

<b>Committee:</b> Markets Committee	<b>Dated:</b> 25 September 2019
<b>Subject:</b> Energy Costs Update	<b>Public</b>
<b>Report of:</b> The City Surveyor report ref CS 400/19	<b>For Information</b>
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### Summary

This report presents the context for the recent energy price increases and a narrative on present commodity prices and forward strategy options.

### Recommendations

Members are asked to receive this report.

### Main Report

#### Background

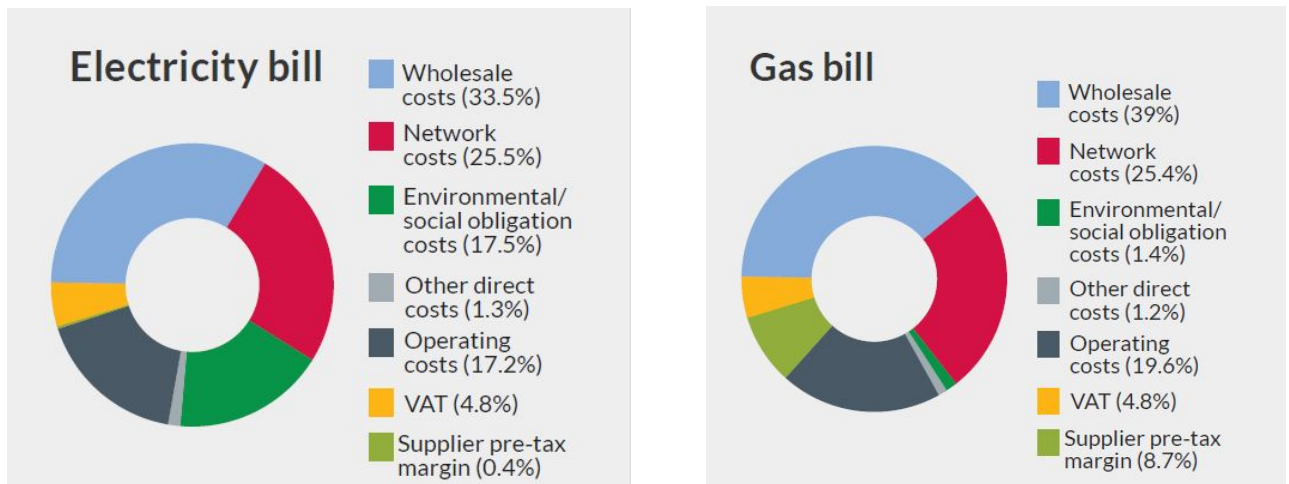
1. In 2017 The Court of Common Council directed the energy and procurement teams to undertake a tender exercise for the provision of energy procurement brokerage. The existing provider, Laser had been incumbent for in excess of 10 years. Following a tender process, Utilyx energy (recently acquired by the Mitie group) were successful in winning this bid. Consultation included working group representatives from the energy management team, procurement, housing, markets, DBE, Open spaces and finance.
2. The Corporation's previous arrangement for procuring energy via Laser expired in September 2018 and following an OJEU tender process Utilyx Energy have been appointed as our new broker. Total Gas & Power have also been appointed as the City's electricity and gas supplier with effect from October 1<sup>st</sup>, 2018. Energy for the core supply contract has been procured in four lots:
  - **Lot 1** – Supply of Electricity (Half Hourly and Non-Half Hourly) Flexible Purchase;
  - **Lot 2** – Supply of Gas Flexible Purchase;
  - **Lot 3** – Supply of Electricity (Half Hourly and Non-Half Hourly) Fixed Price; mainly for Housing - to provide individual households with price security;
  - **Lot 4** – Supply of Gas Fixed Price; mainly for Housing - to provide individual households with price security

