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OXFORD CITY COUNCIL

To: City Executive Board

Date: 1st April 2009 **Item No:**

Joint Report of: Head of Environmental Development and Strategic Procurement and Shared Services Manager

Title of Report: Strategic Overview of the Options for Purchasing Energy

Summary and Recommendations

Purpose of report: To explain the recommendation to purchase most of the Council's energy for up to three years through flexible purchasing contracts. For the Executive Director for Regeneration to be given delegated powers to award the energy contracts following EU tenders by LASER.

Key decision Yes

Executive lead members: Councillor Oscar Van Nooijen / Councillor John Tanner

Report approved by: Councillor Oscar Van Nooijen
Councillor John Tanner
Mel Barrett, Executive Director for City Regeneration

Finance: Andy Collett
Legal: Lindsay Cane

Policy Framework: Oxford City Council Corporate Plan
Transform Oxford City Council by improving value for money and service performance.

Recommendation(s):
That the City Executive Board give approval to:

1) Grant project approval to use LASER for the purpose of letting the Council's replacement energy contracts.

2) Approve the Energy Purchasing Strategy set out in section 4 of this report, and to use the LASER service to enter into new energy contracts based on Flexible Purchasing - In Advance Purchasing, where appropriate to enable the Council to take advantage of the current price reduction in energy prices. This is in line with the recommendations of the professional energy buying consortia.

3) A green energy quote will be obtained whenever it is possible to do so. The price for green energy will be compared against the standard quote and members will be advised of the option to purchase green energy in the context of overall value for money.

4) Delegate authority to the Executive Director for City Regeneration to enter into the new replacement energy contracts identified by the process as set out in recommendations 1 and 2 as and when required.

5) Approve the creation of an Energy Fund for any energy under spend in 2009/10, capped at £250,000, and not attributed to Salix funded energy saving projects, to provide financial resilience against future price rises of up to 12%.

1. Summary

1.1 This report sets out the options for purchasing and managing our energy supply arrangements for up to the next three years and explains why energy procurement requires specialist support to leverage the best pricing and supply arrangements.

1.2 The report also provides information on the current contract costs and potential savings that could be achieved with an option to create an Energy Fund to be used to provide financial resilience against future price rises.

2. Background

2.1 The Council currently spends approximately £1.7 million a year on gas and electricity across all of its buildings. The expenditure is split as follows:

- Gas - £500k
- Electricity - £1.2 million

The current budget for both categories 2008/9 is £1,786,531.

2.2 As a result of the rise in energy prices in the second and third quarter of 2008, the Council increased the energy budgets for 2009/10 to cover the increased costs.

2.3 The increased budget for 2009/10 is £2,101,955, split between each energy as follows:

- Gas - £616k
- Electricity - £1.486 million

Most of this expenditure is currently managed through the contracts currently in place with LASER, which is one of the national energy buying consortia working on behalf of local authorities.

2.4 Energy prices rose steeply in 2008. This has resulted in the Council budgeting for electricity increases of up to 48% and gas increases of up to 23% for 2008/9 and 2009/10. The sharp prices rises of 2008 are now falling and the rates are expected to continue to fall until later in the year.

2.5 The contracts for electricity and gas are due for renewal in:

- Gas (greater than 73,268kWh/2500therms) - 1st October 2009
- Electricity non-half hourly metered sites - 1st October 2009
- Electricity half hourly metered sites - 1st November 2009

2.6 Our current energy usage across each of contract is:

- Gas sites under contract 16,100,000 KWH per annum
- Electricity non half hourly sites 2,850,000 KWH per annum
- Electricity half hourly metered sites 5,600,000 KWH per annum

2.7 Currently thirty-one gas-metered sites are included in the gas contract and approximately 465 electricity-metered sites are included in the electricity contracts. A meter audit is currently underway across the Council covering electricity, gas and water metering. This will assist in ascertaining whether additional sites over a certain usage size, should be included within the gas and electricity contracts. This will also assist in more accurately establishing the KWHs used at each site and will support better budget management of energy consumption. (See other matters section).

2.8 The Council is currently paying a weighted average of 12.5 pence per kWH for electricity and 2.75 pence per KWH for gas at the sites under contract.

