

CHARTERING MADE EASY

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The Basics

Chartering quite simply is defined as the hiring of ships. When an agreement is reached on the terms and condition of carriage between the parties involved, namely the owner of the ship and the charterer (cargo interest), a contract stipulating those terms and conditions agreed is drawn up and signed. The contract is called a charter party.

The two most common types of employment for ships are voyage charters and time charters. Frequently intermediaries are involved in the process called shipbrokers.

Voyage charters involve the payment of freight per ton of cargo transported on terms set out in the charter party which specify amongst others the precise nature and quantity of the cargo (exact or within a range), the port(s) of loading and discharging, the laytime (the time available to the charterer for cargo operations) and demurrage (liquidated damages payable by the charterer to the owner in the case of delays beyond the laytime agreed). All costs associated with and incidental to the performance of the voyage are borne by the owners and include bunker costs, port charges, canal dues and cargo handling costs where applicable. These costs are known as voyage costs.

Time charters can be broken down into two broad categories namely time charter trips and period time charters.

The time charter trip involves the hiring of a ship for a specific voyage of a specific cargo. Owners will at regular pre-agreed intervals (usually every 15 days) be paid hire which is in most cases expressed in United States dollars per day.

A period time charter would involve the hiring of the ship to perform multiple voyages and could be as short as a few months or as long several years in tenure.

The voyage expenses mentioned above are borne by the charterers in the case of time charters.

The operating costs that include such things as crew costs, insurance, repairs and maintenance, etc in both the case of voyage and time charter are borne by the owners.

Present Freight Markets

The demand for ships is a derived demand. The demand is not for the ships themselves but rather for the services that they are able to provide. The nature of the demand and supply curve is such whereby small incremental

changes in demand or supply yield more than proportional changes in freight rates. This inelastic nature of the demand and supply curve explains the volatility that is so characteristic of freight markets. This volatility is more profound the further up we move on the supply curve as we approach full capacity utilization of the fleet with increasing demand, and a demand curve shifting ever outwards. There are two very simple reasons that explain the inelastic nature of the demand curve. The first is the lack of substitution for ocean transportation by other viable alternatives. The second is the relatively small portion that ocean transportations costs account for of the total price of the goods the commodities transported produce. On the supply side at any given moment in time the amount of available ships is given. The supply can change only very slowly as new buildings as delivered to their owners. The time from ordering a vessel until taking delivery would normally not be less than two years. Quantity is expressed in terms of million ton miles, a function of tons and distance carried. As growth in industrialising China increased in momentum so did their demand for raw materials. Raw materials were necessary for the building of infrastructure and manufacturing units necessary to provide goods for domestic consumption but at the same time for export while they capitalized on the very low labour costs and consequently low cost of production. The net result was a huge increase in demand. Consequently freight rates reached levels unprecedented in the past and more importantly lasting thus far for the best part of four years. Chinese port infrastructure was unprepared for the huge influx of raw material arriving for discharge at their door step. At the same time the exporting countries in particular Australia where also struggling to cope with the sheer volume of quantities of coal and iron ore that needed to be exported. The result of the build up of tonnage on both sides (loading and discharging) lead to congestion which in turn placed a constraint on the supply side, further increasing freight rates as a result.

Looking ahead it seems that we will be experiencing high and volatile freight markets for some time to come and even though the growth rates in China may at some stage cool off and the world fleet has been growing at a healthy pace with minimal scrapping there is a very large proportion of overage tonnage that are potential scrap candidates. These will act as a safety value relieving the market for any excessive downward pressure that may be experienced. All in all a new plateau substantially higher than that of past years will be established that will act as a support level for the market in the foreseeable future.