

Washington State Ferries Fiscal Year 2020 Fuel Hedging Report

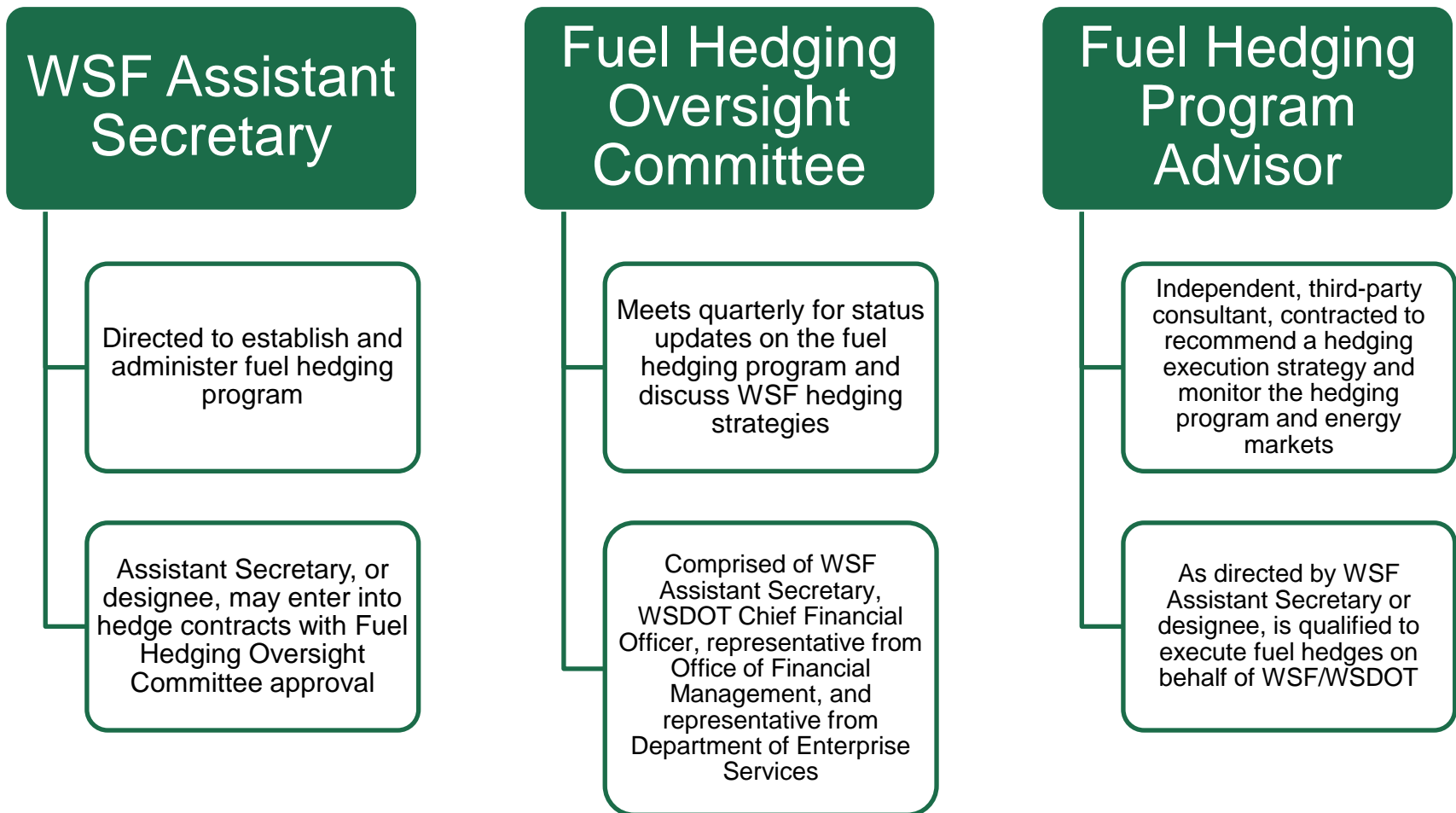
**The WSDOT Fuel Hedging Program and
Fuel Hedging in FY 2020**

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WSDOT Fuel Hedging Program – An Overview

- Established by Secretary's Executive Order Number E 1078.
- Program objectives:
 - Decrease the volatility of fuel costs
 - Increase the likelihood that actual fuel cost will remain below the budgeted cost
- Per the Secretary's Executive Order, cost savings is secondary to managing risk (price volatility)

