

**REPORT TO THE LEGISLATURE
on
Diesel Fuel Price Hedging, Fiscal Year 2021**

**WASHINGTON STATE DEPARTMENT OF TRANSPORTATION
FERRIES DIVISION**

February 1, 2022



Executive Summary

History

In 2011, the Washington State Legislature authorized the Washington State Department of Transportation (WSDOT) to enter a distributor-controlled fuel hedging program. Under this program, Washington State Ferries (WSF) worked directly with WSF's fuel provider. In 2012, the Legislature expanded the authorization to include other methods of hedging approved by the Fuel Hedging Oversight Committee. The first financial hedges were executed in fiscal year 2015. The objectives of this hedging program are to decrease the volatility of fuel costs and increase the likelihood that actual net fuel cost will remain below the budgeted amount.

Since 2015, the hedging program ("program") uses financial hedges, specifically called "Swap Contract Agreements" ("swaps") which is one of the methods authorized for use in RCW 47.60.830.

2021 Highlights

During fiscal year 2021, the amount contracted through price swaps totaled 9,072,000 gallons¹. This amount was 49 percent of budgeted gallons and 59 percent of consumed gallons.

Of the three swaps executed for fiscal year 2021:

- One swap contract was executed with a price below the Washington five-percent biodiesel (B5) forecast price. For this swap, WSF ultimately received \$960,246 from counterparties.
- Two swaps were executed above the Washington B5 forecasted price but within parameters pre-approved by the Fuel Hedging Oversight Committee. For these swaps, WSF ultimately paid counterparties \$987,689.

The following discussion includes additional information and looks at the program in various ways (including overviews of the program, price swaps executed in fiscal year 2021, market conditions, and financial performance) to review many considerations taken into account when executing the program.

Fuel Hedging Authority, Policy, and Practice

Fuel Hedging Policy and Committee

During fiscal year 2021, the WSDOT ferries division continued a hedging program for the purpose of stabilizing fuel expense. The statutory authority to conduct swaps is provided in RCW 47.60.830 (Ferry system operation—Fuel purchasing strategies) and is emphasized in the ferries section of the State Transportation Budget in authorizing proviso language. This report is required per RCW 47.60.830.

The Secretary of Transportation's Executive Order 1078 provides specific direction for implementing a hedging program². The Executive Order established a Fuel Hedging Oversight Committee ("the Committee") to provide guidance; provides for the use of a hedging consultant to advise on timing, quantities, tenure of hedge contracts; sets maximum hedging limits; and outlines other operating

¹ Please see Attachment A for specifics of each hedge contract entered for fiscal year 2021.

² Please see Attachment B for the full Executive Order.

parameters. The Committee consists of the WSDOT Chief Financial Officer, the Assistant Secretary for WSF, a transportation Budget Assistant to the Governor from the Office of Financial Management, and a representative from the Department of Enterprise Services. The Committee meets to receive periodic updates on the status of the market, swaps in place, and future swap plans, or when a need arises to make a policy decision or to set parameters for the program. The Committee is staffed by the Director of Finance and Administration at WSF and receives advisory input from a consultant.

The hedging policy sets forth limitations within which swaps will be executed in terms of maximum quantities, length of contracts, administrative structure, and consultant assistance. The policy states that the purpose of the hedging program is to seek to decrease the volatility of fuel cost and increase the likelihood that actual net fuel cost will remain below the budgeted cost. The Executive Order establishing the policy was changed in August 2014 to authorize hedge contracts at the discretion of the Assistant Secretary for Ferries, provided that the quantities and length of contract were within limits of the “standard recommendation,” which can change by action of the Committee. In January 2017, it was changed again to remove this authorization for “standard recommendation.” The limits established by the Executive Order as of January 6, 2017 are:

Amount Hedged:

- Up to the first twelve months, on a rolling basis, a maximum of 95 percent of the forecasted consumption may be hedged. In addition, hedges will not exceed the forecasted monthly consumption level for any specific month.
- Between the thirteenth and twenty-fourth months, on a rolling basis, the volume of fuel hedged will not exceed 80 percent.
- In times of extraordinary circumstances, the Oversight Committee may decide to hedge fuel in the twenty-fifth month and beyond, at a maximum ratio to be determined at that time by the committee.
- The Oversight Committee may set lower limits, including in consideration of potential service reductions.

Duration:

- The maximum maturity of any contracts entered in conjunction with the program is twenty-four months. Contract terms may cross biennial lines.
- If extraordinary circumstances warrant longer maximum maturity periods, the Committee may approve hedges that extend the maximum maturity beyond twenty-four months on a case-by-case basis.

Fuel Hedging Practice

Since the Washington State Legislature authorized WSDOT to enter a distributor-controlled fuel hedging program in 2011, the Legislature has expanded the fuel hedging program’s authorization to other methods of hedging approved by the Committee. In fiscal year 2015, the hedging program executed its first financial hedges.

