

Environment Department
Town Hall, Upper Street
London, N1 2UD

Report of: Executive Member for Environment, Air Quality and Transport

Meeting of: Executive

Date: 1 September 2022

Ward(s): All

This decision is being taken under the urgency provisions at Procedure Rule 93 of the Council's Constitution. The reason for use of the urgency procedures is as follows:

Energy prices for 2023/24 have risen significantly in the past few weeks, representing an increase of over £20m. The council has an opportunity to access significantly lower prices by terminating its existing energy supply contracts and joining a public buying organisation (PBO), which has already purchased most of next year's energy supplies at a rate lower than current market rates. The potential cost avoidance at current rates is several million pounds. The PBO requires the council to contract with them by mid-September, thus requiring an urgent decision. It is not possible to postpone the decision to a future meeting of the Executive.

If the council is unable to join the PBO, the council's energy consultants have advised that the council should start to hedge (purchase in advance) for next year. The last contract modification notice raised the purchasing threshold to £64m. However, there is only £9m unspent within this, which is insufficient to carry out significant hedging. The issuing of another contract modification notice is therefore urgently required in order to hedge for next year.

The appendix to this report is exempt and not for publication

Subject: Energy purchasing

1. Synopsis

- 1.1. Energy prices have risen significantly since April 2021, with major rises in prices as result of the war in Ukraine and other recent events.
- 1.2. Steep price rises have led to the estimated energy costs for 2022/23 being several times higher than 2021/22, with total estimated spend across the entire energy

portfolio (council buildings, Housing, schools and leisure centres) rising from £8.8m to £39.4m.

- 1.3. The recent price rises also saw prices for 2023/24 increase very significantly, with estimated costs for the next financial year (based on market prices) rising exceptionally quickly from around £30m to potentially as much as £50m.
- 1.4. The council is seeking to transfer into a Public Buying Organisation (PBO) for 2023/24 to obtain prices lower than current market rates. If this is not possible, the council will need to start hedging (buying in advance) for 2023/24 to guard against further rises. This will require the issuing of further contract modification notices to raise the threshold of the original 2020-2024 contract of £32m.
- 1.5. In the meantime, work is ongoing to reduce energy usage across the council's energy portfolio, including schools.

2. Recommendations

- 2.1. It is recommended that Executive:
 1. Agrees to enter into a new energy supply contract arrangement, as set out in section 6.4 and appendix 1 with a Public Buying Organisation (PBO);
 2. Delegates authority to the Corporate Director for Environment to finalise the details and length of term of the energy supply contract arrangements;
 3. Agrees to the mutual termination of the Council's existing energy supply contract and delegates authority to the Corporate Director for Environment to finalise the termination agreement, following consultation with the Director of Law and Governance;
 4. Approves the issuing a contract modification notice to raise the 2020–2024 energy procurement threshold from £64m to £80m.

3. Background

- 3.1. Energy prices have consistently risen since April 2021, with increasing volatility from September 2021 onwards. A report was brought to Executive in June 2022 outlining the potential impacts on the council. The report requested the issuing of a contract modification notice for its energy supply contracts, raising the total authorised spend over the 2020-2024 period from £32m to £48m, which was needed to purchase the energy for the second half of 2022/23.
- 3.2. Since the start of 2022, a number of measures have been put into place to try and mitigate the risk posed to the council by the energy price rises:

- Expanding the Energy Risk Management Committee (which makes trading decisions) to include representatives from Finance and Housing. The committee meets every two weeks.
- The creation of an Energy Steering Group chaired by the Corporate Director for Environment, which met weekly to discuss the price rises.
- The conversion of the steering group to an Energy Board which meets monthly
- The appointment of external consultants to:
 - Produce a risk management strategy to guide trading decisions
 - Produce a medium-term (2023–2026) price forecast
 - Attend the Energy Risk Management Committee meetings

4. Energy market update

- 4.1. Energy prices began rising during mid-2021 due to a range of factors, including a cold winter in 2020/21 leaving storage levels low and increased demand for LNG in Asia. Serious volatility began in September 2021, worsening in December. By this time concerns regarding Ukraine-Russia tensions were beginning to impact the market. The Russian invasion in February sent prices to a record high. Although prices fell back, they remained highly elevated.



- 4.2. In mid-late June 2022 concerns about gas flows from Russia to Europe through the Nordstream pipeline caused another spike in prices. Although prices for the year ahead did not return to the levels seen at the time of the initial Russian invasion, winter 2022 prices for both gas and electricity (covering October 2022 to March 2023) rose sharply to levels well above those at the time of the invasion (see graph above). Issues with France's nuclear power fleet and droughts across Europe reducing hydroelectric capacity have also contributed to recent price rises.

