UNIVERSITY OF ILLINOIS
URBANA-CHAMPAIGN • CHICAGO • SPRINGFIELD

Natural Gas Procurement Program

Status Report to the Board of Trustees

September 10, 2009

Natural Gas Procurement Program

OVERVIEW

At the September 2008 meeting of the Board of Trustees, Walter Knorr, Vice President/Chief Financial Officer and Comptroller, presented and received approval of the Natural Gas Cost Management Policy. Among other things, the policy authorized natural gas purchases for fiscal years 2010 and 2011, with certain restrictions. At its March 2009 meeting, the Board approved the Energy Cost Management Policy to replace the Natural Gas Cost Management Policy. The new policy expanded purchasing authority to include other energy commodities (electricity and coal) and expanded the timeframe to a rolling three-year period.

A strategy for procuring natural gas within the policy framework was developed with assistance from our external advisors, Nicor Enerchange and Larry Altenbaumer. The purpose of the strategy is to provide budget certainty and to dampen the impacts of market volatility for the period 2009 through 2012.

The strategy has two primary components - (i) a rolling 36-month series of regularly timed purchases, and (ii) an opportunistic purchase program based on aggressive pricing targets.

i. The rolling program is designed to even out over time the University's exposure to the spot market and the risk of price spikes; it functions similarly to a "dollar-cost averaging" investment strategy.

ii. The opportunistic purchases program incorporates a capability to increase purchases for a particular period. Consideration is based on variances between currently available market pricing and the established budgeted target price coupled with consideration of levels of actual committed purchases relative to target purchase commitments levels for the specified period.

PROGRESS TO DATE

Significant progress has been made in securing natural gas at a fixed price for fiscal years 2010-2012. All transactions have been reviewed by the *Energy Cost Management Committee* ("Committee") and were executed using forward fixed-price purchase contracts with Nicor Enerchange. No futures contracts or other derivative products were employed.

FORWARD PURCHASE SUMMARY

Through August 15, 2009	FY2009[1]	FY2010[4]	FY2011	FY2012
Volume Requirement (MMBTU)	5,765,821	5,174,946	5,440,865	5,440,865
Volumes Committed To Date (MMBTU)	5,189,240	4,958,798	4,782,165	1,121,002
Percent Committed Volumes (%)	90%	95%	91%	23%
Budgeted Landed Price [2,3] ($/MMBTU)	$10.44	$7.43	$7.43	$7.43
Landed Price for Committed Volumes[2] ($/MMBTU)	$9.59	$7.91	$7.39	$7.38

1. *FY2009 forward purchase program does not include July.*
2. *Landed Price = field price + basis + Nicor Enerchange fee + NGPL fees.*
3. *For purposes of this summary, "Budgeted Landed Price" for fiscal years 2011 and 2012 reflects budgeted pricing equal to fiscal year 2010 budgeted price.*
4. *Beginning in FY2010, the Volume Requirement was based on Must-Run gas (gas required to meet the campus steam load only).*

BACKGROUND ON SUPPLIERS

Supply and transportation is provided by two firms as outlined below.

- **Supply –** the forward purchase contracts for natural gas are with Nicor Enerchange, who stands between the University and the originating field suppliers. Nicor Enerchange is contractually responsible for covering damages if it fails to deliver the nominated amount of gas to the University's specified delivery points. Nicor Enerchange is owned by Nicor, Inc.

- **Transportation –** the natural gas is transported between the gas fields and the University by Natural Gas Pipeline Company of America (“NGPL”). NGPL is a subsidiary of Kinder Morgan and owns in whole or in part over 10,000 miles of interstate pipelines.

FEES

Nicor Enerchange provides the University market advice, transaction execution, analytical and other services under an existing agreement that runs through June 2012. It also acts as the University’s agent in procuring natural gas. Nicor Enerchange charges the University 2.50¢ / MMBTU for providing these services. Based on fiscal year 2009 annual consumption of approximately 6.3 million MMBTU, the annual fee for providing a broad scope of services is approximately $175,000.

NGPL provides natural gas transportation services to the University. NGPL has a variety of charges that typically are in the range of 60¢ to 70¢ / MMBTU.

