

Staff Report



Infrastructure Services Department

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REPORT TO: Special Council

DATE OF MEETING: June 20, 2022

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WARD(S) INVOLVED: All Ward(s)

DATE OF REPORT: June 6, 2022

REPORT NO.: INS-2022-282

SUBJECT: August 2022 Gas Supply Rate Change

RECOMMENDATION:

That the supply rate of natural gas be increased to 21.45 cents per cubic meter from 16 cents per cubic meter for system gas customers of Kitchener Utilities effective August 1st, 2022; and,

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 a mid-year review and recommendations for the natural gas supply rate of Kitchener Utilities.
- The key finding of this report is that the gas supply rates are recommended to increase from 16 cents per cubic metre to 21.45 cents per cubic metre to respond to significant increase in market prices, mitigate the current year financial risks for the utility and significant rate impacts to Kitchener Utilities customers during the upcoming heating season. This rate is lower than Enbridge's projected rates for the same time period.
- The financial implications to KU residential costumers will be an average of \$40.51 over a period of 5 months (remainder of 2022). The rate increase is required to mitigate operating losses due to the escalation in natural gas commodity costs and to also avoid significant rate shock to customers during the upcoming heating season.
- 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 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.

The natural gas market is impacted by the supply and demand; in the past few years, both of the factors were balanced and predictable. However, recent events have changed that balance and created uncertainty in the supply and demand trends. Events such as:

- Global Pandemic that is still impacting the gas supply, while the demand is increasing as the economy is recovering,
- Cold winter in North America in 2021/2022 season drove natural gas storage to very low levels and increased the demand,
- Global uncertainty and demand caused by the war in Ukraine.

These conditions have increased the demand for natural gas and added uncertainty to the gas supply resulting in a volatile and increasing market prices; that are forecasted to last until the end of the year and likely the end of the next heating season.

Kitchener Utilities last rate increase was in January 2022 and the plan was to maintain that rate for a year; however, the recent spike in natural gas price along with the forecasts for future prices indicated that urgent action is needed now. While some of our gas requirements are secured through reasonably priced contracts, we still need to purchase a significant amount of gas at market prices to meet customer demand and provide storage for the coming heating season. Knowing that natural gas prices are rising, we are recommending a rate change now to ensure that revenues are sufficient to address the costs while also managing the impact for customers to avoid a significant rate spike in 2023.

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, non-profit program. The supply stabilization reserve is used to absorb the differences between supply revenues and expenses; and it is essential to maintain supply rate stability in mild volatility market conditions. It is important to maintain the reserve at a minimum level to ensure that future market fluctuations are absorbed.

The delivery program is responsible for delivery of natural gas to customers. This includes billing, meter reading, capital, maintenance, and operating costs of the gas distribution system.

Gas Supply:

The natural gas market prices usually fluctuate with supply, demand, and weather factors. 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, gas models and assist in purchasing KU's natural gas portfolio. Their forward market prices consider supply and demand factors however, the recent pandemic, weather conditions and the global and geopolitical considerations have increased the uncertainty and volatility which made it very difficult for experts to predict future prices. The current prices have been higher than recent forecasts which indicates the volatility as well as the rising trend in market prices. With no simple solution in the horizon for the natural gas supply, the sharp increase is expected to last until the end of the coming heating season as illustrated below.

