HOLLY ENERGY PARTNERS LP
Form 10-Q
August 03, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016
OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____________ to _____________
Commission File Number: 1-32225

HOLLY ENERGY PARTNERS, L.P.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	20-0833098 (I.R.S. Employer Identification No.)
2828 N. Harwood, Suite 1300 Dallas, Texas	75201
(Address of principal executive offices)	(Zip code)

(214) 871-3555
(Registrant’s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes ¨ No ý

The number of the registrant’s outstanding common units at July 29, 2016 was 59,101,847.

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FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains certain “forward-looking statements” within the meaning of the federal securities laws. All statements, other than statements of historical fact included in this Form 10-Q, including, but not limited to, those under “Results of Operations” and “Liquidity and Capital Resources” in Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Part I are forward-looking statements. Forward-looking statements use words such as “anticipate,” “project,” “expect,” “plan,” “goal,” “forecast,” “intend,” “should,” “could,” “believe,” “may,” and similar expressions and statements regarding our plans and objectives for future operations. These statements are based on our beliefs and assumptions and those of our general partner using currently available information and expectations as of the date hereof, are not guarantees of future performance and involve certain risks and uncertainties. Although we and our general partner believe that such expectations reflected in such forward-looking statements are reasonable, neither we nor our general partner can give assurance that our expectations will prove to be correct. All statements concerning our expectations for future results of operations are based on forecasts for our existing operations and do not include the potential impact of any future acquisitions. Our forward-looking statements are subject to a variety of risks, uncertainties and assumptions. If one or more of these risks or uncertainties materialize, or if underlying assumptions prove incorrect, our actual results may vary materially from those anticipated, estimated, projected or expected. Certain factors could cause actual results to differ materially from results anticipated in the forward-looking statements. These factors include, but are not limited to:

- risks and uncertainties with respect to the actual quantities of petroleum products and crude oil shipped on our pipelines and/or terminalled, stored or throughput in our terminals;
- the economic viability of HollyFrontier Corporation, Alon USA, Inc. and our other customers;
- the demand for refined petroleum products in markets we serve;
- our ability to purchase and integrate future acquired operations;
- our ability to complete previously announced or contemplated acquisitions;
- the availability and cost of additional debt and equity financing;
- the possibility of reductions in production or shutdowns at refineries utilizing our pipeline and terminal facilities;
- the effects of current and future government regulations and policies;
- our operational efficiency in carrying out routine operations and capital construction projects;
- the possibility of terrorist attacks and the consequences of any such attacks;
- general economic conditions; and
- other financial, operational and legal risks and uncertainties detailed from time to time in our Securities and Exchange Commission filings.

Cautionary statements identifying important factors that could cause actual results to differ materially from our expectations are set forth in this Form 10-Q, including without limitation, the forward-looking statements that are referred to above. When considering forward-looking statements, you should keep in mind the known material risk factors and other cautionary statements set forth in our Annual Report on Form 10-K for the year ended December 31, 2015, in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and in “Risk Factors.” All forward-looking statements included in this Form 10-Q and all subsequent written or oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. The forward-looking statements speak only as of the date made and, other than as required by law, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
HOLLY ENERGY PARTNERS, L.P.
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(in thousands, except unit data)

	June 30, 2016	December 31, 2015 [1]
ASSETS		
Current assets:		
Cash and cash equivalents	$4,882	$15,013
Accounts receivable:		
Trade	7,288	8,593
Affiliates	42,845	32,482
	50,133	41,075
Prepaid and other current assets	4,638	5,054
Total current assets	59,653	61,142
Properties and equipment, net	1,054,162	1,059,179
Transportation agreements, net	70,330	73,805
Goodwill	256,498	256,498
Equity method investments	165,362	79,438
Other assets	11,324	13,703
Total assets	$1,617,329	$1,543,765
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable:		
Trade	$12,245	$10,948
Affiliates	9,182	11,635
	21,427	22,583
Accrued interest	6,661	6,752
Deferred revenue	9,553	12,016
Accrued property taxes	5,174	3,764
Other current liabilities	3,298	3,809
Total current liabilities	46,113	48,924
Long-term debt	1,083,136	1,008,752
Other long-term liabilities	17,190	20,744
Deferred revenue	42,474	39,063
Class B unit	37,705	33,941
Equity:		
Partners' equity:		
Common unitholders (59,101,847 and 58,657,048 units issued and outstanding	433,551	428,019

at June 30, 2016 and December 31, 2015, respectively)		
General partner interest (2% interest)	(137,882)	(130,297)
Accumulated other comprehensive income (loss)	(405)	190
Total partners' equity	295,264	297,912
Noncontrolling interest	95,447	94,429
Total equity	390,711	392,341
Total liabilities and equity	$1,617,329	$1,543,765

(1) Retrospectively adjusted as described in Note 1.
See accompanying notes.

