

REPORT TO: Finance and Corporate Services Committee

DATE OF MEETING: September 16, 2024

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

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WARD(S) INVOLVED: Ward(s)

DATE OF REPORT: September 2, 2024

REPORT NO.: INS-2024-383

SUBJECT: 2024/2025 Natural Gas Rates

RECOMMENDATION:

That the supply component of the natural gas rate be increased to 13.13 cents per cubic meter from 11.63 cents per cubic meter for system gas customers of Kitchener Utilities effective November 1, 2024; and,

That the proposed Supply Rate Policy as detailed in report INS-2024-383 – Attachment A to change supply rates quarterly starting from January 1, 2025, through council delegated authority be approved; and further;

That Kitchener Utilities’ natural gas variable and fixed delivery rates be approved as proposed in report INS-2024-383 - Attachment B, for all Kitchener delivery customers effective January 1, 2025.

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 2024 and 2025 and to propose a new process to quarterly change the supply rate in 2025 and beyond.
- The key finding of this report is that the supply rate is recommended to increase from 11.63 cents per cubic meter to 13.13 cents per cubic meter starting November 1, 2024. The report also recommends changing the supply rate quarterly starting from January 1, 2025, by following the proposed Supply Rate Policy in Attachment A. The delivery rates are recommended to change as per Attachment B with effect from January 1, 2025.
- The financial implications of the delivery rates change to Kitchener Utilities residential customers will be an increase of approximately \$10.30 annually or 2.1%. The supply rate increase will have an impact of \$30 annually or 13% to Kitchener Utilities system gas average residential customer.
- 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 supply 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. Although this feature is designed to soften spikes in market prices and provide longer range rate stability, it does not protect against rate shocks that usually follows a delayed response to changing market conditions.

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.

In this report, Kitchener Utilities proposes changes to optimise supply rate adjustment process along with changes to supply and delivery rates based on updated market conditions and 2025 budget requirements. The last natural gas supply rate change was in May 2024. At that time, the supply rate was decreased with a plan to review the prices more frequently due to the anticipated volatility in forward market prices. 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 support rate stability.

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 customers 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 increases for system gas customers.
- A proposal for a new process to change the supply rate in the future to increase market responsiveness, reduce rate shock, and mitigate rate spikes.
- Delivery rate increases as proposed in Attachment B.

Gas Supply Rate:

The natural gas supply program is a pass-through program. The rules around what is included in the supply rate are governed by Ontario Energy Board (OEB). Although Kitchener Utilities are not required to seek OEB approval to change their rates, they are required to abide by OEB rules and regulations about how to allocate costs and how to manage distribution services. Only the cost of gas commodity, transportation and related costs can be included in the supply rate. These costs have to be reviewed frequently and savings, or losses have to be passed directly to customers as the program operates as non-profit. The supply rate is calculated based on costs required to acquire the gas and the forecasted gas volumes to be delivered to customers. The gas volumes are weather dependant and the natural gas commodity market prices usually fluctuate with supply, demand, and weather factors.

To mitigate market price fluctuations, Kitchener Utilities relies on its purchasing policy to create a blended portfolio of hedging (fixed price contracts) and market price purchases. Kitchener Utilities sets limits on the percentage of hedging within the portfolio to minimize the risks of, “out of the money”, contracts and maintain market responsiveness. Along with the purchase policy, KU also uses the stabilization reserve to absorb sudden market price increases and soften rate spikes. However, with increased volatility in market prices and consecutive mild winters, Kitchener Utilities made frequent supply rate adjustments in the last couple of years to ensure that stabilization reserve balance remains within policy threshold without the need to increase the hedging percentage of the portfolio.

In 2024, supply rates were set based on normal winter consumption and average market prices forecasts. The 2024 winter was very mild resulting in high storage balances and actual market prices dropped significantly. Kitchener Utilities staff managed to secure very low-priced deals for considerable amount of gas; however, the high storage levels reduced the ability to buy more lower priced gas. Kitchener Utilities was able to reduce the supply rate in May 2024 by more than 30% to pass back the saving to customers. However, assuming normal weather conditions for the coming winter of 2024/2025, and average forward market prices indicate the need to increase the supply rate significantly in 2025. To reduce rate shock to customers, implementing smaller more frequent changes to rates will help support delivering rate stability to customers compared to one or two large rate adjustments per year.