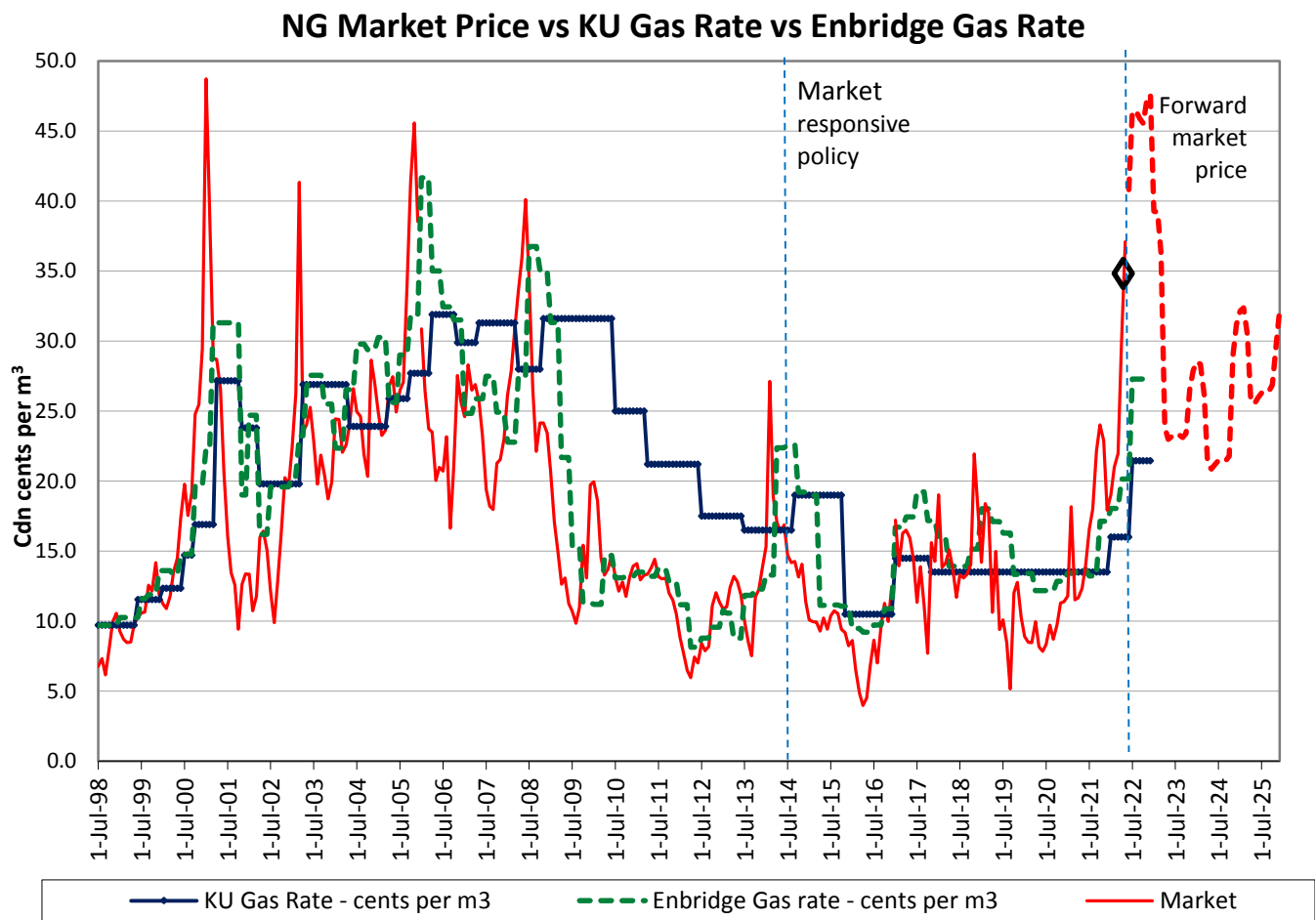


Figure 1: Natural gas supply rates comparison

Kitchener Utilities still needs to purchase significant quantities of natural gas to meet the forecasted requirements for 2022 and 2023. These quantities will be purchased at market prices which are currently nearly double our budget rates and are expected to increase further. This will put additional strain on the stabilization reserve and could drive it into the negative by the end of 2022. This is very risky due to the volatility in the market and the uncertainty in price forecasts. If prices continue to be higher than budget, the financial risks to KU will be significant and a substantial rate increase in 2023 would be required to recover the losses in 2022 and return the stabilization reserve to its minimum balance as well as compensate for the natural gas market prices at that time. That type of rate increase has the potential for rate

shock, would burden our customers during the heating season and is not aligned with our program goal of rate stability.

Gas Supply rate increase August 1, 2022, by 5.45 cents/m³

KU staff used forward market prices to analyse different scenarios to evaluate and recommend plans to mitigate the financial risks to the utility and its customers. The best option to reduce the financial risk and rate spike is to increase the gas supply rate on August 1st, 2022, from 16 cents/m³ to 21.45 cents/m³ with a plan to review the rate quarterly or as required. This scenario maintains the stabilization reserve at a recommended minimum approved level to mitigate the risks caused by forecasts uncertainty. It also eliminates the risk of significant rate shock to customers during the heating season. The budget projection for this scenario is provided in Attachment A.

Comparison with Enbridge Supply Rates

Enbridge's current gas supply rate is 20.15 cents/m³ and they are requesting to increase it in July 2022 to either 31.375 cents/m³ (Enbridge preferred option) or 27.338 cents/m³ (alternate option) in their latest Quarterly Rate Adjustment Mechanism (QRAM) application to Ontario Energy Board (OEB). The OEB decision will be announced on June 16th. The proposed new KU gas supply rate will be lower than Enbridge's gas supply rate and the total gas cost (supply and delivery) for KU customers will also remain below the cost of Enbridge for 2022.

Recommendations

The August rate increase for 2022 is recommended as it will help mitigate the current year financial risks for the utility and reduce the future financial impact to KU customers. It is recommended to:

- Increase the supply rate to 21.45 cents/m³ starting from August 1st, 2022.
- Review the supply rate quarterly and propose changes (either rate reductions or increases) in the future if market conditions change.

Gas Delivery:

There are no proposed changes to delivery rates at this time. Changes to delivery rates will be considered during the 2023 budget process.

STRATEGIC PLAN ALIGNMENT:

This report supports the delivery of core services.

FINANCIAL IMPLICATIONS:

The financial implications to Kitchener Utilities in the current market without a rate increase would increase the risk of the stabilization reserve going into a deficit which would result in a rate increase spike in 2023. The recommendation to increase the gas supply rate to 21.45 cents/m³ effective August 1st, 2022, is required to maintain a positive balance in the reserve. With the rate increase, the forecasted reserve balance in 2023 to 2027 will be below the reserve policy

minimum balance but is anticipated to remain in a positive balance (Attachment A). This forecast assumes moderation in commodity pricing in 2023, however should commodity prices continue at the current rate, this will necessitate a further supply rate increase in 2023.

For an average system gas residential customer consuming 2,100 cubic meters annually, the proposed natural gas supply rates result in an increase to the bill by approx. \$40.51 in 2022.

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:

Kitchener Utilities will work with the Corporate Communications and Marketing Division to ensure that media outlets are provided with a press release to inform customers. An insert will be distributed with utility bills along with information will be posted on the Kitchener Utilities' and City website. An on-bill message will also appear in July and August 2022 natural gas bills.

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

PREVIOUS REPORTS/AUTHORITIES:

- INS-2021-13 2022 Natural Gas Rates

APPROVED BY: Denise McGoldrick, General Manager Infrastructure Services

ATTACHMENTS:

Attachment A – 2022 August supply rate increase projection