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HOLLY ENERGY PARTNERS, L.P.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(In thousands, except per unit data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015 (1)	2016	2015 (1)
Revenues:				
Affiliates	$79,179	$68,297	$162,025	$140,552
Third parties	15,718	15,182	34,882	32,683
	94,897	83,479	196,907	173,235
Operating costs and expenses:				
Operations (exclusive of depreciation and amortization)	27,255	25,400	54,177	53,465
Depreciation and amortization	15,709	15,179	32,260	29,977
General and administrative	2,863	2,696	5,954	5,986
	45,827	43,275	92,391	89,428
Operating income	49,070	40,204	104,516	83,807
Other income (expense):				
Equity in earnings of equity method investments	3,623	631	6,388	1,365
Interest expense	(11,276)	(9,056)	(21,811)	(17,824)
Interest income	112	3	224	3
Gain (loss) on sale of assets	(5)	50	(5)	209
Other income (expense)	5	21	(3)	21
	(7,541)	(8,351)	(15,207)	(16,226)
Income before income taxes	41,529	31,853	89,309	67,581
State income tax benefit (expense)	(54)	64	(149)	(37)
Net income	41,475	31,917	89,160	67,544
Allocation of net income attributable to noncontrolling interests	(2,355)	(1,743)	(7,282)	(5,770)
Net income attributable to Holly Energy Partners	39,120	30,174	81,878	61,774
General partner interest in net income, including incentive distributions	(12,677)	(9,969)	(24,562)	(19,576)
Limited partners' interest in net income	$26,443	$20,205	$57,316	$42,198
Limited partners' per unit interest in earnings—basic and diluted	$0.45	$0.34	$0.96	$0.71
Weighted average limited partners' units outstanding	58,865	58,657	58,761	58,657

(1) Retrospectively adjusted as described in Note 1.

See accompanying notes.

HOLLY ENERGY PARTNERS, L.P.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015 (1)	2016	2015 (1)
Net income	$41,475	$31,917	$89,160	$67,544
Other comprehensive income:				
Change in fair value of cash flow hedging instruments	(255)	(306)	(938)	(1,586)
Reclassification adjustment to net income on partial settlement of cash flow hedge	113	528	343	1,059
Other comprehensive income (loss)	(142)	222	(595)	(527)
Comprehensive income before noncontrolling interest	41,333	32,139	88,565	67,017
Allocation of comprehensive income to noncontrolling interests	(2,355)	(1,743)	(7,282)	(5,770)
Comprehensive income attributable to Holly Energy Partners	$38,978	$30,396	$81,283	$61,247

(1) Retrospectively adjusted as described in Note 1.

See accompanying notes.

HOLLY ENERGY PARTNERS, L.P.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Six Months Ended June 30,	
	2016	2015 [1]
Cash flows from operating activities		
Net income	$89,160	$67,544
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	32,260	29,977
(Gain) loss on sale of assets	5	(209)
Amortization of deferred charges	1,376	930
Amortization of restricted and performance units	1,193	1,762
Distributions less than income from equity investments	(414)	—
(Increase) decrease in operating assets:		
Accounts receivable—trade	2,564	(4,514)
Accounts receivable—affiliates	(10,183)	5,064
Prepaid and other current assets	416	(311)
Increase (decrease) in operating liabilities:		
Accounts payable—trade	(637)	(1,610)
Accounts payable—affiliates	(2,454)	2,573
Accrued interest	(91)	168
Deferred revenue	948	3,600
Accrued property taxes	1,409	1,632
Other current liabilities	(979)	(242)
Other, net	(381)	3,890
Net cash provided by operating activities	114,192	110,254
Cash flows from investing activities		
Additions to properties and equipment	(32,667)	(42,343)
Purchase of El Dorado crude tanks	—	(27,500)
Purchase of interest in Cheyenne Pipeline	(42,500)	—
Proceeds from sale of assets and other	18	965
Distributions in excess of equity in earnings of equity investments	1,496	198
Net cash used for investing activities	(73,653)	(68,680)
Cash flows from financing activities		
Borrowings under credit agreement	239,000	254,100
Repayments of credit agreement borrowings	(165,000)	(221,100)
Contributions from HFC for El Dorado Operating acquisition	—	18,888
Contributions from general partner	120	—
Distribution to HFC for Osage acquisition	(1,245)	—
Proceeds from issuance of common units	13,690	—
Distributions to HEP unitholders	(91,109)	(82,614)
Distributions to noncontrolling interest	(2,500)	(2,875)
Distribution to HFC for Tulsa tank acquisition	(39,500)	—
Contributions from HFC for Tulsa tank expenditures	99	722

Purchase of units for incentive grants	(784)	(247)
Deferred financing costs	(3,084)	—
Other	(357)	(854)
Net cash used by financing activities	(50,670)	(33,980)
Cash and cash equivalents		
Increase (decrease) for the period	(10,131)	7,594
Beginning of period	15,013	2,830
End of period	$4,882	$10,424

(1) Retrospectively adjusted as described in Note 1.