This approach provides the following benefits:

- Reduces rate shock: The impact of each rate change would be smaller as more frequent rate changes improve overall rate stability and support affordability for customers.
- Increases market responsiveness: frequent rate changes allow rates to follow market prices more closely and reduce the need for hedging. Although hedging provides price stability, it comes with a premium and the risk of, “out of the money”, deals in decreasing market conditions.
- Improves financial planning: external factors such as weather conditions or market prices can be addressed quicker with frequent rate changes reducing the impact of uncertainty on closing balances and future budgets.
- Aligns with OEB policies and practices followed by rate regulated gas utilities as well as the approach followed by Utilities Kingston.

Following a planned supply rate adjustment in November 2024, KU staff plan to follow a defined quarterly supply rate adjustment schedule. The supply rates will be changed if needed at the following dates of each year:

- January 1st,
- April 1st,
- July 1st, and,
- October 1st.

Kitchener Utilities staff is also proposing modifications to the supply rate change process to streamline the process and allow the quarterly rate changes to be completed on schedule with reasonable efficiency and oversight.

Supply Rate Change Process:

Enbridge Gas follows the OEB process to review and change their supply rate quarterly. The OEB have created a mechanistic process that allows for oversight and provides approvals in timely manner with minimal intervention. In addition, Utilities Kingston utilizes a similar process to obtain automatic approval from City of Kingston council to change their supply rate quarterly through delegated authority of staff to adjust supply rates quarterly.

Kitchener Utilities is proposing a similar approach to delegate authority to staff to adjust the gas supply rate quarterly. In the event of a supply rate change, Kitchener Utilities staff will notify council members by e-mail at least 2 weeks before the implementation date of the supply rate change. The new delegated authority process would:

- Authorize CFO or their designate to approve rate change.
- Ensure that supply gas rates are reviewed and updated quarterly inline with industry practices.
- Provide more timely benefit to customers in decreasing prices conditions and avoid rate shock during increasing times.
- Maintain transparency and timely communications with customers, stakeholders, and Council members.

KU staff are proposing a new policy that details the new process. The proposed policy is available in Attachment A.

In summary, staff recommend the following:

- Increase the supply rate from 11.63 cents per cubic meter to 13.13 cents per cubic meter effective November 1st, 2024;
- Adopt a quarterly supply rate change approach starting from January 1st, 2025, and;
- Implement a delegated authority policy to approve future supply rate changes as detailed in the proposed policy in Attachment A.

Figure 1 below shows historical and forecasted supply rate changes for Kitchener Utilities compared with market prices and Enbridge rates. 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 forward market price, gas models and assist in purchasing KU's natural gas portfolio.