GOING FORWARD

An RFP for gas supply was issued on July 16, 2009, via Prairieland Energy, a University Related Organization. The RFP was sent to 16 companies. Three companies provided responses to the RFP. They were NICOR Enerchange, BP Canada and Energy USA. On all of the criteria specified in the RFP, NICOR came out equal to or better than the other two responders.

GRAPHICAL ANALYSIS

A graphical analysis of FY09-FY10 activity is attached. FY11-FY12 activity is minimal and is reported in the above chart.

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FY2009 Graphical Analysis

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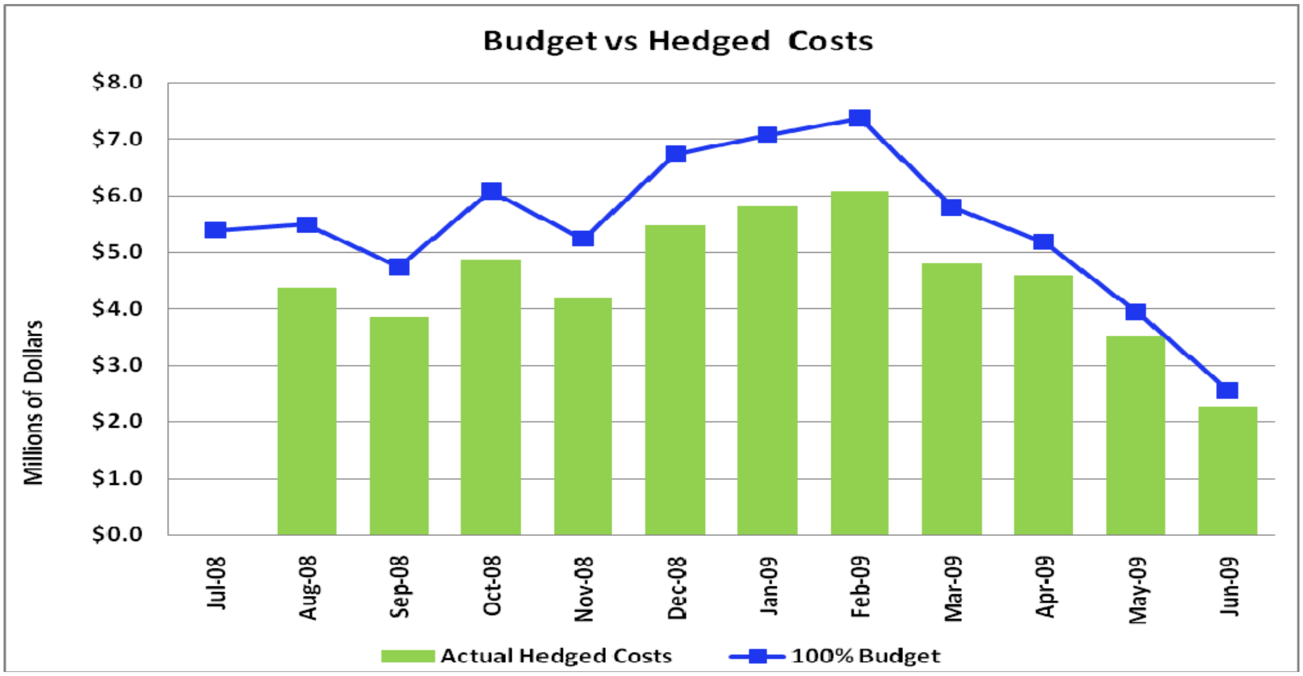
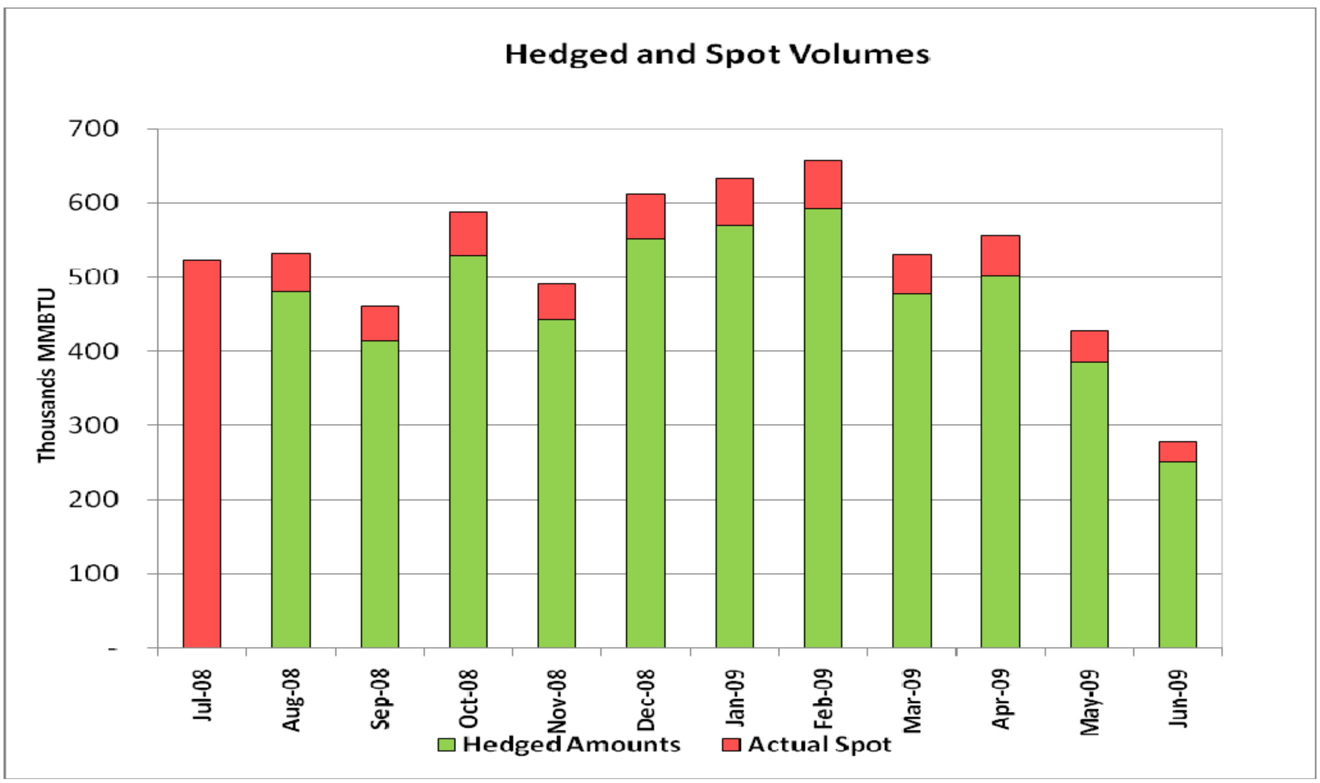
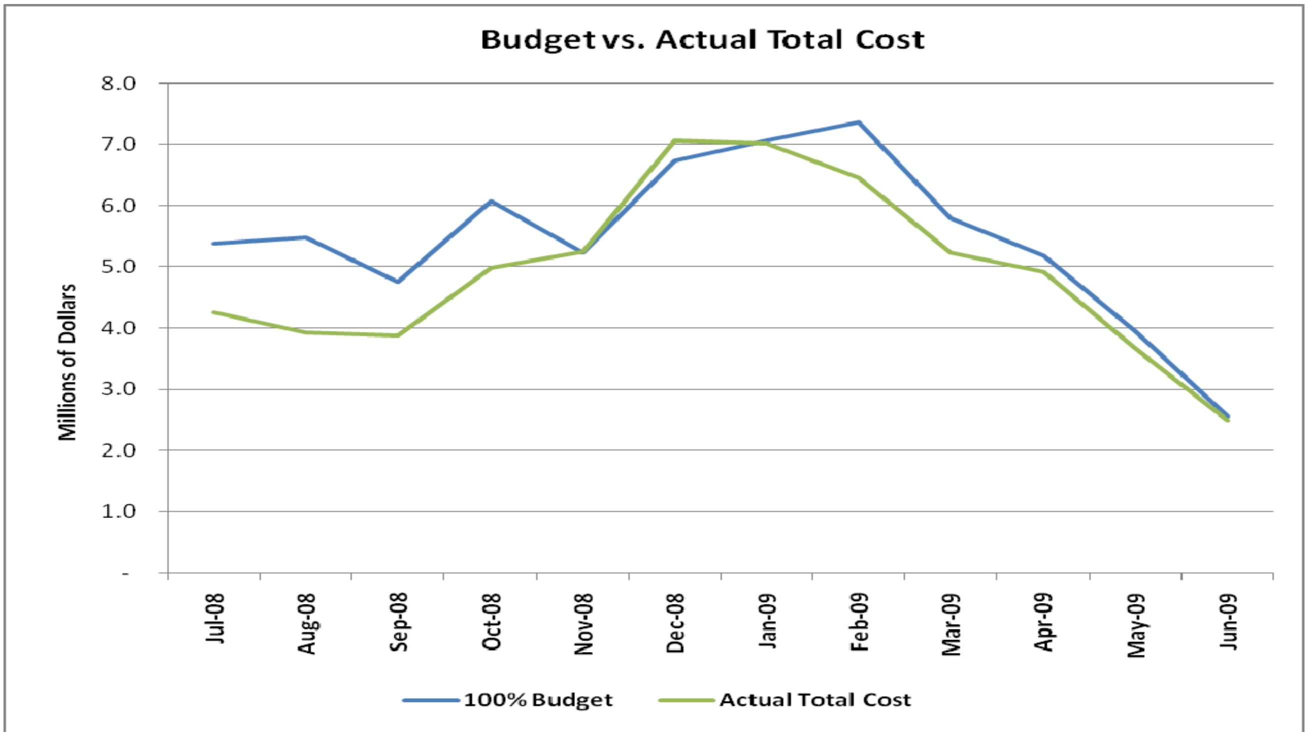