See accompanying notes.

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HOLLY ENERGY PARTNERS, L.P.
CONSOLIDATED STATEMENTS OF EQUITY
(Unaudited)
(In thousands)

	Common Units	General Partner Interest	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Total Equity
Balance December 31, 2015 [1]	$428,019	$(130,297)	$ 190	$ 94,429	$392,341
Contribution from HFC for Osage transaction	—	31,285	—	—	31,285
Contribution from HFC	—	299	—	—	299
Distribution to HFC for Tulsa tank acquisition	—	(39,500)	—	—	(39,500)
Contribution from HFC for Tulsa tank expenditures	—	99	—	—	99
Distributions to HEP unitholders	(66,854)	(24,255)	—	—	(91,109)
Distributions to noncontrolling interest	—	—	—	(2,500)	(2,500)
Issuance of common units	14,586	—	—	—	14,586
Purchase of units for incentive grants	(784)	—	—	—	(784)
Amortization of restricted and performance units	1,193	—	—	—	1,193
Class B unit accretion	(3,689)	(75)	—	—	(3,764)
Net income	61,080	24,562	—	3,518	89,160
Other comprehensive loss	—	—	(595)	—	(595)
Balance June 30, 2016	$433,551	$(137,882)	$ (405)	$ 95,447	$390,711

(1) Retrospectively adjusted as described in Note 1.

See accompanying notes.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1: Description of Business and Presentation of Financial Statements

Holly Energy Partners, L.P. (“HEP”), together with its consolidated subsidiaries, is a publicly held master limited partnership which is 39% owned (including the 2% general partner interest) by HollyFrontier Corporation (“HFC”) and its subsidiaries. We commenced operations on July 13, 2004, upon the completion of our initial public offering. In these consolidated financial statements, the words “we,” “our,” “ours” and “us” refer to HEP unless the context otherwise indicates.

We operate in one reportable segment which represents the aggregation of our petroleum product and crude pipelines business and terminals, tankage, loading rack facilities and refinery processing units.

We own and operate petroleum product and crude oil pipelines, terminals, tankage and loading rack facilities and refinery processing units that support HFC’s refining and marketing operations in the Mid-Continent, Southwest and Rocky Mountain regions of the United States and Alon USA, Inc.’s (“Alon”) refinery in Big Spring, Texas. Additionally, we own a 75% interest in UNEV Pipeline, LLC (“UNEV”), a 50% interest in Frontier Aspen, LLC, a 50% interest in Osage Pipe Line Company, LLC (“Osage”), a 50% interest in Cheyenne Pipeline LLC and a 25% interest in SLC Pipeline LLC.

We generate revenues by charging tariffs for transporting petroleum products and crude oil through our pipelines, by charging fees for terminalling and storing refined products and other hydrocarbons, providing other services at our storage tanks and terminals and by charging fees for processing hydrocarbon feedstocks through our refinery processing units. We do not take ownership of products that we transport, terminal, store or process, and therefore, we are not exposed directly to changes in commodity prices.

The consolidated financial statements included herein have been prepared without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission (the “SEC”). The interim financial statements reflect all adjustments, which, in the opinion of management, are necessary for a fair presentation of our results for the interim periods. Such adjustments are considered to be of a normal recurring nature. Although certain notes and other information required by U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted, we believe that the disclosures in these consolidated financial statements are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2015. Results of operations for interim periods are not necessarily indicative of the results of operations that will be realized for the year ending December 31, 2016.

On July 19, 2016, we closed a private placement of $400 million in aggregate principal amount of 6.0% senior unsecured notes due in 2024 (the “6.0% Senior Notes”). We used the net proceeds to repay indebtedness under our revolving credit agreement.

On May 10, 2016, we established a continuous offering program under which HEP may issue and sell common units from time to time, representing limited partner interests, up to an aggregate gross sales amount of $200 million. We intend to use our net proceeds for general partnership purposes.

Acquisitions

Cheyenne Pipeline

On June 3, 2016, we acquired a 50% interest in Cheyenne Pipeline LLC, owner of the Cheyenne Pipeline, in exchange for a contribution of $42.5 million in cash to Cheyenne Pipeline LLC. Cheyenne Pipeline LLC will continue to be operated by an affiliate of Plains All American Pipeline, L.P. (“Plains”), which owns the remaining 50% interest. The 87-mile crude oil pipeline runs from Fort Laramie to Cheyenne, Wyoming and has an 80,000 barrel per day capacity.

Tulsa Tanks

On March 31, 2016, we acquired crude oil tanks located at HFC’s Tulsa refinery from an affiliate of Plains for $39.5 million. In 2009, HFC sold these tanks to Plains and leased them back, and due to HFC’s continuing interest in the tanks, HFC accounted for the transaction as a financing arrangement. Accordingly, the tanks remained on HFC’s balance sheet and were depreciated for accounting purposes.