With financial hedges, WSDOT enters futures contracts directly, guaranteeing the fuel price in the financial market at a set date in the future. The hedging program does not involve futures contracts or a

“locked in” forward price for B5 biofuels³. This is because the market for B5 is not “investible” and does not have depth or liquidity comparable to widely traded commodities like gasoline or diesel. Rather, WSDOT employs a derivative security known as a “Swap Contract Agreement,” or swap. The Department and a counterparty (usually an investment bank) agree to swap floating prices on a commodity for a fixed price over a set period. The commodity is Ultra Low Sulfur Diesel (“diesel”) which is traded on the New York Mercantile Exchange (NYMEX) using standardized contracts and priced at New York Harbor. As noted above, for the hedging program, WSF retains the services of a financial advisor to evaluate swaps⁴.

Since the Department enters swaps on the price of diesel at New York Harbor, these swaps do not affect the price that WSDOT pays for its purchases of B10 in Washington State. The only way swaps affect the fuel budget is through their performance. If the price of diesel at New York Harbor goes above the mutually agreed upon fixed price between the WSDOT and a counterparty, the counterparty pays WSDOT the price difference multiplied by the number of contracted gallons. If the price of diesel goes below the contracted price between WSDOT and a counterparty, then the Department pays the counterparty. The net effect of these swap transactions is an addition or subtraction of cash to the fuel account.

In its efforts to mitigate the volatility of fuel costs and provide WSF with greater fuel budget certainty, the Department takes on several risks when executing swap contracts, which may incur costs or financial impacts. Specifically:

- As stated above, if the future price of diesel at New York Harbor falls below the contracted diesel price, the Department pays counterparties a settlement amount.
- Because WSDOT enters swaps based, in part, on forecasted B5 prices in Washington State, there is “tracking risk,” wherein forecasted B5 prices in Washington State do not match well the future prices of diesel at New York Harbor. If there is a mismatch, the Department could pay counterparties a settlement amount.
- There is a timing risk. The Department uses annual average prices from quarterly released B5 price forecasts to help guide whether or not to enter a swap. There are times when the quarterly Washington State B5 price forecast will not have the “best available” information on the future trends of biodiesel or diesel prices. As a result, there could be more risk involved when entering swaps based on forecasts of different commodities (B5 and diesel) and using stale B5 price forecasts to determine the correct time and price to execute swaps. Conversely, it is possible using B5 price forecasts could result in lost swap opportunities if the forecasts are not reflective of an upward market, as forecasts project based on prices from the quarter before the forecast; the Committee has taken steps to mitigate this risk in its review and approval of swap plans.

³ WSF purchases and uses ten-percent biodiesel (B10) throughout its fleet. However, per the contract with its fuel provider, WSF purchases B10 using B5 prices. Therefore, the rest of this document will refer to B5 prices.

⁴ Among other tasks, the financial consultant performs a swap effectiveness test to confirm, essentially, that the swaps are functioning and performing as expected. The results of this test for fiscal year 2021 can be found in Attachment D.

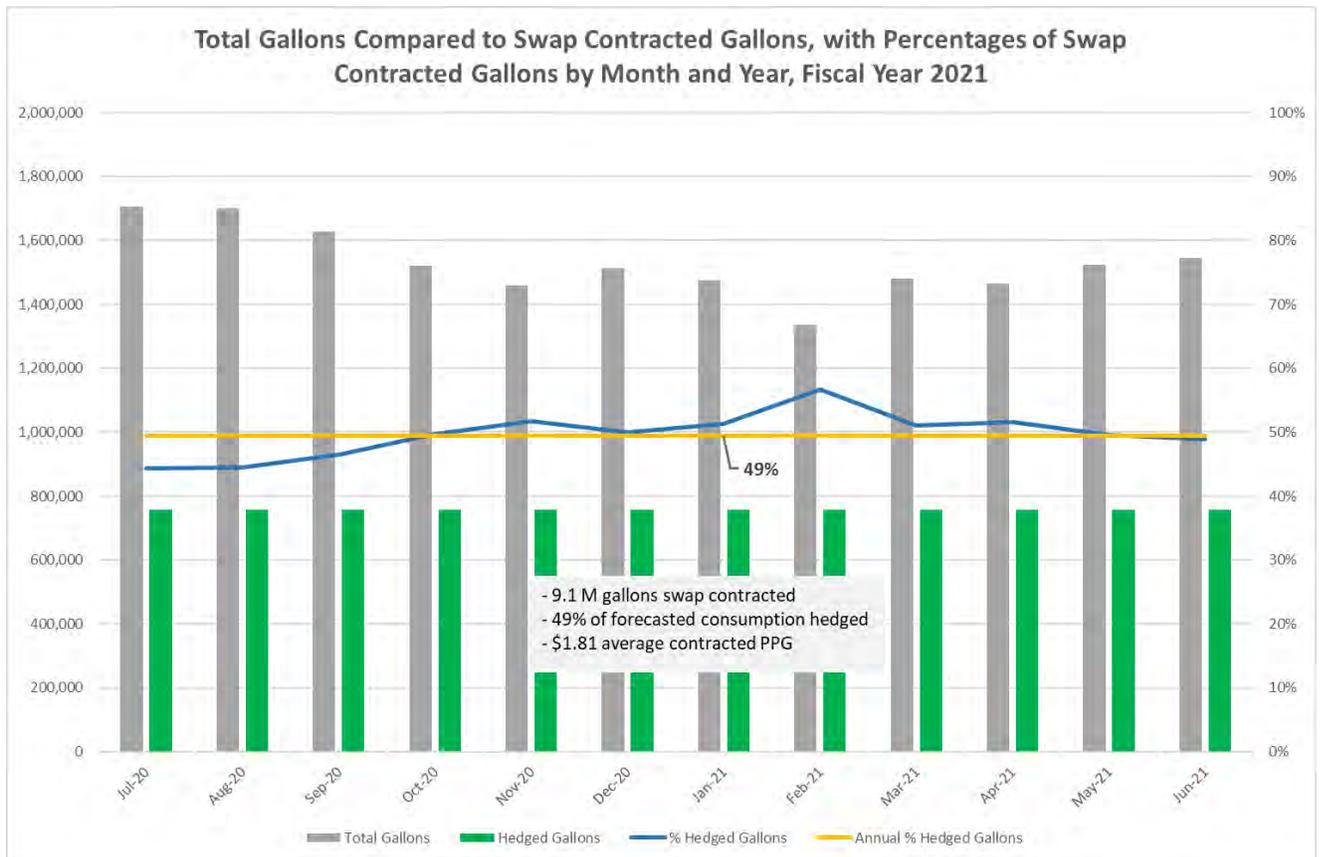
- There is “counterparty risk.” Current swap contracts do not have a guarantee on the trade. If the counterparty defaults, the Department could lose money. The Department is currently entering into agreements with well-established institutions, such as Merrill Lynch, which helps mitigate this risk.

