

Report of: Corporate Director of Environment

Meeting of: Audit Committee

Date: 13 September 2022

Ward(s): All

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## Subject: Risk Deep-Dive: Volatility in the energy market

### 1. Synopsis

- 1.1. In accordance with its Terms of Reference, the Audit Committee (the Committee) is required to consider the Council's arrangements for corporate governance and risk management.
- 1.2. The Committee agreed at its meeting in June to conduct regular deep-dives on individual Principal Risks. The purpose of the deep-dive is for the Committee to obtain a deeper understanding of the chosen risk area, develop insight into risk controls and the action plan, and to get the opportunity to discuss the risk directly with the risk lead.

### 2. Recommendations

- 2.1. The Committee is asked to note the risk management strategy for the Principal Risk 'Volatility in the energy market'.

### 3. Background

#### 3.1 Risk context

While the domestic energy market has price caps, the industrial and commercial market in which the council buys its energy does not. Energy is traded on a futures market basis and prices are constantly changing, based on global supply/demand positions and a plethora of other market drivers. As there are no price caps, the council's only method of alleviating higher prices is through the timing of its purchasing and the periods it purchases for.

- 3.2 The council purchases its energy directly from the market via a contract with SSE. Prior to the current energy contract being awarded in 2020, a procurement strategy was approved by Executive in January 2019, which considered the options of continuing to buy directly (via a contract) or to purchase energy via a Public Buying Organisation (PBO).
- 3.3 It was decided to continue buying in-house due to a range of factors, including the flexibility this offered and the lack of control over timing of purchasing and fees that using a PBO would incur.
- 3.4 The council went on to procure an energy supply contract with SSE for the 2020–2024 period. The contract was not for supply at a specified price but allows the council to purchase through SSE via trades at the time of its choosing. The council can purchase an entire year’s supply in a single trade but can also purchase for longer or shorter periods.
- 3.5 In normal years the council would make a trade for a full year ahead at some point prior to the start of the financial year to give budget certainty, with the aim being to purchase during a dip in prices.
- 3.6 This strategy worked well for several years in a relatively stable energy market, with the council obtaining highly competitive prices. A recent benchmarking exercise with a PBO confirmed that the council obtained significantly lower prices for the first two years of its SSE contract; in 2020/21 and 2021/22 the council secured commodity prices 20% cheaper for gas and 10-12% cheaper for electricity.
- 3.7 However, consistently increasing prices from April 2021 and then significant volatility from September 2021 onwards meant that the council’s usual approach of waiting for prices to fall/dip before buying was not possible prior to the start of the 2022/23 financial year (the council has to purchase energy in advance of a period starting or it will go onto default rates, which are much higher).
- 3.8 As a result, the Energy Risk Management Committee made the decision to purchase for shorter periods with the expectation that prices would come down for the remainder of the year. The energy for Q1 was purchased in late March. Prices did then come down and the energy for Q2 was purchased during a dip in prices during June, at which point commodity prices were around 30% lower than the Q1 purchase. The prices obtained during this dip were the lowest prices available at any point between March and the start of Q2.
- 3.9 However, a significant increase in Q3 and Q4 prices during June and July while the council’s new risk management strategy was being agreed, led to the prices being obtained for these quarters in early August being far higher than Q1 (more than double for electricity and slightly less than double for gas). The combined set of purchasing decisions mean that costs across the entire energy portfolio (council, Housing, schools, leisure centres and streetlighting) are expected to rise from £8.8m in 2021/22 to £39m in 2022/23, should consumption remain the same.

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

Area	2021/22	2022/23	Increase
Council	£1,628,299	£6,439,699	£4,811,400
Streetlighting	£620,269	£2,394,238	£1,773,969
<b>Total</b>	<b>£8,842,547</b>	<b>£39,393,778</b>	<b>£30,551,231</b>

### 3.10 Mitigation strategy

Work has been carried out to mitigate costs for both this and future years. The first priority was to fix our prices and reduce costs for 2022/23, while the second is to reduce our exposure to future price rises from 2023/24 onwards.

3.11 A major part of the first priority was to improve our trading strategy. An energy consultancy firm was appointed to advise the council on its energy purchasing. The consultants produced a risk management strategy following a workshop with key representatives from the Finance and Energy teams. Under this strategy, the consultants make recommendations of when to make trades in order to hedge against potential future increases, and to take advantage of rises and falls in the markets (the council can sell purchases back during rises to create a surplus to use when prices fall and reduce the net price paid). Under this strategy, the Q3 and Q4 energy was purchased at the start of August to guard against continue price rises. Market prices are monitored daily. While energy has now been purchased for the full financial year, there is a possibility to reduce the Q3 and Q4 costs through trades, should market movements be amenable. The possibility of joining a PBO mid-year and accessing pre-bought prices for Q3 and Q4 had been explored, but was not possible due to the notice required and lack of capacity within the PBO.

3.12 Reducing energy consumption was the other main aspect of the first priority. At the start of the year, webinars were held for site managers (council buildings and schools) to provide information on how to reduce energy use. For the forthcoming winter, the council has started working to urgently reduce its energy consumption. Several methods for reducing costs are being taken forward:

- The Energy Services team is working with building managers to review the operation of plant rooms to seek to reduce energy consumption.
- The Corporate Landlord Service is taking various steps to reduce energy consumption from heating, lighting and electronic equipment, including reconsidering council building operating hours.
- Housing is reviewing opportunities to reduce gas consumption in communal boiler plantrooms.
- Highways is continuing LED lighting replacement and considering other options to reduce energy consumption from street lighting.
- 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.