WSDOT Fuel Hedging Program – Key Players (per Exec Order)



WSDOT Fuel Hedging Program – an abridged history

2011

Legislature authorizes WSDOT to enter into a distributor-control fuel hedging program for the 2011-2013 biennium

2012

Legislature expands authorization to include other methods of hedging approved by the Fuel Hedging Oversight Committee

2014

WSDOT executes its first financial hedge. This hedge was for Fiscal Year (FY) 2015

2018

December – WSDOT executes its first financial hedge for FY 2020

2020

January – WSDOT executes its final hedge for FY 2020, ultimately hedging 61% of budgeted gallons

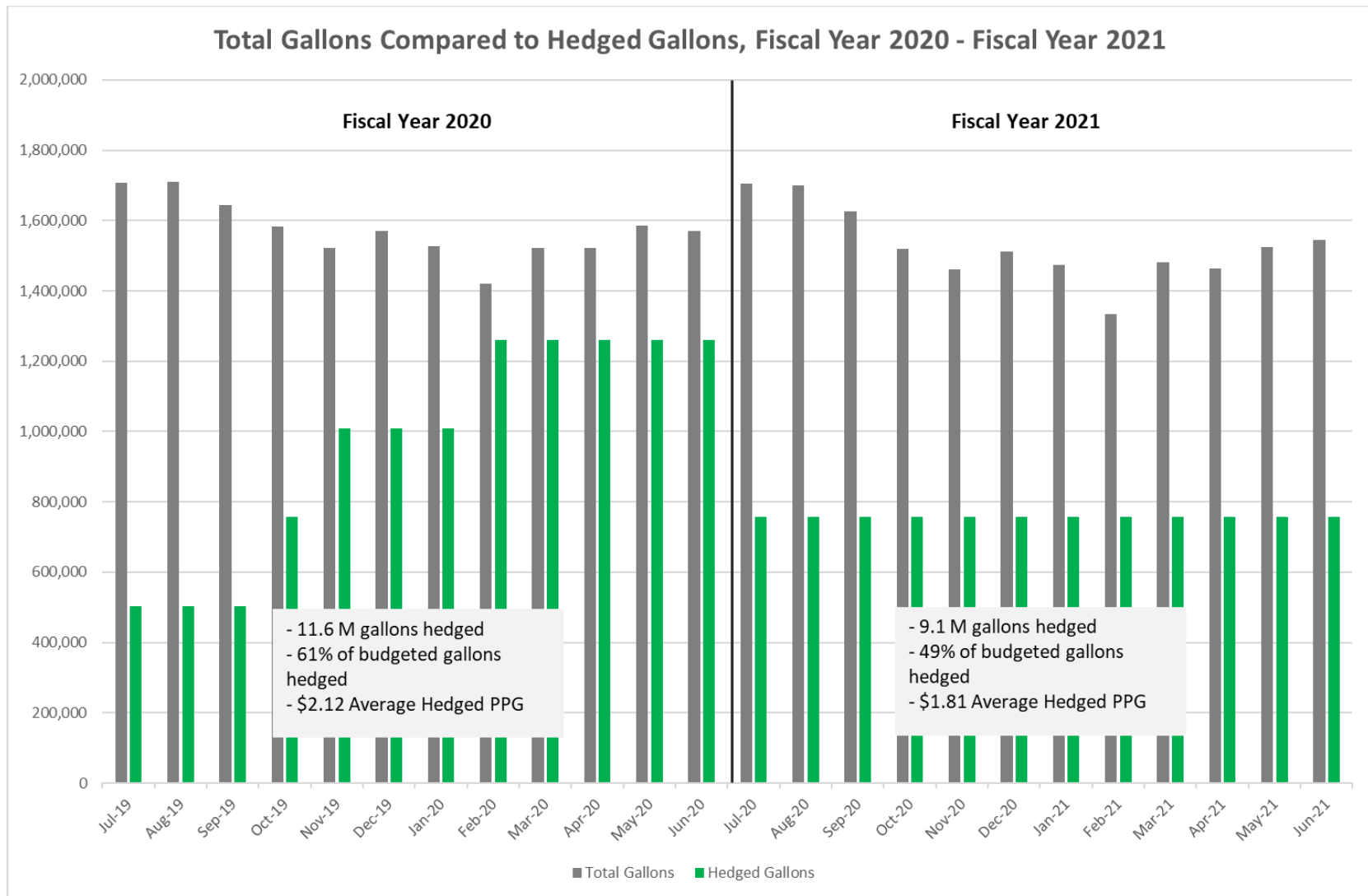
A brief primer on financial hedges

- WSDOT uses a “Swap Contract Agreement” with a counterparty, usually an investment bank, to swap floating prices on a commodity for a fixed price over a set period of time
 - This arrangement guarantees the fuel price in the financial market at a set future date
- The commodity used is Heating Oil (Ultra-Low-Sulfur Diesel) on the New York Mercantile Exchange – this commodity is highly correlated with the price of fuel WSF pays to its fuel provider
- By using a financial hedge, the price for hedging fuel is lower than if WSDOT had hedged fuel directly with the supplier (a distributor-controlled hedge)