Swaps in Fiscal Year 2021

Fuel Budget Portion Entered in Swaps

For fiscal year 2021, the amount of fuel entered in three swaps totaled 9.1 million gallons, which represents 49 percent of budgeted gallons, or 59 percent of consumed gallons. The average price of the swaps in fiscal year 2021 was \$1.81 per gallon. Each swap had 252,000 gallons contracted per month. This information is summarized in Figure 1, below.

Figure 1



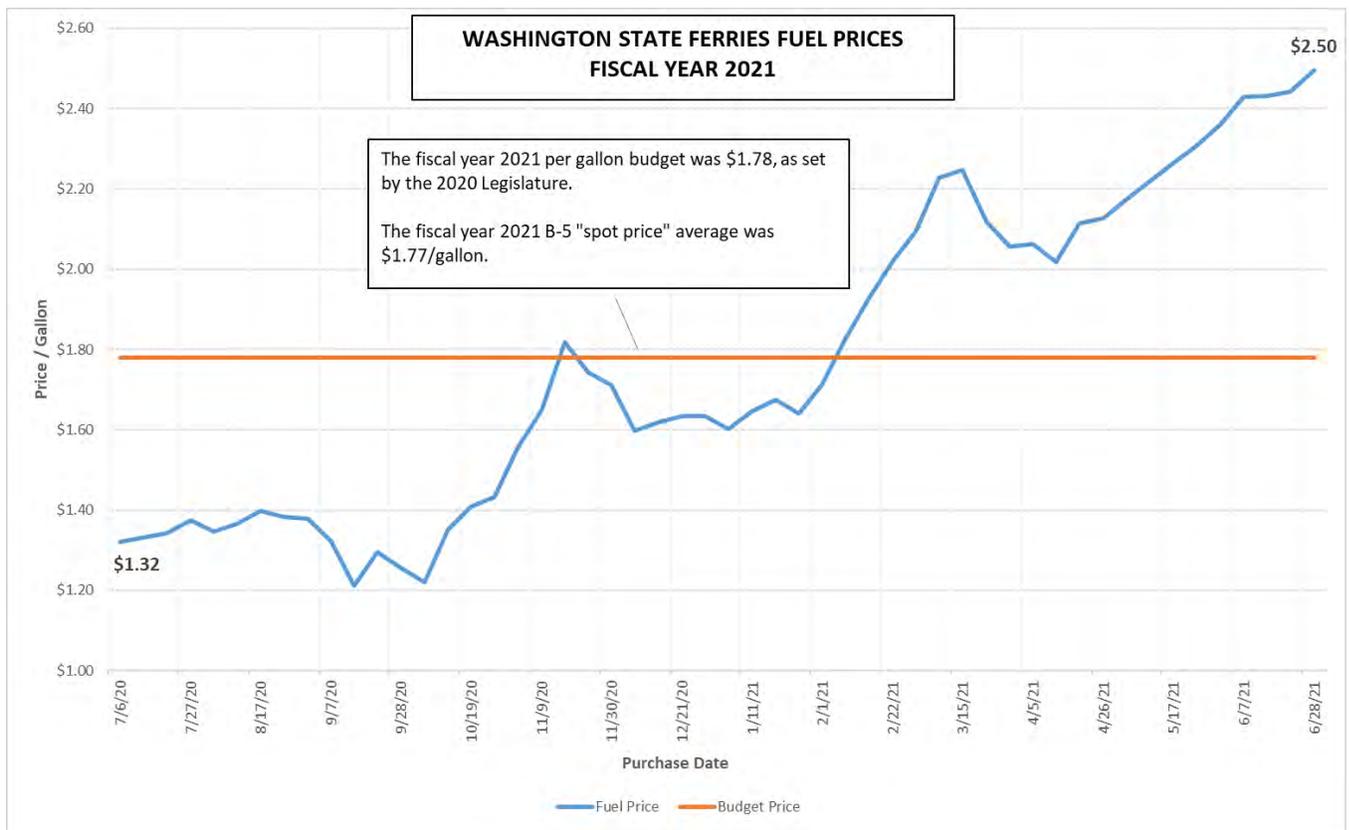
Price History, Fiscal Year 2021

In FY 2021 fuel prices were rising due to the historic lows in fuel price in the year before and continued to rebound throughout the year.

