Clause 3 in Report No. 12 of Committee of the Whole was adopted, without amendment, by the Council of The Regional Municipality of York at its meeting held on June 25, 2015.

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Amending Agreement for Natural Gas Procurement

Committee of the Whole recommends adoption of the following recommendations contained in the report dated April 15, 2015 from the Commissioner of Environmental Services:

1. Recommendation

It is recommended that:

1. Council approve the Region's continued participation in the Association of Municipalities of Ontario's Natural Gas Buying Group and authorize the Commissioner of Environmental Services to execute a revised Natural Gas Agency Agreement with Local Authority Services Limited, for an initial term of three (3) years, with automatic renewals for successive one (1) year terms until terminated by either party.

2. Staff report to Council regarding the performance of its natural gas procurement strategy on an annual basis.

2. Purpose

Purchasing fixed-price natural gas contracts for future delivery is an effective strategy to stabilize and predict the Region's future natural gas expenditures

This report seeks authority to amend an agreement between the Region and the Association of Municipalities of Ontario's (AMO) Buying Group to continue the cooperative purchase of natural gas price contracts in combination with other Ontario municipalities. Housing York Incorporated is excluded from this purchasing strategy as it is legislated to be part of Housing Services Corporation buying program (*Housing Services Act, 2011* Sec. 124 and 152). The Purchasing Bylaw provides for the Region to procure goods and services through cooperative purchasing arrangements where favourable terms have been negotiated by another public agency.

3. Background

In 2004, Council approved joining Association of Municipalities of Ontario's Local Authority Service Natural Gas Buying Group

In 2004, the Region issued a request for proposal to evaluate options for natural gas procurement. Based on the results, it was recommended that the Region join a buying group because its purchased volume was not significant enough to attract competitive pricing. Council approved joining the Association of Municipalities of Ontario's Natural Gas Buying Group (Buying Group) based on the quality of reporting and Buying Group performance. The Region is the largest member, in terms of natural gas volume, of 161 municipalities that include Vaughan, Whitchurch-Stouffville, Aurora, Richmond Hill, and Georgina that purchase natural gas cooperatively. The Buying Group manages natural gas costs in the current year by purchasing up to 80 per cent of the Region's natural gas consumption through multi-year fixed price contracts that extend up to four years into the future.

The Region is currently purchasing half of its natural gas through the Buying Group by using an Agency Agreement established in 2006 with Local Authority Services Limited on behalf of the Association of Municipalities of Ontario. Staff are proposing to move remaining Regional natural gas accounts that are on the spot market to the Buying Group and to amend the Agency Agreement with terms that give the Region greater control over its purchasing strategy within the Buying Group.

The Region has an opportunity to improve its natural gas procurement strategy in light of significant expected growth in future consumption

The Region's current natural gas strategy is fragmented, with half of its natural gas purchased from the spot market and half from the Buying Group. Staff propose consolidating all natural gas accounts under a single buying strategy that the Region is currently employing with the Buying Group. At present, natural gas expenditures are relatively small in relation to other energy commodities purchased by the Region. Taking action to move the majority of the Region's natural gas procurement into the Buying Group will set the groundwork for future financial prudence and accurate multi-year budgeting by the Region.

The 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 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, transmission and storage, and development of 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 price.

A direct comparison of performance across available external programs based on natural gas procurement is challenging as most other municipalities are not willing to openly share their information. Internally, Housing York Inc. participates in the Ontario Non-Profit Housing Association natural gas buying group that is managed by East Coast Natural Gas Inc. A comparison of the two groups indicates a similar financial performance year over year.

The Region is seeking to retain flexibility for its natural gas procurement strategy with a new Agency Agreement within the Buying Group

As part of a buying group, members generally give control of their individual needs to that of the group. However, as the largest member of the Buying Group, the Region has influence over development of the group’s strategy. The Region has negotiated updated terms to the current Agency Agreement that will permit the Region to develop its own procurement strategy and execute it within the Buying Group. This will ensure that the Region’s strategy is executed as part of the larger Buying Group to attract the most competitive price from suppliers. The Agreement will be for an initial term of three years and will automatically renew for successive annual terms unless terminated by either party.