3.13 The second priority is to mitigating costs for 2023/24. Following a recommendation in the June Executive report, the possibility of joining a Public Buying Organisation (which bought further in advance before the large price rises) was investigated. One PBO the council approached had sufficient capacity in its already-purchased volumes for 2023/24 for the council to join at rates significantly below current market levels. This would put the council in the same position costs-wise as other local authorities who purchase through PBOs.

Discussions have also been held with SSE on a mutual early termination of contract. The Executive has provisionally approved proposals to proceed with the mutual termination and join the PBO for up to two years.

- 3.14 Should termination not be possible, it is likely that the council will need to start hedging for 2023/24 based on advice from the consultants.
- 3.15 The existing supply contracts end in March 2024 and officers have begun to look at post-2024 options. This includes the option of a Power Purchase Agreement, where the council will purchase energy from a renewable energy generator at a fixed rate for a long period. A procurement strategy for the next set of contracts will come to Executive for approval when appropriate.
- 3.16 **Risk trend**  
The risk exposure is currently increasing as prices for 2023/24 have consistently risen since mid-June. The actions set out in paragraphs 3.13 and 3.14 are aimed at mitigating this.

## 4. Implications

### 4.1. Financial Implications

- 4.1.1. There are no financial implications arising from this report. The financial implications of the risk are accounted for within the Council's financial management arrangements.

### 4.2. Legal Implications

- 4.2.1. There are no legal implications arising from this report. Legal advice and support will be provided, where necessary, in relation to individual risks as risks are identified.

### 4.3. Environmental implications and contribution to achieving a net zero carbon Islington by 2030

- 4.3.1. There are no environmental implicating arising from the recommendations in this report.

### 4.4. Equalities Impact Assessment

- 4.4.1. 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.

4.4.2. An Equalities Impact Assessment is not required in relation to this report, because the recommendation being sought does not have direct impacts on residents.

## 5. Conclusion and reasons for recommendations

5.1. The Committee is asked to note the risk management strategy for the Principal Risk 'Volatility in the energy market'.

### **Appendices:**

- Appendix 1 – Risk on a Page: Volatility in the energy market

### **Final report clearance:**

Signed by:

**Corporate Director of Environment**

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## Appendix 1: Risk on a page – Volatility in the Energy Market (Extract from Principal Report June 2022)

Risk Information Risk Title – Volatility in the energy market	Risk Scores	Existing Controls			
<p><b>Risk</b> Volatility of energy market causing budget pressures for the Council, Schools and residents</p> <p><b>Cause</b> Unpredictable global energy market, inadequate monitoring of energy prices and Council expenditure, unfavourable terms and conditions from energy providers, services do not adapt budgets and activities to meet pressure in energy expenditure.</p> <p><b>Consequence</b> Significant overspend on Council budget, key projects and programmes scaled down, paused or cancelled, savings targets not met</p> <p><b>Risk Update:</b> Wholesale energy commodity prices saw significant rises in the second half of 2021 with a rapid increase in September. Another large spike followed in December 2021, with prices rising to an all-time high in March 2022 as a result of the Russian invasion of Ukraine. As of 30 March, gas commodity prices were 540% higher than the 2021/22 purchases and the electricity commodity prices are 370% higher. The Energy Services team has developed a provisional purchasing strategy for the remainder of 2022/23 to manage risk. Consideration will also be given to a purchasing strategy for 2023/24, although the situation on long-term price changes may not become clear until the end of the Ukraine conflict. A range of activities is taking place to reduce energy consumption to directly reduce financial impact, including looking at the most efficient way to run council and school buildings (heating, lighting and air conditioning systems). Some of the mitigation measures will require behaviour change from staff, which, if made permanent, will reduce the council's future energy demand and costs. In the short term, site managers for council buildings and schools have been asked to review and reduce energy consumption. In the longer term, the council is planning a set of feasibility studies for all corporate buildings with a gas supply to identify how to decarbonise the buildings.</p>	<p>Current Score: L: 4 I: 5</p> <p>Target Score: L: 3 I: 4</p> <p>Gap to target: L: 1 I: 1</p>	<ol style="list-style-type: none"> <li>1. Weekly meetings of the Energy Risk Management Committee (ERMC) to review current market and take informed decisions on energy purchasing.</li> <li>2. A temporary weekly Energy Steering Group has been created, attended by service and corporate directors and finance and energy teams.</li> <li>3. Daily monitoring and reporting on energy market. The council receives market intelligence daily as well as having access to live market prices through the balancing and settlement system Elexon.</li> <li>4. Electricity purchase on a quarterly basis</li> <li>5. Gas purchased on a monthly basis</li> <li>6. Approval process for trades in place, with ERMC making a recommendation on the prices and period to purchase at to the Corporate Director for Environment, who then gives approval to proceed to purchase at or below the level agreed.</li> <li>7. Provisional purchasing strategy for the remainder of 2022/23.</li> <li>8. Sessions run by the Energy Services team to provide advice for site managers of both council buildings and schools on energy efficiency.</li> <li>9. Annual monitoring and targeting visits and reports produced by Energy Services team</li> <li>10. Develop communications plan to encourage staff to minimise energy use in Council buildings.</li> <li>11. Detailed monitoring of smart meters in council buildings</li> </ol>			
Action	Expected impact	Resources required	Owner	Due Date	Status
Deliver purchasing strategy for 2022/23	Reduce overall score	Staff	K. Townsend	April 2022	In progress
Accelerate installation of smart meters in Council buildings	Reduce overall score	Staff	K. Townsend	Ongoing	In progress
Building managers of the sites responsible for 80% of electricity/gas use asked to develop actions to reduce energy consumption	Reduce overall risk score	Staff	K. Townsend	Ongoing	In progress