Prices bottomed out in April 2020, with both global petroleum demand and production significantly decreasing as countries and economies constricted amidst the pandemic. After this historic low in price, prices generally increased over the course of fiscal year 2021, rising from around \$1.30 per gallon at the start of the fiscal year 2021 to \$2.50 per gallon, a 92-percent gain, by fiscal year close. At the end of fiscal year 2020, petroleum demand decreased faster than producers could reduce supply, causing global petroleum inventories to increase. As a result, in fiscal year 2021, producers controlled production to steadily reduce inventories and restore market stability. With petroleum demand exceeding supply, prices pushed upward throughout the year, though not as steeply as they could have as a result of OPEC efforts to balance the market.

Figure 2 provides a Washington State B5 price history for fiscal year 2021.

Figure 2



Swaps Compared to B5 Budget and Forecast Prices

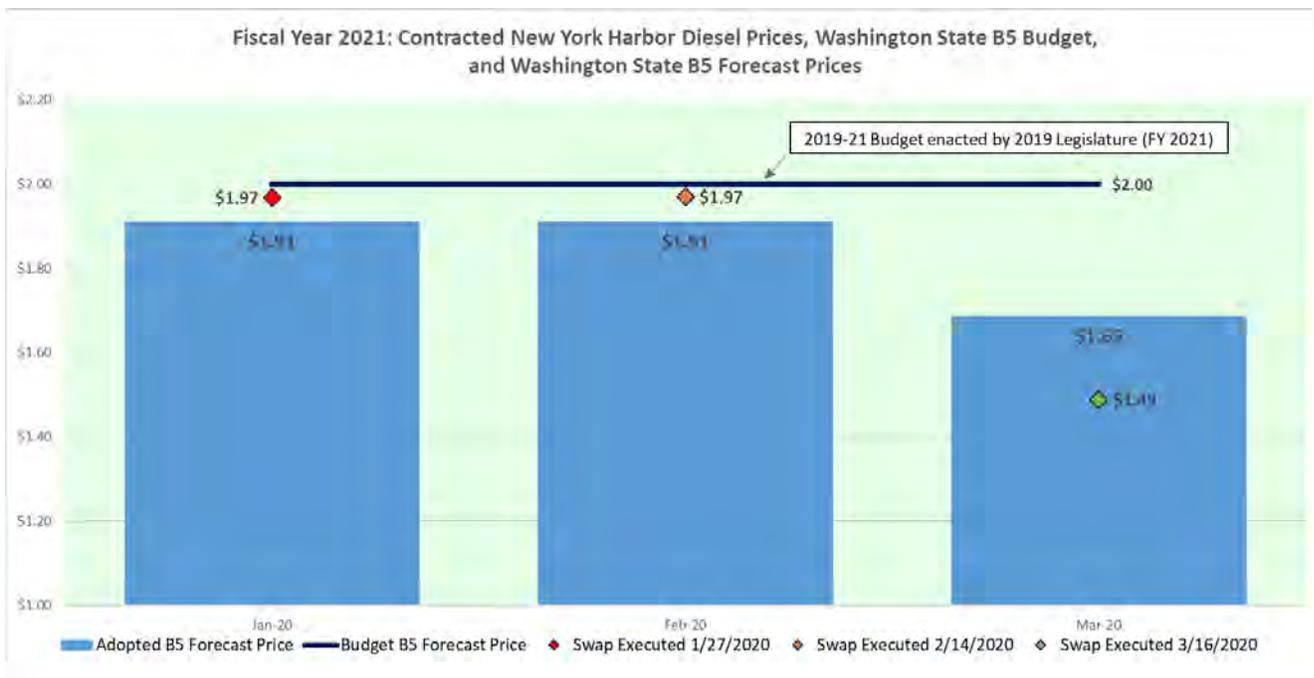
In Figure 3, a horizontal line represents the Washington State B5 forecast price in place for the fiscal year 2021 enacted budget; vertical bars represent the annual B5 price forecasts for fiscal year 2021 in place at the time swaps were executed; and diamond-shaped markers represent the New York Harbor diesel prices at which the swaps were executed. Note that the enacted budget is from the 2019

Legislature. This number is used because that was the budget environment under which WSF, and the Committee, were operating when the three swaps were executed.

For fiscal year 2021, all three swaps were executed before the start of the fiscal year, from January 2020 to March 2020. The first two swaps were put in place prior to the pandemic. Both swaps were below the budget price (\$2.00 per gallon), but above the most recent forecast price for fiscal year 2021 (\$1.91 per gallon from the November 2019 adopted forecast). The third swap at \$1.49 per gallon was executed when the effects of the pandemic were just beginning. This third swap was below both the budget price and the February 2020 forecast price for fiscal year 2021.

All three swaps in fiscal year 2021 were executed within parameters approved by the Committee.