5. Energy purchasing for 2022/23

- 5.1. A report was taken to Executive in June to seek approval for the issuing of a contract modification notice raising of the estimated cost of the 2020–2024 energy contracts from £32m to £48m in order to allow for the purchasing of the remaining energy needs for 2022/23. Following a spend of £16m in 2020/21 and 2021/22, this left £32m for purchasing 2022/23 and 2023/24.
- 5.2. However, due to sharp rises in the winter 2022 energy prices, a second contract modification notice was required to raise the threshold to £64m. As this needed to be issued quickly to allow winter 2022 to be purchased, approval was sought and gained through the urgency procedure and formally approved on 1 August.
- 5.3. The total estimated energy cost for 2022/23 across the entire energy portfolio is now £39m compared to £9m in 2021/22, as broken down in the table below.

Area	2021/22	2022/23	Increase
HRA	£4,352,367	£21,094,280	£16,741,913
GLL	£703,156	£2,890,061	£2,186,905
Schools	£1,538,456	£6,575,501	£5,037,045
Council	£1,628,299	£6,439,699	£4,811,400
Streetlighting	£620,269	£2,394,238	£1,773,969
Total	£8,842,547	£39,393,778	£30,551,23

- 5.4. The total estimated liability to the general fund (council, streetlighting and 50% of the increase in GLL costs) is £9.9m.

6. Energy purchasing for 2023/24

- 6.1. Based on 22 August prices, energy costs for 2023/24 could be even higher than the current year, as set out below:

Utility	2021/22 (actual)	2022/23 (estimate)	2023/24 (forecast)	2024/25 (forecast)	2025/26 (forecast)
Electricity	£6,147,075	£22,114,588	£23,737,989	£18,407,305	£13,085,237
Gas	£2,695,472	£17,279,191	£29,056,852	£17,923,963	£10,413,450
Total	£8,842,547	£39,393,778	£52,794,841	£36,331,268	£23,498,687

- 6.2. As shown in the table, energy prices could remain at least triple pre-crisis levels for the next three years.
- 6.3. It is therefore imperative that the council takes action to reduce its exposure to further increases in prices. There are two options to do this:

- 6.4. Option 1 is to seek to transfer into a Public Buying Organisation (PBO) that has already made significant hedges for 2023/24 at prices lower than current market rates. Further details of this option are set out in appendix 1.
- 6.5. Option 2, should the council not be able to transfer into a PBO, is to start make hedging purchases for 2023/24. However, the latest contract modification notice raised the procurement threshold to £64m, current estimated spend to the end of 2022/23 is £55m, which only leaves a further £9m. At current market rates, this is insufficient to make a significant hedge (as it less than a quarter of the potential annual spend). A further contract modification notice is required in order to allow headroom to make significant hedges.

7. Ongoing work to reduce energy consumption

- 7.1. The council has started working to urgently reduce its energy consumption. Several methods for reducing costs are being taken forward.
- 7.2. The Energy Services team is working with building managers to review the operation of plant rooms to seek to reduce energy consumption.
- 7.3. The Corporate Landlord Service is taking various steps to reduce energy consumption from heating, lighting and electronic equipment, including reconsidering council building operating hours.
- 7.4. Housing is reviewing opportunities to reduce gas consumption in communal boiler plantrooms.
- 7.5. Highways is continuing LED lighting replacement and considering other options to reduce energy consumption from street lighting.
- 7.6. An Energy Reduction Programme Manager is to be appointed to oversee the work across all four areas and report on the savings being achieved, as well as looking at any other ways in which there is the potential to reduce energy consumption across the organisation (including the council's vehicle fleet) and schools.

8. General Fund impact

8.1. Leisure

Greenwich Leisure Limited (GLL) as the Council's leisure operator are responsible for paying for the energy that the Council purchases on their behalf. However, the contract with GLL includes a 50% risk share on price rises that exceed inflation.

This means that the Council could be liable for 50% of the cost increase – potentially £1.1m (approx.) at current prices for 2022/23.

8.2. **Street lighting**

The ongoing energy price increase has an impact on the streetlighting contract. At current prices for 2022/23, the annual estimated forecast is £2.394m, an increase of £1.774m compared to 2021/22.

8.3. **Other general fund**

Other general fund (mainly Corporate Landlord costs) have seen a £4.8m increase year on year. Additional funding was set aside within the Council's budget of £1.4m meaning a £3.4m pressure in 2022/23.

8.4. **Funding**

The Council had set aside a recurrent budget increase of £1.4m for 2022/23. Overall the total General Fund pressure after budgets is £6.3m. In 2022/23 the Council has £5.6m in an earmarked reserve for energy inflation. This will be fully released in Month 4 meaning a net residual pressure of £0.7m on the General Fund. Future year increased costs will be dealt with at budget setting for 2023/24.

