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DATE: 16 June 2000

TO/DEST: Transit Services Committee

FROM/EXP: General Manager

SUBJECT/OBJET: **DIESEL FUEL PRICES**

DEPARTMENTAL RECOMMENDATION

That the Transit Services Committee receive this report for information.

BACKGROUND

OC Transpo's 2000 approved budget for diesel fuel is \$13.7 million and is based on expected consumption of 31.5 million litres at an average cost (excluding taxes) of 24.00 cents per litre. To the end of May, 2000 the actual average diesel fuel price was 33.25 cents per litre and fuel costs are \$1.1 million greater than budget for the same period.

Fuel prices at December 31 over the last five years have been as follows:

Year	1995	1996	1997	1998	1999
Cents/litre	25.27	28.67	23.95	21.00	30.37

In 1999, with crude oil at \$12 US per barrel, the oil exporting countries (OPEC) agreed to cut back oil production by 4.3 million barrels per day - estimated to be 6% of daily global output - in order to increase the price to a stated objective of \$28 US per barrel. Since then, the price of oil has risen steadily. At its March, 2000 meeting, with a market price of \$34 per barrel, OPEC countries agreed to increase daily production by 1.7 million litres in order to reach the \$28 target. It was also agreed to institute a 20-day pricing band strategy that would either increase production by 500,000 barrels of oil a day if the price average for a 20 day period remained above the \$28 level or decrease production by 500,000 barrels a day if it remained below \$22.

Prices initially plummeted after the March meeting by 30 per cent to under \$25 a barrel, but fuel supply problems, particularly in the United States, helped push crude prices back up. The current high prices for distillate products which includes diesel fuel are also a result of a first quarter 2000 cold spell which drew down crude inventory levels. These inventories were already low with the reluctance by the refiners in mid-1999 to buy crude at the then current world prices. Production of crude oil and refined product demand has been un-synchronized since then causing volatility in the downstream market as distillate production moved seasonally into gasoline

production. This volatility will persist into late 2000 when it is expected that inventory will be brought into line with seasonal build demands. It is hoped that this will have a stabilizing effect on prices at that time.

OPEC countries are meeting again at the end of June and there is indication that an agreement will be reached to further increase oil production to stem the recent runup in oil prices. Should this occur, it is anticipated that prices should stabilize at around \$28 a barrel. It is expected that the pricing band strategy adopted at the March meeting or a similarly aimed strategy will be implemented as prices to date have still not moderated. The existence of the strategy also indicates an intent by OPEC to control prices for the foreseeable future.

As prices have risen because of restricted supply, OPEC members have, on previous occasions, broken ranks and taken advantage of the rising prices by producing more oil which has, in turn, sent prices lower. This has not happened during this cutback but may become a moderating force in 2001.

With the expected stabilization in oil prices, it is anticipated that OC Transpo will pay an average of 31 cents per litre for the remaining months in 2000 compared with a budget of 24 cents which will result in an annual budget over-run of approximately \$2.3 million in 2000.

FUNDING

At 1999 year-end OC Transpo's Diesel Fuel Price Stabilization Reserve Fund had a balance of \$1.0 million. As well, the Transit Fund had a surplus of \$6.6 million at 1999 year-end. On 6 June 2000, the Corporate Services and Economic Development Committee reviewed a report on the 1999 Audited Operating Results that recommended contributing the \$6.6 million surplus to the Transit Capital Reserve Fund in accordance with policy.

The report also advised that staff have recently performed an analysis of the current volatility in diesel fuel prices and are developing a detailed policy report to Council on the Fuel Price Stabilization Reserve Fund requirements at OC Transpo. It was indicated that this report to Council may recommend that a portion of the surplus contribution to the Transit capital Reserve Fund be redirected to the Fuel Price Stabilization Fund.

Should this recommendation receive Council approval, funding for the 2000 budget over-run in diesel fuel could be funded from available reserve balances.

A diesel fuel reserve provision of \$2 million was made in the 2000 budget to fund the impact of increasing the average annual fuel price to 24 cents compared with the 1999 budget of 18 cents.

When combined with the expected \$2.3 million cost over-run in 2000, the net requirement for the 2001 budget will be an increase of more than \$4 million to fund escalating diesel fuel costs.

The long-range plan for public transit calls for service hours to increase 23% over the next ten years. Diesel fuel consumption will increase accordingly over this horizon from a 2000 annual rate of 31.5 million litres to a 2010 estimate of 38 million litres. At current prices, the annual cost of diesel fuel will require a net requirement increase of more than \$7 million over the next ten years compared with the 2000 budget. These diesel fuel funding issues will be addressed in the detailed policy report to Council.

*Approved by
Gordon Diamond*