Figure 3



Price Swaps Financial Performance in Fiscal Year 2021

As mentioned previously, the objectives of the WSDOT hedging program are to decrease the volatility of fuel costs and hopefully increase the likelihood that actual net fuel cost will remain below the fuel budget for ferries; price savings is secondary. The two swaps with prices closest to the enacted budget were executed explicitly to provide WSF with greater fuel budget certainty. However, as also noted, there are several risks associated with executing swaps that can result in WSDOT incurring additional costs from its fuel account to pay a counterparty.

Table 1 depicts the payments sent and received by WSF, by month, for the three swaps executed in fiscal year 2021. For fiscal year 2021, after balancing all payments, WSF ultimately paid counterparties \$27,443 for the three swaps. The swaps executed in January and February 2020 had losses of \$492,786

and \$494,903, respectively. The price swap executed in March 2020 gained money (\$960,246) for WSF, offsetting most of the losses of the first two price swaps. Further details on price swap performance can be found in Attachment C.

Table 1

Price Swap	Jul-2020	Aug-2020	Sep-2020	Oct-2020	Nov-2020	Dec-2020	Jan-2021	Feb-2021	Mar-2021	Apr-2021	May-2021	Jun-2021	FY 2021 Total
Swap 1	\$ (121,313)	\$ (120,935)	\$ (149,159)	\$ (143,262)	\$ (118,692)	\$ (68,342)	\$ (35,456)	\$ 16,657	\$ 34,524	\$ 35,960	\$ 76,079	\$ 101,153	\$ (492,786)
Swap 2	\$ (121,489)	\$ (121,111)	\$ (149,335)	\$ (143,438)	\$ (118,868)	\$ (68,519)	\$ (35,633)	\$ 16,481	\$ 34,348	\$ 35,784	\$ 75,902	\$ 100,976	\$ (494,903)
Swap 3	\$ (227)	\$ 151	\$ (28,073)	\$ (22,176)	\$ 2,394	\$ 52,744	\$ 85,630	\$ 137,743	\$ 155,610	\$ 157,046	\$ 197,165	\$ 222,239	\$ 960,246
FY 2021 Total	\$ (243,029)	\$ (241,895)	\$ (326,567)	\$ (308,876)	\$ (235,166)	\$ (84,118)	\$ 14,540	\$ 170,881	\$ 224,482	\$ 228,791	\$ 349,146	\$ 424,368	\$ (27,443)

Fuel Consumption – Fiscal Year 2021

Fuel Consumption and Efficiencies

In April 2018, the WSF Operational Efficiency Working Group introduced a directive to reduce maximum speeds for vessels. This directive is intended to encourage fuel savings and decrease CO₂ emissions as part of WSF’s ongoing efforts to transition to a zero-carbon-emission ferry fleet, as mandated by Governor Inslee’s Executive Order 18-01. Due in part to this identified efficiency, WSF fuel consumption was 162,859 gallons below budget for fiscal year 2019.

For fiscal year 2020, WSF consumed 17,102,927 gallons, or 1,779,423 gallons below budgeted gallons. This consumption underrun was primarily due to pandemic-related service reductions implemented by WSF at the end of March 2020. These service reductions continued into fiscal year 2021. While some service was gradually restored, pandemic-related service reductions, and limited crew availability because of the pandemic, resulted in WSF consuming 15,391,626 gallons, or 2,954,912 gallons below budgeted gallons.

Table 2

WSF X PROGRAM AUTO FERRY FUEL CONSUMPTION -- BUDGETED VS. ACTUAL

	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	FY21 Totals
Budgeted Gallons	1,704,282	1,699,654	1,626,725	1,520,084	1,460,185	1,511,843	1,474,172	1,334,688	1,481,726	1,464,567	1,523,710	1,544,902	18,346,538
Actual Gallons	1,109,012	1,071,742	1,249,198	1,225,497	1,370,602	1,450,025	1,392,318	1,215,960	1,392,695	1,280,569	1,358,617	1,275,391	15,391,626
Variance	595,270	627,912	377,527	294,587	89,583	61,818	81,854	118,728	89,031	183,998	165,093	269,511	2,954,912
Percent Variance	34.9%	36.9%	23.2%	19.4%	6.1%	4.1%	5.6%	8.9%	6.0%	12.6%	10.8%	17.4%	16.1%

Fiscal Year 2021 Swap Contracts

	Swap #29 Executed 1/27/2020 FY2021		Swap #30 Executed 2/14/2020 FY2021		Swap #31 Executed 3/16/2020 FY2021	
	Gallons	Price	Gallons	Price	Gallons	Price
7/1/2020	252,000	1.969	252,000	1.9697	252,000	1.4885
8/1/2020	252,000	1.969	252,000	1.9697	252,000	1.4885
9/1/2020	252,000	1.969	252,000	1.9697	252,000	1.4885
10/1/2020	252,000	1.969	252,000	1.9697	252,000	1.4885
11/1/2020	252,000	1.969	252,000	1.9697	252,000	1.4885
12/1/2020	252,000	1.969	252,000	1.9697	252,000	1.4885
1/1/2021	252,000	1.969	252,000	1.9697	252,000	1.4885
2/1/2021	252,000	1.969	252,000	1.9697	252,000	1.4885
3/1/2021	252,000	1.969	252,000	1.9697	252,000	1.4885
4/1/2021	252,000	1.969	252,000	1.9697	252,000	1.4885
5/1/2021	252,000	1.969	252,000	1.9697	252,000	1.4885
6/1/2021	252,000	1.969	252,000	1.9697	252,000	1.4885
	<u>3,024,000</u>		<u>3,024,000</u>		<u>3,024,000</u>	

Note: Hedges for fiscal year 2021 were executed in fiscal year 2020.