9. **Housing**

9.1. There are around 4,300 households who receive a communal heating service from the council, of which 3,100 households are tenants. These tenants have benefitted from relatively stable costs over the last ten years.

9.2. Prices were increased for 2022/23 to reflect the anticipated rises of +55%, whilst using the reserve to help to flatten this increase. However, further unprecedented price increases for gas during 2022/23 has resulted in an in-year budget shortfall for tenants of £5.702m. If no action is taken, after the current balance in the heating reserve has been taken into account, this would lead to a starting point next financial year of a £4.576m deficit in the heating pool. This represents a debt of £1,476 per household.

9.3. As sustained high prices for gas are projected in the coming years, recovery of this debt will increase the cost-of-living pressures for residents.

9.4. It has been proposed that the deficit is spread over the last four months of 2022/23 and the following two financial years.

9.5. Around 80% of tenants benefit from communal electricity from communal services and are charged through their service charge for communal electricity, relating to the cost of providing services such as communal lighting and lifts. Charges for communal electricity are relatively low and represent only the cost of electricity for

shared services in communal areas. Anticipated cost increases were applied in 2022/23 reflecting the anticipated 49% increase in costs.

- 9.6. However, further unprecedented price increases for communal electricity during 2022/23 has resulted in an in-year budget shortfall for tenants of £3.677m. Costs are spread across 19,500 tenanted homes, resulting in per household shortfall of £189 this year.
- 9.7. Costs are not usually ring fenced in the same way that communal heating costs are, with surpluses or deficits not being used to smooth costs or be recovered from future years. However, due to the unprecedented extra costs it is proposed that these additional costs are recovered over the final four months of 2022/23 and the following two financial years.

10. Schools

10.1. **Forecasts**

Current energy forecasts suggest an increase of £5m when compared to 2021/22.

10.2. **Expected impact on balances**

Energy price increases are a major contributor to schools' financial difficulties in 2022/23, which is likely to continue for the medium term. Based on current calculations, costs are expected to increase in the region of £5m when compared to 2021/22, an increase of £3.5m on estimates previously advised to schools in the autumn term. The government has provided additional funding through the schools supplementary grant in the region of £4.2m intended to support Health and Social Care levy increases as well as 'other cost pressures'. As such the grant funding received by schools will not meet the level of increases currently faced, meaning, this has not kept pace with energy increases following Russia's invasion of Ukraine.

- 10.3. Schools have been advised of the current situation on energy prices and this has been built into their future years budget forecasts.
- 10.4. Schools' ratified budgets for 2022/23 indicate cumulative balances are to reduce by £4.5m to £3.7m when compared to the 2021/22 year-end position with the following two years indicating a cumulative deficit overall.
- 10.5. Despite lobbying DfE, LAs are informed that no additional funding is likely to be announced in the near future and schools are to manage their budgets in line with funding that has been afforded to them. Given the projected future years budget forecasts submitted by schools; the anticipated inflation rates to be as high as 13% by the end of the year as well as teacher pay awards being higher than funding

received, the increases in energy costs are highly likely to impact on quality of teaching and learning and ultimately question the future sustainability of some of Islington schools.

11. Implications

11.1. Financial Implications

11.1.1. The financial implications are set out in sections 8, 9 and 10 of this report.

11.2. Legal Implications

In relation to the first recommendation of this Report, to enter into a new energy supply contract arrangement, as set out in section 6.4 and Appendix 1:

- 11.2.1. Assuming SSE agrees to acceptable mutual termination conditions in relation to their gas and electricity contracts with the council a formal Deed of Termination will be required to evidence the termination and its conditions.
- 11.2.2. The Council has power to procure the supply of natural gas and electricity under section 111 of the Local Government Act 1972 which enables the council to carry out any activity that is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions. The council also has power to purchase these supplies on behalf of third parties under the general power of competence set out in section 1 of the Localism Act 2011. The Council may enter into contracts for such services under section 1 of the Local Government (Contracts) Act 1997.
- 11.2.3. The recommended direct award of replacement gas and electricity contracts via the selected Public Buying Organisation Framework Agreements is a compliant route to market under the Public Contracts Regulations 2015 as the two relevant Framework Agreements were formally tendered via OJEU and winning bidders appointed accordingly (Regulation 33). It is also compliant with the council's Procurement Regulations and in particular Procurement Regulation 3.1.
- 11.2.4. Procurement Regulation 2.6.3 states that where, as here, a contract exceeds £500,000, the contract needs to be agreed in advance by any applicable board, as determined by the Head of Service, Strategic Procurement and Supply Assurance (or their nominated representative). By agreeing to the recommendations in this Report and due to the urgency of the recommendations the Executive will be formally waiving these requirements. Retrospective reporting to the applicable boards is therefore required as soon as possible in these circumstances.
- 11.2.5. If the contracts will be for a period in excess of 12 months (for example one year plus the exercise of an option for a second year) they will be qualifying long term