As we are a consolidated variable interest entity (“VIE”) of HFC, this transaction was recorded as a transfer between entities under common control and reflects HFC’s carrying basis in the net assets acquired. We have retrospectively adjusted our financial position and operating results as if these crude oil tanks were owned for all periods while we were under common control of HFC. The 2015 consolidated income statement was adjusted to reflect a $0.2 million and a $0.4 million increase in operating costs and expenses for the three and six months ended June 30, 2015, respectively. The consolidated balance sheet was adjusted to reflect

HOLLY ENERGY PARTNERS, L.P.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited) Continued

increases of $9.3 million in net properties and equipment, $0.1 million in other long-term liabilities and $9.2 million in general partner interest at December 31, 2015. The consolidated statement of cash flows for the six months ended June 30, 2015, reflects these changes in cash flows from investing and financing activities.

Osage
On February 22, 2016, HFC obtained a 50% membership interest in Osage in a non-monetary exchange for a 20-year terminalling services agreement, whereby a subsidiary of Magellan Midstream Partners (“Magellan”) will provide terminalling services for all HFC products originating in Artesia, New Mexico requiring terminalling in or through El Paso, Texas. Osage is the owner of the Osage Pipeline, a 135-mile pipeline that transports crude oil from Cushing, Oklahoma to HFC’s El Dorado Refinery in Kansas and also connects to the Jayhawk pipeline serving the CHS Inc. refinery in McPherson, Kansas. The Osage Pipeline is the primary pipeline supplying HFC’s El Dorado refinery with crude oil.

Concurrent with this transaction, we entered into a non-monetary exchange with HFC, whereby we received HFC’s interest in Osage in exchange for our El Paso terminal. Under this exchange, we agreed to build two connections on our south products pipeline system that will permit HFC access to Magellan’s El Paso terminal. Effective upon the closing of this exchange, we are the named operator of the Osage Pipeline and are working to transition into that role. Since we are a consolidated VIE of HFC, this transaction was recorded as a transfer between entities under common control and reflects HFC’s carrying basis of its 50% membership interest in Osage of $44.5 million offset by our net carrying basis in the El Paso terminal of $12.1 million with the difference treated as a contribution from HFC. The carrying value of our 50% membership interest in Osage of $44.5 million exceeds the amount of the underlying equity in net assets recorded by Osage by $33.1 million.

El Dorado Operating
On November 1, 2015, we acquired from a wholly owned subsidiary of HFC, all the outstanding membership interests in El Dorado Operating LLC (“El Dorado Operating”), which owns the newly constructed naphtha fractionation and hydrogen generation units at HFC’s El Dorado refinery, for cash consideration of $62.0 million. In connection with this transaction, we entered into 15-year tolling agreements containing minimum quarterly throughput commitments from HFC that provide minimum annualized revenues of $15.3 million.

As we are a consolidated VIE of HFC, this transaction was recorded as a transfer between entities under common control and reflects HFC’s carrying basis in El Dorado Operating’s assets and liabilities. We have retrospectively adjusted our financial position and operating results as if El Dorado Operating were a consolidated subsidiary for all periods while we were under common control of HFC. The consolidated statement of cash flows for the six months ending June 30, 2015, reflects a $18.9 million recast between investing activities and financing activities.

New Accounting Pronouncements

Revenue Recognition
In May 2014, an accounting standard update was issued requiring revenue to be recognized when promised goods or services are transferred to customers in an amount that reflects the expected consideration for these goods or services. This standard has an effective date of January 1, 2018. We are evaluating the impact of this standard.

Consolidation

In February 2015, the FASB issued a standard that modifies existing consolidation guidance for reporting organizations that are required to evaluate whether they should consolidate certain legal entities. We adopted the new standard effective January 1, 2016. This standard had no impact on the entities we consolidate.

Financial Assets and Liabilities

In January 2016, an accounting standard update was issued requiring changes in the accounting and disclosures for financial instruments. This standard will become effective beginning with our 2018 reporting year. We are evaluating the impact of this standard.

Leases

In February 2016, an accounting standard update was issued requiring leases to be measured and recognized as a lease liability, with a corresponding right-of-use asset on the balance sheet. This standard has an effective date of January 1, 2019, and we are evaluating the impact of this standard.

HOLLY ENERGY PARTNERS, L.P.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited) Continued

Earnings Per Unit
In April 2015, an accounting standard update was issued requiring changes to the allocation of the earnings or losses of a transferred business for periods before the date of a dropdown of net assets accounted for as a common control transaction entirely to the general partner for purposes of calculating historical earnings per unit. We adopted this standard as of January 1, 2016. In connection with the dropdown of assets from HFC's Tulsa refinery on March 31, 2016, we reduced net income by $0.2 million and $0.4 million for the three and six months ended June 30, 2015, respectively. This reduction had no impact on the historical earnings per unit.