Swaps #29, #30, and #31 Executed 1/27/2020, 2/14/2020, 3/16/2020						
	Average	Budgeted		Contracted Gallons	Contracted Gallons	
	Contracted Gallons	Price	Gallons	Consumed Gallons	% of Budget	% of Consumed
7/1/2020	756,000	\$1.81	1,704,282	1,109,012	44%	68%
8/1/2020	756,000	\$1.81	1,699,654	1,071,742	44%	71%
9/1/2020	756,000	\$1.81	1,626,725	1,249,198	46%	61%
10/1/2020	756,000	\$1.81	1,520,084	1,249,198	50%	61%
11/1/2020	756,000	\$1.81	1,460,185	1,370,602	52%	55%
12/1/2020	756,000	\$1.81	1,511,843	1,450,025	50%	52%
1/1/2021	756,000	\$1.81	1,474,172	1,392,318	51%	54%
2/1/2021	756,000	\$1.81	1,334,688	1,215,960	57%	62%
3/1/2021	756,000	\$1.81	1,481,726	1,392,695	51%	54%
4/1/2021	756,000	\$1.81	1,464,567	1,280,569	52%	59%
5/1/2021	756,000	\$1.81	1,523,710	1,358,617	50%	56%
6/1/2021	756,000	\$1.81	1,544,902	1,275,391	49%	59%
	<u>9,072,000</u>		<u>18,346,538</u>	<u>15,415,327</u>	<u>49%</u>	<u>59%</u>

Source: Budget Office, Washington State Ferries



**Washington State
Department of Transportation**

**Secretary's Executive Order
Number: E 1078.06**

Signature on file

Roger Millar, PE, AICP
Secretary of Transportation

January 6, 2017

Date

Fuel Hedging Program

I. Introduction

A. Purpose

This Secretary's Executive Order informs employees how to administer fuel hedging in the Ferries Division.

B. Background

In 2011 the Washington State Legislature authorized the Washington State Department of Transportation (WSDOT) to enter into a distributor-controlled fuel hedging program for the biennium of 2011-13. In 2012 the Legislature expanded this authorization to include other methods of hedging approved by the fuel hedging committee. The department is required to consult with the Department of Enterprise Services' Master Contracts and Consulting Program on strategies to reduce the overall cost of fuel and mitigate the impact of market fluctuations and pressure on short-term and long-term fuel costs to the Ferries Division.

C. Definitions

Forward Pricing Period – The term of any fuel hedging contract.

Fuel Hedging – A contractual tool used to reduce exposure to volatile and potentially rising fuel costs. Fuel hedging results in price stability, not necessarily budget savings.

Fuel Hedging Program – The fuel price risk management program.

Hedge Ratio – The ratio of hedged fuel compared to total fuel purchases projected for a certain period of time.

Maximum Maturity – The maximum length of time that a fuel price contract may be extended.

D. Supersession

This Secretary's Executive Order supersedes and replaces the prior version with the same title dated January 14, 2016. All references to the superseded E 1078.05 now reference E 1078.06.

E. What Has Changed

- Language was added to subsection III.B. to allow Fuel Hedging Oversight Committee members to appoint a designee to receive recommendations and take action on potential hedges in their absence.
- The Standard Recommendation and Appendix A and all of their references have been removed.

II. Secretary's Executive Order

The Assistant Secretary for the Ferries Division or designee is directed to establish and maintain a fuel hedging program with the primary purpose of managing price risk on fuel used by the Ferries Division. The fuel hedging program will be carried out by the Ferries Division, executing the appropriate transactions at the appropriate times and prices to create the desired effect within policy constraints.

The objectives of the fuel hedging program are to:

- Decrease the volatility of fuel cost.
- Increase the likelihood that actual net fuel cost will remain below the budgeted cost.

Immediate cost savings is secondary to managing overall price risk.

Specific fuel hedging program strategies may include:

- Entering into financial contracts with hedge providers for specific quantities of fuel at specific times, using a specific index.
- Using price contracts with fuel distributors for quantities to be delivered at fixed times.
- Mitigating transaction timing risk by making numerous small volume transactions as opposed to large transactions at a single point in time.
- Continually monitoring the market and assessing program effectiveness.
- Addressing market opportunities and market risks based upon budget goals.

III. Policy

A. Program Administered by Ferries Division

The Assistant Secretary for the Ferries Division is responsible for administration of the fuel hedging program. The Assistant Secretary or designee may enter into hedge contracts that meet the Oversight Committee's approval.

B. Fuel Hedging Oversight Committee

The Fuel Hedging Oversight Committee shall meet at least quarterly, and includes the Assistant Secretary for the Ferries Division, the Chief Financial Officer, and a representative from the Office of Financial Management (OFM).

The committee provides recommendations to the Assistant Secretary for the Ferries Division regarding hedge contracts. The committee reviews reports from Ferries Division staff and directs Ferries Division staff to provide information on program operations.