2.9 In 2007/8 the Council was paying an average of 8.5 pence per KWH for electricity and 2.3 pence per KWH for gas. This equates to an average increase of 47% for electricity and 20% increase for gas which has been reflected in the budget uplift.

3. Energy Purchasing

3.1 Since gas and electricity markets opened to competition in the 1990's, the energy market has become a highly specialised field of procurement. The complexity of the procurement options can create a risk if not managed by someone with the appropriate level of skills and expertise. It is also time consuming due to the potential number of suppliers and types of contract available.

3.2 In the previous non-volatile market it was possible to purchase energy without detailed specialist expertise. However, since 2006 the market pricing has changed and specialist buyers monitor the market on a daily basis to ascertain the best opportunities to purchase energy, including advance purchasing. Specialist support is now required to ensure value for money and appropriate risk management levels are applied.

3.3 Several buying organisations, both private and public sector, can secure such contracts on our behalf. Public sector organisations are favoured because they focus solely on public sector needs rather than trying to match the potentially competing objectives and requirements of private and public sector organisations. In addition, these groups have a long experience of acting on behalf of the public sector and are therefore well versed in their requirements and processes. Lastly, they will certainly comply with EU procurement rules.

3.4 Purchasing on the energy market has become similar to buying on the stock market. Several recent publications endorse the view that in order to improve

energy procurement, specialists need to be engaged. Examples of recent reports include:

- Office of Government Commerce – 'Saving Money on Energy', March 2007;
- Regional Centres of Excellence Procurement Programme – 'How to Be Successful in Energy Procurement', April 2007;
- Department for Education & Skills – 'Buying Energy, 2007'; and
- Office of Government Commerce, Pan-Government Energy Project – 'Decision Making in Energy Procurement', November 2008.

3.5 Most Councils now either engage specialist consultants to manage the tender process or work with specialist energy consortia to manage their energy procurement. The consortia employ energy procurement specialists who are able to use their skills to purchase at the best times and achieve additional leverage from the volumes purchased on behalf of the organisations for which they work.

3.6 Three well-established buying consortia, the Office of Government Commerce, OGC, the Local Authority South East Region energy buying group, LASER and the Purchasing and Supply Agency, PASA work on behalf of local authorities and public bodies; each employs energy specialists to manage energy supply.

3.7 The PASA buying consortia specialises in energy procurement on behalf of hospitals and the NHS. It does offer its services to the public sector but its buying strategies are based on the demand and usage patterns of the NHS which can be very different from our needs.

3.8 The OGC provides specialist energy procurement on behalf of central government and local authorities. They are able to offer us the procurement service but do not offer the same level of ongoing support in relation to contract management as is offered by LASER.

3.9 LASER specialises in energy purchasing for local authorities and offers a complete procurement service. It manages tenders electronically and has a reputation for achieving excellent pricing. LASER has a good reputation with the supply market. Considerable savings are achieved, not just at the actual point of procurement but through the management of the contract and ongoing supplier relationship. These services are offered as part of their ongoing service management and include:

- Support with billing issues, including bill validation on the larger sites
- Assistance with new sites and changes
- Collection of the Climate Change Levy

3.10 The Energy and Procurement team's officers have met with both OGC and LASER, and have also researched what other local authorities are doing to establish which agency will offer the best financial and added value service for our energy supply.

3.11 All specialist energy procurement support comes with a cost. The estimated costs for using either OGC or LASER are provided in the table below. The basis of

charge by each buying consortia is offered on a slightly different basis so has been calculated back to our building energy use and requirements. (Please note that costs are approximate as site details need to be verified. Current meter audit underway will inform this process – see "Other relevant matters" section below).