agreements under section 20 of the Landlord and Tenant Act 1985, therefore the council will need to comply with the leaseholder consultation requirements applicable to long term qualifying agreements set out in the Service Charges (Consultation Requirements) (England) Regulations 2003 (as amended). In the current circumstances of urgency it will be necessary to consider making an application to the First-Tier Tribunal for retrospective dispensation from the consultation requirements – in this context it will be necessary to show that leaseholders have not suffered financial detriment from the lack of consultation.

In relation to the fourth recommendation of this Report, namely to issue a contract modification notice to raise the 2020–2024 energy procurement threshold from £64m to £80m:

11.2.6. This recommendation will only need to be acted upon if the first recommendation in this Report is not implemented because SSE refuses to terminate its contracts with the council (or refuses to do so on terms which are acceptable to the council).

11.2.7. By a formal Contract Award decision taken by the Corporate Director for Environment on 12th December 2019 the following three energy contracts were awarded by the council (48-month contracts for the period 1st April 2020 to 31st March 2024):

- Gas – Scottish & Southern Energy
- HH 100KW Electricity – Scottish & Southern Energy
- NHH Sub 100KW Electricity – Scottish & Southern Energy

11.2.8. Both the Contract Award Report and the Contract Notice (call for competition) published in the Official Journal of the European Union (OJEU) refer to an estimated total contract value for the three contracts of £32m over the said four-year period (i.e. 4 years x £8m per annum).

11.2.9. This Report identifies certain circumstances which have given rise to unforeseeable energy prices increases and the estimated total contract value over the four-year period has therefore increased from £32m and possibly up to £80m (ie from £32m plus three increments of £16m each, including the third increment of £16m which is the subject of this Report).

11.2.10. Paragraph 16 of the council's Procurement Rules provides:

16.1 The Executive shall:

16.1.1 approve the award or variation of contracts where the value of the contract or variation (to the Council) is estimated to exceed officers delegated authority (in the case of Revenue Spend or Capital Spend)

11.2.11. Regulation 72 (1)(c) of the Public Contracts Regulations 2015 provides as follows:

72.—(1) Contracts and framework agreements may be modified without a new procurement procedure in accordance with this Part in any of the following cases:—

(c) where all of the following conditions are fulfilled:—

(i) the need for modification has been brought about by circumstances which a diligent contracting authority could not have foreseen;

(ii) the modification does not alter the overall nature of the contract;

(iii) any increase in price does not exceed 50% of the value of the original contract or framework agreement.

11.2.12. The recommended increase in the estimated total contract value from £32m up to £80m will require publication of a further Contract Modification Notice on the Find A Tender website. This will be the third incremental increase utilising the provisions of Regulation 72 (£16m each increment - ie each 50% of the original contract value of £32m) within a few months due to the rapid increase in energy prices during 2022. The Executive must be aware of the risk that the market may complain or challenge the lawfulness of the council's repeated reliance upon Regulation 72 in these circumstances, notwithstanding the unprecedented and urgent circumstances.

11.3. Environmental Implications and contribution to achieving a net zero carbon Islington by 2030

11.3.1. Some of the actions detailed in this report around reducing energy consumption will have a positive environmental impact by reducing carbon emissions. However, some work to achieve it, such as replacing lighting, will have an impact in terms of material use and disposal of old light fittings.

11.4. Equalities Impact Assessment

11.4.1. The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding.

11.4.2. An Equalities Impact Assessment is not required in relation to this report, because there is no change in council policy. The proposed actions in this report are designed to mitigate the council's energy costs and those of its tenants and leaseholders.

12. Conclusion and reasons for recommendations

- 12.1. The council is facing an unprecedented increase in its energy costs. The option of transferring into a Public Buying Organisation has the potential to achieve a large cost avoidance compared to current market prices.
- 12.2. If the council is unable to transfer into a PBO, a new contract modification notice will need to be issued to enable purchases to be made for 2023/24 energy supplies.

Appendices:

- Exempt Appendix 1: Transferring to a Public Buying Organisation

Background papers:

- None, however a related paper was considered by the Executive on 9 June 2022: [Revised procurement spend for the council's 2020-2024 energy supply contract](#)

Final report clearance:

Signed by:



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Date: 31 August 2022

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