



## Wards Affected

All

## Implications for:

**Anti-Poverty    Equal Opportunities    Environment    Employment**

No

No

Yes

No

### **1.0 INTRODUCTION**

- 1.1 The City Council's financial expenditure on energy has risen sharply over recent years. This increase is a direct consequence of rising cost of energy from the privatised energy marketplace, and is being driven by global factors such as rising oil prices and conflict in the Middle East, as well as more local concerns about depletion of North Sea gas reserves and the UK's increasing dependence on imported energy.
- 1.2 In recognition of the increasing financial consequences of energy use, the Interim Head of Corporate Procurement, on behalf of the City Treasurer, has carried out a fundamental review of the Council's energy procurement. The review looked at current practices and compared this with that of other local authorities, as well as looking at other procurement routes available to the Council through consortiums and external procurement agencies. The review resulted in the production of a Strategy for the Procurement of Energy, finalised in April 2006.

### **2.0 CURRENT POSITION AND ACTIVITIES**

- 2.1 The Council currently has the following gas and electricity supply contracts in place:

<b>CONTRACT</b>	<b>No. BUILDINGS</b>	<b>ANNUAL USAGE</b>	<b>END DATE</b>	<b>2006/7 EST. CONTRACT VALUE</b>
COMMERCIAL GAS	367	270 GWh	30 <sup>th</sup> Sept 2006	£7,953,000 (e)
DOMESTIC GAS	1100	60 GWh	30 <sup>th</sup> Sept 2006	£1,925,000 (e)
OVER 100 KW ELECTRICITY	64	43 GWh	31 <sup>st</sup> March 2007	£3,657,000
SUB 100 KW ELECTRICITY	689 (plus 1200 Landlords supplies)	39 GWh	31 <sup>st</sup> August 2006	£4,050,000 (e)
PUBLIC STREET LIGHTING	N/A	24 GWh	31 <sup>st</sup> March 2008	£1,691,000

(e) denotes an estimate for contracts not yet renewed or extended, and is therefore based on market expectations as of 7<sup>th</sup> June 2006.

- 2.2 In June 2005, the Committee received a report on the proposed gas contract for the period 1<sup>st</sup> October 2005 to 30<sup>th</sup> September 2006 which needed to be finalised as a matter of urgency. The urgency stemmed from market intelligence suggesting a rising price borne on the back of concerns for the UK's gas supply capacity during winter 05/06. The timely approval of this contract has proved to be prudent in the light of subsequent gas market performance. At the time of contracting in late June, small firm gas loads, typical of MCC's sites, were trading at 74.35p/therm. By mid-July, this price had risen to 85p/therm (+14.3%). Although prices continued to fluctuate throughout the year, they have never returned back to the June 2005 level, and as of 7<sup>th</sup> June 2006 the year on year differential stood at +23.7%. Failing to contract in June 2005 would therefore have led to increased costs being incurred. Assuming a fairly modest average increase across the year of 15%, this would have resulted in an additional £940K expenditure on gas.
- 2.3 The Council's Over 100KW Maximum Demand (large site) Electricity Contract was recently extended from April 2006 until Mar 2007, as allowed for within the original contract provisions. The existing 2 year fixed price contract dated back to January 2004, and therefore a considerable price increase was inevitable. Using benchmark data for wholesale and retail electricity prices, this increase was predicted to be 120%. In actual fact, the eventual negotiated increase was limited to 114%, thus saving approximately £200K off the current years predicted electricity spend for this contract. The contract extension offer was also benchmarked against an indicative offer sourced through the Yorkshire Purchasing Organisation (YPO). The negotiated extension, based on a continuation of the 100% certified "green" electricity from renewable sources, proved to be £63K lower than the standard "brown" electricity YPO could offer.
- 2.4 Public Street Lighting electricity is bought as part of a consortium of other North of England authorities with extensive street lighting networks. The contract includes Lancashire, Cumbria and North Yorkshire County Councils, as well as some smaller authorities. The contract currently provides for 50% of all electricity used to be generated from certified "green" renewable sources. This contract was recently extended from April 2007 to March 2008, at a time when electricity markets presented favourable conditions for the procurement of street lighting loads. The upturn in wholesale/retail markets since the start of this contract indicated likely price rises in the region of 70%. The negotiated extension offered standard "brown" electricity, plus a range of "green" options. On this occasion, as is likely to be the norm in future contracts, the green electricity offer carried an additional price premium. The extension was agreed on the same 50% green basis as previously supplied, and for this, attracted a £12K premium within the total £1.69m pa contract value. The agreed extension was at an increase of 53.7%, considerable lower than the +70% market expectation. This stands to save the Council some £270K over what it might have expected to pay for street lighting electricity in 2007/8, and is a good illustration of how following forward prices and having the flexibility to contract further into the future can yield savings, as well as making budget setting more predictable.
- 2.5 With the Council's gas and electricity expenditure set to reach £19m in 2006/7, the value of saving energy to reduce cost is considerable, especially when allied with the associated environmental benefits. As part of the City Wide Energy Strategy, endorsed by Physical Environment Overview and Scrutiny Committee in April 2005,

a Buildings Energy Policy for the Council's own operational buildings stock was also included. This covers all aspects of practical energy conservation for building operators and managers as well as advice to design teams, and staff using the buildings. Work is underway with the Corporate Property Team to integrate good energy efficiency practices into the Council's Facilities and Asset Management activities, including work to carry out energy rating of all buildings. In 2005/6, the Council participated in the Carbon Trust's Local Authority Carbon Management Programme. The programme provided free consultancy support to help draw up a position statement of all of the Council's activities that directly result in carbon emissions. Emissions from the Council's 800 buildings are a major factor in this equation, and a strategy for future management and control through a wide range of measures is currently being finalised with the Greening Manchester Team.

