TORONTO

Corporate Services Department
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2005 BUDGET BRIEFING NOTE - Utilities – Economic/Inflation Factors

Issue:

To describe the utility rate structures and clarify the methodology in determining the economic/inflation factors for utilities.

Background:

The City has a diverse facility portfolio and uses various energy types for its operations. For all energy types, the projected energy cost is calculated by multiplying the energy use times the energy rate. The energy rate for electricity and natural gas is generally comprised of two components, distribution and commodity. Other energy types usually blend the two components together into one rate.

The distribution rates for electricity and natural gas are regulated by the Ontario Energy Board. The commodity portion of the rate is not regulated.

Electricity: Distribution rates are regulated by the Ontario Energy Board. The distribution rate is comprised of various rate classes based on volume of use. The distribution rate accounts for 35-40% of the total energy cost. Toronto Hydro is the local distribution company.

Commodity rates are **not** regulated and accounts for 60-65% of the total energy cost. The City entered in a Power Purchase Agreement with Toronto Hydro Services Inc. starting May 01, 2002 and the Agreement was recently extended to December 31, 2006. Under the Agreement, the commodity rates have been set for the various City facilities and operations.

It should be noted that the Government of Ontario capped the energy commodity price at 4.3 cents for designated customers retroactive to May 01, 2002 and a new two-tier rate cap was introduced and effective April 01, 2004. The City accepted the 4.3 cents rate cap but elected to go back to the contract rate effective April 01, 2004.

Natural Gas: Distribution rates are regulated by the Ontario Energy Board. The distribution rate is comprised of various rate classes based on the volume of use. The distribution rate accounts for 25-30% of the total energy cost. Enbridge is the local distribution company.

Commodity rates are **not** regulated and accounts for 70-75% of the total energy cost. The City has contracted with three suppliers for a 3 years period starting November 01, 2004. The commodity rate is the same for all City facilities.

Water: Both the distribution and commodity rates are blended into one rate. The City is the local distribution company and sets the rates annually.

Steam: Both the distribution and commodity rates are set by Enwave which is also the sole provider of steam in the City. Enwave adjusts its rates based on the costs for providing steam services.

Heating Oil: Both the distribution and commodity rates are set by the oil supplier and blended into one rate. The rate is not fixed and subject to market conditions.

Economic/Inflation Factors:

The local utility distribution companies adjust their rates at least annually and since the rates are adjusted by rate class, there are different economic/inflation factors for each rate class. The weighted average economic/inflation factor is calculated for each energy type.

Calculation Methodology:

1. Potential energy rate increases/decreases and other energy escalation factor are gathered from the local distribution companies, energy consultants/specialists and energy price index/forecasts.
2. This projected energy inflation rate (both the distribution and commodity) is applied to the various rate classes for all the facilities.
3. The increases/decreases are then averaged for all the facilities and the total energy consumption for each utility type . This net increase/decrease is the weighted average economic/inflation factor for all facilities and operations.

The following table shows the weighted average rate increases for the various utilities for the past 4 years, and the projected rate increase for 2005 and 2006,

Year	Electricity	Natural Gas	Water	Steam	Heating Oil
2001	6%	18%	2%	12%	15%
2002	5%	-25%	9%	-15%	5%
2003	-2%	5%	9%	34%	4%
2004	9%	11%	7%	6%	15%
2005	8%	20%	6%	10%	10%
2006	2%	3%	7%	15%	15%

Conclusion

Energy costs are a large City expenditure. Economic factors can be controlled through effective bulk purchase arrangements such as the Power Purchase Agreement and the Natural Gas Direct Purchase Program. These programs have reduced the risk the City is potentially exposed to in the volatile deregulated energy markets.

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