4. Analysis and Options

Fixing future natural gas prices facilitates accurate multi-year budgeting

The objective of forward purchasing is to fix future natural gas prices, which helps provide a degree of financial predictability for Regional natural gas over a given time period. The practice of forward purchasing supports accurate multi-year budgeting by limiting exposure to the potential volatility of the open market.

The Buying Group reduces non-performance risks that the Region could be exposed to if staff were to pursue alternate buying groups to procure natural gas.

The Region's future rate for natural gas purchased through the Buying Group is predictable and known for the purposes of developing multi-year budgets whereas natural gas purchased from the spot market is variable from month-to-month.

Buying Group provides predictable and competitive price, while reducing energy delivery risk

Table 1 below summarizes the advantages and disadvantages of each procurement option available to the Region. The AMO Buying Group is the recommended option because it meets the Region's need to prudently manage its cost, administrative burden, and risk. Additionally, the Region is already part of the Buying Group for a number of its natural gas accounts and, as part of its membership, the Region sits on the AMO Energy Task Force, which helps advocate on behalf of Ontario municipalities on energy related matters.

Table 1

Comparison of Natural Gas Procurement Options

Advantages	Disadvantages
Option 1: AMO Buying Group (Recommended)	
• Predictable future natural gas cost • Municipal-only customer group • Very large group that acts homogenously for the purposes of execution • Attracts competitive prices from suppliers • AMO holds all risks on behalf of its members • Administrative services and support • Advocacy on behalf of Ontario municipalities	• Slightly higher fee (2¢ per Giga-Joule more than consultants)
Option 2: Spot Market	
• No administrative fee • All administrative actions related to procurement or account management are built into spot market price by the utility	• Difficult to predict and budget future cost • Consumption growth compounded by price volatility will increase future natural gas cost • Subject to Enbridge forecast accuracy and reconciliations • No access to market information

Option 3: Consultant	
• Dedicated to the Region specifically • Good reporting	• Region is not large enough individually to attract the most competitive bids • Only one consultant has a public sector buying group. Members operate autonomously within the group, which may impact pricing • Region holds performance risk and negotiates its own contracts

Corporate Energy Services will continue to be responsible for strategy development and reporting

Procurement strategies and reports to Council will be developed by Corporate Energy Services in consultation with Finance and Property Service groups. Approval to execute the annual natural gas procurement strategy is proposed to reside with the Commissioner of Environmental Services.

Link to key Council-approved plans

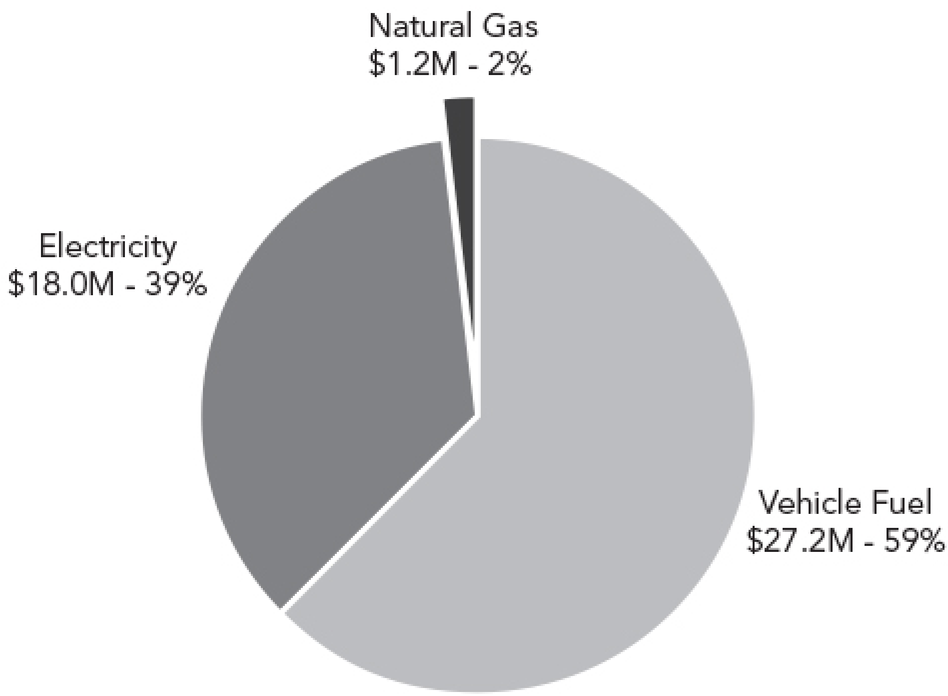
The Strategic Plan encourages a fiscally prudent and efficient Region by delivering multi-year budgets and a Regional fiscal strategy. By participating in the AMO Natural Gas Buying Group the Region will secure fixed multi-year pricing that will provide protection from potential price volatility. Fixed multi-year pricing will also provide stability in forecasting the Region’s cost of natural gas and promote accurate multi-year budget development.