Schedule of Administrative Costs by Specialist Providers			
OGC			
Electricity			
No. of Buildings/Units	**Description of Charge Type**	**Charge**	**Administration Cost**
8	Half Hourly Metered Sites	£240 per meter	£1,920
450	Non-Half Hourly Metered Sites	£24 per meter	£10,800
Gas			
30	Buildings using more than 500,000 KWH pa	£240 per meter	£7,200
50	Buildings using less than 500,000 KWH pa	£36 per meter	£1,800
		TOTAL	**£21,720**

LASER			
	OPTION 1	OPTION 2	OPTION 3
	Fixed Term Fixed Price	**Flexible Option Price in Advance**	**Flexible Option Price Within Period**
Gas			
Fully Managed Service	£5,770	£7,533	£8,174
Electricity			
Half Hourly Sites Fully Managed Service	£5,061	£6,546	£7,096
Non Half Hourly Using More Than 30,000 KWH pa	£2,029	£2,641	£2,845
Sites Using Less Than 30,000 KWH Not Fully Managed	£2,250		
	£15,110	**£16,720**	**£18,115**
Plus Fixed Term Fixed Price Electricity cost for smaller sites where a fully managed service is prohibitive on cost		**£2,250**	**£2,250**
	TOTAL	**£18,970**	**£20,365**

3.12 OGC base their charges on the energy usage per meter point administration unit. For most buildings there is one meter point administration unit at each building. LASER base their charge using a similar calculation but this is then adjusted to reflect the different costs of servicing and managing the different types of energy contracts offered.

3.13 The cost of using OGC to manage our energy would be approximately £21,720 whichever energy purchasing strategy we opt to move to. LASER price their service in accordance with the work involved in delivering and managing the contract type. This is explained below in the purchasing strategy options. The Council can expect to pay approximately £18,970 to LASER based on the purchasing strategy below.

3.14 LASER offers the additional services including bill validation and checking for options 2 and 3. LASER and OGC have reported that additional savings of up to 3% can be achieved by regular monitoring of the usage and billing. LASER will provide this service for all high usage sites.

3.15 The quarterly billed non-half hourly-metered contracts the administrative charge is recovered by LASER direct with the energy provider as a commission.

3.16 For half hourly and monthly non-half hourly-metered site (sites using more than 30,000 KWH per annum), LASER receives the invoices direct from the supplier and validates and pays them. LASER then invoice the Council the cost of the invoice plus their margin for managing this service.

3.17 Based on the information above LASER offer the most competitive pricing on their services as well as provided as services that will assist the Council in reducing energy costs.

4. Energy Purchasing Strategy

4.1 Increasing market complexity and volatility mean that the traditional method of procuring energy, i.e. tendering a contract for price submission by all suppliers for a full year or two years' fixed-price supply, is no longer the most effective strategy across the board.

4.2 Until a few years ago there was no option but to purchase in this way. However, procurement buying consortia and suppliers have increasingly developed more sophisticated mechanisms. These allow direct access to the wholesale market but require the facilitation of quick decisions. These opportunities have needed to be supported by risk management strategies so that not only is it more likely that slightly better prices are obtained but also that governance and purchasing triggers are established that will reduce the risk of volatility in energy 'end-user' prices.

4.3 All of the publications listed state that a risk managed; flexible purchasing arrangement should be employed by Local Authorities wherever possible.

4.4 The identified benefits of such contracts include:

- Aggregation of supplies, creating volumes that allow direct access to wholesale markets;

- Potential price reductions, compared to historical processes – OGC indicates that recent flexible contracts have achieved between a 5% and 10% cost reduction (although some of this may be due to changing market conditions) in addition to the 3% that can be obtained from bill validation;

- Aggregation, providing volumes that help reduce suppliers' administration costs; and

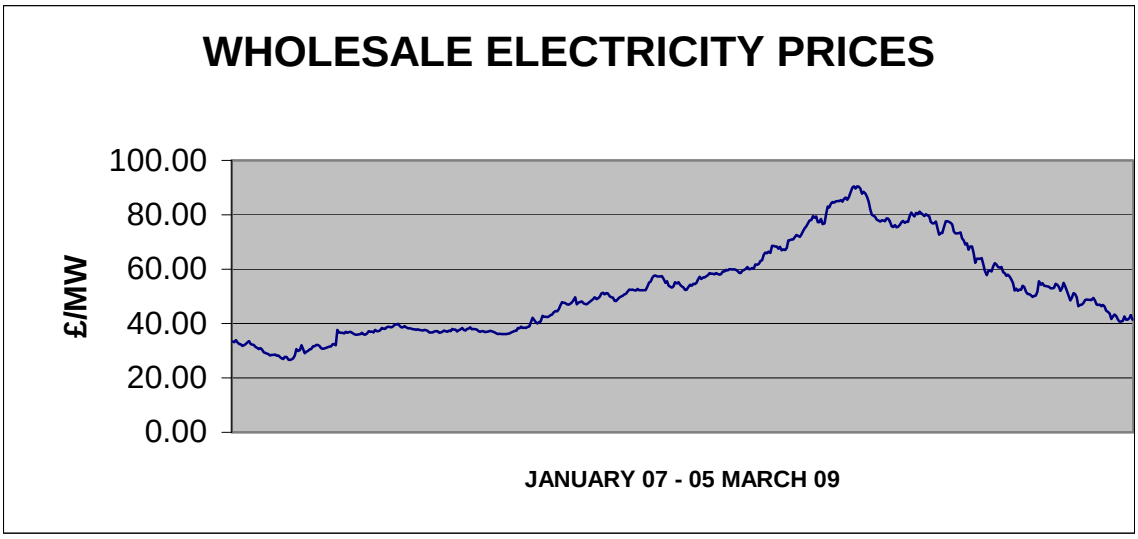
- Development and implementation of risk management strategies.