Note 2: Financial Instruments

Our financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, debt and interest rate swaps. The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term maturity of these instruments. Debt consists of outstanding principal under our revolving credit agreement (which approximates fair value as interest rates are reset frequently at current interest rates) and our fixed interest rate senior notes.

Fair value measurements are derived using inputs (assumptions that market participants would use in pricing an asset or liability) including assumptions about risk. GAAP categorizes inputs used in fair value measurements into three broad levels as follows:

- (Level 1) Quoted prices in active markets for identical assets or liabilities.
- (Level 2) Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, similar assets and liabilities in markets that are not active or can be corroborated by observable market data.
- (Level 3) Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes valuation techniques that involve significant unobservable inputs.

The carrying amounts and estimated fair values of our senior notes and interest rate swaps were as follows:

Financial Instrument	Fair Value Input Level	June 30, 2016 Carrying Value	June 30, 2016 Fair Value	December 31, 2015 Carrying Value	December 31, 2015 Fair Value
		(In thousands)			
Assets:					
Interest rate swaps	Level 2	$—	$—	$304	$304
Liabilities:					
6.5% Senior notes	Level 2	$297,136	$301,500	$296,752	$295,500
Interest rate swaps	Level 2	405	405	114	114
		$297,541	$301,905	$296,866	$295,614

Level 2 Financial Instruments
Our senior notes and interest rate swaps are measured at fair value using Level 2 inputs. The fair value of the senior notes is based on market values provided by a third-party bank, which were derived using market quotes for similar type debt instruments. The fair value of our interest rate swaps is based on the net present value of expected future

cash flows related to both variable and fixed-rate legs of the swap agreement. This measurement is computed using the forward London Interbank Offered Rate ("LIBOR") yield curve, a market-based observable input.

See Note 6 for additional information on these instruments.

HOLLY ENERGY PARTNERS, L.P.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited) Continued

Note 3: Properties and Equipment

The carrying amounts of our properties and equipment are as follows:

	June 30, 2016	December 31, 2015 [1]
	(In thousands)	
Pipelines, terminals and tankage	$1,199,857	$1,231,597
Land and right of way	65,273	66,215
Refinery assets	64,371	63,336
Construction in progress	52,759	28,249
Other	24,524	22,200
	1,406,784	1,411,597
Less accumulated depreciation	352,622	352,418
	$1,054,162	$1,059,179

(1) Retrospectively adjusted as described in Note 1.

We capitalized $0.3 million and $0.6 million in interest attributable to construction projects during the six months ended June 30, 2016 and 2015, respectively.

Depreciation expense was $28.5 million and $26.2 million for the six months ended June 30, 2016 and 2015, respectively.

Note 4: Transportation Agreements

Our transportation agreements represent a portion of the total purchase price of certain assets acquired from Alon in 2005 and from HFC in 2008. The Alon agreement is being amortized over 30 years ending 2035 (the initial 15-year term of the agreement plus an expected 15-year extension period), and the HFC agreement is being amortized over 15 years ending 2023 (the term of the HFC agreement).

The carrying amounts of our transportation agreements are as follows:

	June 30, 2016	December 31, 2015
	(In thousands)	
Alon transportation agreement	$59,933	$ 59,933
HFC transportation agreement	74,231	74,231
Other	50	50
	134,214	134,214
Less accumulated amortization	63,884	60,409
	$70,330	$ 73,805

Amortization expense was $3.5 million for each of the six months ended June 30, 2016 and 2015.

We have additional transportation agreements with HFC resulting from historical transactions consisting of pipeline, terminal and tankage assets contributed to us or acquired from HFC. These transactions occurred while we were a consolidated VIE of HFC; therefore, our basis in these agreements is zero and does not reflect a step-up in basis to fair value.

Note 5: Employees, Retirement and Incentive Plans

Direct support for our operations is provided by Holly Logistic Services, L.L.C. ("HLS"), an HFC subsidiary, which utilizes personnel employed by HFC who are dedicated to performing services for us. Their costs, including salaries, bonuses, payroll taxes, benefits and other direct costs, are charged to us monthly in accordance with an omnibus agreement that we have with HFC. These employees participate in the retirement and benefit plans of HFC. Our share of retirement and benefit plan costs was $1.3 million and $1.7 million for the three months ended June 30, 2016 and 2015, respectively, and $2.9 million and $3.1 million for the six months ended June 30, 2016 and 2015, respectively.

Under HLS's secondment agreement with HFC (the "Secondment Agreement"), certain employees of HFC are seconded to HLS to provide operational and maintenance services for certain of our processing, refining, pipeline and tankage assets, and HLS reimburses HFC for its prorated portion of the wages, benefits, and other costs related to these employees.
We have a Long-Term Incentive Plan for employees and non-employee directors who perform services for us. The Long-Term Incentive Plan consists of four components: restricted or phantom units, performance units, unit options and unit appreciation rights.

