

REPORT TO: Finance and Corporate Services Committee

DATE OF MEETING: August 14, 2023

SUBMITTED BY: Greg St. Louis, Director, Gas & Water Utilities, 519-741-2600 ext. 4538

PREPARED BY: Khaled Abu-Eseifan, Manager, Gas Supply and Engineering, 519-741-2600 ext. 4826

WARD(S) INVOLVED: All Wards

DATE OF REPORT: August 4, 2023

REPORT NO.: INS-2023-334

SUBJECT: 2023/2024 Natural Gas Rates

RECOMMENDATION:

That the supply component of the natural gas rate be decreased to 16.70 cents per cubic meter from 20.85 cents per cubic meter for system gas customers of Kitchener Utilities effective November 1, 2023; and,

That Kitchener Utilities' natural gas variable and fixed delivery rates be approved as proposed in report INS-2023-334 - Attachment A, for all Kitchener delivery customers effective November 1, 2023; and further,

That the supply rate of natural gas be reviewed quarterly against market conditions and necessary changes to be brought forward for Council approval.

REPORT HIGHLIGHTS:

- The purpose of this report is to provide an update and recommendations for the natural gas supply and delivery rates of Kitchener Utilities for the remainder of 2023 and 2024.
- The key finding of this report is that the supply rate is recommended to decrease from 20.85 cents per cubic meter to 16.70 cents per cubic meter to respond to lower market prices in updated forecasts. The report also recommends increasing the delivery rate components as proposed in attachment A; to cover various capital, operations, and financial requirements.
- The financial implications to Kitchener Utilities residential customers will be savings of approximately \$53.00 or 6% in 2024 compared to 2023.
- This report supports the delivery of core services.

BACKGROUND:

Kitchener Utilities (KU) is committed to delivering natural gas using a rate setting approach that focuses on rate stability for our customers. We follow the Council endorsed Gas Purchase Policy for the procurement of natural gas. The policy outlines how much of our natural gas portfolio can be purchased in advance and on the spot market. It provides the ability to blend our natural gas rate with fixed and market price natural gas. The blending of fixed and market price natural gas is used to reduce volatility in prices to keep rates stable for customers. It is also used to respond

to significant changes in market prices within a reasonable time frame. This is a key feature which softens spikes in market prices and provides longer range rate stability while allowing KU to respond to long term sharp market changes.

Other natural gas utilities, regulated by the Ontario Energy Board, purchase natural gas on the market and adjust rates quarterly, due to the volatility of natural gas. This strategy provides rates that are more reflective of market prices, but also includes more frequent rate fluctuations.

Kitchener Utilities last natural gas rate change was in January 2023. At that time, the supply rate was decreased with a plan to review the prices more frequently due to the anticipated volatility in market prices and delivery rates were increased. This report aims to revise the rates based on updated market conditions and the requirements to deliver safe and reliable natural gas for Kitchener Utilities customers. Kitchener Utilities is in a very good storage position and the proposed changes aim to timely adjust rates to benefit customers, avoid significant rate spikes and ensure reasonable rates are maintained for longer periods of time.

REPORT:

Kitchener Utilities natural gas rates have two components: gas supply, and gas delivery. The gas supply program is responsible for the purchase of the gas commodity and transportation of natural gas to Kitchener and is a pass-through cost program. The delivery program is responsible for delivery of natural gas to customers. This includes billing, meter reading, capital, maintenance, and operating costs of the distribution system.

The following are key highlights of this natural gas rate change report:

- Natural gas supply rate decreases for system gas customers;
- Delivery rate increases as proposed in Attachment A;
- With the proposed rate changes, an average residential customer will see an overall rate decrease of approx. \$53.00 or 6% for the period from November 1st, 2023 to October 31st, 2024 compared with the current rates.

Gas Supply:

The natural gas market prices usually fluctuate with supply, demand, and weather factors. Kitchener Utilities relies on its purchasing policy to create a blended portfolio of hedging (fixed price contracts) and market price purchases. Along with the purchase policy, KU relies on the stabilization reserve to absorb sudden price increases and soften rate spikes. In 2023, the supply rate was set to maintain the stabilization reserve in anticipation of high volatility in market prices. Actual market prices were lower than projected and the stabilization reserve is forecasted to be over the maximum limit by the end of 2023. As the supply program is a pass-through-cost program, the rate should be reduced to benefit customers. The recent dip in market prices is forecasted to be short lived and prices are projected to increase in 2024. These conditions indicate the need to reduce the supply rate in 2023 while maintaining the stabilization reserve balance at the maximum limit at the end of 2024 given the uncertainty in market prices and the desire to avoid sudden rate shocks. This would provide financial benefits to customers as well as sufficient funds in the stabilization reserve to absorb market volatility and maintain rate stability. Depending on actual market prices, the ability of KU to continue to secure reasonably priced deals and actual gas consumption volumes, the supply rate should be reviewed frequently and changed as needed subject to Council approval. Therefore, staff recommends the following:

- Decrease the supply rate from 20.85 cents per cubic meter to 16.70 cents per cubic meter effective November 1st, 2023,
- Maintain the stabilization reserve at the maximum limit at the end of 2024,
- Continuously monitor market prices and recommend changes to supply rate if needed.

Figure 1 below shows historical and forecasted supply rate changes for Kitchener Utilities compared with market prices and Enbridge rates. KU's gas supply rate continues to be lower than Enbridge's gas supply rate for 2023. The forward market prices are provided by KU's consultants. These consultants are natural gas subject matter experts who are hired to provide natural gas market analysis, forecasts, gas models and assist in purchasing KU's natural gas portfolio.

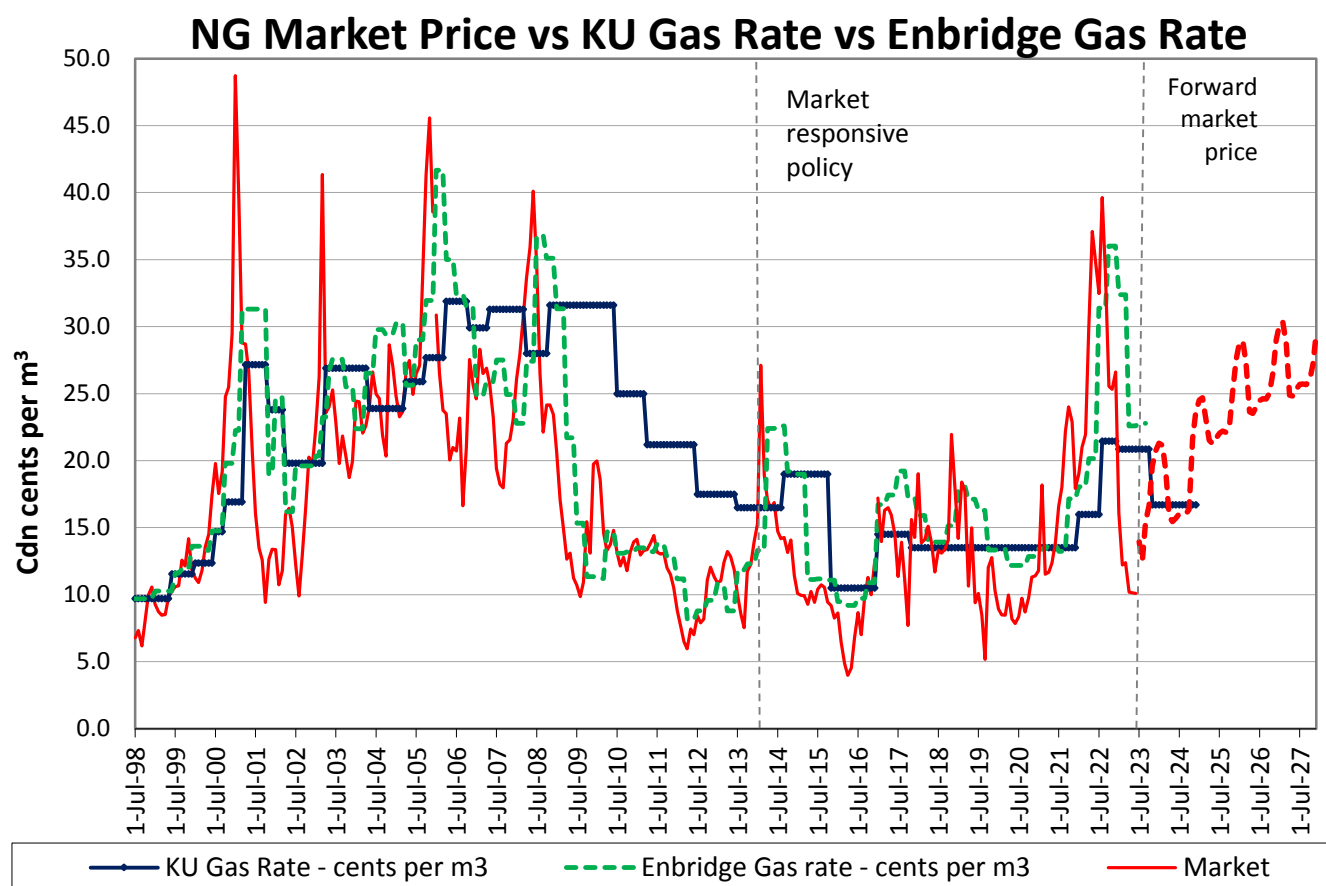


Figure 1: Natural gas supply rates comparison

Gas Delivery:

There are two components to the delivery charges: a daily fixed charge, and a variable rate. There are four Delivery Rate Groups: M1, M2, M4 and M5, (complete definitions are in Attachment A). These rates service customers of different volumetric requirements. Delivery rates are usually changed in January; however, KU staff recommends changing delivery rates this time in conjunction with the supply rate starting November 1st, 2023. This would support customer preference for rate stability by combining the rate changes and avoid confusion from consecutive rate changes. The proposed delivery components of the natural gas rates starting November 1st, 2023, are shown in Attachment A. The key drivers of delivery rate changes are the following:

- Additional resources that are needed to meet Bill 93, Getting Ontario Connected Act, 2022 requirements,
- A significant increase proposed by Enbridge to its rate that is applied to Kitchener Utilities as part of its rebasing application (2024-2028) submitted to the Ontario Energy Board (OEB). KU staff are intervening in the OEB proceeding and revising Enbridge contract parameters to reduce the impact of the proposed increases,
- Additional funding to support Kitchener Utilities energy transition plans,
- Critically low delivery stabilization reserve that should be increased to mitigate financial risks to the gas utility,
- Inflationary increases to operating and capital expenditures.

It is anticipated at this time that there will be no further delivery rate change in January 2024.

Comparison with Enbridge:

For an average system gas residential (M1) customer, the total KU gas bill cost in 2023 is forecasted to be 12% lower than the cost of similar customer in Enbridge franchise area. Enbridge is proposing a significant increase to its M1 rates in 2024 however, a comparison for 2024 cannot be achieved now as Enbridge's supply and delivery rates have not been finalized yet.

STRATEGIC PLAN ALIGNMENT:

This report supports the delivery of core services.

FINANCIAL IMPLICATIONS:

For an average system gas residential (M1) customer consuming 2,000 cubic meters annually, the proposed natural gas rates result in a decrease in the overall annual bill by approx. \$53.00 for the period November 1st, 2023, to October 31st, 2024. This excludes the Federal Carbon Charge.

The increase in delivery rates is necessary to mitigate financial risks to the delivery stabilization reserve. The stabilization reserve balance is forecasted to be below the 2023 budget estimate. This reserve is needed to absorb variances in revenues due to weather factors, (colder weather increases revenue and warmer weather decreases revenue) and to maintain rate stability through out the year. The 5-year operating budget projection for gas delivery is presented in Attachment B.

The natural gas supply stabilization reserve balance is forecasted to be higher than the 2023 budget estimate and therefore, a decrease in the supply rate intends to keep the balance towards the maximum benchmark of the reserve in 2024. The supply stabilization reserve is needed to absorb fluctuations in market prices and soften rate spikes. Due to uncertainty and volatility of gas markets, this reserve should be at the maximum balance to avoid rate shock for KU customers. The 5-year operating budget projection for gas supply is presented in attachment C.

Kitchener Utilities supports the Waterloo Region Energy Assistance Program. This program offers support to customers facing challenges paying their utility bills. The program is administered by the Region of Waterloo and offers support for both electricity and natural gas bills.

COMMUNITY ENGAGEMENT:

INFORM - Kitchener Utilities will work with the Corporate Communications and Marketing Division to ensure that the rate change details are included in the Council Key Decisions media brief. A bill insert will be distributed with utility bills along with posting information on the Kitchener Utilities' and City websites. An on-bill message will also appear on October 2023 natural gas bills.

This report has been posted to the City's website with the agenda in advance of the council / committee meeting.

PREVIOUS REPORTS/AUTHORITIES:

- INS-2022-486: 2023 Natural Gas Rates

APPROVED BY: Denise McGoldrick, General Manager Infrastructure Services.

ATTACHMENTS:

Attachment A – Natural Gas Rates

Attachment B – 5-year operating budget projection – Gas Delivery

Attachment C – 5-year operating budget projection – Gas Supply