



Administrative Report

Office of the Director of Financial Services/Treasurer

To: Warden McNamara and Members of Essex County Council

From: Sandra Zwiers, MAcc, CPA, CA
Director of Financial Services/Treasurer

Date: Wednesday, September 01, 2021

Subject: Electricity and Natural Gas Update – Commodity Price Hedging Strategy 2020

Report #: 2021-0915-FIN-R13-SZ

Purpose

The purpose of this report is to provide Council with an update on the Corporation's utilization of commodity price hedging and recommend continued participation with the Association of Municipalities of Ontario / Local Authority Services Ltd (AMO/LAS) Procurement Programs, to procure, in bulk, electricity and natural gas in the open market on behalf of partnering municipalities.

Background

In accordance with the Municipal Act, 2001, regulation 653/05, and the County of Essex Commodity Price Hedging Policy (Policy 06-11), the Treasurer is required to report annually on all commodity price hedging agreements in place. The goal of the commodity price hedging policy is to allow the Treasurer to enter into fixed price agreements for the future delivery of all or any portion of a commodity when deemed advantageous to do so.

The County continues to utilize the services of AMO/LAS Procurement Programs. As part of the strategy, a hedging contract is used to minimize potential risk of spot market fluctuations.

A hedge is a financial agreement that fixes the price to be paid by the municipality for future delivery of a commodity. A hedge is typically used to reduce cost fluctuations and provide cost certainty.

The County's current agreement with LAS includes a hedge of 50% of its total electricity requirements. This hedging level has been in place since the last report to County Council in August 2020. The hedge is applicable to all electricity purchased by the Corporation with the exception of street light usage which is kept on the spot market. Because street light energy demand typically occurs during off-peak/lower cost times, the benefit of hedging is low.

For natural gas, LAS purchases incremental gas contracts at various points each year with a goal of building a total hedge portfolio of 80-90% of program requirements for the current year, with the remaining consumption settling at prevailing market rates.

Discussion

Electricity

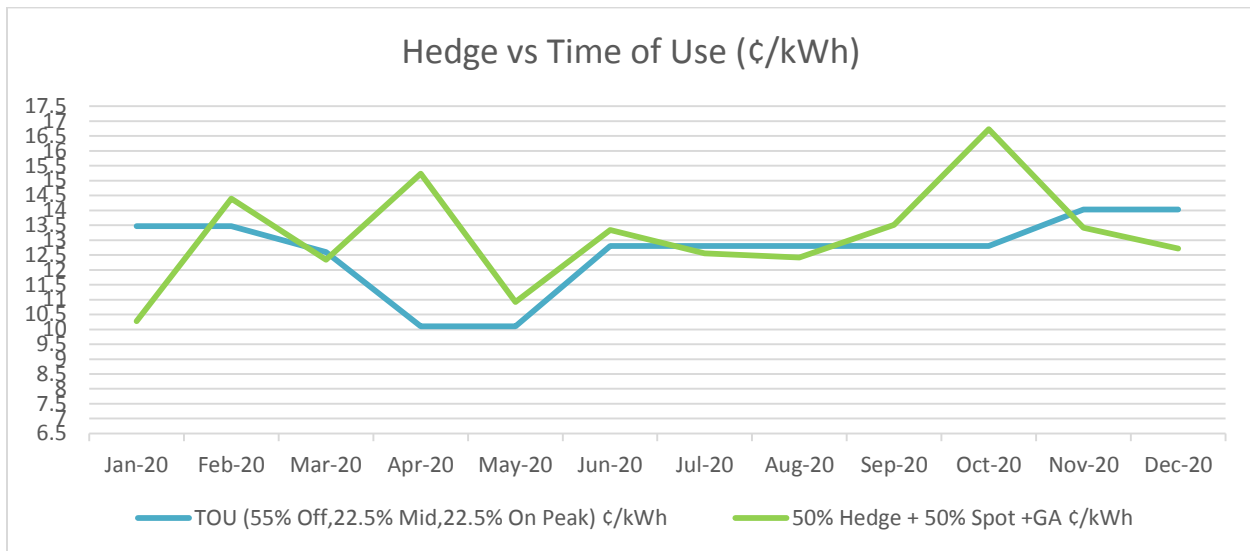
The Corporation's electricity bills consist of a number of cost components:

- Energy Charge (based on actual usage and set by retailer)
- Global Adjustment Charge (set by province)
- Delivery Charge (set by regulation)
- Regulatory Charges (set by regulation)

The only component of the bill that is eligible for hedging is the energy charge. All other components of the bill are regulated and ineligible for hedge protection.

The graph in Table 1 illustrates the hedging results for the Corporation for the period January 1, 2020 to December 31, 2020. The year started with hedge savings but time of use (TOU) rates were supported by provincially implemented COVID-19 Relief Rate reductions which made TOU Rates fall below the Corporation's hedge rates for the majority of the year. Had COVID-19 Relief Rates not been in place during 2020, the hedge program would have generated annual savings of \$23,007. Due to pandemic subsidies, the hedge rates resulted in excess costs of \$19,416 for 2020.