As of June 30, 2016, we have two types of incentive-based awards outstanding, which are described below. The compensation cost charged against income was $0.5 million and $0.9 million for the three months ended June 30, 2016 and 2015, respectively, and $1.2 million and $1.6 million for the six months ended June 30, 2016 and 2015, respectively. We currently purchase units in the open market instead of issuing new units for settlement of all unit awards under our Long-Term Incentive Plan. As of June 30, 2016, 2,500,000 units were authorized to be granted under our Long-Term Incentive Plan, of which 1,487,498 have not yet been granted, assuming no forfeitures of the unvested units and full achievement of goals for the unvested performance units.

Restricted and Phantom Units
Under our Long-Term Incentive Plan, we grant restricted units to non-employee directors and selected employees who perform services for us, with most awards vesting over a period of one to three years. Although full ownership of the units does not transfer to the recipients until the units vest, the recipients have distribution and voting rights on these units from the date of grant.

In addition, we previously granted phantom units to certain employees. All outstanding phantom units vested in 2015, and no phantom units are currently outstanding. Vested units were paid in common units. Full ownership of the units transferred to the recipients at vesting, and the recipients did not have voting or distribution rights on these units until they vested.

The fair value of each restricted unit award is measured at the market price as of the date of grant and is amortized on a straight-line basis over the requisite service period for each separately vesting portion of the award.

A summary of restricted unit activity and changes during the six months ended June 30, 2016, is presented below:

Restricted Units	Units	Weighted Average Grant-Date Fair Value

Outstanding at January 1, 2016 (nonvested)	101,408	$ 33.63
Granted	10,725	24.48
Forfeited	(3,030)	34.21
Outstanding at June 30, 2016 (nonvested)	109,103	$ 32.71

As of June 30, 2016, there was $1.6 million of total unrecognized compensation expense related to nonvested restricted unit grants, which is expected to be recognized over a weighted-average period of 1.1 years.

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Performance Units
Under our Long-Term Incentive Plan, we grant performance units to selected executives who perform services for us. Performance units granted are payable in common units at the end of a three-year performance period based upon the growth in our distributable cash flow per common unit over the performance period. As of June 30, 2016, estimated unit payouts for outstanding nonvested performance unit awards ranged between 100% and 150% of the target number of performance units granted.

We granted 10,725 performance units during the six months ended June 30, 2016. Performance units granted in 2015 and during the six months ended June 30, 2016, vest over a three-year performance period ending December 31, 2018 and are payable in HEP common units. The number of units actually earned will be based on the growth of our distributable cash flow per common unit over the performance period, and can range from 50% to 150% of the target number of performance units granted. Although common units are not transferred to the recipients until the performance units vest, the recipients have distribution rights with respect to the common units from the date of grant.

A summary of performance unit activity and changes during the six months ended June 30, 2016, is presented below:

Performance Units	Units
Outstanding at January 1, 2016 (nonvested)	45,494
Granted	10,725
Vesting and transfer of common units to recipients	(26,157)
Forfeited	(2,679)
Outstanding at June 30, 2016 (nonvested)	27,383

The grant-date fair value of performance units vested and transferred to recipients during the six months ended June 30, 2016, was $1.1 million. Based on the weighted average fair value of performance units outstanding at June 30, 2016, of $0.8 million, there was $0.6 million of total unrecognized compensation expense related to nonvested performance units, which is expected to be recognized over a weighted-average period of 2.4 years.

Note 6: Debt

Credit Agreement
In March 2016, we amended our senior secured revolving credit facility (the "Credit Agreement") expiring in November 2018, increasing the size of the Credit Agreement from $850 million to $1.2 billion. The Credit Agreement is available to fund capital expenditures, investments, acquisitions, distribution payments and working capital and for general partnership purposes. It is also available to fund letters of credit up to a $50 million sub-limit.

Our obligations under the Credit Agreement are collateralized by substantially all of our assets. Indebtedness under the Credit Agreement involves recourse to HEP Logistics Holdings, L.P. ("HEP Logistics"), our general partner, and is guaranteed by our material, wholly-owned subsidiaries. Any recourse to HEP Logistics would be limited to the extent of its assets, which other than its investment in us are not significant. We may prepay all loans at any time without penalty, except for payment of certain breakage and related costs.

The Credit Agreement imposes certain requirements on us with which we were in compliance as of June 30, 2016, including: a prohibition against distribution to unitholders if, before or after the distribution, a potential default or an event of default as defined in the agreement would occur; limitations on our ability to incur debt, make loans, acquire other companies, change the nature of our business, enter into a merger or consolidation, or sell assets; and covenants that require maintenance of a specified EBITDA to interest expense ratio, total debt to EBITDA ratio and senior debt to EBITDA ratio. If an event of default exists under the Credit Agreement, the lenders will be able to accelerate the maturity of the debt and exercise other rights and remedies.

