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ELECTRICITY PROCUREMENT STRATEGY UPDATE

The Finance and Administration Committee recommends the adoption of the recommendation contained in the following report dated April 6, 2010, from the Commissioner of Corporate Services.

1. RECOMMENDATION

It is recommended that this report be received for information.

2. PURPOSE

This report provides Council with an update on the York Region Electricity Procurement Strategy, specifically with respect to initial cost-saving strategies proposed by the external Program Manager, and the longer-term recommended hedge strategy.

3. BACKGROUND

Electricity costs are a significant expense for the Region

Total energy costs for the Region were $31.6 million in 2009. Of this, $10.9 million or 34% was spent on electricity. The largest electricity consumer was the Environmental Services Department at $6.1 million, for operating water and wastewater pumping and treatment processes.

The Region is already achieving savings from managing electricity consumption. After the Ontario electricity market deregulated in 2002, there have been multiple options for procuring electricity. Installation of interval meters at select sites has reduced cost, and the purchase of green power has reduced environmental impact. Demand response through shutdown of non-essential equipment has been implemented at the Administrative Centre and demand response using emergency generators is being investigated at the Aurora Sewage Pumping Station, with additional sites being reviewed for feasibility.

Recent renewable energy initiatives include completion of the Sutton Wind Turbine Feasibility Study, the Region’s first geothermal installation at Vaughan Community Environmental Centre, the Region’s largest solar array at Stouffville Zone 2 Pumping Station, and the issuance of an RFP to explore the business case for solar electric at nine Regionally owned sites.

A Program Manager is helping the Region to further manage electricity price risk

With the phase-out of the Regulated Price Plan (RPP) for the bulk of municipal electricity purchases in November 2009, there is an increased risk of higher price volatility, leading to greater budgeting uncertainty.

As reported to Council in November 2009, WattsWorth Analysis Inc. was hired for a three-year term to help the Region further develop its electricity procurement strategy and assist in balancing risk and cost minimization. WattsWorth is a professional services company that specializes in managing risk for large electricity customers in Ontario. WattsWorth currently manages a municipal buying group that purchases in excess of $100 million worth of electricity per year and includes municipalities such as Richmond Hill, Markham, Mississauga and the Regions of Durham and Halton. WattsWorth is not affiliated with electricity suppliers, nor does it profit or gain extra fees from selling electricity or providing additional services.

WattsWorth has already developed an electricity procurement strategy for the Region that evaluates all procurement options along with the expected financial outcomes and associated risk.

4. ANALYSIS AND OPTIONS

The short-term strategy involves further re-positioning of mid-size electricity accounts to achieve the lowest possible rates

The Region’s smallest accounts (891 accounts but just 3% of consumption) will continue to be eligible for the Regulated Price Plan. The RPP provides built-in price smoothing and, for such small accounts, a better overall rate.

The Region’s largest interval-metered electricity accounts were previously moved to the spot market from RPP and achieved cost savings of approximately $210,000 per year, plus a one-time favourable settlement of $120,000. There are only 21 such accounts but they account for 53% of total consumption.

Another 30 large accounts representing 28% of consumption are in the process of being moved to the spot market by the local distribution companies (i.e. Powerstream, Hydro One and Newmarket Hydro). A cost savings of $470,000 is anticipated; therefore Property Services and WattsWorth will work to ensure the move occurs expeditiously.

Mid-size electricity accounts (98 accounts and 16% of total consumption), including consolidated street and traffic light accounts, can also yield savings of approximately $120,000 if moved to the spot market. However, the process for these accounts is not automatic and will require the services of a third-party Billing Agent at a cost of approximately $7,000 per year. WattsWorth has already solicited prices from potential Billing Agents and recommended the agent with the lowest price that meets the technical requirements. Legal Services is currently reviewing the terms of the Billing Agent's contract.

The long-term strategy will implement financial hedges to reduce the impact of spot market volatility

Financial hedges will be a key part of the enhanced electricity procurement strategy. A hedge is a fixed-price contract for a portion of electricity use, typically no more than 30%, for specific times of the week, e.g. 7x24 or 5x16, extending up to three years into the future. The purpose of the hedges is to reduce price volatility, not necessarily to reduce cost.

One or more hedges will be secured for large and mid-size electricity accounts that consume the majority of their electricity at times when price risk is at its greatest, i.e. during business hours on weekdays.

Regional staff are exploring several options for engaging hedge suppliers, with support from WattsWorth and in accordance with the Region's Commodity Price Hedging Policy, and will report later to Council as to risks and costs prior to implementation.

Implementation of the preferred hedge strategy will be deferred until electricity market conditions are more favourable

It is currently an expensive time to contract for electricity. Reduced electrical demand in the Province and low fuel (natural gas) prices has brought spot market prices down but long-term prices remain high. WattsWorth has developed a set of triggers that will indicate when a stable market has returned, at which point staff recommend implementation of the hedging strategy subject to Council approval.

The strategy will be monitored and refined on an ongoing basis during the Program Manager's three-year contract

WattsWorth will report monthly and annually on results of the electricity procurement strategy, analyze legislative changes and market developments that impact results, and recommend changes as appropriate.

York Region's electricity approach is consistent with many Ontario municipalities

York Region's approach in hiring a consultant to program manage the implementation and execution of forward fixed price electricity contracts mirrors the best practices of other municipalities in Ontario. York Region's program manager WattsWorth Analysis Inc. is actively engaged with other Ontario municipalities such as: Town of Markham, Town of Richmond Hill, Region of Durham, Region of Halton, Town of Halton Hills, City of Burlington, City of London, City of Windsor, and the Town of Ajax.

5. FINANCIAL IMPLICATIONS

WattsWorth's fees as Program Manager are $19,800 per year plus tax, for three years.

Annual electricity cost reductions of $680,000 are already being, or soon to be, realized through spot market pass-through rates on larger accounts.

The new Billing Agent's fee for short-term re-positioning of mid-size electricity accounts to take advantage of more favourable rates is estimated at $7,000 per year. This will be more than offset by the expected savings of $120,000 per year.

The cost and savings of the long-term hedge strategy will be detailed in a subsequent report to Council when a stable market, more favourable for transacting, returns.

Table 1
Electricity Procurement Annual Cost Impacts

Component	Cost	Savings
WattsWorth Program Management Fee	$19,800	
Spot Market Rates for Large Accounts		$680,000
Repositioning of Mid-Size Accounts	$7,000	$120,000
Long-Term Hedge Strategy	TBD	TBD
Totals	**$26,800**	**$800,000**

6. LOCAL MUNICIPAL IMPACT

There are no local municipal implications associated with this report.

7. CONCLUSION

The Electricity Procurement Strategy as detailed in this report will provide cost savings and risk management for the Region in a prudent, proactive manner.

For more information on this report, please contact Barry Crowe, Director, Property Services Branch at Ext. 1684.

The Senior Management Group has reviewed this report.