Table 1 – Electricity Hedging Results 2020



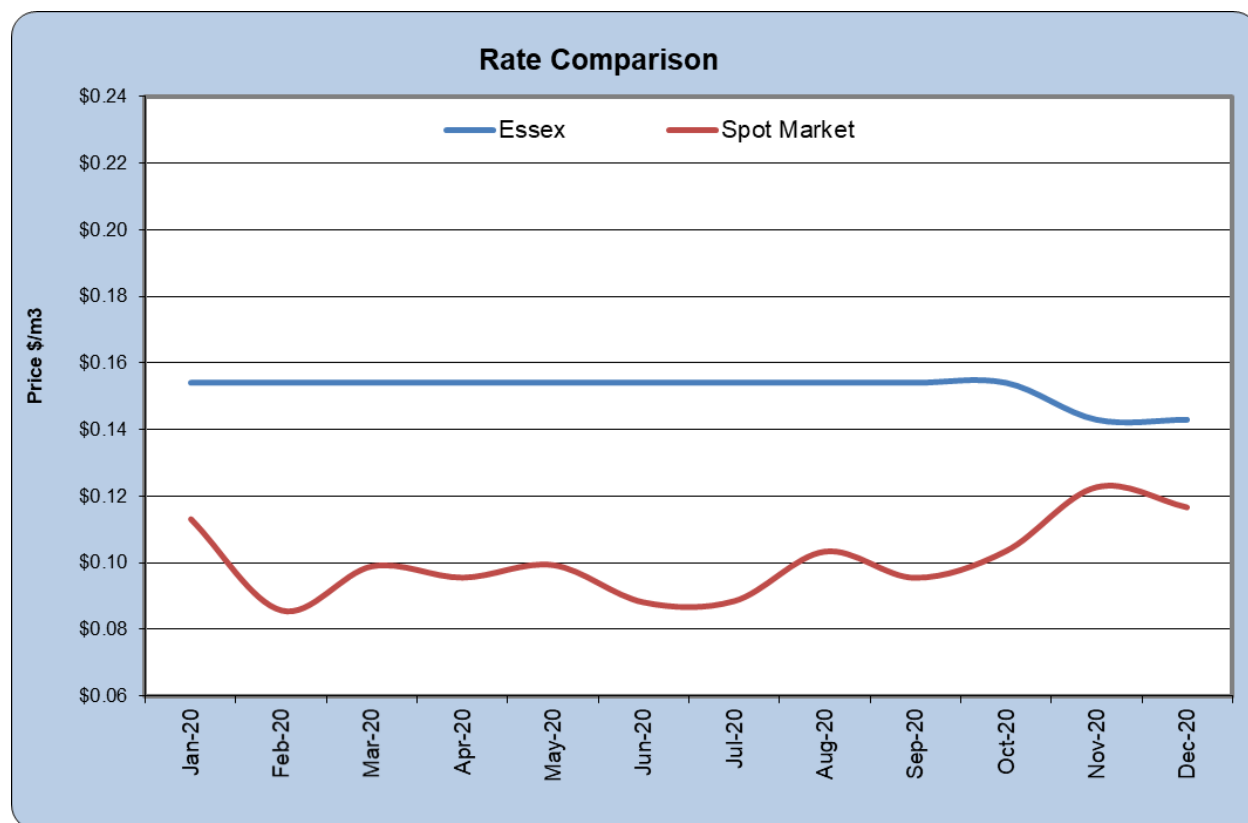
Natural Gas

The hedging program for natural gas includes a rebate feature that returns program savings back to participating municipalities. In 2020, the Corporation received a rebate payment in the amount of \$4,905 for the savings earned in 2019.

In terms of the components of the natural gas bill that are eligible for hedging, the program offers pricing stability for the commodity charge as well as the deregulated transportation charges. All other components of the natural gas bill are regulated and ineligible for hedging.

The graph in Table 2 illustrates the stability offered by the hedging program for the period from January 1, 2020 to December 31, 2020. The program is designed to provide rate stability rather than guarantee rate savings.

Table 2 – Natural Gas Hedging Results 2020



It was anticipated that natural gas storage, which was above the five-year average in 2020, would result in improved hedging results. The graph illustrates this impact by a narrowing of the difference between the hedge and spot market rates over the course of the year. Unfortunately, as the end of 2020 approached, the trend appeared to begin to reverse as the spot market rate began to diverge from the hedge. Administration will continue to monitor the results in the natural gas hedging program to assess whether changes for the Corporation are warranted.

Financial Implications

The goal of participating in the LAS hedging programs is to ensure stable commodity rates to assist in annual budgeting. The high level of regulation in the commodity markets does admittedly have a limiting effect on any hedging program.

Rebates received from the natural gas program are recorded in miscellaneous revenue as they are received. The Corporation's Budget

reflects the anticipated costs of hydro and natural gas based on the hedge prices obtained through participation in LAS Commodity programs.

Recommendation

That Essex County Council receives the Electricity and Natural Gas Hedging Strategy – 2020 report for information.

Respectfully Submitted

Sandra Zwiers

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Concurred With,

Mike Galloway

Mike Galloway, Chief Administrative Officer