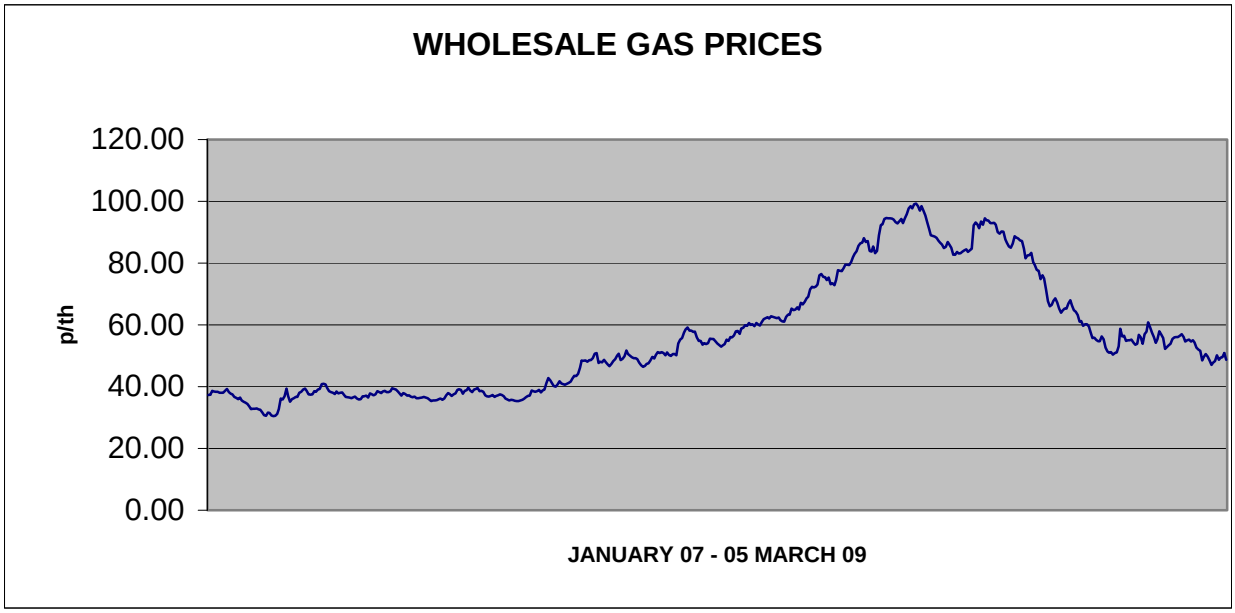
4.5 The only sites where the option of moving to flexible purchasing is not recommended are the smaller sites with lower usage. LASER and OGC recommend that for these sites fixed term fixed pricing contracts are put in place and that they use their leverage and tendering solution to buy at the optimum time on behalf of organisations. The Council's non-half hourly-metered sites fall under this solution.

4.6 The maximum likely period that an energy supplier will enter into a fixed term fixed price contract is two years. Depending on the market predicted changes the suppliers may add on an increase based on the market for year two.

