to compete in the global market. Until the PNW ports are able to entice and anchor more import business in the region, we are likely to see a capacity-based growth limitation for exports. An additional challenge our local exports face is the availability of the specialized equipment they need, 40-foot-high cube dry containers and refrigerated containers ("reefers"). Retail and other consumer goods transloaded locally can provide a better supply of containers for our export market as they traditionally move in 40-foot- high cubes and carriers can also provide a dry-reefer program for some shippers to help reposition refrigerated containers back from Asia.

Representative of the supply/demand situation in the PNW, one new trend in hay shipments to China and other markets from the PNW has been developing. Due to the strong demand for vessel space and specialized equipment in the PNW, export rates for hay in the PNW are much higher than rates in the Pacific Southwest (PSW) due to surplus vessel capacity and containers in the PSW. This disparity has given shippers an opportunity to source a comparable hay product from the I-15 corridor as far north as Idaho and Alberta. They utilize cheap backhaul rates offered by 53-foot trucks returning to the LA Basin and transload the hay into shipping containers near the Ports of LA/LB, all at a lower cost than sourcing the hay in Washington and shipping over the ports of Seattle and Tacoma. Only a change in the supply of vessel capacity in the PNW would address the imbalance in rates.

State and Port Incentives to Anchor Business

Other states and ports have seen the benefit of anchoring imports in their region to help increase import volumes in their region and supply containers for exports. Georgia and Savannah, a high volume export region, were the first to implement a coordinated strategy to offer incentives for locating import warehouse and distribution activity in their region. The increase in distribution activity also increased the volume of containers through the port and the number of ships calling at the port. Incentives include job creation tax credits, favorable corporate tax rates, and even a port tax credit bonus for companies that increase volumes through the port. Other states such as South Carolina, Virginia and Texas have implemented similar strategies to anchor business by providing incentives. In contrast, the State of Washington does not have a program to increase this type of port-beneficial business activity.

As a result of a very competitive and cost focused environment, some ports are offering incentives directly to shipping lines to encourage more cargo. The Port of Virginia has a first port of call incentive. The Port of Portland is offering a $10/container incentive to keep cargo in their port.

Port of Seattle Situation

The Port of Seattle has four container terminals, three with dock infrastructure capable of handling Super Post-Panamax (SPPX) cranes. One terminal will need capital improvements to the dock and electrical grid before large cranes could be installed. Water depth is 50 feet at most berths and waterways, but the West Waterway is only authorized to 34 feet. The Port is exploring the feasibility of increasing berth and channel depth to 53-55 feet. Port of Seattle terminals are estimated to be at 50% capacity and could potentially handle double the volume in the current footprint. From a regional perspective, trends in Transpacific Asian volumes show a flat-line for the PNW, decline in market share of the West Coast in general, and continued increase in East Coast market share. Comparing our Washington port volumes to British Columbia ports, we see a trend line narrowing the gap, with PNW volumes falling since 2005, while B.C. volumes continue to increase.

OTHER DOCUMENTS ASSOCIATED WITH THIS BRIEFING:

- Competitive Briefing – Containers – PowerPoint presentation

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS:

- None.