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WHY YOUR HYDRO COSTS ARE SO HIGH

There has been a lot of discussion among the owners and with the Board about why hydro costs at 40 Homewood are so far over budget and how such an error in budgeting could have been made. I hope that this brief article on how the Ontario electricity market operates will shed some light on the subject.

When the electricity marketplace in Ontario was de-regulated (and then re-regulated) a number of years ago, consumers ended up with 3 options for purchasing electricity. The first was through your Local Distribution Company (LDC), Toronto Hydro, under a regulated rate structure called the Regulated Price Plan. The second was through an electricity retailer under a long term fixed price contract and the third was simply buying electricity on the spot market. The spot market option is quite risky and very few residential consumers purchase electricity in this manner and, as a result, will not be discussed in the space available.

The Regulated Price Plan

Most condominiums today are purchasing electricity from their local distribution company (LDC) at rates that are established by the Province through the Ontario Energy Board (OEB). After the turmoil of wild spot price fluctuations that occurred a number of years ago, the Province sought to stabilize electricity prices and established a Regulated Price Plan (RPP) that condominiums are eligible for. The table below illustrates historical rates of the RPP.

The rates in effect on November 1st are shown in the top right corner of the table. The first 1000 kWh per unit are charged at .058 cents. This means that the first 492,000 kWh (492 units multiplied by 1000) of consumption in any month from November until next April would be charged at .058 cents and any consumption beyond that threshold would be charged at .067 cents. The threshold levels alternate between 600 and 1000 every 6 months. The lower 600 kWh threshold at the lower rate from May to the end of October is an attempt to encourage you to conserve electricity during the summer months when demand for electricity is higher.

REGULATED PRICE PLAN RATES

	2007/08	2008/09	2009/10
November 1 – April 30			
1st 1000 kWh/unit	0.050	0.056	0.058
Remaining Volume	0.059	0.065	0.067
	2008	2009	2010
May 1 – October 31			
1st 600 kWh/unit	0.050	0.057	To Be
Remaining Volume	0.059	0.066	Announced

The actual rate per kWh is adjusted every six months by the OEB. The OEB monitors the cost of power produced and a number of other variables. If the market price or cost of power during any 6 month period is higher than the RPP rates, the rates are adjusted upward for the next 6 months to recover the “deficit”. If the actual cost is lower, the rates are adjusted downwards to refund the surplus during the next 6 months. In this way, there is a relatively stable price environment. The blended price that 40 Homewood would have paid had it remained on the RPP would have been almost 6 cents during 2009.

Retail Contracts

In December 2007, your Board of Directors entered into a 5 year fixed price contract with Constellation Energy at a rate of 6.4 cents per kWh. During a time when there was a great deal of concern about rising electricity prices, the decision to fix rates for an extended period of time probably had some merit and the purpose of this article is not to question the decision. It may still turn out to be a good one. One part of the sales pitch by any retailer is that by moving off the RPP to a retail contract, the condominium would receive a credit from the Province. This credit is called the “final RPP Variance Settlement Amount.” This amount reflects the consumer’s share of any accumulated variance between the actual price paid to generators and the forecast price paid by price plan (RPP) consumers. It is essentially your share of the surplus or deficit resulting from the 6 month monitoring of prices by the OEB discussed above. The notion of getting a credit would likely have been appealing to the Board of the time. The credit you would have received is equal to your total kWh consumption for the 12 month period preceding

conversion to a retail contract multiplied by the Settlement Factor. The settlement factor was .3369 cents per kWh in February, 2008 (the first month of the retail contract) and 40 Homewood's annual kWh consumption is approximately 5,800,000 kWh's per year. This would have produced a credit of \$19,540 at that time. The Factor changes monthly and you can find it and the historical pattern on the OEB website, www.oeb.gov.on.ca.

The Not So Fixed 'Fixed' Price Contract

Also, as part of the sales pitch for a 5 year fixed price contract, the Board was likely told that it would be easy to budget and it would shelter the condominium from rate increases for that period. However, my sense is that the Board at the time was not aware that once you go off the RPP and onto a retail contract you will now see another expense item on your hydro bill called 'Provincial Benefit'. You need to know what that is.

The Province regulates the price you pay and it also regulates the price it pays to electricity generators. These could be large producers like Ontario Power Generation (OPG) or smaller producers of solar or wind generated electricity. To encourage more 'green' production of electricity some of the contract prices with green producers far exceed what we are paying. Regardless, the Province needs to ensure power generators stay in business and green production is encouraged and it contracts with these producers to produce power at fixed rates. If the actual market price for electricity is higher than the contracted fixed price that these generators could have received had they not been subject to government regulations or contracts, you will get a credit on your share of the surplus revenue. If the actual market price is lower, you will be charged your share of what is effectively a subsidy the Province is paying when the market prices are lower than the contracted fix prices. Essentially, when market prices are high, you get a credit. When market prices are low, you get charged. This difference is either a credit or a charge and the difference is called the 'Provincial Benefit'.

What has been the experience since the inception of your retail contract? In 2008, your actual Provincial Benefit charges were \$30,143. This was offset by the \$19,540 variance settlement credit discussed above so it wouldn't have shown a huge increase in hydro costs from 2007 to 2008.

However, 2009 has been a totally different story. In August, the Provincial Benefit was 4.33 cents per kWh. This means that your actual cost for August was 10.73 cents per kWh after the Provincial Benefit was added (6.4+4.33). The Provincial Benefit changes monthly. In September, the rate dropped to 3.36 cents per kWh. Your actual cost per kWh was 9.76 cents in September. The lowest Provincial Benefit cost in 2009 was in February when it was 0.546 cents per kWh. For the year, it has been averaging around 3 cents.

The point is that during 2009, you would have paid somewhere between 6.946 cents and 10.73 cents per kWh under a "fixed" price contract of 6.4 cents per kWh. That's not very

‘fixed’ when compared to the RPP. In summary, your actual Provincial Benefit cost in 2008 was \$30,143 and your Provincial Benefit cost in 2009 is expected to exceed \$120,000. That’s a substantial difference and that is the primary reason why your hydro cost is running over budget.

It is not easy for anyone to properly budget this cost. Do you know what the difference will be between the actual spot market price of electricity for 2010 and the blended cost of all of the 2010 fixed price contracts the province has with all electricity producers across the Province? I don’t and I don’t think you will find anyone who can answer that question. It’s pure speculation of the electricity market. If that’s the case, how could it have been possible to anticipate such a high Provincial Benefit in 2009 (or such low spot market prices in 2009)? The appeal of the fixed price contract is completely lost once you realize that budgeting requires speculation on the spot price of electricity going forward.

An excellent source of information on how the electricity market place operates and how retail energy contracts work is the Ontario Energy Board website – www.oeb.gov.on.ca. If interested, have a look around the site. For your interest, read the page on “Contracting with Natural Gas Marketers and Electricity Retailers”. This sounds like consumer protection at its best. However, be cautious, the consumer protection rules on that page don’t apply to condominiums. They only apply to single family homeowners. There are no rules for larger commercial clients like 40 Homewood and that needs to change. Your Board in 2007 applied its collective wisdom to enter into a retail contract and I am convinced it wasn’t provided with all of the information it needed in order to make an informed decision. If electricity prices skyrocket in the next 3 years, that Board will be perceived as being brilliant in its foresight. If prices stay low, 40 Homewood will indeed have paid a price.