4.7 Currently the Council is paying approximately 12.5 pence per KWH for electricity on both the half hourly metered and 450 smaller sites on non-half hourly metering. The contracts for these sites are due for renewal in October and November 2009. If the Council gives the authority to LASER to tender for the new fixed price contracts whilst the market prices are lower, the Council may be able to achieve savings of between 1 and 2p per KWH on both the fixed price fixed term contracts and possibly more on the flexible purchasing - purchase in advance contract. All of this depends completely on the market and if any unforeseen economic changes occur during this period.

4.8 The graph below illustrates the changes in the electricity and gas wholesale unit pricing and the current wholesale pricing levels.





5. What is Flexible Purchasing?

5.1 Flexible contracts differ from historical arrangements in that the volume of use is covered through many purchases of components ("known as clips") of the total requirement over a period of time, rather than all in one purchase.

5.2 There are two options within their Flexible Purchase arrangements – Purchase in Advance and Purchase within Period.

- Purchase in Advance – all purchases are concluded prior to the supply period so that the price for the supply period is known by the start of the supply period.

- Purchase Within Period – some or all purchases are completed within the supply period. Generally, this is a more risky strategy but can result in better prices overall. In such an arrangement, a target price is established for invoicing purposes and this is reconciled against actual prices either after each billing period or at the end of the supply period (usually one year).

5.3 In each case, various control mechanisms are put in place, e.g. high and low price trigger points which are set to influence purchasing decisions; however any individual decision to purchase is not automatic but requires the agreement of two or more professional buyers employed by the consortia.

5.4 Based on the advice provided by LASER and the ability of the Council to agree to purchase the energy at known prices before the contract start date, it is recommended that the Council opt for Flexible Purchasing – In Advance for all of the eight larger sites and for the 6 monthly non-half hourly metered sites.

5.5 The graph above also illustrates the advice given by LASER that by giving them authority to include the Council's electricity purchasing requirements in their wholesale purchasing activity over the summer period is likely to enable the Council to obtain the best prices which will be paid over the contract period which will start on 1st November 2009.

5.6 LASER recommends that 'smaller' sites do not participate in flexible contracts but continue with fixed-term/fixed-price agreements. Prices for these sites can be agreed at a time that suits the state of the market rather than being arranged on a fixed date shortly before the supply period. The highest proportion of electricity spend is at the larger sites and will be aggregated into a single contract purchase.

6. Level of Risk

6.1 There is a small risk that the recommended purchasing option is not the better option when calculated over the year if the wholesale utility market performs very differently from the prediction given by the consortia over the next few months. This is a low to medium risk as these agencies have the most skill and expertise in the public sector and are highly skilled in this type of purchasing.

6.2 At any point during the tender period the market could change so it is difficult to predict the outcome of the likely savings with any certainty until after the tender process is complete.

6.3 The evidence of the use of these contracts, even during the recent period of increased costs, has resulted in lower costs being obtained by authorities over the contract period.

6.4 The agencies are constantly checking the market and our energy purchasing will be a very small part of the larger volumes purchased. The consortia use the usage levels to bulk purchase in advance whenever there is any drop in the price even though we may not use the energy until a later date.

6.5 It is proposed that we enter into 'Flexible Purchasing - In Advance' which enables LASER to purchase our energy requirements at the prices being offered leading up to the new contract start date at times whilst the pricing is offered at more competitive rates.

7. Potential Saving that may be Achieved and the Creation of an Energy Fund

7.1 The budget for energy spend across the Council has been increased to £2,101,955 for 2009/10 to cover the 2008 price increases. The recent reduction in energy wholesale pricing is now also starting to benefit both the wholesale and consumer market but cannot be relied on in the longer term. The current price reduction should benefit the Council, but until the new contracts are agreed and the pricing known it is not possible quantify the saving with any certainty.

7.2 If the electricity KWH prices for both the fixed price fixed term contracts and flexible purchasing – in advance new contracts achieve a saving of:

- 1p per KWH the saving could be £84,500 in a full year
- 2p per KWH the saving could be £169,000 in a full year

As the new contracts will not be in place until the second half of this year, a full years saving will not be achieved until 2010/11 subject to the reduced prices being obtained.

7.3 The current budget for gas is based on usage and pricing of approximately 2.75pence per KWH. LASER has advised that it would hope to achieve

approximately this price at re tender based on known market conditions but has advised that the Council should not predict savings below this until the outcome of the tender activity is known. If the meter audit identifies additional sites that should be included within the gas contract then additional gas savings may be achieved.

