

Clause 11 in Report No. 6 of Committee of the Whole was adopted, without amendment, by the Council of The Regional Municipality of York at its meeting held on April 21, 2016.

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## Natural Gas Procurement Update

Committee of the Whole recommends adoption of the following recommendation contained in the report dated March 10, 2016 from the Commissioner of Environmental Services:

1. Council receive this report for information.
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Report dated March 10, 2016 from the Commissioner Environmental Services now follows:

1. Recommendation

It is recommended that Council receive this report for information.

2. Purpose

Council approved the Region's participation in bulk cooperative procurement of natural gas and requested annual updates. This report summarizes activities taken in 2015 as part of the Region's procurement of natural gas through the Association of Municipalities of Ontario's Natural Gas Buying Group.

3. Background

Using fixed-priced contracts for natural gas helps stabilize and predict the Region's future natural gas expenditures

Natural gas is consumed by the Region primarily for heating buildings. To a lesser extent natural gas is also used for domestic hot water heating, backup power generation, humidification and cooking. Fixed-priced natural gas contracts set a firm price for future delivery of natural gas required for Regional services. The Region's Commodity Hedging Policy permits the Region to fix the price of up

to 80 per cent of the forecasted annual natural gas volume for a term of up to thirty months from the execution date of the contract. The limit of 80 per cent gives the Region price certainty for the majority of the commodity purchase, flexibility to respond to demand uncertainty and ensures compliance with the *Municipal Act, 2001* that prohibits speculative investing by municipalities.

Fixed-priced contracts are agreements entered into with suppliers of natural gas or financial institutions that set a price for a specified quantity of natural gas to be purchased over a stipulated timeframe.

In 2006, the Region joined the Buying Group organized through the Association of Municipalities of Ontario to secure competitive pricing for natural gas

In 2004, Council approved joining the Association of Municipalities of Ontario's (AMO) Natural Gas Buying Group (Buying Group) based on the Buying Group's performance and quality of reporting. The Region entered in to an agreement with AMO Buying Group in 2006.

Through the Buying Group, the Region aims to secure more competitive pricing than it would on its own due to the larger quantity of natural gas purchased by the Buying Group. The Region is the largest natural gas consumer of the 161 municipalities in the Buying Group, which includes the City of Vaughan, Towns of Aurora, Georgina, Richmond Hill, and Whitchurch-Stouffville.

In June 2015, Council adopted the recommendation to continue participation in the Natural Gas Buying Group and to execute a revised agreement with AMO. The new agreement between the Region and AMO was finalized on November 1, 2015, which required agreement on terms and conditions by both parties' legal counsel and obtaining binding authorizations.

Purchase agreements are arranged through the Buying Group

AMO maintains agreements with suppliers that facilitate purchases of natural gas fixed-price contracts for Buying Group members. The Buying Group arranges delivery of the contracted quantity of natural gas to the local distribution company on behalf of the Region. There are no direct contractual links between the Region and suppliers with whom AMO negotiates.

Buying Group leverages volume to achieve competitive pricing for its members and offers additional savings by providing administrative services

Through the Buying Group, the Region is able to secure more competitive fixed-price natural gas contract pricing than it would on its own. In addition to lower contract pricing for natural gas, the Region benefits from additional administrative

services offered through the Buying Group, including monthly invoicing through utility bills, transmission and storage, and support for developing procurement strategies.

The Buying Group holds all agreements and contracts, assumes all non-performance risk, and conducts due diligence on behalf of the group. The structure enables the Buying Group to execute strategies as a cohesive group, which attracts the most competitive pricing. The new agreement also contains provisions that allow the Region to use the spot market when it believes that the premiums are too high relative to the benefits.

Housing York Incorporated accounts are excluded from the Buying Group as it is legislated to be part of Housing Services Corporation buying program (*Housing Services Act, 2011* Sec. 124 and 152).

#### 4. Analysis and Options

York Region's natural gas strategy was strengthened in 2015

The Region first joined the Buying Group in 2006 with 23 natural gas accounts. In 2008, the spot market price of natural gas fell drastically due to an economic recession and increased production. It was decided at the time that all new Regional natural gas accounts would benefit by staying in the spot market until the market stabilized. Over this time period, staff monitored both spot market and Buying Group performance.

Recent market conditions appeared to signal stabilized pricing, which prompted staff to revise the agreement with AMO and transition the remainder of the Region's accounts into the Buying Group. Transition of 52 Regional accounts from the spot market to the Buying Group was completed in December 2015. As a result, the 52 natural gas accounts that were newly enrolled in the Buying Group were charged to the spot market for 2015. The results reported below are for 23 natural gas accounts in the Buying Group throughout 2015.

