Clause 8 in Report No. 9 of Committee of the Whole was adopted, without amendment, by the Council of The Regional Municipality of York at its meeting held on May 19, 2016.

8
Fuel Price Hedging Program 2015

Committee of the Whole recommends adoption of the following recommendation contained in the report dated April 28, 2016 from the Commissioner of Finance:

1. Council receive this report for information, in accordance with Ontario Regulation 653/05 of the Municipal Act, 2001.

Report dated April 28, 2016 from the Commissioner of Finance now follows:

1. Recommendations

It is recommended that Council receive this report for information, in accordance with Ontario Regulation 653/05 of the *Municipal Act, 2001*.

2. Purpose

This report summarizes the activities undertaken during 2015 as part of the Region's fuel price hedging program, as well as its historical performance.

3. Background

The goal of the hedging program is to achieve greater cost certainty for fuel prices

Council has adopted a *Commodity Price Hedging Policy* (the Policy) that allows for the price hedging of commodities, in particular the fuel that is used for transit and fleet vehicles. The goal of the Policy is not to speculate on the future price of the commodity, but rather to manage the Region's financial risk by helping to fix the price of the commodity for a predetermined amount and volume.

The Policy permits the hedging of up to 80 per cent of the forecasted annual commodity volume for a term of up to thirty (30) months beyond the execution date of the contract.

Fuel hedging agreements are contracts entered into with financial institutions that set a price for fuel over a stipulated timeframe. These contracts are purely financial transactions and do not involve the physical receipt of fuel, which continues to be sourced at the pump or through bulk delivery contracts.

Under a hedging agreement, the Region receives a payment when the average market price of the specified index exceeds the stated price in the contract, which is settled on a monthly basis. This payment is used to help offset the higher prices paid at the pump. Conversely, the Region is obliged to pay if and when the price falls below the contract price, but this cost should be offset through savings at the pump.

Fuel hedging agreements are arranged through Canadian financial institutions on a competitive basis

Before entering into a fuel hedging agreement, staff obtain quotes from at least two Canadian financial institutions. The Region then enters into the agreement with the financial institution offering the lowest quote. Other than the price, the terms in the hedging agreements are subject to the International Swaps and Derivatives Association Master Agreement, which is a standardized agreement that is published by the Association.

Ultra-Low Sulfur Diesel is used for hedging both diesel and gasoline

Since May 2013, the New York Mercantile Exchange uses the Ultra-Low Sulfur Diesel futures as an index for either diesel or gasoline. Approximately 80 per cent of the Region's fuel consumption is either Ultra-Low Sulfur Diesel or biodiesel, the majority of which is acquired through bulk purchases.

4. Analysis and Options

The Region hedged 79 per cent of its 2015 fuel requirements at a net price of $1.04 per litre and paid $4,054,605 in hedging settlements

During 2013 and 2014, the Region entered into three fuel hedging agreements that covered 79 per cent of its expected fuel consumption for 2015, at an equivalent price of $1.04 per litre, net of HST rebates (see Table 1). The Region is also hedged at an equivalent price of $1.05 per litre for 2016.

Table 1
Fuel Price Hedging Transactions for 2015

Hedging Agreement Execution Date	Counterparty	Hedging Year	Hedged Volume (Litres)	Hedging Contract Price (CA$/litre)	**Region's Equivalent Diesel Price (CA$/Litre) Net of Taxes**
Sept 23, 2013	CIBC	2015	8,196,000	0.7745	1.04
Oct 1, 2013	CIBC	2015	10,104,000	0.7768	1.04
Oct 8, 2014	CIBC	2015	360,000	0.7825	1.05
Hedging Total / Average			**18,660,000**	**0.7759**	**1.04**
Forecast Annual Demand		2015	23,591,000		
Total Hedged Volume as % of Forecast Demand			**79%**		