7.4 The Council's Carbon Team has in place a programme of carbon reduction activities, however many of the savings attributed to this work programme will be achieved through Salix funded projects. The financial impact of these activities may not benefit the Council short term until the loan payments are made back to the Salix Fund.

7.5 The Carbon Team is also establishing a Council wide Carbon Champions Network to work with service to drive through reductions in energy use in the workplace. It is estimated that an additional 5% in electricity savings could be achieved in this way.

7.6 Based on the above advice and market predictions it is possible that the Council will under spend the 2009/10 budget through reduced pricing in the new contracts and better management of use. This provides the Council with the opportunity to consider setting any under spend aside and the ability to create an Energy Fund to provide resilience against price rises in future years.

7.7 Any calculation of savings into an Energy Fund will need to take into account energy savings attributed to Salix-funded energy savings projects that must be repaid into the Salix ring-fenced fund until the technologies are paid for (as directed by the strict rules of the Salix fund).

7.8 The creation of an Energy Fund of £250,000 capped at would create financial resilience against future price rises of up to 12%.

8. Other Relevant Matters.

8.1 This purchase will be further informed by the body of work, ongoing at present, to baseline the actual utility consumption. A full meter audit is currently underway as part of an Invest to Save Bid and this will come to fruition in a few months time. This work, involving around 600 meter locations spread across the estate, is being overseen by the Transformation Board and will also contribute to the Council's carbon reduction programme – being overseen by the Member lead Carbon Management Board. This work should facilitate a move to best practice, which may subsequently involve smart metering across the estate (subject to future funding).

9. Climate Change/Environmental Impact

9.1 The energy buying proposal will have no adverse impact on our carbon dioxide emissions.

9.2 The Energy Officer will work closely with LASER and obtain a green energy quote whenever this option is available. The green energy and standard energy price options will be provided to members who will be given the option of purchasing green energy in the context of overall value for money.

9.3 The Council is able to request renewal energy options are purchased if available and subject to a premium for green supply. As a minimum requirement the Flexible Purchasing – In Advance will obtain Climate Change Levy exemption, which is the green non-renewable option available.

10. Equalities Impact

10.1 There are no equalities implications.

11. Financial Implications

11.1 The Council has increased the gas and electricity budgets to cover the increased costs that were predicted. By using the flexible purchasing option and receiving regular updates it is hoped that the new contracts put in place during 2009/10 will fall below the current budget set aside for 2009/10.

11.2 Excluding savings related to Salix-funded energy savings projects, the Council has the option to use any budget under spend achieved through better procurement and management of use to create an Energy Fund to be used to off-set increases in future years or to support carbon and energy reduction projects.

12. Legal Implications

12.1 LASER, which was set up specifically to manage energy procurement on behalf of local authorities, uses the EU procurement regime for all their procurement activity. It therefore complies with both the Council's own procurement requirements and external regulation.

13. Financial Implications

13.1 The Council has already revised the gas and electricity budgets to cover the likely increases. However, it is hoped that the new contracts may be able to reduce the current estimates required if the prices continue to fall.

14. Staffing Implications

14.1 There are no staffing implications.

Recommendation(s):
That the City Executive Board gives approval to:

1) Grant project approval to use LASER for the purpose of letting the Council's replacement energy contracts.

2) Approve the Energy Purchasing Strategy set out in section 4 of this report, and to use the LASER service to enter into new energy contracts based on Flexible Purchasing – In Advance Purchasing, where appropriate to enable the Council to take advantage of the current price reduction in energy prices. This is in line with the recommendations of the professional energy buying consortia.

3) A green energy quote will be obtained whenever it is possible to do so. The price for green energy will be compared against the standard quote and members will be advised of the option to purchase green energy in the context of overall value for money.

4) Delegate authority to the Executive Director for City Regeneration to enter into the new replacement energy contracts identified by the process as set out in recommendations 1 and 2 as and when required.

5) Approve the creation of an Energy Fund for any energy under spend in 2009/10, capped at £250,000, and not attributed to Salix funded energy saving projects, to provide financial resilience against future price rises of up to 12%.

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List of background papers: None
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