In 2015, the Region paid less than one per cent (\$1,847) over the spot market rate to provide price certainty

A 2015 fixed-price contract was purchased in 2014 for 23 natural gas accounts that expired in October 2015. The total volume of natural gas purchased through the Buying Group contract was 1.7 million cubic meters, which is approximately 80 per cent of the volume consumed by the 23 accounts. A comparison of the contract rate received through the Buying Group with the spot market rate for the same volume is provided in Table 1.

**Table 1**  
**Comparison of 2015 Contract Performance to Spot Market Pricing<sup>1</sup>**

| Distribution Source  | Volume                     | Rate                    | Total     |
|----------------------|----------------------------|-------------------------|-----------|
| Contract Performance | 1.7 million m <sup>3</sup> | \$0.157 /m <sup>3</sup> | \$268,018 |
| Spot Market          | 1.7 million m <sup>3</sup> | \$0.156 /m <sup>3</sup> | \$266,171 |
|                      |                            | \$0.001 /m <sup>3</sup> | \$1,847   |

<sup>1</sup> This summary reflects 23 contracts in the Buying Group for 2015.

The \$1,847, or 0.7 per cent, over the final spot market cost is incurred to offset the market risk that is inherent in commodity markets such as natural gas. Regional facilities that purchased natural gas directly from the utility at spot market rates were subject to market price fluctuations throughout the year. A new fixed-price contract was established for these 23 accounts in November 2015, which can be renewed again by October 2016, when all 75 Regional accounts will be eligible to be included.

Participating in the Buying Group resulted in stable and predictable natural gas costs since the Region joined in 2006

Fixed-priced contracts provide cost certainty, which offers predictable in-year costs. Once a contract has been purchased, the Region is no longer impacted by changes in the underlying spot market. Since joining the Buying Group in 2006, the Region has achieved stable and predictable annual natural gas costs for accounts in the Buying Group contract. This ensures accurate multi-year budgeting of annual natural gas expenditures, which assists with assessing impacts to property taxes and user rates.

In June 2015, Council approved continued participation in the Buying Group. The new Buying Group agreement contains conditions that give the Region more control over future strategy development. An option available to the Region is to forgo any fixed-price contracts in favour of the spot market while still being part of the Buying Group. In addition, future Buying Group strategies for natural gas procurement will be developed by Regional staff. Staff are presently developing a strategy for all 75 of the Region's natural gas accounts. The new strategy is anticipated to begin November 1, 2016 once the contracts for the 23 accounts expire on October 31, 2016.

Link to key Council-approved plans

The Strategic Plan encourages a fiscally prudent and efficient Region by delivering multi-year budgets and a Regional fiscal strategy. Purchasing fixed-price contracts for natural gas promotes stability in a volatile commodities market

and ensures that the Region is able to accurately develop a multi-year budget of future natural gas costs.

## 5. Financial Implications

In 2015, the Region paid less than one per cent (\$1,847) over the spot market rate for price certainty to purchase 1.7 million cubic meters of natural gas

In 2015, the Region was able to accurately budget its cost of natural gas. This was achieved by way of a fixed-price natural gas contract for 1.7 million cubic meters of natural gas. The cost to manage the Region's risk was \$1,847 or 0.7 per cent over the spot market cost of natural gas.

The Region has purchased fixed-priced contracts for 28 per cent of its 2016 natural gas consumption at a price of 13.5 cents per cubic meter. This represents a 20 per cent drop in price compared to the 2015 fixed-price contracts. These contracts will expire on October 31, 2016. All natural gas consumption that is not purchased as part of these contracts will be subject to the spot market price.

## 6. Local Municipal Impact

The City of Vaughan, Towns of Aurora, Georgina, Richmond Hill, and Whitchurch-Stouffville are also members of the AMO Buying Group.

## 7. Conclusion

In 2015, the Region's natural gas procurement strategy was in transition. Council adopted the recommendation to enroll all of the Region's natural gas accounts into the Buying Group. This transition was completed by the end of December 2015. For those accounts that were already in the Buying Group, the Region purchased a fixed-price natural gas contract for 80 per cent of their expected consumption. This is consistent with the Region's Commodity Hedging Policy and the *Municipal Act, 2001*. The benefit was to fix the future price of natural gas in support of accurate multi-year budgets. The contract premium paid for the risk mitigation was \$1,847 or 0.7 per cent over the cost of the spot market.

## Natural Gas Procurement Update

For more information on this report, please contact David Szeptycki at ext.75723.  
The Senior Management Group has reviewed this report.

March 10, 2016

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