- *Budget used in FY09 was the anticipated Total Gas Required to generate both steam and electricity.*



- *Hedging Program commenced in August 2008.*



- *Actual total costs include both hedged purchases and spot purchases.*
- *Spread between budget and actual in early months a result of the unexpected commodity price decrease between time when budget was prepared and commodity consumed.*
- *Spread between budget and actual also affected by lower consumption than anticipated.*

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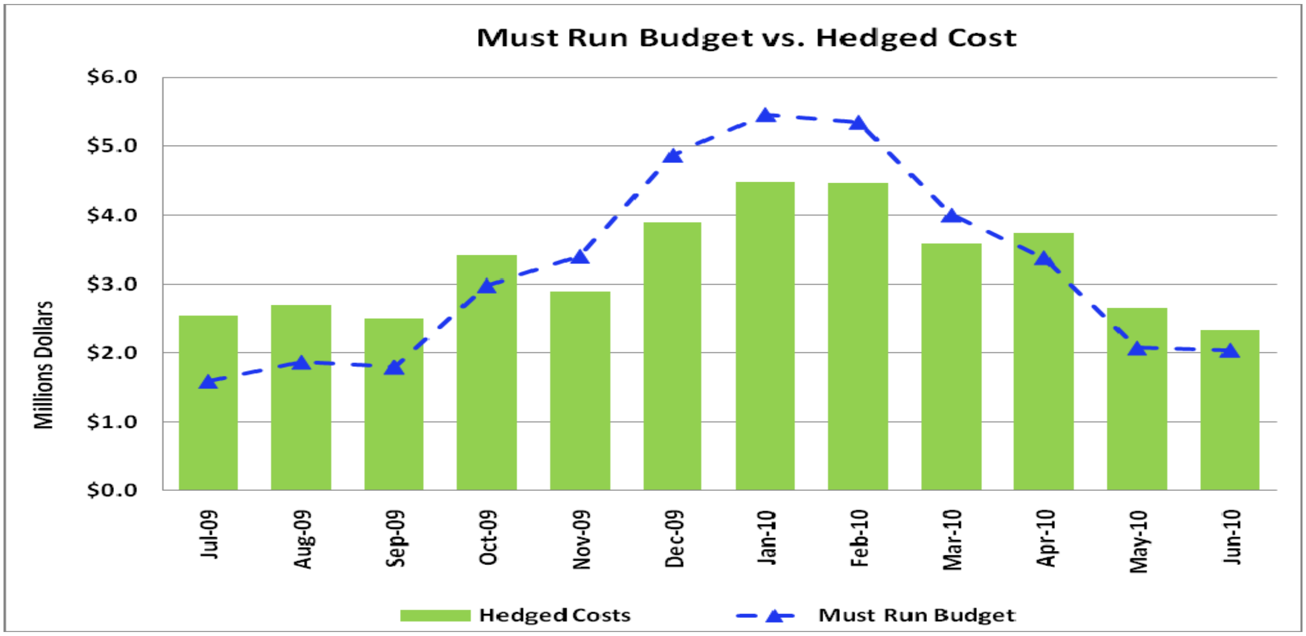
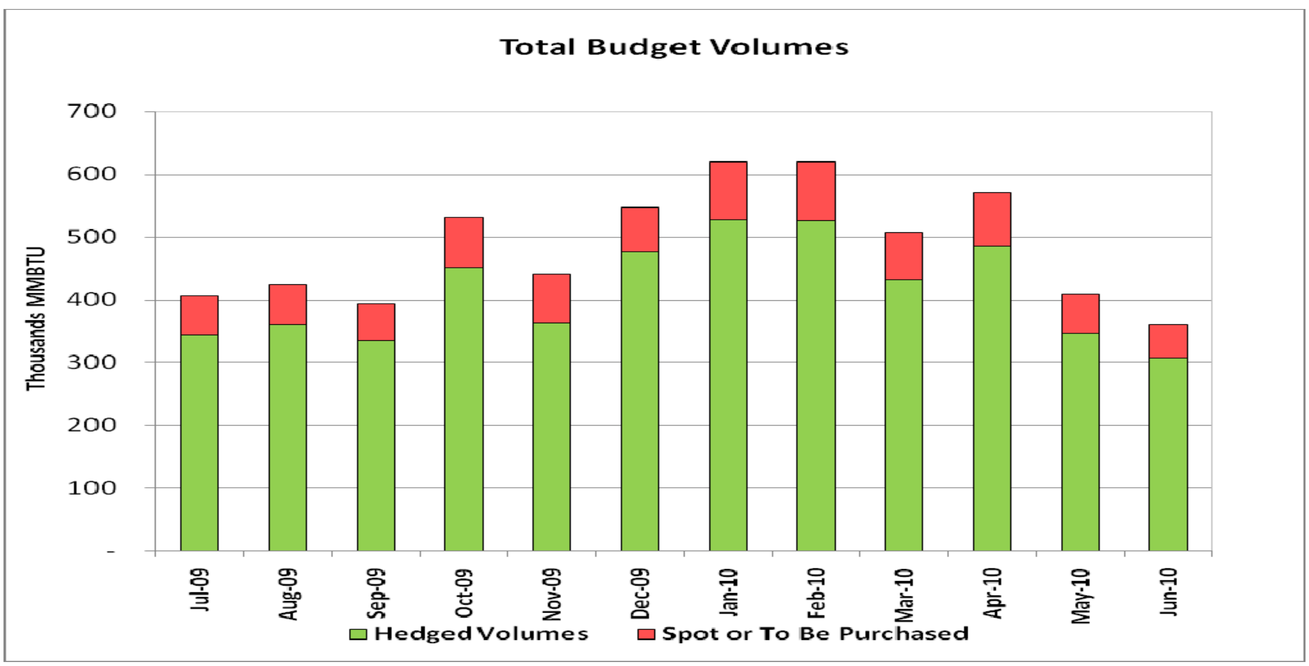
FY 2010 Graphical Analysis