Senior Notes

We have $300 million in aggregate principal amount outstanding of 6.5% senior notes (the “6.5% Senior Notes”) maturing March 2020.

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On July 19, 2016, we closed a private placement of $400 million in aggregate principal amount of 6.0% senior unsecured notes due in 2024 (the “6.0% Senior Notes” and together with the 6.5 % Senior Notes, the “Senior Notes”). We used the net proceeds to repay indebtedness under our revolving credit agreement.

The Senior Notes are unsecured and impose certain restrictive covenants, including limitations on our ability to incur additional indebtedness, make investments, sell assets, incur certain liens, pay distributions, enter into transactions with affiliates, and enter into mergers. We were in compliance with the restrictive covenants for the 6.5% Senior Notes as of June 30, 2016. At any time when the Senior Notes are rated investment grade by both Moody’s and Standard & Poor’s and no default or event of default exists, we will not be subject to many of the foregoing covenants. Additionally, we have certain redemption rights at varying premiums over face value under the Senior Notes.

Indebtedness under the Senior Notes is guaranteed by our wholly-owned subsidiaries.

Long-term Debt
The carrying amounts of our long-term debt are as follows:

	June 30, 2016	December 31, 2015
	(In thousands)	
Credit Agreement		
Amount outstanding	$786,000	$712,000
6.5% Senior Notes		
Principal	300,000	300,000
Unamortized discount and debt issuance costs	(2,864)	(3,248)
	297,136	296,752
Total long-term debt	$1,083,136	$1,008,752

Interest Rate Risk Management
We use interest rate swaps (derivative instruments) to manage our exposure to interest rate risk.

As of June 30, 2016, we have two interest rate swaps with identical terms that hedge our exposure to the cash flow risk caused by the effects of LIBOR changes on $150 million of Credit Agreement advances. The swaps effectively convert $150 million of our LIBOR based debt to fixed rate debt having an interest rate of 0.74% plus an applicable margin of 2.25% as of June 30, 2016, which equaled an effective interest rate of 2.99%. Both of these swap contracts mature in July 2017.

We have designated these interest rate swaps as cash flow hedges. Based on our assessment of effectiveness using the change in variable cash flows method, we have determined these interest rate swaps are effective in offsetting the variability in interest payments on $150 million of our variable rate debt resulting from changes in LIBOR. Under hedge accounting, we adjust our cash flow hedges on a quarterly basis to their fair values with the offsetting fair value adjustments to accumulated other comprehensive income (loss). Also on a quarterly basis, we measure hedge effectiveness by comparing the present value of the cumulative change in the expected future interest to be paid or received on the variable leg of our swaps against the expected future interest payments on $150 million of our variable rate debt. Any ineffectiveness is recorded directly to interest expense. As of June 30, 2016, we had no ineffectiveness on our cash flow hedges.

At June 30, 2016, we have accumulated other comprehensive loss of $0.4 million that relates to our current cash flow hedging instruments. Approximately $0.4 million will be transferred from accumulated other comprehensive loss into interest expense as interest is paid on the underlying swap agreement over the next twelve-month period, assuming interest rates remain unchanged.

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Additional information on our interest rate swaps is as follows:

Derivative Instrument	Balance Sheet Location	Fair Value	Location of Offsetting Balance	Offsetting Amount
	(In thousands)			
June 30, 2016				
Interest rate swaps designated as cash flow hedging instrument:				
Variable-to-fixed interest rate swap contracts ($150 million of LIBOR-based debt interest)	Other long-term liabilities	$ (405)	Accumulated other comprehensive income	$ (405)
		$ (405)		$ (405)
December 31, 2015				
Interest rate swaps designated as cash flow hedging instrument:				
Variable-to-fixed interest rate swap contract ($150 million of LIBOR-based debt interest)	Other long-term assets	$ 304	Accumulated other comprehensive loss	$ 304
Variable-to-fixed interest rate swap contracts ($155 million of LIBOR-based debt interest)	Other long-term liabilities	(114)	Accumulated other comprehensive income	(114)
		$ 190		$ 190

Interest Expense and Other Debt Information
Interest expense consists of the following components:

	Six Months Ended June 30,	
	2016	2015
	(In thousands)	
Interest on outstanding debt:		
Credit Agreement, net of interest on interest rate swaps	$10,284	$7,488
6.5% Senior Notes	9,757	9,757
Amortization of discount and deferred debt issuance costs	1,376	930
Commitment fees and other	679	261
Total interest incurred	22,096	18,436
Less capitalized interest	285	612
Net interest expense	$21,811	$17,824
Cash paid for interest	$20,736	$17,280

Capital Lease Obligations
Our capital lease obligations, which relate to vehicle leases with initial terms of 0 to 36 months, are $3.0 million and $1.8 million as of June 30, 2016 and December 31, 2015, respectively. The total cost of assets under capital leases was $4.6 million and $3.0 million as of June 30, 2016 and December 31, 2015, respectively, with accumulated depreciation of $1.6 million and $1.1 million as of June 30, 2016 and December 31, 2015, respectively. We include depreciation of capital leases in depreciation and amortization in our consolidated statements of income.