### **3.0 SUMMARY OF THE STRATEGY FOR THE PROCUREMENT OF ENERGY**

- 3.1 The UK energy market has high price volatility with a strong underlying upward trend. As a result, the traditional short duration (1 or 2 year), fixed price energy supply contract is unlikely to deliver best value for money. The timing of energy contracting is now the dominant factor in determining price.
- 3.2 Utilising electricity generated from "green" renewable sources such as wind, small-scale hydro and biomass dramatically reduced the Council's adverse impact on the environment by reducing CO<sub>2</sub> emissions. Currently all of the electricity used in the Council's buildings, and 50% of that used for public street lighting comes from certified renewable sources. This use of renewable energy strongly supports the Greening Manchester agenda, and the Council should continue to source electricity from renewable sources whenever available and affordable.
- 3.3 Some of Manchester's smaller neighbouring authorities procure energy independently, but several others use external procurement agencies such as Yorkshire Purchasing Organisation (YPO), the Office of Government Commerce (OGC) or the Lancashire Purchasing Agency (LPA) to secure energy contracts on their behalf. By contrast, consultation with larger cities (Birmingham, Bristol, Leeds and Liverpool) revealed similar procurement methods to Manchester, where the authority contracts direct with the supplier without the external procurement agent, and the authority tends to be the hub of a smaller consortium located within their boundaries. Manchester's contracts include MANCAT and City College, other colleges, plus Museums and Housing Associations.
- 3.4 As part of the review process, the in house costs of energy procurement were identified as £15K per annum. Alternative costs were sought from external service providers and fell within the range of £70K to £120K. Using an external service provider would therefore increase costs, but if this gave access to lower energy prices could still represent a worthwhile spend to save opportunity. Both OGC and YPO have existing pre-tendered supply frameworks, and an exercise was carried out to benchmark the Council's large site electricity contract (Over 100 KW maximum demand) contract against them. In both instances, Manchester's own in house direct procurement route proved more cost effective with the YPO offering at +2% and the OGC offering some 9.6% more expensive. If these figures are then extrapolated across the other electricity and gas contracts, it would increase the Council's energy spend by between £200K and £1m per annum, plus the increased contracting fees indicated above.

3.5 The review therefore recommended retaining the current in house procurement route, and in so doing identified a number of strengths and weaknesses within the in house arrangements:

**Strengths:**

- A high level of “in house” experience, skills and knowledge relating to energy and energy markets.
- First class systems in place for the effective recording analysis and presentation of the energy data required for effective procurement.
- A proven ability to effectively manage energy contracts for the benefit of the authority as a whole.
- An in depth understanding of the way the energy supply industry works and the dynamics that affect it.
- In December 2005, the Council’s Energy Management Service was awarded membership of the national Energy Efficiency Accreditation Scheme. This is the UK’s most prominent quality system for managing energy within both public and private sector organisations. The award is made after a comprehensive technical audit by independent assessors, and looks at all aspects of energy management, including procurement.

**Weaknesses:**

- Restricted by the rigidity of traditional short term fixed duration energy contracting
- Long lead times to market (OJEU)
- Inability to take advantage of any short duration windows of opportunity in energy supply markets due to rigidity of contracts
- Experiences difficulty in making the necessary quick decisions on energy procurement contracts, probably because of poor transparency and a lack of supporting information available to decision makers.

In order to build on the strengths, the review identified that by using longer term, more flexible framework supply agreements, the current weaknesses could be overcome. These longer term contracts would allow for periodic price setting for specific supply periods, thus giving the flexibility to agree future prices when the market is most favourable. To take full advantage of this, better market intelligence would be required, and this would be accessed through setting up specific contract “trackers” with an independent analyst. By monitoring prices two or three years ahead in this way, we would be able to make earlier better informed “buying” decisions, and in so doing give more transparency and information to support the decision making process.

## **4.0 RECOMMENDATIONS**

- 4.1 Recognise the internal expertise for energy procurement that already exists within the Council, and use this as the nucleus for implementing the future strategy.
- 4.2 Retain control of the procurement process through the Corporate Procurement Team, and of the key decision making processes.
- 4.3 Set up 4 year supply framework agreements for both gas and electricity with appropriate licensed energy suppliers. Supply frameworks to commence 1<sup>st</sup> April 2007, with contracts migrating to the new framework agreements as current

arrangements expire. Where existing arrangements have earlier finish dates, existing options to extend these arrangements up to or beyond the start of the framework agreements should be utilised.

- 4.4 Strengthen the method of market intelligence to incorporate contract specific market tracking, providing information on the most beneficial time to approach the market and draw down energy from the framework contracts.
- 4.5 Seek to add value to the supply frameworks by developing longer term relationships, especially in the areas of e-billing and electronic meter reading.
- 4.6 Establish a mechanism for ensuring that the flexibility to purchase energy through the framework be established, and the necessary control mechanisms for doing so are in place.
- 4.7 Establish improvements for briefing the City Treasurer on price movements that impact on the Council's financial planning.
- 4.8 Re-affirm the Council's commitment to procure energy from renewable sources, wherever possible and cost effective.