September 10, 2009

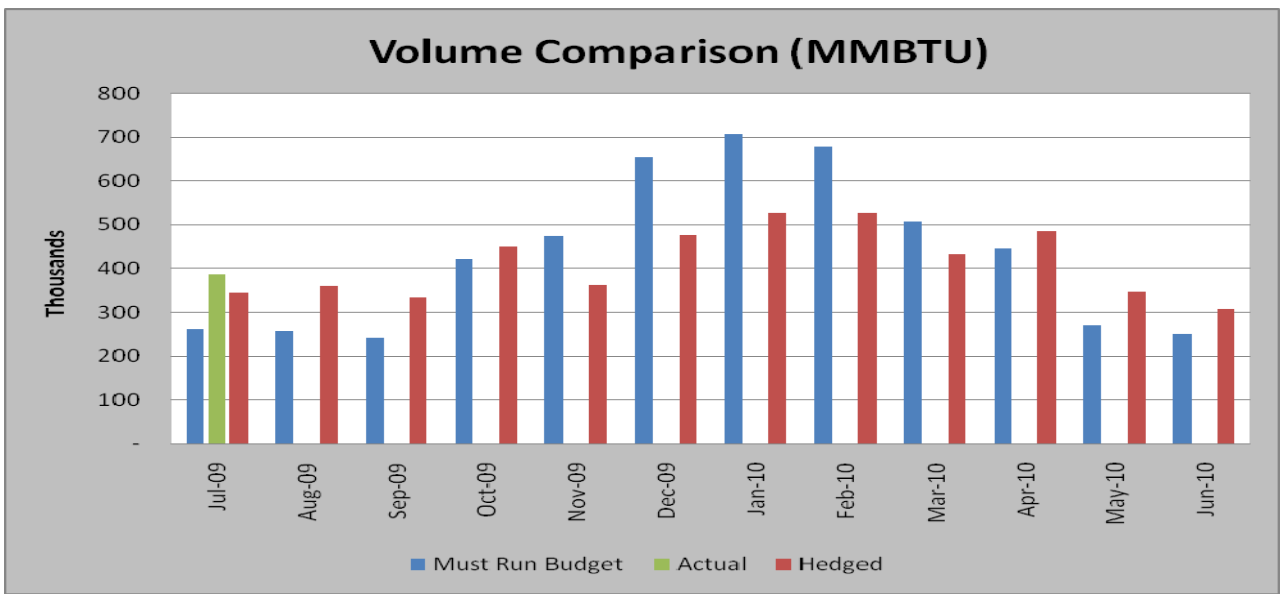


- *During the FY10 hedging activity, the basis for hedging moved from Total Gas Requirements to Must Run Gas Requirements. Must Run gas is that gas required to support campus demand only.*
- *Hedging for the winter months has been suspended because the spot prices are at abnormally low levels.*