FY 2020 Annual Hedging Report

Key Points

Hedging overview



Note: There are no hedges in place for FY 2022 or beyond

Hedging effects in the 19-21 Biennium

For FY 2020:

- Hedging decreased the price of hedged gallons by an average of \$0.42 per gallon, compared to actual supplier prices – this difference was driven, in part, by a price spike in October 2019 caused by refinery outages in California
- Hedges were an average of \$0.02 per gallon lower than the price forecast at the time the hedges were executed

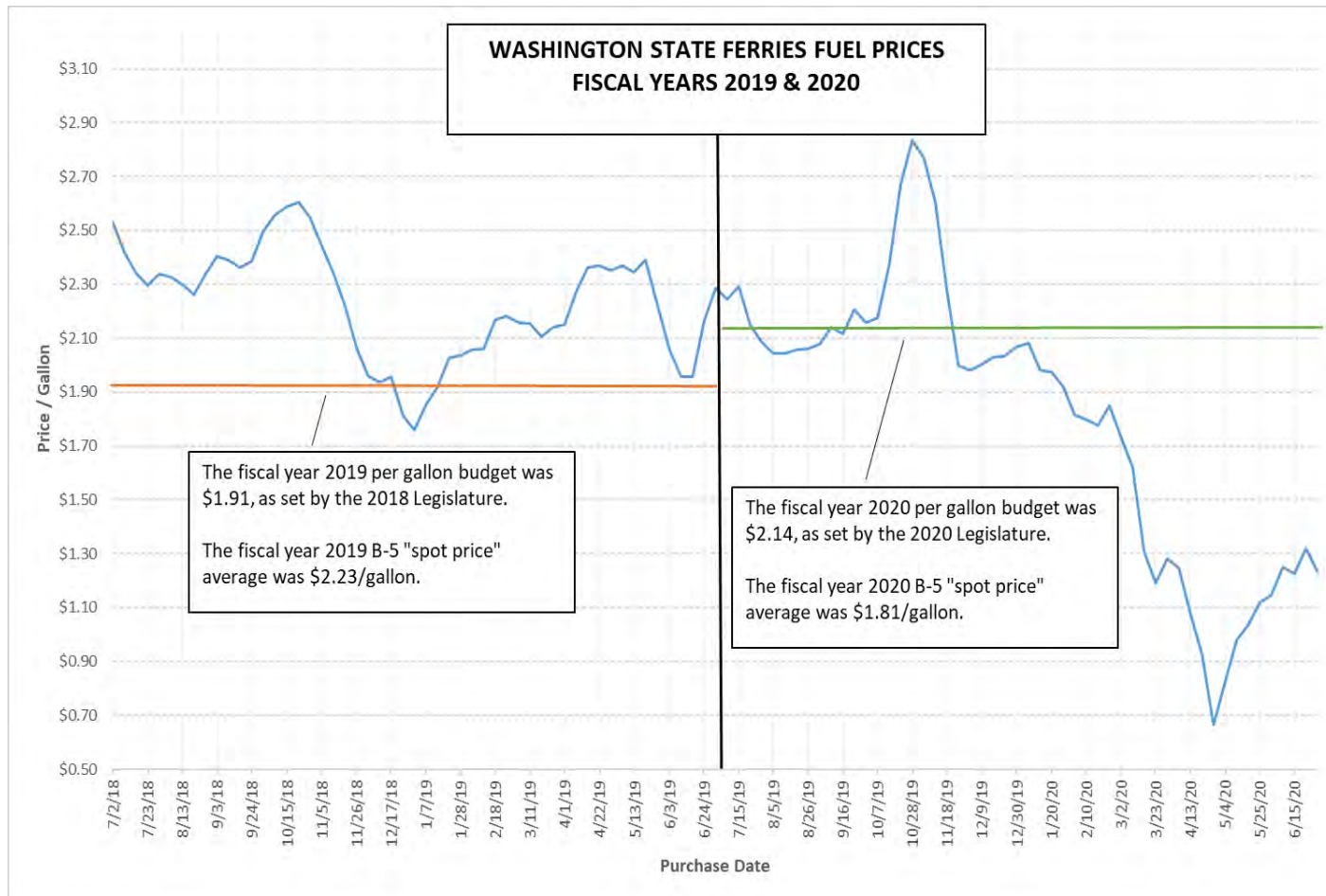
For FY 2021:

- The average price of hedged gallons is \$0.03 per gallon higher than the adopted budget and \$0.41 per gallon above the November 2020 forecast (the most recent fuel forecast)

Comparing hedge prices to budget and forecast prices



Fuel price history



Prices were more volatile in FY 2020 than FY 2019:

- In October 2019, an unusually high number of refinery outages in California caused prices to spike
- Prices cratered in late FY 2020 with the onset of the global pandemic

The petroleum market at a glance (FY 2020)

- Global petroleum production exceeded demand primarily due to pandemic-related reductions in demand
 - This mismatch in supply and demand did not occur until 3rd quarter of FY 2020
 - The sudden decrease in demand, and inability of oil producers to similarly cut production, caused global petroleum inventories to increase and prices to decrease
- US daily domestic production increased from FY 2019 (11.66 million barrels per day) to FY 2020 (12.39 million barrels per day)
- OPEC daily production decreased 3.31 million barrels per day
 - OPEC's decrease in production is a primary reason petroleum prices were able to recover after crashing in March and April 2020

The petroleum market outlook (FY 2021 and beyond)

- Expectations are that the global market will be balanced by FY 2022. Excess global inventories are being drained (due to supply cuts, led by OPEC), and eventually global supply and demand are expected to align
- OPEC is forecast to take on greater market share and manage production levels to ensure that supply and demand are in balance.
 - While this might mean greater price volatility, OPEC is expected to step in (and increase supply) should fuel prices go too high
- US domestic production has steadied after a steep, pandemic-related decline

Is hedging effective?

- Yes, according to the statistical effectiveness test established by Government Accounting Standards Board Statement No. 53 (GASB 53)
- The effectiveness test requires the hedging instrument index, in this case the rolling spot-month diesel fuel futures price, to exhibit a minimum level of statistical relationship to WSF's fuel cost in terms of correlation, regression slope, and F-Statistic confidence and is typically performed using 36 months of historical data on WSF fuel cost per gallon and the hedging index price
- Hedge effectiveness analysis for the five years ending June 30, 2020, shows that the department's hedges fall within the acceptable tolerance level

Is hedging providing cost savings?

- In a market with falling fuel prices, it is difficult to execute hedges that ensure cost savings. Hedging secures price certainty (less price volatility) but cannot guarantee savings. Conversely, in a market with rising prices, hedging may both ensure price stability and result in savings against what would be paid at market prices
- Since the onset of the pandemic, prices have fallen and stayed relatively low, and WSDOT has forecast prices to stay low in FY 2022 and beyond. As a result, WSDOT has not executed any hedges past FY 2021
- WSDOT continues to assess its hedging strategy and discuss, within the Fuel Hedging Oversight Committee, how to balance price certainty with cost savings

Fuel consumption – pandemic-related savings

- For FY 2020, WSF fuel consumption was 1,779,423 gallons below budget
 - This underrun was primarily due to pandemic-related service reductions implemented by WSF at the end of March 2020
 - WSF implemented a Winter service schedule on all routes which includes no service to Sidney, BC, Canada
 - WSF removed one vessel on the Seattle-Bainbridge, Seattle-Bremerton, and Fauntleroy-Vashon-Southworth ferry routes
 - For the last three months of FY 2020, WSF fuel consumption was 1,394,513 gallons below budget

Fuel Surcharge

WAC 468-300-080:

In order to manage the financial risk associated with fuel price volatility, it is hereby declared to be the policy of the Washington state transportation commission to implement a fuel surcharge as an added component to the regular posted fares for passage on vessels operated by Washington state ferries (WSF) to mitigate the financial impacts associated with unexpected increases in fuel prices which exceed those incorporated in WSF's fuel budget.

WSF has never imposed a fuel surcharge, and it is unlikely a surcharge will occur except under the most exceptional of circumstances.

Questions?

For more information on the
FY 2020 Annual Fuel Hedging Report, please contact:

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