5. Financial Implications

In 2014, natural gas expenditures accounted for three per cent ($1.2-million) of the Region’s energy costs

In 2014, the Region’s rate for natural gas consumption was $0.33 per cubic metre (including transportation, distribution, and fuel), amounting to a total cost of $1.2 million as depicted in Figure 1.

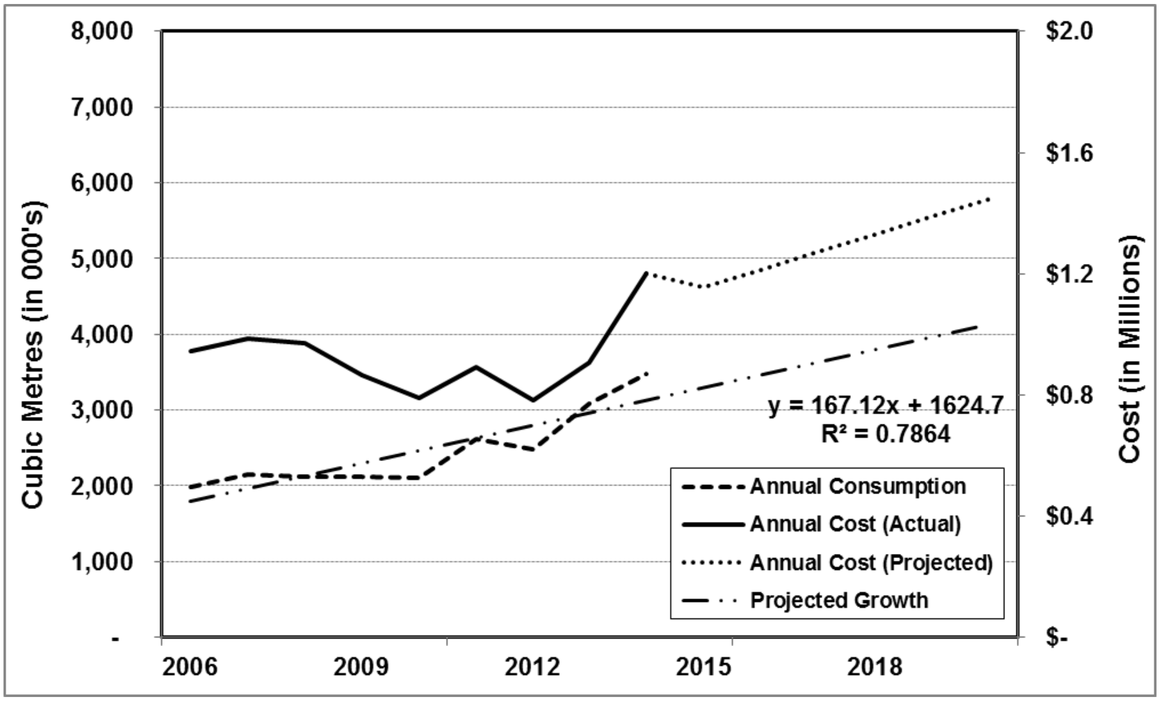
Figure 1
2014 Regional Energy Costs



Regional natural gas consumption continues to increase

Regional consumption of natural gas has increased year over year since 2006 (dashed lines in Figure 2), which is the result of an increase in the number of Regional facilities replacing electric heating with cheaper natural gas. Growth in consumption is not reflected in the Region's total cost (solid line in Figure 2) from 2008 to 2012 due to a significant price decline caused by the economic recession and introduction of shale gas. Since 2012, the natural gas spot market has experienced increased volatility and price strength, which has resulted in greater costs for the Region as consumption grows. It is anticipated that the Region will be able to manage price volatility risk with the multi-year procurement strategy.