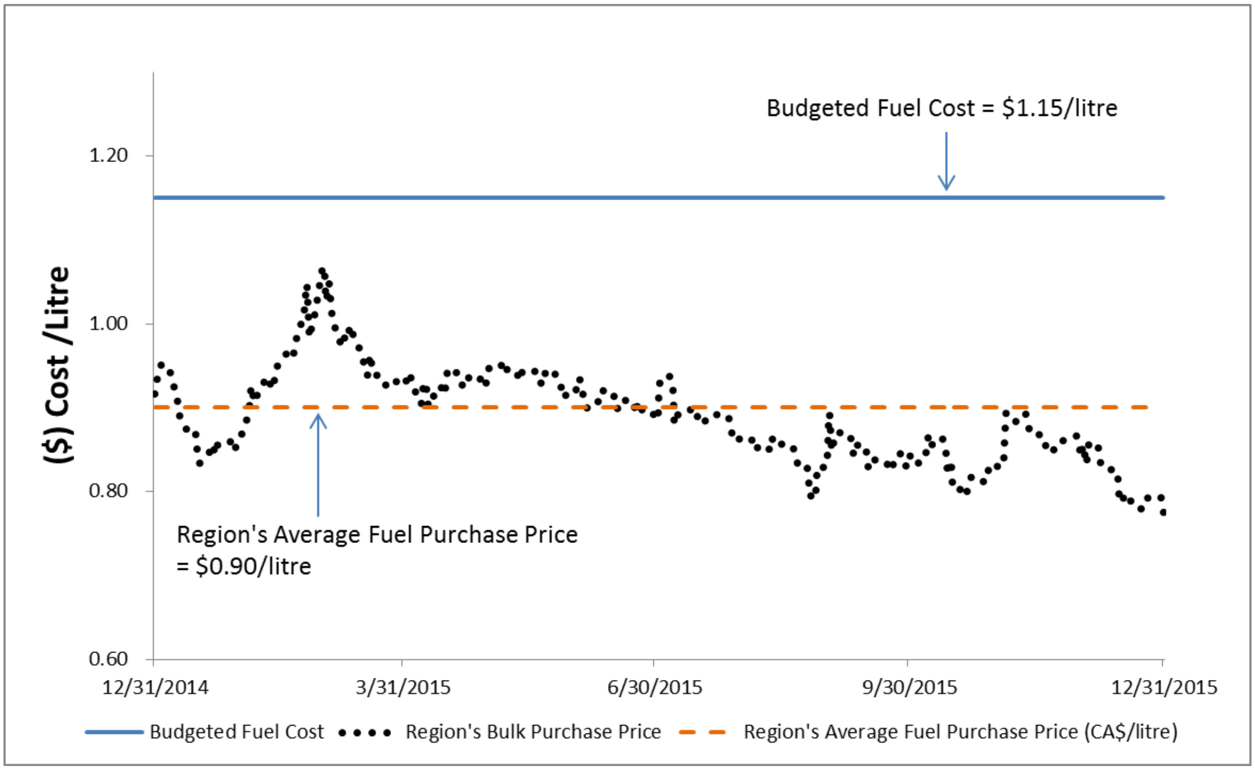
During 2015, the average settlement price for Ultra-Low Sulphur Diesel was about $0.22 per litre lower than the hedged price. As a result, the Region paid a total of $4,054,605 through its hedging program.

During 2015, the average net fuel purchase price paid by the departments was $0.90 per litre

The 2015 budget assumed a net fuel cost of $1.15 per litre (department base of $1.00 per litre plus a $0.15 per litre corporate contingency) with a forecast fuel volume of 23.6 million litres. The actual fuel consumption for 2015 was below budget, with an average price (net of HST rebates) of $0.90 per litre (see Graph 1 below). The difference between the budgeted and actual average fuel costs was contributed to the Fuel Cost Stabilization Reserve Fund.

Graph 1

Region's Fuel Purchase Price vs Budget Price in 2015



Note: The Region's average fuel purchase price of $0.90/litre included the bulk purchases and purchases at the pump for both diesel and gasoline fuel in 2015.

The Fuel Cost Stabilization Reserve Fund received approximately $2.1 million from operating departments

The purpose of the Fuel Cost Stabilization Reserve Fund is to address differences between actual and budgeted fuel rates during the year, as well as any costs or savings arising from the fuel hedging program. The reserve is funded from the corporate fuel contingency (currently at $0.15 per litre), the net receipts from the fuel hedging agreements, and contributions from operating departments.

During 2015, with actual fuel cost of $0.90 per litre, the operating departments contributed approximately $2.1 million to the reserve fund to offset the costs incurred in hedging settlements of approximately $4.0 million. In addition, approximately $3.8 million in corporate fuel contingency was contributed to the Fuel Cost Stabilization Reserve (see Table 2).

Table 2
Fuel Cost Stabilization Reserve Fund Activity for 2015

Activity	$
Balance as at December 31, 2014	3,753,050
Fuel hedging settlements	(4,054,605)
Corporate fuel contingency	3,750,000
Operating departments' contributions	2,114,635
Interest earned on reserve balance	81,088
Balance as at December 31, 2015	**$5,644,168**

At the end of 2015, the reserve had a balance of $5,644,168, which is an increase of approximately $1.9 million over 2014.

Higher refining and retail margins and continuing volatile market conditions reduced the effectiveness of the hedge in 2015

Historically, the futures index price of Ultra-Low Sulfur Diesel has been highly correlated with the Toronto Diesel Rack price (a reference point for the price paid by the Region), and the Region's fuel hedge worked effectively.