#### Energy market conditions

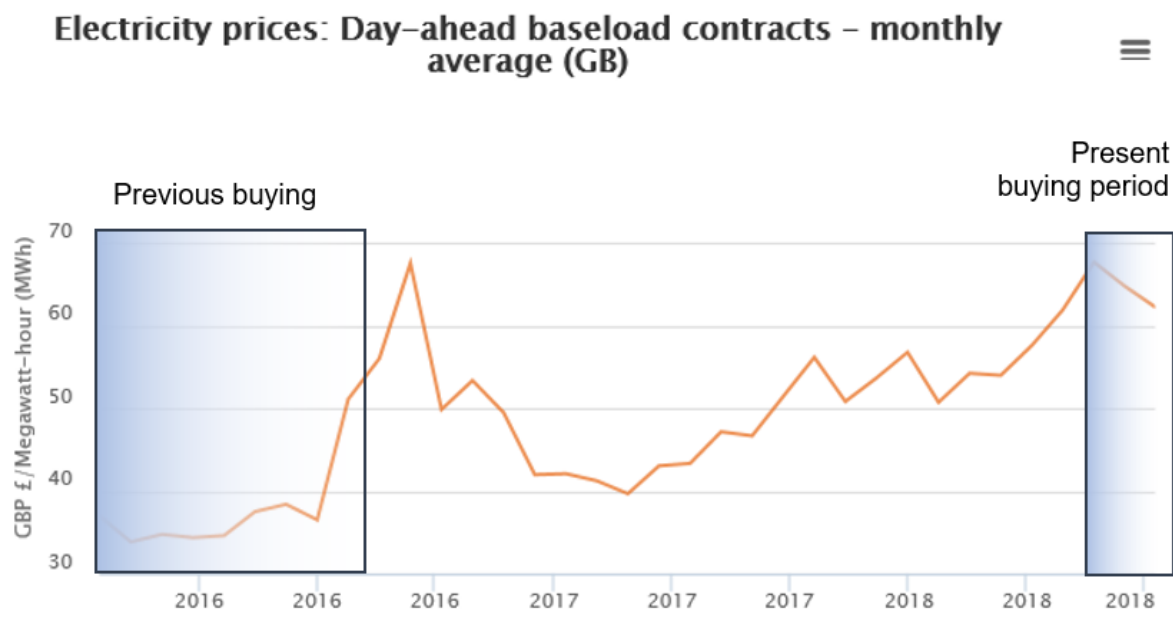
3. Energy market prices have proved to be extremely volatile in the last 24 months with the market seeing significant rises well above inflation due to a number of factors:

- Shortage of UK long-term gas storage increasing prices for winter gas supply
- Rapid escalation of carbon markets which is incurred by suppliers and passed through to consumers
- Increase in non-energy grid costs and environmental levies, which are now representing over half the delivered cost
- Increase in oil prices caused by sanctions and reduction in output from OPEC nations.
- Surge in energy commodity volatility caused by increase in trading from non-end users