Ferries Division staff coordinates times, locations, and agendas for the committee. The committee reviews performance reports and policy and strategy recommendations from Ferries Division staff. The committee directs Ferries Division staff to provide additional information on program operations.

Hedge committee members may each appoint a designee to receive recommendations and take action on potential hedges in their absence.

C. Fuel Hedging Program Advisor (Consultant)

The Fuel Hedging Program Advisor is selected by the department through a competitive process and will:

- Provide contracted services for a time period established by the department.
- Recommend an execution strategy.
- Generate monthly reports on the program's status and results.
- Monitor the program and energy markets.

The costs associated with the program advisor consultant position will be budgeted and accounted for separately from fuel purchases, but will be considered as part of Ferries Division's fuel budget.

D. Qualified Independent Representative

The Assistant Secretary for the Ferries Division or designee will designate one or more persons or entities that represent or otherwise demonstrate that they meet the requirements of a qualified independent representative as set forth in Title 17 Code of Federal Regulations (CFR) [§23.450\(b\)\(1\)](#) adopted by the Commodity Futures Trading Commission (CFTC) under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Ferries Division staff will review at the time of each fuel hedge transaction whether the persons or entities continue to represent or otherwise demonstrate that they meet these requirements. These requirements may be satisfied through representations or other evidence that the qualified independent representative (which may be the Fuel Hedging Advisor to the extent the Fuel Hedging Program Advisor provides these representations or other evidence):

- Has undertaken a duty to act in the best interests of the Ferries Division.

- Has sufficient knowledge and capability to independently evaluate Fuel Hedging.
- Has appropriate risk management and valuation policies and procedures under which the representative evaluates risks with regard to the relevant trade or trading strategy involving Fuel Hedging and the fair pricing and appropriateness of Fuel Hedging transactions.
- Has conflict of interest policies and procedures reasonably designed to manage and mitigate material conflicts of interest.
- Provides appropriate and timely disclosures to the Ferries Division, including disclosure of all material conflicts of interest that could reasonably affect the judgment or decision-making of the representative with respect to its obligations to the Ferries Division.
- Is independent of counterparties to Fuel Hedging transactions, and agrees to comply with restrictions on political contributions (if and when imposed by the CFTC).

E. Maximum Hedge Ratio

Ferries Division fuel consumption is highly predictable and without significant variability over time within a given service, schedule, and fleet. Given this predictability, the maximum hedge ratio will be:

- Up to the first twelve months, on a rolling basis, a maximum of 95 percent of the forecasted consumption may be hedged. In addition, hedges will not exceed the forecasted monthly consumption level for any specific month.
- Between the thirteenth and twenty-fourth months, on a rolling basis, the volume of fuel hedged will not exceed 80 percent.
- In times of extraordinary circumstances, the Oversight Committee may decide to hedge fuel in the twenty-fifth month and beyond, at a maximum ratio to be determined at that time by the committee.
- The Oversight Committee may set lower limits, including in consideration of potential service reductions.

F. Biodiesel Hedging

Hedge ratios may be adjusted if Ferries Division's planned percentage of biodiesel changes significantly from a level of five percent, or if the price correlation between diesel and biodiesel diverges more than five percent from its historical average.

G. Maximum Maturity

To allow the establishment of cost certainty in current and future budget periods, the maximum maturity of any contracts entered into in conjunction with the program is twenty-four months. If extraordinary circumstances warrant longer maximum maturity periods, the Oversight Committee may approve hedges that extend the maximum maturity beyond twenty-four months on a case-by-case basis. Contract terms may cross biennial lines.

H. Physical Fuel Supply

The physical supply of fuel will continue according to the current process of Ferries Division under the Department of Enterprise Services contract. The physical supply price is based on the Oil Price Information Service (OPIS) index for ultra-low sulfur diesel for Tacoma and Anacortes, with taxes and other costs determined by the supply contract.

I. Reporting Responsibilities

1. Ferries Division staff, along with the Program Advisor, will:
 - a. Generate for the Assistant Secretary for the Ferries Division semiannual updates on the status and results of the Program. These updates will include:
 - The cost of fuel as delivered by the fuel supplier compared to prices that would have been available on the spot market.
 - Year to date and biennium to date performance of fuel expenses relative to the budget (including hedged purchases).
 - Any recommendations for changes in policy or strategy. These will also be reported by the Assistant Secretary for the Ferries Division to the Deputy Secretary for concurrence.
 - b. Compile annual reports. Periodic reports are required per Revised Code of Washington [\(RCW\) 47.60.830](#). The reports will be distributed to the Oversight Committee prior to submittal to the state legislature and the Department of Enterprise Services.
 - c. Generate for the Fuel Hedging Oversight Committee quarterly updates on the status and results of the Program. These updates will include:
 - Details of hedge contracts entered into to include the transaction amount, gallons hedged, transaction price per gallon, variance between transaction price per gallon and budgeted price per gallon, and variance between transaction amount and budgeted amount.
 - Comparison of projected fuel usage and actual fuel usage in gallons.
 - Current energy market conditions.
2. Accounting and Financial Services Division staff will:
 - a. Review the accounting and financial reporting for derivative instruments for compliance with Governmental Accounting Standards Board (GASB) standards.
 - b. Make appropriate entries to record deferred inflows and outflows of resources related to financial contracts.
 - c. Prepare notes to the Comprehensive Annual Financial Report (CAFR) for financial hedging contracts as required by GASB 53.

