

# Staff Report



Infrastructure Services Department

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**REPORT TO:** Finance and Corporate Services Committee

**DATE OF MEETING:** December 12, 2022

**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:** December 5, 2022

**REPORT NO.:** INS-2022-486

**SUBJECT:** 2023 Natural Gas Rates

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## RECOMMENDATION:

That the supply component of the natural gas rate be decreased to 20.85 cents per cubic meter from 21.45 cents per cubic meter for system gas customers of Kitchener Utilities effective January 1, 2023; and,

That Kitchener Utilities' natural gas variable and fixed delivery rates be approved as proposed in report INS-2022-486 - Attachment A, for all Kitchener delivery customers effective January 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 2023
- The key finding of this report is that the supply rate is recommended to decrease from 21.45 cents per cubic meter to 20.85 cents per cubic meter to respond to slightly lower market prices in updated forecasts. The report also recommends increasing 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 approximately \$81 or 10% during 2023 over the 2022 natural gas rates
- 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

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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 disruption to natural gas supply due to the war in Ukraine, extreme weather conditions and increased demand for economic recovery have resulted in a volatile and increasing market prices. They also increased the uncertainty in market forecasts, made forecasting much harder and increased the margin of error in all forecasts and predictions.

Kitchener Utilities last natural gas supply rate increase was in August 2022 and the plan was to review the prices more frequently due to the anticipated volatility in market prices. 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 entering the heating season and the proposed changes aim to timely adjust rates to reduce future impacts, 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 decrease for system gas customers;
- Delivery rate increases as proposed in Attachment A;
- An average residential customer will see an overall rate increase of approx. \$81 or 10%, for the period January 1st, 2023 to December 31st, 2023 with the proposed rate changes

## **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. The recent increase in market prices was significant and risked driving the stabilization reserve into the negative. Given the uncertainty and high volatility in market prices, a rate increase in August of 2022 was needed to ensure sufficient funding was available and to maintain the stabilization reserve within the approved limits, by the end of 2022. Although gas prices increased

significantly in recent months, the increase was below forecasts. Additionally, KU used a measured approach to secure reasonably priced deals for its 2022 requirements. This helped KU in keeping the stabilization reserve at a very good balance at the end of 2022.

As the high prices, high volatility and uncertainty are expected to continue into 2023, staff recommend keeping the stabilization reserve balance at the maximum limit, continue monitoring market conditions and revise the supply rate as needed. Staff also recommend reducing the supply rate from 21.45 cents per cubic meter to 20.85 cents per cubic meter effective January 1<sup>st</sup>, 2023 to reflect the fact that actual market prices were slightly lower than forecasts.

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 significantly 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.

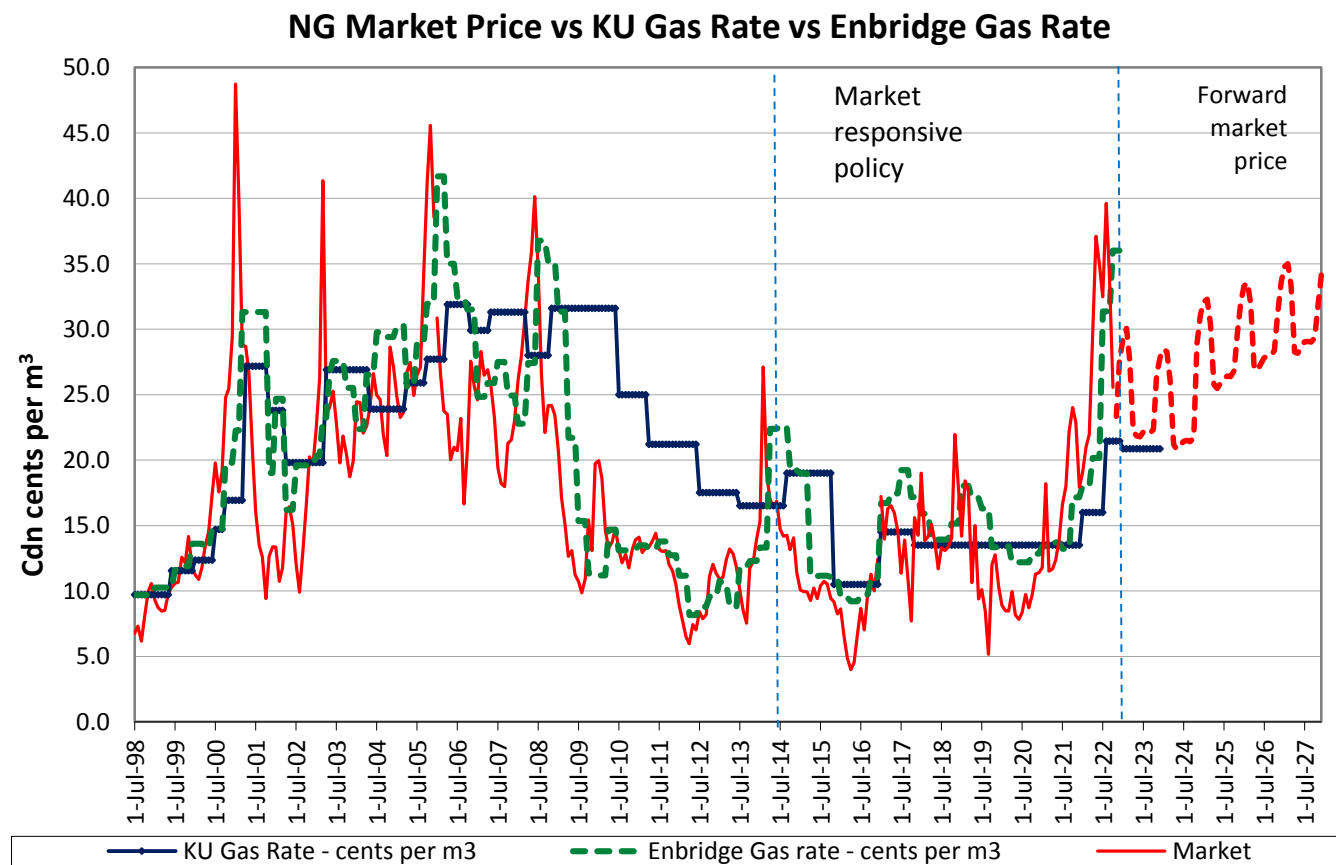


Figure 1: Natural gas supply rates comparison

**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. The

proposed delivery components of the natural gas rates starting January 1<sup>st</sup>, 2023 are shown in Attachment A. The key drivers of delivery rate changes are the following:

- Additional resources that are needed to meet new regulatory requirements
- Critically low delivery stabilization reserve that need to be increased to mitigate financial risks to the gas utility and its customers
- Inflationary increases to operating and capital expenditures

### **Comparison with Enbridge:**

For an average system gas residential (M1) customer, the total KU gas bill cost in 2022 was 14% lower than the cost of similar customer in Enbridge franchise area. It is expected that the total gas cost for Kitchener Utilities customers will continue to be lower than Enbridge in 2023 as their gas supply rate is forecasted to remain high although it has not been determined 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 an increase to the overall annual bill by approx. \$81 for the period January 1, 2023 to December 31, 2023. 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 2022 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 2022 budget estimate and therefore, a decrease in the supply rate intends to keep the balance towards the maximum benchmark of the reserve. 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 needs to 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 media outlets are provided with a press release to inform customers. An 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 in January 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-2021-13 2022 Natural Gas Rates
- INS-2022-282 August 2022 Gas Supply Rate Change

**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