



Report to: General Committee

Report Date: May 2, 2011

SUBJECT: 2010 Hedging Contract Results
PREPARED BY: Mark Visser,
Senior Manager, Financial Strategy & Investments

RECOMMENDATION:

- 1) THAT the report dated May 2, 2011 entitled “2010 Hedging Contract Results” be received.
- 2) And that Staff be authorized and directed to do all things necessary to give effect to this resolution.

EXECUTIVE SUMMARY:

Not applicable

PURPOSE:

Pursuant to Regulation 653/05 Section 7, the Municipal Act requires the Treasurer to prepare and present to the municipal council, once in that fiscal year, a detailed report of all commodity price hedging agreements.

BACKGROUND:

In December 2007, Council approved an “Electricity Procurement Strategy for the Corporation of the Town of Markham” that was brought forward by the Markham Energy Conservation Office with assistance from Wattsworth Consulting. The strategy involved altering the way the Town purchases electricity in an attempt to lower total costs and minimize financial risk.

As part of the strategy, Wattsworth Consulting recommended entering into a hedging contract to minimize potential risk of spot market price fluctuations and to ensure that Town accounts would be removed from the more costly Regulated Price Plan (RPP) that the Province had in place at the time for municipalities (this was eliminated in November 2009).

A hedge is merely a financial agreement that fixes the price to be paid by the municipality for the future delivery of a commodity. A hedge is typically used to reduce cost fluctuations and provide cost certainty. The Town agreed to hedge approximately 10% of its total electricity requirements as most of the Town’s electricity purchases are at a fixed amount or demand patterns dictate another strategy (i.e. street lights are kept on the spot market because of low non-peak rates).

OPTIONS/ DISCUSSION:

In 2010, the total savings of the Electricity Procurement Strategy were \$255,000. Because each of the Town's electricity accounts (approximately 150) is different, the overall strategy identifies the optimal procurement method for each account based on consumption patterns. Currently, part of this strategy involves hedging for future electricity usage. In 2009, the Town extended the Electricity Procurement Strategy and Wattsworth purchased hedges on behalf of the Town through to April 2011. The net cost of the hedge in 2010 was \$55,000, which is incorporated into the \$255,000 net savings. The details are as follows:

Volume of Hedging Contract = 3,026 MWh (Megawatt Hours)
Average Dollar Amount of Hedging Contracts = \$62.62 per MWh
Average On-Peak Spot Market Price = \$44.41 per MWh
Cost of Hedge (and billing fees) = \$55,000 $[3,026 * (\$62.62 - \$44.41)]$

Since the Town started with the Wattsworth Procurement Strategy in 2008, the total savings (as compared to the previous procurement methodologies) have been \$834,000 (rate related savings of \$993,000 less hedging costs of \$159,000)

As the Town only hedges a small portion of its electricity procurement, the cost certainty that it provides has been minimal. Furthermore, hedging has cost the Town money in each of the three years of the program. Therefore, based on the past hedging results (cost of \$159,000 over the past 3 years) and advice from Wattsworth, staff have decided not to continue with purchasing hedge contracts for electricity procurement in the near future.

FINANCIAL CONSIDERATIONS AND TEMPLATE: (external link)

ENVIRONMENTAL CONSIDERATIONS:

Not Applicable

ACCESSIBILITY CONSIDERATIONS:

Not Applicable

ENGAGE 21ST CONSIDERATIONS:

Not Applicable

BUSINESS UNITS CONSULTED AND AFFECTED:

Not Applicable

RECOMMENDED BY:

21/04/2011

21/04/2011

X 

Joel Lustig
Treasurer

X 

Andy Taylor
Commissioner, Corporate Services