NG Market Price vs KU Gas Rate vs Enbridge Gas Rate

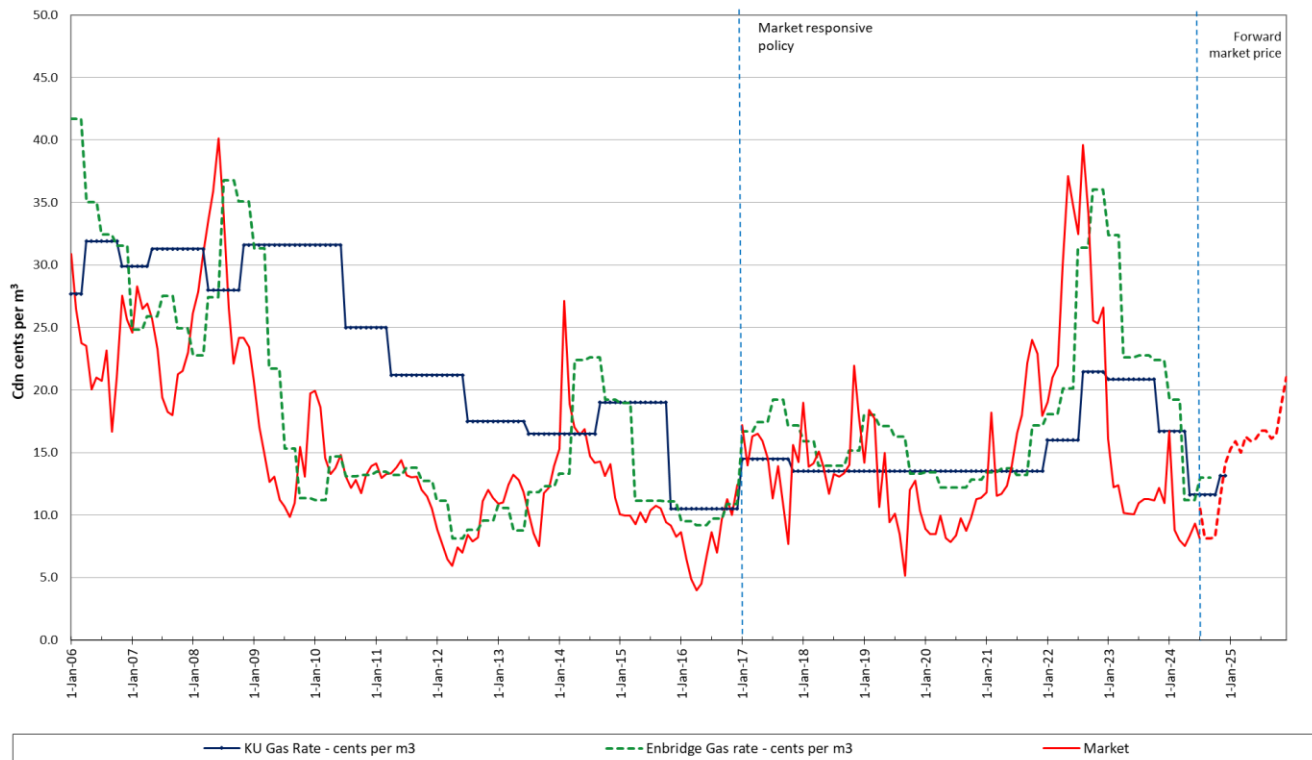


Figure 1: Natural gas supply rates comparison.

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 Appendix B). These rates service customers of different volumetric requirements. The gas delivery revenues fund all Kitchener Utilities operating and capital programs in addition to the cost of Enbridge’s T3 contract with KU. However, these revenues are weather dependant as mild winters reduces gas sales. Kitchener Utilities relies on delivery stabilization reserve to mitigate the impacts of weather on gas revenues.

Changes to delivery rates are typically required at least once a year to absorb cost inflation and to fund new programs or requirements. For 2025, the new programs costs are offset by savings resulting from the successful intervening by KU staff in the Enbridge rate application before the OEB. That rate application proposed significant rate increases to Kitchener Utilities T3 contract which were denied by the OEB. KU staff is recommending a small increase to all delivery rate components in all rate groups starting January 1st, 2025. The changes vary between 2% to 3% for the majority of customers (M1 and M2 customers). These changes are needed to maintain the delivery stabilization reserve at a reasonable balance to mitigate the impacts of mild winters. The proposed fixed and variable rates for all rate groups are available in Attachment B.

Comparison with Enbridge:

Comparison to Enbridge rates cannot be completed at this time as Enbridge supply and delivery rates for 2025 have not been announced yet. Historically, Kitchener Utilities considered Enbridge rates during the rate setting process as it relates to competitiveness and affordability

considerations. Kitchener Utilities is expected to continue to do so even with moving to a more frequent supply rate setting approach.

STRATEGIC PLAN ALIGNMENT:

This report supports the delivery of core services.

FINANCIAL IMPLICATIONS:

The planned delivery rate increase will bring the stabilization reserve to a reasonable balance within the thresholds to mitigate weather factors on revenues. The delivery rate increase will also increase the capital stabilization reserve. However, the capital stabilization reserve remains significantly below the minimum threshold. The 5-year operating budget projection (as of August 23, 2024), for gas delivery is presented in Attachment C.

The planned delivery rate increase will have an impact of \$10.30 per year or 2.1% on Kitchener Utilities average M1 residential customer.

The planned increase to supply rate is forecasted to grow the supply stabilization reserve over the maximum threshold in 2024; however, it still required to mitigate rate shock to customers in 2025. The plan is to maintain the supply stabilization reserve within the thresholds by the end of 2025 using quarterly adjustments, as required. The 5-year operating budget projection (as of August 23, 2024), for gas supply is presented in Attachment D.

The impact of the planned increase to the supply rate to Kitchener Utilities system gas average residential customers will be around \$30 per year or 13%.

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

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 about the change on the Kitchener Utilities' and City websites.

Future supply rate changes will be posted on the Kitchener Utilities' and City websites along with bill message on the utility bills. A public notice will also be placed in the paper.

PREVIOUS REPORTS/AUTHORITIES:

- [INS 2023-247](#) Natural gas Purchase Policy Review -2023
- [INS-2023-334](#) 2023-2024 Natural gas Supply and Delivery Rates
- [INS-2024-168](#) 2024 Natural gas Supply rate Change 1

APPROVED BY: Denise McGoldrick, General Manager Infrastructure Services.

ATTACHMENTS:

Attachment A – Gas Supply Rates Policy

Attachment B – Natural Gas Rates

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

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