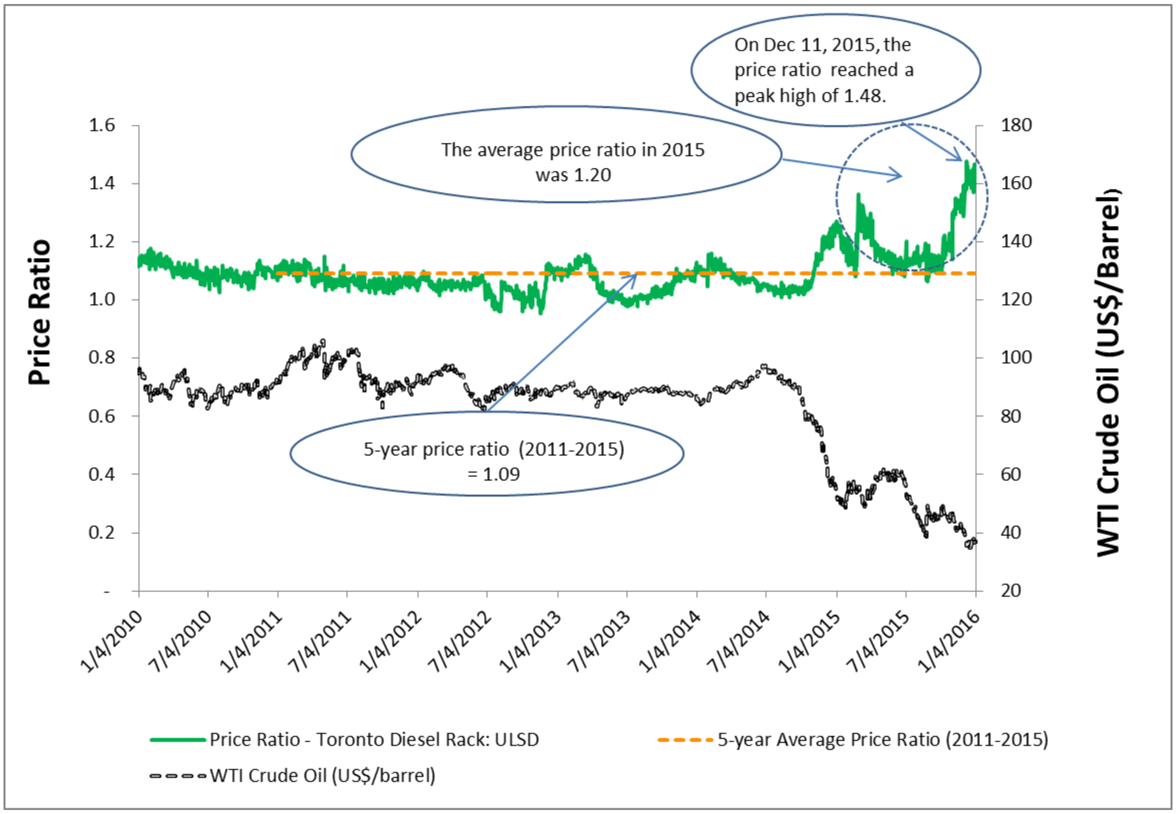
However, due to market volatility in 2015, the correlation between the Ultra-Low Sulfur Diesel index and the Toronto Diesel Rack price weakened considerably. This effect was amplified by sticky diesel prices, which meant that savings from purchases at the pump did not fully offset the cost of the hedging program, as would normally be the case.

Graph 2 below illustrates how the Toronto Diesel Rack price has moved in relation to the Ultra-Low Sulfur Diesel futures index price over the course of the fuel hedging program. The price of oil fell to $34 in December 2015, with signs of future uncertainty heading into 2016. The price ratio of Toronto Diesel Rack and the futures index reflected rapidly widening margins, as refineries and retailers increased profits instead of passing on the full value of the oil price decrease. This meant that the Region was paying more on the hedge than it was saving at the pump for the year.

The price gap between the Ultra-Low Sulfur Diesel index and retail diesel remains unexpectedly large. Staff will continue to monitor the market and have not entered into any fuel hedging contracts since the market volatility began.

Graph 2

Toronto Diesel Rack and Ultra-Low Sulfur Diesel Index Price Ratio



Link to key Council-approved plans

Fuel price hedging under the Region's *Commodity Price Hedging Policy* enables the Region to manage its finances prudently, a strategic priority area in the 2011 to 2015 Strategic Plan. Specifically, it provides greater cost certainty for fuel purchases.

5. Financial Implications

The Region hedged approximately 79 per cent of its 2015 forecasted fuel volume at a net price of $1.04 per litre and paid approximately $4.1 million in hedging settlements as a result of the lower price of oil during this period.

The Region budgeted $1.00 per litre base and $0.15 per litre contingency. As a result of actual fuel cost being lower than the $1.00 per litre, the Fuel Cost Stabilization Reserve received approximately $2.1 million from the operating departments and $3.8 million from the corporate fuel contingency.

6. Local Municipal Impact

There is no impact on local municipalities arising from the fuel price hedging program.

7. Conclusion

The fuel price hedging program helps provide cost certainty for the Region’s fuel consumption. Regional staff will continue to monitor the effectiveness of the program.

For more information on this report, please contact Edward Hankins, Director, Treasury Office, at extension 71644.

The Senior Management Group has reviewed this report.

April 28, 2016

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Accessible formats or communication supports are available upon request