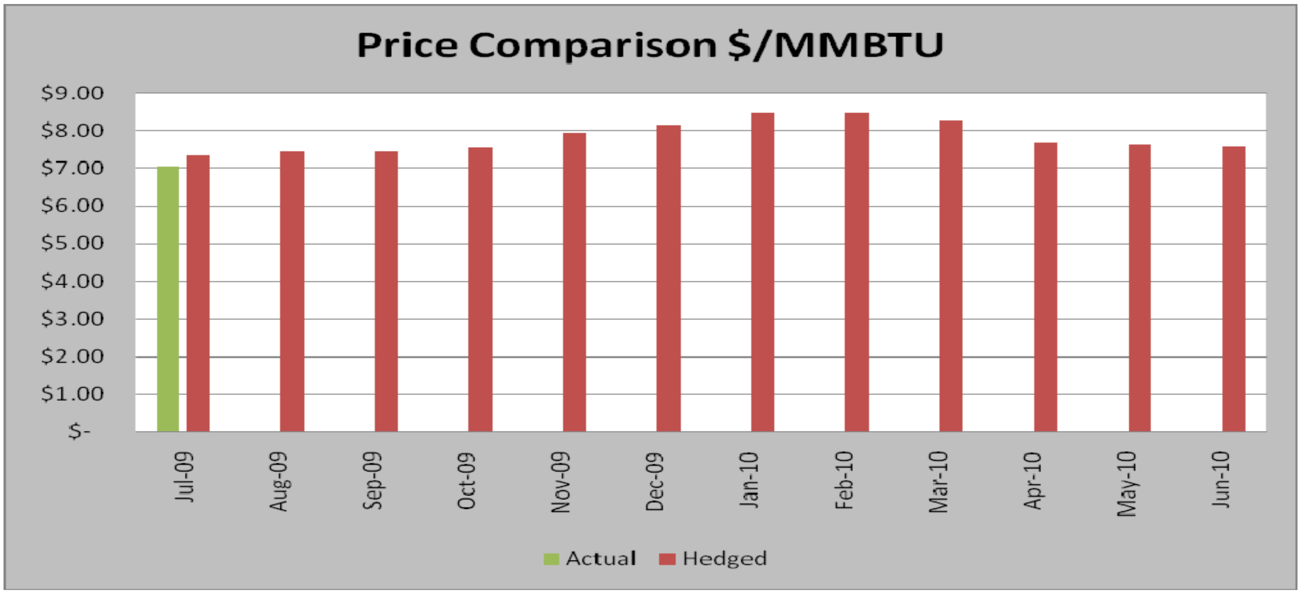


- *This graph is based on Total Gas Requirements.*

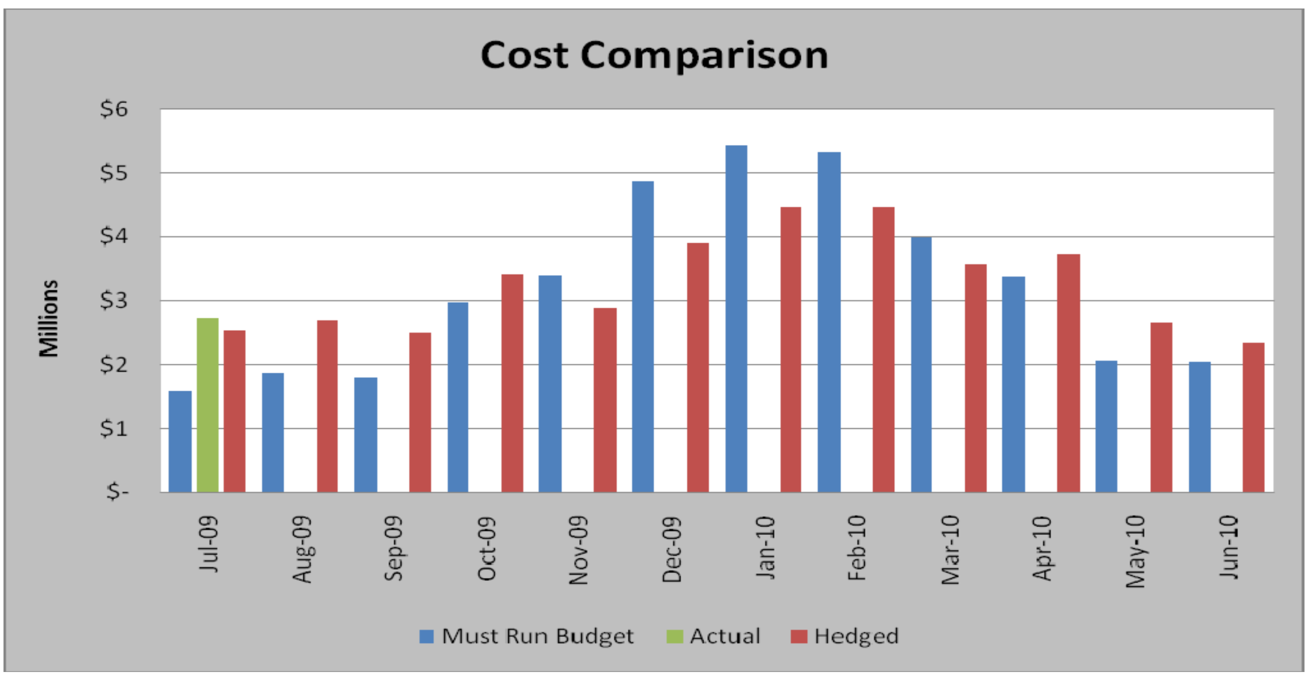
- *Market data based on August 19, 2009 NYMEX prices.*
- *Spot prices continue to drop to abnormally low levels resulting in a negative mark to market position.*



- *During the FY10 hedging activity, the basis for hedging moved from Total Gas Requirements to Must Run Gas Requirements. Must Run gas is that gas required to support campus demand only.*
- *This graph is based on Must Run Gas Requirements (represented as the Budgeted data). Actual is defined as the total gas consumed.*



- *The spot prices were lower than the hedged price, resulting in an averge unit price lower than the hedged price.*



- *This graph is based on Must Run Gas Requirements (represented as the Budgeted data). Actual is defined as the total gas consumed.*