Contact for More Information

For more information on the Fuel Hedging Program, please contact the Director of Finance and Administration of the Ferries Division at 206-515-3403.

References

- [17 CFR §23.450\(b\)\(1\)](#) *Requirements for swap dealers and major swap participants acting as counterparties to Special Entities*
- [RCW 47.60.830](#) *Ferry system operation — Fuel purchasing strategies — Report*

Review and Update Requirements

When changes are necessary to update this document, inform the Chief Financial Officer. The Chief Financial Officer periodically reviews this document and proposes updates to the Secretary of Transportation for approval.

Americans with Disabilities Act (ADA) Information

This material can be made available in an alternate format by emailing the Office of Equal Opportunity at wslotada@wsdot.wa.gov or by calling toll free, 855-362-4ADA(4232). Persons who are deaf or hard of hearing may make a request by calling the Washington State Relay at 711.

Attachment C

Fiscal Year 2021 Monthly Reconciliation of Fuel Price Swaps

Monthly Market Compared to Contract - Amount of Money Received or Paid to Counterparties														
Counterparty/Date of Contract	Contract Price (\$/gallon)	Jul-2020	Aug-2020	Sep-2020	Oct-2020	Nov-2020	Dec-2020	Jan-2021	Feb-2021	Mar-2021	Apr-2021	May-2021	Jun-2021	Total
Merrill Lynch (Jan. 27, 2020)	\$1.72	\$ (121,313)	\$ (120,935)	\$ (149,159)	\$ (143,262)	\$ (118,692)	\$ (68,342)	\$ (35,456)	\$ 16,657	\$ 34,524	\$ 35,960	\$ 76,079	\$ 101,153	\$ (492,786)
Merrill Lynch (Feb. 14, 2020)	\$1.72	\$ (121,489)	\$ (121,111)	\$ (149,335)	\$ (143,438)	\$ (118,868)	\$ (68,519)	\$ (35,633)	\$ 16,481	\$ 34,348	\$ 35,784	\$ 75,902	\$ 100,976	\$ (494,903)
Merrill Lynch (March 16, 2020)	\$1.24	\$ (227)	\$ 151	\$ (28,073)	\$ (22,176)	\$ 2,394	\$ 52,744	\$ 85,630	\$ 137,743	\$ 155,610	\$ 157,046	\$ 197,165	\$ 222,239	\$ 960,246
Grand Total Difference (\$)		\$ (243,029)	\$ (241,895)	\$ (326,567)	\$ (308,876)	\$ (235,166)	\$ (84,118)	\$ 14,540	\$ 170,881	\$ 224,482	\$ 228,791	\$ 349,146	\$ 424,368	\$ (27,443)

Source: WSDOT - Accounting

Referenced Market: New York Mercantile Exchange (NYMEX)

Commodity: Ultra Low Sulfur Diesel Heating Fuel

Terms: 252,000 gallons per month

Price Swap and Price Differential Effectiveness Test

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The hedge effectiveness test is established by Government Accounting Standards Board Statement No. 53 (GASB 53) and serves to ensure that the hedging activity of a governmental or public entity is producing the desired effect which, in this case, is to offset increases and decreases in diesel fuel costs in order to make future diesel costs more certain and manage fuel budget risk. 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.

Although the regression analysis for the hedge effectiveness test is prepared by the hedging consultant, the department ensures that the results fall within the acceptable categories of an effective hedge.

The test is performed to ensure that the hedge is operating and performing as expected and desired. Generally speaking, the test is to answer the question, "is the hedge doing what it should be doing and what it was expected to do?" If the test determines that the hedge is effective, the department can include the results of the hedging activity on its income statement as an element of cost of the hedged item, in this case diesel fuel. When the hedge is effective and there are hedge gains, this is accounted for as a negative fuel cost. When there are hedge losses, positive fuel cost. If there were a situation where the hedge were determined to be not effective, then, according to GASB 53, the financial effects of the hedge could not be included in the income statement and would have to be accounted for as a change in asset value on the balance sheet. This is an extremely remote possibility for WSF.

The hedge effectiveness test is performed quarterly and is included in annual financial statements.

Hedge effectiveness analysis for the three years ending June 30, 2021, shows that the department's hedges fall within the acceptable tolerance level. The data analysis compared WSF average fuel cost per gallon on a monthly basis to the monthly average settlement price for the nearest diesel fuel futures contract which is the index upon which WSF hedges are based.

The WSF statistical results for FY 2021, compared to GASB 53 rules:

- The R-squared statistic must be greater than 0.8000 and the WSF result is 0.9236.
- The regression slope must be between -0.80 and -1.25 and the WSF result is -0.9887.
- The F-statistic must be significant within a 95 percent confidence interval, which it is.

With these statistical tests, WSF hedging is effective, according to GASB 53 rules.

The current three-year average differential between WSF diesel cost per gallon and diesel futures price per gallon (fiscal year 2019 – fiscal year 2021) is now \$0.2859 per gallon, compared to the previous three-year differential (fiscal year 2018 – fiscal year 2020) of \$0.2675.