Note 7: Significant Customers

All revenues are domestic revenues, of which 92% are currently generated from our two largest customers: HFC and Alon.

The following table presents the percentage of total revenues generated by each of these customers:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
HFC	83%	82%	82%	81%
Alon	9%	10%	8%	10%

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Note 8: Related Party Transactions

We serve HFC's refineries under long-term pipeline, terminal and tankage throughput agreements, and refinery processing unit tolling agreements expiring from 2019 to 2036. Under these agreements, HFC agrees to transport, store and process throughput volumes of refined product, crude oil and feedstocks on our pipelines, terminals, tankage, loading rack facilities and refinery processing units that result in minimum annual payments to us. These minimum annual payments or revenues are subject to annual rate adjustments on July 1st each year based on the Producer Price Index ("PPI") or Federal Energy Regulatory Commission ("FERC") index. As of June 30, 2016, these agreements with HFC require minimum annualized payments to us of $261.4 million.

If HFC fails to meet its minimum volume commitments under the agreements in any quarter, it will be required to pay us the amount of any shortfall in cash by the last day of the month following the end of the quarter. Under certain of these agreements, a shortfall payment may be applied as a credit in the following four quarters after its minimum obligations are met.

Under certain provisions of an omnibus agreement we have with HFC (the "Omnibus Agreement"), we pay HFC an annual administrative fee (currently $2.5 million) for the provision by HFC or its affiliates of various general and administrative services to us. This fee does not include the salaries of personnel employed by HFC who perform services for us on behalf of HLS or the cost of their employee benefits, which are charged to us separately by HFC. Also, we reimburse HFC and its affiliates for direct expenses they incur on our behalf.

Related party transactions with HFC are as follows:

- Revenues received from HFC were $79.2 million and $68.3 million for the three months ended June 30, 2016 and 2015, respectively, and $162.0 million and $140.6 million for the six months ended June 30, 2016 and 2015, respectively.
- HFC charged us general and administrative services under the Omnibus Agreement of $0.6 million for each of the three months ended June 30, 2016 and 2015 and $1.2 million for each of the six months ended June 30, 2016 and 2015.
- We reimbursed HFC for costs of employees supporting our operations of $9.5 million and $7.5 million for the three months ended June 30, 2016 and 2015, respectively, and $19.4 million and $16.2 million for the six months ended June 30, 2016 and 2015, respectively.
- HFC reimbursed us $5.0 million and $4.4 million for the three months ended June 30, 2016 and 2015, respectively, for reimbursable expense and capital projects and $6.7 million and $7.0 million for the six months ended June 30, 2016 and 2015, respectively.
- We distributed $25.3 million and $22.3 million for the three months ended June 30, 2016 and 2015, respectively, and $49.8 million and $43.9 million for the six months ended June 30, 2016 and 2015, respectively, to HFC as regular distributions on its common units and general partner interest, including general partner incentive distributions.
- Accounts receivable from HFC were $42.8 million and $32.5 million at June 30, 2016, and December 31, 2015, respectively.
- Accounts payable to HFC were $9.2 million and $11.6 million at June 30, 2016, and December 31, 2015, respectively.
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Revenues for the six months ended June 30, 2016 and 2015, include $5.5 million and $6.0 million, respectively, of shortfall payments billed in 2015 and 2014, respectively. Deferred revenue in the consolidated balance sheets at June 30, 2016, and December 31, 2015, includes $3.2 million and $6.4 million, respectively, relating to certain shortfall billings. It is possible that HFC may not exceed its minimum obligations to receive credit for any of the $3.2 million deferred at June 30, 2016.

- On February 22, 2016, HFC obtained a 50% membership interest in Osage in a non-monetary exchange, whereby a subsidiary of Magellan will provide terminalling services for all HFC products originating in Artesia, New Mexico that require terminalling in or through El Paso, Texas. Concurrent with this transaction, we entered into a non-monetary exchange with HFC, whereby we received HFC's interest in Osage in exchange for our El Paso terminal. See Note 1 for a description of this transaction.
- On March 31, 2016, we acquired crude oil tanks located at HFC's Tulsa refinery from an affiliate of Plains for $39.5 million. See Note 1 for a description of this transaction.

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Note 9: Partners' Equity

As of June 30, 2016, HFC held 22,380,030 of our common units and the 2% general partner interest, which together constituted a 39% ownership interest in us. Additionally, HFC owned all incentive distribution rights in us.

Continuous Offering Program

On May 10, 2016, we established a continuous offering program under which HEP may issue and sell common units from time to time, representing limited partner interests, up to an aggregate gross sales amount of $200 million. As of June 30, 2016, HEP has issued 444,799