Figure 2
Natural Gas Volume and Cost for Facilities Operated by York Region



New and future Regional facilities will increase the Region's consumption of natural gas; examples include 9060 Jane Street, where the cost of natural gas was the contractor's responsibility until recently, 145 Harry Walker Parkway, where the current warehouse space will be converted to office space, 55 Orlando Drive (the recently commissioned Transit Operations, Maintenance and Storage Facility), and the proposed Annex. By 2024, the Water Reclamation Centre (Upper York Sewage Solutions) is modelled to add 2.5 million cubic metres of natural gas per year.

Based on the projected trend line, Regional natural gas use is estimated to be 4 million cubic metres in 2020. At the current average price of $0.33 per cubic metre (including transportation, distribution and fuel), the Region's annual costs for natural gas are forecasted to be approximately $1.45 million in 2020.

Natural Gas for third party contracted operations and leased facilities not included in cooperative purchase

Due to the nature of operating and lease agreements the Region currently has in place for third party contracted operations and leased facilities, natural gas used at these facilities is directly invoiced to the contractor or landlord (55 Orlando Drive is an exception to this). The Region is not billed for consumption of natural gas at any of these locations. In some cases, natural gas consumption can be high due to the nature of the operations being undertaken at these facilities (i.e.

material recovery facility, most bus garages). As contracts for these services are renewed, staff will look into opportunities to exercise more control over how natural gas is used to achieve efficiencies and determine fit with the cooperative purchase of natural gas with the Buying Group.

Buying Group Agreement provides a degree of predictability in future Regional natural gas costs

As part of the Buying Group, the Region will be able to establish price security for 80 per cent of its future natural gas consumption; the remaining 20 per cent would be purchased at market price. Under the terms of the Agency Agreement, as each year concludes, a forward purchase can be made to top up any shortfalls in the strategy volumes. The Buying Group will purchase natural gas from the spot market to make up the shortfall or arrange for storage of any surplus. Fixing forward natural gas energy prices facilitates accurate long-term budgeting of future costs and is the basis for prudent financial management.

The Buying Group Agreement provides the Region with the ability to approve the term, target price, and volumes for natural gas and its transportation based on Regional specific needs regardless of the proposed Buying Group strategy. For its part, the Buying Group will maintain and administer all agreements between the various parties, execute the Regional approved strategy, provide market information and Region specific reporting, and arrange with the local utility on behalf of the Region for all administrative functions necessary to deliver natural gas at the fixed contract price. The Region's financial and contractual risk is managed by updated terms of the Agency Agreement with the Buying Group. Natural gas is only purchased on behalf of the Region when staff authorize the Buying Group to execute a buying strategy. If the Region chooses not to execute future strategies then no obligations can be made by the Buying Group effectively ending the Agency Agreement with no financial consequence to the Region.

6. Local Municipal Impact

The Region is the largest member of the Buying Group. Withdrawing its volume from the co-operative purchase will impact the total amount of natural gas being offered to the market, which may impact the price offered by suppliers to the remaining members. Additionally, the Region brings valued experience and knowledge to the development of procurement strategies that other Buying Group members have come to rely upon.

The following local municipalities in York Region are members of the AMO Buying Group: Vaughan, Whitchurch-Stouffville, Aurora, Richmond Hill, and Georgina.

7. Conclusion

As part of its participation in the Natural Gas Buying Group, the Region has been a valued participant in the Association of Municipalities of Ontario's boards and committees related to energy strategy and policy. In addition to facilitating accurate multi-year budgeting, participation in the Buying Group achieves competitive pricing and ancillary services beneficial to the Region's interest in effectively exercising prudent financial management.

Amendments to the current Agency Agreement will allow the Region greater flexibility in developing and modifying its natural gas procurement practices

To gain greater control over the Region's natural gas strategy and to have the flexibility required in shaping future strategies to accommodate for current and projected natural gas consumption, amendments to the current Agency Agreement are recommended. Through a revised Agency Agreement with Local Authority Services Limited, the Region has an opportunity to enhance its ability to meet forecasted demands, control costs, and accurately budget for future natural gas expenditures.

For more information on this report, please contact David Szeptycki, Head, Strategy, Liaison and Policy Implementation at ext. 75723.

The Senior Management Group has reviewed this report.

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