Figure below: Breakdown of typical electricity and gas bill – Source OFGEM



Figures below: Energy commodity (wholesale) market tracking



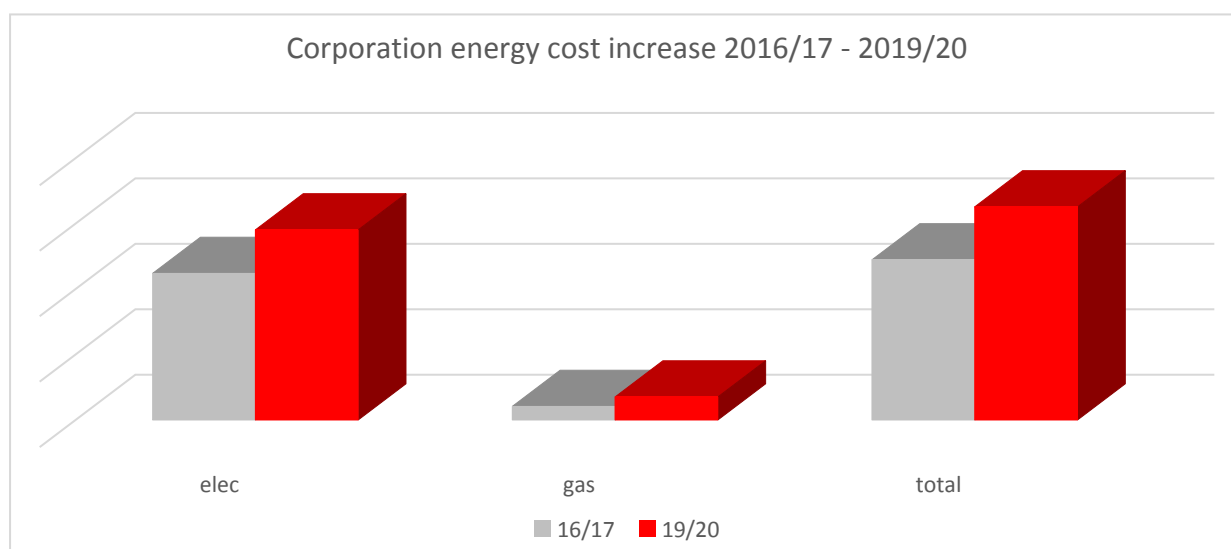
## Gas prices: Day-ahead contracts – monthly average (GB)



What this means for the City and the budget implications from October 2018 onwards is that gas and electricity prices for the Corporation have risen by 33%<sup>1</sup> across the portfolio compared to prices secured in 2016, which was purchased at the market low point. On average this means:

- 30% cost increase for electricity
- 70% cost increase for gas

*Figure below: Corporation Energy Cost Budgets*



## Renewable Energy

4. In support of the City's Responsible Business plan the Corporation has committed to procure 100% renewable electricity across the portfolio from October 2018 onwards from a combination of certified solar, wind and hydro sources. This has incurred a very small cost premium <0.2% of overall energy costs, however this cost is being met centrally so that there is **No additional cost to departments for renewable energy provision.**

<sup>1</sup> This is an average figure across the portfolio and the energy team can provide individual figures per lot

## Future Outlook

5. The non-energy invoice elements, such as transmission, distribution and carbon taxes are set to continue rising for the next five years while commodity (energy elements) continue to show high volatility in the wholesale energy market. To cover this volatility the energy team are now forward buying to provide an element of protection.
6. The outcome of the UK leaving the European union is also likely to have a marked effect on energy prices going forward. A hard Brexit is likely to reduce carbon prices for an interim period while the UK moves to an independent cap and trade scheme. A soft Brexit indicates that the UK will continue to participate for a further 2 years in the exiting EU scheme which means prices may remain high and volatile. Currency devaluation may also be a factor in forward energy prices.

## Mitigation

7. Consumption management: A series of energy efficiency initiatives at Smithfield markets have reduced costs by £200k year to date. The energy team continues to work on identifying further consumption savings.

## Commodity Price Risk

8. The energy team are presently undertaking a tender exercise to forward buy 50% of the Corporations electricity supply through a renewable energy development or power purchase agreement. The aim of this exercise will be to provide cost certainty and long-term reduced commodity cost. Should the tender prove attractive, the revised energy supply contract will take effect from October 1<sup>st</sup> 2020.

## Strategy

9. The present 'lots' which cover the provision of energy to the markets expire in September 2021. To allow sufficient time to develop any potential alternative strategy for the markets, the energy team propose a dedicated energy strategy session for the markets to fully crystalize constraints, risk appetite and communication requirements.

## Conclusion

10. **Energy price increases for the Corporation reflect price increase in the market more generally.** We recommend a separate review meet with markets to confirm future energy procurement risk and tenant communication strategy. In order to mitigate the unavoidable market rate increase for energy prices, the energy team have reduced consumption at Smithfield Market by circa £200k year to date and will continue to identify further savings.

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